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# MINUTES OF MONETARY POLICY COMMITTEE MEETING

## 5 and 6 May 2004

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These are the minutes of the Monetary Policy Committee meeting held on 5 and 6 May 2004.

They are also available on the Internet  
(<http://www.bankofengland.co.uk/mpc/mpc0405.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 9 and 10 June will be published on 23 June 2004.



## **MINUTES OF THE MONETARY POLICY COMMITTEE MEETING HELD ON 5-6 MAY 2004**

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

### **Financial markets**

2 Short-term and long-term interest rates had moved up in the United States in the latest month. The rise in short rates reflected market perceptions that monetary policy would begin to tighten sooner than previously expected, following some stronger recent economic data, comments by monetary officials, and the statement issued following the May meeting of the Federal Open Markets Committee (FOMC). The smaller rise in longer-term forward rates reflected an increase in forward real rates. Interest rate movements in the euro area and the United Kingdom had been small. The current pattern of short-term rates suggested that the chance that the next change in the ECB's repo rate would be a reduction was believed to be less than in April. A 25 basis point rise in the UK repo rate at the Committee's May meeting was fully anticipated in financial markets; respondents to the latest Reuters survey of economists had almost unanimously expected a rise.

3 The US dollar effective exchange rate had appreciated by about 2½% since the Committee's April meeting. Changes in interest differentials, to which the stronger US economic data had contributed, substantially accounted for the upward movement. Against that background, the effective exchange rate for sterling had fallen by over 2%. Changes in interest differentials could broadly account for the depreciation of sterling against the dollar, but only for a small part of its smaller depreciation against the euro, which had a much larger weight in the sterling effective exchange rate index. Overall, sterling still stood around 1% above the 15-day average incorporated into the February *Inflation Report* projections.

4 There had been only modest movements in most major equity markets. The FTSE All-Share index had risen by over 1%. Within the FTSE All-Share, larger companies, which typically have greater international exposure, had on average outperformed others since the Committee's April meeting.

## **The international economy**

5 The latest evidence suggested that the recovery in the world economy had continued broadly as envisaged. World output and trade had grown strongly in 2003, and the continuing recovery might be contributing to signs of emerging inflationary pressures. World demand weighted to reflect the pattern of UK exports was, as expected, growing somewhat more slowly than aggregate world demand.

6 In the United States, estimated Q1 GDP growth of 1.0% suggested that the recovery remained on track. An improvement in the labour market was apparently beginning to support consumer confidence, which, together with the tax rebates being implemented this year, should help to underpin consumption. Business surveys for April pointed to continuing robust growth. There had been some significant news about prices. The consumer price index had increased by 0.5% in March to stand 1.7% above its level a year earlier. While part of the rise was attributable to higher energy prices, measures of core inflation excluding food and energy were also rising. Employment costs had increased by 1.1% in Q1, the highest quarterly rise for a year. However, the annual rate of consumer price inflation was still modest and there was probably still some spare capacity in the US economy, with productivity growing strongly and labour participation likely to rise as employment increased. The statement issued by the FOMC after its recent meeting had suggested that the risks to price stability had moved into balance.

7 The picture in the euro area was little changed over the past month. The Q4 GDP second release estimated growth to have been 0.3%, which was a little less than would be consistent with the Committee's February projections, but the latest data for France suggested that the euro-area aggregate might be revised up slightly.

8 The key issue for the Committee was to assess whether the euro-area recovery would continue. The latest data, although mixed, suggested that the downside risks had diminished. Looking first at demand, export growth had been modest in 2003 Q4, and looked likely to be so in 2004 Q1, with the effect of the global recovery offset by the appreciation of the euro during 2003. The more recent euro depreciation and the continuing pickup in global activity should provide a modest stimulus to net trade in 2004 and 2005. Investment growth was positive in Q4, but, within the aggregate, the strong contribution from Germany partly reflected a temporary boost from the imminent cut in subsidies to residential construction investment. The increase of 1% in retail sales in 2004 Q1 suggested a pickup in consumption, which had previously shown little growth since 2003 Q1, and recent and prospective

tax cuts in several countries might be supportive. Turning to output, indicators of euro-area business activity so far in 2004 had been mixed. The purchasing managers indices for manufacturing and services, taken together, were consistent with a pickup in quarterly growth in Q1. But annual euro-area industrial production growth had fallen slightly in February. German manufacturing foreign orders had also fallen in February, for a second consecutive month, possibly reflecting the influence of the stronger euro. Euro-area business indicators available so far for Q2 on balance suggested continuing positive output growth.

9 The flash estimate of euro-area HICP inflation in April showed an increase to 2%. It was too early to assess the sources of the rise, but it was one of several factors which could have reduced market perceptions of the likelihood of a reduction in euro-area interest rates.

10 The Asian economies in aggregate continued to grow strongly. Chinese GDP had increased by 9.7% in the year to 2004 Q1, but the exceptionally high ratio of investment to GDP suggested that the pace of growth might not be sustainable. Early measures of activity in Japan indicated that growth had eased in Q1, but it had probably been erratically strong in Q4.

11 The price of crude oil had risen further during the month. In dollar terms it was now at its highest levels since 1990, and in the latest month it had risen when measured in terms of other currencies too: the sterling price had risen by some 16% since the Committee's April meeting. Several factors seemed to underlie this rise: the general global upturn in activity; the low level of private inventories in the United States; particularly buoyant demand from China; market speculation that OPEC would raise its target price range; and political events in the Middle East. These factors suggested that the balance of demand for and supply of oil might be shifting, so that the rise in oil prices might persist. Oil futures prices for a year ahead were 15% higher in dollar terms than at the time of the February *Inflation Report*. Other commodity prices had on average risen modestly in sterling terms since the Committee's April meeting. The implications for monetary policy of higher oil and commodity prices depended on whether inflation expectations overall remained well anchored.

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

12 The ONS provisional estimate of GDP growth in Q1, at 0.6%, had been materially weaker than envisaged in the Committee's February projections. Other evidence, such as business surveys and reports from the Bank's regional Agents, was consistent with a higher figure, and the Committee put

some weight on this latter evidence. The available information suggested that underlying demand had remained strong, and a stronger figure for output growth would also be more consistent with the rise in employment.

13 The latest evidence suggested that consumption continued to grow robustly. Retail sales had risen by 0.6% in March, so that growth in the first quarter had been the highest since 2002 Q1, and the CBI Distributive Trades survey for April had also pointed to strength. Among the monetary indicators, household deposits and notes and coin (adjusted for various technical factors) maintained firm growth. The annual growth of total lending to individuals had remained above 14½% in March. The annual growth of unsecured lending had been unchanged overall at just over 12%, but within that credit card lending had increased sharply. It was striking that average lending rates on credit cards, personal loans and overdrafts had all fallen since October, before the first repo rate rise. This suggested strong competitive pressures in these markets, a conclusion which was reinforced by Bank contacts with several major lenders. Mortgage equity withdrawal had been very strong in 2003 Q4, and this looked likely to continue in Q1.

14 Alongside the growth in consumption, the latest indicators from the housing market also suggested strength in both prices and activity. The average of the Nationwide and Halifax indices of house prices had increased by 6% in the three months to April over the previous three months. This rate of house price inflation was significantly higher than had been envisaged at the time of the February *Inflation Report*. Estimated growth rates of secured lending to individuals going back for more than a year had been revised up, and the twelve-month growth rate had increased in March to 15.2%. Housing transactions were at a high level, while loan approvals, and the ratio of housing sales to stocks in the March survey by the Royal Institution of Chartered Surveyors, pointed to continuing buoyant activity.

15 The prospects for house prices were an important component of the Committee's assessment of the momentum behind household consumption. There were three key uncertainties: the extent to which house prices were above a sustainable level relative to earnings; the adjustment path of the house-price-to-earnings ratio back to a sustainable level; and the impact of house prices on consumption.

16 The Committee's central projection reflected a judgment that the sustainable ratio of house prices to earnings was higher than its previous long-run average, but was still probably below the

current ratio, so that house prices were likely to rise less rapidly than earnings at some stage. But there was considerable uncertainty about this judgment and its implications. The Committee noted, first, that there had been few past instances, either in the United Kingdom or abroad, when house prices had fallen without there having been a prior shock to economic or monetary conditions. The Committee's central projections, on the rising profile for interest rates implied by market expectations, showed steady growth and modest inflation, an outlook which in itself seemed unlikely to bring about a sharp correction in house prices. Second, investment demand for housing, including through the buy-to-let market, had increased rapidly in recent years. That had provided support for the market. It was now possible that either a fall in rental income relative to mortgage servicing costs, or a change in expectations about future house prices, could reduce this investment demand. Third, Bank contacts with the major lenders, although pointing to mixed views about whether the supply of mortgage lending would continue to grow as rapidly as in the recent past, suggested that most borrowers could service their loans at a significantly higher repo rate, provided that unemployment did not rise materially.

17 The Committee noted that the growth in consumption in 2003 had been underpinned by strong growth in personal disposable income, and that the relationship between house prices and consumption did not appear to have been as close recently as during the rise and fall in house prices in the late 1980s and early 1990s. Its central projection incorporated a judgment that this weaker relationship would continue to prevail, both in the near term, as house prices continued to rise rapidly, and later in the forecast period, as housing inflation slowed sharply. Nevertheless the central projection incorporated a slowdown in consumption growth. But there were clearly risks to this view in addition to those concerning the relationship between house prices and consumption. On the one hand, consumption and its determinants had grown more rapidly than the Committee had expected for several years. On the other hand, the increases in house prices that had already occurred entailed a continuing rise in mortgage borrowing. That in turn meant that household income gearing was likely to rise over the next few years towards levels last seen in the early 1990s. That could increase the vulnerability of the household sector, and hence of consumption growth, to changes in interest rates and to any unforeseen slowdown in income growth.

18 Business indicators were consistent with a buoyant outlook for the corporate sector. The latest surveys from the CBI and the British Chambers of Commerce suggested that manufacturing continued to recover; the April surveys for manufacturing and services by the Chartered Institute of Purchasing and Supply (CIPS) indicated high rates of activity growth; and new orders balances pointed to

prospective further growth in services and manufacturing output.

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

19 Labour market conditions had continued to tighten slowly. Employment had risen by 0.3 percentage points in the three months to February, and unemployment had continued to fall. The CIPS survey of manufacturers had suggested that they were looking to increase employment. There was some anecdotal evidence of increasing skill shortages. Earnings had increased by 1.3% in the three months to February, and although this mainly reflected a particularly strong contribution from bonuses, which was likely to be temporary, regular private sector earnings growth and settlements were edging up. Given the current tightness in the labour market, in order for output to continue to grow at faster than its historical trend rate without creating inflationary pressure, there would need to be a rise in underlying productivity growth, or an increase in labour force participation or inward migration.

20 CPI inflation had fallen to 1.1% in March, and both goods and services price inflation had weakened. It was likely that inflation would rise in the next few months, as utilities prices rose and because of a rising contribution from petrol prices, in turn reflecting both the recent rise in oil prices and, separately, the fact that the corresponding months a year earlier had seen particularly low prices. Recent business surveys and a special survey by the Bank's regional Agents pointed to a pickup in the inflation rate for domestic manufactures, and suggested that increasing cost pressures would be passed on to consumers. However, recent CPI data had been surprisingly weak, which might suggest that the competitive pressures on margins were stronger than the Committee had realised. Moreover, the prices of imported finished manufactures were falling quite rapidly.

### **The May GDP growth and inflation projections**

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

22 The Committee's central projection, based on the assumption of the existing official rate of 4.0%, was for GDP to grow at above its trend rate during 2004. Then, as private consumption and public spending growth slowed, GDP growth was expected to ease back. GDP growth was expected to be slightly faster in the near term than in the February projections, largely because of a higher profile

for consumption. But GDP growth was projected to be lower further out, reflecting weaker growth of consumption and a judgment that the path of the ONS measure of real government output would be lower than in the February projections. Utility and petrol prices were expected to exert upward pressure on CPI inflation over the next few months. But with output projected to exceed its trend level throughout most of the forecast period, underlying inflation was also likely to start rising, so that CPI inflation would somewhat exceed the 2% target rate by the two-year horizon.

23 The Committee also examined projections for GDP growth and CPI inflation conditioned on an estimate of market expectations for official interest rates. These estimates implied a slightly higher level of interest rates by the end of the projection than in the equivalent projections in February. The profile for GDP growth was marginally lower than in the constant rate projections. The profile for CPI inflation was also lower, but still a little above the 2% target rate at the two-year horizon.

24 The Committee noted various risks surrounding these projections. The main risks related to the outlook for the world economy, the prospects for exchange rates, the prospects for earnings, the degree of demand pressure on potential supply and, in particular, the prospects for house prices and consumption.

25 Overall, the Committee's best collective judgment was that the risks to the central projections for both GDP growth and CPI inflation were broadly balanced. Committee members held slightly different views on the most likely path for inflation and on the balance of risks around them.

### **The immediate policy decision**

26 The balance of news on the month was consistent with a stronger overall picture for output and prospective inflation. Sterling had fallen by over 2%. Indicators from the world economy suggested that the recovery in activity was continuing broadly as previously expected, but consumer price inflation had risen in the United States and the euro area, and oil prices were materially higher. In the United Kingdom, the ONS provisional estimate of Q1 GDP growth had been surprisingly weak, but other evidence was consistent with a higher figure; indicators of consumption suggested continuing strength, and household borrowing growth had increased further; house price inflation had increased and indicators of housing activity were also robust. Business confidence was buoyant, investment intentions remained bright and, over a longer perspective, government spending growth was adding to the pressure of demand on resources. Labour market conditions were tightening, even though it was



not clear how rapidly. Consumer price inflation had fallen, and was well below the target. It was, however, expected to rise in the next few months, though it was difficult to judge the extent of underlying pressure. It was possible that geopolitical risks had increased, but it was not clear whether, if any of those risks materialised, higher or lower inflation would result in the medium term.

27 The Committee agreed that a rise in interest rates was appropriate this month. On the May central projection, and assuming the existing repo rate of 4.0%, inflation two years ahead was projected to be somewhat above the target. On the market rate assumption, which entailed a rising repo rate through the forecast period, inflation would be a little above the target at the forecast horizon. Risks were broadly balanced around the central projection. It was therefore appropriate to raise the repo rate now, withdrawing some of the current monetary stimulus to demand.

28 In presenting a decision to raise the repo rate, it would be important for the Committee to make clear that this did not imply that it was targeting house price inflation, or any other asset price. The significance of the unexpected acceleration in house prices was that it supported a stronger short-term outlook for consumption and output growth, and hence a steeper projected rise in inflation. It also increased the uncertainties relating to these projections.

29 Arguments for a rise of 50 basis points were discussed. First, the forecast suggested that interest rates might need to rise more rapidly at some point than currently expected by the market. A 50 basis point rise could therefore be warranted by the Committee's central projection. Moreover, there were upside risks to this projection; for example, it was not certain that domestic demand would ease as markedly as projected. Second, if interest rates increased broadly in line with market expectations, inflation would be rising towards and then above target in the second year of the forecast period. A more gradual rise in inflation towards target, requiring a somewhat more rapid increase in interest rates than the market currently expected, would run less risk that above-trend output would lead to accelerating inflation further ahead. Third, the surprise entailed by a 50 basis point increase might help to moderate the continuing rapid rate of increase in consumer indebtedness by affecting the behaviour of both borrowers and lenders, although even a 50 basis point rise would not by itself dampen consumer borrowing to any marked degree.

30 There were also a number of arguments for implementing a smaller rise, of 25 basis points. First, current inflation was below the target and was projected to remain so for most of the next two years, and there were considerable downside as well as upside risks to this outlook. So even if it

proved necessary for interest rates to rise a little more rapidly at some point than the market currently expected, there was, therefore, time to assess and explain further month-to-month economic developments before implementing a further increase if needed in the light of subsequent news. Second, although the argument for caution in raising the repo rate, given the uncertainty about the effect of interest rate increases on the economy, was now less persuasive than at the turning point in the repo rate last November, it should still be given some weight when contemplating a larger-than-expected repo rate change. Finally, there was a risk that a larger-than-expected rise now could be mistaken for a change in the Committee's reaction function, rather than as a response to the change in outlook given the news in recent months.

31 All members, taking these arguments together, judged that the arguments for a 25 basis point rise were decisive.

32 The Governor invited members to vote on the proposition that the repo rate should be increased by 25 basis points to 4.25%. The Committee voted unanimously in favour of the proposition.

33 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 30 April 2004, in advance of its meeting on 5-6 May. 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 5 May, UK short-term interest rates had changed little. Market expectations of official UK rates implied by overnight indexed swap rates had been that UK official rates would be increased by 25 basis points at the May meeting. Out of 46 economists polled by Reuters, 45 had expected a 25 basis point rise in May. US short-term interest rates had increased following some stronger-than-expected US data. The expected timing of an increase in official interest rates in the United States, as implied by overnight indexed swap rates, had been brought forward. Euro-area short-term interest rates had risen since the previous Committee meeting.

A3 Beyond very short maturities, UK nominal forward rates had risen slightly since the April Committee meeting. US nominal forward rates had risen at all maturities, whereas euro-area rates had risen at short and long maturities, but had fallen at medium-term maturities.

A4 The sterling effective exchange rate index (ERI) had fallen by 2.4% to 103.7 since the previous Committee meeting. Sterling had depreciated by 2.9% against the dollar and by 2.5% against the euro, but had appreciated by 0.4% against the yen. Changes in relative interest rates had been able to account for part of the movement in the dollar/sterling exchange rate and, to a lesser extent, of the euro/sterling exchange rate. The Consensus Economics survey published in April had pointed towards a modest depreciation of the sterling ERI over the next two years. Option-based implied volatility measures had suggested that there had not been much change in forward-looking uncertainty about the sterling/dollar and the sterling/euro exchange rates. In addition, option-based risk reversals had indicated that the distribution of risks for bilateral exchange rates between sterling and other major currencies had remained broadly symmetric.

A5 Between 7 April and 5 May, the FTSE All-Share index had risen by 1.6% in local currency terms, while the other major international indices had fallen – the S&P 500, Topix and the Dow Jones Euro Stoxx had fallen by 1.7%, 1.5% and 0.7% respectively. Within the FTSE All-Share, the FTSE 100 had risen by 2.3%, while the FTSE Small Cap and the FTSE 250 had both fallen by 1.6%. The rises in the FTSE All-Share had been concentrated in the consumer goods, general industrials and non-cyclical services sectors. Uncertainty about the future level of the FTSE 100, as measured by three and twelve-month futures implied volatilities, had fallen back from its peak in late March. Sterling and euro-denominated investment-grade option-adjusted spreads had narrowed slightly, while dollar-denominated spreads had been unchanged.

## **II The international environment**

A6 According to the advance estimate, US GDP had risen by 1.0% in 2004 Q1, following a similar rise in 2003 Q4. Compared with a year earlier, GDP had risen by 4.9%. Consumption had risen by 0.9% on a quarter earlier in 2004 Q1. Investment had increased by 1.3% on the quarter, reflecting rises of 1.7% in business investment and 0.5% in residential investment. Government spending had risen by 0.5% on the quarter. Stockbuilding had contributed +0.1 percentage points to quarterly GDP growth and net trade had made a zero percentage point contribution.

A7 Among the monthly indicators, industrial production had fallen 0.2% on the month in March, after rising by 0.8% in February. Retail sales had risen by 1.8% in March, following an upwardly revised rise of 1.0% in February. The University of Michigan measure of consumer confidence had fallen to 94.2 in April (revised up from 93.2 in the preliminary release), from 95.8 in March. But the Conference Board measure had risen to 92.9 in April, from 88.5 in March. The Institute for Supply Management (ISM) purchasing managers' index for manufacturing had fallen slightly to 62.4 in April, from 62.5 in March. The non-manufacturing survey had risen to 68.4 in April, from 65.8 in March, reaching the highest level since the series began in July 1997.

A8 US producer prices for finished goods had increased by 1.4% in the year to March, less than the 2.1% rise in the year to February. The US headline consumer price index had risen by 1.7% in the year to March, the same as in the year to February. The core CPI, which excludes food and energy, had increased by 1.6% in the year to March, up from 1.2% in the year to February. The core measure of the personal consumption expenditures deflator had risen by 1.3% on a year earlier in 2004 Q1, up

from 1.0% in 2003 Q4. Employment costs had risen by 1.1% over the quarter in 2004 Q1, compared with 0.8% in 2003 Q4.

A9 In the euro area, estimated GDP growth in 2003 Q4 had been unrevised at 0.3% according to the second release. As a result of small revisions to private and government consumption, the estimated contribution of final domestic demand to GDP growth had been reduced by 0.1 percentage points compared with the first release, to 0.2 percentage points. The contribution from stockbuilding had been revised down to 0.5 percentage points, from 0.6 percentage points, and the contribution from net trade had been revised up, to -0.5 percentage points from -0.7 percentage points in the first release. There had also been upward revisions to estimated French quarterly GDP growth, to 0.7% from 0.4% in 2003 Q3, and to 0.7% from 0.5% in Q4.

A10 Industrial production in the euro area had risen by 0.1% in February, after falling by 0.3% in January. Retail sales had fallen by 0.2% in March, following a 1.1% fall in February, but retail sales had grown by 1.0% in 2004 Q1. The euro-area purchasing managers' index (PMI) for manufacturing had risen to 54.0 in April, from 53.3 in March. The PMI measure of business activity for the euro-area service sector had risen slightly, to 54.5 in April from 54.4 in March. The European Commission's industrial confidence indicator for the euro area had risen to -5.0 in April, from -7.0 in March. The European Commission's consumer confidence indicator for the euro area had been -14.0 in April for the third month running. The German IFO index had risen to 96.3 in April, from 95.4 in March, and the French INSEE business confidence survey had been unchanged in April, at 104.0. The German unemployment rate had increased by 0.1 percentage points in April, to 10.5% .

A11 Twelve-month HICP inflation in the euro area had risen to 1.7% in March, from 1.6% in February. Annual core inflation, which excludes energy, food, alcohol and tobacco, had been unchanged at 1.8% in March. The Eurostat flash estimate for euro-area HICP inflation had indicated a rate of 2.0% in the year to April. Annual producer price inflation (excluding construction) in the euro area had risen to 0.4% in March, from 0.0% in February.

A12 In Japan, industrial production had increased by 0.1% in March, after falling by 3.8% in February. Export volumes had risen by 14.2% in March, after increasing by 12.0% in February; Import volume growth had also picked up, to 17.6% from 3.1%. The all-activity index had fallen by 3.6% in February, after rising by 2.2% in January.

A13 In the year to 2004 Q1, GDP in China had grown by 9.7%, following growth of 9.9% in the year to 2003 Q4. According to the output measure, primary industry had grown by 4.5%, while secondary industry had grown by 11.6%. Growth in the tertiary sector had been 7.7%.

A14 Since the Committee's previous meeting, the spot price of Brent crude oil had risen by \$4.21 per barrel, and *The Economist* dollar non-oil commodity price index had fallen by 1.7%. The indices for metals and foods had fallen by 4.4% and 1.8% respectively, while the index for non-food agriculturals had risen by 2.3%.

### **III Money and credit**

A15 The annual growth rate of notes and coin (adjusted for special factors) had fallen slightly, to 6.9% in April from 7.0% in March. Annual M4 growth had fallen to 7.7% in March, from 8.0% in February. The annual growth rate of M4 lending (excluding the effects of securitisations) had risen by 0.1 percentage points, to 12.2% in March. Excluding other financial corporations (OFCs), annual M4 growth had risen to 8.4% in March, compared with 8.2% in February, and annual M4 lending growth (excluding the effects of securitisations) had fallen to 12.2% in March, from 12.7% in February.

A16 The annual growth rate of households' M4 had risen to 8.2% in March, from 8.0% in February. The annual growth rate of households' M4 borrowing (excluding the effects of securitisations) had increased by 0.1 percentage points, to 14.1% in March. Within total net lending to individuals – lending by a broader set of institutions than just banks and building societies – the estimates of secured lending growth had been revised up for all months since July 2002 because of a widening of the sample of non-bank lenders. According to the revised figures, the annual growth rate of secured lending had risen slightly, to 15.2% in March compared with 15.1% in February. The annual growth rate of unsecured lending had fallen by 0.1 percentage points, to 12.2% in March. Annual growth in credit card borrowing had risen sharply, to 17.2% in March from 16.6% in February, while annual growth in other unsecured lending had fallen, to 10.1% from 10.5%.

A17 In March, the average two-year fixed rate on secured debt had risen by 1 basis point to 4.90%, the average standard variable rate (SVR) had risen by 22 basis points to 5.81%, and the effective mortgage rate had risen by 12 basis points to 4.90%. The average quoted rate on credit card borrowing

had fallen by 16 basis points to 14.8% in March, while the average quoted rate on overdrafts was little changed.

A18 Owing to a widening of the sample of non-bank lenders, the estimated number of loan approvals for house purchase had been revised up for all months since July 2002. According to the revised figures, the number of loan approvals for house purchase had been 127,000 in March, the same as in February. Housing transactions completions, as measured by land transaction returns, had risen by 22.7% in the three months to March compared with the same period a year earlier. According to the monthly survey of the Royal Institution of Chartered Surveyors, the number of unsold properties per surveyor had fallen to 57 in March, from 58 in February, while the number of properties sold per surveyor had remained unchanged at 32 in the three months to March.

A19 The annual growth rate of M4 deposits by private non-financial corporations (PNFCs) had declined very slightly to 9.0% in March, from 9.1% in February. The annual growth rate of M4 lending to PNFCs (excluding the effects of securitisations) had fallen to 6.6% in March, compared with 8.9% in February. PNFCs had raised £4.9 billion in external finance in March, compared with a monthly average of £3.7 billion in 2004 Q1, little changed from 2003 Q4. The strength in March had primarily reflected bond and equity issuance, while there had been net repayment of bank debt. The industrial breakdown of bank lending had shown a positive net flow to manufacturers in Q1.

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

A20 The ONS preliminary estimate for GDP growth at market prices had been 0.6% in 2004 Q1, following 0.9% growth in 2003 Q4. Annual GDP growth at market prices had picked up, to 3.0% in 2004 Q1 from 2.7% in 2003 Q4. Gross value added at basic prices had also been estimated to have risen, by 0.6% in Q1.

A21 The preliminary estimate for quarterly service sector output growth in 2004 Q1 had been 0.8%, down from 1.0% in 2003 Q4. But the ONS had cautioned that the services data were potentially more subject to revision than usual, because of an unusually low survey response in March. The preliminary estimate for production sector output growth had been -0.5% in 2004 Q1, down from -0.1% in 2003 Q4.

A22 Retail sales volumes had been estimated to have risen by 0.6% in March, marking the tenth consecutive month of non-negative growth, the longest such run since the series began in 1986. Retail sales growth had picked up, to 1.9% in 2004 Q1 from 1.7% in 2003 Q4. The GfK consumer confidence balance had risen by 1 point, to -2 in April.

A23 The Nationwide house price index had risen by 2.1% in April, while the Halifax house price index had risen by 1.8%. The three-month on three-month growth rates had also risen, to 5.8% and 6.1% respectively. Annual house price inflation, as measured by the ODPM house price index, had been estimated at 9.8% in February, up slightly from 9.7% in January. Data from both Nationwide and Halifax had suggested that in Q1 house price inflation had risen particularly sharply in northern England.

A24 Recent surveys had suggested that business confidence in the service and manufacturing sectors had remained high in 2004 Q1. For the service sector, the British Chambers of Commerce (BCC) survey balance of business confidence regarding profitability had been broadly unchanged, at +48 in Q1, and the Chartered Institute of Purchasing and Supply (CIPS) services survey of business expectations had also been broadly unchanged, at 77.6 in April.

A25 For the manufacturing sector, the BCC survey balance of business confidence regarding profitability had been broadly unchanged, at +38 in 2004 Q1. The CBI *Quarterly Industrial Trends* survey's business optimism balance had fallen back slightly, to +12 in Q1, from +17 in Q4.

A26 Surveys of investment intentions had remained at or above their historical averages. The BCC balances on investment intentions in plant and machinery for the service and manufacturing sectors had been +18 and +10 respectively in Q1. The CBI investment intentions balance for the manufacturing sector had fallen back, to -1 in 2004 Q1 from +6 in 2003 Q4.

A27 The CIPS services business activity index had risen slightly to 59.0 in April, from 58.7 in March; the incoming new business index had been broadly unchanged at 60.5. The BCC services domestic orders balance had been little changed, at +24 in Q1.

A28 The CIPS manufacturing output index had risen to 57.2 in April, from 56.4 in March; the new orders balance had risen to 55.9, from 55.2. The BCC manufacturing domestic orders balance had



picked up to +17 in 2004 Q1, from +8 in 2003 Q4. The CBI total new orders balance had risen to +18 in 2004 Q1, from +13 in 2003 Q4.

## **V The labour market**

A29 According to the Labour Force Survey (LFS), employment had increased by 183,000 in the three months to February, compared with the previous three months. Almost all of this increase had been accounted for by employees. The 16+ employment rate had increased by 0.3 percentage points, both on the quarter and on the year, to 60.1%. Following revisions to the series, Workforce Jobs were estimated to have increased by 114,000 in the three months to December, including an increase of 54,000 in the distribution, hotels and restaurants sector, and an increase of 44,000 in the public sector.

A30 Total hours worked had increased by 0.7% in the three months to February, and by 0.6% on the same three months a year earlier. Average hours worked in the three months to February had been little changed on the previous three months, but had fallen by 0.6% on the same three months a year earlier.

A31 In the three months to February, LFS unemployment had fallen by 33,000, and had been 76,000 lower than for the same three months a year earlier; the unemployment rate had fallen to 4.8%, 0.1 percentage points lower on the previous three months and 0.3 percentage points below its rate in the same three months a year earlier. At 2.9%, the claimant count unemployment rate had been unchanged in March. The 16+ inactivity rate had fallen 0.2 percentage points in the three months to February, and by 0.1 percentage points on the same three months a year earlier, to 36.8%.

A32 Overall annual whole-economy earnings growth had been 4.9% in the three months to February, 0.2 percentage points higher than in the three months to January. Private sector pay growth had increased by 0.3 percentage points to 5.1%, within which private sector services had also increased by 0.3 percentage points, to 5.5%. Whole-economy earnings growth in the year to February fell sharply, down 3.3 percentage points to 4.0%, consistent with the large decline in the contribution of bonuses between January and February. Annual earnings growth excluding bonuses had been 3.8% in the three months to February, up 0.2 percentage points on the three months to January. The comparable public sector growth rate had been flat at 4.2%, while the private sector growth rate had increased 0.2 percentage points to 3.7%.

A33 According to settlement information available to the Bank, the mean whole-economy twelve-month average earnings index (AEI)-weighted settlement had been 3.3% in the year to March, unchanged on the equivalent figure for the previous two months. The twelve-month mean settlement in both the private (AEI-weighted) and the public sector (sample-weighted) had remained flat, at 3.3%.

## VI Prices

A34 Since the Committee's previous meeting, sterling oil prices had risen by 16%.

A35 Manufacturing input prices had risen by 1.9% in March, mainly owing to higher oil prices. This meant that the annual rate of change had risen, to 0.8% in March, from -1.5% in February. The CIPS manufacturing survey had pointed to a rise in input prices in April: although the input price balance fell slightly, it remained high, at 62.6.

A36 Manufacturing output prices excluding duties (PPIY) had risen by 0.1% in March. Owing to base effects, the annual inflation rate had fallen by 0.5 percentage points, to 0.9% in March. Survey data had pointed to small rises in output prices in the near future: the expected output price balance from the CBI *Quarterly Industrial Trends* survey had been +2 in April, the highest level for over three years.

A37 CPI inflation had fallen to 1.1% in March, from 1.3% in February. Within this, annual goods price inflation had fallen by 0.2 percentage points, to -0.6% in March. Services price inflation had fallen by 0.1 percentage points, to 3.1% in March. RPIX inflation had fallen by 0.2 percentage points, to 2.1%. RPI inflation had risen to 2.6% in March, from 2.5% in February.

A38 The Bank's regional Agents had conducted a special survey of the pricing intentions of 166 firms. Firms in the retail sector reported that average domestic prices had been falling over the previous twelve months, and that prices were expected to fall further over the coming year. By contrast, firms in the manufacturing and corporate services sectors reported that average domestic prices were expected to rise over the coming twelve months, and at a slightly faster rate than during the previous twelve months. Looking at the sample as a whole, firms cited labour costs as the main factor that was likely to put upward pressure on their prices, while competitive pressure and efficiency gains were likely to be the main sources of downward pressure.

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

A39 The Bank's regional Agents reported that manufacturing output and orders had continued to rise steadily in recent months. That had contrasted with the provisional ONS data, which indicated that manufacturing output had fallen between December 2003 and February 2004. Some contacts had reported shortages of steel, with consequent strong upward pressure on its price, but that had not had a major impact on manufacturers as a whole. Export markets had performed slightly better than domestic ones, with the strongest demand coming from the United States, Asia and Eastern Europe. The sterling value of exports had continued to be eroded by the dollar's depreciation, which had reduced exporters' profit margins. Although business confidence had improved, most manufacturers had planned to invest only to raise productivity and not to expand capacity.

A40 Output growth in the service sector had picked up, perhaps to its fastest pace for several years. That had been mostly the result of a strong pickup in business services, including information technology. The recovery in consumer services had been less pronounced. According to Bank contacts, this was partly because the recent downturn in consumer services activity had not been as pronounced as that in business services.

A41 The overall picture for retail sales suggested that the growth of spending had continued, but at a more modest pace since the turn of the year. Broad conclusions had been difficult to reach, partly because contacts had reported very different trading conditions for different products. Demand had been strong for electronic goods, including mobile telephone equipment, but weaker for clothing and footwear. Price competition in the retail sector had remained fierce.