Bank of England
Agents' summary of business conditions

August 2005

- The value of **retail spending** may have stabilised, but growth in spending on **consumer services** has weakened.
- Activity has been stable in the **housing market**, albeit at a much lower level than a year ago. The stock of properties on estate agents' books remained high.
- **Export** prospects have improved in light of the dollar appreciation against sterling. **Import** growth weakened further.
- **Investment intentions** fell back a little as firms became more cautious about the outlook for the economy.
- **Manufacturing output** fell due to weaker domestic sales. Export growth has held up.
- The pace of **construction output** growth eased, but was still robust.
- **Service sector output** growth eased, and there were some signs that the weakness in the consumer-facing sectors was starting to have an impact on business services.
- **Employment** intentions and recruitment difficulties have fallen over the past month.
- **Capacity utilisation** was below normal in manufacturing, but above normal in the service sector.
- **Pay** pressures remained muted.
- **Input price inflation** was broadly stable.
- **Consumer price inflation** eased a little.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 700 businesses in the period between late-June and late-July 2005. It provides information on the state of business conditions, from firms 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 firm 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/agentssummary/index.htm.

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, 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/inflationreport/index.htm.*

DEMAND

Consumption[(a)] and housing

There were some signs that the value of retail spending may have stabilised over the past month. But most contacts still reported that sales were flat or down on a year ago. The weakness in spending continued to be most pronounced for durable goods, and private car sales remained poor. A number of retailers had extended their summer sales, either by starting them earlier than usual, discounting by more than usual, or including a wider range of goods in the sales. That was partly to clear the involuntary build-up in stocks that resulted from the weaker pattern of spending since the end of last year. Most retailers believed that growth in the second half of 2005 was likely to be weak, and had reduced orders for new stock accordingly.

Spending on consumer services rose, but the pace of growth weakened. Restaurant and leisure contacts were most affected, and hotels were also reporting weaker demand from consumers.

Contacts in and around London reported a sharp slowing in consumer spending on both goods and services following the terrorist attacks on 7 July. But demand returned to more normal levels in the weeks following the bombings.

Activity in the housing market was broadly stable over the past month, though it was significantly down on a year ago. House builders were offering increasingly larger discounts in an attempt to shift completed stock, and were cutting back on new building. Estate agents continued to report high stocks of properties on their books, and the average duration of sales also rose. There was a mismatch between the price sellers wanted to achieve and the price buyers were prepared to pay, and the lack of first-time buyers was a major concern. Generally prices had been flat to falling since the start of the year, and were seen as likely to remain flat or even fall over the rest of 2005 as the excess supply was worked out.

Exports and imports

A number of contacts reported improved prospects for exports over the past month. In particular, contacts often cited the appreciation of the dollar against sterling, although they believed the impact was more likely to be seen in margins than in volumes in the short term. In terms of actual volumes, exports to the United States grew over the past month. Exports to Asia also rose, though there were tentative signs that growth may have softened recently for some goods. Contacts remained generally downbeat about prospects in the major European economies, although there were some reports that demand in Germany may have been gradually improving.

The Agencies also reported that import growth weakened significantly over the past month. This primarily reflected the slowdown in demand for consumer goods, with retailers wanting to reduce their existing stocks and also reducing orders for the rest of the year. However, generally contacts were importing more goods and components from low-cost economies, and were moving away from traditional suppliers.

Investment

Contacts' investment intentions eased again over the past month. Manufacturing investment was rising modestly, but this usually reflected cost-saving motives rather than a desire to increase capacity. Service sector investment was more positive, concentrated in IT and telecoms. But both consumer and business service companies were becoming more cautious about investing to increase capacity. In particular, although retailers had remained reasonably sanguine about their investment plans in previous months, some chains were now reviewing these due to the squeeze on their margins and cashflow.

OUTPUT

Primary production

Oil producers were looking to bring new sites on stream rapidly in order to benefit from the high oil price. The impact of the Single Farm Payment continued to be a key concern for farmers, but a number of contacts reported that conditions look favourable for this year's harvest. However, margins were continuing to be squeezed.

Manufacturing

Reports from a large number of contacts suggested that manufacturing output had fallen over the past month, due to the easing in domestic demand for goods. There were some reports that manufacturers had been surprised by the weakening in demand, and had been left with excess stocks of unsold goods. Competition from abroad also intensified, and producers offering niche or high-spec items fared best — for example some engineering firms (eg aerospace) were still reporting rises in output and new orders. Once again exports outperformed domestic sales.

Construction

Construction output increased at a robust pace, but several Agencies reported that growth had slowed. This partly reflected a lull in new demand from the public

(a) The intelligence for this summary was gathered before the second London alert on 21 July.

sector, which could prove to be temporary, but also weaker private demand and less work on repairs and maintenance. New builds in the housing market also weakened. Some suppliers to construction firms also reported a slowdown in sales. Looking further ahead, contacts from several different regions expressed concern about whether there was enough capacity in the industry to cope with the development work for the 2012 Olympics as well as other work in the pipeline.

Services

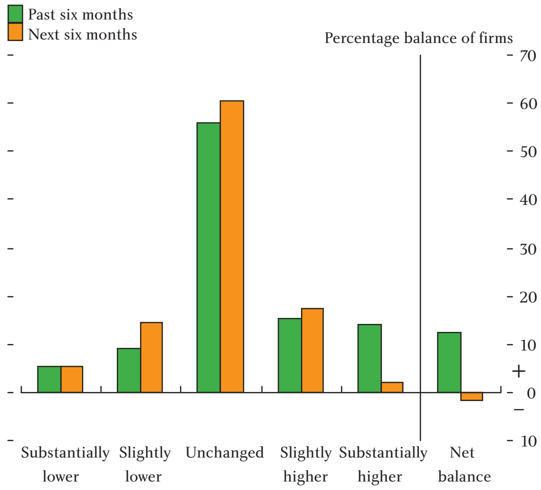
While services growth was strong overall, there were reports of an easing in growth over the past month. Growth in business services and finance remained much stronger than in consumer services. But there were some signs of spillover from the slowing in consumer demand — for example, some logistics and advertising firms reported a downturn in business. There were also some reports that sentiment may have weakened a little, as businesses were reluctant to take major spending decisions while the economic climate is uncertain.

EMPLOYMENT

There were further signs of easing in the labour market. Employment prospects weakened, with falls in recruitment and job creation across many sectors. Staff turnover was low, and contacts had less need to use employment agencies. Job cuts intensified in the manufacturing sector, and public sector recruitment slowed. Recruitment difficulties eased on the month, and for many sectors contacts were having little trouble finding staff to fill posts. However, skill shortages remained particularly pronounced in some instances, primarily in the professional services sector, although there were signs that shortages in the construction sector may have eased a little. Where possible employers were recruiting from abroad to address shortages, particularly from Eastern Europe.

In July, the Agents carried out a survey of their contacts regarding employment. The survey, which covered around 200 companies employing a total of 260,000 people, suggested that over the next six months private sector employment may be broadly unchanged, following a rise in employment over the past six months (Chart 1). There was some sectoral divergence: construction firms planned to increase employment markedly, but non-retailing service sector companies thought their employee numbers would be unchanged. Respondents noted that increased costs and improvements in productivity were most likely to reduce headcount, while stronger demand for their products was most likely to lead to them taking on staff.

Chart 1
Changes to the number of workers employed in the United Kingdom(a)



(a) Net balance of firms reporting an increase in employee numbers, or an intention to take on more staff. Individual responses have been weighted by firms' employee numbers.

CAPACITY UTILISATION

Capacity utilisation eased in manufacturing, particularly for firms providing consumer goods. Utilisation in the service sector was above normal, but the underlying picture was mixed, with constraints most prevalent in professional services, reflecting skill shortages. In this instance, the pressure on capacity was sufficient to generate rises in output prices. Some contacts — from both manufacturing and services — remarked that capacity could often be 'flexed' in response to changes in demand.

COSTS AND PRICES

Pay

There was little change in settlements, and more generally upward pressures on pay were subdued. This was partly due to less pressure on employers to concede wage increases, given the easing in recruitment difficulties. The exception was professional services, where some firms offered significantly enhanced packages to attract and retain staff. Bonus payments continued to be high this year, reflecting companies' strong profitability last year. But contacts expected bonuses to be lower in the year ahead as profits started to be squeezed following the economic slowdown.

Input prices

Overall, input price inflation was broadly unchanged. Energy and utility prices continued to be the main concern for most contacts, given the substantial rises over the past year. Many contacts were also worried about the likelihood of future increases in these costs. This may have been linked to the further rise in the oil price in recent months, which had been exacerbated by the fall in the pound against the dollar. The exchange rate movement also increased the cost of many other imports, including finished goods. However, most Agencies reported that some other commodity prices, such as steel, had fallen back a little after rising sharply over the past year. Companies were also sourcing components from lower-cost economies, which offset some of the upward pressure on imported costs.

Output and consumer prices

A number of firms were managing to raise their own prices in response to the higher oil price, for example via 'escalator' clauses in contracts. But more generally, companies were finding it difficult to raise prices in the face of continued global competition. Overall, annual output price inflation eased over the past month.

Retail goods prices continued to fall. There has been additional downward pressure on prices over the past month, due to bigger than usual discounting in an attempt by retailers to clear stock and stimulate sales. In addition, some of the recent rise in food prices may have unwound. Retail services prices rose at a similar pace to last month, as competitive pressure was generally less intense than for goods. There were further increases in transport-related prices.