BANK OF ENGLAND

Agents' summary of business conditions

December 2006

- Consumer spending growth increased; sales of household durable goods picked up further and car sales improved a little.
- Activity in the housing market was unchanged.
- Export growth slowed a little, mostly reflecting the weaker US housing market.
- Investment intentions continued to strengthen.
- Manufacturing output growth stabilised.
- Construction output continued to grow strongly.
- Service sector activity accelerated again; growth of consumer and other business services output was slightly firmer.
- Firms' employment intentions rose, but their current recruitment difficulties remained less than normal.
- Capacity pressures intensified a little.
- Pay growth rose slightly due to increased wage drift.
- Input price inflation was steady. Higher prices of some metals and foodstuffs offset lower oil prices.
- Consumer price inflation was unchanged.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with around 700 businesses in the period between late October and late November 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.

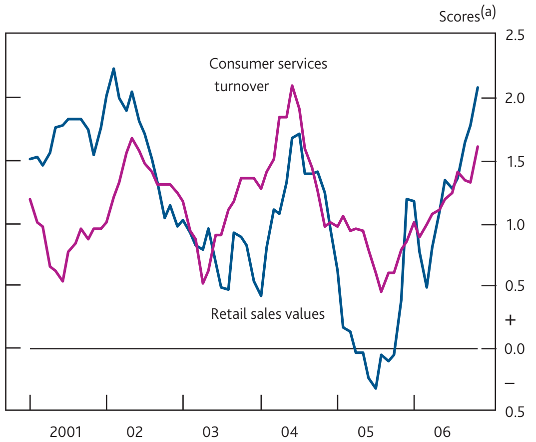
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption and housing

Consumer demand growth increased a little in November (**Chart 1**). Retailers reported higher-than-anticipated demand in the past month and improved confidence in the short-term outlook. But some of those reports predated the November rise in interest rates and many retailers remained cautious regarding prospects for sales after Christmas, partly on account of the two recent rate increases. Also, some thought that the seasonal pattern of demand may have changed, with consumers more willing to spend during the Christmas period but then expected to retrench more than usual in January and February. Spending on bigger-ticket items such as furniture and white goods continued to pick up and sales of high-tech electrical goods remained strong. There was a further substantial gain in the market share of internet retailers.

Chart 1 Annual growth of retail sales and consumer services turnover



(a) A score of zero indicates that retail sales and consumer services turnover over the next twelve months was expected to be unchanged, compared with the past twelve months. A positive (negative) score indicates that retail sales and consumer services turnover was expected to be higher (lower) than a year earlier. For more information see Ellis, C and Pike, T (2005), 'Introducing the Agents' scores', *Bank of England Quarterly Bulletin*, Winter, pages 424–30.

There were tentative signs that private new car sales had improved a little, possibly stimulated by greater than normal price discounts. Sales of high-volume brands were slightly higher than a year ago: increased motoring costs had encouraged buyers to purchase cheaper, more fuel-efficient models.

Consumer services growth also picked up a little in November, largely reflecting firmer growth in leisure spending. Up-market hotels reported stronger demand for weekend breaks, passenger numbers using low-cost airlines continued to grow rapidly and overseas visitor numbers accelerated. But there were further reports of weakening demand from pubs, clubs and restaurants, particularly those serving young and other low-income groups.

Overall, the secondary housing market was fairly steady, with transactions generally reported to be around their historical average level and house price inflation was stable. A few Agencies reported a slightly softer market compared with last month, with a lower level of enquiries. But most estate agents judged this to be erratic and few believed that the outlook for the housing market had weakened. The top end of the market had strengthened noticeably in London and, especially for properties with land, some parts of southern England.

House builders reported a steady level of demand. There was continued strong growth in sales of lower-priced new housing, but discounting and the use of part exchange remained necessary to stimulate demand for mid-priced and higher-priced properties.

Developments in the buy-to-let market mirrored those of the wider housing market. In most regions, investor demand was a little weaker, especially for new apartments. Also there were some signs of greater investor distress, including increased repossessions. By contrast, the buy-to-let market had strengthened in London and Northern Ireland, partly due to increased activity by overseas investors. The lettings market remained brisk, partly reflecting demand from a growing number of migrant workers. Also, many potential first-time buyers preferred to rent on account of the high level of house prices and mortgage payments in relation to their earnings.

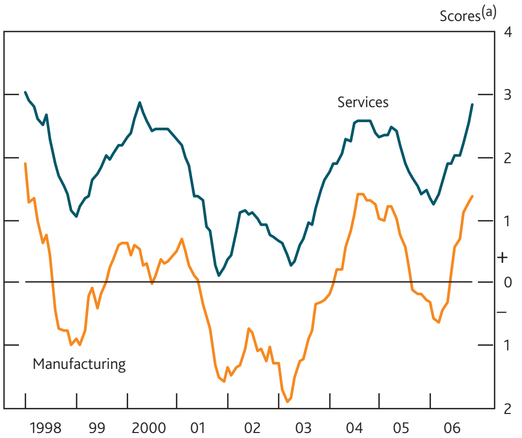
Exports and imports

Export growth eased slightly in November. The slowdown in the US housing market had started to affect UK exporters of construction materials and equipment. Otherwise the US market remained robust, though exporters' margins were reduced by the dollar's depreciation. Euro-area sales continued to recover, with German industrial demand particularly strong. Russia was increasingly cited as a significant market for UK luxury consumer goods. Turning to imports, growing difficulties in securing ships and UK port storage facilities, particularly in the run up to Christmas, had forced some importers to bring forward the timing of purchases earlier in the year.

Investment

Investment intentions strengthened further in November, principally in the service sector (**Chart 2**). In manufacturing, there were more reports of increased investment to meet domestic capacity pressures. Even so, most capital spending remained directed at reducing costs and to meet regulatory requirements. In the service sector, retailers continued to invest in new floor space; air and sea ports were expanding capacity to meet increased commercial and leisure traffic; and investment by utility and telecommunication companies in

Chart 2 Investment intentions



(a) See footnote to **Chart 1**.

infrastructure projects remained at high levels. Lastly, very strong growth in the professional and financial services sector, coupled with increasing skill shortages, continued to stimulate IT investment in order to free up the chargeable hours of companies' fee earners.

Output

Primary production

The dairy sector continued to face significant margin pressure. That, together with an increase in agricultural land prices, had resulted in a large number of farm sales and further consolidation in the sector. Although grain prices had increased sharply in recent months, many farmers had already sold forward at least a proportion of their 2006 harvests at lower prices. And the price of feed had increased for farmers of poultry etc.

Manufacturing

Production growth stabilised. While domestic demand growth continued to strengthen, that was offset by a slight deceleration in exports. Nevertheless, growth in exports remained comfortably above that in domestic markets. Demand was strongest for companies with links to the construction, defence, aerospace, pharmaceuticals and oil and gas sectors.

Construction

Construction output continued to grow strongly. A few Agencies reported tentative signs of a slight slowing, mostly arising from delays to some public programmes. But growth in private sector demand, especially for utilities infrastructure, remained robust. Looking forward, business confidence remained at a high level. Order books were strong and firms noted that expenditure stemming from the 2012 Olympics would start to have a significant impact on construction activity over the next year or so.

Services

In November, output growth in the professional and financial services sector was broadly unchanged, remaining at a high rate. The main drivers of demand remained compliance with a wide range of Government regulations, corporate consolidation — reflected in a high level of mergers and acquisitions activity — and commercial and personal tax planning. Public sector demand for professional services continued to grow strongly, for example some primary care trusts had sought help with resolving their budget deficits. In the commercial property market, investor demand remained buoyant but occupancy rates increased only modestly. Rental growth was subdued. According to some contacts, yields had declined too far and the growth of property prices was likely to slow.

Other business services activity accelerated a little in the past month, though growth remained much more muted than in the professional and financial sector. The slight improvement reflected growing demand in areas such as recruitment, transport (passenger and freight) and telecommunications. Advertising spend recovered somewhat from a period of sluggish growth, though spending was increasingly being redirected from traditional media to the internet, and to transmission via mobile phones. Consumer services growth was slightly firmer (see earlier).

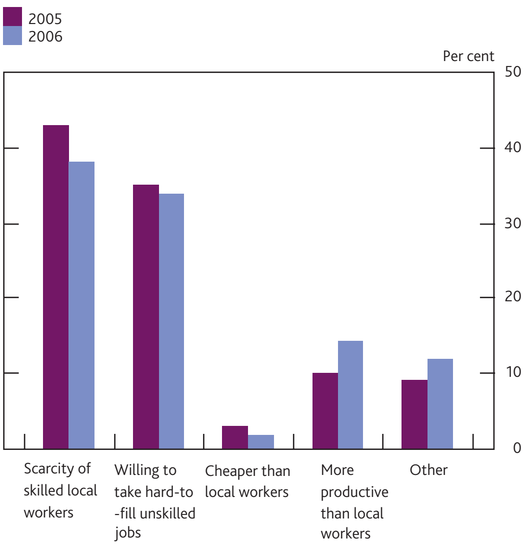
Employment

Firms' employment intentions over the next six months rose slightly. Overall, recruitment difficulties were little changed and remained significantly less than normal.

Manufacturing employment was expected to remain broadly stable and the employment intentions of companies in the consumer services sector increased a little. The strongest demand remained from business services firms, whose skill shortages continued to increase. By contrast, the amount of slack in the market for lower-skilled workers rose slightly. For example, retailers generally reported fewer difficulties compared with last year in meeting their demand for temporary staff at Christmas. In addition to an increased supply of migrant labour, there were some reports that the latest increase in the national minimum wage had dampened labour demand.

In November, the Agents carried out a survey of their contacts regarding the use of migrant labour. The survey — whose questions largely replicated those in an earlier survey carried out in November 2005 — covered over 200 companies with a total workforce of about 300,000. Overall, firms had employed a larger number of migrant workers in the past twelve months and were anticipating a further increase in their use over the next twelve months, perhaps to a slightly greater extent than over the past year. The hospitality and agricultural sectors continued to have the highest proportion of migrant workers in their workforces, but there was a greater use of migrants compared with last year's survey by firms in the business services sector. Respondents continued to report that the main reasons for employing foreign workers were the scarcity of local workers and migrants' willingness to take hard-to-fill jobs (**Chart 3**). The proportion of firms employing foreign workers because of their greater productivity had increased in the latest survey, but nonetheless remained quite small at just over 10%.

Chart 3 Reasons why companies employ non-UK nationals(a)



(a) The responses reflect firms' primary motivation only for employing non-UK nationals.

Capacity utilisation

Capacity pressures intensified a little. In manufacturing, more businesses were working at, or close to, full capacity and some had introduced additional shifts and overtime working. Even so, most were reluctant to install new capacity without firmer evidence that recent strong demand growth would persist. In business services, more firms were turning away less-profitable work owing to skill shortages. But companies were also more adept at flexing capacity to relieve supply bottlenecks, for example by flying in temporary staff from overseas, locating more low-value functions offshore and investing in IT to raise efficiency (see above).

Costs and prices

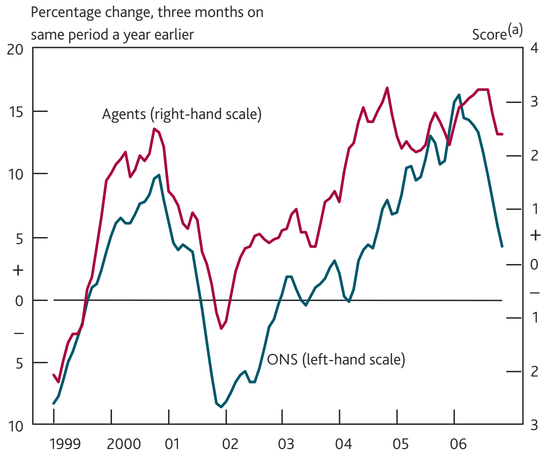
Pay

Pay settlements were broadly stable. Growing skill shortages had some upward effect on wage drift and there was an acceleration in the gap between the pay of lower and higher-skilled employees. Employers of professional staff reported increased poaching and staff turnover, and many had offered large pay increases to retain key personnel. Looking ahead, employers expected pay settlements next year would be similar to, or slightly higher than, those in 2006, mostly depending on trends in profitability.

Input prices

Input price inflation was steady in November (**Chart 4**). Lower oil prices had started to feed through to a reduced cost of some energy-intensive products such as ethylene. By contrast, the prices of grain and some metals had risen, and further increases were expected soon for materials such as timber and paper due to global supply and demand imbalances. The dollar's recent depreciation had contributed to a slight deceleration in prices of imported finished goods.

Chart 4 Input price inflation



(a) See footnote to **Chart 1**.

Output and consumer prices

Manufacturing output price inflation crept up again in November, as firms looked to rebuild margins. Consumer price inflation was broadly unchanged. There was some acceleration in the prices of consumer services, including hotel room rates. Goods price inflation eased slightly, partly reflecting lower petrol prices. And there were some reports that price discounts had been greater than usual recently to stimulate new car sales. By contrast, food price inflation continued to increase.