# Bank of England
# Agents' summary of business conditions

## July 2006

- **Consumer spending** growth picked up, although the pattern of sales was affected by the World Cup.
- The **housing market** recovery continued, but contacts were cautious about the near-term outlook.
- **Export sales** accelerated again; **import** growth also rose.
- Manufacturing **investment intentions** strengthened: contacts now expected broadly unchanged investment spending over the next twelve months.
- **Manufacturing production** for domestic markets rose, but less quickly than exports.
- **Construction output** growth was steady.
- **Professional and financial services** activity continued to grow strongly.
- **Employment intentions** picked up, but recruitment difficulties remained low.
- **Capacity utilisation** increased a little in both the manufacturing and service sectors.
- There was no evidence of widespread **pay pressure**.
- **Input price inflation** remained high, reflecting energy prices.
- Manufacturing **output price inflation** also stayed high; there was some further pass-through of energy costs to **consumer prices**.

*This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 750 businesses in the period between late May 2006 and late June 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 improved modestly in June. Retail sales were affected by the football World Cup and the good weather, with some goods such as flat screen televisions, beer and convenience foods selling well. Offsetting this strength, there was a dearth of shoppers during the first England game, which led to notably weaker sales that weekend. Underlying sales strengthened slightly across a range of goods, and the general mood among contacts was more positive, with sales higher than a year earlier in most regions. However, sales of basic and luxury items continued to outpace 'middle market' items, and many retail contacts were still cautious about the outlook for the rest of the year. There were some reports that demand was improving in the car market, but this was patchy at best: many contacts still reported weak sales.

Consumer services growth also edged higher in June. Leisure services showed signs of improving demand, although the extent was mixed from region to region and the usual pattern of spending on overseas holidays was disrupted by the World Cup.

The recovery in housing market activity continued at a modest pace, with small price rises being driven by a shortage of supply. The main exceptions were still city centre apartments, where prices were weak due to supply outstripping demand. In most areas, estate agents were cautious about the prospects for further price rises and activity during the rest of 2006, noting that affordability remained an issue for most first-time buyers. Set against that, there were some reports of increased demand from buy-to-let investors.

House building activity was still rising in response to better sales, but at a slower pace than the rise in housing transactions. Planning constraints were the main factor impeding new building, although there were also more reports of skill shortages in specialised areas.

## Exports and imports

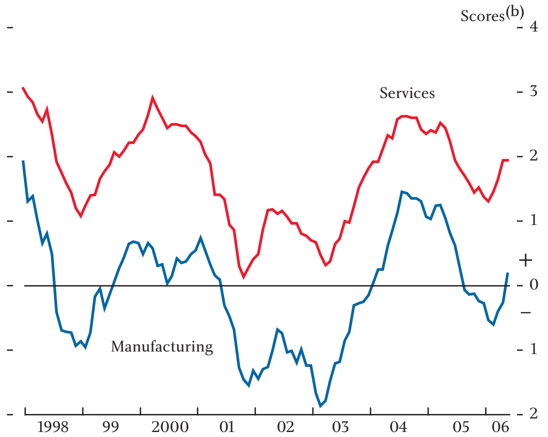
Export growth picked up again, with UK producers seeing robust demand from many areas of the world. In particular, demand from the United States, the Middle East and Asia was strong. European sales were also improving, reflecting both a pickup in orders from established markets such as Germany and new opportunities in Eastern Europe.

UK imports also rose in June. In recent months import growth has been outpaced by export growth, but there were signs that the gap may be closing. Imports of components and finished goods from lower-cost producers continued to rise at a marked rate, as manufacturers sought to reduce other costs following the recent energy price rises. But there were also signs that imports of consumer goods started to accelerate, reflecting the modest recovery in consumer demand.

## Investment

Manufacturing investment intentions picked up: over the next twelve months contacts now expected domestic manufacturing investment spending to be broadly unchanged, rather than falling (Chart 1). With many manufacturers continuing to outsource production abroad, this improvement in domestic investment spending was primarily driven by companies with higher value-added or niche products. These companies have recently seen strong demand, and were investing to increase capacity and ease bottlenecks. Service sector investment intentions remained positive, with the distribution sector continuing to invest in new floor space. As ever, new investment plans in both manufacturing and services were concentrated in ICT. But there were also a number of plans that focused on reducing costs (particularly energy costs).

**Chart 1**
**Investment intentions**[(a)]




(a) 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.
(b) A score of zero indicates that UK investment spending over the next twelve months is expected to be unchanged, compared with current spending. A positive (negative) score indicates investment spending is expected to be higher (lower) than current spending. For more information see Ellis and Pike (2005).

# OUTPUT

## Manufacturing

Manufacturing production rose, with production for foreign markets accelerating while growth in domestic output was broadly unchanged. The strength of export sales and relative weakness of production for domestic markets was a pattern seen across a range of industries. High-tech and niche manufacturers were performing the strongest, but there were also tentative reports that some firms producing more 'commoditised' products had seen the decline in their sales slow.

### Construction

Construction output growth was robust and steady. Government-sponsored work was an important component of demand, but private sector projects were also significant, including retail investment, new office space, and increased house building activity. Contacts' views about the outlook for activity over the rest of 2006 were somewhat mixed: while many reported good order books, some others noted declining enquiries for industrial and commercial projects.

### Services

The strong growth in professional and financial services activity was sustained in June. The recent high volumes of regulation and tax-related accountancy work, mergers and acquisitions, and consultancy (notably IT) activity were maintained, and contacts were still having difficulty keeping up with the pace of demand. Demand for other business services also rose, but at a less pronounced pace. The advertising market was seeing weaker growth, but logistics and warehousing activity picked up. Growth in consumer services activity also edged higher, with some leisure attractions reporting stronger demand.

## EMPLOYMENT

Contacts' employment intentions over the next six months were slightly stronger in June. Consumer services companies expected a small increase in headcount; the expected rate of job losses in manufacturing slowed; and business services firms raised their employment plans again. But despite this increased demand for labour, most companies were able to fill vacancies with little difficulty (Chart 2). The main

**Chart 2**
**Recruitment difficulties**[(a)]


(a) The score refers to skill shortages before January 2005.

exceptions were when contacts were recruiting for particular skilled roles. These shortages were especially prevalent in the professional and financial services sector, although there were also some reports of specialised skill shortages in other sectors, such as construction.

## CAPACITY UTILISATION

Capacity utilisation rose somewhat, both in manufacturing (reflecting increased demand) and in the services sector. Capacity pressures were most pronounced for professional and financial services, reflecting a lack of skilled staff. Outside of professional services, other sectors saw signs of rising utilisation, but generally capacity pressures were still relatively subdued.

## COSTS AND PRICES

### Pay

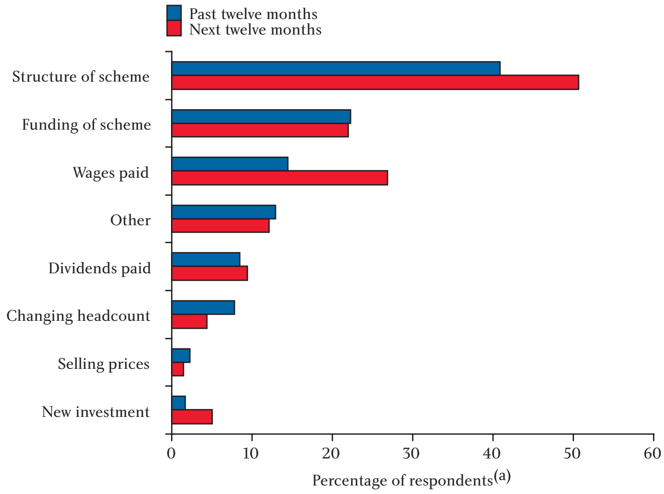
There was no evidence of widespread pay pressure. A very high proportion of settlements in both manufacturing and services were around 2% to 3%, broadly unchanged from a year earlier. There were some instances of larger increases, for example higher pay awards or wage drift in sectors experiencing skill shortages, but these were relatively few and far between. Pension costs continued to be a more pressing concern for contacts with a defined-benefit scheme, with many also noting the significant amount of management time taken up with addressing pension fund shortfalls.

During May and June, the Agents carried out a survey of their contacts regarding their pension funds. The survey covered around 210 companies with a total turnover of over £270 billion, and included a number of companies who were known to have pension fund deficits. The majority of contacts reported pension deficits of less than 10% of annual turnover, although a significant number faced higher funding shortfalls.

In response to the deficits, companies had made several changes over the past year. The main changes had been to the structure of their pension schemes, and associated funding decisions; there had also been an impact on pensionable wage increases. A number of respondents also noted that deficits had affected mergers and acquisitions activity, in terms of buying and selling companies. Only a small minority of companies had changed employment, selling prices or capital expenditure as a result of pension deficits (Chart 3), although the impact on investment spending had been more pronounced for smaller companies.

Over the next twelve months, companies expected further changes to the structure and funding of their

**Chart 3**
**The impact of pension fund deficits**




(a) Individual responses have been weighted by turnover.

pension schemes, and also to pensionable pay. But the impact on headcount, pricing and investment was expected to be negligible.

## Input prices

Input price inflation stayed high. The main concern was again the rising cost of energy. Some contacts still had not felt the full impact of the recent price increases due to long-term contracts, but those contacts were increasingly nervous about the eventual impact when those contracts expired. For many companies, energy and import prices were still a relatively small component of total costs, compared with the cost of labour. But companies were continuing to minimise their energy use and cut back on other costs to compensate for the rise in energy prices, for example by sourcing inputs more cheaply from abroad. Even here the impact of energy prices and other inflationary pressures was being felt, with contacts noting rises in the prices of goods imported from lower-cost economies. Other input prices were generally less of an issue, but several contacts noted a recent firming in the price of steel.

## Output and consumer prices

Manufacturing output price inflation remained relatively high, as the pass-through of higher energy costs to output prices continued. It was easiest to raise prices where firms could demonstrate a clear link from increasing energy costs; at the same time, contacts were still unable to pass the full extent of the energy cost rises on in higher prices. Business services inflation was somewhat higher than manufacturing output price inflation, with services companies generally finding it easier to force through higher prices than manufacturers.

Retail goods price inflation picked up in June, partly reflecting consumer utility prices but also due to greater pass-through of energy costs from producer prices to consumer prices more generally. However, the continued downward competitive pressure on prices meant that the full rise in costs was still not reflected in the price faced by consumers. Retail services price inflation was unchanged. Where possible, leisure operators and travel companies were passing on their higher energy costs. But apart from either direct or indirect energy price effects, contacts saw little evidence that underlying inflation was rising for either goods or services.