Bank of England

Agents' summary of business conditions

September 2005

- Growth of **consumer demand** has remained weak in the past month. The value of retail spending remained relatively flat, while growth in spending on consumer services eased.

- The **housing market** was generally subdued, and some house builders reported a downturn in activity. But in some regions there were tentative signs of a pickup in activity.

- **Export prospects** have improved, with demand growing strongly from regions such as the Middle East due to the higher oil price. Growth in imports of consumer goods could remain subdued in the months ahead.

- **Investment intentions** have eased a little further as firms remained cautious about the outlook for the economy.

- **Manufacturing output** has been steady, underpinned by stronger overseas orders.

- The pace of **construction output** growth has eased.

- **Service sector output** growth has been fairly steady. Growth in professional and financial services remained robust, though demand growth has weakened in some other sectors.

- **Employment intentions** and recruitment difficulties have both fallen over the past month.

- **Capacity utilisation** eased a little, though it was perhaps still slightly above its normal level for the economy as a whole.

- **Pay pressures** have remained muted.

- **Input price inflation** has started to pick up again, mainly due to rising oil and energy costs.

- Manufacturing **output price inflation** eased, but business services price inflation increased.

- **Consumer price inflation** edged up.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 730 businesses in the period between late July and late August 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

Overall, consumption growth was broadly unchanged in the past month. Retail sales values remained relatively flat, but retailers generally reported a better balance in their stock positions. The build-up in stocks in previous months had been largely unwound. Spending on consumer services has been helping to support consumption growth. But contacts reported slightly weaker growth in the past month.

Consumers remained cautious and were looking to repay debt. Consumer caution was reflected in weaker discretionary spending on leisure services such as restaurants and leisure centres; consumers had switched to less expensive alternative products (with up-market jewellers for example reporting weaker sales); and sluggish demand for consumer durables continued, especially housing-related goods and cars. It appeared to some dealers that potential buyers were extending the period before replacing their car, and demand was not anticipated to revive until early next year.

Contacts had reported a second slowing in retail sales following the attempted terrorist attacks on 21 July. And spending was taking longer to recover than it had following the earlier attacks on 7 July. Contacts were also concerned about the ongoing impact on both domestic and foreign tourism over the next six months.

The housing market was subdued. Estate agents' stocks of unsold houses continued to increase and some were not expecting activity to pick up significantly without further house price falls. Potential first-time buyers remained cautious and seemed to be awaiting signs of recovery before making offers. Some house builders reported a slowdown in sales and a consequent scaling back of their new building plans. Nevertheless, there were tentative signs of a gentle recovery in housing market activity in some regions, though so far this year transactions had remained significantly lower than in the first half of 2004.

Exports and imports

Export growth had rallied further, helped by the firmer dollar exchange rate against sterling. Demand in the Middle East had grown strongly, largely due to the continued rise in the price of oil. That had boosted real incomes in those regions and increased their demand for related goods and services, such as mining and exploration equipment and the design and construction of petro-chemical plants. By contrast, Western European markets remained fairly static.

The slowdown in UK consumption continued to reduce the growth of imported consumer goods. But that was at least partly offset by the continued shift towards overseas sourcing by manufacturers, which increased imports of parts and assemblies. Contacts reported that growth of imported consumer goods was expected to remain subdued in the months ahead, reflecting the fairly long lead times between the slowdown in consumer demand and its full impact on imports.

Investment

Investment intentions eased further. For some contacts, particularly those in the retail sector, a more cautious assessment of economic prospects had resulted in investment projects being delayed until a recovery was more clearly in train. Some manufacturers' investment plans had been dented by a further squeeze on their profit margins.

OUTPUT

Primary production

Milk production was reported to be below quota levels, with dairy farmers continuing to exit the industry due to low prices, the CAP reforms and high labour and investment costs. While those ceasing production had been mostly small farms, contacts expected some of the larger producers to downsize or even exit the sector later this year. Cereals harvests were helped by the good summer weather and contacts expected that exports would be boosted as a result.

Manufacturing

Reports from contacts suggested that the level of manufacturing output was broadly unchanged in the past month. Increased export orders were offset by lower domestic demand. Exports in the aerospace industry and of energy-related products (such as generators and turbines) were particularly strong. In the metals sector, weak domestic demand partly reflected a continuing rundown by customers of stocks of steel and steel components, following earlier stockpiling when prices were rising. By contrast, weak domestic demand for new cars resulted in an increase in stocks with manufacturers and dealers, and had started to affect production.

Construction

Construction output growth continued, if at a slightly slower pace. That was partly due to reduced activity of house builders. And a slower rate of expansion in the retail sector had reduced the demand for new distribution centres. Most contacts reported continuing strong demand growth from the public sector.

Services

Output growth was fairly steady in the past month, underpinned by persistently strong demand for professional and financial services. Buoyant equity markets helped support growth of corporate finance activity, with higher levels of initial public offerings, management buyouts and mergers and acquisitions. But there were tentative signs of slightly weaker growth in some business to business services such as marketing, advertising and recruitment agencies. Output of consumer services had slowed in recent months, particularly for housing-related services. And there were also signs of weaker discretionary spending on leisure activities for example.

EMPLOYMENT

Contacts' reports suggested that the labour market continued to soften gently. Employment prospects, recruitment difficulties, staff turnover and skill shortages had eased in most sectors. The main exception was professional and financial services, where employers were continuing to recruit in response to stronger demand.

Contacts reported a variety of factors underlying the slightly softer labour market, including the slowdown in the economy; the need to raise productivity (especially in manufacturing against a background of strong price competition); the relocation of operations overseas; and the greater availability of migrant labour, particularly from Eastern Europe.

CAPACITY UTILISATION

Capacity utilisation continued to ease in manufacturing and was perhaps slightly below its normal level. By contrast, oil refining capacity was extremely tight. That was adding to the upward pressure on diesel and petrol prices. Utilisation in the service sector had eased in recent months, though it remained above normal levels. That easing mostly reflected the slowdown in the consumer services sector.

COSTS AND PRICES

Pay

Pay pressures were subdued in most sectors and may have eased slightly in the past few months. That was partly due to the recent softer state of the labour market. Contacts noted that the pickup in CPI inflation since the start of the year had not resulted in any increase in wage settlements, perhaps because there had not been a corresponding rise in RPI inflation, which was usually seen as the main measure of inflation when negotiating pay.

Input prices

Input price inflation had started to pick up again. That was largely on account of renewed price increases of petrol/diesel, other oil-based materials and utilities. Those increases had more than offset some slight fall in the prices of non-oil materials, for example metals. Some manufacturers reported that their bills for oil, gas and electricity had risen by more than 50% in the past twelve months, and that the increases had significantly exceeded those faced by overseas competitors. Higher world prices for fuel and energy and the stronger dollar were also starting to be reflected in higher sterling prices for imported parts and assemblies.

Output and consumer prices

Overall, manufacturers' price inflation may have eased a little further in the past month. The scope for manufacturers to raise prices continued to be limited, despite increases in the costs of materials. Some contacts reported that their overseas competitors had not seen equivalent increases in their own input costs, so that UK producers were forced to reduce profit margins to remain competitive. By contrast, price inflation for business to business services increased, partly on account of higher energy costs that contacts were more easily able to pass on to their customers.

Reports of consumer prices were mixed, but overall inflation may have picked up a fraction. Retail goods prices continued to fall, though the rate of decline may have eased slightly compared with a month ago. Price discounting was most evident for those goods where demand was weakest, such as furniture and cars. Consumer price inflation for services increased a little. Contacts were more able to raise prices and maintain profit margins in the face of rising costs.