Bank of England

Agents' summary of business conditions

December 2005

- Growth in the value of **consumer spending** may have picked up a little, but the underlying picture remained subdued.
- Activity continued to edge up in the **housing market**; prices were flat.
- Growth in **exports** continued. **Imports** also rose, despite weaker imports of consumer goods.
- **Investment intentions** eased slightly.
- The level of domestic **manufacturing** sales may have stabilised.
- **Construction** output growth remained lower than a year ago.
- **Business services** growth was robust; there was a small rise in **consumer services** growth.
- The **labour market** softened again.
- **Capacity pressures** eased.
- There was little sign of any upward pressure on **pay**.
- Overall, **input price inflation** eased back. But wholesale gas prices increased markedly.
- **Consumer price inflation** edged lower.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 600 businesses in the period between late October and late November 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 and housing

Consumer spending growth remained weak in November, although there were some tentative signs of improvement and some regional variation. Several contacts reported slightly stronger sales of clothing following the onset of the colder weather, but many retailers continued to report lower sales than a year ago. This was particularly true for 'big-ticket' items and more discretionary items such as jewellery. Growth in sales by mail order and over the internet continued to outperform high-street sales growth.

Retailers remained cautious about the outlook for sales around Christmas and the New Year, and generally expected spending to be down on a year ago. Contacts reported that the timing of sales was likely to be mixed: there were some reports that pre-Christmas discounting could be less marked than last year, although a number of stores were planning 'one-day' reductions as the festive season progressed.

Growth in spending on consumer services also picked up a little on an annual basis. But again, the underlying picture was weaker than in the first half of the year. Restaurants and bars generally reported weaker trade, but other leisure services, such as hotels and low-cost air travel, reported stronger sales.

The new-build residential market was weak. But some contacts reported a slight increase in sales of new houses, although levels remained much lower than last year. Correspondingly, while part-exchange deals and other incentives remained prevalent in order to sell completed homes, the scale of these incentives was no longer increasing.

Overall, activity in the housing market continued to recover gently, although the picture was patchy, with some regions reporting that the recovery had stalled. Generally contacts expected the market to remain relatively quiet until the usual upturn in interest in the spring. House prices remained generally flat across most regions.

Exports and imports

Exports continued to rise in November for a range of businesses, and the recent rate of growth was broadly unchanged. Once again the pickup in sales was concentrated in the Middle East and Eastern Europe; US demand also remained strong. Trade growth with Western Europe was subdued, with most contacts reporting only a weak pickup in demand at best.

Imports of consumer goods, particularly from the Far East, have decelerated in recent months, consistent with retailers' views that Christmas spending would be more subdued than last year. But, more generally, contacts reported that import penetration continued across a range of sectors, including services companies outsourcing administration functions as well as manufacturers importing components more cheaply.

Investment

Contacts' investment intentions eased in November. Manufacturing investment intentions were unchanged, with firms still expecting to reduce spending a little over the next six months. Service sector investment intentions fell slightly. More generally, investment spending remained concentrated in IT, with a view to reducing costs and increasing efficiency, as well as meeting regulatory requirements. And the retail sector continued to invest heavily in new capacity, despite the slowdown in sales growth during this year.

OUTPUT

Primary production

Output from farming remained flat at best, and contacts were generally pessimistic about long-term prospects as the Single Farm payment system takes effect. Planned and unplanned interruptions in the oil and gas sector were continuing to affect production.

Manufacturing

Overall, manufacturing output was broadly flat in November. Export sales continued to outperform domestic orders, but the latter may have stabilised as some firms started to replenish stocks that had been previously run down. The emphasis continued to shift towards higher value-added production for niche markets and products. The trend of manufacturers closing their UK operations and switching production overseas continued.

Construction

Annual output growth stabilised in November, but remained noticeably weaker than in 2004. Some house builders slowed the pace of new starts until their existing stock of finished properties — particularly flats — were sold. Private demand was mixed, with some contacts reporting stabilising demand in areas like commercial development, while others cited fewer projects entering the pipeline. But public sector demand — spending on roads, hospitals and schools — remained strong, and there were some reports that the recent slowdown in public sector spending may not have been sustained.

Services

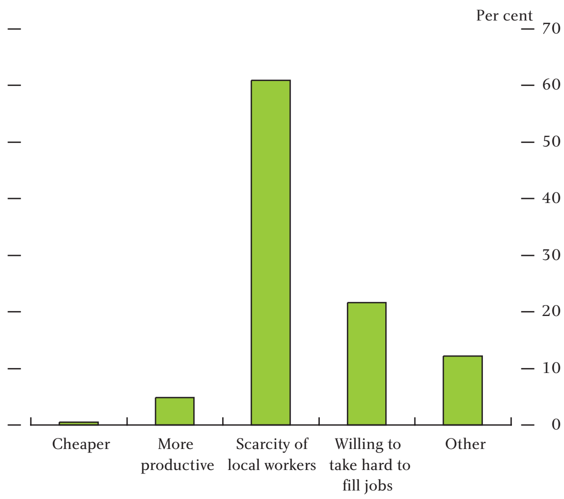
Growth in business services turnover was broadly unchanged. Financial and professional firms continued to see robust growth, with high levels of mergers and acquisitions and further strong demand for advisory services that was likely to persist for some time. Other business services also continued to see healthy growth, although the picture was more mixed across contacts, with some sectors such as haulage continuing to feel the squeeze from the slowdown in consumer demand. There were tentative signs that growth in consumer services turnover started to recover slightly in November, reflecting stronger demand for leisure services. But consumer services growth remained much weaker than in the business services sector.

EMPLOYMENT

The labour market slackened a little over the month. Manufacturing firms continued to lay off staff in the face of overcapacity and the continuing shift of production abroad. Overall, consumer service firms expected to keep employment broadly unchanged over the next six months: within that, retailers were taking on fewer staff this year for the Christmas period. Employment intentions in business services were also broadly unchanged; overall firms expected to increase headcount. There were also reports of weaker public sector recruitment. Against this backdrop, and in the face of companies hiring more workers from overseas, recruitment difficulties were lower than for some time. The main exception was in the professional and financial services, where there were consistent reports of skill shortages throughout the regions.

In November, the Agents carried out a survey of their contacts regarding the use of migrant labour. The survey covered around 220 companies employing a total of over 275,000 workers. For a quarter of respondents, migrants made up at least a tenth of the workforce, particularly in the hospitality and agricultural sectors. Overall, firms expected that the proportion of non-UK nationals in their workforce would rise over the next twelve months, although perhaps not as fast as over the past year. Respondents reported that the main reason for employing foreign workers was the scarcity of local workers. Migrants were also more willing to take 'hard to fill' jobs. But very few companies employed migrants primarily because they were cheaper than UK workers (Chart 1).

Chart 1
Reasons why companies employ non-UK nationals(a)



(a) Percentage of firms reporting the main reason for employing non-UK nationals in their workforce. Individual responses have been weighted by the size of companies' workforces.

CAPACITY UTILISATION

Utilisation eased in both the manufacturing and service sectors. Skill shortages in professional and financial services were the key constraint that was uniformly cited across Agencies. But even here, employers were using human resources more flexibly, continuing the trend of companies adjusting or 'flexing' capacity. Given the slack in the labour market, many service sector contacts could increase capacity quickly in the short run to deal with increases in demand. And most manufacturers had sufficient capacity to deal with any upturn in demand — indeed, there was overcapacity in the sector as a whole.

COSTS AND PRICES

Pay

There was little upward pressure on wage growth, and in general contacts were not expecting any increase in pressure for the 2006 wage round. Settlements looked likely to be either linked to RPI inflation, which was the usual benchmark, or set at around the 3% level. Some contacts also thought that wage drift — the gap between earnings and settlements — was likely to be modest. Pay pressures were slightly higher in construction, although these were less intense than compared with the last couple of years. Pay was likely to rise faster in professional services, particularly financial services where bonuses were expected to be much stronger than last year. The recent increase in the National Minimum Wage had some effect on pay differentials, but the impact on overall pay was negligible.

Input prices

On balance, annual input price inflation eased. Petrol and diesel prices fell slightly, and some metals prices continued to edge lower. But past price rises were still feeding through to other products such as plastics. The biggest news in November was the marked rise in wholesale spot gas prices. Contacts across the regions were concerned that the rise in spot gas prices could trigger increases in costs when fixed-price gas and electricity contacts were next renewed. In the short term, many firms were likely to see lower margins as there was often little scope to pass the cost increase on to their customers.

Output and consumer prices

Output price inflation was broadly stable. In the face of intense competition, many manufacturers continued to find it hard to recover cost increases fully through higher prices. Retail goods prices fell, and the pace of deflation increased following the slight easing last month. This reflected more pressure on margins given softer consumer demand. Consumer services price inflation was unchanged.