

Bank of England

Agents' summary of business conditions



January 2006

- **Consumer spending growth** picked up.
- Activity continued to improve in the **housing market**; prices were flat.
- **Export** growth rose.
- **Investment intentions** were unchanged.
- Domestic **manufacturing** sales stabilised.
- **Construction** output growth remained steady.
- Growth in **professional and financial services** remained strong; **consumer services** growth was more subdued.
- The state of the **labour market** was unchanged, as were capacity pressures.
- There was little sign of any upward pressure on **pay**.
- Overall, **input price inflation** fell.
- **Consumer price inflation** edged higher; discounting in the January 'sales' may be less marked than usual.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 680 businesses in the period between late November and late December 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

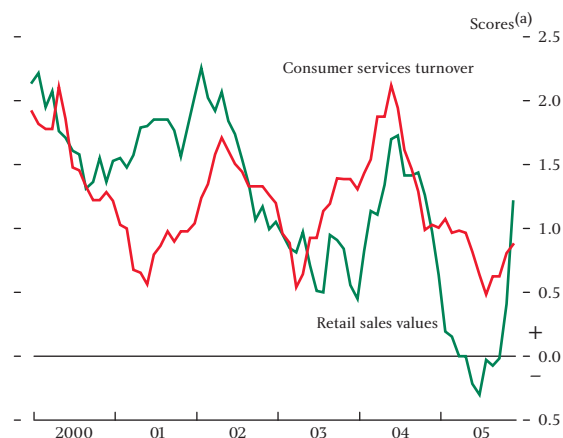
Overall, consumer spending growth picked up in December.⁽¹⁾ A number of retail contacts, particularly department stores, reported an upturn in annual sales growth ahead of Christmas; in several instances, the colder weather was cited as a factor behind improved sales of clothing and footwear. There was some regional variation in spending, with some Agencies reporting strong sales of electronic items, such as high-specification televisions, while others noted much weaker demand for the same goods. But sales of household items, such as kitchens, bedrooms and DIY goods, generally remained weak. Sales growth via the internet outpaced high street sales growth yet again, although the proportion of total retail spending remained relatively small.

Given the better-than-expected sales before Christmas, and retailers having previously chosen to hold lower inventories than last year, stocks fell to low levels. That could have had some impact on post-Christmas discounting.

Consumer services growth was slightly higher in December. Pub chains continued to report weak demand and Christmas bookings at some restaurants were at best unchanged on a year ago. Travel services fared better, with passenger numbers holding up well.

Chart 1 shows the overall Agents' scores for retail sales values and consumer services turnover.⁽²⁾ The recent

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).

(1) This summary is largely based on information gathered up to 22 December 2005; the exception is retail sales, where it is based on information gathered up to 30 December.

(2) 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.

pickup in growth appears to have continued. However, overall growth rates remain lower than during 2004.

Activity in the housing market recovered further in December. But the extent of the pickup was uncertain given the quiet time of year. Estate agents reported more enquiries from first-time buyers, although these were still at a relatively low level. The stock of homes for sale remained high, but sales were continuing to take place. Overall, prices were probably unchanged compared to a year ago.

In the new-build market, housebuilders continued to cut prices and to offer incentives in order to sell completed stock and ease cashflow constraints. But the scale of those discounts and incentives generally eased.

A number of contacts commented on the recent clarification of the rules for including residential property in self-invested pension plans (SIPPs). In particular, demand for new flats was thought to have previously been buoyed by investors wanting to include those properties in their SIPPs. Now, some of those reservations were likely to fall through. But as the impact of SIPPs on the property market was previously thought to have been small prior to the Pre-Budget Report (PBR), the impact of these cancellations resulting from the PBR clarification was likely to be insignificant.

Exports and imports

Overall, export growth picked up in December. Demand remained strong from the United States, the Middle East and the Far East. But there were also some reports of increased demand for UK products from the euro area. The general picture was unchanged, with UK exports in niche markets performing well, but manufacturers of more 'commoditised' products struggling in the face of growing overseas competition and import penetration.

There was little news on import growth this month, with import penetration continuing as UK companies re-sourced materials and components. These continue to be increasingly bought from India and China: some contacts recently commented on improvements in the quality of those imports.

Investment

Contacts' investment intentions were broadly unchanged in December compared with November, with service sector firms planning to increase spending over the next

six months and manufacturers planning to reduce it. Few manufacturing contacts expect to invest to increase capacity in the United Kingdom. Retailers were still planning to continue expanding and refurbishing stores, despite weaker sales growth. Other service companies' investment was generally concentrated in IT, with the focus primarily on improving efficiency rather than directly increasing capacity.

OUTPUT

Manufacturing

Exports continued to outpace domestic orders and sales in the manufacturing sector. But after previously falling, output for domestic markets may have stabilised: in December, it was broadly unchanged on a year ago. The aerospace, defence and pharmaceutical sectors continued to perform most strongly. Contacts remained concerned about high energy prices, particularly spot gas prices. But only a small number of companies shut down production for longer than usual in December.

Construction

Demand for construction continued to grow steadily, underpinned by relatively stable demand growth from the public sector for schools, hospitals and social housing. This was expected to persist for some time. Investment demand for commercial property remained strong, but there were some tentative signs that developers were starting to become more cautious. Occupier demand for commercial property remained somewhat weaker in most instances. Homebuilding activity was relatively weak, with some major builders continuing to scale back housing starts.

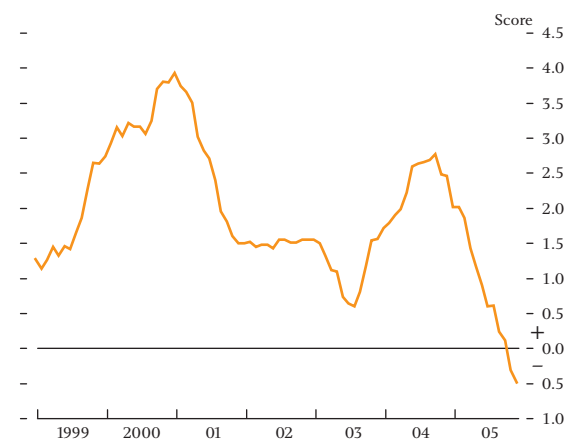
Services

Growth in business services turnover was broadly unchanged. As in previous months, financial and professional firms continued to see robust growth. However, some contacts were not confident that they would be able to maintain growth at current levels during 2006. In particular, accountancy firms expected demand growth to slow when much of the regulatory work they are currently undertaking is completed. Forward bookings for training and corporate events fell. On a related note, there were some signs that public sector demand for consultancy services has weakened. Demand for other business services, such as logistics, PR and advertising, remained weaker than for professional and financial services. And demand for consumer services was still weaker than demand for other services, but growth was slightly higher in December.

EMPLOYMENT

Overall, labour market conditions were broadly unchanged in December. Generally recruitment difficulties were low (Chart 2). The pattern of employment intentions by sector persisted, with manufacturing companies expecting to reduce the size of their labour force, business services firms planning to recruit workers, and consumer service providers anticipating unchanged staff numbers. Contacts continued to recruit a significant number of workers from overseas.

Chart 2
Recruitment difficulties^(a)



(a) Score refers to skill shortages prior to January 2005. For more information see Ellis and Pike (2005).

CAPACITY UTILISATION

Utilisation was broadly unchanged. Generally, capacity was not a constraint on meeting current or expected levels of demand. Skill shortages in professional and financial services were once again the main example of capacity constraints across regions, although these did not increase. In other services, labour was also the relevant factor, but there was sufficient flexibility to cope with significant variations in demand.

COSTS AND PRICES

Pay

Reports continued to suggest that pay settlements in 2006, and also increases in overall pay, are likely to be similar to those seen in 2005. For most firms, RPI still provides a benchmark for pay reviews even if performance-related pay is significant. Perhaps partly reflecting the recent easing in RPI inflation, companies were relaxed about pay pressures overall, with the only real upward pressure in isolated areas of skill shortages such as professional services. In financial services, bonus pools were higher than last year, particularly in more successful business areas such as mergers and acquisitions.

Input prices

Annual input price inflation eased in December. But the high level of oil and gas prices remained a concern for most contacts. Many businesses are on annual or longer-term contracts, and some of these will be renegotiated in 2006. So it will take time for the full effect of the rise in the level of oil and gas prices to be passed through. Thus far, there were only limited reports of companies closing for longer than originally planned in December due to the high level of gas prices.

Output and consumer prices

Output price inflation was broadly stable. There was little evidence of inflationary pressure being passed on from earlier in the supply chain, with contacts typically making efficiency savings where they could not fully pass on the higher costs of fuel and materials.

In the retail sector, the recent pickup in growth may have curbed the need for pre-Christmas discounting: annual retail goods price inflation increased a touch in December, while services inflation was broadly unchanged. And with retail stocks at unusually low levels, less merchandise may be discounted in the January 'sales'.