Bank of England
Agents' summary of business conditions

March 2005

- The growth of **consumer spending** eased. Retail sales growth has weakened, though parts of the consumer service sector continued to show reasonable growth.
- Confidence in the **housing market** improved a little, but remained fragile.
- **Exports** continued to grow modestly. Looking ahead, exporters expected a little stronger growth in demand in the next six months.
- **Investment intentions** remained fairly upbeat, though there were risks that future investment plans might be cut back should consumption growth continue to weaken.
- **Manufacturing output** continued to grow gently.
- **Construction output** growth remained above trend and was buoyed by strong demand from the public sector. Looking towards the end of the year, the expectation was for the rate of growth to ease slightly.
- **Service sector output** growth has been brisk, though perhaps slightly off its recent highs.
- The labour market remained tight, but may have eased very slightly. **Private sector employment** growth was subdued.
- **Capacity utilisation** remained slightly above normal.
- **Pay pressures** have edged a little higher, though most businesses reported that wage costs remained under control.
- **Input prices**, especially of oil-based products, continued to increase. But the rate of increase was a little lower and there were signs that the annual rate of input price inflation may have peaked.
- **Output and consumer price inflation** remained on a gently upwards trend.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with around 600 businesses in the period between late-January and late-February 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/agencies/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: Publications Group, Monetary Analysis, Bank of England, London EC2R 8AH (Price £3.00).*

DEMAND

Consumption and housing

The Agencies reported that the pace of consumer demand growth has slowed in recent months. The slowdown has been fairly widespread, though it was most evident in the demand for consumer durables. And some previously buoyant sectors were now seeing weaker growth. For example, contacts indicated that spending on mobile phone services has levelled out. That was despite the availability of new services such as 3G — for which sales growth has been below contacts' expectations.

Despite a weak start to 2005, many retailers were budgeting for a fairly average year by historical standards. The strength of prospective consumer spending over Easter was seen by many as an important indicator of the short-term outlook. Car sales remained weak. Some dealers detected early signs of a possible pickup in demand in the spring, although new car sales in March were likely to be down on a very buoyant period a year earlier.

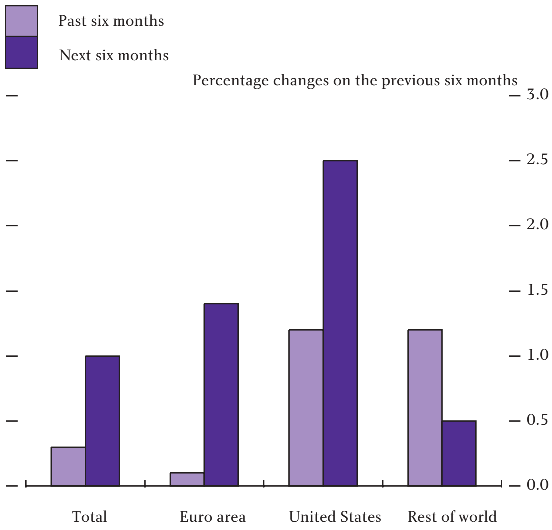
Following a sharp decline towards the end of last year, estate agents reported modestly higher levels of housing market activity in the first two months of 2005. But confidence was fragile and most contacts thought it was too early to judge whether a sustained recovery was in train. The ratio of sales to stocks was either rising or steady for most estate agents.

Nevertheless, with potential buyers no longer expecting prices to rise, most were taking longer to reach decisions and a cautious mood prevailed. Sentiment was also affected by expectations of an approaching general election, and by uncertainty about future movements in interest rates. Also, prices remained high in relation to households' earnings, especially for first-time buyers. All in all, most contacts expected only a very slow pickup in activity. Some believed that current levels of housing demand were not sufficient to prevent prices easing a little further in the short term.

Exports and imports

Exports continued to grow modestly. Demand growth was strongest for capital and intermediate goods, mostly in North American and Far Eastern markets. Exports to eastern Europe were growing quickly, but from a low base. Demand in the euro area remained subdued. Contacts reported that recent exchange rate movements continued to have relatively little impact on their export volumes. Turning to imports, contacts noted that the recent strong pace of growth seemed to have been maintained, despite the easing in consumption growth.

Chart 1
Past and prospective growth in export values



In February, the Agencies carried out a survey of their contacts regarding export prospects. The survey covered firms with total exports of around £14 billion a year, equivalent to nearly 5% of total UK exports. A high proportion of the firms surveyed were manufacturers. On average, exports in the past six months were reported to have risen fractionally compared with the previous six-month period (Chart 1). That was somewhat weaker than indicated by the official data for export values. Looking ahead, exporters expected a little stronger growth in demand in the next six months. Prospects were strongest for exports to the United States. Most contacts expected that much of the growth in their export values in the next six months would be accounted for by higher volumes. Around one fifth of contacts expected that higher export prices would be more important. Only a few contacts expected that the sterling exchange rate would be an important influence on the value of their exports in this period.

Investment

Investment intentions remained reasonably upbeat, though most contacts were not planning to expand capital spending to the same degree as in previous economic cycles. Contacts reported particularly strong growth of capital spending in the retail and distribution sector. That was despite the recent slowdown in retail sales growth. A number of retailers were investing in additional floor space to improve sales and productivity. Investment growth was also robust in the logistics sector, with new and larger warehouse facilities as well as improved management information systems. However, some contacts reported that sentiment towards capital spending could change if consumer demand remained soft after Easter.

Manufacturing investment continued to grow modestly. Investment was driven by the need to reduce costs and meet regulatory requirements. Investment in the oil and gas extraction sector was expected to pick up strongly in 2005.

OUTPUT

Primary production

Without further details of the new Single Farm Payment scheme, farmers were uncertain how it would affect their business and the industry in general. But some thought that the decoupling of payments from production levels would reduce their activity.

Manufacturing

Output grew gently. Contacts pointed to weaker growth of output and orders in the second half of 2004 as suggestive that the cycle may have passed its peak. Most reported that exports were growing more strongly than domestic sales. Aerospace was seeing the strongest growth in orders, while the information, communications and technology (ICT) sector continued a steady recovery. By contrast, contacts supplying the automotive sector reported weak levels of activity, with car manufacturers cutting production to reduce inventory. Looking ahead, the recent slowdown in domestic consumption and the housing market, along with the steady loss of market share to overseas competitors, led some contacts to predict a weaker outlook for the rest of 2005.

Construction

Construction output growth was above trend and continued to be underpinned by demand from the public and retail sectors. Health and education remained the cornerstones of public sector activity. Looking ahead, contacts mostly believed that the outlook for 2005 was less robust and that growth may slow to rates more in tune with the rest of the economy. That was partly because of the slowdown in the housing market and the faltering buy-to-let market. Most contacts expected that public sector activity would remain supportive in the coming year.

Services

Service sector output growth remained brisk, though perhaps a little off its recent highs. Business and financial companies reported strengthening growth. Mergers and acquisitions continued to pick up, after a mostly subdued 2004, which was generating work for a wide range of businesses including investment banks, lawyers and accountants. There were further reports of a recovery in demand for consultancy services and there was continuing growth of outsourcing of functions such as call centres to achieve cost savings and greater efficiency.

Consumer services growth was more modest. Even so, demand was holding up better than many contacts had expected, in view of the recent slowdown in retail sales and lower levels of housing market activity. Although financial services connected to the housing market were seeing a drop-off in demand, contacts in other consumer services reported reasonable growth. Those included rail and bus transport, hotels, leisure and overseas travel.

EMPLOYMENT

Private sector employment growth was subdued. Labour demand weakened for housing-related services, but picked up for services in the ICT and consultancy sectors. Many contacts reported that the labour market had become a little looser recently, due to an increased supply of workers. Participation of older workers rose and there was a greater availability of overseas labour, particularly from EU accession countries. Contacts noted that there were well established arrangements for recruiting eastern European workers with, for example, employment agencies in eastern Europe routinely contacting British firms about supplying workers.

CAPACITY UTILISATION

Whole-economy capacity utilisation remained slightly above normal.

Manufacturing capacity utilisation was perhaps slightly below normal. Most manufacturers reported that there were no capacity constraints on their activities: even when spare capacity was limited they were readily able to sub-contract work. More often, contacts sought to reduce capacity (sometimes by mergers and subsequent rationalisation), to bring it more into line with expected demand. By contrast, pressures on capacity were much more evident in the service sector, particularly professional services where qualified accountants were in short supply.

COSTS AND PRICES

Pay

Overall, pay settlements continued to edge higher, and total pay growth was increasing faster still. But those trends were not evident in all regions — pay pressures generally appeared to be stronger in southern England where the service sector was a comparatively larger share of the economy. And there were reports of significantly higher bonus payments for staff in financial and professional services in those regions. Even so, pay pressures were not a major concern for most contacts, though some were nervous about the size of the increase in the National Minimum Wage due to take effect in October.

Input prices

Input price inflation continued to ease. Nevertheless, not all contacts recognised that picture, with many continuing to see the lagged effects on their costs of past increases in commodity prices. That was most evident where firms had annually negotiated contracts (most frequently for utilities). There continued to be reports of contacts circumventing input price increases by searching out cheaper suppliers, particularly in dollar-based markets, or by building up stocks ahead of pre-announced rises.

Output and consumer prices

Output and consumer price inflation remained on a gently upward trend. In the service sector the Agencies reported that contacts were more able to raise prices for services with a relatively high amount of value added, particularly in professional services where capacity constraints were most evident. For business to business services, there was generally strong demand growth, rising output price inflation and improving margins. By contrast, manufacturing output price inflation may have peaked, following a steady increase in the past 18 months.

Consumer services price inflation continued its gradual increase of the past year. Goods prices were reported to have continued to fall gently and new car prices were under renewed downward pressure, reflecting over-capacity in the industry.