Agents’ summary of business conditions
2016 Q3

- The annual rate of activity growth had slowed overall as uncertainty had risen following the EU referendum, although it had remained positive. However, business sentiment had improved slightly in August following a marked dip in the immediate aftermath of the referendum.
- Consumer spending growth and confidence had been more resilient. Although housing market activity had fallen markedly in London and in parts of the surrounding area, it had held up relatively well in other parts of the United Kingdom.
- Companies’ investment and employment intentions had fallen, and were consistent with broadly flat levels of capital spending and employment over the coming six to twelve months.

**Consumer spending** growth and confidence had remained resilient over the past three months. Growth in spending on consumer services had been stable, remaining stronger than for retail goods.

**Business services** turnover growth had slowed, with heightened uncertainty affecting activity among professional services companies and those servicing the commercial real estate market in particular. Business sentiment had recovered slightly in August following a marked dip in the immediate aftermath of the referendum result.

Growth in **manufacturing** output for the domestic market had increased a little. Manufacturing export volume growth had turned positive.

**Construction** output growth had slowed, partly reflecting easing growth among house builders.

**Investment intention scores** had fallen, particularly among services companies, and pointed to flat business investment over the year ahead.

**Corporate credit availability** had remained broadly unchanged over the past three months, although there were some reports of tighter terms and conditions for lending to the commercial real estate sector.

Investor demand for **commercial real estate** had fallen, particularly in London and from foreign investors. Occupier demand had showed some early signs of easing.

**Housing market** activity had slowed markedly in London and in some parts of the surrounding area, but had held up better in other parts of the United Kingdom.

**Capacity utilisation** was close to normal among services companies and slightly below normal in manufacturing.

**Employment** intentions had fallen overall, and were consistent with stable private sector employment over the coming six months. **Recruitment difficulties** had changed little, remaining modestly above normal.

Growth in **labour costs** per employee had edged higher among manufacturers, but had eased slightly in services.

The recent depreciation of sterling had started to feed through to higher **raw materials and imported finished goods prices**.

Manufacturing **output prices** were little changed on a year earlier. Business services price inflation had remained modestly positive overall.

**Consumer price inflation** had edged higher.

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**Changes to the publication arrangements for the Agents’ summary and scores**

The Agents’ summary is generally published on the Wednesday after the Monetary Policy Committee meeting minutes are published. So as the MPC meeting schedule moves to eight meetings a year (see www.bankofengland.co.uk/publications/Pages/news/2016/051.aspx), the Agents’ summary will move to a schedule of eight publications a year. Consequently, there will not be an Agents’ summary published in October, with the remaining Agents’ summary publications for 2016 scheduled for Wednesday 9 November and Wednesday 21 December. In addition, the timing of Agent’s scoring of the economy will move to eight sets of scores a year alongside the publication of the Agents’ summary. The next set of Agents’ scores will be published on Wednesday 9 November.

This publication is a summary of monthly reports compiled by the Bank of England’s Agents between late May 2016 and late August 2016. It generally makes comparisons with activity and prices a year earlier. The report does not represent the Bank’s own views, nor does it represent the views of any particular company or region.
Consumer services and retail sales
Overall, most contacts reported modest growth in retail sales values during the summer months, with annual growth picking up in the three months to August, after a fall in the three months to July (Chart 1). Clothing and footwear sales growth in particular had been boosted by improved weather relative to that seen earlier in the summer. Growth in demand for new cars had continued to slow, with some increase in caution about purchases reported since the EU referendum. Consumer credit demand growth was reported to be steady overall. Consumer services turnover growth had changed little (Chart 1). Within the total, tourism spending growth had picked up, with evidence of both increased ‘staycationing’ and higher overseas visitor numbers.

Business and financial services
Growth in business services turnover had slowed over the past three months (Chart 2). That had mainly reflected heightened uncertainty, which had reduced demand for a range of professional and financial services. In particular, transactional activity relating to real estate had slowed. Haulage and distribution companies reported a weakening of turnover growth, as companies sought to keep stock levels low to preserve cash in the face of higher uncertainty. Publishing and broadcasting contacts had seen advertising revenues weaken. Services exports growth had picked up moderately. For example, inward tourism for short breaks had benefited from sterling’s depreciation, notably into London. Consultancy services noted improved overseas revenues in Europe, in areas such as online retail and IT. Many professional and financial services companies were waiting to see whether business growth recovered after the traditionally quiet summer months, to assess better underlying demand conditions and inform strategic decision-making. Some contacts — such as advisory firms — were hopeful that demand in certain areas of work would rebound, as firms started to take major business decisions in light of the EU referendum vote. Business sentiment had recovered slightly in August following a marked dip in the immediate aftermath of the referendum.

Production
The pace of growth in manufacturing output for the domestic market had remained modest (Chart 3). Output growth in automotive and aerospace supply chains had strengthened. However, a softening of investment intentions had led to reduced orders for capital goods, and a slowing in housebuilding activity was affecting demand for building materials. Some manufacturers hoped to benefit from import substitution as a result of sterling’s weakness, but there were few examples of that so far. Growth in exports of manufactured goods had edged up, with volumes marginally higher on a year ago (Chart 3). That had largely reflected sterling’s earlier depreciation since November 2015 and a pickup in underlying export demand growth in the United States and the Far East. Export order books pointed to stronger growth over the next year.

Construction
Construction output growth had eased and remained moderate. The growth rate of private housebuilding had slowed overall, although reports were mixed across regions. Construction activity for industrial units and student
accommodation had been robust, albeit in some cases constrained by skill shortages. Growth in repair and maintenance work had remained firm. Demand growth for construction related to rail, road and utilities had remained steady. Across the sector overall, a majority of projects that had been underway before the referendum were continuing, but there were concerns among contacts that the pipeline of work over the next six to 18 months could weaken.

**Investment**

Investment intentions had fallen since the EU referendum and pointed to broadly flat business investment over the next year (Chart 4). There were reports of projects being challenged more rigorously and, in some cases, being scaled back or deferred. Projects already underway were largely continuing, however, and contacts across all sectors were still investing to generate cost efficiencies and increase productivity. The slowing in capital spending had been most pronounced among companies providing professional services to the commercial real estate (CRE) market. In contrast, investment among consumer services firms had remained more resilient.

**Property markets**

**Commercial real estate**

Transactions and investor demand for CRE had fallen since the EU referendum. Investor demand for large prime office blocks had declined, particularly in London. But there had been some areas of positive demand growth for warehousing space and student accommodation, as well as for smaller regional properties. Investor demand for retail space had been mixed, with continued interest in prime shopping centres but weaker demand for secondary sites. The investment appetite of UK property funds had fallen as they sought to preserve liquidity, with some properties sold rapidly at a discount. Demand by foreign investors was unusually low, but there remained a modest flow of purchases being made, in some cases encouraged by the depreciation in sterling. Commercial property prices were reported to have fallen overall, particularly in London, although there was considerable uncertainty around valuations. In the occupier market, there were some signs of easing demand. Occupier enquiries and viewings had declined and many tenants had put their intentions to move on hold. However, vacancy rates had remained low and rents were generally unchanged.

**Housing market**

In London and in some surrounding areas, contacts reported that transaction numbers were materially lower than a year earlier, reflecting the effects on demand of the vote to leave the EU and, in some areas, earlier changes made to stamp duty. Housing market activity had held up much better elsewhere in the United Kingdom, however, especially in the market for lower-to-medium value homes. The major house builders had remained bullish about the prospects for demand for new homes, with little evidence that the referendum had materially affected site visits, reservations, or fall-through rates outside parts of the South East. Mortgage availability had remained highly favourable, although increased caution about lending at loan to value ratios above 95% was reported and surveyors’ had been more cautious in valuations. Demand for mortgages had eased a little overall, but with considerable variability by region.

**Capacity utilisation**

Capacity utilisation had fallen in services but had risen in manufacturing over the past three months, reflecting the pattern of developments in output. Overall, utilisation was close to normal in services and slightly below normal in
manufacturing. For manufacturing, some excess capital capacity was reported in many subsectors, partly offset by high rates of staff utilisation, which were being managed by altering shift patterns, using temporary workers and subcontracting. In services, there was excess capacity in retail and, as a result of weaker activity, in property-related professional services. That was offset in aggregate by higher utilisation in other services, such as warehousing and hotels.

Employment and pay

Employment intentions had softened overall, and were consistent with broadly flat staffing levels over the coming six months (Chart 5). Among professional and financial services firms, hiring activity had slowed following the EU referendum and leavers were being replaced only where the business case was strong. In some cases, primarily in CRE-related subsectors, all non-essential recruitment had been frozen. In consumer services, subdued recruitment plans largely reflected efforts to bear down on costs in the face of the National Living Wage (NLW) and, for retailers in particular, intense competition. Manufacturing intentions still suggested small falls in employment, but at a slightly slower pace, as a period of scaling back production, for example in the oil and gas sector, had been completed and as sterling’s depreciation had improved export prospects. Recruitment difficulties were little changed and remained modestly above normal. Slowing employment intentions had resulted in a narrowing in the range of reported skill shortages, although certain job roles remained difficult to fill, including IT specialisms, construction, logistics, health care and sales. To date, there had been no material change in the availability of migrant labour since the EU referendum result, although many contacts reported seeking to address concerns expressed by their foreign workers.

Contacts saw pressures acting in opposite directions: on the one hand, slowing turnover growth could put downwards pressure on wage inflation, but on the other, expectations of rising consumer price inflation could lead to pressure to increase pay awards to maintain real wages. Manufacturing wage inflation was lower than for services, partly reflecting skills shortages and retention issues among some professional services and finance companies. The impact of the NLW on aggregate labour cost growth had been modest, although it was having a more sizable impact for those companies with a high proportion of low paid staff. While some companies had sought to mitigate the effects on their labour costs this year by reviewing other terms and conditions, there was thought to be less scope for further such adjustments in future years.

Pricing

Supply chain pricing
Sterling’s depreciation had started to feed through to higher costs of imported raw materials and finished goods (see Chart A in the box on page 5). Suppliers to supermarkets reported intense pressure to maintain existing prices notwithstanding higher costs. In other supply chains, however, customers had been more accepting of some increase in price inflation. As a result, a period of declining manufacturing output prices had come to an end. The pass-through of higher raw materials and import prices to output prices was likely to increase later in the year as more currency hedges and forward contracts started to expire. Within business services, pricing had increased where a high proportion of employees had been affected by the NLW, such as cleaning and security, but professional service providers remained reluctant to raise prices in a softening market.

Consumer prices
Consumer price inflation had edged higher, as earlier falls in fuel and food prices had dropped out of the calculation. Food price inflation remained negative, and the extent of exchange rate pass-through in the coming months would largely depend on the evolution of price competition between grocery retailers. In non-food goods, some contacts were seeking to increase prices in response to rising materials costs, but the impact was expected to be seen more fully next year. Consumer services price inflation had remained moderate. Resilient demand growth had generated some increase in pricing power, allowing some pass-through of increases in labour costs arising from the NLW.

Growth in total labour costs had remained moderate. Few contacts cited the outcome of the referendum as having a direct influence on pay decisions over the past two months.
Box 1
How is the fall in the exchange rate feeding through to the economy?

The sterling ERI has fallen by some 10% since the EU referendum and by around 15% relative to its November 2015 peak. This box summarises the early intelligence on how the fall in the exchange rate has been feeding through the economy.

The fall in sterling had led to an increase in margins for many exporters, offset in some cases by previous hedges against moves in the exchange rate. Recent growth in manufacturing export volumes was reported to reflect the earlier depreciation seen between November 2015 and early 2016; export volumes were described as being yet to respond to the post-referendum depreciation. Contacts had not seen a step change in manufacturing export growth as yet following the referendum, probably reflecting the time required for companies to break into new markets, and for overseas customers to realise the benefits of switching suppliers. Inward tourism numbers were, however, already picking up on the back of sterling's post-referendum fall.

There had also been a switch domestically to UK-based tourism away from overseas holidays. Beyond that, there were as yet few examples of import substitution in response to the fall in the exchange rate, partly reflecting the fact that it would take some time (if at all) for companies to source domestic alternatives, particularly in parts of manufacturing. Indeed, the early intelligence suggested that import substitution for manufactured goods was expected to be limited, given that in many cases there were no UK suppliers available.

There were signs of prices starting to respond to the fall in sterling, with Agents’ scores for annual inflation in material costs and imported finished goods prices having risen to their highest levels since 2013 (Chart A). Further cost increases were expected over the next twelve months as supplier contracts were renewed and pre-referendum hedging expired. There had been little evidence of greater than usual hedging of foreign currency exposures ahead of the referendum: if anything there were more reports of less hedging given expectations of a Remain vote, and in some cases protection had been bought for smaller moves than had actually occurred.

There was little evidence of pass-through to retail pricing as yet, but there were signs that would begin over the coming months, with the extent of the depreciation helping persuade some retailers of the need for higher prices. That said, retailers were very cautious about any increases in prices, given that consumers remained highly price sensitive, and so the extent and timing of pass-through would largely depend on competitors’ actions, particularly in food retail. Some food retailers were re-engineering products to maintain existing prices. In non-food goods, some retailers were starting to increase prices in response to rising material costs, particularly for products sourced in US dollars, but the impact was expected to be seen more fully through 2017.