

Publication date: 19 November 2003

MINUTES OF MONETARY POLICY COMMITTEE MEETING

5 and 6 November 2003

These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 November 2003.

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0311.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 December will be published on 17 December 2003.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 5-6 NOVEMBER 2003

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

Financial markets

2 Short-term interest rates had risen during the past month in the major industrial economies, but by more in the United Kingdom than in the United States or the euro area. The release of the minutes of the Committee's October meeting had led to widespread market expectations of an increase in the Bank's repo rate. By contrast, market participants did not expect the Federal Open Markets Committee to raise US interest rates until well into 2004.

3 Despite the rise in short rates, forward rates in the United Kingdom had fallen at long maturities. This might have reflected short-term positioning by market participants, taking views on the future shape of the yield curve, against the background of continuing demand for longer gilts to hedge the liabilities of life assurance companies and pension funds. A small short-term movement in long forward rates was of no particular significance for monetary policy. But the broad stability of long-term rates was encouraging evidence for the continuing credibility of monetary policy.

4 The effective exchange rate index for sterling had risen by over 3% since the Committee's October meeting. This movement was broadly consistent with changes in short-term interest differentials over the same period. Given that the recent rise in sterling reflected expectations of a rise in the Bank's repo rate, a repo rate increase should not result in further appreciation.

5 Equity markets had moved little in the past month, which implied that the upward influence from economic news and the downward influence from higher interest rates had been broadly offsetting. The major equity indices for the United States, the United Kingdom and the euro area had risen significantly from the levels embodied in the *August Inflation Report*.

The world economy

6 The continuing weakness evident in data releases from the euro area suggested that near-term prospects for external demand for UK goods and services were slightly weaker than at the time of the *August Inflation Report*, even though news from other areas had been positive, particularly in the latest month. The changes in the Committee's projections for the world economy since August had only a modest negative impact on the projections for UK inflation.

7 GDP had increased by 1.7% in the United States in the third quarter, which was the fastest rate for nearly twenty years. Consumption and investment had both grown robustly. Net trade had also made a positive contribution, but the weakness of imports looked anomalous, even though US competitiveness would have been helped by the depreciation of the dollar over the previous year. The composition of growth supported the view that the recovery would be durable. The performance of investment was particularly important in this respect: the pickup in Q3 had been broadly based, with investment rising in both the information, communications and technology (ICT) and producer durables (excluding ICT) sectors. The Institute for Supply Management's manufacturing index had reached its highest level since January 2000, and industrial production had risen by 0.4% in September. The financial environment for investment was supportive: third-quarter corporate earnings had been stronger than expected, and equity values had risen, so that a large increase in borrowing from banks had not been necessary. There were some signs that large corporations were recovering their confidence to undertake merger and acquisition activity. By contrast, some of the strength of US consumption might prove to be temporary. Consumption had probably been stimulated in the short term by tax rebates paid in July and August, and the profile of retail sales suggested that the pace had eased towards the end of the quarter. Moreover, the rise in longer-term interest rates since May meant that less support could be expected from mortgage refinancing. And household gearing was high, so that consumers might be vulnerable to adverse shocks. However, other factors should be supportive for consumption. The elements of the tax package due to take effect in 2004 were much larger than those which had already been implemented, although consumers might already have anticipated them to some extent. Household confidence might be bolstered by signs of improvement in the labour market, although this would probably require further evidence of an upturn in employment prospects. And monetary policy remained highly accommodative.

8 In the euro area, new data in the latest month had been limited. There remained a disjunction between disappointing economic data and more encouraging business surveys. Euro-area industrial

production had fallen in August; if it were to remain at that level in September, the rise in the third quarter as a whole would be insufficient to offset the fall in Q2. But business survey data pointed to a resumption in growth: the Purchasing Managers' Indices (PMIs) for manufacturing and services had both increased in October; the European Commission measure of euro-area industrial confidence had also increased slightly, reflecting improved orders and recent production; and the German IFO index had increased for the sixth consecutive month in October. Stronger surveys did not invariably precede improved economic performance, and the relationship between the IFO index and German output had recently been less close. But taken together, the business surveys suggested an upside risk to euro-area output in the near term relative to the Committee's projections. The latest euro-area consumer confidence survey showed no change and remained below its long-run average.

9 Economic prospects for the euro area over the next two years were uncertain. There were some positive factors. Real interest rates were low, though to a lesser extent than in the United States. Domestic demand in the euro area had been over 1% higher in 2003 Q2 than a year earlier. Household debt was less burdensome in several euro-area countries than in the United States or the United Kingdom, which could facilitate stronger future consumption growth. The firmer economic prospects in the rest of the world would support external demand. But there were also some possible adverse influences. Corporate gearing levels might further restrain investment growth. The rise in the euro over the past year would probably weaken the contribution to be expected from net trade. The largest three economies – Germany, France and Italy – were all relatively weak at present, and the weakness of Germany might be particularly important for its trading partners. And from a longer-term perspective, it was possible that the Committee's expectations for the sustainable rate of output growth in the euro area were too high. With low population growth, output and demand growth might average only 2% per annum, or possibly less, if productivity growth in recent years represented the underlying trend.

10 There had been little economic news from Japan in the latest month. It remained difficult to reconcile the strong expenditure-based and weaker output-based measures of growth. Industrial production was reported to have increased by 3% in September, but this was a volatile series. Output growth had increased across most of non-Japan Asia; in China, the annual rate of GDP growth was close to 9%. It now appeared that the impact of SARS on the region had been temporary, mainly affecting 2003 Q2. Exports from the region were picking up. But the performance of some of the newly industrialised Asian countries, notably Korea, was weaker.

Money, credit, demand and output

11 The monetary aggregates, on the deposit side, were supportive of demand growth without suggesting that a further increase was in prospect. Aggregate M4 deposit growth had been fairly steady in 2003, at an annual rate of 7% to 8%. Household M4 growth was also steady, at an annual rate of around 8%; the growth of households' Divisia, a monetary aggregate which gave greater weight to deposits that were more likely to be used for making transactions, was a little lower than at the beginning of 2003; and the annual growth rate of notes and coins in circulation had declined in October.

12 The credit aggregates suggested greater strength. The annual growth rate of aggregate M4 lending to the non-bank private sector had been over 11% for several months. Total lending, secured and unsecured, to individuals had increased by 14% in the twelve months to September, and this rate had picked up during the year.

13 Several indicators suggested that the housing market had strengthened in recent months. On activity, net reservations of new houses and loan approvals had both increased, suggesting that completed transactions were likely to pick up. The average time taken to sell a property had fallen over the past two months. On house price inflation, an average of the Halifax and Nationwide indices in the three months to October showed a rise of 3.7%, and, according to the Royal Institution of Chartered Surveyors, the balance of estate agents reporting price increases in the previous three months had risen sharply in September. This generally buoyant picture was supported by evidence from the Bank's regional Agents.

14 It remained difficult to explain the continuing rise in the ratio of house prices to earnings, and hence to assess prospects for the housing market. The Committee had previously considered three hypotheses: that the equilibrium ratio had increased further in the past year, reflecting in part the balance of demand and supply; that the recent rise in prices might have been driven by speculative behaviour or over-optimistic views about the sustainable level of house prices, in which case a correction would be expected at some stage; and that the lenders' house price indices might be exaggerating the underlying rate of increase. As before, it remained extremely difficult to distinguish between these hypotheses.

15 Most of the news on UK output and demand during the past month had been positive. GDP in Q3 was estimated to have grown by 0.6% over the previous quarter, in line with the Committee's expectations, although the weak industrial production data for September might imply a small downward revision. Recent business surveys had all strengthened. For example, the Chartered Institute of Purchasing and Supply (CIPS) services activity balance had risen in October to its highest level since November 1999. The CBI and BCC measures of manufacturing confidence also suggested a pickup, while the CIPS manufacturing output index had reached its highest level for seven years. And the CIPS report on construction was consistent with robust growth in the second half of the year. Overall, the evidence from the various surveys of business activity suggested that quarterly GDP growth could exceed its trend rate in 2003 Q4.

16 On the expenditure side, the revisions to the National Accounts data released at the end of September had suggested that demand was better balanced than previously thought. The level of business investment was estimated to have been higher, and the outlook was more encouraging. The most recent indicators suggested that consumer spending had not decelerated by as much as the Committee had previously expected. Retail sales had grown by 1.2% in the third quarter, and the quarterly growth rate had averaged 0.9% since the first half of 2002. The CBI Distributive Trades survey for October had pointed to continuing buoyancy into 2003 Q4. However, the persistent strength of house price inflation seemed to be having less upward impact on consumption than would have been expected on the basis of historical experience.

The labour market, costs and prices

17 Surveys suggested that private sector demand for labour had strengthened. CIPS employment surveys suggested a rise in private sector employment, with the construction sector particularly robust. Demand for agency staff had increased further in October. Reports from the Bank's regional Agents suggested tighter labour conditions in services and an increase in skills shortages. Unemployment remained flat.

18 Pay pressures were little changed. Whole-economy average earnings rose by 3.4% in the three months to August, remaining within the 3% to 3½% range that had prevailed so far this year. Pay settlements had increased slightly in September, but survey evidence pointed to little upward pressure on settlements in the forthcoming year. By contrast, the Bank's Agents reported suggestions that pay negotiations could be more difficult in 2004 than in the recent past. This might reflect the fact that real

post-tax labour incomes had been falling in recent months, for the first time since 1995.

19 RPIX inflation had been 2.8% in the year to September. The recent unexpected strength of house prices meant that the fall in RPIX inflation envisaged over the next few months, reflecting the falling contribution of the housing depreciation component, might not be as marked as the Committee had thought. There had recently been a broadly based rise in global non-oil commodity prices, which were up by nearly 40% in dollar terms since their low point in 2001. But although this implied a significant rise in sterling UK input prices, it would not have much direct impact on the projection for RPIX inflation. However, the Committee noted that if the recent rise in commodity prices reflected stronger global demand, that could eventually put upward pressure on the world price of finished goods, which in turn would have a more material effect on UK inflation. By contrast, oil prices had fallen by around 2% in dollar terms since the Committee's October meeting.

Other considerations

20 A rise in the official repo rate was widely expected. Out of 43 economists polled by Reuters in the week before the meeting, 37 expected a 25 basis point increase. A few commentators had suggested that a rise of 50 basis points was possible. And the short-term yield curve was as steep as at any time since the Committee's inception in 1997; short sterling contracts implied an expectation that the official repo rate would exceed 5% in early 2005.

The November GDP growth and inflation projections

21 The Committee reached its policy decision in the light of the projections to be published in the *Inflation Report* on Wednesday 12 November.

22 The Committee's central projections continued to imply a benign outlook for the economy. On the assumption of an official repo rate of 3.75%, the profile for GDP growth was rather stronger than in the August *Inflation Report*, and quarterly GDP was expected to grow marginally above trend through the forecast period. The profile for annual RPIX inflation was somewhat higher than in the August *Report*, and was projected to edge down in the near term, reflecting the diminishing impact of housing costs, and then to remain around the target during the rest of the forecast period. Imported and domestic cost pressures were projected to build gradually into the medium term.

23 The Committee noted various risks surrounding these projections. There were uncertainties relating to the outlook for the world economy; to the outlook for UK household spending, including the sustainable level of house prices and consumers' own perceptions of the likely rate of increase of real incomes; and to short-term prospects for earnings. One key judgment related to the interpretation of the recent revisions to GDP. The estimated level of output for several years past had been revised upwards, but there had been no revision to RPIX inflation. The judgment embodied in the central projection was that the level of output and employment consistent with stable inflation had been higher than previously thought. But it was possible that the faster growth in the past was indicative of a more rapid rate of underlying productivity growth, which would continue into the future; that might imply lower future inflationary pressure than in the central projection. An alternative possibility was that the factors bearing down on inflation in the past, for example the appreciation of sterling, had been more powerful than previously thought, and that, as these effects disappeared over the forecast period, inflationary pressures would be higher than in the central projection.

24 The Committee judged that, relative to the central projection, the overall risks to growth were slightly on the downside and those to inflation were broadly balanced.

The immediate policy decision

25 The balance of news in the latest month had been positive for UK output and inflation. The US economy had grown strongly in Q3, and the recovery there looked more firmly established, although above-trend growth could persist for some time before output reached full capacity. The outlook for the euro area was still uncertain. In the United Kingdom, the latest data for retail sales, household borrowing and the housing market were all strong, and investment intentions surveys pointed to a pickup. Equity prices at home and abroad had risen since the *August Inflation Report*, although not materially on the month. The recent rise in sterling would tend to bear down on inflation, but that was probably associated, to some extent, with market expectations that the official repo rate would be raised at this meeting, rather than being an independent factor.

26 The Committee also noted that, because of higher household debt burdens, there was increased uncertainty as to the strength of the response of consumption to any given interest rate change. It would therefore be appropriate to move interest rates cautiously. Nevertheless, it was important that policy should remain forward-looking, so the present decision should be based on the Committee's assessment of the prospects for inflation and the associated risks.

27 Most members thought that a modest rise in the repo rate was now appropriate. This view was supported by a number of arguments, to which different members gave different weights. The forecast suggested that inflation would be above the target and rising at the forecast horizon. This was for several reasons. First, there was now stronger evidence of recovery in the world economy. The upturn in US investment was particularly significant, since there had previously been uncertainty as to whether this would occur before US consumption slowed. Second, the growth in UK domestic demand now appeared to have been more broadly based and better balanced in the past few years than the Committee had previously thought, following the September revisions to the National Accounts. Third, consumption growth and housing activity were not slowing as much as the Committee had expected, and investment and government expenditure were likely to continue to strengthen. Survey evidence suggested a pickup in output in services and manufacturing, and the labour market appeared to be tightening a little. Finally, even after a modest repo rate increase, monetary policy would still be accommodative.

28 Moreover, a consideration of the risks to the outlook suggested that a rise in the repo rate was appropriate. First, the change to the global outlook had reduced the downside risks to activity, and, to the extent that the July repo rate reduction had been a precaution against the crystallisation of such risks, that reduction should now be reversed. Second, if rates were not raised, household borrowing would be more likely to continue to grow at a rate that would eventually prove unsustainable, and there would be a greater risk of a sharp downward adjustment to house prices if they became more overvalued, complicating the operation of monetary policy.

29 The Committee reviewed the arguments for leaving interest rates unchanged, to which, again, different members attached different weights. First, once housing depreciation was excluded, the current rate of inflation was low and wage pressures were muted. Second, the recent weakness of manufacturing output suggested that there were downside risks to output as a whole in the near term and hence to inflation. Third, there remained many uncertainties about the interpretation of the data which had yet to be resolved. For most members, however, these arguments were not sufficient to outweigh the arguments for a repo rate rise.

30 For one member, the Committee's central projection for inflation was somewhat too high. First, following the revisions to the National Accounts, the balance of potential supply relative to demand might be more favourable than in the Committee's central projection. The stronger demand which had

materialised over the past four years might have been directly associated with a stronger supply performance and therefore implied rather less inflationary pressure than in the central projection. Second, the projections for growth in the euro area might be too optimistic. There had been few signs of recovery in reported data; most of the surveys, although higher than in earlier months, were below their long-term average and so did not suggest that trend growth would be achieved soon; and the fragility of corporate balance sheets might restrain investment. The most likely outcome was therefore for a more delayed recovery than in the Committee's central projection. Taken together, these points could imply a materially lower projection for RPIX inflation at the two-year horizon. Inflation was likely to be rising at that point, so, on this forecast, a rise in repo rate some time in 2004 was likely to be warranted to continue meeting the target. But to increase it now was not necessary and would involve some cost in output.

31 The Governor invited members to vote on the proposition that the repo rate should be raised by 25 basis points to 3.75%. Eight members (the Governor, Rachel Lomax, Andrew Large, Kate Barker, Charles Bean, Richard Lambert, Stephen Nickell and Paul Tucker) voted in favour. One member (Marian Bell) voted against, preferring to maintain the repo rate at 3.50%.

32 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

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 31 October 2003, in advance of its meeting on 5-6 November. 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 advance estimate, US GDP in 2003 Q3 had grown by 1.7% on a quarter earlier, following a rise of 0.8% in Q2; it had been 3.3% higher in Q3 than a year earlier. Government spending had risen by 0.3% on a quarter earlier, with defence spending flat. Consumption had grown by 1.6%, reflecting a rise of 6.1% in spending on durable goods. Private investment had grown by 3.3%; residential investment had increased by 4.8%, and non-residential investment by 2.7%. Stocks had reduced growth by 0.2 percentage points. Exports had risen, and imports had been flat, with net trade contributing 0.2 percentage points to GDP growth in Q3.

A3 US industrial production had risen by 0.4% on a month earlier in September, compared with a fall of 0.1% in August. The September rise had included an increase of 6.6% in the production of motor vehicles and parts, and a 1.5% increase in the production of information, communications and technology (ICT) goods. Total industry capacity utilisation had risen to 74.7% in September, from 74.5% in August. New orders for non-defence capital goods had risen by 3.4% in September, compared with a month earlier. The Institute for Supply Management (ISM) Purchasing Managers' Index for the manufacturing sector had increased to 57.0 in October, from 53.7 in September; the ISM index for the non-manufacturing sector had also increased, to 64.7 in October from 63.3 in September.

A4 US retail sales values had fallen by 0.2% in September, following a rise of 1.2% in August. The Conference Board measure of US consumer confidence had risen to 81.1 in October, from 77.0 in September. The rise in the index had reflected improvements in both the expectations and the present situation components. The final release of the University of Michigan headline index of consumer confidence had risen to 89.6 in October, from 87.7 in September.

A5 Annual headline consumer price inflation in the United States had increased to 2.3% in September, from 2.2% in August. Annual core consumer price inflation (excluding food and energy prices) had fallen to 1.2%, from 1.3%, and producer price inflation had risen to 3.5% in September, from 3.4%. Annual core US producer price inflation had fallen, to 0.1% in September from 0.4% in August.

A6 According to the second release, euro-area GDP had fallen by 0.1% in 2003 Q2, unchanged from the previous estimate, and compared with no growth in 2003 Q1. Industrial production in the euro area had fallen by 0.4% in August compared with a month earlier, following an increase of 1.0% in July. In Germany, industrial production (excluding construction) had fallen by 2.1% on a month earlier in August, having risen by 2.9% in July. French industrial production had also fallen, by 0.9% on a month earlier in August, having been unchanged in July. The euro-area Purchasing Managers' Index (PMI) for the manufacturing sector had risen to 51.3 in October, from 50.1 in September; and the services sector PMI had increased to 56.0 in October, from 53.6 in September. The euro-area unemployment rate (ILO measure) had been 8.8% in September, unchanged from August. Unemployment rates in Germany and France had also been unchanged in September, at 9.4% and 9.5% respectively.

A7 The European Commission measure of business confidence had risen to -8 in October, from -9 in September, whereas consumer confidence had been unchanged at -17. The German IFO business climate index had increased to 94.2 in October, from 92.0 in September. Both the future expectations and current business components of the index had risen. According to Eurostat, the volume of retail sales in the euro area had fallen by 0.1% on a month earlier in August, following a rise of 0.3% in July. German retail sales had fallen by 0.5% on a month earlier, following a 1.3% fall in July. French retail sales had risen by 0.6% in August, following a 0.1% rise in July. French consumer expenditure on manufactured goods had increased by 3.4% in September, after falling by 2.9% in August.

A8 Annual harmonised consumer price inflation (HICP) in the euro area had been 2.1% in September, unchanged from August. Annual core consumer price inflation (excluding energy, food, alcohol and tobacco) had risen to 1.8% in September, from 1.7% in August. The Eurostat flash estimate for euro-area HICP inflation had indicated a rate of 2.1% in the year to October. Annual producer price inflation in the euro area had fallen to 1.1% in September, from 1.4% in August.

A9 In Japan, industrial production had risen by 3.0% in September, compared with a fall of 0.7% in August. The index of tertiary activity had risen by 1.0% in August compared with a month earlier, and the all-activity index had increased by 0.3% in the same period. Export volumes had risen by 5.3% in the year to September, and import volumes had increased by 10.8% over the same period. Nominal retail sales had fallen by 2.2% in the year to September, having fallen by 2.1% in the year to August. In the worker household survey, real living expenditures had fallen by 1.9% in the year to September, having risen by 2.2% in the year to August. The unemployment rate had remained at 5.1% in September.

A10 Since the Committee's previous meeting, the spot price of Brent crude oil had fallen by \$0.65 per barrel to \$28.56. The Economist dollar non-oil commodity price index had increased by 5.5% over the same period.

II Financial markets

A11 Between 8 October and 5 November, the short end of the UK nominal forward rate curve had steepened, with the implied forward rates now rising out to about four years. Economists polled by Reuters between 28 and 29 October had attached a mean probability of 65% to a 25 basis point rise in the Bank's official repo rate at the November meeting, and a mean probability of 30% to no change. Their mean expectations for rates at the end of 2003 and 2004 had increased, to 3.72% and 4.37% respectively. The short end of the nominal forward rate curve had also steepened in both the United States and the euro area. At maturities beyond ten years, nominal forward rates in the United Kingdom, the United States and the euro area had fallen by up to 25 basis points since the October MPC meeting. Over the same period, UK real forward rates had increased at maturities up to eight years, euro-area ten-year real yields had remained largely unchanged, and US ten-year real yields had fallen by around ten basis points.

A12 Forward RPI inflation expectations out to ten years, as implied by index-linked and nominal gilt yields, had risen between 8 October and 5 November. There had been a sharp rise in implied inflation expectations two and a half years ahead, continuing an upward drift evident since July. Surveys of UK inflation expectations, however, had been broadly unchanged, with mean expectations for 2003 in line with recent RPIX outturns, and expectations for 2004 stable at around the inflation target.

International ten-year break-even inflation rates in the United States and the euro area had risen on the month, consistent with news on the global recovery.

A13 The sterling effective exchange rate index (ERI) had appreciated by 3.5%, to 101.6, between 8 October and 5 November. Sterling had appreciated against the US dollar and the euro by 1.3% and 5.2% respectively. These movements had been broadly consistent with changes in relative interest rate differentials. Forecasts in the latest Consensus Economics survey for the euro-sterling and the dollar-sterling exchange rates had suggested that the sterling ERI was expected to depreciate to a level of around 98 between the three-month and the two-year horizon.

A14 The dollar had been broadly unchanged in effective terms. Option-based implied volatilities of dollar bilateral exchange rates, however, had been well above those of sterling, the dollar-yen implied volatility having increased sharply following the G7 communiqué in mid-September. Risk reversals had indicated that markets had perceived a continuing risk of dollar depreciation over the following three months.

A15 The FTSE All-Share index had risen by 0.9% between 8 October and 5 November. Over the same period, the FTSE 250 and the FTSE Small-Cap indices had risen by 0.9% and 2.4% respectively. Within the All-Share index, the performance of different sectors had been mixed. The Information Technology sector had risen most, and the Basic Industries sector had fallen furthest. Between 8 October and 5 November, the S&P500 and EuroStoxx indices had risen by 1.7% and 5.2% respectively. The Topix had risen by 0.8%.

A16 The main corporate news on the month had been Q3 earnings results. In the United States, around 85% of S&P500 companies had reported their Q3 earnings, which had risen on the quarter. This improvement in corporate conditions had been reflected in fewer profit warnings. In the United Kingdom too, fewer profit warnings had been reported in October than in the same month a year earlier. This had continued a pattern evident since July. Also consistent with an improvement in corporate conditions, investment-grade and high-yield corporate bond spreads had fallen on the month, as had uncertainty around the future levels of the FTSE 100 and S&P 500, as measured by implied volatilities from option prices.

III Money and credit

A17 The twelve-month growth rate of notes and coin had fallen to 7.3% in October, compared with 7.9% in September. Annual growth of M4 had risen to 7.4% in September, from 7.2% in August. The twelve-month growth rate of M4 lending (excluding the effects of securitisations) had fallen to 11.4% in September, from 11.9% in August. Excluding other financial corporations (OFCs), the annual M4 growth rate had risen slightly, to 8.3% in September from 8.2% in August, and the annual M4 lending growth rate (excluding the effects of securitisations) had risen to 13.5% in September, from 13.4% in August.

A18 The twelve-month growth rate of households' M4 had increased slightly, to 8.2% in September from 8.1% in August. The twelve-month growth rate of households' M4 borrowing (excluding the effects of securitisations) had risen to 14.9% in September, from 14.7% in August. Within total net lending to individuals – a measure that included borrowing from a broader set of institutions than just banks and building societies – the annual growth rate of secured lending had increased to 14.1% in September, from 13.9% in August. The annual growth rate of unsecured lending had fallen, however, to 13.4% in September, from 13.7% in August.

A19 The average standard variable mortgage rate (SVR) quoted for existing borrowers had been unchanged in October at 5.30%. However, the average two-year fixed mortgage rate had risen by 25 basis points, and the average two-year discounted mortgage rate had risen by 4 basis points, in October. Quoted rates on personal loans in excess of £10,000 had fallen by 2 basis points in October.

A20 The number of loan approvals for house purchase, after adjusting for the number of working days in the month, had risen to 131,000 in September, compared with 127,000 in August. 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 risen sharply in September compared with August, after allowing for seasonal factors. The number of particulars delivered had been unchanged in September, at 105,000.

A21 The annual rate of growth of private non-financial corporations' (PNFCs') M4 deposits had been unchanged at 8.8% in September. The twelve-month growth rate of PNFCs' M4 lending (excluding the effects of securitisations) had fallen to 9.4% in September, from 9.6% in August. PNFCs had

raised a monthly average of £2.4 billion of total external finance in 2003 Q3, compared with an average of £2.9 billion in the preceding six months.

A22 The quarterly breakdown of sterling bank lending for 2003 Q3 had shown that the annual rate of debt repayment by the manufacturing sector had increased; the annual rate of lending to real estate companies and the construction sector had eased.

A23 The twelve-month growth rate of other financial corporations' (OFCs') M4 deposits had risen to 4.3% in September, from 3.6% in August. The twelve-month growth rate of OFCs' M4 lending (excluding the effects of securitisations) had fallen to 4.2% in September, from 6.9% in August.

IV Demand and output

A24 The ONS' preliminary estimate for GDP growth at market prices had been 0.6% in 2003 Q3, following 0.6% growth in Q2. Annual GDP growth had slowed down slightly, to 1.9% in Q3 from 2.0% in Q2.

A25 The preliminary estimate for service sector output growth had been 0.7% in 2003 Q3, following growth of 0.2% in Q2. Within the service sector, output in the distribution, hotels and catering sector had risen by 0.5%, following 0.8% growth in Q2. The ONS had, for the first time, also published an estimate for production output in Q3 in the preliminary GDP release, which had shown it unchanged on the quarter, following 0.2% growth in Q2. Following the preliminary GDP release, the September Index of Production had shown production output falling by 0.2% in Q3; within this, manufacturing output had been flat, and energy output had fallen by 1.1%.

A26 Retail sales were estimated to have risen by 0.6% in September. Estimated retail sales growth had been revised up in July and August, to -0.1% and 0.5% respectively. Retail sales had grown by 1.2% in 2003 Q3, following growth of 1.5% in Q2. The Confederation of British Industry (CBI) Distributive Trades survey's retail sales balance had risen sharply, to +35, in October, from +17 in September. The GfK consumer confidence headline balance in October had been -3 for the third consecutive month.

A27 The Nationwide and Halifax house price indices had risen by 2.0% and 1.2% respectively in October. The three-month on three-month growth rates of the Nationwide and Halifax house price indices had also risen, to 3.5% and 4.0% respectively.

A28 The Bank's regional Agents had conducted an informal survey of around 135 firms involved in the residential property sector on house price inflation. Most respondents had reported that house prices had risen by between 0% and 4% over the previous six months, and had expected this trend to continue over the following six months. Respondents in London, the South and the South-East had reported slower increases than those in the other regions over the past six months, but responses pointed to more uniform increases over the next six months. The level of interest rates had been perceived to be the principal determinant of house price inflation over the next six months, with expected future house prices the most important.

A29 Surveys showed that business confidence had risen since the beginning of the year, with confidence in both the service and manufacturing sectors above their historical averages. For the service sector, the British Chambers of Commerce (BCC) survey's balance of business confidence regarding profitability had risen to +40 in 2003 Q3, from +32 in Q2. The Chartered Institute of Purchasing and Supply (CIPS) survey's index of business expectations in the services sector had also risen, to 76.3 in October from 76.1 in September. For the manufacturing sector, the BCC survey's balance of business confidence regarding profitability had risen to +37 in Q3, from +29 in Q2, and the CBI Quarterly Industrial Trends survey's business optimism balance had risen to -7 in Q3, from -13 in Q2.

A30 The CIPS services business activity index had risen to 59.1 in October, from 58.7 in September, but the incoming new business balance had fallen slightly, to 58.4 from 58.6. The BCC services survey's domestic order balance had risen to +18 in Q3, from +9 in Q2.

A31 In manufacturing, the CIPS survey's output index had risen sharply, to 59.0, in October, from 54.9 in September, and the new orders balance had also risen slightly, to 57.0. In 2003 Q3, the CBI total new orders balance had risen to -16, from -18 in Q2, and the BCC domestic orders balance had remained broadly unchanged.

V The labour market

A32 According to the Labour Force Survey (LFS), employment had fallen by 9,000 in the three months to August, compared with the previous three months. This had followed a rise of 63,000 in the three months to July, and a 101,000 rise in the previous non-overlapping quarter. The fall in employment in the three months to August had largely reflected a 90,000 fall in the number of employees. Self-employment had increased by 58,000, and the number of unpaid family workers had risen by 13,000. The working-age employment rate had fallen by 0.2 percentage points, to 74.5%.

A33 Total weekly hours worked in the June-to-August quarter had risen by 0.5% compared with the previous non-overlapping quarter. This increase in total hours had reflected a 0.5% increase in average weekly hours over the same period. Average hours worked had increased for both full-time and part-time workers.

A34 The CIPS surveys in October had again suggested that private sector employment was increasing, and surveys of employment intentions had pointed to a pickup in employment growth.

A35 LFS unemployment had risen by 5,000 in the three months to August, but the unemployment rate had remained stable at 5.0%. The claimant count had fallen by 1,900 in September; both inflows into, and outflows from, the count had risen slightly. Working-age inactivity had risen by 59,000 in the June to August quarter. The working-age inactivity rate had increased by 0.1 percentage points on the quarter, to 21.4%.

A36 Headline (three-month average) whole-economy average earnings had increased by 3.4% in the year to August, up 0.1 percentage points on the July rate. This had reflected a 0.5 percentage points rise in headline public sector pay growth, to 5.6%. Headline pay growth in the private sector had been unchanged at 2.9%. Actual whole economy pay growth had been 3.5% in the year to August, down 0.1 percentage points on the previous month. Bonuses had made a small negative contribution of -0.3 percentage points to earnings growth in August.

A37 The Bank's twelve-month whole-economy mean measure of pay settlements, weighted to match the composition of the average earnings index, had remained at 3.1% in the year to September.

VI Prices

A38 Sterling oil prices had fallen by around 4% since the October MPC meeting but, on average, had been higher in October than in September.

A39 Manufacturing input prices had fallen by 1.2% in September, mainly owing to lower oil prices. The annual inflation rate had as a result fallen to 0.5% in September, from 1.7% in August. The CIPS manufacturing survey had pointed to a rise in input prices in October, with an input price balance of 52.9.

A40 Manufacturing output prices excluding duties (PPIY) had risen by 0.1% in September, but the annual inflation rate had been unchanged at 1.4% in September. Survey data had continued to point to downward pressure on output prices: the expected output price balance from the CBI Quarterly Industrial Trends survey had remained negative, at -7, in October.

A41 Annual RPIX inflation had fallen to 2.8% in September, from 2.9% in August. Within this, annual goods price inflation had fallen by 0.1 percentage points to 0.5% in September. Annual services price inflation had fallen by 0.4 percentage points to 3.6%. Annual RPI inflation had also fallen by 0.1 percentage points in September, to 2.8%. But both annual RPIY inflation and annual HICP inflation had been unchanged, at 2.7% and 1.4% respectively.

VII Reports by the Bank's Agents

A42 The Bank's regional Agents reported that the recovery in service sector activity had broadened recently and that some acceleration of output had been expected in the fourth quarter. Turnover of business services may have grown at its fastest rate since mid-2001. That had partly reflected strong public sector demand. Growth of turnover of consumer services had also been recovering, supported by the housing market. Nonetheless, the improvement in business confidence across the service sector as a whole had been patchy, and only a sluggish recovery had been apparent in telecommunications, information technology, stockbroking and advertising.

A43 Producer input prices had been edging up. Utilities costs had risen, and further increases had been expected next year. Prices of some fresh foods had increased sharply, in part the result of the

warm summer weather which had affected yields. Competitive pressures meant that firms had mostly been unable to pass on these price increases, so that profit margins had narrowed a little. Prices of finished manufactured goods had been either flat or falling.

A44 There had been some tightening in regional labour markets. Employment in the service sector had been growing strongly, in part the result of an expanding public sector. Manufacturing employment had begun to stabilise. Some private sector firms had increasingly relied on agency staff or on overseas recruitment to fill vacancies. Skill shortages had begun to intensify in a number of regions. There had been increasing evidence of pay disputes. Some contacts had believed that this indicated that there would be a more difficult pay round in the year ahead. The 7% increase in the National Minimum Wage in October had significantly affected wage costs in a few sectors such as the leisure industry, but overall its effects on wage costs had been small.