

Bank of England

Agents' summary of business conditions



February 2006

- Annual growth in **consumer spending** was broadly unchanged from December, but retailers remained cautious.
- Activity continued to improve in the **housing market**, and prices started to edge up.
- **Export** growth outpaced domestic **manufacturing** sales.
- **Investment intentions** eased a little.
- **Construction** output growth remained steady.
- Growth in **business services** eased, but was still strong; **consumer services** growth increased slightly.
- **Employment intentions** rose a little, but continued hiring of workers from overseas helped to ease pressure in the labour market.
- **Capacity pressures** picked up a little, but remained modest.
- Most **pay** rises were likely to be broadly similar to last year, but rises in overall labour costs may be larger.
- **Input price inflation** increased following the rise in gas prices.
- **Consumer price inflation** edged higher, with less discounting in the January 'sales' than usual.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 600 businesses in the period between late December 2005 and late January 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.

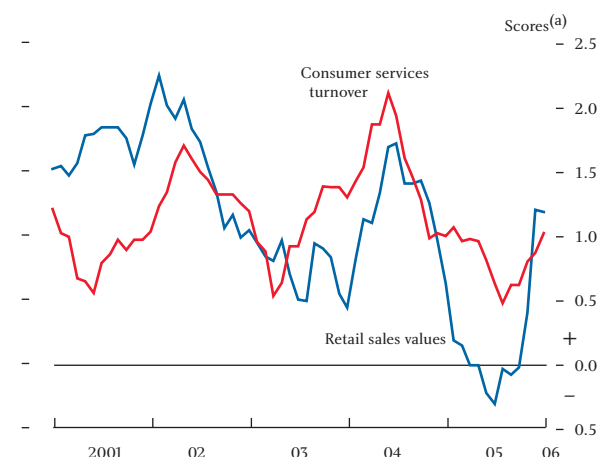
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: www.bankofengland.co.uk/publications/inflationreport/index.htm.

DEMAND

Consumption and housing

Overall, the Agents reported that annual growth in consumer spending levelled off in January. In December, sales picked up sharply, although they were also volatile from week to week. Spending in January was steadier through the month, but year-on-year growth was broadly in line with December as a whole. Sales of electronic items remained strongest. Once again, demand for more traditional household goods was weaker. Most retailers were surprised by the extent of the upturn in sales over the festive period. In contrast to previous years, the resulting low stocks of goods meant that stores were able to sell more goods at full price, rather than reducing margins. But despite the continued growth in sales into January, many retail contacts remained cautious about the outlook for the near future and throughout 2006.

Chart 1
Consumption indicators



(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).

Consumer services growth picked up slightly in January (Chart 1).⁽¹⁾ Demand for leisure services was good, with encouraging signs for summer holiday bookings alongside the continued popularity of air travel. Spending in pubs and restaurants was generally weak, but there were some reports that demand had begun to pick up.

The recent resurgence in housing market activity continued, with estate agents reporting that the momentum in demand was sustained into the New Year.

More first-time buyers were making enquiries, and sales continued to increase. Given the variable quality of unsold property remaining on the market, some estate agents were even chasing new instructions in an attempt to meet demand. House prices have started to edge up, and most contacts expect modest inflation over the course of 2006.

This pickup in demand was also evident in the new build market: housebuilders were finding it a little easier to sell properties, and in some cases were able to scale back the incentives they were offering. There still appeared to be an over-supply of apartments. Delays and problems in getting planning permission for new developments were continuing to restrain new housing supply.

Exports and imports

Export growth was broadly unchanged in January. The United States, the Middle East and the Far East were the strongest markets for UK export growth. But there were further reports of a gradual increase in demand from the euro area. Those firms performing strongest were typically producing specialised products, including capital and construction equipment to meet demand from the Far and Middle East.

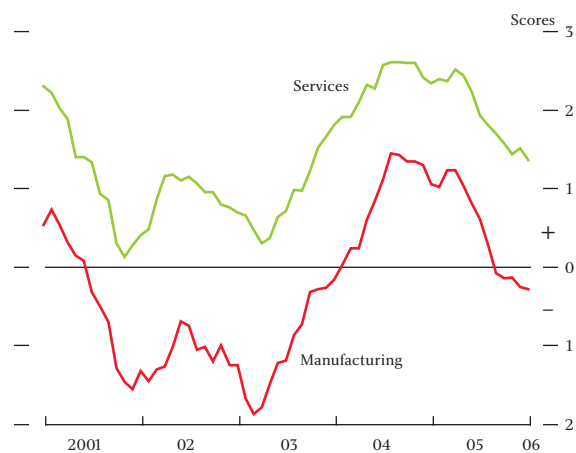
Import growth may also have strengthened, partly reflecting retailers restocking following the better-than-expected Christmas. Growth was strongest in goods from the Far East, as UK manufacturers re-sourced materials and components.

Investment

Contacts' investment intentions edged down in January (Chart 2). The price of energy has influenced investment decisions by some contacts, but there was also a general mood of greater caution in the face of uncertainty about future demand and other calls on cash, notably for pension funding. Some capital goods suppliers have seen customers defer orders. Investment that was taking place was normally focused on reducing cost rather than expanding capacity. The two main exceptions were retail, where companies continued to invest in new stores and upgrading older ones; and professional and financial services, where demand in the economy has been strongest.

(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.

Chart 2
Investment intentions



OUTPUT

Primary production

Agricultural output continued to fall modestly. Oil and gas production rose recently, but the long-term decline in those sectors also looked set to continue. And there were signs that coal production could decline further, as some mines shut down without replacements opening.

Manufacturing

Output for domestic sale was broadly unchanged on a year ago. Exports took up the slack to some degree. Output growth was increasingly concentrated in particular sectors, such as aerospace and chemicals. Only a small number of companies had shut down production for longer than usual in December in response to high gas prices; and, given the recent easing in the spot price, contacts were generally more optimistic that output could be maintained at the higher price level.

Construction

Construction output continued to grow steadily. But the composition of demand may change in the future. In particular, although public sector demand was strong, contacts from several regions were concerned that its current strength would not be sustained. However, there were signs that demand from the private sector may be increasing: commercial office activity strengthened, alongside robust demand from the retail sector. And some housebuilders were reviewing their building plans in the light of the recent upturn in the housing market.

Services

While growth in most areas of business services remained rapid, with strong activity in areas such as mergers and acquisitions and IT services, the overall pace of expansion eased a little in January. Many contacts, particularly in accountancy, also noted the likely fall-off in new work during the course of this year, following the completion of work arising from the regulatory changes last year. Demand for other business services was also a little patchier than it had been in 2005, with a mixed picture of demand in the training, advertising and haulage sectors. But growth in consumer services turnover was slightly higher in January, continuing the gradual pickup in growth seen in recent months.

EMPLOYMENT

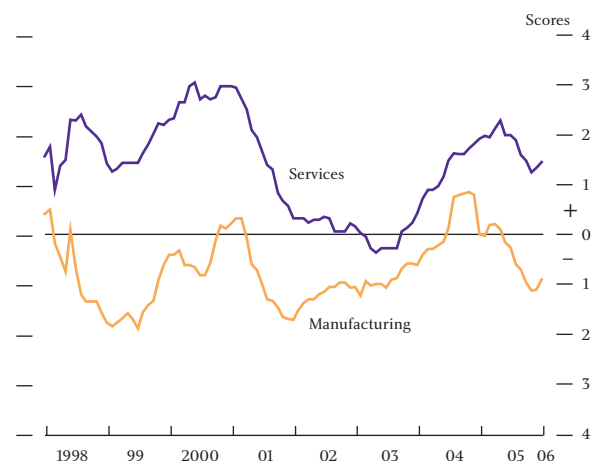
There were some tentative signs that companies may be starting to revise up their employment plans in 2006, but with some variation around the United Kingdom. While the manufacturing sector continued to shed jobs in the face of overcapacity, employment intentions in the services sector, and particularly business services, picked up a little. This was due to several sectors — notably the professional and financial services sectors — seeing continued rapid growth in demand. However, at the same time, public sector demand was easing. Recruitment from abroad was also strong, with a number of contacts increasingly hiring migrant workers to fill more skilled roles than had previously been the case. Overall, labour market conditions slackened slightly.

CAPACITY UTILISATION

Capacity pressures picked up slightly in January (Chart 3). In manufacturing, continuing consolidation and the relocation of production overseas was gradually reducing the degree of spare capacity remaining in the United Kingdom. And some areas of manufacturing, where demand had picked up, were facing more capacity pressure. Most service sector companies had ample spare capacity to meet demand. But a lack of capacity to meet demand was present in specific sectors, such as in professional and financial services. In these instances, offshoring was alleviating some of the constraints.

Chart 3

Capacity constraints^(a)



(a) Over the next six months. Before January 2005, scores refer to utilisation relative to normal.

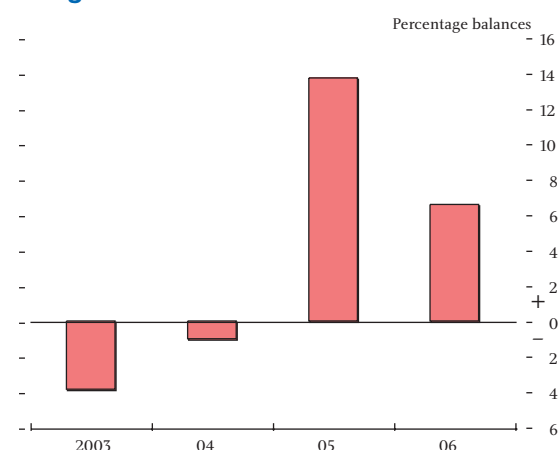
COSTS AND PRICES

Pay

There was very little sign of pay pressure this month. Most reports continued to show that 2006 settlements are likely to be broadly similar to 2005 — in several instances, agreed settlements were actually lower than a year ago. Some contacts also reported that pay drift was generally likely to be at or below last year's levels. The main exception was in financial services, where there were still some skill shortages and strong performance during 2005 meant that bonus pools were higher than last year. But generally employers were keen to keep a tight rein on regular pay, given that pension liabilities remained a key concern for many companies.

Chart 4

Changes in settlements^(a)



(a) Net balances of firms in each sector reporting that settlements in 2006 were (likely to be) higher than in 2005. Individual responses have been weighted by numbers employed.

In December 2005 and January 2006, the Agents carried out a survey of their contacts regarding the prospects for pay and labour costs during 2006. The survey covered around 290 companies employing a total of over 560,000 workers. The results from this survey suggested that settlements might be a little higher in 2006 than in 2005 (Chart 4). But overall labour costs were likely to pick up a little more strongly, partly reflecting the continued costs of funding company pensions, but also the need to retain specialist staff and recruit new employees.

Input prices

Annual input price inflation picked up in January, partly reflecting the first pass-through of higher spot gas prices in the supply chain. And although the recent easing in the spot price had allayed contacts' worries, they were still concerned about the longer-term impact of the price rise, given that many of them are on fixed-price contracts for a year or more. Aside from energy costs, there was little sign of more widespread input price pressure.

Output and consumer prices

Annual output price inflation was broadly stable in January. Firms continued to find it difficult to pass on higher input costs to customers, and were often cutting costs elsewhere to compensate. Those firms that could raise their prices were typically either niche producers of specialised goods or less exposed to competition from imports.

In the retail sector, contacts from several regions noted that post-Christmas discounting had been less ferocious than last year. That reflected the lower level of inventories that retailers had carried into the festive period, and the surprising strength in sales. Consumer services inflation remained steady. But several contacts cited the likelihood of large increases in consumer gas prices during 2006. Although the extent and timing of these rises was uncertain, they could exert upward pressure on headline inflation.