Households had responded to squeezed incomes by trading down or focusing on essential purchases. As a result, demand growth had slowed across a number of consumer-facing sectors, and modest nominal consumer spending growth primarily reflected price inflation.

Investment intentions indicated weaker growth within services, but were more positive for goods exporters.

Growth in labour costs per employee had been subdued, with settlements clustered around 2% to 3%. Recruitment difficulties remained elevated, with conditions becoming very tight for some skills.

The impact of past falls in sterling on consumer goods price inflation appeared to have reached its peak. Consumer services price inflation was steady overall.

Retail sales growth had remained subdued in values terms, with volumes falling in several categories including for big-ticket items. Consumer services turnover growth had eased slightly further, with increased reports of tightening discretionary spending.

Business services turnover growth was stable overall. Contacts reported buoyant demand for corporate transactions.

Growth in manufacturing output was steady. Exporters continued to report growth above normal levels, though some contacts questioned the sustainability of this over the medium term.

Construction output growth had remained modest, with some signs of a slowing.

Investment intentions indicated weaker growth within services, mostly reflecting the perceived subdued outlook for consumer demand. For manufacturers there was some continued evidence of a modest rebalancing towards exports, driven by macroeconomic factors.

Credit availability for corporates was generally accommodative, but with some evidence of increased discrimination in lending decisions in a toughening macroeconomic environment.

Occupier demand for commercial real estate continued to ease. Investor demand growth and transactions had remained strong, reflecting in part increased appetite among foreign investors. This was resulting in below-normal yields.

Housing market activity had been subdued in most parts of the United Kingdom, in particular in the secondary market and in higher price brackets. Price inflation had continued to moderate.

Capacity utilisation in manufacturing had increased modestly, but remained around normal levels in services.

Employment intentions indicated a modest planned increase in staffing in manufacturing, however employment intentions in services were weaker, with headcount reductions planned in some sectors. Recruitment difficulties remained elevated, with conditions becoming very tight for some skills.

Growth in labour costs per employee had remained subdued. Settlements had been clustered around 2% to 3%.

Materials costs and imported finished goods price inflation were broadly unchanged but remained elevated. Pass-through effects appeared to be easing slightly, but rises in some commodity prices had added to cost pressures.

Manufacturing output price inflation was stable, as contacts struggled to achieve full pass-through of input cost inflation. Business services price inflation had picked up slightly.

The impact of past falls in sterling on consumer goods price inflation appeared to have reached its peak (absent a further material depreciation of sterling), and was expected to ease slightly by year end. Consumer services price inflation was steady overall. The past falls in sterling had squeezed companies’ profit margins, with margins currently below normal levels.

Results from the Decision Maker Panel suggest that Brexit is an important source of uncertainty for many but not all companies, and that Brexit is likely to weigh on investment over the next year.
Consumer services and retail sales
Retail sales growth had remained subdued in values terms, especially in non-food sectors; there were more reports of consumers trading down and focusing on essential purchases. Growth was challenged by modest rises in earnings and weakening consumer confidence; some contacts also reported weaker growth in sales associated with housing transactions, such as carpets and curtains. Value growth primarily reflected price inflation; volume growth had been weaker overall and volumes had fallen across several sectors, notably bigger-ticket items including new cars. And demand for clothing and footwear had been depressed by poor weather.

Consumer services turnover growth had slowed (Chart 1), but reports across sectors were more mixed. Tourism contacts generally reported resilient demand, though some hotels, music venues and visitor attractions reported a softening. Terror incidents were thought to have weighed on demand for some domestic travel services, but had not affected foreign travel materially. In other sectors, contacts reported that consumers were becoming more price-sensitive and seeking to tighten discretionary spending — some leisure contacts reported slower growth and heightened competition and communications contacts reported more consumers switching to SIM-only mobile phone deals. However, sales of private health insurance were increasing.

Business and financial services
Business services turnover growth had been stable overall. Buoyant demand for corporate transactions (eg mergers and acquisitions (M&A)) had boosted activity for some financial and professional services contacts. Strategic advisory work had picked up, including on Brexit-related issues, while demand was also solid for IT and logistics services. In contrast, turnover growth had been subdued for insurance, audit and insolvency services, and for architects and surveyors.

Services exports growth had continued at a solid pace, helped by stronger international demand and the part fall in the exchange rate. Business services export providers had reported strengthening demand for their services — this included legal and accounting firms supporting overseas clients on corporate transactions. IT and software providers also reported robust growth. Inbound tourist numbers had increased markedly this summer. Demand for services supporting the oil and gas sector had remained weak, though the sector appeared to be stabilising.

Production
Domestic manufacturing output growth was stable, remaining around normal levels (Chart 2). Food and drink producers had continued to see good growth in demand, although those supplying supermarkets reported consumers switching to lower-value products as their incomes were squeezed. Manufacturers of products for use in housing construction and renovations continued to report strong growth, but volumes in parts of the wider construction sector were flattening. Activity remained buoyant in the aerospace and automotive sectors. The weaker exchange rate meant that some UK buyers were re-sourcing from domestic suppliers to mitigate increased import costs, though in some areas such as electronics the opportunity to do so was limited by shallow UK supply.

Growth in goods exports volumes was steady overall and remained slightly above normal levels (Chart 2). Firms producing luxury or niche consumer goods and high-tech goods reported stronger growth in demand, and aerospace and defence contacts also reported strong sales. Export growth was supported by the past fall in the exchange rate, and the continuing strengthening in global demand. But some contacts noted that generating additional export volume growth could take time given the need to win first orders from new clients, re-focus internal resources and realign international supply chains. Some exporters described the current environment as a ‘sweet spot’, but noted future risks around market access and supply chains following the United Kingdom’s departure from the European Union.

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Chart 1 Retail sales values and consumer services turnover

Three months on the same period a year earlier

Chart 2 Manufacturing exports

Three months on the same period a year earlier
Construction
Construction growth had remained modest, with signs of softening and some contacts expressing concern over the sector’s near-term prospects. Although housebuilding remained the strongest segment, signs of weakening in the housing market had prompted some builders to reduce their growth rates, with others standing ready to do so if market conditions worsened. Skills shortages may also limit further growth in some parts of the country. Commercial construction was growing slowly overall, and was weaker in retail than elsewhere. Contacts expressed mixed views on infrastructure, with some contacts expressing concern about potential delays or deferrals of major projects, which could leave a shortfall in work when current projects concluded.

Investment
Investment intentions had softened somewhat in services, reflecting the perceived subdued outlook for consumer demand. Lower UK growth prospects, sterling depreciation and a pickup in demand from outside the United Kingdom had begun to encourage a modest rebalancing towards exports, supporting investment in business systems, plant, and infrastructure such as ports. Conversely, there were some reports of firms, particularly larger corporates, favouring direct investment overseas. And uncertainties regarding the United Kingdom’s future trading arrangements continued to deter investment for some firms. There had also been further reports of funds flowing into overseas or cross-border facilities, such as office space and storage, as a contingency.

Capacity constraints were prompting some producers to expand, though there was still reluctance from some contacts to commit to major investment schemes. In business services, many firms were pursuing more productive use of office space. Investment in consumer leisure facilities continued but the expansion of retail services was slowing.

Corporate financing conditions
Finance generally remained readily available, including lending to support M&A activity. While there were signs that credit was becoming slightly more difficult to access for smaller companies in some sectors, availability was stable on balance. Certain foreign and challenger banks were starting to lend to a wider range of firms, such as regional house builders. But there was also some evidence of increased discrimination in lending decisions in a toughening macroeconomic environment. Demand for finance had remained subdued relative to normal, with reports pointing to a further softening in recent months.

Property markets
Commercial real estate
Enquiries from foreign investors for London commercial real estate had continued to ease, and valuations remained stretched despite recent modest declines. Elsewhere in the United Kingdom, demand from domestic and foreign investors had remained strong, resulting in below-normal yields. Investor and occupier demand had remained highest for distribution sheds and warehouses, in response to the shift towards online buying, and more mixed for office space. Investors were scrutinising potential rental income streams more carefully and as a result, transactions were taking longer to negotiate. Land values were softening, reflecting easing demand growth from house builders and uncertainties about longer-term prospects for UK farming. Occupier demand for retail space was also softening. With footfall in shopping centres declining and business rates rising for some, retailers were less willing to commit to additional space, which acted as a drag on rents.

Housing market
Activity and price inflation in the housing market had continued to soften, with the slowdown concentrated in the secondary market and especially in higher price brackets. For many contacts, the market had slowed around the general election. But there were some signs of a further weakening following the election, and the market had remained subdued during the summer. Contacts in London and surrounding areas reported the weakest sentiment across regions; in contrast, parts of the Midlands, Scotland, Wales and Northern Ireland were more buoyant. Supply and demand appeared to be broadly in balance across the overall market. Demand had proved more resilient in the new-build sector, though some contacts pointed to early signs of a slight weakening in this market. Help to Buy was regarded as crucial to sustaining demand among first-time buyers.

In the residential mortgage market, both lender and broker contacts reported that competition remained intense, driven by new market entrants and low funding costs. However, this competition was mainly concentrated on customers with the cleanest credit history. More customers were taking out fixed-rate deals; mortgages with longer terms, in many cases over 30 years, were becoming more popular. There were more reports of transactions falling through due to surveyors down-valuing properties, reflecting concerns about falling prices.

Capacity utilisation
There had been a modest increase in capacity utilisation in manufacturing over the past quarter (Chart 3). Capacity was tighter than normal for some exporters that have been
Box 1
Survey: UK profit margins

During August, the Bank’s Agents undertook a survey of business contacts to assess trends in UK profit margins, as well as the drivers of changes in margins over the past 18 months and the next 18 months. Over 250 companies responded to the survey. For firms in the sample, the current average operating profit margin on UK sales was 13%, but there was a wide range of reported margins among respondents.

On balance companies’ margins on UK sales were judged to be around ‘normal’ levels in early 2016, but had since deteriorated to below normal levels (Chart A). And firms expected margins to weaken a little further over the coming 18 months.

Over the next 18 months, a stronger balance of firms said they would attempt to rebuild margins by raising productivity, for example by investing in automation, and also by raising prices. Non-labour cost pressures were thought likely to abate slightly, having affected consumer-facing firms in particular over the past 18 months. But the overall picture is of continued increases in costs, which firms are struggling to pass through, particularly in competitive and price-conscious markets.

The fall in margins had been seen across sectors, but was most pronounced for consumer sector firms (Chart B). Further worsening in margins was only expected in services sectors. While manufacturers reported lower margins on UK sales in the survey, many may have seen increased margins on their exports.

Respondents were asked about the impact of certain factors on their profit margins (Chart C). Over the past 18 months, the drag on margins from cost increases had more than outweighed benefits from productivity growth, price increases and changes in product mix. Among the most important influences on costs were the impact of the depreciation of sterling on import costs, and increases in pay including those relating to increases in the National Living Wage.
benefiting from sterling’s depreciation. Capacity constraints remained around normal levels in services, though some skills shortages persisted in areas such as IT and parts of professional services. Fixed-asset utilisation had increased in some parts of the service sector, eg commercial property and transport infrastructure, but there was considerable spare capacity in retail.

### Employment and pay

Employment intentions (Chart 4) had pointed to only modest headcount growth as, rather than increasing staff numbers, firms sought to improve productivity through efficiency gains and increased automation. This was particularly the case for firms heavily exposed to increasing labour costs, such as the National Living Wage and the apprenticeship levy.

Manufacturing employment intentions had edged up a little, notably for exporters. In business and consumer services employment intentions had eased slightly. There were reports of planned reductions in headcount for some estate agencies and firms in the oil and gas supply chain. Some financial firms were more reluctant to hire given the uncertainty around future passporting arrangements, and given the continuing shifts towards customers banking on-line or through mobile apps. Conversely, there was strong headcount growth within IT firms.

### Pricing

Supply chain pricing

The initial effects of pass-through of the past fall in sterling into manufacturers’ materials cost and output price inflation (Chart 5) appeared to have reached its peak. Increases in global commodity prices, including for dairy products, added to cost pressures in many manufacturing processes.

Professional and IT services contacts painted a mixed picture on business services prices. For some, persistent growth in activity had allowed them to increase fees, particularly for niche activities. But for most other services, the pace of economic growth had been insufficient to drive widespread changes in rates. And competition in provision of baseline services remained intense as technological progress ‘commoditised’ more activities.

### Chart 3 Capacity utilisation

Over the coming six months, relative to normal

<table>
<thead>
<tr>
<th>Scores</th>
<th>2006</th>
<th>07</th>
<th>08</th>
<th>09</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
<th>17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total services</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>

Recruitment difficulties remained elevated. Conditions were becoming very tight for some skills — these included finance, IT, construction, engineering, healthcare, and hospitality (including chefs). In an increasing number of cases, skills shortages were resulting in ad-hoc double digit pay inflation to retain existing staff or recruit new ones; employers were also increasing training and recruiting more apprentices to address recruitment difficulties. Some sectors were adversely affected by a weaker supply of migrant labour, including agri-food, construction and haulage. Overall staff turnover generally remained at low levels.

Growth in total labour costs was modest overall, with the majority of pay settlements clustered around 2% to 3%. Labour cost inflation was greatest across a range of IT skills and within construction, where skills shortages were most acute. The National Living Wage continued to put upwards pressure on total labour costs as more employees were included. A number of firms reported focusing on addressing pay differentials, including skewing pay increases towards lower paid staff.

### Chart 4 Employment intentions

Over the coming six months

<table>
<thead>
<tr>
<th>Scores</th>
<th>2006</th>
<th>07</th>
<th>08</th>
<th>09</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
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</thead>
<tbody>
<tr>
<td>Business services</td>
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<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Consumer services</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

### Chart 5 Material costs and imported finished goods prices

Three months on the same period a year earlier

<table>
<thead>
<tr>
<th>Scores</th>
<th>2006</th>
<th>07</th>
<th>08</th>
<th>09</th>
<th>10</th>
<th>11</th>
<th>12</th>
<th>13</th>
<th>14</th>
<th>15</th>
<th>16</th>
<th>17</th>
</tr>
</thead>
<tbody>
<tr>
<td>Materials costs</td>
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<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Imported finished goods prices</td>
<td>2</td>
<td>3</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
</tbody>
</table>
Consumer prices
Contacts believed that, absent any significant further depreciation, the impact of sterling’s past falls on annual consumer price inflation had peaked and was likely to ease slightly by the year end. Competitive pressure continued to moderate retail goods price rises by the major grocery multiples, in spite of upward pressure on commodities. Prices for new cars had continued to increase. As noted in Box 1 on page 4, the past falls in sterling had squeezed companies’ profit margins, with margins currently below normal levels.

In retail services, a shortage of private rental housing stock was supporting further increases in private rents. But catering prices were being held back by the level of competition and scope to reconfigure menus. Across a range of leisure services — hotel rooms, shows, concerts, visitor attractions — prices had risen, but suppliers were becoming more cautious about what further increases would be achievable.
Box 2
Results from the Decision Maker Panel

Overview
To better understand the uncertainty facing British businesses ahead of the United Kingdom’s withdrawal from the European Union, the Bank has recently established the Decision Maker Panel (DMP) in partnership with Stanford University and the University of Nottingham. The role of panel members, comprising a large number of UK Chief Financial Officers (CFOs), is to provide direct insight into business expectations and complement the more qualitative intelligence gathered from the Bank’s Agents’ contacts.

So far, around 2,500 executives from small, medium and large UK companies, operating in a broad range of industries, have agreed to participate, with a large majority not previously being contacts of the Bank’s Agency network. The panel is designed to be representative of the UK business population, excluding a small number of sectors such as finance. It includes questions on topical policy issues and it can provide valuable insights into firms’ perceptions of the challenges and opportunities facing the UK economy.

Since August 2016, panel members have been asked about their employment, investment, prices and sales. Decision makers are asked to provide five scenarios for each variable: from the worst case to the best case, and to specify how likely they think each scenario is. From this, it is possible to calculate average expected growth rates and measures of uncertainty around those expectations. Participants are also asked special questions, which so far have mostly related to Brexit.

Although this project runs independently of the Agents’ intelligence gathering, regular summaries of information provided by decision makers will be published on a quarterly basis alongside the Agents’ reports. Aggregate level data will also be available on the Bank website.

Business expectations
The expected average growth rates for employment, nominal sales and prices over the next year are shown in Chart A alongside growth rates from the past year. Companies expect some slowing in nominal sales growth over the year. Over the year to 2017 Q2, sales are estimated to have grown by an average of 7.6%, but growth over the year to 2018 Q2 is expected to be lower at around 5.3%. Expectations for year ahead sales growth have slowed over the past two quarters (as shown by the dashed orange line on Chart A). Employment growth is also expected to slow over the next year, although expectations for employment growth during the year to 2018 Q3 have picked up.

DMP members have reported that annual price inflation has risen over recent quarters to 3.2% in 2017 Q3 (as shown by the solid blue line on Chart A). Price inflation is, however, expected to slow slightly to 2.7% in the year to 2018 Q3.

The survey indicates that firms are uncertain about their predictions for the year ahead. For example, while, on average, panel members thought that there was a one-in-four chance of sales growth being above 10% over the year to 2018 Q1, they thought that the probability of a fall in sales was around one-in-eight (Chart B). The latest responses show that while expected average sales growth over the year to 2018 Q2 was little changed from Q1 (Chart A), the size of both tails of the distribution had become larger (Chart B), indicating that there has been some increase in uncertainty.

Role of Brexit
In the August 2017 DMP survey, around 40% of respondents cited EU withdrawal as at least one of the top two or three sources of uncertainty facing their businesses (Chart C). In that August survey, a greater proportion of businesses reported that Brexit was a source of uncertainty for them than when the same question was asked in September 2016.

On two occasions in the past twelve months, panel members have been asked about how they expected Brexit to affect their plans for capital expenditure over the next year. In the
May to July 2017 surveys, a greater proportion of companies thought that it was more likely that Brexit would have no material impact on their investment over the next year than was the case in October 2016 (Chart D). That said, in the most recent surveys, companies indicated that there was still about a 25% chance, on average, that Brexit will have a negative impact on investment, with only an 8% chance of there being a positive impact.