

Publication date: 21 April 2004

MINUTES OF MONETARY POLICY COMMITTEE MEETING

7 and 8 April 2004

These are the minutes of the Monetary Policy Committee meeting held on 7 and 8 April 2004.

They are also available on the Internet
(<http://www.bankofengland.co.uk/mpc/mpc0404.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 5 and 6 May will be published on 19 May 2004.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 7-8 APRIL 2004

1 Before turning to its immediate policy decision, the Committee discussed developments in financial markets; the international economy; money, credit, demand and output; the labour market, costs and prices; and some other considerations. The Committee noted a letter from the Chancellor (attached as an annex) setting out the remit for the Committee over the following year, in accordance with section 12 of the Bank of England Act 1998.

Financial markets

2 Short-term interest rates were around 10 basis points higher on the month in sterling markets, unchanged in US dollar markets and around 10 basis points lower in euro markets. The weak US non-farm payrolls data for February and the Madrid bombings had triggered falls in rates, but the strong US payrolls data for March had led to increases. Sterling short-term interest rates had also moved upwards after the strong UK retail sales data were released and in response to public remarks by various MPC members during the month. In the euro area, speculation about the likelihood of a future cut in the ECB's official rates had affected market rates. Longer-term nominal sterling and euro interest rates were slightly lower. Real US dollar interest rates had first fallen, touching their lowest level since Treasury Inflation-Protected Securities had been launched, but then had more than reversed those falls in response to the March payrolls data.

3 The biggest exchange rate movements during the month had been associated with the yen, which had appreciated by 3½% in effective terms, probably because market participants were anticipating reduced foreign exchange intervention by the Bank of Japan. The US dollar effective exchange rate was around 2% weaker on the month, largely reflecting the movement of the US dollar against the yen. The effective exchange rate for sterling was slightly higher on the month, with depreciation against the yen offset by modest appreciation against the euro and US dollar. This left the sterling effective exchange rate index some 3% above the fifteen-day average level taken as the starting point for the exchange rate projections in the February *Inflation Report*.

4 With the notable exception of the Topix, major equity markets had fallen a little over the month. This was difficult to account for in terms of real interest rates - ten-year spot real rates had fallen in the United Kingdom and the euro area - or prospects for corporate earnings, which, on the basis of surveys of investment analysts, had probably improved. Markets had reacted sharply to the terrorist attack in Madrid, and it seemed possible that equity prices were reflecting perceptions of increased geopolitical risk. That was consistent with the fact that the attack had triggered equity price falls across most industry sectors. Also, option prices suggested that the risk of significant falls in equity market indices was being given more weight than before.

5 Equity price-earnings ratios (using a trailing average of corporate earnings) were still around their average levels since 1990, and above their longer-run historical averages. But the period since 1990 included a period of exceptional stock market strength. Together with the low level of bond yields and spreads (notably for emerging-market and high-yield corporate debt), that posed the question of whether financial assets were collectively becoming overvalued, implying a risk of a future correction and an adverse shock to wealth and the cost of capital. Market anecdote suggested that a 'search for yield' was giving rise to increased activity in the markets for a wide range of fixed-income securities, driven in part by the need for some financial intermediaries to meet guaranteed nominal returns on some of their own liabilities. The US yield curve might also have been affected by the high demand for US Treasuries from official institutions in Asia. These points suggested that the risk of a sharper-than-expected change in yields at some stage was skewed to the upside, and hence the risk to asset prices skewed to the downside.

The international economy

6 News during the past month about the international economy had been mixed, but the global economic recovery still seemed to be developing broadly as expected.

7 In the United States, the latest estimates for GDP and expenditure in 2003 Q4 had left estimated GDP growth unrevised at 1% on the quarter. Data for 2004 Q1 suggested that growth had been robust, but probably a little weaker than the Committee had expected at the time of the February *Inflation Report*. On the output side, industrial production had increased rapidly in January and February. New orders had continued to pick up, and the Institute for Supply Management's headline indices for both manufacturing and services had risen in March – the latter reversing its fall in February, reaching

its highest level since the series began in 1997. Corporate profitability had continued to rise and the share of profits in GDP was at its highest since 1968. However, consumer spending growth had been lower in January and February than the Committee had expected, and consumer confidence had not risen significantly in March, after a sharp fall in February.

8 Uncertainty about labour market prospects might have been affecting US consumer confidence. But there had been a very strong increase of 308,000 in non-farm payrolls in March – well above market expectations. This data series was erratic, but the March figure offered some reassurance that employment would expand at the pace necessary to be consistent with the MPC's February projections, and would help to sustain consumer spending. Some of the increase reflected one-off factors such as the end of a grocery workers' strike and a weather-related rise in construction employment, but these probably accounted for only a relatively small share of the total increase. There had also been substantial upward revisions of the payrolls data for January and February. The data were now more in line with the stronger upward trend in the employment data from the household survey over the past twelve months. However, job growth was still muted by the standards of past economic recoveries and monthly increases of around 150,000 had been necessary in the past just to keep the unemployment rate constant.

9 US consumer spending was likely to be supported by the rapid increase in house prices as well as somewhat improved job prospects. Tax rebates during the first half of this year might also have an effect, although a recent survey by the National Retail Federation suggested that many people were planning to use the refunds to add to their savings or to pay down debt.

10 In the euro area, GDP growth in 2003 Q4 had been 0.3%, according to the first release (unchanged from the flash estimate), somewhat lower than the MPC had expected at the time of the February *Inflation Report*. However, final domestic demand had been broadly in line with the February projections: the surprise had been the speed at which the large positive net trade contribution in 2003 Q3 had unwound. On the data available so far, the recovery this year seemed fragile: although industrial confidence was slightly above its long-run average in March (unchanged on the month) and the manufacturing PMI had increased slightly, the services PMI had fallen for the second month running and the German IFO index had fallen below its long-run average for the first time since last October. Although the sharp increase in retail sales in January had not been fully unwound in February, consumer confidence was unchanged in March, remaining below its long-run average.

11 The growth rate of euro-area consumption was weaker than expected in Q4. Its recent sluggishness was something of a puzzle. It could not be explained easily by the behaviour of real incomes, or by wealth and the other variables usually used to explain the behaviour of consumption. One possible explanation was increased precautionary saving. That might be explained by concerns about the impact on job security of proposed structural reforms in several European countries, and about the implications of projected fiscal deficits for pension entitlements and taxes. These concerns were unlikely to disappear quickly, so consumption growth might be muted for some time. Investment growth seemed to have picked up in Q4, but that partly reflected increased residential investment in Germany, in anticipation of the removal of tax subsidies in January this year. In a longer-term perspective, the euro area seemed to have been suffering from past over-investment in some sectors such as German construction.

12 In contrast to the euro area, Asian economies had been reporting strong growth. Real GDP growth in Japan had been 1.6% in 2003 Q4, according to the second estimate, well above the Committee's expectation in February. The latest Tankan survey suggested that there had been a further improvement in confidence in the corporate sector. Elsewhere in Asia, notably China and India, growth had also been robust.

Money, credit, demand and output

13 In the United Kingdom, estimated GDP growth in 2003 Q4 had been unrevised in the National Accounts, at 0.9% at market prices and 0.8% at basic prices. Revisions to earlier data had more or less reversed the increase in the estimated level of Q4 GDP discussed by the Committee last month, so the Committee's February assessment of the pressure of demand on supply at the beginning of 2004 remained valid.

14 As far as output was concerned, the only new data were for manufacturing. Manufacturing output was reported to have fallen 0.6% in February and the estimate for January had been revised downwards. The fall had been broadly based across industry subsectors. Business surveys, however, had pointed to a continuing recovery. The CIPS index for manufacturing output had been well above the 50 mark in February (despite dipping slightly from January), and had remained so in March. The CBI Industrial Trends survey had also been strong. The reports of the Bank's regional Agents, although a little less upbeat than business surveys, had also suggested that conditions had been

improving. It was possible that the February manufacturing data were a rogue observation; the series was more volatile than were business survey measures, and was prone to revision.

15 Data revisions had helped to resolve past puzzles on the demand side. The GDP revisions indicated that consumption growth had been slightly weaker in 2003 Q4 and investment growth somewhat stronger than previously thought. Together with revisions to back data, this implied that the level of business investment in Q4 had been around 3% higher than expected at the time of the February *Inflation Report*. The ratio of business investment to GDP had drifted upwards throughout 2003. The share of profits in GDP had been increasing and the rate of return in the non-oil corporate sector was at its highest level since 1999. Combined with most of the evidence on investment intentions, this suggested that the prospects for investment were improving. However, there were some contrary indicators. A special survey carried out by the Bank's Agents suggested that investment between mid-2003 and mid-2004 would be rather muted compared with the previous year, although it also suggested that investment was primarily intended to raise productive capacity. And, according to the CIPS index, new orders for investment goods had weakened significantly between January and March.

16 Consumption growth in the first quarter had been robust, judging by the strong retail sales data; the estimate for retail sales in January had been revised up sharply. Motor vehicle registrations had been high. The growth rates of notes and coin and of broad money had remained broadly steady, and the growth rate of total borrowing by individuals was still strong. But there was some tentative evidence that consumer spending might have moderated during the quarter: the CBI Distributive Trades survey suggested some easing in March, consumer confidence had fallen slightly, and unsecured lending had dropped back a little in February. Despite those signs, household spending seemed likely to remain buoyant in the near term, and might also be supported by the strength of the housing market. The average of the Halifax and Nationwide indices had risen by over 5% in the three months to March. House price inflation now looked as if it had been picking up since the middle of last year. The Royal Institution of Chartered Surveyors had reported an increase in the ratio of house sales to stocks in March, the ninth consecutive increase, and the RICS backward- and forward-looking house price balances had risen. The lending data also suggested that the housing market remained strong; the twelve-month growth rate of secured lending to individuals had risen slightly in February.

17 The behaviour of house prices posed a problem for the assessment of the likely path of consumption. First, house prices had risen faster than expected for some time. Second, it was unclear what the implications were of higher-than-expected house prices for household spending in these circumstances.

18 There were two possible, not mutually exclusive, explanations for the rises in house prices. First, the equilibrium house price-earnings ratio might be higher than the Committee had thought, even though the Committee had revised its estimate upwards significantly in 2002. There were good reasons why that ratio might have risen, but it was necessarily very uncertain. Low interest rates had reduced the cost of borrowing and the burden of ‘front-loading’ of repayments; the growth in the number of households was outstripping a constrained supply; and there was some evidence that the equilibrium demand for housing as an investment asset – in particular, as a means of saving for retirement – might have risen. Second, prices might have been driven up by expectations about the size and persistence of future price increases. Even if some of the price increases were unsustainable, however, they need not reverse suddenly; they might instead unwind gradually. That would depend on whether a change in behaviour was triggered by some external shock to the household sector and, if so, on the nature of that shock. The experience of other countries that had had rapid house price increases did not offer clear guidance: in some countries, such as the Netherlands and Australia, house prices had slowed but not fallen, whereas in Hong Kong and Japan they had dropped considerably below peak levels.

19 If house prices did follow a higher trajectory over the next year or so than the Committee had previously expected, that would not necessarily imply that consumption need be markedly stronger. That would depend on the strength of the causal link from house prices to spending via higher collateral for credit-constrained households. It was notable that the growth rate of consumption in nominal terms had not been particularly rapid over the past couple of years or so and the saving rate had been broadly stable, despite the strength of the housing market during that period.

The labour market, costs and prices

20 The labour market had been strengthening recently. The employment rate in the three months to January had been 0.2 percentage points higher than in the previous three months, according to the Labour Force Survey, and the unemployment rate 0.1 percentage points lower. The LFS data now

showed the buoyancy of employment already evident in the Workforce Jobs data and survey measures of employment intentions. But average hours had continued to fall. The fact that average hours had continued to drop while GDP growth had been picking up was consistent with an explanation in terms of structural factors, including the increased importance of part-time employment. It was possible that average hours would continue to drift downwards, but the prospects for labour supply also depended on whether participation rates increased.

21 Overall earnings growth in January had risen by 0.9 percentage points, with a large contribution from bonuses; some of the rise probably reflected a shift in the timing of bonus payments from December and February to January. The growth rate of regular pay in the private sector had edged up, and the real cost of labour to employers for the economy as a whole had been rising a little faster than before. But faster productivity growth meant that unit labour cost growth had fallen slightly. The overall picture was consistent with the outlook at the time of the February *Inflation Report*.

22 CPI inflation had been 1.3% in February, slightly lower than expected. Goods prices were no longer falling and the gap between goods and services price inflation had narrowed. This was despite the likely impact of recent sterling appreciation on the prices of imported goods and the continuing productivity growth differential in favour of goods production. Inflation pressures in the supply pipeline were muted. Although the input price balance from the CIPS manufacturing survey had reached its highest level since July 1995, the ONS measure of input price inflation had remained subdued. It was possible that the ONS measure covered a greater range of inputs than did business survey respondents: for example, the official data included the prices of imported parts and equipment such as electronic components and office machinery parts and accessories, which – in contrast to the prices of many raw materials – had been falling. Oil prices had risen sharply in US dollar terms, but sterling's appreciation this year would offset some of the impact, as would the postponement of higher fuel duty.

Other considerations

23 According to the most recent Reuters poll, of the 44 economists surveyed, 19 expected a 25 basis point increase in the repo rate this month and 25 expected no change. The mean probability attached to a 25 basis point increase was 48%. Respondents were unanimous that if the repo rate were to be left unchanged this month, it would be raised in May. The mean expectation of the repo rate at

the end of 2004 was now 4.68%, a rise of 9 basis points over the past month.

The immediate policy decision

24 There had been no uniform pattern to the news during the past month. The world economic recovery appeared to be on track, although the picture was patchy. US indicators for the first quarter – with the exception of the latest non-farm payrolls data – had perhaps been a little softer than expected, but Asian indicators had been stronger. Growth in the euro area so far this year, although less robust than elsewhere, had probably been broadly consistent with expectations at the time of the February *Inflation Report*. Sterling had strengthened since the *Report* and UK output data had been weaker than expected. But the labour market had continued to tighten gradually and the housing market had been unexpectedly robust. There was considerable uncertainty about the past and future impact of housing market developments on consumption and aggregate demand. The November and February repo rate rises had not had a noticeable impact on either consumer spending or confidence.

25 The Committee's February inflation projection at constant interest rates had indicated that CPI inflation was likely to be rising at and beyond the two-year horizon. The broad economic outlook had not changed very much since then: it seemed likely that the economy was still growing above trend and there was not much spare capacity. But that analysis did not by itself imply that a repo rate rise was necessary immediately.

26 There were, however, a number of arguments for increasing the repo rate this month, to which different members attached different weights. First, some downside risks to inflation had diminished. The first rises in rates since February 2000 did not seem to have had a disproportionate effect on household consumption and borrowing so far, so the argument for caution, which had seemed persuasive in November, now appeared less relevant. Also, for some members, the latest US non-farm payrolls data were an indication that the downside risks to US consumption growth had diminished. Second, a rise this month would not be a major surprise in financial markets, so there was less danger of triggering an upward shift in the sterling yield curve or effective exchange rate. Third, a rise in rates now might help to discourage unsustainable rates of house price inflation. That would address an upside risk to consumption in the near term and also reduce the risk of a sharp correction to the housing market and to consumption later. Were such a correction to take place, that might pose difficulties for the Committee in keeping CPI inflation close to the 2% target. One member put

particular weight on possible future complications for the Committee arising from the increased vulnerability of the household sector to shocks due to the continuing increase in its debt relative to disposable income to historically high levels. That member also argued that the still-high growth rate of secured and unsecured debt pointed to continuing robust consumption growth in the near term.

27 There were also several arguments for maintaining the current repo rate this month. First, although it would be appropriate to withdraw some of the monetary stimulus in due course, it did not at present appear necessary to raise rates faster than the profile implied by the market yield curve in February. The February projection on the market interest rate assumption had suggested that inflation would undershoot its target at the two-year horizon, and would be unlikely to exceed it by a significant amount further out. Since February, UK-weighted world demand prospects had weakened slightly, but the strengthening UK housing market had raised prospective consumption and aggregate domestic demand growth. Offsetting this had been the rise in sterling, which had not fallen back towards its level at the beginning of the year and hence warranted more weight this month than last. Taken together, those factors suggested little change to the February inflation projection. For some members, certain downside risks to inflation had increased. For instance, euro-area domestic demand showed little sign of increasing at the pace that would be necessary by the second half of the year to be consistent with the Committee's projections. Geopolitical risks to world demand might also have increased. Second, although the current inflation rate was below the target, interest rates had already been increased in anticipation of rising inflationary pressures. The fact that inflation expectations remained firmly linked to the target reduced the risks of delaying any further move in rates. The *Inflation Report* next month would provide an opportunity to evaluate the mixed economic news and reconsider some of the unresolved economic issues, such as the reasons for the pickup in house prices and the relationship with household spending and borrowing. It would also provide a better opportunity to explain the Committee's thinking. Overall, most members put more weight on the arguments, taken together, for not raising the repo rate this month.

28 The Governor invited members to vote on the proposition that the repo rate should be maintained at 4.0%. 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.

29 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

Sir Andrew Large attended the meeting on Thursday 8 April but was not, for unavoidable reasons, able to attend the beginning of the meeting on Wednesday 7 April. The Committee in accordance with the provisions of paragraph 12 of Schedule 3 to the Bank of England Act 1998 agreed that he should be treated as present at the meeting.

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 2 April 2004, in advance of its meeting on 7-8 April. 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 Financial markets

A2 Between the previous Committee meeting and 7 April, US short-term interest rates had risen slightly, with two significant intra-month movements: a fall after the weaker-than-expected February non-farm payrolls data on 5 March and then a sharp rise following the stronger-than-expected March non-farm payrolls on 2 April. Euro-area short-term interest rates had fallen since the previous Committee meeting, especially after the 5 March US data. UK short-term interest rates had increased. Expectations of an increase in UK interest rates in April had been fairly evenly split, with market participants fully pricing in a 25 basis point repo rate rise by May.

A3 Ten-year nominal government yields had risen in the United States and fallen in the euro area. These moves had mostly been accounted for by changes in real interest rates. In the United Kingdom, ten-year nominal yields had been broadly unchanged, with little change in real interest rates or implied inflation. UK survey-based CPI inflation expectations for 2004 and 2005 had been similar in March to those in February.

A4 The sterling effective exchange rate had risen by 0.3%, to 106.2. This could only partly be accounted for by movements in relative interest rates. Sterling had risen by 1% against the US dollar and by 0.7% against the euro. Consensus surveys on 8 March had suggested that sterling was expected to depreciate over the coming year. Sterling risk reversals against the US dollar and the euro had continued to indicate that risks of rises and falls in these sterling bilateral exchange rates were broadly balanced. The US dollar had fallen by 4.5% against the yen but risen by 0.3% against the euro. The US dollar ERI had fallen by 2.2% over the month. Dollar-yen implied volatilities had fallen but then increased again sharply following speculation about changes in the Bank of Japan's foreign

exchange intervention strategy. And risk reversals had also moved to indicate an increased risk of yen appreciation.

A5 The FTSE All-Share index had fallen by 1.1%, the EuroStoxx had declined by 1.7% and the S&P 500 had fallen by 0.9%. The declines had begun after the Madrid bombings on 11 March and had been broadly based across industry sectors, consistent with a common factor of heightened geopolitical risk. The downside risk to UK and US equities, as measured by the skewness implied by three-month futures, had increased. Investment-grade spreads had widened slightly in the United Kingdom, but had been broadly unchanged in the United States and the euro area. High-yield corporate spreads had widened in the United Kingdom and contracted in the United States and the euro area. Global emerging-market corporate spreads had also narrowed.

II The international environment

A6 The final estimate of US GDP growth in 2003 Q4, at 1.0%, had been unchanged from the preliminary estimate. There had been small revisions to some demand components. Estimated non-farm business sector labour productivity growth had been revised down to 0.6%, from an earlier estimate of 0.7% on the quarter in 2003 Q4. US industrial production had risen by 0.7% on the month in February, following a rise of 0.8% in January. The Institute for Supply Management (ISM) manufacturing index had risen to 62.5 in March, from 61.4 in February, while the ISM non-manufacturing index had risen to 65.8, from 60.8. Estimated US non-farm payrolls had increased by 308,000 on the month in March, following a rise of 46,000 in February (revised up from an increase of 21,000).

A7 Real consumption in the United States had been unchanged on the month in February, following a rise of 0.2% in January. Real personal disposable income had increased by 0.2% in February, after rising by 0.6% in January, while the saving rate had risen to 1.9%, from 1.8%. The Conference Board measure of consumer confidence had fallen to 88.3 in March, from 88.5 in February (revised up from 87.3). The University of Michigan headline index of consumer confidence had risen to 95.8 in March, from 94.4 in February.

A8 Twelve-month headline consumer price inflation in the United States had been 1.7% in February, down from 1.9% in January. Twelve-month core consumer price inflation (which excludes food and

energy prices) had been 1.2% in February, up from 1.1%. US producer prices had risen by 2.1% in the year to February, having risen by 3.3% in the year to January. US house prices (on the Freddie Mac Conventional Mortgage Home Price Index) had risen by 4.2% in the fourth quarter last year, the most rapid quarterly rise since 1977 Q2.

A9 According to the first release, euro-area GDP had increased by 0.3% on the quarter in 2003 Q4 (unrevised from the flash estimate), following an increase of 0.4% in 2003 Q3. Final domestic demand had made a 0.3 percentage points contribution to quarterly GDP growth in 2003 Q4. Net trade had subtracted 0.7 percentage points from quarterly GDP growth, while inventories had added 0.7 percentage points. Italian GDP had been unchanged from the previous quarter in 2003 Q4, following estimated growth of 0.4% in 2003 Q3 (revised down from 0.5% in the Q3 release).

A10 Industrial production in the euro area had fallen by 0.4% on the month in January, following an increase of 0.1% in December (revised down from 0.2%). Industrial production had risen on the month in Germany and the Netherlands, but that had been more than offset by falls in France, Italy and Spain. According to the European Commission Survey, the euro-area business confidence indicator had remained at -7 in March, unchanged from February (revised down from -6). The purchasing managers' index (PMI) for the manufacturing sector in the euro area had been 53.3 in March, up from 52.5 for the previous month. The purchasing managers' index for the euro-area service sector had fallen to 54.4 in March, from 56.2 in February. The German IFO index had fallen to 95.4 in March, from 96.4 in February.

A11 According to Eurostat, the volume of retail sales in the euro area had fallen by 0.8% on the month in February, compared with a rise of 2.3% in January. The euro-area consumer confidence index had remained at -14 in March, unchanged from February.

A12 Twelve-month inflation in the euro area, as measured by Eurostat's harmonised index of consumer prices (HICP), had been confirmed at 1.6% in February, down from 1.9% in January. Twelve-month core inflation (excluding energy, food, alcohol and tobacco) had increased to 1.9% in February, from 1.7% in January.

A13 According to the second release, real GDP in Japan had grown by 1.6% in 2003 Q4, compared with an estimate of 1.7% in the first release. The Japanese tertiary and all-activity indices had

increased by 2.6% in January compared with the previous month. Industrial production in Japan had fallen by 3.7% on the month in February, following a rise of 3.3% in January. Japanese export volumes had risen by 12.0% on a year earlier in February, after increasing by 13.1% in the year to January. Import volumes had risen by 3.1% on a year earlier in February, compared with a rise of 5.7% in the year to January. According to the Bank of Japan's Tankan survey, the large manufacturers' business conditions diffusion index had increased by 5 percentage points, to +12 percentage points in March, from a revised +7 percentage points in December. The large non-manufacturers' diffusion index had also increased by 5 percentage points, to +5 percentage points.

A14 Since the Committee's previous meeting, the spot price of Brent crude oil had fallen by \$0.10 per barrel to \$33. *The Economist* dollar non-oil commodity price index had risen by 5.0% for food, fallen by 0.9% for non-food agricultural products and fallen by 1.0% for metals.

III Money and credit

A15 The annual growth rate of notes and coin (adjusted for special factors) had been 7.0% in February, unchanged from January. Annual growth of M4 had fallen to 8.2% in February, from 8.4% in January. Annual growth in M4 lending (excluding the effects of securitisations) had fallen to 12.2% in February, from 12.7% in January. Excluding other financial corporations (OFCs), annual M4 growth had fallen to 8.2% in February, from 8.4% in January, while annual M4 lending growth (excluding OFCs and excluding the effects of securitisations) had risen by 0.1 percentage points, to 12.7%.

A16 The annual growth rate of households' holdings of M4 had fallen to 8.0% in February, from 8.1% in January, and annual growth of M4 lending to households (excluding the effects of securitisations) had risen to 14.0%, from 13.9%. Within total net lending to individuals – a measure that includes lending by a broader set of institutions than just banks and building societies – annual secured lending growth had risen to 14.5% in February, from 14.4% in January, and annual unsecured lending growth had fallen to 12.5%, from 12.6%. The annual rate of growth of credit card lending had fallen to 16.4% in February, from 17.2% in January, and annual growth in other unsecured lending had risen to 10.8%, from 10.6%.

A17 As a proportion of personal disposable income, new unsecured lending had fallen to 2.0% in 2003 Q4, from 2.5% in Q3, and mortgage equity withdrawal – gross equity withdrawn from the housing market minus gross injections – had risen to 8.3% in Q4, from 7.0% in Q3. Households' debt interest payments as a percentage of disposable income had remained at 7.0% in Q4. Debt interest plus regular repayments of principal had risen to 9.7% of disposable income, from 9.5%. The ratio of households' debt to annual income had risen to 1.34 in Q4, from 1.32 in Q3.

A18 The average standard variable rate (SVR) on secured debt had risen by 23 basis points in March to 5.81%, and the average two-year discounted rate had risen by 8 basis points to 4.22%. According to latest data from the Council of Mortgage Lenders, the share of all new mortgages that had fixed rates had fallen to 21% (by volume) in February, from 26% in January.

A19 Interest rates for unsecured lending quoted by banks and building societies were broadly unchanged in March. Since October 2003, the MPC had increased the repo rate by 50 basis points. But over the same period, the average quoted interest rate had fallen by 8 basis points for credit cards, by 42 basis points for overdrafts, and by 44 basis points for personal loans of £10,000. These falls had continued a trend of lower spreads on unsecured debt.

A20 The number of approvals of loans for house purchase had fallen to 118,000 in February from 120,000 in January. Unsold stocks of properties measured by RICS had fallen to 60 per surveyor in February, from 62 in January, while the number of sales per surveyor was unchanged at 32 in February.

A21 The annual rate of growth of M4 deposits by private non-financial corporations (PNFCs) had fallen to 9.2% in February, from 9.8% in January. The annual rate of growth of M4 lending to PNFCs (excluding the effects of securitisations) had risen to 9.0% in February, from 8.6% in January. Total external finance, a broad measure of PNFCs' funding, had been £1.1 billion in February, compared with £4.6 billion in January.

A22 PNFCs' income gearing had fallen to 17.3% in Q4, from 17.8% in Q3. PNFCs' capital gearing at replacement cost had fallen to 28.0% in Q4, from 29.8% in Q3, and had fallen at market value to 30.3%, from 33.2%.

IV Demand and output

A23 The Quarterly National Accounts release for 2003 Q4 was published on 26 March. Estimated real quarterly GDP growth at market prices had been unrevised from the previous release, at 0.9%. Estimated GDP growth in 2003 as a whole had been revised down by 0.1 percentage points to 2.2%. The latest release had contained revisions to GDP and its components back to 2002 Q1, the cumulative effect of which had been to revise down the estimate of the level of GDP at market prices by 0.2% in 2003 Q4.

A24 On the expenditure side of the accounts, domestic demand and final domestic demand had both grown by 1.3% in 2003 Q4. The estimated growth of households' real consumption (including non-profit-making institutions serving households) had been revised down by 0.2 percentage points to 0.9% in 2003 Q4. The cumulative effect of revisions to past data had been to lower the estimated level of household consumption by 0.7% in 2003 Q4 relative to the previous release. Business investment growth had been 1.9%, revised up by 0.6 percentage points relative to the previous release. Net trade had made an estimated negative contribution to growth in 2003 Q4 of -0.5 percentage points, weaker than the -0.2 percentage points contribution in the previous release. Excluding the effects of identified missing trader intra-community (MTIC) fraud, estimated export and import growth had been 1.4% and 2.9% respectively.

A25 The Bank's regional Agents had conducted a special survey of investment spending by 231 firms. On average, firms had planned to spend less over the year to mid-2004 than they had over the year to mid-2003. This was true for all sectors apart from construction. Firms reported that UK demand conditions and financial issues had been the most significant factors influencing their investment spending. And the primary purposes of investment had been the expansion of productive capacity and the need for efficiency gains.

A26 On the output side of the National Accounts, the estimated level of GDP at basic prices in 2003 Q4 had been revised down by 0.3% relative to the previous release. Estimated GDP growth at basic prices in Q4 had been unrevised, at 0.8%.

A27 On the income side of the accounts, households' real post-tax income had risen by 0.8% in 2003 Q4. Within this, post-tax labour income had grown less quickly than households' total income in Q4.

Household consumption had grown in line with income, so the household saving ratio had been broadly unchanged relative to the previous quarter, at 6.0% in 2003 Q4. This was in line with its average over the previous six years. The household sector had remained in financial deficit for the eighth consecutive quarter in 2003 Q4, at 0.4% of GDP.

A28 The gross operating surplus of private corporations (excluding the alignment adjustment) had fallen by 1.2% in 2003 Q4. This had been driven by falls in the operating surpluses of oil and financial companies, which tend to be quite erratic. The gross operating surplus of private non-oil, non-financial corporations had grown by 1.7% in 2003 Q4. Private corporations' financial surplus (excluding the alignment adjustment) had picked up to 2.3% of GDP in 2003 Q4. The public sector net financial deficit had risen to 3.6% of GDP in Q4, up from 2.7% in Q3, and the current account deficit had eased slightly, to 1.9% of GDP.

A29 Turning to indicators of output in 2004 Q1, industrial production had fallen by 0.6% in February, following a fall of 0.1% in January. In February, manufacturing output had fallen by 0.6%, while energy output had risen by 1.8%. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output index had risen slightly to 56.4 in March, from 56.0 in February, and the new orders index had also risen, to 55.1 in March, from 53.2 in February. Both indices had continued to point to strong manufacturing output growth. The expected output balance and total orders balance in the Confederation of British Industry (CBI) Monthly Trends enquiry had also both increased on the month. The former had increased to +15 in March, from +14 in February; the latter had risen to -8 in March, from -15 in February. The CIPS services survey business activity index had fallen slightly, to 58.7 in March, from 59.5 in February. But the incoming new business index had changed little, at 60.7, and both indices remained well above the 'no change' level of 50.

A30 Turning to indicators of expenditure in 2004 Q1, retail sales had been flat on the month in February, following growth of 1.2% in January. In the CBI *Distributive Trades Survey*, the balance of retailers reporting positive annual growth in sales volumes had fallen to +17, from +26 in February. The GfK consumer confidence balance had been broadly unchanged in March, falling to -3, from -2 in February.

A31 Three-month-on-three-month house price inflation measured by the Nationwide index had increased to 4.7% in March, from 4.2% in December. The same inflation rate measured by the Halifax house price index had risen by 6.0% in March, up from 4.4% in December.

A32 Excluding oil and erratics, goods export volumes had fallen sharply, by 7.0%, in January. This mainly reflected a very sharp 18.5% fall in exports to non-EU countries, including a 29.4% fall in the value of exports to the United States. Future data would give a better indication of how erratic the January data had been. By contrast, goods exports to the European Union had increased by 3.3%. Goods imports (excluding oil and erratics) had increased by 0.4% in January.

V The labour market

A33 According to the Labour Force Survey (LFS), employment had increased by 121,000 in the three months to January, compared with the previous three months. Employee numbers had increased by 112,000 over the same period, in contrast to their recent downward trend. The 16+ employment rate had increased by 0.2 percentage points, both on the quarter and on the year, to 60.0%. Workforce jobs had increased by 95,000 in the three months to December, including an increase of 61,000 in the distribution, hotels and restaurants sector and an increase of 47,000 in the public sector.

A34 Total hours worked had fallen by 0.1% in the three months to January, but had been flat on the same three months a year earlier. Average hours worked had fallen by 0.5% on the previous three months, and by 0.9% on the year.

A35 LFS unemployment had fallen by 33,000 in the three months to January, and had been 34,000 lower than a year earlier. The unemployment rate had fallen to 4.8%, 0.1 percentage points lower on the quarter and 0.2 percentage points below its rate a year earlier. At 2.9%, the claimant count unemployment rate had been unchanged in February. The 16+ inactivity rate had fallen 0.1 percentage points, both in the three months to January and on the year, to 36.9%.

A36 Annual whole-economy earnings growth had been 4.4% in the three months to January, 0.9 percentage points higher than in the three months to December. Public sector pay growth had fallen by 0.2 percentage points, to 4.2%, while private sector pay growth had increased 1.3 percentage points, to 4.5%. Whole-economy earnings growth in the year to January had been 6.6%,

up 3.2 percentage points from the rate in the year to December. Annual earnings growth excluding bonuses had been 3.6% in the three months to January, up 0.1 percentage points on the three months to December. The comparable public sector growth rate had fallen by 0.2 percentage points, to 4.2%, while the private sector growth rate had increased 0.2 percentage points, to 3.5%.

A37 According to settlement information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI)-weighted settlement had been 3.3% in the year to February, unchanged on the equivalent figure for the previous month. The twelve-month sample-weighted mean settlement in both the private and the public sectors had been flat, at 3.3% and 3.4% respectively.

VI Prices

A38 Since the Committee's previous meeting, sterling oil prices had fallen by around 1%.

A39 Manufacturing input prices had fallen by 0.8% in February, and the annual rate of change had fallen to -1.8% in February, from -0.6% in January. The CIPS manufacturing survey had pointed to rising input prices in March, the input price index having risen to 63.9, from 61.0 in February.

A40 Manufacturing output prices excluding duties had risen by 0.2% in February, and their annual rate of increase had been unchanged at 1.4%. Survey data had pointed to a small fall in output prices: the balance on expected output prices from the CBI Monthly Trends survey had fallen to -6 in March, from -2 in February.

A41 March's National Accounts release showed that the GDP deflator at market prices had risen by 0.5% in 2003 Q4, and the annual inflation rate had fallen to 2.8% in 2003 Q4, from 3.0% in 2003 Q3. Within this, the annual inflation rate of the household consumption deflator had been unchanged at 1.7% in 2003 Q4. The annual inflation rate of the government consumption deflator had fallen to 7.9% in 2003 Q4, from 8.2% in 2003 Q3. The annual inflation rate of the exports deflator had fallen by 0.4 percentage points to 1.3% in 2003 Q4, while the annual inflation rate of the imports deflator had fallen by 0.2 percentage points to 1.1%.

A42 CPI inflation had fallen by 0.1 percentage points to 1.3% in February. Within this, goods price inflation had fallen to -0.4% in February, while services price inflation had risen to 3.2%.

RPIX inflation had fallen by 0.1 percentage points in February, to 2.3%. RPI and RPIY inflation had also fallen in February, to 2.5% and 1.9% respectively.

VII Reports by the Bank's Agents

A43 The Bank's regional Agents reported that export volumes had strengthened in the first quarter. That contrasted with the official data for January, which indicated that goods export volumes had fallen by 7.7% compared with the previous month. Contacts reported that the strongest growth in overseas demand had continued to come from Asia and the Middle East. Demand from the United States had also been quite strong, but the sterling value of US exports had been eroded by the dollar's depreciation, which had reduced exporters' profit margins. Demand from the euro area had remained sluggish. But exporters had expected to benefit from the forthcoming enlargement of the European Union. Importers reported that sterling's appreciation against the dollar had partly offset the effects on import prices of rising commodity prices.

A44 News on retail sales had been largely consistent with the official data. That indicated that, while retail sales volumes had been unchanged in the month to February, growth had been strong in the three months to February compared with the previous three months. The Agents reported that, while there had been some tentative evidence of growth slowing in March, that had perhaps been partly the result of temporary factors such as the cold weather, and retailers had anticipated stronger demand over the Easter holidays.

A45 In the housing market, demand had strengthened since the start of the year, particularly for lower priced houses. Recent interest rate increases had so far had little effect on demand. Contacts had expected that the rate of house price inflation would slow only gradually in the rest of 2004, in part because strong competition between lenders might restrain their interest rate margins in spite of prospective strong growth of mortgage demand.