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MINUTES OF
MONETARY POLICY COMMITTEE MEETING
9 and 10 June 2004

These are the minutes of the Monetary Policy Committee meeting held on 9 and 10 June 2004.

They are also available on the Internet (http://www.bankofengland.co.uk/mpc/mpc0406.pdf).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 7 and 8 July will be published on 21 July 2004.

MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 9-10 JUNE 2004

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

Oil prices

2 Oil prices had risen sharply during 2004, and the Committee discussed the possible implications for the global economy and for the United Kingdom. Since the beginning of 2004, the spot price of Brent crude oil had risen by some 17% in dollar terms. Oil futures prices had also risen. However, the spot price had fallen by around 6% in dollar terms, and 8% in sterling terms, since the Committee's May meeting, in part because of the decision by OPEC to raise official quotas.

3 Several factors had contributed to the rise in oil prices during 2004, and it was important to distinguish between those which might be transitory and those which were more likely to be associated with a rise in the price which could be sustained in the longer term. Among the shorter-term influences, first, demand had risen, reflecting the cyclical recovery in the global economy; second, there was at present only a limited amount of additional capacity which could be brought into production quickly in response to a rise in prices; third, stocks had been low in some oil-consuming countries, which had been looking to rebuild them; and, fourth, perceived geopolitical risks to the supply of oil had probably increased. There had also been an underlying increase in demand in countries where production was energy-intensive, notably China, which implied some pressure on available capacity. More generally, the equilibrium price would depend on the cost of opening up new non-OPEC sources of supply. Although it seemed likely that oil prices would fall back from their present level in the longer term, the more immediate prospects were uncertain, and there might be limits to the ability of OPEC to vary the supply of oil in response to price movements.

4 A rise in oil prices could influence the UK economy through various channels. First, there was an initial upward impact on the current rate of inflation. Second, there was likely to be an adverse effect on domestic demand and activity. That would tend to bear down on inflation further forward.

Third, there would also be effects on global inflation and activity, in turn affecting the cost of imports and the strength of external demand for UK goods. Finally, there could be second-round effects on UK earnings and prices.

5 The overall impact on the United Kingdom of the oil price rises seen so far this year was therefore uncertain, but was likely in aggregate to be modest. In real terms, the price of oil was less than half of its high levels in the late 1970s and early 1980s. The intensity with which oil was used in production had fallen in the United Kingdom over time, and the increase in labour market flexibility and better-anchored inflation expectations mitigated the risk of second-round effects. But there could be more pronounced effects on particular sectors of the economy, and on those countries where the oil intensity of production was higher.

Financial markets

6 Short-term interest rates had risen in the major economies since the Committee's May meeting, probably reflecting both stronger economic data and the perception that higher oil prices might lead to higher interest rates. UK interest rates six months forward had risen by some 50 basis points, compared with rises of around 40 basis points in the United States but only around 15 basis points in the euro area. The greater increase in the United Kingdom appeared to be a response both to stronger data and to the May *Inflation Report* and Minutes.

7 Longer-term nominal spot interest rates had risen modestly over the past month in the United Kingdom, the United States and the euro area. But this primarily reflected developments at the short end. Longer-term nominal forward rates had been relatively little changed in these markets over the past month, although taking the past three months together there had been a material rise in US forward rates.

8 There had been contrasting movements in the inflation expectations which could be inferred from financial markets. In the United Kingdom, implied CPI inflation expectations appeared to have risen materially only at the short end, perhaps reflecting the Committee's *Inflation Report* projections. But in the United States and the euro area, the apparent rise in implied inflation expectations had also taken place at longer maturities. In the United States, the rise had been associated with an increase in the

current rate of inflation. There had been little rise in real interest rates in the United States.

9 The sterling effective exchange rate index had risen by over 2% since the Committee's May meeting. This could in part be explained by the recent rise in short-term interest differentials in favour of sterling.

10 Equity price movements in the major economies had generally been modest in the past month in local currency terms.

The international economy

11 The balance of news from the world economy over the past month had been positive overall, particularly when taking account of the pattern of UK trade, and the global recovery now appeared to be more broadly based.

12 It was estimated that euro-area GDP had increased by 0.6% in 2004 Q1. This was stronger than the Committee had expected at the time of the May *Inflation Report* projections. There had been a strong positive contribution, of 0.4 percentage points, from net trade, which implied that the stimulus to external demand from the global recovery had outweighed the influence of the appreciation of the euro during 2003. Euro-area net trade performance had been volatile quarter-to-quarter during 2003, so it was too early to be confident that the recovery would be sustained at a more rapid rate than expected, but this was welcome evidence.

13 There was mixed news about the strength of euro-area domestic demand. Investment had fallen in 2004 Q1, but that may have reflected the unwinding of earlier temporary strength in German investment. Consumption had grown by 0.6% in Q1, with healthier growth in France but a relatively weak performance in Germany. A key issue was whether euro-area consumption would continue to grow at this stronger rate. It was, for example, possible that household spending in Germany might remain weak, if it was linked to uncertainty about the impact of structural reform. Early indicators for 2004 Q2 were encouraging: euro-area retail sales had risen by 1.3% on the month in April, with some growth in Germany. However, euro-area consumer confidence had eased in May. Surveys of euro-area output also pointed to continued healthy growth in Q2, broadly in line with the recovery

envisaged in the *Inflation Report*.

14 The flash estimate for euro-area HICP inflation in May showed a rise from 2.0% to 2.5%. That probably reflected rising petrol prices, by comparison with particularly low energy prices twelve months earlier, and the impact of higher administered prices. An important question was whether these temporary influences on inflation would prompt higher wage increases.

15 The US economy had strengthened. The estimate of GDP growth in Q1 had been revised up slightly, to 1.1%, and the strength of nominal demand was consistent with the pickup in broad money growth since the turn of the year. It was particularly significant that the non-farm payrolls data for April and May, which had both been published since the Committee's May meeting, showed strong increases in employment: there had been a rise of nearly one million in payrolls in the past three months. That might underpin household spending, although the latest indicators were mixed, with consumption growth easing slightly in April and consumer confidence flat or falling in May. The output indicators pointed to continuing strong growth in Q2. The output gap had probably narrowed: capacity utilisation was at its highest level since mid-2001, and inflationary pressures were increasing, both on the core and headline measures of consumer prices. This had contributed to a widespread market expectation that US interest rates would soon begin to rise.

16 The recovery in Japan had continued. GDP growth in 2004 Q1, at 1.5%, was more rapid than had been envisaged at the time of the *Inflation Report*, and represented the fastest growth among the G7 economies. Consumption growth in Q1 was strong in both real and nominal terms; the upward trend in nominal growth was welcome, since it opened the prospect of an end to deflation. Strong growth of industrial production and buoyant indicators of consumer spending in April suggested a continued healthy growth performance in Q2.

17 GDP growth in China continued to be rapid. There were some risks to this performance, both from rising inflation and possible problems in the banking sector. But medium-term prospects still looked strong.

Money, credit, demand and output

18 In the United Kingdom, output and demand growth appeared to have continued at around or above trend so far in 2004, but there remained some tension between the official data for output growth and the more buoyant evidence from surveys.

19 Aggregate broad money growth had eased a little in April, but lending growth continued to be very strong. The monetary data were consistent with steady growth in aggregate nominal demand.

20 The ONS estimated GDP growth in 2004 Q1 to have been 0.6%, unchanged from the previous release. The service sector was estimated to have continued to grow strongly in Q1. In contrast, manufacturing sector output had been estimated to have contracted by 0.5%, although that had been revised to a fall of 0.3% in the Index of Production release for April. However, the survey data had pointed to more buoyant manufacturing activity in Q1. And the ONS had reported a rise in manufacturing output of 0.9% in April, which suggested that the apparent weakness in Q1 could be temporary or erratic. Survey evidence pointed to gathering strength. The Chartered Institute of Purchasing and Supply (CIPS) had reported increased activity and new orders balances for manufacturing in May. A special survey by the Bank's regional Agents suggested that manufacturing output had increased in Q1 and would pick up further in Q2. Surveys by the EEF and the CBI reinforced this picture. The CIPS services activity and new orders balances had both eased slightly in May but still pointed to robust growth.

21 Consumption was estimated to have grown by 0.9% in Q1. Retail sales growth in the same period had suggested an even stronger performance. Aggregate investment growth had been weaker than expected: investment in the services and manufacturing sectors had been robust, but there had been a large negative contribution from the construction sector. Nominal government consumption was stronger than expected in Q1. Net trade was unusually weak, making a negative contribution of 0.4 percentage points. The weakness of exports, in particular, had been surprising, against the background of strengthening global recovery in Q1, since it was unlikely that the rise in sterling since the beginning of the year could have had an impact so quickly. However, goods exports were reported to have grown by 1.5% in April, so it was possible that the weakness of exports in Q1 might prove to be temporary. Changes to reporting methods meant that there were particular uncertainties relating to

the profile of export growth at present.

22 Evidence on the pace of household sector spending in 2004 Q2 was mixed. Retail sales had increased by only 0.3% in April, and private car registrations in both April and May had been lower than a year earlier. The annual growth rate of unsecured lending to individuals had eased again in April, although at 12% it remained very strong relative to nominal demand. It was possible that the easing was explained by the substitution by households of secured borrowing at lower interest rates. Other indicators suggested continuing robust growth in consumption. The CBI Distributive Trades survey and the British Retail Consortium survey had both pointed to stronger growth in May.

23 Indicators from the housing market suggested that house price inflation had picked up further, and so was likely to be even stronger in 2004 Q2 than the Committee had expected at the time of the *Inflation Report*. The average of the Nationwide and Halifax house price indices had increased by 6.1% in the three months to May, a rise of 0.1 percentage points from April. But there were a few tentative signs that activity might be easing. A preview of the Royal Institution of Chartered Surveyors (RICS) survey for May pointed to a sharp decline in the balance expecting house price increases in the next three months, and the ratio of sales to unsold stocks suggested that the market had loosened slightly in April and May. The number of housing loan approvals, although still high, had fallen a little from its peak at the end of 2003. The annual rate of secured lending growth had increased in April to 15.3%, but past rises in house prices meant that the rate of secured lending growth was likely to remain high for some time even if inflation soon began to ease. There were also some anecdotal reports that houses were becoming harder to sell. But these indicators of easing activity were very tentative, and it was clear that any slowdown in house price inflation would be later and from a higher rate than the Committee had previously envisaged.

The labour market, costs and prices

24 Evidence from both labour market quantities and prices suggested that conditions were tightening gradually, consistent with the May *Inflation Report* projections.

25 According to the Labour Force Survey (LFS), the employment rate had risen by 0.3 percentage points in Q1, to 60.1%, and average hours had also increased. On average, employment had increased by about 110,000 a quarter over the past two quarters, whereas an average rise of only around 40,000 a

quarter was needed to maintain the employment rate. The unemployment rate on the LFS measure had fallen to 4.7%, the lowest rate since the mid-1970s. Both survey evidence and contacts of the Bank's regional Agents had suggested that there were wide-ranging labour shortages and that employment was expected to increase further.

26 Overall earnings growth increased by 1.8 percentage points to 5.2% in 2004 Q1, reflecting an exceptional contribution from bonuses in January. Regular pay growth in the private sector had increased by 0.2 percentage points to 3.9%. Taking account of hours worked, the rate of increase of whole economy earnings was 4.5%. Private sector settlements were increasing slowly.

27 There might now be an upside risk to the Committee's projections for employment. If that materialised, the effect on inflation would depend on where the rate of unemployment consistent with stable inflation now stood, and on the strength of immigration. In a longer-term perspective, it remained surprising that pay had not increased more rapidly in response to the tightening in the labour market. That might partly reflect labour market flexibility, changes to patterns of remuneration and perhaps also the weakness of demand for labour elsewhere in Europe, which had helped to encourage immigration to the United Kingdom.

28 CPI inflation had risen by 0.1 percentage point to 1.2% in April. In line with pre-release arrangements, an advance estimate of CPI inflation in May was provided to the Governor 3½ days ahead of publication, and this suggested a rise of 0.3 percentage points to 1.5%. The latest news on oil prices was likely to add moderately to inflation in the near term, but the effect of this would be roughly offset by weaker-than-expected prices for a range of miscellaneous services, including financial services. It was likely that inflation would rise over the next month or so, but that it would remain below target.

29 ONS data suggested that, despite rises in the price of oil, steel, and some other materials, supply chain pressures were relatively subdued. But evidence from the Bank's Agents on manufacturers' input prices suggested a pickup, and the CIPS manufacturing survey showed a sharp rise in input prices in May, to the highest level since mid-1995. The Agents reported that so far there were few signs that higher pay and input costs were being reflected in higher output prices. However, the CIPS manufacturing and services surveys suggested that output prices were rising, although less rapidly than input prices. The Committee noted the possibility that since higher oil and commodity prices would

affect both domestic and foreign competitors, they might eventually be passed through to consumers rather than being absorbed in profit margins.

Other considerations

30 More than half the economists surveyed by Reuters expected a rise of 25 basis points in the repo rate at the June meeting; the survey showed an average probability of 51% attached to a 25 basis point increase, and a 4% chance of a 50 basis point increase. Since the survey was taken, other indicators of market sentiment had pointed to an increase in the perceived probability of a repo rate rise, and both anecdotal evidence and the pattern of very short-term interest rates suggested that this probability might be around 70-80%. Market participants generally believed that there would be a repo rate increase in July if there were not one in June. Following the information published by the Committee during May, market participants would now see a further repo rate rise before the August *Inflation Report* round as consistent with the Bank's reaction function.

The immediate policy decision

31 The balance of news on the month suggested stronger external demand and inflation, particularly in UK-weighted terms. Euro-area growth had strengthened, while the recoveries in the United States and Asia were well established. Oil prices had risen sharply so far in 2004, but the impact on the UK economy looked likely to be modest. Short-term interest rates had risen by more in the United Kingdom than elsewhere in May, which helped account for a rise of over 2% in sterling. ONS estimates of GDP growth had been less than expected in Q1 given the survey evidence, but indicators of output growth so far in Q2 had been robust. There was mixed evidence on the strength of household spending, and, while house price inflation was stronger than the Committee had envisaged in May, there were tentative indicators that housing market activity might be easing. Labour market conditions were tightening, in terms of both employment and earnings. The near-term outlook for CPI inflation was little changed; a pickup was expected but inflation was likely to remain below the target in the next few months.

32 Against this background, the Committee agreed that there were several arguments for a rise of 25 basis points in the repo rate this month. First, for most members, the May *Inflation Report* projections could have warranted a rise of 50 basis points at that time. That would have helped to reduce the risk

that inflationary pressures would gather momentum. An important argument against such a step in May had been the risk at that time that it might have been mistaken for a change in the Bank's strategy, especially since CPI inflation remained well below target. Since then, the Committee had had the opportunity to explain the change in the economic outlook in the May *Inflation Report* and the Minutes of its May meeting so that a further repo rate increase would now be understood as a response to this more robust outlook. For one member, however, the May *Inflation Report* projections would not have warranted a rise of 50 basis points at that time. Those projections did not suggest a need to raise rates more rapidly than the market had expected, given that inflation was not expected to exceed the target until close to the two-year horizon, when growth had returned to trend. Nevertheless, in the view of that member, a repo rate rise in June was consistent with the path of rates which conditioned the market rate projection published in May. Second, the balance of risks had moved towards the upside, given the tightening in the labour market and the more broadly based world recovery. Inflation expectations derived from financial markets also appeared to have risen a little. It was important that monetary policy responded so as to ensure that inflation expectations remained in line with the target. Third, for some members, the need for a repo rate increase was reinforced by the prospect of higher domestic debt service levels and personal income gearing. Household debt continued to rise rapidly and to outstrip earnings growth. A further increase in interest rates now might encourage a more prudent approach towards incurring higher levels of prospective debt servicing, so helping to contain the vulnerability of demand to subsequent shocks.

33 The Committee considered possible arguments for keeping rates unchanged. First, the Q1 UK National Accounts and 2004 Blue Book data would be published at the end of June. Second, there were some possible downside risks to the outlook. The three earlier repo rate increases had not yet taken their full effect. The past rise in oil prices might dampen sentiment both at home and abroad, and there were also geopolitical risks to confidence. Consumer confidence, the housing market and the manufacturing sector could all turn out to be more fragile than the Committee currently believed.

34 Taking these arguments together, the Committee favoured an immediate repo rate increase of 25 basis points. For one member, the decision was finely balanced.

35 The Governor invited members to vote on the proposition that the repo rate should be increased by 25 basis points to 4.50%. The Committee voted unanimously in favour of the proposition.

36 The following members of the Committee were present:

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

Jon Cunliffe was present as the Treasury representative.

ANNEX: SUMMARY OF DATA PRESENTED BY BANK STAFF

A1 This Annex summarises the analysis presented by Bank staff to the Monetary Policy Committee on 4 June 2004, in advance of its meeting on 9-10 June. At the start of the Committee meeting itself, members were made aware of the information that had subsequently become available, and that information is included in this Annex.

I Financial markets

A2 Between the previous Committee meeting and 9 June, short-term interest rates had risen in the major industrial economies, but by more in the United Kingdom than in the United States or the euro area. Internationally, the most significant rise in short-term interest rates had occurred following the stronger-than-expected US non-farm payrolls data for April released on 7 May. In the United Kingdom, however, the release of the May *Inflation Report* and the subsequent publication of the minutes of the Committee's May meeting also had a significant effect on short-term interest rates. These developments had led market participants to price in one further 25 basis point repo rate rise by the year end, compared with expectations at the time of the previous Committee meeting. Market expectations for a 25 basis point rise in UK interest rates had increased over the course of the week before the Committee's June meeting.

A3 UK and US long-maturity nominal forward rates had fallen, while those in the euro area had risen slightly. In the United Kingdom, real forward rates had also changed little, except for a slight increase at shorter maturities. These moves in nominal and real forward rates had implied that forward measures of UK inflation had fallen at longer maturities and risen at shorter maturities. By contrast, forward measures of US and euro-area inflation had risen at both short and medium maturities, which could reflect higher inflation expectations and/or an increase in inflation risk premia.

A4 The sterling effective exchange rate index (ERI) had risen by 2.4% to 106.1, some of which could be accounted for by movements in relative interest rates. Sterling had appreciated by 2.2% against the US dollar and by 2.5% against the euro. Surveys by Consensus Economics had suggested that some of the recent appreciation of the sterling ERI was expected to unwind, but also that the depreciation would perhaps be more gradual than previously anticipated. Despite the recent sterling appreciation, uncertainty, as measured by implied volatility from option prices, had changed little. Over the month, the dollar ERI had fallen by 0.3%, which market contacts had suggested was because of geopolitical concerns and high oil prices. The US dollar had appreciated by 0.3% against the euro and by 0.3% against the yen, but had depreciated by 2.2% against sterling, by 1.0% against the Canadian dollar, and by 1.5% against the Swiss franc. The yen weakness may have reflected Japan's relatively high dependence on oil imports.

A5 The FTSE All-Share index and the Dow Jones EuroStoxx had fallen by 1.7% and 1.1% respectively, whereas the S&P 500 had risen by 0.9%. The downside risk to UK equities, as measured by the skews implied from options on three-month futures, had changed little, while that to US equities had increased slightly. Investment-grade corporate credit spreads had widened slightly in the United Kingdom, the United States and the euro area. At the beginning of the month, high-yield corporate credit spreads had widened sharply in the United Kingdom, the United States and the euro area, but had fallen back somewhat towards the end of the period. The same pattern had been evident in emerging market corporate credit spreads.

II The international environment

A6 According to the preliminary estimate, US GDP had risen by 1.1% on the quarter in 2004 Q1, revised up from the advance estimate of 1.0%. Within this total, the estimates for consumption and private fixed investment growth had both been unchanged, at 0.9% and 1.3% respectively, while the growth of government spending had been revised up by 0.2 percentage points from the advance release, to a preliminary estimate of 0.7%. The net trade contribution to GDP growth in 2004 Q1 had been revised down to –0.1 percentage points, from zero in the advance estimate. Stocks had contributed 0.2 percentage points to quarterly GDP growth, revised up from the advance estimate of 0.1 percentage points. Non-farm business sector labour productivity had risen by 0.9% in 2004 Q1, following a rise of 0.6% in 2003 Q4. Unit labour costs had risen by 0.3% in 2004 Q1, following growth of 0.4% in 2003 Q4.

A7 US industrial production had risen by 0.8% in April compared with the previous month, following a fall of 0.1% in March. New orders for non-defence capital goods had fallen by 3.0% in April compared with the previous month. The Institute for Supply Management (ISM) manufacturing index had risen to 62.8 in May, from 62.4 in April. The ISM non-manufacturing index had fallen to 65.2 in May, from 68.4 in April.

A8 US non-farm payrolls had increased by 248,000 on the month in May, following a rise of 346,000 in April. Real consumption in the United States had increased by 0.2% on the month in April, following a rise of 0.3% in March. Real personal disposable income had increased by 0.4%, after rising by 0.2% in March. The saving rate had risen to 2.4% in April, from 2.2% in March.

A9 Nominal retail sales had fallen by 0.5% on the month in April, following growth of 2.0% in March. The Conference Board measure of consumer confidence had risen to 93.2 in May, from 93.0 in April; but the University of Michigan headline index of consumer confidence had fallen to 90.2, from 94.2, reflecting falls in both the current conditions index and in the expectations index.

A10 Annual headline consumer price inflation in the United States had been 2.3% in April, compared with 1.7% in March. Annual core consumer price inflation (which excludes food and energy prices) had been 1.8% in April, compared with 1.6% in March.

A11 According to the first release, euro-area GDP had increased by 0.6% on the quarter in 2004 Q1, following an increase of 0.4% on the quarter in 2003 Q4. Within this total, private consumption had increased by 0.6%, investment had fallen by 0.1% and government consumption had fallen by 0.2%. Net trade had contributed 0.4 percentage points to growth in 2004 Q1, while inventories had detracted 0.1 percentage points.

A12 German GDP had increased by 0.4% on the quarter in 2004 Q1, following growth of 0.3% in 2003 Q4. Private consumption had been unchanged on the previous quarter in 2004 Q1, following a fall of 0.2% in 2003 Q4; investment had fallen by 1.8%, after rising by 1.6%; and government consumption had fallen by 1.2%, after falling by 0.2%. Net trade had contributed 0.8 percentage points to GDP growth in 2004 Q1, while inventories had added 0.2 percentage points. French GDP had increased by 0.8% in 2004 Q1, following an increase of 0.6% in 2003 Q4. Private consumption had increased by 1.1%; total investment had increased by 1.2%; and government consumption had risen by 0.4%. Net trade had subtracted 0.1 percentage points from quarterly GDP growth, while inventories had made a zero contribution. Italian GDP had risen 0.4%; Spanish GDP had risen 0.6%; and Dutch GDP had risen 0.4% on the quarter in 2004 Q1.

A13 The purchasing managers' index for the euro-area manufacturing sector had risen to 54.7 in May, from 54.0 in April, and the index for the service sector had risen to 55.8 in May, from 54.5 in April.

According to the European Commission survey, the euro-area business confidence indicator had fallen to –5 in May, from –4 in April. The euro-area consumer confidence indicator had fallen to –16 in May, from –14 in April. German industrial production had risen by 2.3% in April, after falling by 0.3% in March. The German IFO index had fallen to 96.1 in May, from 96.3 in April.

A14 Annual inflation in the euro area, as measured by the harmonised index of consumer prices (HICP), had risen to 2.0% in April, from 1.7% in March. Annual core inflation (excluding energy, food, alcohol and tobacco prices) had been unchanged at 1.8% in April. According to the Eurostat flash estimate, euro-area annual HICP inflation had risen to 2.5% in May.

A15 According to the revised estimate, Japanese real GDP had risen by 1.5% in 2004 Q1, compared with a 1.8% increase in the previous quarter. Within the total, private consumption had increased by 1.0%, business investment had increased by 1.7% and government consumption had risen by 0.4%. Net trade had contributed 0.2 percentage points to quarterly growth and inventories had contributed 0.5 percentage points. Japanese nominal GDP had risen by 1.0% in 2004 Q1, compared with a 0.7% increase in the previous quarter.

A16 Industrial production in Japan had risen by 3.3% on a month earlier in April, following a rise of 0.6% in March. The workers' household survey had reported a 7.2% rise in real spending in the year to April, compared with a fall of 0.5% in the year to March. Annual growth in export volumes had been 13.2% in April, down from 14.2% in March. Annual growth in import volumes had slowed to 10.2% in April, from 17.6% in March.

A17 Since the Committee's previous meeting, the spot price of Brent crude oil had fallen by $2.18 per barrel to $35.03, and *The Economist* US dollar non-oil commodity price index had fallen by 2.0% over the same period.

III Money and credit

A18 The twelve-month growth rate of notes and coin, adjusted for special factors, had been 6.6% in May, down slightly from April. However, the annualised three-month growth rate had risen to 8.6% in May. Annual growth of aggregate M4 deposits had fallen to 7.1% in April, from 7.7% in March. Annual growth of M4 lending (excluding the effects of securitisations) had been unchanged in April at

12.3%. Excluding other financial corporations, annual M4 deposit growth had risen slightly in April, to 8.4%, while annual M4 lending growth (excluding the effects of securitisations) had been unchanged at 12.2%.

A19 The annual growth rate of households' holdings of M4 had been unchanged at 8.2% in April, while the annual growth rate of M4 lending to households (excluding the effects of securitisations) had risen to 14.2% in April, from 14.1% in March. Within total net lending to individuals – a measure that includes lending by a broader set of institutions than the banks and building societies that account for M4 lending – the annual growth of secured lending had risen to 15.3% in April, from 15.2% in March. The annual growth of unsecured lending to individuals had fallen to 12.0% in April, from 12.2% in March. Within unsecured lending, the annual growth of credit card lending had fallen to 16.5% in April, from 17.2% in March. Annual growth of other unsecured lending, including bank loans and overdrafts, had fallen slightly to 10.0% in April, from 10.1% in March.

A20 The average standard variable rate on mortgages quoted for existing customers had increased slightly, to 5.83% in May from 5.81% in April. The average two-year discounted rate quoted to new business had increased to 4.46% in May, from 4.23% in April. According to the latest survey data from the Council of Mortgage Lenders, the share of fixed-rate take-up by new borrowers had risen to 30% in April, from 25% in March. The Bank's own survey of the general public, the *Public Attitudes to Inflation* survey, had indicated that expectations of interest rate rises over the next year had increased slightly in May, compared with February's survey.

A21 Interest rates on unsecured borrowing quoted by banks and building societies had changed little in May, as had deposit rates.

A22 Approvals of loans for house purchase had fallen to 124,000 in April, from 127,000 in March. Unsold stocks of properties measured by the Royal Institution of Chartered Surveyors had risen to 58 per surveyor in April, from 57 in March. The number of sales per surveyor had remained unchanged at 32 in April.

A23 The annual growth of private non-financial corporations' (PNFCs') holdings of M4 deposits had risen to 9.4% in April, from 8.6% in March. The annual growth of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 6.4% in April, from 6.7% in March. Total external finance, a broader measure of PNFCs' funding, had been £2.1 billion in April, compared with an average of £3.7 billion in Q1.

A24 PNFCs' income gearing had fallen to 17.4% in 2003 Q4, from 18.1% in Q3. PNFCs' capital gearing at replacement cost had been broadly unchanged, at 37.0% in 2003 Q4, while capital gearing at market value had fallen to 29.9% in Q4, from 33.2% in Q3.

IV Demand and output

A25 Quarterly growth of GDP at constant market prices had been unrevised in the 2004 Q1 Output, Income and Expenditure release, at 0.6%.

A26 On the output side of the accounts, estimated quarterly service sector output growth had been revised up, by 0.1 percentage points to 0.9% in 2004 Q1. Within the service sector, output of the business services and finance sector had risen by 1.3%, output of the distribution, hotels and catering sector had risen by 1.5%, but output of the transport, storage and communications sector had fallen by 0.5%.

A27 Estimated quarterly production sector output growth had been revised down, by 0.1 percentage points to –0.6% in 2004 Q1. Within that, manufacturing output had been estimated to have fallen by 0.5% on the quarter. Construction output had been estimated to have risen by 0.8% in Q1, following a rise of 1.4% in 2003 Q4.

A28 On the expenditure side of the accounts, real household consumption (including that of non-profit institutions serving households) had grown by 0.9% in 2004 Q1. Real government consumption had risen by 0.7% and whole-economy investment by 1.1%. Within whole-economy investment, business investment had risen by 0.3% on the quarter in Q1, reflecting increases in both private services and private manufacturing investment.

A29 Final domestic demand had risen by 0.9% in 2004 Q1. The change in inventories (including the statistical alignment adjustment) had contributed 0.1 percentage points to GDP growth in Q1, such that domestic demand had risen by 1.0% on the quarter.

A30 Total exports had fallen by 2.1%, while total imports had fallen by 0.4% in 2004 Q1. So overall net trade had detracted 0.4 percentage points from quarterly GDP growth in Q1. Adjusting for the effects of missing trader intra-community (MTIC) VAT fraud, export and import growth had been estimated at –1.9% and –0.2% respectively.

A31 Turning to indicators of expenditure in 2004 Q2, retail sales had risen by 0.3% on the month in April. The Confederation of British Industry (CBI) *Distributive Trades Survey* retailers' sales balance had pointed to an increase in annual retail sales volumes growth in May: the balance had risen to +51, from +30 in March. The headline GfK consumer confidence measure had been unchanged at –2 in May.

A32 The Nationwide and Halifax house price indices had risen, by 1.9% and 2.2% respectively, in May. The annual growth rates had risen to 19.5% and 21.8% respectively.

A33 Turning to indicators of output in 2004 Q2, the April Index of Production release had indicated that manufacturing output had risen by 0.9% in April, having fallen by 0.2% in March. The Chartered Institute of Purchasing and Supply (CIPS) services business activity index had fallen slightly, to 57.4 in May. The index of incoming new business had also fallen slightly, to 58.2. The CIPS manufacturing output index had fallen, to 57.1 in May. But the new orders index had risen, to 56.5 in May. The May CBI *Monthly Trends Enquiry* total orders balance had picked up sharply, to +1 in May from –14 in April. The expected output balance had risen by 10 points, to +22 in May.

A34 The Bank's regional Agents had conducted a survey into the prospects for output and employment in the manufacturing sector. Of the 166 respondents, over three quarters had suggested that quarterly manufacturing output had been unchanged or rising in 2004 Q1, with the strongest growth reported in the semi-finished/component goods subsector. Looking ahead to 2004 Q2, respondents had suggested that the outlook for output was a little stronger: over four fifths had expected non-negative quarterly manufacturing growth. However, the majority of manufacturers had also reported that they intended to reduce their employee numbers over the next six months.

V The labour market

A35 According to the Labour Force Survey (LFS), employment had increased by 195,000 in 2004 Q1 compared with 2003 Q4. The 16+ employment rate had increased by 0.3 percentage points, both on the quarter and on the year, to 60.1%. Total hours worked had increased by 1.0% on the quarter, and by 0.5% on a year earlier. Average hours worked had increased by 0.3% on the quarter, but had fallen by 0.5% on a year earlier.

A36 The overall CIPS employment survey for May had continued to suggest employment growth. All three sector indices (construction, manufacturing, and services) had remained above the 'no change' level of 50. According to the May 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.

A37 LFS unemployment had fallen by 48,000 in 2004 Q1, and had been 91,000 lower than a year earlier. The LFS unemployment rate had fallen to 4.7%, 0.2 percentage points lower on the quarter and 0.3 percentage points lower compared with the same three months a year earlier. The claimant count unemployment rate had been unchanged in April at 2.9%. The level of 16+ inactivity had fallen by 76,000 in 2004 Q1. The 16+ inactivity rate had fallen by 0.2 percentage points on the quarter, and by 0.1 percentage points on the year, to 36.9%.

A38 Overall annual whole-economy earnings growth had been 5.2% in 2004 Q1, 0.3 percentage points higher than in the three months to February. Private sector pay growth had increased by 0.5 percentage points to 5.5%, within which that of private sector services had increased by 0.8 percentage points, to 6.2%. Public sector pay growth had been 4.3% in 2004 Q1, and had been unchanged on the same figure for the three months to February. Whole-economy earnings in the year to March had increased by 4.3%, an increase of 0.4 percentage points on the figure for the year to February. Annual earnings growth excluding bonuses had been 3.9% in 2004 Q1, up 0.1 percentage points on the three months to February. The comparable public sector growth rate had increased by 0.1 percentage points, to 4.3%, while the comparable private sector growth rate had increased by 0.2 percentage points, to 3.9%.

A39 According to settlements information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI)-weighted settlement had been 3.3% in the year to April, unchanged on the equivalent figure for March. The twelve-month mean settlement in the private sector (AEI-weighted) had been 3.4%, up 0.1 percentage points on the year to March, while that in the public sector (sample-weighted) had fallen to 3.1%, down 0.3 percentage points.

VI Prices

A40 Since the Committee's previous meeting, sterling oil prices had fallen by around 8%.

A41 Manufacturing input prices had risen by 0.8% in April. This meant that the annual inflation rate had risen to 3.2%, from 0.9% in March. The CIPS manufacturing survey had pointed to further rises in input prices in May: the input price balance had risen to 66.8 in May, from 63.0 in April.

A42 Manufacturing output prices excluding duties (PPIY) had risen by 0.1% in April. Partly because of base effects, the annual inflation rate had risen to 1.4%, from 0.9% in March. Looking ahead, survey data had pointed to further small rises in output prices: the balance on expected output prices from the CBI *Monthly Trends Enquiry* had risen to +3 in May, from +2 in April.

A43 According to the ONS's experimental corporate services price index (CSPI), corporate services prices had risen by 0.3% in Q1. This meant that the annual inflation rate had fallen to 2.4% in 2004 Q1, from 2.8% in 2003 Q4. The CIPS services survey had pointed to rising output prices in May: the average prices charged index rose to 54.6, from 53.5 in April.

A44 According to the ONS's Output, Income and Expenditure release, the annual inflation rate of the GDP deflator at market prices had fallen to 2.0% in 2004 Q1, from 2.8% in 2003 Q4. Within this, the annual rate of inflation of the household consumption deflator had fallen by 0.2 percentage points, to 1.5% in 2004 Q1. The annual inflation rate of the government consumption deflator had fallen to 5.0% in 2004 Q1, from 7.7% in 2003 Q4. The annual inflation rates of the imports and exports deflators in 2004 Q1 had been –0.8% and –1.9% respectively.

A45 Annual CPI inflation had risen to 1.2% in April, from 1.1% in March. Within this, annual goods price inflation had risen by 0.1 percentage points, to –0.5%, while annual services price inflation had fallen by 0.1 percentage points, to 3.0% in April. Both annual RPI and annual RPIX inflation had fallen in April, to 2.5% and 2.0% respectively.

VII Reports by the Bank's Agents

A46 The Bank's regional Agents reported that the labour market had continued to tighten gently. The contraction of manufacturing employment had slowed, while the demand for labour had remained strong in the service sector. Wage growth had been rising as a result, although the acceleration in pay had been fairly modest to date. Many contacts had linked pay rises to performance, and bonus payments had increased by more than basic pay. Some contacts had reported that the scheduled 7.8% increase in the National Minimum Wage this October might have some knock-on effect on wages, as employees sought to restore differentials against lower paid staff.

A47 Manufacturers had seen sizeable price increases for some inputs of raw materials and semi-finished goods, especially for steel and oil-related products, and delivery times had lengthened for the former. Prices of utilities had also risen strongly for some contacts. However, some input prices had continued to fall, most notably for electronic goods. And official data had suggested that inputs of raw materials and semi-finished goods accounted for only about one quarter of manufacturers' total costs. So although many contacts had reported increasing input costs, for the manufacturing sector as a whole the increases had not been substantial. Furthermore, there had been few signs that these cost increases had resulted in higher prices either of manufacturers' outputs or of retail goods, partly because of still intense downward pressure on prices in some sectors, including the automotive industry and supermarkets.