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# MINUTES OF MONETARY POLICY COMMITTEE MEETING 7 and 8 January 2004

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

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0401.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 4 and 5 February will be published on 18 February 2004.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 7-8 JANUARY 2004**

1 Before turning to its immediate policy decision, the Committee discussed financial markets; the world economy; money, credit, demand and output; the labour market, costs and prices; and some other considerations. The Committee noted a letter from the Chancellor, which confirmed the new operational target for monetary policy to be a 2% twelve-month increase in the Consumer Price Index. The new remit and an annex outlining details of the new inflation target are attached to these minutes.

### **Financial markets**

2 The most significant development in financial markets had been a further fall in the US dollar, which had depreciated by around 5% against the euro and sterling since the Committee's December meeting, bringing its cumulative depreciation to over 20% in effective terms since the beginning of 2002. The dollar had now more than retraced its rise against the euro since the beginning of 1999, although it had recently not been as weak against the currencies of some other important trading partners of the United States, such as Japan and Mexico.

3 There remained a risk that the dollar might fall further. The depreciation to date in effective terms was unlikely by itself to be sufficient to return the US current account to a sustainable level. The financing of this deficit had recently depended heavily on official purchases of dollar assets by overseas central banks, which could reflect a desire to build up liquid reserve balances as well as to resist the appreciation of their currencies against the dollar. Such purchases might not continue on the same scale. And there had been a tendency in the past for swings in the major currencies to overshoot long-term sustainable values. The Committee would need to assess further the full implications of the fall in the dollar for the world economy and the prospects for UK external demand in the forthcoming *Inflation Report* round.

4 Short-term and long-term nominal interest rates had fallen materially in the United Kingdom, the United States and the euro area. The movements in US and UK short rates apparently reflected

perceptions by market participants that the prospective tightening of monetary policy in both countries would be slower to materialise than previously believed. This change of view had been associated with lower-than-expected consumer price inflation in both countries, and – in the United States – with public comments by monetary officials that had been interpreted as meaning that interest rates would remain low for some time to come, even though the statement released by the FOMC at the time of their December meeting suggested that the risks to inflation had become more balanced.

5 The falls in US and UK long-term government bond interest rates appeared to reflect a decline in real rates rather than in implied inflation rates. These movements did not appear easy to reconcile with some fundamental economic developments, such as the strength of US productivity and the prospective increase in the US fiscal deficit.

6 Equity prices had risen slightly in most major markets, possibly supported by the decline in long-term interest rates as well as by strengthening global economic prospects. The emergence of accounting difficulties at Parmalat had caused a rise in that company's bond yields, but there did not appear to have been any significant general effect on European corporate bond markets.

### **The world economy**

7 The global economy had on balance strengthened since the November *Inflation Report*, although the news over the past month was more mixed. However, the rise in the euro against the dollar would adversely affect prospects for euro-area activity. Euro-area demand had a high weight in overall external demand for UK goods, so this would to some extent counteract the positive impact of stronger global demand.

8 In the United States, the latest estimate for GDP growth in the third quarter was unrevised at 2.0% over the previous quarter, and initial indicators pointed to continued strong growth in Q4. Prospects for investment looked more solid than those for consumption. Estimates of corporate profits had been revised upwards, which was consistent with very strong productivity growth; industrial production, especially production of information and communications technology goods, had risen in November; and the Institute for Supply Management's manufacturing index had reached its highest level for twenty years in December. Consumption had grown strongly in November. But consumer confidence had weakened slightly in December, and although non-farm payrolls had turned upwards

over the past three months, they had been increasing by less than the rise in the labour force. In addition, estimates of the personal saving ratio had been revised downwards, which suggested an increased risk of an upward adjustment to saving at some point. There was little sign that inflation would start to pick up in the near future. The annual growth rates of broad and narrow money had both weakened in recent months, and the core CPI measure of prices had declined on the month in November for the first time since 1982. Strong productivity growth, associated with falling unit labour costs, a low level of capacity utilisation and unemployment around 6% suggested that demand growth could remain high for some time without placing undue pressure on supply. However, monetary and fiscal policy were both highly stimulatory, and, together with the fall in the dollar and higher dollar prices for oil and commodities, were likely to imply upward pressure on inflation at some stage.

9 Euro-area output growth in 2003 Q3 had been stronger than expected at the time of the November *Inflation Report*, and prospects for the fourth quarter had also improved. But there were questions about the sustainability of the pickup. Domestic demand in the third quarter had been at the same level as in the second, so the rise in output rested entirely on the net trade contribution to growth. The magnitude of this contribution had been surprising given the strength of the euro over the past two years. Moreover, on the data currently available, it was difficult to identify the counterpart countries outside the euro area. The judgment that prospects for growth in 2003 Q4 were improving rested in large part on survey evidence: the Purchasing Managers' Index (PMI) for manufacturing had risen in each of the six months up to December, and the PMI for services, although it had eased, remained buoyant. Only limited official data were so far available on activity in the fourth quarter. Euro-area industrial production had risen by 1.1% in October, but French consumption of manufactured goods and German retail sales had both been weak in November. And given the strength of the euro it was not clear that the strong export performance reported for the third quarter would continue: if export volume growth had been maintained only by a reduction in exporters' profit margins, it might not be sustainable. Investment might also weaken if margins had been squeezed. However, if the stronger euro implied a rise in the terms of trade, and hence higher real wages measured relative to the price of consumer goods, it might result in higher consumption.

10 There continued to be signs of a modest recovery in Japan. The estimate for GDP growth in 2003 Q3 had been revised down from 0.6% to 0.3%, which was more consistent with the profile of the all-activity index. However, industrial production had increased strongly in October and November. Demand and output were growing strongly in the main Asian economies, with the exception of South

Korea, and growth in the region did not appear to depend so much on that in the United States.

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

11 News on the growth of output and aggregate demand in the UK economy had been generally positive since the Committee's December meeting. The estimate of GDP growth at market prices for 2003 Q3 had been revised upwards, although the level of GDP measured at basic prices was slightly lower because of revisions to earlier data. Both household and government consumption growth were now estimated to have been stronger than thought at the time of the November *Inflation Report*. Business investment had been revised downwards, and was still estimated to have fallen in the third quarter. But the statistical discrepancy between the estimates for output and income and for aggregate expenditure was unusually large, and it seemed possible that the estimated level of business investment might eventually be revised up. Early indications were that robust output growth had continued into the fourth quarter, matching and possibly exceeding the rate of growth of potential output. Manufacturing production had been stronger than expected in October, and business surveys for both the services and manufacturing sectors remained strong in November. Prospects for investment were underpinned by improving corporate profitability and cashflow and easier access to long-term finance through the bond and equity markets. Aggregate annual M4 growth had increased to 7.0% in November, although the growth of corporate deposits, which had been particularly strong, might partly reflect temporary factors.

12 The evidence on consumer demand was on balance positive, though the estimated saving ratio had been revised upwards. The latter suggested that the risk to future consumption arising from a sharp upward correction to household saving might be less than previously thought. Indicators for 2003 Q4 were more mixed. Retail sales had risen only modestly in November, but there was anecdotal evidence that while sales growth had also been slow early in December it had picked up close to Christmas, partly encouraged by price discounting. The GfK measure of consumer confidence had risen slightly in December, suggesting that the repo rate rise in November had not had an unduly adverse effect, although it was too early to reach a conclusive assessment.

13 Household borrowing remained very strong, although the growth of unsecured credit had eased slightly in recent months. Past rises in house prices meant that secured borrowing was likely to grow strongly for some time to come. The housing market appeared to be strengthening. Housing loan

approvals adjusted for the number of working days had risen in November; the November survey by the Royal Institution of Chartered Surveyors showed a rise in sales and a fall in unsold stocks of houses; and both the Halifax and Nationwide indices had shown strong house price increases in December, again providing early evidence that the November repo rate increase had not adversely affected confidence.

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

14 There were again signs that the labour market was tightening. The Labour Force Survey (LFS) measure of the unemployment rate had fallen to 5.0%, and survey indicators and reports from the Bank's regional Agents suggested that private sector employment was rising. Private sector pay settlements had been edging up for about a year, and it was likely that larger bonuses, notably in financial services, would push up overall earnings figures in the coming months. On one measure, whole-economy unit labour costs had risen by over 3% in the year to 2003 Q3; non-wage labour costs had been rising particularly fast, accounted for by employers' pension and social contributions. But current rates of increase in pay were still moderate, particularly when account was taken of the rise in retail price inflation since mid-2002 and the increase in employees' National Insurance contributions. The pickup in employment and earnings growth seemed broadly consistent with the *Inflation Report* projections, and did not suggest that the labour market was overheating.

15 RPIX inflation had been exactly on target at 2.5% in November. Inflation measured by the new target measure, the consumer price index (CPI), had fallen to 1.3%, which was a little weaker than expected and below the new target of 2%. However, prospective increases in utility prices meant that it was likely to rise closer to the target rate during the first half of 2004.

16 Global oil and commodity prices had been rising sharply in recent months in dollar terms. But this largely reflected the fall in the dollar; for example, the Economist commodity price index had risen by only 5% in sterling terms in the year to December, as compared with a rise of 17% in dollar terms. In a period of large movements in relative currency values, it was difficult to choose an appropriately neutral yardstick. However, it seemed that there was some upward pressure on commodity prices from the recovery in global activity.

## **Other considerations**

17 Most market participants did not expect an increase in the Bank's repo rate. The average probability attributed by respondents in the monthly Reuters poll to a 0.25 percentage point increase was 26%.

18 The Committee considered the implications of the change in the inflation target, from 2.5% on the RPIX measure to 2.0% on the CPI measure. On the new definition inflation had been below its target over the past year, whereas on the old definition it had been slightly above its target for most of this period. However, given the lags between changes in the repo rate and their impact on output and inflation, monetary policy needed to be forward looking. The Committee had not yet formally agreed a central projection for CPI inflation through the comprehensive process of an *Inflation Report* round, but noted that the gap between RPIX and CPI inflation was currently unusually large and was likely to narrow over the forecast horizon as house price inflation moderated. Some two years ahead, the difference would probably be around half a percentage point, so the change in target variable combined with the change in numerical target should not have material implications for the current stance of policy.

## **The immediate policy decision**

19 News from the world economy had on balance been positive since the November *Inflation Report*, with the United States showing strong growth and with developments in the euro area being more encouraging. The balance of news from the United Kingdom had also been positive, with output growth expected to be at or above trend in the second half of 2003, although the level of output at basic prices had been revised downwards. Consumption was still growing steadily, and house price rises were once again above expectations. The labour market was tightening modestly, broadly in line with the November *Inflation Report* projections. Although consumer price inflation was currently well below its target, it was expected to rise in early 2004, and upward pressure on inflation was expected to build gradually over the medium term as demand growth put increasing pressure on supply capacity. The effect of the continuing weakness of the dollar on activity in the euro area and on external demand for UK output was a key uncertainty. The impact of the November repo rate increase on UK domestic demand was also not yet clear, but so far it did not seem to have had a significant adverse effect on consumer confidence, consumer demand or the housing market. The change in the Committee's

inflation target did not by itself warrant a change in the current stance of policy because, at the two-year horizon, the gap between the two measures of inflation seemed likely broadly to match the change in the numerical target.

20 Against this background, there were some arguments for an immediate rate rise, to which different members gave different weight. First, the November *Inflation Report* central projection, on the constant interest rate assumption, was that inflationary pressure would gradually be building over the next two years. If the economy continued to evolve as had then been envisaged, a gradual rise in interest rates would be necessary. Second, the news from the global economy since the November *Inflation Report*, although mixed, had on balance been positive. Third, domestic demand and output growth were on balance stronger than envisaged in November.

21 Nevertheless most members agreed that it was not necessary to change the repo rate this month. First, there were few signs that costs and prices in the United Kingdom were currently rising more rapidly than had been envisaged in the November *Inflation Report*. Second, inflation expectations remained well-anchored. Third, there were material downside risks in the current conjuncture. The fall in the dollar could put the nascent euro-area recovery at risk, and the euro area was a particularly significant source of external demand for UK goods. The decline in the dollar had also recently been associated with a modest rise in the sterling effective rate index, which implied downward pressure on UK activity and inflation. Fourth, the rise in indebtedness of UK consumers implied increased uncertainty about the effect of a change in monetary policy on consumption, and for that reason, changes in interest rates should be gradual. Finally, the success of monetary policy rested in part on the ability of the Committee to explain its decisions clearly. This was particularly important given the new target measure of inflation, the implications of which were best explored in the context of the next *Inflation Report*, which would be the first to contain projections for the CPI.

22 One member, however, despite the above factors and risks, put particular weight on the continuing strong growth of household debt. If the repo rate were to rise as implied by current short-term market interest rates, household income gearing could rise from its current moderate levels towards levels last seen in the late 1980s and early 1990s. It was therefore appropriate to seek proactively to moderate the build-up in levels of domestic borrowing now, in order to reduce the risk of an abrupt adjustment to consumption further out. There was no evidence as yet that the November repo rate increase was bringing this about. Against the background of positive news from the domestic and



world economy, a further rise in repo rate was therefore warranted. This would be a surprise to financial markets, though the surprise would be one of timing not direction, since expectations of a further rise in due course were already factored into market rates. An element of surprise might have more impact on consumption, particularly that element of consumer demand which emanated from increases in domestic borrowing, than one which was fully expected. That decision could be explained in terms of the underlying data.

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

24 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 5 January 2004, in advance of its meeting on 7-8 January. 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 Short-term interest rates had fallen in the United Kingdom, the euro area and the United States. The economic data in the United States, and the consumer price index (CPI) figures in the United Kingdom, had been weaker than the market had expected. The central market expectation had been that there would not be any change in official rates in the United Kingdom in January. Expectations of rate rises in the euro area had been put back, in part the result of the weaker-than-anticipated US data. Expectations concerning US interest rates had also been influenced by comments pertaining to US labour market weakness, in the minutes of the October FOMC meeting.

A3 Since the previous MPC meeting, ten-year nominal forward rates had fallen by over 20 basis points in the United Kingdom. In the United States and the euro area, they had fallen by around 12 basis points and 5 basis points respectively. Ten-year break-even inflation rates had been broadly unchanged on the month in the United Kingdom and United States, but had fallen by around 12 basis points in the euro area. In the United Kingdom, forward annual RPI inflation expectations, as implied by index-linked and nominal gilt yields, had risen slightly at maturities of less than three years, but had fallen by over 10 basis points at maturities of around five years. Survey-based measures of UK RPIX inflation expectations for 2004 had been unchanged. Consensus surveys suggested a slight rise in inflation expectations in the United States and the euro area for 2004.

A4 The sterling effective exchange rate index (ERI) had appreciated by 1.7%, to 101.8. Sterling had appreciated by 0.5% against the euro and by 5.4% against the US dollar. The euro had appreciated by 4.8% against the dollar. The dollar had depreciated by 1.9% against the yen, accompanied by further Japanese intervention. The US dollar effective rate had fallen by 2.9%. Changes in relative longer-term interest rate differentials could only partially account for the dollar depreciation, and market

contacts had suggested that concerns about the US current account deficit had continued to weigh on the dollar.

A5 Between 3 December and 7 January, the FTSE All-Share index had risen by 1.7% and the FTSE 100 had increased by 1.8%. The FTSE 250 and FTSE Small-Cap indices had risen by 0.8% and 2.0% respectively. Increases in share prices in the resource sector had accounted for just under half of the increase in the FTSE All-Share index. The major international equity indices had also risen; the S&P 500 index by 5.8%, the DJ EuroStoxx by 2.3% and the Topix index by 3.5%. Uncertainty about future movements in the FTSE 100 and S&P 500 indices, as measured by the volatility implied by options prices, had fallen by 2.4 percentage points and 1.2 percentage points respectively and had remained below recent averages. Uncertainty about the future level of the DJ EuroStoxx index had been broadly unchanged. UK profit warnings in December had increased on the month, but remained broadly unchanged compared with December 2002. Profit warnings in the United States had fallen in the past month and remained below the average level for 2003. Between 3 December and 7 January, sterling and dollar-denominated investment-grade option-adjusted spreads had fallen and euro-denominated spreads had been unchanged. Investment-grade bond yields had fallen for all three currencies.

## **II The international environment**

A6 The final estimate of US GDP growth in 2003 Q3, at 2.0% on the quarter, had been unchanged from the preliminary estimate. Estimated consumption growth had been revised up, to 1.7% on the quarter, from 1.6%. Government spending growth had been revised up, to 0.4% on the quarter, from 0.3%. Export growth had been revised down, to 2.4% on the quarter, from 2.7%; and import growth had also been revised down, to 0.2% on the quarter, from 0.4%. The estimated net trade contribution to GDP growth had been unchanged at 0.2 percentage points. The current account deficit had fallen to 4.9% of GDP, from 5.1% in 2003 Q2. Overall, the comprehensive revision of the National Income and Product Accounts had left the recent profile of estimated US GDP growth broadly unchanged.

A7 Industrial production in the United States had increased by 0.9% on a month earlier in November, following an increase of 0.4% in October. Total new orders had fallen by 6.2% on a month earlier in November. The Institute for Supply Management (ISM) manufacturing index had increased to 66.2 in December, from 62.8 in November, with the index for new orders reaching the highest level

since July 1950. The ISM non-manufacturing index had fallen to 58.6 in December, from 60.1 in November.

A8 Real consumption in the United States had grown by 0.5% in November, after increasing by 0.1% in October. Retail sales had increased by 0.9% in November, having been unchanged in October (revised up from -0.3% in the previous release). The Conference Board measure of US consumer confidence had fallen to 91.3 in December, from 92.5 in November. The University of Michigan headline index of consumer confidence had fallen to 92.6 in December, from 93.7 in November. US non-farm payrolls had increased by 57,000 in November, following a rise of 137,000 in October.

A9 Annual headline consumer price inflation in the United States had fallen to 1.8% in November, from 2.0% in October. Annual core consumer price inflation (which excludes food and energy prices) had fallen to 1.1% in November, from 1.3% in October. US producer prices had risen by 3.4% in the year to November, unchanged from the increase in the year to October.

A10 Euro-area GDP had increased by 0.4% on the quarter in 2003 Q3, compared with a fall of 0.1% in 2003 Q2. Final domestic demand had made no contribution to quarterly GDP growth in 2003 Q3; net trade had contributed 1.0 percentage points, while inventories had subtracted 0.6 percentage points. French GDP had increased by 0.4% on the quarter in Q3 (unrevised from the first release), while estimated French private consumption growth had been revised up to 0.5% on the quarter, from 0.4% in the first release. Italian GDP growth had been unrevised in the latest release, at 0.5% on the quarter. Italian private consumption had increased by 0.7% on the quarter, following an upwardly revised increase of 0.5% in 2003 Q2. The contributions of inventories and net trade to GDP growth in Italy had been large and almost offsetting. Estimated Dutch GDP growth in 2003 Q3 had been revised down to zero in the latest release, from 0.1% in the first estimate.

A11 Industrial production in the euro area had increased by 1.1% on the month in October, following a fall of 0.4% in September. According to the European Commission Survey, the euro-area business confidence indicator had decreased to -8 in December, from an upwardly revised -6 in November. The euro-area purchasing managers' index (PMI) for manufacturing had increased to 52.4 in December, from 52.2 in November. The PMI for the services sector had fallen to 56.6 in December, from 57.5 in November. The West-German IFO index had increased to 96.8 in December, from 95.7 in November.

A12 According to Eurostat, the volume of retail sales in the euro area had fallen by 0.6% on a year earlier in September. The euro-area consumer confidence index had increased to –16 in November, from –17 in October.

A13 According to Eurostat's flash estimate, annual inflation in the euro area, as measured by the harmonised index of consumer prices (HICP), had fallen to 2.1% in December, from 2.2% in November. Annual core inflation (excluding energy, food, alcohol and tobacco) had been unchanged at 1.7% in November.

A14 According to the second release, real GDP in Japan had grown by 0.3% on a quarter earlier in 2003 Q3, compared with an estimate of 0.6% in the first release. This downward revision had reflected weaker estimated domestic demand. In the second release, total investment had grown by 0.5% on the quarter, compared with an estimate of 2.8% in the first release. The estimated contribution of net trade had been unchanged, at 0.2 percentage points, in the second release.

A15 Japanese export volumes had risen by 1.7% on a year earlier in November, following a rise of 7.5% in the year to October. Import volumes had risen by 3.4% on a year earlier in November, following an increase of 8.9% in the year to October.

A16 The Japanese tertiary activity index had risen by 1.1% in October compared with the previous month, while the all-activity index had increased by 0.8%. Industrial production in Japan had risen by 0.8% in November, following a rise of 1.0% in October. According to the Bank of Japan's December Tankan survey, the large manufacturers' business conditions diffusion index had risen to +11, from +1 in September. The large non-manufacturers' diffusion index had increased to –9 in December, from –13 in September. According to the all-households' survey, real living expenditure had fallen by 0.8% in the year to October; it had fallen by 1.8% in the year to September.

A17 Since the Committee's previous meeting, the spot price of Brent crude oil had risen by \$1.97 per barrel to \$31.24. *The Economist* dollar non-oil commodity price index had fallen by 3.2% for food, risen by 0.3% for non-food agricultural products and increased by 5.9% for metals.

### III Money and credit

A18 The twelve-month growth rate of notes and coin (adjusted for special factors) had fallen to 7.0% in December, from 8.0% in November. The twelve-month growth rate of M4 had risen to 7.0% in November, from 6.6% in October. Annual growth of M4 lending (excluding the effects of securitisations) had fallen to 11.6%, from 11.7%. Excluding other financial corporations (OFCs), the annual M4 growth rate had risen to 8.7%, from 8.2%, and the annual M4 lending growth rate (excluding the effects of securitisations) had fallen by 0.1 percentage points, to 13.4%.

A19 The twelve-month growth rate of households' M4 had fallen to 8.3% in November, from 8.4% in October, and the annual growth rate of M4 lending to households (excluding the effects of securitisations) had fallen to 15.1% in November, from 15.2% in October. Within total net lending to individuals – a measure that includes borrowing from a broader set of institutions than just banks and building societies – the annual growth rate of secured lending had been 14.4%, the same as in October. The annual growth rate of unsecured lending had risen to 13.0%, from 12.9%. The annual growth rate of credit card lending had fallen to 18.5%, from 19.0%, and annual growth in other unsecured lending had risen to 10.7%, from 10.4% in October.

A20 As a proportion of personal disposable income, the amount of new unsecured lending had fallen to 2.6% in Q3, from 2.8% in Q2, and mortgage equity withdrawal – gross equity withdrawn from the housing market minus gross injections – had risen to 7.0% in Q3, from 6.0% in Q2. The household sector's capital gearing – gross liabilities as a percentage of gross assets – had risen to 17.5% in Q3, from 17.4% in Q2. By contrast, the sector's income gearing – gross interest payments as a percentage of disposable income – had fallen to 7.0% in Q3, from 7.1% in Q2. Allowing for regular repayments of principal, the household sector's income gearing had fallen to 9.6% in Q3, from 9.7% in Q2. The sector's debt-to-income ratio had risen to 1.35 in Q3, from 1.33 in Q2.

A21 The average standard variable mortgage rate (SVR) quoted for existing borrowers had risen by 25 basis points in December, to 5.58%, and the average two-year discounted rate had risen by 5 basis points, to 4.22%. According to the latest data from the Council of Mortgage Lenders, the take-up of fixed-rate mortgages had fallen to 28% of new mortgages in November, from 34% in October.

A22 Interest rates for unsecured lending quoted by banks and building societies had been broadly similar to their levels in June 2003 (when the repo rate was also 3.75%). The exception had been for

personal loans: the average quoted rate for a personal loan of £10,000 had fallen by 43 basis points between the end of June and the end of December, continuing a trend towards lower spreads on unsecured debt.

A23 The number of loan approvals for house purchase, when adjusted for the number of working days in the month, had risen to 119,000 in November, from 117,000 in October. Housing transaction completions, measured by particulars delivered, had fallen by 16.8% in the latest three months compared with the same three months a year earlier. Unsold stocks of properties, measured by the Royal Institution of Chartered Surveyors (RICS), had fallen to 61 per surveyor in November, from 65 in October, while the number of sales per surveyor had risen to 31 in November, from 30 in October.

A24 The twelve-month growth rate of private non-financial corporations' (PNFCs') M4 had risen to 10.3% in November, from 7.4% in October. The annual growth rate of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 8.5% in November, from 8.7% in October. The flow of total external finance, a broad measure of PNFCs' funding, had been £5.3 billion in November, compared with £3.2 billion in October.

A25 PNFCs' aggregate income gearing had fallen to 17.8% in Q3, from 18.2% in Q2, in part the result of increases in PNFCs' gross operating surplus. PNFCs' aggregate capital gearing at replacement cost had risen to 30.8% in Q3, from 28.9% in Q2, but had fallen at market value, from 34.1% to 33.7%.

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

A26 The Quarterly National Accounts release for 2003 Q3 had been published on 23 December 2003. Estimated real quarterly GDP growth at market prices had been revised up, to 0.8%, from 0.7% in the previous release. Estimated annual GDP growth had been revised up, to 2.1%, from 2.0%. The latest release had contained revisions to GDP and its components starting in 1999 Q1, the cumulative effect of which had been to raise the estimate of the level of GDP at market prices by 0.1% in 2003 Q3.

A27 On the output side of the accounts, the estimated level of GDP at basic prices in 2003 Q3 had been revised down by 0.3% relative to the previous release. Estimated GDP growth at basic prices in Q3 had been unrevised, at 0.7%. Service sector output growth had been revised up, to 0.9%, from 0.8%, and manufacturing output growth had been revised up to 0.1%, from 0.0%. Construction output

growth had been revised down to 2.0%, from 2.5%. The cumulative revisions to past growth rates had implied that the level of service sector output had been 0.1% higher in 2003 Q3 than previously estimated, while the level of manufacturing output had been 0.2% higher.

A28 On the expenditure measure, the estimated quarterly growth rate of households' real consumption (including the consumption of non-profit making institutions serving households) had been revised up, to 0.9%, in 2003 Q3. The level of nominal government consumption had been revised down by 1.3% in 2003 Q3. That, together with upward revisions to the government consumption deflator, had implied that the level of real government consumption had been revised down by 2.1%. Whole-economy investment growth in 2003 Q3 had been revised up, to -0.5%, from -1.3% in the previous release. Within that, business investment growth had been revised up, to -1.2%, from -1.6%. Quarterly government investment growth in Q3 had been 5.6%.

A29 The level of final domestic demand had been revised down by 0.3% in 2003 Q3. Domestic demand had grown by 0.8% in Q3, while the growth of final domestic demand had been 0.5%. The contribution of inventories (including the net acquisition of valuables) to the quarterly growth of GDP had been 0.3 percentage points in Q3. Stockbuilding had been almost entirely confined to the manufacturing and the distributive trades sectors.

A30 Export growth in 2003 Q3 had been revised up, to 0.4%, from 0.1% in the previous release, while import growth had been revised down, to 0.5%, from 1.0%. Excluding the effects of identified missing trader intra-community (MTIC) fraud, export and import growth had been 1.0% and 1.2% respectively. Net trade had made a zero contribution to GDP growth in 2003 Q3.

A31 The expenditure statistical discrepancy is the difference between GDP calculated as the average of the output, income and expenditure measures, and GDP measured by the sum of the expenditure components. In 2003 Q3, this discrepancy had been revised up. It was estimated at 0.5% of GDP, implying that the expenditure data had been weaker than the available output and income data.

A32 Households' real post-tax income had risen by 1.5% in 2003 Q3, reflecting growth in both labour and non-labour income. The increase in non-labour income in turn reflected increased investment income from insurance company and pension fund reserves held on behalf on households. The household saving ratio had risen to 5.9% in 2003 Q3, and had been revised up in the previous three



quarters. The household sector had remained in financial deficit for the seventh consecutive quarter, but households' net financial deficit had shrunk to 0.5% of GDP in 2003 Q3.

A33 The gross operating surplus of private corporations (excluding the alignment adjustment) had risen by 2.8% in 2003 Q3, up from 0.9% in Q2. That had been largely accounted for by a 3.2% increase in the gross trading profits of non-oil private non-financial corporations in Q3. Private corporations' financial surplus (excluding the alignment adjustment) had fallen, to 1.1% of GDP in Q3. The public sector net financial deficit had fallen slightly, to 2.6% of GDP in Q3, and the current account deficit had remained broadly unchanged, at 2.9% of GDP.

A34 Turning to indicators of output in 2003 Q4, industrial production had increased by 1.0% in October. Manufacturing output had increased by 1.0%, while energy output had risen by 0.8%. The Chartered Institute of Purchasing and Supply (CIPS) manufacturing survey output index had risen to 58.4 in December, from 58.1 in November, but the new orders index had fallen slightly, to 57.6 in December, from 57.8 in November. 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 both increased on the month. The former had increased to +5 in December, from -2 in November; the latter had risen to -19 in December, from -24 in November. The CIPS services survey business activity index had fallen slightly, to 58.5, in December, from 59.6 in November, and the incoming new business index had also fallen, to 59.0 from 60.1. But both indices had remained well above the 'no change' level of 50.

A35 Turning to indicators of expenditure in 2003 Q4, retail sales had grown by 0.1% in November, following growth of 0.6% in October. In the CBI Distributive Trades survey, the balance of retailers reporting positive annual growth in sales volumes had increased to +33 in December, from +19 in November. The balance reporting sales volumes above average for the time of year had also increased slightly, having fallen sharply in November. The GfK consumer confidence balance had been broadly unchanged in December, increasing to -5, from -6 in November. Quarterly house price inflation measured by the Halifax index had increased to 3.9% in 2003 Q4, from 3.7% in Q3. And the quarterly change in the Nationwide house price index had risen to 4.2% in Q4, from 3.1% in Q3.

A36 Excluding oil and erratics, goods export volumes had increased by 2.2% in October, after falling in August and September. Exports to EU countries had remained weak, falling by 1.1% in October.

By contrast, exports to non-EU countries had increased by 6.5% in October. Goods import volumes had increased by 2.4% in October. The total deficit on trade in goods (including oil and erratics) had narrowed slightly, to £4.4 billion in October from £4.7 billion in September.

## **V The labour market**

A37 According to the Labour Force Survey (LFS), employment had increased by 37,000 in the three months to October, compared with the previous three months. The rise in employment in the three months to October had been more than accounted for by self-employment (up 103,000) and part-time employment (up 42,000). The working-age employment rate had fallen 0.1 percentage points, to 74.6%, compared with the previous three months, but had been unchanged compared with the same three months a year earlier. Workforce jobs had increased by 63,000 in the third quarter, including an increase of 41,000 in the construction sector.

A38 Total hours worked had fallen by 0.4% in the three months to October, but had increased by 0.3% on a year earlier. Average hours in the three months to October had fallen by 0.6%, both on the previous three months and on a year earlier.

A39 The overall CIPS employment index for December had suggested further strengthening in private sector employment. The CIPS manufacturing and services indices had both ticked up, while the construction index had fallen slightly. All three had been above the 'no change' level of 50.

A40 The LFS measure of unemployment had fallen by 33,000 in the three months to October compared with the previous three months, and had been 71,000 lower than in the same three months a year earlier. The unemployment rate had fallen to 5.0%, down 0.1 percentage points on the previous three months and 0.3 percentage points lower than a year earlier. In November, the claimant count unemployment rate had been unchanged. Outflows from the claimant count had risen by 1,100, while inflows had fallen by 700. Working-age inactivity had increased by 76,000 in the three months to October. The working-age inactivity rate had increased by 0.2 percentage points, both on the previous three months and on a year earlier, to 21.4%.

A41 Overall annual whole-economy earnings growth had been 3.6% in the three months to October, unchanged from September. Private sector pay growth had increased by 0.1 percentage points, to

3.2%, while public sector pay growth had fallen by 0.2 percentage points, to 5.4%. Actual whole-economy earnings growth in the year to October had been 3.7%, unchanged from the previous month. Annual whole-economy earnings growth excluding bonuses had been 3.7% in the three months to October, unchanged from September. The comparable private sector growth rate had increased by 0.1 percentage points, to 3.3%, while public sector growth had fallen by 0.2 percentage points, to 5.4%.

A42 According to the settlements information available to the Bank, the whole-economy twelve-month average earnings index (AEI)-weighted mean settlement had been 3.2% in November, unchanged on the previous month. The twelve-month sample-weighted mean settlement for the public sector had ticked down by 0.1 percentage points, to 3.4% in November.

## **VI Prices**

A43 Sterling oil prices had been broadly unchanged in December, compared with November.

A44 Manufacturing input prices had been unchanged in November. Because of base effects, the annual inflation rate had risen to 4.0% in November, from 1.9% in October. Looking ahead, the CIPS manufacturing survey had pointed to rising input prices in December. The input price index had risen to 56.7, from 55.1 in November.

A45 Manufacturing output prices excluding duties (PPIY) had risen by 0.4% in November. The annual inflation rate had risen to 1.5% in November, from 1.3% in October. Survey data had pointed to less downward pressure on output prices in the future. The expected output price balance from the CBI Monthly Trends survey had risen to –3 in December, its highest level in nearly three years.

A46 According to December's National Accounts release, the GDP deflator at market prices had risen by 0.4% in 2003 Q3, and by 3.2% in the year to Q3, compared with 3.4% in the year to Q2. Within that, in the year to Q3 the household consumption deflator had increased by 1.5%; the estimated government consumption deflator had been revised up and had increased by 8.3% (down from 8.8% in Q2); the exports deflator had risen by 1.9%; and the imports deflator had risen by 1.0%.

A47 Annual CPI inflation had fallen by 0.1 percentage points, to 1.3%, in November. Within that, both annual goods price inflation and annual services price inflation had been unchanged, at –0.3%

and 3.2% respectively. Annual RPIX inflation had fallen by 0.2 percentage points, to 2.5%, in November. Annual RPI and RPIY inflation had both fallen, to 2.5% and 2.1% respectively.

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

A48 The Bank's regional Agents reported that, in the month leading up to Christmas, the annual growth rate of retail sales at current prices had possibly been the lowest since the previous July. This had followed official data that had indicated a weak picture for retail sales in November. Recent developments had been difficult to interpret, in large part because of changing patterns of consumer spending. For example, it had appeared that changes in shopping patterns had gathered pace last year, with supermarkets and, to a lesser extent, internet retailers taking market share from many high street shops. Overall, it had appeared that retail sales had remained weak in early December, with many retailers reducing prices, especially for clothing, in order to encourage demand. Retail spending had only begun to pick up strongly a few days before Christmas. However, for many high street retailers, this late surge had been insufficient to make up for relatively weak sales earlier in the month. Even so, the volume of retail sales in December had perhaps increased slightly compared with November, stimulated by a greater than normal degree of price discounting for that time of the year.