# Bank of England
# Agents' summary of business conditions

## July 2005

- **Retail sales** values have fallen slightly, and demand remained weaker for durable goods. Consumer services grew at a subdued pace.
- The **housing market** remained muted, with both activity and prices broadly flat. Stocks on estate agents' books rose.
- **Exports** grew at a moderate pace, and at a slightly slower rate than last month. There were signs that imports had weakened in response to the consumer slowdown.
- **Investment intentions** eased a little, but still pointed to firm growth.
- **Manufacturing output** growth fell back as sales for domestic consumption eased further.
- **Construction output** growth continued to be strong, although there were tentative signs of slower growth ahead.
- **Service sector output** growth may have slowed. But growth in business services and finance remained much stronger than in consumer services.
- **Employment** intentions and recruitment difficulties eased, although the demand for labour was still strong in the construction and professional service sectors. Staff turnover continued to be low.
- **Capacity utilisation** edged slightly lower, but was still above normal. However, apart from those sectors facing labour constraints, there were few signs that capacity pressures were pushing up output prices.
- **Wage settlements** remained flat, with the most commonly cited increase at 3%.
- Some **commodity prices** flattened off, but the full impact of the past oil price rises had not yet been felt.
- **Consumer price inflation** may have edged slightly lower.

*This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 680 businesses in the period between late-May and late-June 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

The value of retail sales fell slightly over the past month, with footfall also weaker during June. Most Agency reports told a similar story, with few signs of an underlying pickup in sales. The weakness in spending remained most pronounced for durable goods such as furniture. And sales of cars to private buyers have continued to be flat recently, although significantly down on a year ago. Motor traders expected only a gradual improvement in demand during the second half of the year.

Sales of some goods (eg clothing) continued to rise in volume terms, but that appeared to be due to price discounting, as values were generally flat. Spending on consumer services continued to increase, but at a subdued pace, with pubs, restaurants and leisure centres being the weakest sectors.

Overall prices and transactions in the housing market had been broadly stable in recent months. Early signs of a pickup in demand since Easter had not been sustained. Housebuilders were reducing prices and offering incentives (eg cash back, more part exchange, help with legal fees) to try and maintain sales. In the secondary housing market both buyers and sellers were more reluctant to enter the market and any sales were taking much longer to complete. Turnover as a proportion of stock remained very low. The continuing rise in the stock of unsold properties on estate agents' books showed little sign of abating. Contacts expected the market to continue in a similar vein for the rest of the year. An increasing number mentioned the change to self-invested pensions in 2006, which will allow tax relief on buy-to-let investment property included in pension portfolios. This could provide a stimulus to the housing market, but some contacts believed the scheme would be slow to take off, and the effects on the housing market may initially be small.

## Exports and imports

Exports grew at a moderate pace. The United States was a key source of demand for UK goods, and the recent strengthening of the dollar could act to boost export volumes, but had not yet had an effect. A number of Agencies reported increased demand from China and other Asian economies, but also the new EU members, eastern Europe and Russia. Contacts generally remained downbeat about the prospects for demand from western Europe, with many citing conditions as flat or sluggish.

Most Agencies also reported that import growth had weakened over the past month, reflecting the slowdown in demand for consumer goods such as durables. And some contacts reported that high stocks in the supply chain had also affected orders for the rest of the year. But contacts were continuing to import more goods and components from low-cost economies.

## Investment

Contacts' investment intentions eased over the past month, but were still reasonably firm compared to official data, which had shown broadly flat business investment over the past two quarters. Both service sector and manufacturing investment intentions were a touch lower, but still pointed to growth in investment. While business confidence remained subdued and firms were cautious about the outlook, the majority of contacts appeared to be pressing ahead with planned investment, although most of this was aimed at improving efficiency and cutting costs rather than expanding capacity.

Despite the slowdown in sales, retailers and consumer service providers were generally pressing ahead with investment in new stores and refurbishment, with most companies taking a long-term view, based on a desire to grow market share by having a larger presence. Telecoms operators were also investing heavily.

# OUTPUT

## Primary production

The oil and gas sectors were benefiting from high energy prices, and were using the funds to invest. In the same vein, the coal sector had seen high demand over the past year. The impact of the Single Farm Payment, particularly potential disruptions to the pattern of cash flow, continued to be a key concern for farmers.

## Manufacturing

Manufacturing output growth continued to weaken. This was mainly due to poor sales of goods to the domestic market, reflecting the weaker outlook for consumer spending. Manufacturing exports grew at a more robust pace than domestic production, although export growth also eased in June (see above). Niche producers performed best.

The shift in plant capacity from the United Kingdom to lower-cost economies continued, with activities such as the processing of perishable food moving abroad as well as the production of more durable goods.

## Construction

Construction output increased rapidly, underpinned by robust public sector demand. However, some contacts were becoming concerned about whether the strength of public spending would persist, citing a lull in early stage work for civil projects. And some contacts at the front end of the construction chain reported activity levelling off.

The commercial property sector had also held up well due to continued demand from investors, although some contacts were worried that the market may be overheating. In the housing market, new builds may have started to slow, and housebuilders had to offer a number of incentives in order to try and shift stock (see earlier). However, social housing work was continuing to fill some of the gap.

### Services

Private services output growth may have eased a touch over the past month. The service sector continued to exhibit two-speed growth, with business services and finance outperforming consumer services. Most Agencies reported that business services growth remained broad-based, although a number also reported that growth eased slightly overall. But it was too soon to tell whether this reflected spillover from the slowdown in other sectors of the economy. Once again, growth in consumer services was significantly weaker than in business services, reflecting the slowdown in both consumption and housing market activity.

## EMPLOYMENT

The degree of tightness in the labour market had eased. Employment intentions fell a little, and recruitment difficulties had also diminished in recent months. These weaker intentions partly reflected an increased rate of job loss in manufacturing, but also lower recruitment — and in some cases job cuts — in the retail and public sectors. Some retailers were also responding to weaker demand by cutting hours. Another reason recruitment had eased was the very low rate of staff turnover, which perhaps reflected caution on the part of workers. However, in some parts of the economy labour demand was still strong, underpinned by high levels of utilisation and skill shortages: this was particularly the case in the construction and professional service sectors. Employers were recruiting from abroad to meet these shortages.

## CAPACITY UTILISATION

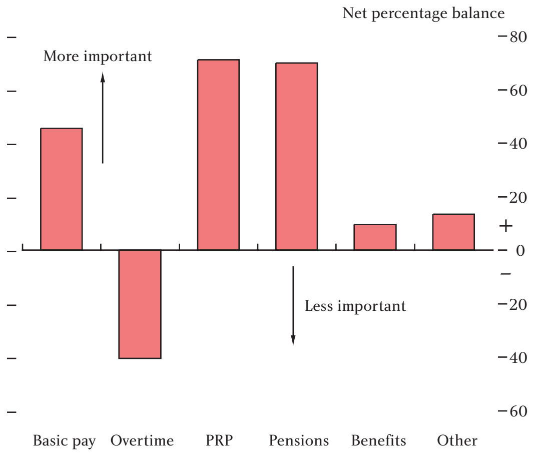
Whole-economy capacity utilisation eased slightly over the past month, but remained above normal. Nevertheless, outside the construction and professional service sectors, where labour constraints were prevalent, there were few signs that contacts were seeking to expand capacity, or that capacity pressures were resulting in rising output prices. Given the uncertain outlook for UK growth, many contacts were cautious about increasing capacity.

## COSTS AND PRICES

### Pay

Pay pressures were generally stable, with most respondents citing a settlement in the region of 3%. Few contacts reported growing pressure on pay, with the exception of heavily unionised sectors and those continuing to experience significant skill shortages. The lack of any broad-based upward pressure on pay was consistent with the recent easing in recruitment difficulties and a more uncertain outlook for the economy.

**Chart 1**
**Changes in importance of different types of pay**(a)




(a) Weighted net balance of firms reporting a pay component having become more important in recent years.

In May and June, the Agents carried out a survey of their contacts regarding pay flexibility. The survey, which covered around 230 companies employing a total of 400,000 people, suggested that the use of performance related pay (PRP) had become more important in recent years (Chart 1). This had been driven by companies wanting to make wage increases more self-financing, and hence unit labour costs less variable. Employers' contributions to pension schemes had also become more important following the recent shortfalls in funds. Respondents cited labour market conditions and individual performance as the most important factors determining basic pay; for other types of pay, such as bonuses, company profitability and individual performance were the two key influences.

### Input prices

Input price inflation eased over the past month. And there were signs that some commodity prices have been stabilising. In particular, a number of contacts from different Agencies reported that the price of steel and other metals appeared to have levelled off. However, the full impact of the past oil price rises was yet to be felt, which was likely to put further upward pressure on input prices and costs over the next few months. The recent appreciation of the dollar had also had an impact on costs. But utility price rises continued to be the chief concern for many contacts, with increases of 50% or more cited over the past year.

## Output and consumer prices

Some manufacturers had managed to push through price increases in recent months to cover their higher input costs. But those supplying the major retail groups continued to face strong downward pressure on prices, particularly in light of the slowdown in consumer spending. Overall, output price inflation may have eased a little over the past month.

This downward pressure, and the tendency for retailers to move towards sourcing goods from cheaper overseas economies, meant that retail goods prices probably fell in June. Generally contacts reported that services inflation was unchanged, although there were some reports of downward pressure on retail services prices. Overall, consumer price inflation may have eased a little.