Bank of England
Agents' summary of business conditions

May 2005

- **Retail spending** has shown few signs of recovery. Retailers were increasingly cautious about the short-term outlook, though few anticipated a further deterioration.
- The **housing market** continued to pick up slowly from its end-2004 trough. Estate agents expected a moderate recovery to continue in the months ahead.
- **Export growth** was modest, with markets in Western Europe remaining subdued.
- **Investment intentions** were fairly upbeat, partly due to growing pressures on capacity.
- **Manufacturing output** continued to rise gently, though the pace of growth may have weakened further. The global recovery in investment was underpinning demand for capital goods.
- **Construction output** growth remained strong.
- **Service sector output** growth picked up slightly. Activity in the business and professional services sector was especially strong.
- **Private sector employment** growth may have stabilised in recent months. Stronger jobs growth in the service sector partly reflected the greater availability of skilled workers. Recruitment difficulties had eased.
- **Capacity utilisation** increased slightly in the service sector, though that partly reflected special factors in professional services.
- **Pay pressures** continued to edge up slightly.
- **Input price inflation** remained high, though somewhat off its peak in late 2004.
- Manufacturers were more able to secure price increases, though **prices of retail goods** continued to fall.

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-March and late-April 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.

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.*

DEMAND

Consumption and housing

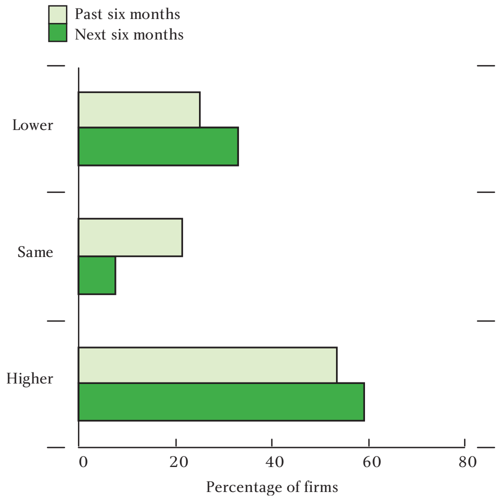
Retail spending growth remained fairly weak. Overall, retailers reported that after taking account of seasonal effects, the volume of sales in April may have been broadly unchanged compared with the previous month, with few indicating any significant pickup. New car sales had not improved and stocks continued to build in dealers' showrooms and at the ports. Growth of spending on consumer services had been more resilient recently than spending on goods, though it too had been fairly stable compared with the previous month.

Contacts reported a variety of factors that might help to explain the recent slowdown in consumption growth. Those included uncertainty among households regarding future rates of interest and taxes; the softening of the housing market; the cumulative impact on households' debt servicing costs of previous interest rate rises; and the effects on discretionary spending from recent cost increases of utilities, petrol and Council Tax. Some of those were expected to have only a temporary effect on spending. Most contacts believed that economic conditions remained healthy, and few expected that demand would weaken much further. Nevertheless, some contacts perceived that the current cautious mood of consumers would persist for a while and were not anticipating a significant upturn in demand in the months ahead.

In April, the Agents carried out a survey of their contacts regarding prospects for consumer spending on services. The survey covered 166 firms with a total annual turnover of nearly £24 billion, equivalent to around 6% of total UK consumer spending on services. A weighted net balance of 28% of firms reported that turnover had been higher in the latest six months compared with the previous six months (Chart 1, where the net balance is derived by subtracting the 'Lower' balance from the 'Higher' balance). Looking ahead to the next six months, a weighted net balance of 26% of firms expected turnover to be higher than in the latest six months. This suggested that any future slowdown in household spending on services might only be modest.

After allowing for seasonal factors, the housing market had continued a slow recovery from its trough in late 2004. Many estate agents reported that activity was below expectations. That had dented their confidence regarding prospects for the rest of the year, though they expected a moderate recovery to continue in the months ahead. Potential buyers remained cautious and were taking longer to make offers. And some prospective sellers were reluctant to accept offers below the asking price. First-time buyers remained scarce. In some regions, those factors had resulted in an overhang of unsold properties.

Chart 1
Bank of England regional Agents' survey of consumer spending on services(a)



(a) Firms were asked about the value of sales compared with the previous six months. Their responses were weighted by turnover. The survey was conducted in April 2005.

There were several reports that house builders had maintained sales volumes recently, by offering discounts and/or incentives equivalent to around 5%–10% of the asking price. That had been sufficient to bolster demand, suggesting that buyers were not expecting house prices to fall significantly from current levels.

Exports and imports

Exports continued to grow at fairly modest rates. Strong investment growth worldwide had boosted contacts' exports of capital goods, especially to the United States and the Far East. Profit margins in those markets remained tight owing to the dollar's weakness and there were growing reports of contacts looking to export more to China and other developing economies. The rising oil price had stimulated exploration activity in the Middle East and Eastern Europe. That in turn had increased demand for capital equipment and the products of engineering and construction companies. There were few reports of increasing demand from Western Europe. Shipping contacts confirmed the recent picture of weakening growth of imported consumer goods, especially from the Far East. Nevertheless, import competition remained intense in some sectors and was expected to increase further in others, as Eastern European producers continued to raise the quality of their products.

Investment

Contacts' investment intentions were a little more upbeat, having weakened slightly during the previous six months. There were further reports from corporate banking contacts that businesses' investment plans were strengthening, driven by capacity shortages and an increased appetite for investment in information technology (IT) as a means of improving productivity. In the service sector, investment was being propelled by widespread expectations of continuing expansion, and business optimism was fairly strong in all regions. By contrast, reports from manufacturers were more varied, with some contacts indicating that the recovery in investment was losing strength. That partly reflected financial pressures in sectors where profits have been eroded by falling margins, and expectations that output growth could weaken in the rest of 2005. Following the regulatory review, water companies were undertaking substantial investment programmes.

OUTPUT

Primary production

Dairy farmers had benefited from recent increases in milk prices, though there were doubts about how sustainable the increases would be. Arable farmers continued to face steep, oil-related increases in the cost of fertilisers and agrichemicals. There were growing concerns among some farmers that they could face cash-flow problems arising from delays to the new EU compensation payments.

Manufacturing

Contacts' reports suggested that manufacturing output continued to rise gently in April, though the pace of growth may have weakened further. There were rather divergent trading conditions between industries. Companies in aerospace and those supplying the public, oil and construction sectors reported robust growth and IT manufacturers were seeing steady improvement. By contrast, manufacturers of consumer goods reported some deterioration in activity. That was most apparent in the car industry. The closure of MG Rover, coupled with high levels of car stocks, was having adverse effects on component suppliers.

Construction

Construction output continued to grow at a fairly strong pace. Public sector demand had been buoyant for some time. And demand for commercial property had strengthened a little recently as more service sector contacts reported shortages of office space. Contacts in the retail and distribution sector continued to invest in new capacity. Although activity in the secondary housing market had slowed considerably in the past year, most house builders had not reduced the number of new starts and they continued to buy land. Government planning guidance and changes in demand were encouraging builders to build more apartments and social housing units, and fewer large houses. That was reducing profitability.

Services

The Agencies' reports suggested that private services output growth may have picked up a little in the past month, though it remained somewhat below its peak last summer. The growth of turnover rose further in business and financial services. Strong growth of demand had spread to a wider range of activities, with reports of a pickup in discretionary spending on business services such as marketing, public relations, training and conference facilities. Even so, the growth of demand for those activities was slower than for professional and financial services and remained very price sensitive.

Contacts reported that spending patterns within consumer services were changing, with no clear evidence of either a pickup or a slowdown in overall growth. Demand for services linked to the housing market had slowed, though there were some reports of stronger demand for services such as for overseas travel and domestic transport.

EMPLOYMENT

Overall, the Agencies' reports suggested that employment growth had been broadly unchanged in recent months. Employment growth in private services may have picked up a little. Contacts reported that this partly reflected the greater availability of skilled workers, both from overseas and due to a downturn in recruitment by the public sector. Manufacturers indicated that overall, their labour forces may have contracted at a slightly faster rate recently. That mostly reflected an increased rate of job loss in areas that had already been losing jobs for some time, such as steel and printing, in addition to the closure of MG Rover.

With labour supply increasing at a slightly faster pace than employment (mostly due to the steady increase in the number of migrant workers), the Agencies noted that the labour market had continued to ease slightly. Contacts' reports of recruitment difficulties were at their lowest level for around 18 months.

CAPACITY UTILISATION

Whole-economy capacity utilisation edged a little higher.

Capacity utilisation in manufacturing was thought to be at around normal levels. By contrast, service sector capacity utilisation was reported to be at its highest level for around four years. Many contacts in the accounting and legal sectors were working at almost maximum capacity, and close to the levels in the late 1980s. In accountancy, that partly reflected the increased audit demands from the Sarbanes-Oxley Act and the new

International Accounting Standards. So for some contacts, current growth rates of activity were not expected to persist for more than a few months.

COSTS AND PRICES

Pay

Pay pressures were fairly steady but with a slight upward drift. Across-the-board wage settlements had risen marginally in recent months, owing partly to an increase in those settlements that were linked to RPI inflation. But not all settlements were so linked and the average increase in settlements was quite small when judged in relation to the pickup in RPI and CPI inflation in the past year. There were some reports that the recruitment of migrant workers was holding down pay.

The prospective increase in the National Minimum Wage (NMW) in October was putting some upward pressure on wages in lower-paying industries. That was partly because the NMW was directly affecting the pay of a larger number of workers, and because there were greater indirect effects as an increasing number of higher-paid employees sought to maintain their pay differentials.

Input prices

Input price inflation remained high, though somewhat below its peak at the end of last year. Past increases in oil prices continued to feed through the supply chain, affecting the prices of a wide variety of materials, energy sources and services (including road and rail freight and shipping). For some contacts, those higher costs had been at least partly recovered by applying surcharges to their own prices (see below). And some had offset these higher costs by re-sourcing from dollar-based suppliers. For many contacts, increases in business rates and regulatory costs (associated with waste disposal and employment, for example), were of more concern.

Output and consumer prices

Manufacturers reported that higher input costs were being passed on to customers more quickly and to a greater degree than in recent months. Customers were more willing to accept increases in factory gate prices that arose from higher costs of oil-derived inputs, which were widely expected to persist and were affecting suppliers globally, but continued to resist all other price rises. Business to business price inflation for services had increased in recent months, largely reflecting growing pressures on capacity.

By contrast, there was scant evidence that falls in the prices of retail goods had come to an end. Intense competition from supermarkets and easier price comparisons on the internet were limiting the ability of retailers to raise prices, despite increasing overheads. As a result, many contacts had been reliant on volume growth to maintain profitability, which was now not possible owing to the slowdown in consumer spending.