

Publication date: 21 April 1999

MINUTES OF MONETARY POLICY COMMITTEE MEETING

7 and 8 April 1999

These are the minutes of the Monetary Policy Committee meeting held on 7 and 8 April 1999.

They are also available on the Internet (<http://www.bankofengland.co.uk/mpc9904.pdf>).

The Bank of England Act 1998 gives the Bank of England operational responsibility for setting interest rates to meet the Government's inflation target. Operational decisions are taken by the Bank's Monetary Policy Committee. The Committee meets on a regular monthly basis and minutes of its meetings are released on the Wednesday of the second week after the meeting takes place. Accordingly, the minutes of the Committee meeting held on 5 and 6 May will be published on 19 May 1999.



MINUTES OF THE MONETARY POLICY COMMITTEE MEETING ON 7-8 APRIL 1999

1 The Committee discussed the prospects for the world economy; the exchange rate, money and credit; demand and output (including business confidence indicators); the housing market; the labour market; prices; and other issues including tactics, before turning to its immediate policy decision.

The world economy

2 The Committee discussed whether the prospects for the world economy had improved over the past month. In the United States, domestic demand in particular had continued to grow strongly, with little sign yet of any slowdown in growth or any pick-up in inflation. Supply side developments in the United States appeared to be more favourable than in the euro area, although in several European countries output remained below potential. Growth was sluggish and industrial sentiment weak, particularly in Germany. Meanwhile expectations had grown of a reduction in interest rates by the European Central Bank (ECB). In Japan, the Nikkei had recovered strongly in the last few weeks of the financial year, with buying from foreign investors amid signs of a higher probability of corporate restructuring. But any recovery in business sentiment had been muted - and might be reversed - while consumer confidence could be further damaged by record levels of unemployment.

3 Outside the major industrial countries, spreads on emerging market sovereign dollar debt - as measured by J P Morgan - had fallen by over 200 basis points during the month. Sentiment - and in some cases activity - was a little stronger in East Asia and Latin America, where some countries had benefited from higher oil prices. The markets appeared to have discounted a deterioration in prospects in Russia. So in general, developments in the world economy seemed much as expected in the February *Inflation Report*, although the downside risks to activity might have diminished somewhat. A major uncertainty was over the events in Kosovo, where the effects on consumer and business confidence elsewhere, and on the budgetary positions of the NATO countries, were not yet clear.

4 There were some signs that commodity prices had begun to bottom out, and oil prices had risen sharply as a result of agreed cutbacks in supply. While it was too soon to judge whether these increases would persist, the cutbacks appeared to have greater credibility in the market than had

sometimes been the case. The downward pressure on world prices from oil and other commodities might therefore be less than in the recent past. But with most economies outside the United States below productive capacity, the scope for a generalised pick-up in inflation was limited.

The exchange rate, money and credit

5 For most of the month sterling had been stronger than at the time of the previous meeting of the Committee, particularly against the euro, although it had weakened a little in recent days. But the effective exchange rate index remained over 2% higher than implied by the central projection in the February *Inflation Report*. Many possible explanations had been advanced for sterling's strength, and discussed by the Committee in this as in previous meetings. If this strength in the exchange rate were sustained, it would tend to dampen inflation, and also activity in the internationally traded sectors of the economy.

6 So far as money was concerned, growth rates for M4 had continued to slow, as expected, with a sharp decrease in the contribution from other financial corporations (OFCs). Growth in M4 lending had also slowed further.

Demand and output

7 The Committee discussed the revisions made to the estimates of the level and composition of GDP for 1997 and 1998. Since the February *Inflation Report*, the estimated level of GDP at market prices in 1998 Q4 had been reduced by $\frac{1}{2}$ %, although by only $\frac{1}{4}$ % when measured at basic prices. This had consequences for measures of the output gap and labour productivity. The implications for future price developments were unclear. On one interpretation, this implied that there was less pressure on capacity and that, given the lags involved, the effects of slower GDP growth had yet to feed through fully into lower inflation. On an alternative view, it suggested a less favourable short-run trade-off between activity and inflation; inflation was unchanged and either capacity utilisation was lower, core inflation higher or estimates of capacity had been reduced. But the size of the changes had not been large, and it was not clear on either view how much significance should be attached to this.

8 Estimates for the growth of GDP in 1998 Q4 had also been revised downwards, to 0.1% over the previous quarter. Within this total, the weakest demand components had been government

consumption and net trade. In contrast private consumption and investment had been revised up, significantly so in the case of business investment. At the same time, the downwards revision to inventories suggested that the risks of a significant stock cycle in 1999 had diminished, particularly since stocks held by manufacturers and retailers appeared under control. This interpretation was in line with earlier survey evidence for these sectors. But because of the downwards revision to the level of GDP, the estimated stock-output ratio was little changed.

9 Retail sales volumes had declined in February, and on a three month average had been only 1% above the levels of a year earlier. But the CBI distributive trades survey suggested that a trough might have been reached, and spending on services, which was not included in retail sales, had continued to grow faster than spending on goods. The GfK consumer confidence index was now positive for the first time in nine months. When taken together with other information on consumer spending, the data appeared in line with the *Inflation Report* projections for consumption in the first quarter of 1999.

10 The Committee considered the prospects for investment. The financial deficit of the private non-financial corporations (PNFCs) had widened to 3% of GDP, the highest level since 1990. This might in part reflect the growth of business investment in the second half of 1998. The increase appeared to have been most marked in the services sector, and might represent a bringing forward of IT-related spending ahead of the millennium. The millennium might also boost spending on construction this year, with signs, perhaps, that next year would be less buoyant. All this might have implications for the profile of activity over the next two years. But work by Bank staff suggested that movements in the credit and money holdings of the PNFCs were consistent both with the recent strength of investment, and continued growth in 1999.

11 The Committee agreed that the Budget contained little that altered the outlook for inflation. At its previous meeting it had decided that the figures for the overall fiscal position, on which the Committee had been briefed, were in line with the assumptions made in the February *Inflation Report*. Following the Budget itself, an analysis of the implications of the detailed measures for the composition of demand suggested that these should not have a significant additional effect on the prospects for activity and inflation over the forecast period.

12 Forward-looking survey evidence continued to suggest an improvement (from a low base) in business confidence in all sectors of the economy. But official data and that from surveys indicated