Bank of England

Agents' summary of business conditions

April 2006

- **Consumer spending growth** fell back as retail sales decelerated.
- Activity and prices rose in the **housing market**.
- Domestic **manufacturing** sales were broadly unchanged; export sales accelerated, and contacts were optimistic about future prospects.
- **Investment intentions** were unchanged, implying modest increases in future investment spending.
- Growth in **business services** turnover was strong; in response, **employment intentions** in the business services sector picked up.
- Overall, there was significantly more slack in the **labour market** than a year earlier.
- **Capacity pressures** remained subdued.
- There was little sign of widespread **pay** pressure.
- **Input price inflation** rose, reflecting the impact of energy prices.
- **Consumer price inflation** picked up a little.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 700 businesses in the period between late February 2006 and late March 2006. 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 & Oxfordshire, and Yorkshire & the Humber.

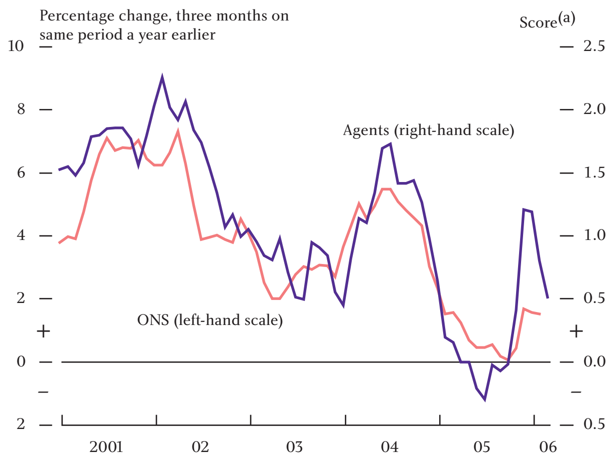
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report*, obtained from: www.bankofengland.co.uk/publications/inflationreport/index.htm.*

DEMAND

Consumption and housing

Consumer spending growth eased in March, reflecting a slowing in the pace of retail sales growth (Chart 1).[1] Electrical goods sold well, and there were some signs that spending on carpets, furnishings and other items linked to the housing market were beginning to pick up. But spending on other products was more fragile, with clothing and footwear sales particularly weak. Some contacts noted that the cold weather could have affected sales, and the timing of Easter may also have had an impact on the pattern of spending. Generally, retailers remained cautious about the outlook for this year. As a result, a number of contacts reported that they were trying to maintain lower inventory levels than a year ago.

Chart 1
Retail sales[(a)]



(a) A score of zero indicates that sales or turnover were unchanged in the latest three months compared to a year earlier. A positive (negative) score indicates sales or turnover were higher (lower) than a year earlier. For more information see Ellis and Pike (2005).

Contacts reported that underlying car sales were weak in March: although there was the usual boost to sales from the registration plate change, spending remained weaker than a year earlier. Those consumers who were spending were very brand-specific, and there was little sign of recovery in the sector as a whole.

Consumer services held up rather better than retail sales, with growth broadly unchanged. But there were still signs of belt-tightening, with restaurants, pubs and clubs reporting flat or falling demand compared with last year. Spending on holidays and travel was stronger, with contacts reporting higher spending than a year ago.

The recent revival in housing market activity was sustained, with estate agents reporting healthy activity levels and more interest from first-time buyers. The shortage of stock on the market intensified, as new instructions were weaker than sales. In light of this, both advertised and achieved selling prices were now rising in most parts of the United Kingdom.

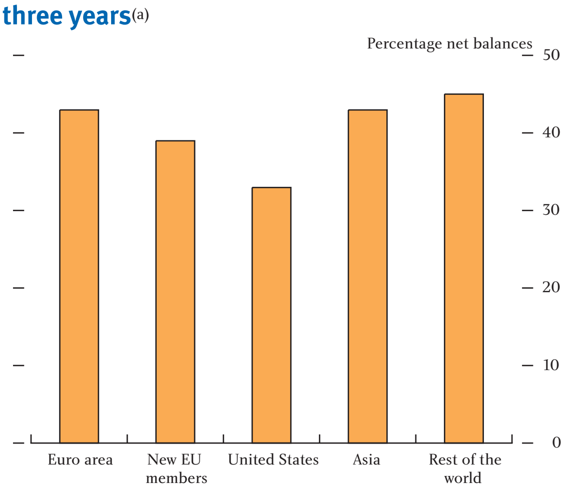
Housebuilding activity remained relatively subdued, although the recent revival in the residential market had spurred on builders to start work on a larger number of new sites. The main hindrance faced by housebuilders was getting planning approval, but several contacts noted that the requirement for a large amount of 'affordable' or social housing in most new developments was also acting as a disincentive.

Exports and imports

Export growth picked up in March, and contacts were generally more optimistic about the outlook for sales. Demand from the Middle East and Asia was increasing rapidly, although these markets were still relatively small, and euro-area demand was also reviving. Export sales of high-tech capital and consumer goods rose at a fast rate.

During February and March, the Agents carried out a survey of their contacts regarding the prospects for exports. The survey covered around 150 companies with a total export turnover of over £20 billion. The results from the survey suggested that contacts expected export sales over the next six months to pick up compared with the previous six months. Respondents were also optimistic about the outlook for exports over the next two to three years to a range of markets including the new EU member states and Asia (Chart 2). Product innovation and world demand were the strongest factors

Chart 2
Prospects for export sales over the next two to three years[(a)]



(a) Net balances of firms reporting that the prospects for export sales to different regions were favourable. Within sectors individual responses have been weighted by export turnover, and sectoral totals have been weighted by ONS export shares.

(1) For more information on the Agents' scores, see Ellis, C and Pike, T (2005), 'Introducing the Agents' scores', *Bank of England Quarterly Bulletin*, Winter, pages 424–30, available at www.bankofengland.co.uk/publications/quarterlybulletin/qb050401.pdf.

boosting export sales, together with UK companies exploiting new export markets.

Import growth was steadier, with materials, intermediate and consumer goods increasingly being sourced from abroad. If anything, this process may have accelerated as firms sought to reduce costs following recent energy price rises. However, this was partly offset by retailers tending to hold lower levels of stock.

Investment

Overall, companies' investment plans were broadly unchanged. As in previous months, the manufacturing sector was reducing investment spending in the United Kingdom. Those companies that were experiencing strong demand were generally investing in extra capacity abroad. The service sector continued to increase investment spending at a relatively modest rate, and spending was concentrated in information, communications and technology. Generally, contacts were focusing on reducing costs rather than expanding capacity. There were also reports of companies cutting back on their investment spending in order to reduce pension fund deficits.

OUTPUT

Primary production

Many farmers in England and Wales had still to receive their Single Farm Payments. More generally, confidence was low and the long-term prospect was for agricultural output to fall, as selling prices were generally lower than production costs. Electricity generators were maximising output from coal-fired stations due to the significant price advantage over gas, but coal production itself remained in long-term decline.

Manufacturing

The two-speed nature of manufacturing output continued, with domestic sales broadly unchanged compared to last year, and exports accelerating in the face of increased demand (see earlier). Demand was strongest in the aerospace, engineering and chemical sectors, and more generally for producers of high-tech goods. The recent high gas prices were affecting firms, but so far only a small number of contacts had cut output in response.

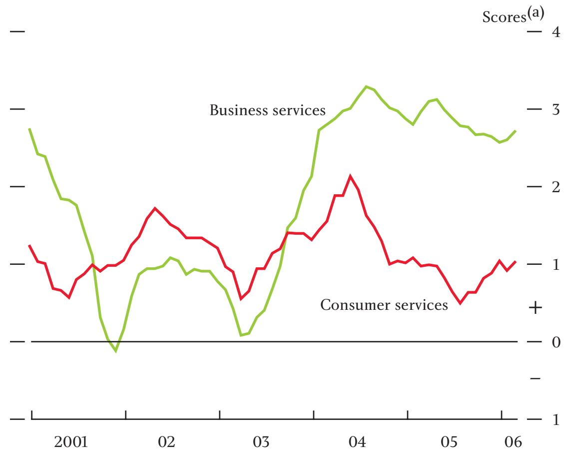
Construction

Construction output grew steadily, with some signs of a lift in demand. Government-sponsored projects were the main source of growth. And although demand from investors in commercial property was still stronger than occupational demand from companies, the recent pickup in commercial construction and infrastructure work gathered pace. Housebuilding activity also improved following the strengthening in the residential market.

Services

Business services turnover rose strongly, particularly in professional and financial services. IT services reported robust demand, with ongoing regulatory requirements boosting activity in the accounting and consultancy sectors. Growth in financial services turnover was strong, with buoyant mergers and acquisitions activity. Turnover for other business services such as conference services and logistics also grew steadily, albeit at a more subdued pace than professional services. Generally, contacts in the business services sector were optimistic about the outlook for growth in 2006. Growth in the consumer services sector was weaker than for business services, continuing the trend in recent years (Chart 3).

Chart 3
Services turnover



(a) See footnote to Chart 1.

EMPLOYMENT

While the manufacturing sector continued to lay off staff, and consumer services contacts expected broadly unchanged staffing levels over the next six months, employment intentions in the business services sector picked up in the face of strong demand from their customers. Skill shortages were most prominent in professional and financial services, where some firms were running at full capacity. Elsewhere skill shortages were less pronounced, and more generally the labour market was significantly slacker than a year earlier. Where contacts were recruiting, they were often doing so from overseas, notably Eastern Europe. This had helped to ease skill shortages, for example in the construction sector, in recent months.

CAPACITY UTILISATION

Capacity pressures were broadly unchanged in March. There was spare capacity in most sectors, with the main exception being professional and financial services.

COSTS AND PRICES

Pay

A significant proportion of private sector pay settlements for 2006 were now finalised, and were broadly similar to those seen in the previous year. There was scant evidence of widespread upward pressure on pay, apart from occupations with particular skill shortages. Some contacts reported increased employee nervousness about job security, which had made them more willing to accept modest pay rises or even freezes. Funding final salary pension schemes was a major concern for many contacts, resulting in the cost of labour increasing at a faster rate than pay awards alone would suggest.

Input prices

Input price inflation remained high, reflecting both the recent surge in gas prices but also the rising cost of energy intensive materials such as plastics and petrochemicals. Many contacts had long-term fixed-price contracts, which meant that the impact of higher energy prices was only slowly trickling down to companies, and the full pass-through from energy costs may not yet have been felt. The cost of imported components was also rising, having fallen in previous years. However, there were signs that insurance costs may be stabilising.

Output and consumer prices

Manufacturing output price inflation edged higher, as more contacts posted price increases in an effort to recoup rises in their input costs. The lack of pricing power meant that companies were generally unable to pass on the full cost increase, and were having to accept lower margins while they looked for other cost reductions and efficiency savings.

There were also tentative signs that the rises in output prices were starting to feed through into retail goods prices. But the extent of the pass-through was small, with overcapacity in the retail sector acting as a restraint. Services price inflation was broadly steady; some leisure companies passed on cost increases in time for the new tourist season.