



BANK OF ENGLAND

Agents' summary of business conditions

September 2014

- **Retail sales values** growth had eased, but this was due to lower food price inflation; **consumer services values** had continued to grow steadily.
- **Housing market** activity had stabilised at lower transaction levels, after a weakening in earlier months, which contacts largely attributed to the implementation of the Mortgage Market Review. House price inflation had eased.
- **Investment intentions** for the next twelve months had remained steady, and were consistent with more rapid growth in services investment than manufacturing.
- **Business services** turnover growth had remained strong.
- **Manufacturing** output growth for the domestic market had eased. Fragile European demand, sterling's appreciation and the crisis in Ukraine had affected export volumes.
- **Construction** output growth had eased slightly but remained robust.
- **Corporate credit conditions** had improved further.
- **Employment intentions** had weakened in manufacturing and consumer services but had increased further for business services.
- **Recruitment difficulties** had edged up, and were affecting a widening range of sectors.
- **Capacity utilisation** had eased over the month, as investment and recruitment had boosted capacity at some firms ahead of expected demand growth.
- Growth in **total labour costs per employee** had remained steady.
- **Materials costs** and **imported finished goods prices** had continued to fall on a year earlier.
- **Output price inflation** had edged lower, but **profitability** had continued to rise modestly.
- **Consumer price inflation** had remained modest.

This publication is a summary of monthly reports compiled by the Bank of England's Agents following discussions with contacts in the period between late July 2014 and late August 2014. It provides information on the state of business conditions from companies across all sectors of the economy. The report does not represent the Bank's own views, nor does it represent the views of any particular company or region. The Bank's Monetary Policy Committee uses the intelligence provided by the Agents, in conjunction with information from other sources, to assist its understanding and assessment of current economic conditions. A copy of this publication can be found at: www.bankofengland.co.uk/publications/Pages/agentssummary/default.aspx.

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The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.

Demand

Consumption

Annual growth of retail sales values had eased. That was largely attributed to intense competition between grocery retailers that had resulted in lower food price inflation, rather than any pronounced weakness in retail sales volumes. Growth in demand for household durable goods such as furniture, new kitchens and white goods had remained robust. Consumer services values had continued to grow at a steady rate. The tourism industry had reported some growth overall in visitor numbers during the summer, compared with last year, resulting in higher rates of hotel occupancy. Pubs, coffee bars and restaurants had continued to report good growth in demand.

Housing market

Housing market activity had stabilised at lower transaction levels than at the start of the year, following a softening in Q2. The slowdown had been especially marked in Central London, where the appreciation of sterling had also deterred some foreign buyers. More generally, demand had been dampened by the implementation of the Mortgage Market Review (MMR) — principally because of the lengthening of mortgage processing times. Contacts suggested that underwriting standards would be tighter over the longer term as a result of the MMR, although overall, contacts felt the longer-term impact on housing market activity would be relatively limited. House price inflation had slowed, especially in areas that had seen significant earlier increases in prices. Some estate agents felt that this reflected a more balanced market, with supply in the secondary market gradually improving, though that was not even across regions and shortages of properties for sale were said to be persisting in some areas. Shortages of surveyors, solicitors and authorised mortgage advisers were also having an impact on activity in some regions.

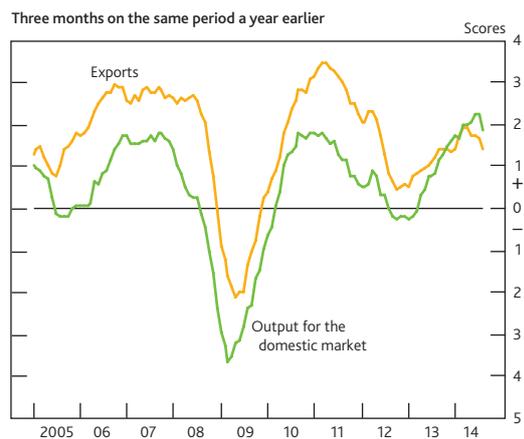
Business investment

Investment intentions for the next twelve months had remained steady, and were consistent with more rapid growth in services investment than manufacturing. Investment growth was underpinned by sustained positive sentiment about demand, and improvements in credit conditions had removed a constraint to investment for some firms. Investment in both new-build and refurbished commercial, retail and industrial property had strengthened in recent months. Across sectors, previously deferred projects to replace or update assets were now taking place. IT spending had remained strong. For the minority of firms that were investing less than in prior years, capital spending was typically lower because previous investment programmes had provided adequate capacity for expansion plans.

Exports

Manufacturing export volumes growth had weakened (Chart 1). Goods exports to the United States, Asia and the Middle East had continued to increase. But demand from Europe was still fragile and there were concerns that growth in the emerging economies was slowing. Political instability in Ukraine was having an adverse impact on exports to the wider region and the Russian embargo on certain Western products had resulted in a loss of trade for some exporters. Sterling's appreciation had primarily affected exporters' margins, but there were an increasing number of examples of adverse effects on export volumes. Services exports growth had continued at a steady rate. Strong growth in professional services firms' work for clients globally had been maintained. UK engineering and construction consultancy had remained in strong demand outside Europe. Inbound tourism, both leisure and business, was often reported to be rising, though some contacts in London reported overseas visitor numbers had been below expectations.

Chart 1 Manufacturing output



Output

Business services

Business services turnover growth had remained robust. In professional and financial services, greater confidence in economic prospects had led to increasing activity across a range of services such as consultancy, recruitment and corporate finance. Mergers and acquisition activity had held up and there was more evidence this month that UK funds and institutions were acquiring commercial property assets outside London. The number of initial public offerings had fallen back a little recently and new public sector work was reported to be starting to slow in the run-up to the 2015 general election. Other business services turnover had remained strong, especially IT. Demand for warehousing and distribution services had strengthened, particularly for firms providing services to the construction sector. Spending on business travel, hotel stays and conferencing had increased, with growth in these subsectors stimulating demand for other services such as laundry, cleaning and security.

Manufacturing

Manufacturing output growth had eased a little (**Chart 1**). Manufacturers of construction products and materials had reported the strongest growth in demand. Manufacturers of consumer goods had reported, for the most part, steady growth with rising demand for home improvement products and furniture. Food and drink manufacturers had benefited from better weather. Output in the engineering supply chain had continued to grow at a steady rate reflecting sustained demand by UK manufacturers supplying the overseas automotive and aerospace sectors. But growth in output had eased a little in some other export supply chains and in the energy sector there had been a softening in near-term demand from the nuclear sector and for oil and gas exploration.

Construction

Construction output growth had eased a little but remained strong. There was growing evidence that shortages of labour and, to a lesser extent, materials were delaying projects and pushing up costs. Activity was increasingly broad based, including house building, industrial and commercial development (especially warehousing) and transport projects, such as highways and railways. Utility companies were also investing significantly in infrastructure improvements. Increasing demand for office accommodation was said to be leading to some speculative development outside London. Public sector backed schemes were said to be supporting activity across the United Kingdom, although some contacts had concerns that this activity might ease back around the general election in 2015. House builders' output was rising, but still at a relatively modest rate and, according to some forecasts, growth in the number of housing starts was expected to slow in 2015.

Credit conditions

Corporate credit availability and pricing had continued to improve gradually. That picture included conditions for some small and medium-sized enterprises (SMEs), although those operating in sectors like house building or leisure had continued to struggle to obtain finance. Many SMEs had remained wary of relying on bank borrowing and had continued to pay down debt. Non-traditional funding providers — such as crowdfunding or peer-to-peer lenders — were often more expensive than high street banks, but could provide funds more flexibly or quickly, did not require covenants, and were willing to look at lending opportunities that other banks had turned away. There had appeared to be some increase in the availability of commercial real estate development funding from a low base. The trend for corporates to extend payment terms and offer supply-chain finance to enable suppliers to manage the effects on their cash flow had continued.

Employment

Employment intentions pointed to continued growth in staff numbers, despite having diverged somewhat across sectors (**Chart 2**). Business services intentions had edged up further, with particular strength in professional and property-related services, IT and logistics. In banking, consolidation was still taking place, but the effects on employment were being partly offset by job creation in areas such as compliance. Consumer services intentions had eased back. There had also been a slight weakening in intentions in manufacturing, in part reflecting an anticipated pickup in productivity, often on the back of past or planned capital expenditure. Recruitment difficulties had picked up further, and were spreading beyond IT, engineering, and construction and associated sectors. Those difficulties partly reflected a lack of graduate recruitment and apprenticeships during the downturn, with increasing reports of a shortage of experienced qualified professionals and skilled manual labour. While many companies had reinstated trainee programmes, those would only address skills shortages over a number of years. Unskilled labour had appeared to remain readily available, in some cases reflecting the supply of migrant workers. Attrition rates had remained low relative to pre-recession norms for most contacts, but reports of greater churn and some poaching of staff had increased, particularly within construction and professional services.

Chart 2 Employment intentions



Capacity utilisation

Capacity utilisation across both manufacturing and services had eased over the month, though remained close to normal (**Chart 3**). Capacity constraints for both labour and materials in the construction sector had persisted and had led to delays on some projects. In manufacturing, utilisation of labour remained higher than for capital. For a minority of manufacturing contacts, investment had added to capacity. Most reported comfortable levels of physical capacity with, some skills shortages aside, sufficient labour capacity readily available through the addition of overtime and extra shifts. In

the service sector, investment and increases in staffing had lowered capacity utilisation for some companies. The balance between labour and capital utilisation was more even across the service sector than for manufacturing. Some professional services, retail and estate agency firms had reported skilled labour constraints, although in some other subsectors there was reported to be some excess labour capacity following recruitment made in expectation of higher demand to come. In retailing, new store openings by large discounters and growth in e-commerce had continued to place demands on logistics and warehousing capacity. Hotel occupancy rates had continued to rise.

Chart 3 Capacity utilisation

Over the coming six months, 'relative to normal'



Costs and prices

Labour costs

Steady growth in labour costs per employee had continued (**Chart 4**), with the majority of pay settlements continuing to be in the 2%–3% range. There was increased evidence however that pressure on pay costs was emerging, either as a result of some catch-up after periods of wage restraint or to retain and attract specific skills in areas where there were skills shortages. That had led to some targeted or discretionary awards that were somewhat above 3%. Overtime payments and performance-related bonuses were reported to be moderately higher than a year ago. There were continued reports of employers taking on more apprentices/trainees, hiring more junior or lower skilled staff to train up, or outsourcing jobs to reduce wage growth, all of which would bear down on average salaries to a small extent. In addition, other costs of employing people, such as pension auto-enrolment costs, 'salary sacrifice' schemes and other benefits may have led to lower wage growth in some companies. The increase in the National Minimum Wage in October 2014 was reported to be putting upward pressure on some pay awards to maintain differentials between staff.

Chart 4 Total labour costs per employee

Three months on the same period a year earlier



Non-labour costs

Material costs had remained lower than a year earlier. The main exception had continued to be construction materials where reports of double-digit increases for some building materials were widespread. Outside construction, the recent appreciation of sterling and a softening of global demand had continued to dampen inflation in imported commodities and components prices. Energy cost inflation had moderated and some businesses had reported lower prices on renewal of annual contracts. Imported finished goods price inflation had remained slightly negative. The use of exchange rate hedges or fixed price sterling contracts meant that some of the impact of the recent appreciation of sterling had yet to feed through. For some contracts, such as clothing businesses, rising production costs in emerging market economies had to some extent offset the downward pressures on import costs from the recent strength of sterling.

Output prices and margins

Inflation in manufacturing output prices had eased. The scope to increase prices had remained limited for most manufacturing contacts as material costs had continued to fall and competition remained intense, including from imports as a result of sterling's recent appreciation. Companies supplying the retail sector had been under increased pressure from the major supermarkets to reduce prices. Some niche producers, however, had been able to make limited increases to prices. Price inflation for construction products remained stronger than for other manufacturing subsectors. Business services output price inflation had edged down slightly. Contacts reported that clients were highly price sensitive, with the use of competitive tendering widespread. In professional services, some companies had been able to increase fees modestly as demand had picked up, especially in recruitment and specialist areas such as engineering services. Profitability had continued to rise modestly in both manufacturing and services sectors, as increased volumes had lowered average costs and efficiency had risen. Sterling's recent appreciation had reduced input

costs, although for manufacturing exporters those effects had been more than offset by pressure on their selling prices.

Consumer prices

Consumer price inflation had remained modest. The rate of food price inflation had fallen further, and was expected to remain low in the light of weakening commodity prices, the earlier rise in sterling, and intense competition among retailers. Vehicle and heating oil prices had softened a little, reflecting past falls in the price of oil. In contrast, gradually rising consumer spending had enabled more household durables, clothing and footwear to be sold at full price than a

year ago. Consumer services price inflation had remained a little stronger than for goods, but contacts were cautious about pricing prospects. For example, hotel room rates had continued to edge higher, but the stock of available package holidays was higher than a year earlier and had begun to be discounted; and inflation in ticket prices for many leisure attractions and events was generally restrained. A number of service contacts, however, reported that future increases in labour costs, such as those arising from the increase in the national minimum wage, would be reflected in consumer prices relatively quickly.