

Publication date: 17 December 2003

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# MINUTES OF MONETARY POLICY COMMITTEE MEETING 3 and 4 December 2003

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These are the minutes of the Monetary Policy Committee meeting held on 3 and 4 December 2003.

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0312.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 7 and 8 January will be published on 21 January 2003.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 3-4 DECEMBER 2003**

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

### **Financial markets**

2 The most significant of the month's developments in financial markets was the further marked fall in the US dollar exchange rate, which had depreciated by more than 5% against the euro – taking the euro/dollar exchange rate to its highest since the launch of the euro in January 1999. Though this depreciation was consistent with the changes in medium-term interest rate differentials, it was possible that it also reflected mounting concerns about the sustainability of the US current account deficit.

3 That deficit had earlier been associated with private sector borrowing, financed by private sector inflows, but it was now largely the counterpart of a public sector deficit, financed by inflows from overseas public sector entities – particularly Asian central banks. It was unclear how long this pattern of financing could continue. So there could be further sharp movements in the dollar exchange rate, even without the stimulus of an adverse economic event. So far, sterling had been largely unaffected (in effective rate terms) by the revaluation of the euro relative to the dollar, and remained broadly in line with the assumption underlying the November *Inflation Report* projections.

4 Short-term interest rates had moved little over the month, in either the United Kingdom or the euro area. The market expectation was that there would be no change in UK official rates this month, and official rates were expected to remain at current levels for a while in other countries too. The Federal Open Market Committee was not expected by market participants to start increasing the Fed funds rate until May. Longer-term rates had moved up a little in both the United Kingdom and the euro area, but had fallen in the United States, for which there did not seem to be any wholly convincing explanation in terms of macroeconomic news. Equities were a little stronger in most markets, and corporate spreads had generally eased.

5 Market expectations of inflation prospects in the United Kingdom had been moving steadily upwards over the past six months or so, and the Committee considered what might account for this. One possibility was that it might reflect market speculation about a change in the inflation target. If the market expected this target to be 2%, on the Harmonised Index of Consumer Prices measure of inflation, and also took the view that the long-run difference between this measure and RPIX inflation was around three-quarters of a percentage point, that could account for about half the apparent increase in inflation expectations. The remainder might perhaps reflect increased uncertainty about whether the inflation target would be met. An alternative explanation was simply that expectations were based on past outcomes: RPIX inflation had been somewhat below the 2½% target for several years, but had now been above target for a year. In any case, inflation expectations had been below the target for RPIX for a while and the recent increase had returned them to around the target rate.

### **The world economy**

6 The news on the world economy in the past month had generally been positive, and in some respects stronger than expected. Data for the third quarter showed that growth in the United States had been revised up, and that the euro area had been growing for the first time for a year. In addition, survey information, including that from a special survey of euro-area demand carried out by the Bank's regional Agents through their business contacts, was generally positive.

7 Within the euro-area data, however, there were some less positive features. Final domestic demand growth would probably need to be a key feature of a sustainable euro-area recovery, particularly if the US dollar were to continue to weaken against the euro. But it had made no overall contribution to growth in the third quarter: the main positive contribution had come from net trade. It was also noteworthy that the past level of consumption and output in Germany had been revised down.

8 In the United States, GDP was now estimated to have grown by 2.0% in the third quarter – the fastest quarterly growth since 1984 – and business surveys pointed to a strong fourth quarter. The main issue remained the durability of this recovery. On that, too, the news was encouraging. Much of the upward revision to third-quarter growth was attributable to investment growth; and corporate profitability and confidence seemed to be recovering, so the investment recovery was likely to be sustained. The outlook for consumption was also positive: consumer confidence had improved

somewhat, on both the main measures; there was greater optimism about labour market conditions; and non-farm payrolls had increased by nearly 300,000 in three months. Nevertheless, uncertainties remained. The improvement in the labour market was modest, and unemployment had not yet fallen substantially. Past recoveries had been associated with a sharp pickup in durables spending, but that had weakened in recent months. The financial incentives offered to purchasers by auto manufacturers were becoming less generous. It was also possible that next year's tax cuts had already been anticipated by consumers and so would generate less additional stimulus when they actually took effect. Mortgage refinancing, which had sustained consumption growth earlier in the year, was now much lower, and (partly as a result) the M2 measure of the money stock had contracted in the past two months. That too might indicate that the recovery was faltering. Equally, though, the contraction might be related to changes in the relative attractiveness of non-monetary assets, and associated portfolio shifts.

9 Japanese GDP estimates, based on expenditure data, showed the seventh successive quarter of growth, with the third-quarter estimate somewhat stronger than had been expected by the Committee at the time of the November *Inflation Report*. Investment was estimated to be growing strongly, and net trade had also made a positive contribution to overall growth: exports to other Asian countries continued to grow strongly. But there were doubts about the price deflators used in these estimates, particularly for business investment. The all-activity index of output growth continued to suggest a markedly weaker recovery than that shown by the GDP estimates.

10 Third-quarter growth in non-Japan Asia had rebounded from the weak second-quarter outturn, reinforcing the view that that weakness had reflected the temporary effects of SARS-related disruption. It was encouraging that, in the area as a whole, domestic demand was making a strong contribution to growth.

### **Money, credit, demand and output**

11 The month's news on the UK economy was also mostly positive. GDP was now estimated to have grown by 0.7% in the third quarter, 0.1 percentage points faster than the preliminary estimate, with both services and construction growing more strongly than expected – and more than offsetting somewhat weaker production output data.

12 The pattern of expenditure was, however, rather different from that envisaged in the November *Inflation Report*, with investment falling rather than rising, a strong positive contribution to growth from stockbuilding and the net trade position weaker than expected. As a result, the economy seemed a little less well-balanced. The news on consumption growth tended to reinforce the view that it was not slowing as rapidly as expected. The fall in investment, however, was unexpected. It was possible that the investment data – one of the less reliably measured components of GDP – would be revised.

13 The outlook for the fourth quarter was one of continued strength, with growth if anything likely to be a little stronger than in the third quarter and so at an above-trend rate. Surveys remained generally, but not uniformly, strong, with the CIPS services business activity index at its highest level since 1997 and the manufacturing PMI at its highest since the end of 1999; and construction was also up strongly. By contrast, aggregate M4 was now growing at only 6½% on twelve months ago – compared with over 8% during the second quarter. That might suggest some slowing in the overall pace of nominal GDP growth in the coming quarters.

14 Retail sales were showing some signs of slower growth, and the Bank's regional Agents reported that some retailers were disappointed with their sales in November. The GfK measure of consumer confidence had fallen a little, largely because consumers were less confident that it was a good time to make a major purchase. But that was perhaps to be expected, given the increase in interest rates and the extensive press commentary on the dangers of excessive household borrowing. The latest CBI Distributive Trades survey showed less buoyancy in retail sales in November, and falls in optimism in all three distribution sectors. The growth of unsecured lending, while still rapid, had also eased – continuing a pattern that had now been evident for some months. This might be a better indicator of the immediate outlook for consumer spending than the growth in secured borrowing, as that was driven largely by house prices and housing market turnover. But the easing in unsecured borrowing growth could simply reflect substitution of secured for unsecured borrowing, a shift which was both cost-effective and was being encouraged by lenders. It was also noted that credit card borrowing growth remained strong.

15 The monthly rates of house price inflation shown by the two main lenders' indices were a little lower. Nonetheless, prices continued to surprise on the upside. The preview of the survey by the Royal Institution of Chartered Surveyors (RICS) pointed to some moderation in expectations of price increases in the coming months. There had also been fewer new buyer enquiries. In addition, there

had been substantial downward revisions to mortgage approvals data, which now showed a much less marked increase over the past few months. It would be a little while before the effects of last month's increase in the repo rate would become evident in the data. All this was consistent with the Committee's previous judgment that both activity and house price inflation would moderate in the coming months.

### **The labour market, costs and prices**

16 Surveys continued to point to a modest tightening in the labour market. Agency staff were in increasing demand, and their availability was falling; private sector employment was reported to be increasing; and the public sector was continuing to recruit. There was some evidence to suggest that underlying earnings growth was picking up, with annual earnings growth in the third quarter 0.3 percentage points higher than in the second, once the effects of bonuses were excluded. This was partly accounted for by rapid public sector earnings growth, which was temporarily inflated by the lagged effects of the delayed agreement and implementation of last year's Local Authorities pay settlement. But private sector earnings growth was also picking up, as were pay settlements. It was likely that bonus payments would be higher in the coming months than they had been a year ago, particularly in the financial sector. Employers in some areas were becoming more concerned about possible difficulties in reaching agreement in pay negotiations in the coming pay round, though members noted that such concerns were by no means country-wide and did not necessarily imply that settlements would be higher. The surprise this year had been that there had not so far been more upward pressure on wages, given the increase in National Insurance contribution rates and the higher levels of retail price inflation. The increase in earnings growth over the past few months was consistent with the modest tightening suggested by the surveys, rather than with overheating.

17 RPIX inflation had eased to 2.7% in October, as expected. But the contribution from housing depreciation, which was based on the ODPM index of house prices rather than the lenders' indices, had been a little smaller than expected and implied a somewhat lower profile for RPIX inflation over the next few months than thought likely a month ago. HICP inflation was also likely to be a little lower than previously expected. Nevertheless, there was little in these data that seemed likely to be material to inflation prospects further out.

18 Within the aggregate outturns, annual goods price inflation had increased by some 2 percentage points over the past year, and services price inflation – at least, of those services produced domestically and in competitive rather than regulated markets – remained high. This pickup in goods price inflation was a feature of price developments in other countries too, earlier in the year, and might have been related to the increased cost of fuels and to the effects of the war in Iraq. But it had not subsequently eased in the United Kingdom, perhaps suggesting growing demand pressures here.

### **Other considerations**

19 The Committee had been briefed, immediately before their meeting, by Treasury officials on the macroeconomic and fiscal projections to be published in the Chancellor's Pre-Budget Report on 10 December. They noted that the net borrowing requirement was now projected to be higher than in the Budget projections in each of the next five years, and by £10 billion in the current fiscal year. The Treasury still expected to meet both of its fiscal rules, though with a smaller margin for error. The implications for monetary policy of the information in the Pre-Budget Report would be assessed more fully in the coming months.

### **The immediate policy decision**

20 The month's news on the world economy, most of which related to the third quarter, matched or exceeded the expectations reflected in the November *Inflation Report*. The US economy was growing particularly strongly, and the euro area too now showed signs of recovery although overall domestic demand there remained flat. The Asian economies had rebounded from the weakness associated with SARS-related disruption, and growth there seemed in significant part to be generated within the region. It now seemed plausible that the euro-area recovery would materialise earlier than previously thought. But it was by no means certain that it would be more rapid. The continuing weakness of domestic demand in the euro area, together with the risks to the recovery from the possibility of further falls in the US dollar exchange rate, suggested that it was too early to judge its underlying strength.

21 In the United Kingdom too, the news on the month had been positive, but the medium-term outlook remained broadly as envisaged in the November *Inflation Report* projections. The upside news in the upward revision to third-quarter growth had been accompanied by a rather less balanced composition of demand, with consumption growth remaining strong and business investment

apparently falling back. House price inflation continued to exceed expectations, though data revisions and new information suggested rather less buoyancy in housing market activity than previously thought. The labour market was tightening modestly, but with no evidence yet that earnings were growing any more strongly than had been expected. So the medium-term outlook for RPIX inflation remained consistent with the projection on which last month's interest rate decision had been based.

22 Against this background, most members agreed that it was not necessary to change the repo rate this month. First, the news on the month suggested that the downside risks to the outlook were somewhat less than had been thought last month, but it did not have material implications for the central projections. For one member, whose assessment of the medium-term outlook for inflation was somewhat more subdued, the news was not sufficient to discriminate between the alternative views of the balance between potential supply and demand in the economy, and the pace at which underlying inflation was likely to pick up. Second, the full implications of the recent revisions to past National Accounts data were still to be unravelled; and those of the Chancellor's Pre-Budget Report were still to be assessed. Third, a significant factor in the previous month's decision had been the high level of household debt and the consequent uncertainties about the impact of monetary policy. Though the immediate effects of last month's increase in the repo rate had not been unusually large, it was too early to judge whether its eventual effects on the economy – and particularly on households – would match or exceed previous experience; and some of the upside risks in the housing market now appeared to be moderating. Overall, policy needed to remain forward-looking, and to be based – as always – on a fresh assessment each month of the accumulated data, against the projections for output and inflation. If the economy continued to evolve in line with the Committee's central projections, a further increase in the repo rate would be warranted at some point. But the news was not yet sufficient to justify another increase.

23 One member, however, while accepting the thrust of these arguments, put particular weight on the vulnerabilities created by the continued build-up of household debt and felt that an increase in the repo rate this month was justified. While acknowledging that it was too soon to judge the extent of the impact of last month's increase in the repo rate, it could be some time before conclusive evidence on that issue was available to the Committee and next month's decision could in practice be complicated by the probable change in the Committee's target. The news on the month might be small, but it was almost uniformly in an upside direction – both domestically and especially overseas. Inflation expectations had also edged upwards in recent months. Delay in moving the repo rate higher risked



allowing interest rates to fall increasingly below their warranted path. Action, by contrast, would be purposeful and at the same time consistent with caution. It would be more likely to ensure a dampening effect on consumption growth and on the further accumulation of debt, and so would help to reduce the future vulnerability of the household sector to adverse economic shocks.

24 The Governor invited members of the Committee to vote on the proposition that the repo rate should be maintained at 3.75%. Eight members (the Governor, Rachel Lomax, Kate Barker, Charles Bean, Marian Bell, Richard Lambert, Stephen Nickell and Paul Tucker) voted in favour. One member (Andrew Large) voted against, preferring to increase the repo rate by 25 basis points.

25 The following members of the Committee were present:

Mervyn King, Governor  
Rachel Lomax, Deputy Governor responsible for monetary policy  
Andrew Large, Deputy Governor responsible for financial stability  
Kate Barker  
Charles Bean  
Marian Bell  
Richard Lambert  
Stephen Nickell  
Paul Tucker

Gus O'Donnell was present as the Treasury representative.

## **ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF**

A1 This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on 28 November 2003, in advance of its meeting on 3-4 December. At the start of the Committee meeting itself, members were made aware of the information that had subsequently become available, and that information is included in this Annex.

### **I The international environment**

A2 According to the preliminary estimate, US GDP had risen by 2.0% on the quarter in 2003 Q3, higher than the 1.7% growth previously suggested in the advance estimate. Within this total, consumption growth had been unchanged from the advance estimate, at 1.6%; private investment growth had been revised up, from 3.3% to 3.9%; and the growth of government spending had been unchanged at 0.3%. The net trade contribution to GDP growth had also been unchanged, at 0.2 percentage points. The contribution from stocks had been revised up to zero, from -0.2 percentage points in the advance estimate. Non-farm business sector labour productivity had risen by 2.2% on the quarter in 2003 Q3, following a rise of 1.7% in 2003 Q2.

A3 US industrial production had risen by 0.2% on a month earlier in October, following an increase of 0.5% in September; new orders for non-defence capital goods had risen by 2.8%. The Institute for Supply Management (ISM) manufacturing index had risen to 62.8 in November, from 57.0 in October. The ISM non-manufacturing index had fallen to 60.1 in November, from 64.7 in October.

A4 US non-farm payrolls had increased by 126,000 in October, following an upwardly revised increase of 125,000 in September. Real consumption in the United States had been unchanged in October, after a fall of 0.6% in September. Real personal disposable income had increased by 0.4% on a month earlier in October, following a fall of 1.2% in September. Nominal retail sales had fallen by 0.3% in October, following a downwardly revised fall of 0.4% in September. Excluding sales of automobiles, retail sales had risen by 0.2% in October, following an increase of 0.2% in September. The Conference Board measure of consumer confidence had increased to 91.7 in November, from 81.7 in October, and the University of Michigan headline index had risen to 93.7, from 89.6.

A5 Annual headline consumer price inflation in the United States had been 2.0% in October, compared with 2.3% in September. Annual core consumer price inflation (which excludes food and energy prices) had been 1.3% in October, having been 1.2% in the year to September. US producer prices had risen by 3.4% in the year to October, following an increase of 3.5% in the year to September.

A6 According to the first release, euro-area GDP had increased by 0.4% on the quarter in 2003 Q3, unchanged from the flash estimate, after falling by 0.1% in 2003 Q2. Final domestic demand had made no contribution to quarterly GDP growth in 2003 Q3. Private consumption had been unchanged on the quarter, after an increase of 0.1% in 2003 Q2. Investment had fallen by 0.5%, after a similar fall in the previous quarter. Government consumption had increased by 0.5%, compared with 0.4% in 2003 Q2. Net trade had contributed 1.0 percentage points to quarterly GDP growth in 2003 Q3, and inventories had subtracted 0.6 percentage points.

A7 German GDP had increased by 0.2% on the quarter in 2003 Q3, following a fall of 0.2% in 2003 Q2. Within total German GDP, private consumption had fallen by 0.6% in Q3 compared with a fall of 0.5% in 2003 Q2. Total investment had fallen by 0.8%, after falling by 0.7% in Q2. Government consumption had grown by 0.4%, after rising by 0.5% in 2003 Q2. Inventories had subtracted 1.1 percentage points from GDP growth in Q3, while net trade had added 1.8 percentage points. French GDP had increased by 0.4% on the quarter in 2003 Q3, following a fall of 0.3% in 2003 Q2. Private consumption had increased on the quarter by 0.4%, total investment by 0.3% and government consumption by 0.7%. Net trade had contributed 0.3 percentage points to quarterly GDP growth, while inventories had reduced it by 0.4 percentage points. Italian GDP had increased by 0.5%; Spanish GDP had increased by 0.7%; Dutch GDP had increased by 0.1%; and Belgian GDP had increased by 0.5% on the quarter in 2003 Q3.

A8 Industrial production in the euro area had fallen by 0.6% on the month in September, following a monthly decline of 0.7% in August. The Purchasing Managers' Index for the manufacturing sector had risen to 52.2 in November, from 51.3 in October; and the Index for the services sector had risen to 57.5, from 56.0. According to the European Commission survey, the euro-area business confidence indicator had increased to -7 in November, from -8 in October. The euro-area consumer confidence indicator had also increased, to -16, in November, from -17 in October. The West German IFO index had increased to 95.7 in November, from 94.3 in October.

A9 The Bank's regional Agents had conducted an informal survey of 155 firms that either exported to, or had operations in, the euro area, regarding their sales there. Most of these firms had reported that sales volumes had increased during the second half of 2003, compared with the first half of the year. A majority had also expected sales to increase during the first half of 2004 compared with the second half of 2003. An improvement in euro-area demand had been identified by the firms as the main reason for these results.

A10 Annual inflation in the euro area, as measured by the harmonised index of consumer prices (HICP), had fallen to 2.0% in October, from 2.2% in September. Annual core inflation (excluding energy, food, alcohol and tobacco) had fallen to 1.7% in October, from 1.8% in September. According to the Eurostat flash estimate, euro-area annual HICP inflation had risen to 2.2% again in November.

A11 According to the preliminary estimate, Japanese real GDP had risen by 0.6% in 2003 Q3, compared with a 0.9% increase in the previous quarter. Within the total, private consumption had been unchanged, business investment had increased by 2.8% and total government expenditure had fallen by 1.0%. Net trade had contributed 0.2 percentage points to quarterly growth and inventories had made no contribution. The Japanese tertiary activity index had fallen by 0.2% in 2003 Q3 compared with the previous quarter, while the all-activity index had been unchanged.

A12 Industrial production in Japan had risen by 0.8% on a month earlier in October, following a 3.8% increase in September. The workers' household survey had reported an annual decline of 1.1% in real spending in October, compared with an annual fall of 1.9% in September. Annual growth in export volumes had been 7.5% in October, after an increase of 4.5% in September. Annual growth in import volumes had slowed to 8.9% in October, from 10.9% in September.

A13 Since the Committee's previous meeting, the spot price of Brent crude oil had increased by \$0.71 per barrel to \$29.27, and *The Economist* dollar non-oil commodity price index had risen by 0.2%.

## **II Financial markets**

A14 Between 5 November and 3 December, short-dated sterling interest rates had fallen. Economists polled by Reuters between 25 and 27 November had attached a mean probability of 73% to there being

no change in the repo rate at the December MPC meeting. Their mean expectation for rates at the end of 2004 had been 4.45%, slightly up on a month previously. The Bank of England/NOP Inflation Attitudes Survey conducted between 13 and 18 November had shown that 71% of the members of the public interviewed had expected interest rates to increase over the coming year, up from 36% in August. In the euro area and the United States, where economic data releases were generally stronger than the market had expected, short-term market interest rates had risen. At longer maturities, ten-year nominal forward rates had risen by around 15 basis points in the United Kingdom and by around 5 basis points in the euro area. In the United States, by contrast, they had fallen by around 15 basis points. These falls had been difficult to explain, given the stronger-than-expected US economic data. Some market participants had attributed them to a change in market positioning by dealers and speculators.

A15 International ten-year break-even inflation rates in the United States and the euro area had been broadly unchanged on the month. In the United Kingdom, forward RPI inflation expectations, as implied by index-linked and nominal gilt yields, had risen since the previous MPC meeting at maturities between 5 and 15 years but had fallen slightly at longer maturities. There had also been a slight fall in implied RPI inflation expectations two and a half years ahead, although survey-based measures of inflation expectations had risen. The Bank's quarterly survey of members of the public had shown that expectations for year-ahead inflation had risen by 0.4 percentage points, to 2.6%; and the quarterly HMT medium-term survey of economic forecasters had indicated that expected RPIX inflation for 2004 had risen by 0.3 percentage points, to 2.6%.

A16 Between 5 November and 3 December, the sterling effective exchange rate had depreciated by 1.5%, to 100.1. It had remained within a range of 97 to 102 since February 2003. Sterling had depreciated by 2.6% against the euro but appreciated by 2.7% against the US dollar. The US dollar had depreciated by 1.6% against the yen and by 5.1% against the euro. The US dollar effective exchange rate had fallen by 3.2% over the period. This was broadly consistent with changes in relative longer-term interest rate differentials, but market contacts had also reported concerns about the sustainability of the US current account deficit.

A17 US and European equity indices had risen between 5 November and 3 December. The Japanese Topix index, however, had fallen by 4.4%. Rises in the FTSE All-Share index had been broadly based across economic sectors. The Non-Cyclical Services sector had risen the most, mainly because of

increases in the share prices of mobile phone companies. The General Industrials sector had fallen furthest.

A18 There had been little news about corporate credit conditions on the month. Profit warnings had remained near recent lows in the United Kingdom and the United States. Sterling investment-grade spreads had been broadly unchanged, while spreads on US dollar and euro-denominated non-government bonds had fallen slightly. Sterling and euro high-yield bond spreads had also fallen slightly; US dollar high-yield bond spreads had fallen more markedly. All bond spreads had remained low compared with their averages since 1997.

### **III Money and credit**

A19 The annual growth rate of notes and coin (adjusted for special factors) had risen to 7.5% in November, compared with 7.3% in October. Annual M4 growth had fallen slightly in October, to 6.6%, from 6.8% in September. The annual growth rate of M4 lending (excluding the effects of securitisations) had risen to 11.7% in October, compared with 11.3% in September. Excluding other financial corporations (OFCs), annual M4 growth had fallen slightly in October, to 8.1%, from 8.2% in September, and annual M4 lending growth (excluding the effects of securitisations) had fallen by 0.1 percentage points, to 13.4%.

A20 The annual growth rate of households' M4 had increased to 8.2% in October, from 8.1% in September. The annual growth rate of households' M4 borrowing (excluding the effects of securitisations) had risen to 15.1% in October, from 15.0% in September. Within total net lending to individuals – a measure that included household borrowing from a broader set of institutions than just banks and building societies – the annual growth rate of secured lending had increased to 14.4% in October, from 14.2% in September, while the annual growth rate of unsecured lending had fallen further, to 12.8% in October, from 13.4% in September.

A21 The average two-year fixed mortgage rate had risen by 15 basis points, and the average two-year discounted mortgage rate had increased by 18 basis points, in November. Based on the announcements of mortgage lenders in November, the average standard variable mortgage rate (SVR) quoted for existing borrowers had been set to rise by 26 basis points to 5.58% in December. The average quoted rates on personal loans in excess of £10,000 had risen by only 5 basis points in

November, and rates on credit cards and overdrafts had been unchanged. Based on announcements in November, average quoted rates on household deposits had been set to rise in December, by 19 basis points for time deposits and by 9 basis points for instant access accounts.

A22 Mortgage lenders had approved 115,000 loans for house purchase in October (adjusting for the number of working days in the month). The corresponding figure for September had been revised down to 115,000, from 131,000. And these data had been revised downwards for all months since February 2003. The House Builders Federation monthly survey had shown that the balance of members reporting an increase in net reservations compared with the corresponding month of the previous year had fallen in October compared with September, after allowing for seasonal factors. The number of particulars delivered had risen slightly in October, to 108,000, from 106,000 in September.

A23 The annual rate of growth of private non-financial corporations' (PNFCs') M4 deposits had fallen to 7.6% in October, from 8.5% in September. The annual growth rate of PNFCs' M4 lending (excluding the effects of securitisations) had fallen to 8.4% in October, from 9.5% in September. PNFCs had raised £2.7 billion of total external finance in October, compared with an average of £2.1 billion in the preceding three months.

A24 Data from the major British banking groups (MBBG) had shown that manufacturing companies had made £48 million of net repayments on sterling loans in October, lower than average net repayments of £234 million over the previous six months. MBBG net sterling lending to real estate companies had only been £214 million in October, significantly lower than the average of £1.0 billion over the preceding six months.

A25 The annual growth rate of other financial corporations' (OFCs') M4 deposits had fallen to 1.3% in October, from 2.0% in September. The twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had risen to 5.6% in October, from 3.4% in September.

#### **IV Demand and output**

A26 Estimated real GDP growth at market prices in 2003 Q3 had been revised up by 0.1 percentage points, to 0.7%, in the Output, Income and Expenditure release. The annual growth rate had also been revised up, by 0.1 percentage points, to 2.0%.

A27 Service sector output growth had been revised up by 0.1 percentage points, to 0.8%, in Q3. Within the service sector, output growth of the distribution, hotels and catering sector had been revised up by 0.2 percentage points, to 0.7%. Output in the transport, storage and communication sector had grown by 0.4%, while output in the business services and finance sector had risen by 1.0%. Output growth in the production sector in Q3 had been revised down, by 0.2 percentage points, from the estimate in the preliminary release, to -0.2%. Manufacturing output had been flat on the quarter. Construction output had risen by 2.5% in Q3, following a rise of 4.4% in 2003 Q2.

A28 On the expenditure measure, real private sector consumption (including that of non-profit institutions serving households) had grown by 0.8% in Q3. Real government consumption had risen by 0.6%, while whole-economy investment had fallen by 1.3%. Within whole-economy investment, business investment had fallen by 1.6% in Q3, reflecting falls in services, manufacturing and other categories.

A29 Total exports had risen by 0.1% in 2003 Q3, while total imports had risen by 1.0%, so that net trade had reduced GDP growth by 0.3 percentage points on the quarter. After adjusting imports and exports to take account of the impact of missing trader intra-community (MTIC) VAT fraud, exports had risen by 0.6%, and imports by 1.6%, on the quarter.

A30 Final domestic demand had risen by 0.4% in 2003 Q3. The change in inventories (including the alignment adjustment) had made a 0.6 percentage point contribution to GDP growth in Q3, so domestic demand had risen by 1.0% on the quarter.

A31 Turning to indicators of expenditure in 2003 Q4, retail sales volumes had risen by 0.6% in October, following a rise of 0.7% in September. The Confederation of British Industry (CBI) Distributive Trades survey had pointed to a fall in annual retail sales volumes growth in November: the reported retailing sales balance had fallen to +19, from +35 in October.

A32 The headline GfK consumer confidence indicator had fallen in November to -6, from -3 in October. This was driven by a fall in the balance of respondents thinking it was a good time to make a major purchase. The Nationwide and Halifax house price indices had risen by 1.2% and 1.0% respectively on the month in November, and the three-month on three-month growth rates had been 3.8% and 4.3% respectively.



A33 Turning to indicators of output in Q4, the Chartered Institute for Purchasing and Supply (CIPS) services activity balance had risen to 59.6 in November, from 59.1 in October. The incoming new business index had also picked up, to 60.1, from 58.4 in October. Both balances had reached their highest levels since mid-1997.

A34 The CIPS manufacturing output index had fallen to 58.0 in November, from 58.8 in October. The new orders index had risen to 57.9, from 57.2 in October. The November CBI Monthly Trends Enquiry had suggested continued weakness in the manufacturing sector. The total orders balance had risen to -24, from -40 in October, and the balance on expected output had also picked up slightly, to -2, in November, from -4 in October.

## **V The labour market**

A35 According to the Labour Force Survey (LFS), employment had increased by 28,000 in 2003 Q3, compared with 2003 Q2. The working-age employment rate had fallen by 0.1 percentage points on the quarter, to 74.6%, but had risen by 0.3 percentage points from a year earlier. Average hours worked had increased by 0.1% on the quarter, to 32.2 hours per week, but were down 0.6% compared with 2002 Q3.

A36 The CIPS employment survey for November had confirmed recent indications of stronger employment growth. According to the Recruitment and Employment Confederation survey, the demand for staff from agencies had also increased, and the availability of agency staff had started to fall.

A37 The LFS measure of unemployment had risen by 12,000 in 2003 Q3, while the unemployment rate had remained at 5.0%. But the claimant count measure had fallen by 3,300 in October and the rate had fallen by 0.1 percentage points, the first change for 21 months. Both outflows and inflows from the claimant count had fallen back in October, reversing September's slight increase. Inactivity amongst those of working age had risen by 33,000 in 2003 Q3, with the rate up by 0.1 percentage points at 21.3%.

A38 Whole economy average earnings (including bonuses) had increased by 3.6% in 2003 Q3 over the same period a year earlier, up 0.6 percentage points from the 2003 Q2 figure. Average annual

earnings growth in the public sector had been 5.6%, up 0.5 percentage points ; and in private sector services, annual earnings growth had been 3.1%, up 0.7 percentage points. After excluding bonuses, the annual growth of average earnings in the economy as a whole had increased by 0.3 percentage points, to 3.7%, in the third quarter.

A39 According to the settlements information available to the Bank, the mean whole-economy settlement (weighted to match the sectoral composition of the average earnings index) had been 3.2% in the year to October, 0.1 percentage points higher than in the year to September.

## **VI Prices**

A40 Sterling oil prices had been broadly unchanged since the November MPC meeting but, on average, had been lower in November compared with October.

A41 Manufacturing input prices had risen by 1.6% in October, mainly because of higher oil prices. This meant that their annual inflation rate had risen to 1.8%, from 0.7% in September. And the CIPS manufacturing survey had pointed to further rises in input prices: the input price balance had risen to 55.2 in November, from 53.3 in October.

A42 Manufacturing output prices excluding duties (PPIY) had been unchanged in October, while the annual inflation rate had fallen to 1.2%, from 1.4% in September. Survey data had continued to point to downward pressure on output prices. The balance on expected output prices from the CBI Monthly Trends survey had fallen to -15 in November, from -7 in October.

A43 The ONS's experimental corporate services price index (CSPI) had suggested that annual corporate services price inflation had risen to 3.4% in Q3, from 3.1% in Q2. The CIPS services survey had pointed to rising output prices in November: the average prices charged balance rose to 52.3, from 51.4 in October.

A44 According to the ONS's Output, Income and Expenditure release, the annual inflation rate of the GDP deflator at market prices had fallen to 2.8% in Q3, from 3.1% in Q2. Within this, the annual rate of inflation of the household consumption deflator had risen by 0.1 percentage points, to 1.4% in Q3. The annual inflation rate of the government consumption deflator had fallen to 7.2% in Q3, from 7.6% in Q2. The annual inflation rates of the imports and exports deflators had been 0.3% and 1.4% respectively.

A45 Annual RPIX inflation had fallen to 2.7% in October, from 2.8% in September. Within this, annual goods price inflation had risen by 0.1 percentage points to 0.6%, and annual services price inflation had fallen by 0.2 percentage points, to 3.4%. Annual RPI and RPIY inflation had also fallen in October, to 2.6% and 2.4% respectively. But annual HICP inflation was unchanged in October, at 1.4%.

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

A46 The Bank's regional Agents reported that investment intentions had continued to recover, especially in the service sector where intentions had perhaps been at their most buoyant level since early 2001. The most important factor behind that improvement had been greater confidence in the economic outlook. While intentions had also improved in manufacturing, it appeared that firms had still been planning to reduce slightly the level of their investment.

A47 Deflationary pressures on manufacturers' domestic output prices had eased since the first half of 2003, although prices had continued to fall slightly. Price increases had in general only been possible either for new products or in niche markets. There had continued to be strong competitive pressures on manufacturers to cut costs, so as to allow price reductions for customers without damaging profit margins. Costs of materials had been rising. And while annual wage increases had been fairly steady, at around 3%, labour costs had increased - mostly because of higher employer National Insurance and pension contributions.

A48 The annual growth of retail sales values had perhaps eased slightly in the past two months. On balance, it seemed that retailers had been positive about the prospects for the Christmas trading period, although it had appeared that some price discounting had been necessary to clear an overhang of stock from the autumn. There had been some concern amongst retailers that consumer confidence could diminish in the first quarter of 2004.