Bank of England
Agents' summary of business conditions

November 2005

- Growth in the **value of consumer spending** remained subdued, with few signs of a pickup in the near term.
- A modest recovery continued in **housing market activity**, but prices were flat.
- **Export** growth remained robust. **Imports** also continued to rise, despite some weakness in consumer goods.
- **Investment intentions** eased as firms became more cautious.
- Domestic **manufacturing** sales were weak, with export sales faring notably better.
- The pace of **construction** output growth eased, but activity remained high.
- **Service sector** output growth was broadly unchanged; professional and financial service companies reported continued robust growth in demand.
- The **labour market** continued to soften.
- Fewer firms were worried about **capacity pressures**.
- **Pay pressures** remained muted.
- **Input price inflation** was broadly unchanged, although not all companies had yet felt the full impact of past rises in energy prices.
- **Output price** increases were tempered by competition, but **consumer price inflation** edged a little higher.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 830 businesses in the period between late September and late October 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 in October remained unchanged on the previous month at modest levels. Overall, retail sales were relatively flat. Consumers continued to cut back on discretionary spending, which was reflected in weaker sales of, for example, furniture, white goods, and jewellery. Clothing sales were also weaker than retailers expected, perhaps partly as a result of poor weather conditions, and some contacts were considering earlier-than-usual price discounting in an attempt to clear unsold stock. Spending on some leisure goods was more robust, particularly where the product was innovative. But, overall, contacts from across the United Kingdom were cautious about the outlook for Christmas trading — even some contacts who had seen the seasonal pickup in orders begin to materialise noted that the rise was weaker than usual.

There were also signs that consumers were deferring major purchasing decisions for durable goods. The most obvious example was cars, with contacts throughout the country reporting weak sales, particularly in the important September plate change month.

Spending on consumer services grew moderately, but the picture was very mixed across regions. For example, some leisure attractions reported rising visitor numbers, while others experienced flat demand at best. There were some signs of increased consumer caution, such as more shopping around — often using the internet — for the best travel prices.

Overall, there were further signs of a modest recovery of activity in the housing market. Enquiries and completions in the secondary market continued to improve, and contacts reported that sellers were a little more willing to do deals on price. As a result, selling prices probably remained broadly flat across the country as a whole, despite the improvement in activity.

In the new-build market, some contacts reported higher viewings, but this improved level of interest was not being translated into completed sales. As a result, part-exchange deals and other incentives remained prevalent, especially for house builders whose strategy was to maintain volumes.

Exports and imports

Export growth was steady at high levels. Sales to the Middle East and Asia continued to grow quite strongly, reflecting higher oil revenues and continued strong growth in China and other emerging economies, including Latin America. Sales to these markets reflected demand for both capital equipment and consumer goods. UK exporters also continued to benefit from robust demand in the United States, although the level of the US dollar remained a concern for some contacts with the dollar's partial recovery this year not yet translated into higher sales. Demand in the euro area was patchy and had generally remained subdued.

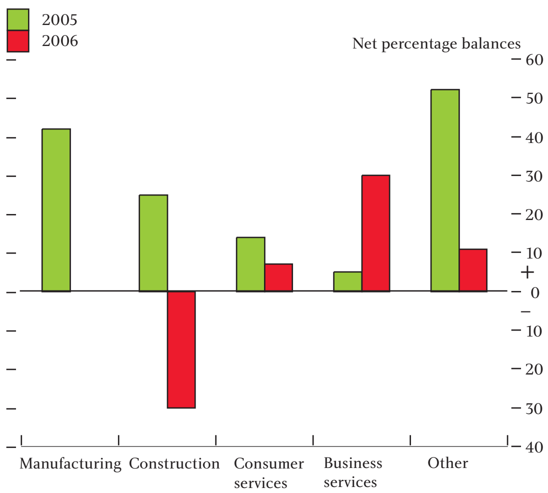
Imports were still rising, mainly reflecting the continuing increase in sourcing of products or components from lower-cost overseas economies. But the recent weakness of imports of consumer goods persisted: the normal seasonal spike in these imports ahead of Christmas was possibly less pronounced than a year ago.

Investment

Contacts' investment intentions eased modestly over the past month. The manufacturing sector's UK investment plans remained weak, reflecting overcapacity in the United Kingdom, squeezed margins and global trends to relocate production capacity. Service sector firms were generally still planning additional investment, but there were signs of a more cautious mood. Where investment was planned, it was generally aimed at improving efficiency and reducing costs, which frequently involved an intensified use of IT and telecommunications. Yet even here the picture was patchy, with some IT contacts reporting lower sales of hardware. A minority of contacts — typically those firms most directly affected by energy price rises — were increasing their capital spending to invest in more energy-efficient equipment. Some retailers had revised down their investment plans in the face of weaker demand, but overall the retail sector was continuing to invest in new floor space, reflecting a strategy of competing for market share by opening new stores and expanding existing ones.

In October, the Agents carried out a survey of their contacts regarding capital investment. The survey covered around 180 companies with a total turnover of over £40 billion. Overall, firms expected that the rise in investment spending in 2006 would be lower than in 2005, with only business services companies expecting their investment spending in the United Kingdom to accelerate (Chart 1). Strong UK and foreign demand were acting to boost investment, as was healthy cash flow

Chart 1
Actual and planned investment by sector(a)



(a) Net balances of firms in each sector reporting that actual investment in 2005 was higher than in 2004, and that planned investment in 2006 was higher than actual spending in 2005. Individual responses have been weighted by firms' turnover.

and profitability. But, as noted above, some firms were relocating production abroad, which was depressing their UK investment spending. Higher energy costs were acting as a stimulus to investment spending in some cases, but as a constraint in others — mainly where energy costs had substantially impaired cash flow and profits.

OUTPUT

Primary production

The gradual rationalisation of agriculture continued. The autumn harvest was variable across the United Kingdom but, overall, was at or above the average of the past few years. Combined oil and gas production, which declined sharply in the summer because of maintenance work, had begun to improve.

Manufacturing

Domestic sales remained weak, offset by better exports. Those sectors faring best were aerospace, defence, medicine and pharmaceuticals. There were some signs of increasing financial fragility for firms, particularly those worst affected by the energy price rises and those faced with overcapacity. More production continued to shift overseas, as the long-term trend of rationalisation continued.

Construction

Output growth eased a little. While demand continued to be underpinned by the public sector, contacts from different regions reported a slowdown in public sector spending. It was unclear whether that was likely to be temporary — projects being delayed rather than cancelled — or more permanent, perhaps due to concerns over budgets. In the past, government departments have often chosen to defer maintenance in the face of tighter budget constraints, which could lead to a shift in the composition of spending.

Private sector demand was more subdued, although ongoing long-term retail investment (see earlier) was supporting activity. The number of new homes built had reached a plateau or was falling in most regions, as house builders' sales targets were proving more difficult to meet. Some developers were delaying new starts accordingly.

Services

Growth in professional and financial services remained strong. This was underpinned by continued demand for advisory work on regulation, M&A activity and commercial property investment. Demand growth in the financial sector was also robust. There were some reports of banks tightening their lending criteria following increased payment difficulties and defaults from corporate and personal borrowers. Spending by companies on other business services — such as advertising and transportation — was somewhat weaker. Spending on consumer services continued to grow more moderately than on business services, reflecting the deceleration in consumer demand over the past year.

EMPLOYMENT

The past tightness of the labour market softened a little further in October. Manufacturing firms continued to lay off staff in the face of overcapacity. And employment intentions of consumer services firms may have weakened for the first time this year. Business services continued to recruit new staff, but even here the pace of hiring had eased. Overall, private sector employment may be flat at best over the next six months. Coupled with the slower pace of public sector recruitment, the continued inward migration of foreign workers from Eastern Europe, and increased staff retention due to employee caution, recruitment difficulties eased. The main sector continuing to experience skill shortages across the country was professional and financial services.

CAPACITY UTILISATION

Utilisation eased across the economy as a whole. Once again only professional and financial service firms reported concerns about capacity pressures, reflecting specific skill shortages. Many contacts were reducing capacity following the slowdown in demand, continuing the trend of more companies 'flexing' capacity.

COSTS AND PRICES

Pay

Wage growth was little changed. Most across-the-board settlements were closely linked to RPI. Given that RPI inflation was slightly lower than a year ago, the impact of the recent pickup in CPI inflation had been minimal. There was little evidence of increased militancy or dissatisfaction among employees, although there were reports of pay freezes. There had as yet been little upward pressure on earnings in the economy as a whole following the introduction of the new National Minimum Wage rates. Pay continued to rise fastest in a handful of sectors where firms were faced with specific skill shortages. However, some contacts reported that pension contributions were likely to add to labour costs in the short term.

Input prices

Annual input price inflation was broadly unchanged in October. The apparent plateauing in inflation reflected the decline in the oil price from its recent peak, and continued easing of some commodity prices such as minerals and metals. However, the full impact of past increases in oil prices on some intermediate products, such as plastics, had probably not yet been felt. The major concern was energy costs, with some companies facing very significant increases in gas and electricity bills. Contacts were expecting the higher oil and energy prices to persist over the medium term. There were concerns that insurance premia could rise in the aftermath of the US hurricane season.

Output and consumer prices

There was little news on output price inflation, which had steadied reflecting companies' mixed success in passing input price rises on to their customers. The pace of decline in retail goods prices may have eased a little, reflecting further oil price effects and higher import costs. Consumer services price inflation was unchanged.