Bank of England

Agents' summary of business conditions

October 2005

- Growth in the **value of consumer spending** appeared to have stabilised at a low rate.
- Activity began to recover in the **housing market**.
- **Exports** continued to pick up, reflecting demand from a variety of sources. Imports of consumer goods remained sluggish.
- **Investment intentions** weakened further, partly reflecting uncertainty about the impact of rises in energy prices.
- Domestic sales of **manufactured goods** were weak, but export growth has improved.
- The pace of **construction output** growth slackened.
- **Service sector** output growth was unchanged, with professional services the most buoyant.
- The easing in the **labour market** continued.
- **Capacity utilisation** eased.
- **Pay pressures** remained muted.
- **Input price inflation** picked up, reflecting rising energy and fuel costs.
- Overall, **consumer price inflation** edged higher.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 740 businesses in the period between late August and late September 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 level of retail spending was broadly unchanged over the past month. Demand was still generally weak for major purchases such as furniture, although reports from different regions were more mixed than in previous months. Overall, retailers thought that Christmas may be worse than last year. Consumers were spending more of their income on petrol following the rise in its price. As usual, private car sales were boosted by the new registration plate in September, but sales were still weaker than last year.

Spending on consumer services remained subdued, but the underlying pace of growth may have stabilised. There was still some weakness in central London due to fewer bookings following the July terrorist attacks, but more generally growth in spending on services held up. Leisure attractions in several other regions reported good demand in recent months, in some instances reflecting tourists shunning London, but also helped by the good weather compared with last year. Spending in bars and restaurants was little changed on the month.

There were signs that activity in the housing market may have started to revive. Estate agents in a number of regions reported higher footfall and viewing numbers, alongside more visits from first-time buyers. Some of the revival in housing activity could have reflected pent-up demand over the summer, so it was too soon to judge whether underlying demand had started to recover. Across the country as a whole, prices remained stable.

Notwithstanding these tentative signs of improvement, builders were still having trouble selling finished homes, despite offering discounts and other incentives. Builders were cutting back on new starts while their existing properties remained unsold.

Exports and imports

The improvement in export growth continued this month. Contacts were generally more optimistic and reported strong sales to the Middle East arising from the surge in oil revenues. Demand from the Far East was also strong, partly reflecting infrastructure spending. And contacts continued to report robust demand from the United States, although margins were often thin because of the weak dollar. Exports to Western Europe remained flat.

Imports of consumer goods were sluggish at a time when shops would normally be building up their Christmas stocks. That was consistent with the cautious mood among retailers, although some may have been postponing orders until the outlook became clearer. But manufacturers continued to source more products from lower-cost economies.

Investment

Contacts' investment intentions weakened again over the past month. The higher energy prices have generated additional uncertainty and many contacts were concerned about the possible implications for demand prospects, as well as the impact on margins: as a result some contacts have delayed investment plans until next year. Only a small minority of contacts planned to increase investment as a result of the higher energy prices. Where investment was planned, it was generally focused at reducing costs, rather than directly expanding capacity. The retail sector was continuing to invest in new floor space, although some non-food chains had become more cautious.

OUTPUT

Primary production

The cereals harvest was variable across the United Kingdom, with some regions enjoying higher quantities but others reporting lower volumes. Most meat production was only marginally profitable. And although higher prices had generated improved prospects for oil and gas production, volumes recently fell due to maintenance work.

Manufacturing

The underlying picture in manufacturing was broadly unchanged, with output for domestic sales remaining weak. Niche producers once again fared the best, while other production continued to move overseas gradually. However, manufacturing exports rose again this month, reflecting continued strong demand in several markets (see above).

Construction

Annual growth in construction output eased further, to around its lowest level for two years. Private residential construction remained relatively weak, as builders struggled to sell completed homes. Other construction work grew more strongly, underpinned by public sector spending on health, education and social housing. However, contacts had noted a slight easing in demand from the public sector. Retail investment should continue to support construction activity for some time, but the outlook for other commercial projects was more mixed.

Services

Underlying growth was broadly unchanged over the past month, and stronger than in other sectors of the economy. Professional services remained most buoyant with high levels of activity, especially for corporate finance. But a variety of other sub-sectors were also seeing robust growth in activity, including consulting and accountancy. Demand for consumer services was weaker, and this had also affected related industries such as advertising.

EMPLOYMENT

The labour market continued to soften slowly. Recruitment difficulties were broadly unchanged compared with a year ago. There had been a combination of less recruitment and more job shedding across several sectors as firms responded to the weakening in the economy. Overall, companies generally intended to hold or to reduce staffing levels in the short term. And employees were also cautious about changing jobs in the current environment. The main exceptions were professional services companies, where robust demand for their products was resulting in continued recruitment; this was also where skill shortages remained most prevalent. Workers from Eastern Europe were filling job vacancies in a range of sectors, including hotels, construction, transport and heavy industry.

CAPACITY UTILISATION

Utilisation eased across the economy as a whole. Contacts reported few concerns about capacity constraints: and those that did mentioned specific skill shortages (normally in professional services) rather than physical capacity. The slowing in the economy had resulted in some slack, and where capacity could be reduced fairly quickly this was starting to happen. That continued the trend of companies 'flexing' capacity in response to changes in demand.

COSTS AND PRICES

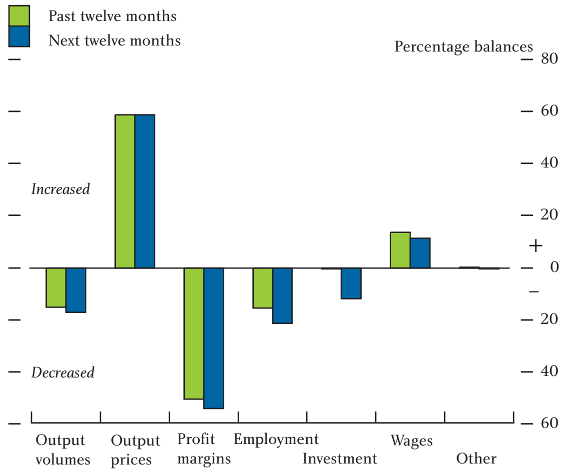
Pay

There had been little news on settlements, as few firms settle at this time of year. But pay pressures remained generally muted, and there was little sense that total labour costs were accelerating. At this point, contacts had little expectation that employees would seek larger pay rises despite the pickup in petrol prices and CPI inflation. Employers in some sectors — particularly leisure, cleaning and retailing — were concerned about the new rates for the National Minimum Wage, which was due to come into effect in October. Apart from that, pay pressures were only marked in sectors where there were significant skill shortages, such as professional services.

Input prices

Input price inflation picked up again. That reflected rising energy and fuel costs, with some contacts expecting the rises to persist for some time. Together these effects dominated flat or falling prices for other raw materials, such as steel. Contacts were increasingly sourcing materials from abroad to achieve cost savings. Insurance costs also stabilised, or even fell in some instances. But higher energy costs were the main concern for most businesses.

Chart 1
The impact of input cost changes over the past twelve months(a)



(a) Net balances of firms reporting an impact from input price rises on a variety of factors. Individual responses have been weighted by firms' turnover.

In September, the Agents carried out a survey of their contacts regarding their response to higher input prices. The survey covered around 180 companies with a total turnover of over £36 billion. The vast majority of firms reported that the cost of their raw materials and inputs had risen over the past year, with service sector firms and manufacturers having faced similar scales of increase. The biggest impact of these increases had been to reduce profit margins and push up output prices but the effects on employment and investment had been modest (Chart 1). Over the next twelve months firms expected similar effects, although the past price rises could also result in lower investment.

Output and consumer prices

Companies were having mixed success in passing on the substantial rises in input costs to their customers. Transport companies had been reasonably successful, normally due to 'escalator' clauses in contracts. Other firms were finding it hard to raise prices in the face of continued intense competition from overseas, although there were more reports that some firms had managed to do so. Overall, manufacturing output price inflation had picked up.

Retail goods prices continued to fall, although the pace of decline had eased. That largely reflected the marked rise in petrol prices in recent months, notwithstanding the recent competition on supermarket forecourts. But some retailers had managed to reduce their stock holdings of other goods, resulting in fewer discount offers. Retail service price inflation was broadly unchanged: there were some reports of increases in utility and transport prices, but a weaker picture from hotels, restaurants and telecoms. Business services inflation was also unchanged.