

Publication date: 18 August 2004

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# MINUTES OF MONETARY POLICY COMMITTEE MEETING 4 and 5 August 2004

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These are the minutes of the Monetary Policy Committee meeting held on 4 and 5 August 2004.

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0408.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 8 and 9 September will be published on 22 September 2004.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 4-5 AUGUST 2004**

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

### **Financial markets**

2 Price movements in financial markets had been small over the past month, suggesting that market participants had not found the news about economic prospects and official interest rates particularly surprising. Short-term market interest rates had risen somewhat in US dollar, euro and sterling markets, apparently influenced by Chairman Greenspan's Congressional testimony, but had fallen back after the release of the preliminary data for US GDP growth in the second quarter, leaving US dollar and sterling rates up only slightly on the month. The forward sterling interest rates implied by the market yield curve pointed to a strong expectation that the Committee would raise the repo rate this month. So did the Reuters survey of economists: 44 out of 45 respondents expected a 25 basis point increase, attaching a mean probability of 75% to a rise of that size. Longer-term market interest rates and, judging by the prices in the markets for index-linked bonds, inflation rates expected over the next ten years were little changed at home or abroad.

3 Exchange rate movements over the month had been small. The sterling effective rate had appreciated by around 0.5%, broadly consistent with the movements in market interest rates. The sterling effective rate was now some two percentage points above the level at the time of the *May Inflation Report*.

4 Most major equity market price indices had dropped a little over the month, although the FTSE-All Share index was up slightly. Indices with heavy representation of information technology stocks had tended to fall the most. All the main market indices were a few per cent below their levels

at the time of the *May Inflation Report*; only some of these falls could be explained by the movements in interest rates over the period.

### **The international economy**

5 The news over the past month had left the broad picture of a robust and broadly based global recovery largely intact, although the US economy had been a little weaker than expected.

6 In the euro area, the latest data had been consistent with overall growth near its trend rate. The estimate of 0.6% GDP growth in the first quarter had not been revised, although revisions to estimates of expenditure components suggested that final domestic demand had been stronger last year than previously thought. Indicators of output pointed to growth at a similar pace in the second quarter and the beginning of the third. Industrial production had increased in May for the fourth successive month and the Purchasing Managers Index (PMI) for manufacturing had risen slightly in July, although the PMI for services had remained unchanged. The evidence about consumers' demand was more mixed. Euro-area consumer confidence was unchanged in July, remaining below its long-run average, but retail sales had increased strongly in June, after a weak figure for May. Inflation on the HICP measure remained above the levels implied by the ECB's definition of price stability.

7 The pattern of recovery in Germany was still different from that in the euro area as a whole. Whereas final domestic demand growth had picked up in the rest of the euro area, the German recovery had relied more heavily on the growth of exports. Past experience suggested that export growth would eventually stimulate the growth of German domestic demand, but this did not appear to have happened yet. German domestic demand growth might be being held back by uncertainty about the timing, extent and consequences of various proposed structural reforms and about their possible implications for unemployment and the future tax burden.

8 For the United States, the main news was the weaker-than-expected estimate for second-quarter growth, of 0.8%. Consumption growth had eased markedly, primarily because of a slowing in spending on non-durable goods, although car sales had been particularly weak in June. It seemed likely that consumption growth would pick up in Q3; the main measures of consumer confidence had risen in the summer. Although the June non-farm payrolls figure had been weak, these data were prone to revision; unemployment claims had remained at a low level, which might help to support

consumer confidence. Indicators of output also suggested that growth would be robust in Q3; both the manufacturing and non-manufacturing ISM indices had risen in July, the latter sharply, and the weakness of industrial production in June had probably been due to a temporary weather-related fall in the output of the utilities sector. The headline annual measure of CPI inflation had ticked up in June, and so had the annual core CPI inflation measure that excludes (volatile) energy costs, suggesting that underlying inflationary pressures had risen during the second quarter.

9 In Asia, the data suggested that the Japanese recovery was continuing. Industrial production in June had been around 8% higher than a year earlier. Nominal GDP growth had now been increasing for four consecutive quarters and the consumer price index was unchanged over the year to June. The Chinese economy might have slowed a little in Q2, but there had been no sign of a ‘hard landing’ so far.

10 The most striking development in the past month had been the sharp rise in the price of oil: up over 17% in sterling terms. The *Economist* non-oil commodities index, in contrast, had fallen. The oil price rise reflected a range of factors, including the continuing concerns about the security of Middle East supplies, renewed worries about terrorism in the United States and uncertainty about Russian supplies in the light of the threat of bankruptcy to Yukos, a major producer. OPEC had increased production in June, but the margin of spare capacity in the short run was now very low. Unlike in some other recent episodes of oil price rises, longer-term futures prices had also moved upwards significantly. The risk of a much more pronounced rise in oil prices, with possibly adverse consequences for world demand, had probably increased. If oil prices remained at their current levels, the direct consequences for activity, income and retail prices in the United Kingdom would probably not be great, given relatively low UK reliance on oil imports, the prevalence of less oil-intensive production methods than two decades ago and the large tax wedge between crude oil prices and retail petrol prices.

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

11 The ONS preliminary estimate of 0.9% for GDP growth in the second quarter was broadly in line with what the Committee had expected, as were the relative contributions of services and the production industries, which had expanded at similar rates. BCC and CBI surveys had shown a sharp increase in capacity utilisation in the quarter.

12 There were, however, some signs of a possible easing in the pace of growth. The twelve-month growth rates of broad money (M4) and M4 lending had fallen a little in June (the latest month for which data were available), and that of narrow money in July. According to the CBI quarterly Industrial Trends Survey, business optimism had been lower in July than in April, although it remained above its historical average. The CIPS indices of business activity and incoming new business for the services sector had eased during Q2 and had been lower in July than in the preceding three months, while the Bank's regional Agents had reported that, according to their contacts, the growth of consumer services might have slowed. However, the Bank's Agents also reported that the growth of manufacturing output had become more broadly based, and the CIPS Purchasing Managers Index for manufacturing in July had reached its highest level since 1994 (though other surveys of manufacturing gave more mixed signals). Given the greater weight of services in total output, these indicators were consistent with a slight slowdown in overall growth in July. But they also suggested that there had been some rebalancing of growth; that might – as suggested by the Agents' contacts – reflect some improvement in export prospects for manufacturers as a consequence of the global economic recovery.

13 On the demand side, there had been mixed signals about the strength of consumption. In the light of the service sector output data and surveys of consumer services as well as retail sales, the Committee continued to be of the view that there had been more momentum in consumption in Q1 than currently reflected in the official data. Retail sales growth had been rapid in June, giving a growth rate for the second quarter of 1.9%, very similar to that in Q1. As the Q1 data demonstrated, retail sales were not always a good guide to what the ONS measure of overall consumption would be; one reason was that the growth of items of consumption not included in retail sales, such as tourism and car sales, could be very different. Indicators suggested that new car sales had slowed significantly in the second quarter. In July, consumer confidence had picked up slightly, partly reflecting an increase in the balance of respondents planning to make major purchases over the next twelve months. But the CBI Distributive Trades survey and reports from the Bank's Agents indicated that the annual growth of retail sales might have slowed in July; some respondents had suggested that retailers might have brought forward summer sales to June in response to a perceived weakening in the growth of consumer demand.

14 There were now more signs that the pace of house price increases was beginning to slacken. The three-month-on-three-month rate of increase of the average of the Halifax and Nationwide indices had fallen in July for the second consecutive month. The June RICS survey showed a second

consecutive fall in the net balance of estate agents reporting price increases and a fall in the ratio of house sales to stocks on estate agents' books: a range of other indicators of housing market activity, such as those of mortgage approvals and net reservations, had also declined. Agents' contacts confirmed this picture. A deceleration in house prices would tend to slow the growth of consumption, but it was unclear how rapidly and by how much house price inflation would moderate. Also, it was uncertain how large the impact would be of any given change in house prices on consumption. That depended on factors such as the proportion of households who were credit constrained and the extent of demand for housing as an investment asset.

15 One additional complicating factor was the recent rapid growth of the buy-to-let market, raising the demand for housing as an investment asset. According to an informal survey by the Bank's Agents, the growth of this market was now slowing, but there was little evidence of selling in anticipation of lower future capital gains. Nevertheless, compared with owner-occupiers, buy-to-let owners' demand for property might be more sensitive to changes in prospective returns on different assets, for example because their transactions costs were likely to be lower, as these would not include the costs of moving house. So, to the extent that house prices were currently out of equilibrium, sales by buy-to-let owners could help to precipitate a more abrupt adjustment.

16 After two strong quarters of business investment in 2003 Q4 and 2004 Q1, investment intentions remained at or above their historical averages. However, high capital gearing might make some companies cautious about taking on more debt.

17 The latest plans for nominal government spending, as published in HM Treasury's *2004 Spending Review* in July, projected continued rapid growth into 2005, after which it would moderate. The impact of government spending on the outlook for inflation was best captured by its effect on the demand for resources in the economy; this too was likely to grow rapidly.

### **Wages, costs and prices**

18 The data from the labour market over the past month had been mixed, but were broadly consistent with a continuing gradual tightening. Surprisingly, the employment rate had fallen 0.2 percentage points in the three months to May compared with the three months to February; the counterpart had largely been a rise in inactivity rather than in unemployment. But other indicators

of the demand for labour had held up: average hours had stayed steady and the unemployment rate had remained unchanged. Employment surveys continued to point to moderate growth in the demand for labour. The Agents' contacts reported that labour markets were tightening slowly and the REC survey had found that the availability of staff had decreased further in June. So it seemed likely that the unexpected fall in the employment rate had reflected short-term volatility or sampling error. Whole-economy and private sector settlements had continued to drift up; so had whole economy annual regular pay growth. The Agents' contacts also reported some continuing upward pressure on pay, mentioning among other factors the pressure to restore differentials in response to earlier increases in the minimum wage; pay drift was thought to be increasing, and that might be an indication of higher future pay settlements. But regular pay growth in the private sector had remained steady, and, indeed, fallen a little on the three-month-on-three-month measure. The growth in regular pay per hour in the economy as a whole had also remained flat.

19 CPI inflation had picked up to 1.6% in June, half a percentage point above its level three months earlier. The main factors had been the recent rise in petrol prices and the 'base effect' from falls in petrol prices a year earlier. In the short run, CPI inflation was likely to fall back during the rest of this year partly because that 'base effect' disappeared and the proposed increase in the tax on petrol had been deferred. In addition, the prices of foodstuffs and miscellaneous services had risen less rapidly than expected at the time of the May *Inflation Report*, which also contributed to a lower short-run projection of the rate of CPI inflation. In line with pre-release arrangements, an advance estimate of CPI inflation in July had been provided to the Governor 3½ working days ahead of publication, and this suggested a fall in the rate to 1.4%. However, there was evidence of mounting inflationary pressure along the supply pipeline, with the rates of increase of input, output and import prices rising and a number of surveys pointing to higher output price inflation.

20 The Committee noted that CPI inflation had been subdued over the past few years. One reason might have been that pricing margins had narrowed more than expected, perhaps as a result of a greater degree of competition. The terms of trade had also moved further in the United Kingdom's favour than expected. But it was not clear whether these changes would persist or go further, or whether they would to some degree turn out to be a cyclical phenomenon that might reverse.

## **The immediate policy decision**

21 The Committee reached its policy decision in the light of the projections published in the *Inflation Report* on Wednesday 11 August.

22 The Committee's central projection, based on the assumption that official interest rates follow a path implied by the market yield curve, was for four-quarter GDP growth to remain above its long-run average in the near term, but then to slow during the second year of the projection as final domestic demand growth moderated. This profile was broadly similar to the one published in the May *Inflation Report*. The Committee's central projection for CPI inflation, also on the assumption that official interest rates follow a path implied by the market yield curve, was for an initial slowdown, after which it would pick up steadily to meet the target around the two-year point. Thereafter, CPI inflation was projected to stabilise close to the 2% target. Temporary weakness in some components of the CPI, and some reduction in the current strong contribution from petrol prices, were responsible for the near-term slowdown. Subsequently, the impact of domestic demand pressures would become more apparent, and the effect in the first year of the forecast of the weakness of import prices would die away. For the first two years, this projection was broadly similar to that published in May.

23 The Committee also examined projections for GDP growth and CPI inflation based on the assumptions that the official interest rate remained constant at either 4.5% or 4.75%. These projections showed slightly more rapid demand growth, particularly in the former case, and lower exchange rate paths; hence they also suggested a slightly higher profile for CPI inflation.

24 The Committee discussed the various risks – in both directions – around these central projections. There were a number of major downside risks to inflation. A more abrupt house price correction was possible, associated with a sharper-than-expected slowdown in the growth of consumption. There might be a slower-than-expected pickup in inflation if wage bargainers and price setters formed their price expectations by extrapolating recent low inflation rates. The narrowing of pricing margins might continue. External demand growth might slacken, in particular if oil prices were to rise even more sharply. And faster-than-expected productivity growth, perhaps as a result of the late '90s boom in information, communications and technology investment, might raise the rate of growth of potential supply. But there were major upside risks to inflation as well. In particular, the narrowing of goods producers' margins might reflect cyclical factors and therefore start to reverse.



And, given the degree of labour market tightness, wage inflation might rise more rapidly than expected.

25 Overall, the Committee's best collective judgment was that the risks to the central projections for both GDP growth and CPI inflation were broadly balanced. There was a range of views among members, about both the central projections and the risks around them, but the differences were small.

26 Neither the news on the month, nor since the May *Inflation Report*, had significantly changed the picture of a broadly based world recovery and UK GDP growth above trend. Fiscal and monetary policies in most countries were still stimulatory. The US economy had perhaps been a little weaker than expected, but the recovery in the euro area now seemed more robust and the major Asian economies continued to expand strongly. In the United Kingdom, consumption growth seemed a little weaker than expected, but demand as a whole was likely to grow faster than the supply capacity of the economy. There was considerable uncertainty about the degree of slack in the labour market and about the level of capacity utilisation, but it seemed likely that the level of demand for resources was now high relative to potential supply. The increases in the repo rate since November were likely to have started to moderate activity, but it was too soon to assess the size of the pass-through to CPI inflation. The Committee noted that it would be necessary to monitor closely how this uncertainty and the other major risks, in both directions, evolved.

27 The Committee considered the case for raising the repo rate by 25 basis points. First and foremost, the Committee's forecasts, whether based on the market yield curve or the constant interest rate assumption, suggested that an increase would be consistent with bringing CPI inflation back to its 2% target over the next couple of years. Second, although an argument could be made for bringing CPI inflation back towards target more rapidly if it could then be stabilised at that level, in practice, that degree of fine tuning, entailing more volatile demand growth, was neither feasible nor desirable. Third, for some members, the consequences of the upside risks to the inflation outlook materialising outweighed those of the downside risks because of their impact on future inflation expectations. Fourth, for one member, the continuing rapid growth of household debt, well in excess of the growth of disposable income, was increasing the vulnerability of consumption to the crystallisation of any of the downside risks to activity; a rise in the repo rate now would help to reduce the difficulties that could pose for monetary policy in the future.

28 The Committee also reviewed some possible arguments against an increase, although they did not find them persuasive. First, although the projections implied that a rise in rates might be appropriate at some point, that did not necessarily mean this month. Inflation expectations among wage bargainers and price setters generally appeared to be well-anchored, so a short delay, during which the risks to the outlook could be re-evaluated in the light of new information, might not be costly. Second, the projections for CPI inflation, under both the market and constant rate assumptions, showed it undershooting the target for a considerable period.

29 The Governor invited members to vote on the proposition that the repo rate should be increased by 25 basis points to 4.75%. The Committee voted unanimously in favour of the proposition.

30 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

Nick Stern 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 30 July 2004, in advance of its meeting on 4-5 August. 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 Most market participants had expected the repo rate to be increased in August: only one of the 45 economists surveyed by Reuters had predicted otherwise. Over the period as a whole since the Committee's previous meeting, short-term interest rates had been broadly unchanged in the euro area but up slightly in the United Kingdom and the United States. Intra-month movements, particularly in the United States, had been more significant. Short-term interest rates in the United States had fallen initially following weaker-than-expected US CPI data on 16 July, and UK short-term interest rates had also fallen markedly. Short-term interest rates had then increased following the testimonies of the Federal Reserve Chairman to the US Congress on 20 and 21 July, and some stronger-than-expected US and UK data releases. Toward the end of the period, rates had declined again, most notably in the United States in response to weaker-than-expected second-quarter US GDP and personal consumption data on 30 July.

A3 US, UK and euro-area longer-term maturity nominal forward rates had changed little since the Committee's previous meeting. Ten-year break-even inflation spot rates, which had been falling before the previous meeting, had fallen slightly in the United Kingdom, the euro area and the United States. The indicative UK CPI inflation forward curve, as inferred by the Bank from the RPI inflation forward curve, had fallen slightly at short and longer-term maturities. UK survey-based CPI inflation expectations had remained unchanged since April.

A4 The sterling effective exchange rate index (ERI) had risen by 0.5% to 106.3. The first half of the period had been characterised by low levels of activity in foreign exchange markets, reflected in relatively low trading volumes. But activity had increased following the Federal Reserve Chairman's testimonies on 20 and 21 July. The foreign exchange market had interpreted the comments as indicating a stronger outlook for the US economy, which had led to an appreciation of the US dollar. And the US dollar had appreciated further after stronger-than-anticipated US consumer confidence data on 27 July. Over the period, the US dollar ERI had risen by 1.7%. Against this international background, sterling had depreciated by 1.6% against the dollar, but had appreciated by 0.9% and 1.0% against the euro and the yen respectively. Over the period, there had been a relatively sharp decrease in short-term foreign exchange uncertainty, as measured by volatility implied by three-month option contracts. But the low level of uncertainty was not unprecedented, and longer-maturity implied volatility measures suggested that exchange rate volatility was expected to rise.

A5 In local currency terms, the FTSE All-Share index had increased by 0.5%, whereas the S&P 500, Dow Jones Euro Stoxx and Topix indices had fallen by 1.8%, 2.4% and 2.2%, respectively. The financials and resources sectors had contributed to the rise in the FTSE All-Share index. By contrast, the financials sector had contributed negatively to the US and euro-area indices, together with the technology, cyclical services and non-cyclical consumer goods sectors. Market views on uncertainty about future equity indices, as inferred from forward volatility term structures implied by the prices of option contracts on FTSE 100 and S&P 500 index futures, had been little changed from recent low levels. Investment-grade corporate credit spreads had changed little internationally, while spreads for lower quality corporate debt had fallen slightly.

## **II The international environment**

A6 According to the advance estimate, US GDP had risen by 0.8% in 2004 Q2, following a rise of 1.1% in 2004 Q1 (revised from the earlier estimate of 1.0%). Compared with a year earlier, GDP had risen by 4.8%. Private consumption had risen by 0.3% in 2004 Q2 compared with a quarter earlier. Private investment had increased by 2.7% on the quarter, reflecting a rise of 2.1% in business investment and a rise of 3.6% in residential investment. Government spending had risen by 0.6% on the quarter. Net trade had made a zero contribution to quarterly GDP growth and stockbuilding had contributed 0.1 percentage points. Estimated annual GDP growth in 2003 had been revised to 3.0%,

from 3.1% previously, and growth in 2002 to 1.9% from 2.2%. Estimated annual GDP growth in 2001 had been revised up, to 0.8%, from 0.5% previously.

A7 Among the monthly indicators, industrial production had fallen by 0.3% in June compared with a month earlier, after rising by 0.9% in May. Retail sales had fallen by 1.1% in June, following an upwardly revised increase of 1.4% in May. Consumption had fallen by 0.9% in June compared with a month earlier and saving as a percentage of nominal disposable income had increased to 2.0% in June, from 1.2% in May (previously estimated to be 2.2%). The estimated saving ratio in 2001 had been revised up from 1.7% to 1.8%; the ratio in 2002 had been revised down from 2.3% to 2.0%; and the ratio in 2003 from 2.1% to 1.4%. The University of Michigan measure of consumer confidence had risen to 96.7 in July (revised up from 96.0 in the preliminary release), from 95.6 in June. The Conference Board measure had risen to 106.1 in July, from 102.8 in June. The Institute for Supply Management (ISM) manufacturing index had risen to 62.0 in July, from 61.1 in June. The ISM non-manufacturing index had risen to 64.8 in July, from 59.9 in June.

A8 US producer prices for finished goods had increased by 4.0% in the year to June. The US headline consumer price index had risen by 3.3% in the year to June, compared with a 3.1% rise in the year to May. The core CPI, which excludes food and energy, had increased by 1.9% in the year to June, up from 1.7% in the year to May. The core measure of the private consumption expenditures deflator had risen by 1.6% compared with a year earlier in 2004 Q2, up from 1.4% in 2004 Q1. Employment costs had risen by 0.9% in 2004 Q2 compared with a quarter earlier, down from 1.1% in 2004 Q1.

A9 In the euro area, the estimate of GDP growth in 2004 Q1 had been unrevised at 0.6% according to the second release, although there had been offsetting changes to components and revisions to past data. Quarterly private consumption growth had been revised up by 0.1 percentage points in each quarter from 2003 Q2 to 2003 Q4, but had been unchanged at 0.6% in 2004 Q1 compared with the first release. The estimates of gross fixed capital formation growth in each quarter from 2003 Q2 to 2004 Q1 had been revised up. In 2004 Q1, the estimated growth rate had been 0.2%, revised up from -0.1% previously. Import growth in 2004 Q1 had been revised up to 0.9% compared with a quarter earlier, from 0.8% previously. Export growth had been revised down to 1.5% in 2004 Q1, from 1.7% previously. The contribution to GDP growth from stockbuilding had also been revised down in 2003 Q3 and 2003 Q4, but had been unchanged at zero percentage points in 2004 Q1. The contribution

from net trade in 2004 Q1 had been revised down to 0.3 percentage points, from 0.4 percentage points in the first release.

A10 The euro-area Purchasing Managers' Index (PMI) for the manufacturing sector had risen to 54.7 in July, from 54.4 in June. The service sector PMI had been 55.3 in July, unchanged from its level in June. Industrial production in the euro area had risen by 0.7% in May compared with a month earlier, after rising by 0.3% in April. The European Commission measures of business and consumer confidence had been -4 and -14 respectively in July, both unchanged from their levels in June. The German IFO index had risen to 95.6 in July, from 94.6 in June.

A11 The euro-area unemployment rate had been 9.0% in June, unchanged from its level in May. The unemployment rate in Germany had increased in July to 10.6%, from 10.5% in June. According to Eurostat, the volume of retail sales in the euro area had risen by 1.8% on a month earlier in June, following a downwardly revised fall of 2.2% in May. Total German retail sales had increased by 0.4% in June compared with a month earlier, following a downwardly revised decline of 2.6% in May.

A12 Harmonised twelve-month consumer price inflation in the euro area had fallen to 2.4% in June, from 2.5% in May. Annual core inflation, which excludes energy, food, alcohol and tobacco, had risen to 1.9% in June, from 1.8% in May. The Eurostat flash estimate for euro-area HICP inflation had indicated a rate of 2.4% in the year to July. Annual producer price inflation (excluding construction) in the euro area had remained unchanged at 2.4% in June.

A13 In Japan, industrial production had fallen by 1.3% in June compared with a month earlier. But it had increased by 2.6% in 2004 Q2 compared with a quarter earlier. Export volumes had risen by 17.9% in June compared with a year earlier, after having increased by 10.5% in the year to May. Import volume growth had also picked up, to 10.0% in June compared with a year earlier, from -0.3% in May. The all-activity index had fallen by 0.7% on the month in May, after rising by 2.3% in April.

A14 GDP in China had grown by 9.6% in the year to 2004 Q2, following growth of 9.8% in the year to 2004 Q1. Annual consumer price inflation had risen to 5.0% in June, from 4.4% in May.

A15 Since the Committee's previous meeting, the spot price of Brent crude oil had risen by \$5.62 per barrel, and *The Economist* dollar non-oil commodity price index had fallen by 6.2%. The indices for

metals and food had fallen by 3.0% and 9.9% respectively. The index for non-food agricultural products had been unchanged since the Committee's previous meeting.

### **III Money and credit**

A16 The twelve-month growth rate of notes and coin, adjusted for special factors, had fallen further in July, to 6.0%. The annualised three-month growth rate had also fallen, to 5.6% in July from 7.4% in June. Annual growth of aggregate M4 deposits had fallen slightly, to 7.8% in June from 8.0% in May. Annual growth of M4 lending (excluding the effects of securitisations) had also fallen by 0.2 percentage points, to 12.1%. Excluding other financial corporations, annual M4 deposit growth had risen slightly, to 9.2%, while annual M4 lending growth (excluding the effects of securitisations) had fallen slightly, to 11.8%.

A17 The annual growth rate of households' holdings of M4 had fallen slightly, to 8.5% in June from 8.6% in May, while the annual growth rate of households' M4 lending (excluding the effects of securitisations) had risen slightly, to 14.0% from 13.9%. Within total net lending to individuals – a measure that includes lending by a broader set of institutions than the banks and building societies that comprise M4 lending – the annual growth of secured lending had been unchanged, at 15.3% in June. The annualised three-month growth rate had fallen slightly, to 14.8%. The annual growth rate of unsecured lending to individuals had risen slightly, to 11.8% in June from 11.6% in May. The annualised three-month growth rate had also risen, by 0.5 percentage points to 11.8%.

A18 The average standard variable rate on mortgages quoted for existing customers had increased to 6.33% in July, from 6.08% in June. The average two-year discounted rate quoted to new business had increased to 4.78%, from 4.66%. According to the latest survey data from the Council of Mortgage Lenders, the share of new mortgages that had fixed rates had risen to 33% in June.

A19 The average interest rate on credit card borrowing quoted by banks and building societies had increased in July, by 12 basis points to 15.19%. The average interest rate quoted on personal loans larger than £10,000 had fallen by 16 basis points in July, to 7.64%. The fall since October 2003 had been 76 basis points. The average quoted interest rate on time deposit accounts had increased by 27 basis points in July, to 2.81%.

A20 Housing transactions completions, as measured by land transaction returns, had increased by 41% in the three months to June compared with the same period a year earlier. Approvals of loans for house purchase had fallen sharply, to 114,000 in June from 124,000 in May. According to the Royal Institution of Chartered Surveyors, unsold stocks of properties had risen to 58 per surveyor in June, from 56 in May. The number of sales per surveyor had fallen, to 29 per surveyor in June, from 30 in May.

A21 The annual growth of private non-financial corporations' (PNFCs') holdings of M4 deposits had risen to 12.4% in June, from 11.2% in May. The annual growth of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 5.1% in June, from 6.3% in May. Total external finance, a broader measure of PNFCs' funding, had averaged £2.4 billion per month during Q2, compared with an average monthly value of £3.8 billion in Q1. The industrial breakdown of bank lending had shown a recovery in borrowing by manufacturers for the past two quarters, although the twelve-month growth rate of lending remained negative. Growth in lending to the real estate sector had remained strong.

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

A22 The ONS preliminary estimate for GDP growth at market prices in 2004 Q2 had been 0.9%, following 0.7% growth in 2004 Q1. Annual GDP growth at market prices had picked up, to 3.7% in 2004 Q2 from 3.4% in 2004 Q1.

A23 The preliminary estimate for quarterly service sector output growth in 2004 Q2 had been 0.9%, unchanged from 0.9% in 2004 Q1. The preliminary estimate for production sector output growth had been 0.9% in 2004 Q2, up from -0.5% in 2004 Q1.

A24 Retail sales volumes had risen by 1.1% in June, up from 0.7% in May. Retail sales growth had been 1.9% in 2004 Q2, down just slightly from 2.0% in 2004 Q1. The GfK consumer confidence balance had risen by 1 point in July, to -3.

A25 The Nationwide house price index had risen by 2.1% in July, while the Halifax house price index had risen by 1.3%. The three-month-on-three-month inflation rates had fallen, to 4.9% and 5.5% respectively. Annual house price inflation measured by the ODPM house price index had been 12.2%



in May, up slightly from 10.0% in April. Data from both Nationwide and Halifax had suggested that in 2004 Q2 house price inflation remained highest in northern England.

A26 Recent surveys had suggested that in 2004 Q2 business confidence in the service sector had remained broadly unchanged, but had fallen slightly in the manufacturing sector; survey measures for both the service and manufacturing sectors had remained above their recent historical averages. For the service sector, the British Chambers of Commerce (BCC) survey balance of business confidence regarding profitability had been broadly unchanged at +47 in 2004 Q2, and the Chartered Institute of Purchasing and Supply (CIPS) services survey of business expectations had fallen to 74.6 in July, from 77.3 in June.

A27 For the manufacturing sector, the BCC survey balance of business confidence regarding profitability had fallen slightly to +35 in 2004 Q2 from +38 in 2004 Q1. The CBI *Quarterly Industrial Trends Survey's* business optimism balance had fallen back to +7 in 2004 Q2, from +12 in 2004 Q1.

A28 Surveys of investment intentions had remained at or above their historical averages. The BCC balances on investment intentions in plant and machinery for the service and manufacturing sectors had been +21 and +9 respectively in 2004 Q2. The CBI investment intentions balance for the manufacturing sector had risen slightly, to 0 in 2004 Q2 from -1 in 2004 Q1.

A29 The CIPS services business activity index had fallen slightly, to 56.2 in July from 56.8 in June; the incoming new business index had fallen to 56.5 in July, from 57.1 in June. The BCC services domestic orders balance had risen to +28 in 2004 Q2, from +24 in 2004 Q1.

A30 The CIPS manufacturing output index had risen to 59.5 in July, from 57.9 in June; the new orders balance had risen to 58.1, from 55.6. The BCC manufacturing domestic orders balance had fallen to +10 in 2004 Q2, from +17 in 2004 Q1. The CBI total new orders balance had fallen to +2 in 2004 Q2, from +18 in 2004 Q1.

## **V The labour market**

A31 According to the Labour Force Survey (LFS), 16+ employment had decreased by 29,000 in the three months to May compared with the previous non-overlapping quarter. The quarterly changes in

the growth rate of employment had been volatile in recent quarters. The 16+ employment rate had decreased by 0.2 percentage points in the three months to May to 60.0%, but had increased by 0.1 percentage points compared with the same three months a year earlier. Total hours worked had decreased by 0.1% in the three months to May, but had increased by 0.3% on the year. Average hours had been unchanged in the three months to May, but had fallen by 0.4% on a year earlier.

A32 The CIPS whole-economy employment survey for July had continued to suggest employment growth. All three sector indices (construction, manufacturing, and services) had remained above the 'no change' level of 50. Seasonally adjusted information from recent surveys of employment intentions had generally shown positive percentage balances of employers planning to recruit staff. The average level of vacancies in the three months to June had increased by 10.4% compared with the same period a year earlier. The latest CBI *Quarterly Industrial Trends Survey* had reported an increase in the percentage of manufacturing firms that had forecast shortages of skilled and other labour. According to the July Recruitment and Employment Confederation (REC) survey, the demand for agency staff had continued to increase, while the availability of agency staff had continued to fall.

A33 LFS unemployment had risen by 6,000 in the three months to May, but had been 52,000 lower compared with the same three months a year earlier. The LFS unemployment rate had been unchanged at 4.8% in the three months to May and had decreased by 0.2 percentage points on the year. The claimant count unemployment rate had been unchanged in June at 2.7%. The level of 16+ inactivity had risen by 93,000 in the three months to May. The 16+ inactivity rate had increased to 37.0% in the three months to May, up 0.1 percentage points compared with both the previous non-overlapping quarter and the same period a year earlier.

A34 According to settlements information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI)-weighted settlement had been 3.4% in the year to June, up 0.1 percentage points on the equivalent figure for May. The twelve-month mean settlement in the private sector (AEI-weighted) had been 3.4%, up 0.1 percentage points on the year to May; that in the public sector (sample-weighted) had been unchanged at 3.1%.

A35 Overall annual whole-economy earnings growth had been 4.3% in the three months to May and had been unchanged on the three months to April. Private sector pay growth had increased by 0.1 percentage points to 4.4%, within which private sector services had been unchanged at 4.3%.

Annual public sector pay growth had been unchanged at 4.3%. Whole-economy earnings growth in the year to May had decreased by 0.5 percentage points on the year to April, to 4.1%. Annual earnings growth excluding bonuses had been 4.2% in the three months to May, up 0.1 percentage points on the three months to April. The comparable public sector growth rate had increased by 0.1 percentage points, to 4.4%, while the comparable private sector growth rate had been unchanged at 4.1%. Shorter-run measures of whole-economy earnings growth excluding bonuses had remained above the twelve-month growth rates.

## **VI Prices**

A36 Since the Committee's previous meeting, sterling oil prices had risen by 17%.

A37 Manufacturing input prices had fallen by 1.6% in June. The annual inflation rate had fallen to 3.4% in June, from 5.3% in May. The *CIPS Report on Manufacturing* had pointed to a rise in input prices in July: the input price balance rose to 65.2, from 64.4 in June.

A38 Manufacturing output prices excluding duties (PPIY) had risen by 0.2% in June. The annual inflation rate had risen by 0.3 percentage points to 2.6% in June. Survey data had pointed to further rises in output prices in the future: the expected output price balance from the *CBI Quarterly Industrial Trends Survey* had risen to +6 in July, its highest level for over seven years.

A39 Annual CPI inflation had risen to 1.6% in June, from 1.5% in May. Within this, annual goods price inflation had risen by 0.1 percentage points to 0.0% in June. Annual services price inflation was unchanged at 3.3% in June. Annual RPIX inflation had been unchanged at 2.3% in June. Annual RPI inflation had risen to 3.0% in June, from 2.8% in May.

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

A40 The Bank's regional Agents reported that the growth of service sector output had remained strong, but might have eased recently. Companies providing services to business customers had mostly reported continuing strong growth of activity, although there had been some signs of weakness in parts of the financial services sector, possibly related to lower world equity markets. Demand for consumer services had slowed in July, following a strong June when retail sales may have been

boosted by the Euro 2004 football championships, as well as advanced summer sales. That may have masked an underlying slowdown in sales in June that had continued into July.

A41 Manufacturers had reported continuing steady growth. But many were cautious about their future prospects, partly because of perceived downside risks to the world economy and upside risks to the prices of oil and other commodities.

A42 Contacts' planned investment had continued to pick up. Many had cited plans to invest in information technology to improve their cost competitiveness. Relatively few contacts had planned to increase capacity by investing in new buildings and equipment. The Agents' reports suggested that capacity utilisation had risen above normal levels. That could stimulate investment in new capacity if activity strengthened and business optimism improved.

### **VIII The Agents' special topic**

A43 The Bank's regional Agents had conducted a special survey of the buy-to-let property market, questioning around 130 firms involved in the sector. Respondents had been asked to compare expected investment demand over the next six months with the level of demand over the previous six months. Respondents had also been asked what they believed would influence investor behaviour over the second half of 2004.

A44 On balance, respondents thought that the level of buy-to-let activity would fall over the coming six months relative to the previous six months, reflecting higher interest rates and weaker rents and property prices. The survey indicated that the majority of respondents had thought that landlords held long-term views about their investments and so believed that the buy-to-let market would not provide a significant source of instability over the coming months.