BANK OF ENGLAND

Agents' summary of business conditions

March 2015

- Consumer demand had continued to grow steadily.
- There were signs of a pickup in housing market activity since the start of the year.
- Investment intentions for the next twelve months were consistent with moderate growth overall.
- Business services turnover growth had remained robust and broadly based.
- Manufacturing output growth for the domestic market had edged lower. But manufacturing export growth had picked up slightly from low levels.
- Construction output growth had continued to ease slightly, but remained robust overall.
- Corporate credit availability had continued to improve.
- Employment intentions had eased further for business services firms, but were consistent with modest headcount growth overall.
- Recruitment difficulties had changed little, at a level somewhat above normal.
- Capacity utilisation had remained at broadly normal levels in manufacturing, but slightly above normal for services.
- Growth in total labour costs per employee had been broadly steady.
- Materials costs and imported finished goods prices had remained lower than a year earlier.
- Output prices had been broadly flat on a year earlier for manufacturers, although they had risen moderately for business services firms. Profitability had increased modestly.
- Consumer price inflation had fallen further for goods. Moderate rates of inflation in services prices had continued.

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 January 2015 and late February 2015. 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.**

The Bank of England has Agencies for Central Southern England, the East Midlands, Greater London, the North East, the North West, Northern Ireland, Scotland, the South East & East Anglia, the South West, Wales, the West Midlands & Oxfordshire, and Yorkshire & the Humber.

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 been steady. Grocery sales volumes had risen, although price falls — partly reflecting competitive pressures within the sector — meant that sales values had changed less. Demand growth for larger household goods, such as furniture, kitchens and bathrooms, had been robust. Clothing and footwear retailers reported improved trading of seasonal lines. New car sales had also started the year well. Growth in turnover of consumer services had continued to be stronger than for goods. Restaurants, pubs and leisure attractions had reported robust growth. More generally, contacts reported that a recovery in real disposable incomes, in part reflecting lower fuel prices, was acting to stimulate consumer demand.

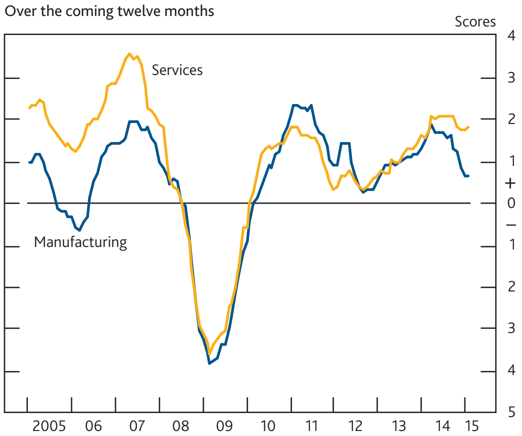
Housing market

There had been some signs of a pickup in housing market activity since the start of the year, with a number of estate agent contacts reporting modest increases in new instructions to sell and viewings. Activity had remained weaker than a year ago in most areas, which some contacts attributed to shortages in the available stock of properties for sale. Overall, housing supply and demand was now seen to be more balanced. The rental market had continued to grow strongly, supporting steady growth in buy-to-let activity. Mortgage availability was reported to have remained constrained for some borrowers, such as those with volatile incomes, although mortgage rates had fallen overall.

Business investment

Having eased over previous months, investment intentions had stabilised and indicated a moderate increase in capital expenditure over the coming twelve months (**Chart 1**). Intentions remained stronger among services companies than for manufacturing businesses, often reflecting plans to increase spending on existing or new premises. Some non-food retailers had become more confident on the back of sustained demand growth, and were looking to invest in logistics and distribution and store renovation, contrasting with decisions by some supermarkets to cut back their plans for new stores. Manufacturers' investment plans pointed to modest growth in 2015, often focusing on efficiency rather than capacity growth. Lower energy costs were weighing on investment plans in the oil and gas sector and related supply chains.

Chart 1 Investment intentions



Exports

Manufacturing export growth had edged up slightly, after slowing in recent months. Demand from the euro area had remained weak, as had demand from Russia. But US demand had strengthened further, partly reflecting the appreciation of the dollar. Services export growth had continued at a steady rate and was often reported to be stronger than for manufactured goods. Real estate and law firms had benefited from strong foreign demand for UK assets, including property and businesses. While lower oil prices were beginning to depress overseas earnings for some firms in the energy sector, they had also acted as a stimulus for some to seek out contracts abroad as domestic activity had fallen. Inbound tourism had continued to show robust growth.

Output

Business services

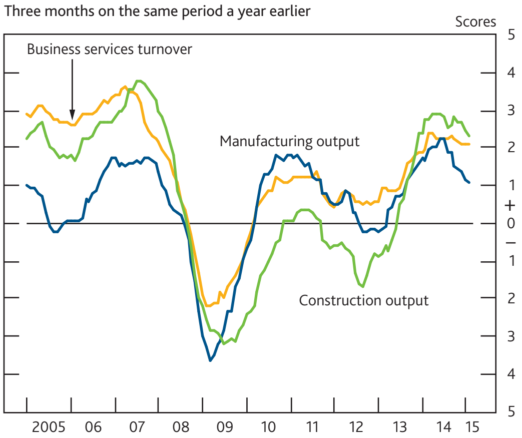
Robust growth in business services turnover had continued (**Chart 2**). Activity in the commercial real estate sector, and among associated professional and construction-related services, had been buoyed by strong occupier and investor demand. Although mergers and acquisitions activity among larger firms had flattened out following a strong 2014, it had picked up among smaller firms. Rising e-commerce had supported activity in warehousing and transportation, as well as among IT and digital media companies. Corporate demand for hotel nights, conferencing and travel had continued to increase. But lower prices arising from strong competition or excess capacity had slowed turnover growth in some consultancy and commoditised services, such as data storage. And suppliers to the oil industry had seen some softening in demand.

Manufacturing

Growth in manufacturing output for the domestic market had edged lower (**Chart 2**). The strongest upside reports remained in the construction materials sector. Automotive and civil aerospace supply chains had seen steady growth in output. But food volumes had remained flat on average. Falling agricultural commodity prices had reduced demand for agricultural capital goods. And the deferral of oil and gas exploration projects was starting to feed through to supply chains, although many firms reported healthy order books for 2015.

Chart 2 Activity

Three months on the same period a year earlier



Construction

Construction output growth had remained robust, although it had eased slightly over recent months, compared with a year earlier (**Chart 2**). That easing had partly reflected the strength of activity at the same time a year ago, although some contacts also noted recent weakness in repair and maintenance spending. Looking ahead, major house builders expected to raise output at a slightly slower rate in 2015 than in 2014, as some focused on improving margins rather than increasing volumes. Smaller builders planned to increase output a little relative to last year, aided by improved access to finance. Elsewhere, infrastructure projects had continued to support activity, along with industrial investment, warehousing, and offices in some cities. Continuing supply constraints, notably of labour, were expected to moderate future growth.

Credit conditions

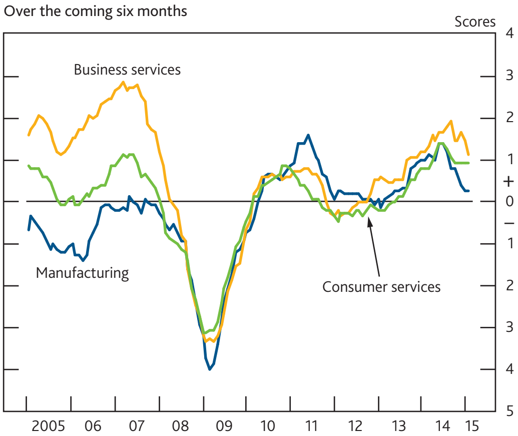
Credit availability had eased further, including for most small and medium-sized companies. The number of credit suppliers had expanded, with foreign and 'challenger' banks, private equity and sovereign wealth funds seeking to provide funding, and major banks more willing to lend alongside others. Overall there had been little evidence of a material loosening of bank underwriting standards; any such easing was reported to be restricted to lending to companies with strong balance sheets and a track record of good profitability. Finance had remained more difficult for smaller firms with short trading histories, and more generally for those with limited or intangible assets, although their funding options were also reported to be improving. Commercial real estate developers had begun to see greater availability of funds outside London, alongside increasing activity by institutional investors. Cash-flow difficulties among companies had picked up a little, but insolvency numbers had remained low.

Employment

Employment intentions had eased, but were consistent with modest headcount growth overall (**Chart 3**). In business services the easing reflected a return to more normal hiring patterns after a period of strong staffing growth, although recruitment had remained strong for a range of professional services. Consumer service employment growth had been concentrated in labour-intensive leisure services and discount and online retailing, partially offset by consolidation among supermarkets. Manufacturing employment intentions were broadly flat. Recruitment difficulties had become less acute in some areas such as engineering due to retrenchment in the oil and gas sector. But, across the economy overall, they remained somewhat above normal and had become more broad-based. Skill shortages had remained most prevalent within IT, professional services and construction. Migrants had continued to bolster the supply of unskilled and, increasingly, skilled staff. Staff attrition had picked up on the back of greater confidence among workers to move on for higher pay, career progression or to improve their work-life balance.

Chart 3 Employment intentions

Over the coming six months



Capacity utilisation

Capacity utilisation had remained broadly at normal levels in manufacturing and slightly above normal in services. Where there were capacity constraints within manufacturing companies, such as in parts of the automotive sector, firms were often able to subcontract to other manufacturers where resources were under-employed. In services, strong demand growth for professional and financial services had left some firms short of office space and labour. There were also some constraints in warehousing and logistics. Hotels had reported improved occupancy levels. In construction, constraints in the supply of materials had eased a little, but skilled labour remained scarce.

Costs and prices

Labour costs

Steady growth in total labour costs had continued. Most settlements had remained in the 2%–3% range, although pay freezes had become commonplace in the oil and gas sector. Where pay growth was above 2%–3%, concerns over staff retention were usually cited, but those had not increased significantly since last year. Upward pressures were still most evident in construction and parts of IT and professional services. Average wage growth in some services companies had been moderated by the use of a greater proportion of more junior staff. Falls in CPI inflation were rarely reported to be reducing the level of realised wage settlements, with companies' own profitability and wider labour market conditions generally seen to be more important in determining pay.

Non-labour costs

Costs had remained lower than a year ago across a broad range of inputs, largely driven by falls in global commodity prices. Energy costs had not yet fallen for many contacts, however, often because of firms' forward purchasing or hedging. Greater pass-through of lower oil prices was anticipated over time as existing contracts expired, but the extent of that pass-through was likely to diminish through supply chains as firms attempted to rebuild margins. The rate of inflation for construction materials had eased back as a result of improved supply, increased inventories and moderating demand. Imported finished goods prices were also lower than a year earlier, largely reflecting a fall in shipping rates in response to overcapacity and the impact of the appreciation of sterling around 2013 feeding through as forward contracts had expired. Some importers had also benefited from lower costs as a result of the recent appreciation of sterling against the euro.

Output prices and margins

Manufacturing output prices had remained broadly flat overall. Suppliers to supermarkets had quickly passed on lower ingredient costs under strong competitive pressures. Firms supplying into the oil and gas sector were experiencing comparable pricing pressures. Across manufacturing, output price inflation had remained highest in construction materials, although it had shown signs of easing. Business services prices had continued to increase modestly overall, in part reflecting a cost base that, outside haulage, was generally less affected by commodity price falls. Pricing power had been limited by a combination of strong competition and customer resistance to price increases, especially in relatively commoditised services, such as parts of IT. Slowing RPI inflation had started to be reflected in regulated prices, such as airport landing fees, but the main effect was still to come. Profitability had continued to grow modestly, in part reflecting increasing efficiency and, for some, falling non-labour input costs.

Consumer prices

Consumer goods price inflation had fallen further (**Chart 4**). Competition for grocery sales had intensified and further reductions in the cost of domestic energy were expected. New car list prices were creeping up, but some dealers expected increased discounting to come in an effort to reach ambitious sales targets for the year. Retail services price inflation had remained modest. Many consumer services firms continued to report that customers were highly price sensitive, notwithstanding rising demand. Household rents had been slowly increasing. Falling oil prices were prompting some passenger transport firms to reconsider planned fare increases, but air fares had not fallen yet.

Chart 4 Retail prices

Three months on the same period a year earlier