Bank of England

Agents' summary of business conditions

March 2006

- **Consumer spending growth** fell back following the pickup over Christmas and the New Year.
- **Housing market** activity grew steadily.
- Domestic **manufacturing** sales were broadly unchanged; **export** sales rose.
- **Investment intentions** eased a little; overall companies expected modest increases in investment spending.
- **Construction** output growth was steady.
- **Business services** growth remained strong.
- There was little change in **employment** or intentions, and recruitment difficulties were generally low.
- **Capacity pressures** were subdued.
- So far, there has been little sign of increased **wage** pressure from the ongoing pay round.
- Rising energy costs boosted **input price inflation**; **output price inflation** also picked up.
- **Consumer price inflation** was broadly unchanged.

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 January 2006 and late February 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.

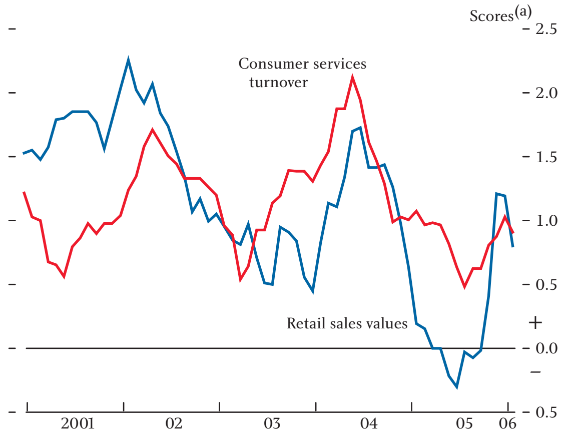
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, *obtained from: www.bankofengland.co.uk/publications/inflationreport/index.htm.*

DEMAND

Consumption and housing

After picking up over the Christmas period, consumer spending growth has fallen back. The weakness was most pronounced in retail sales, where contacts from several regions reported a notable easing in sales growth. The gloomier picture has left many retailers cautious about the outlook for spending in the rest of 2006, with some choosing to keep inventories below last year's levels. Sales growth was strongest for electronic items such as flat-screen televisions and mobile phones, but spending was weaker on other items such as clothing and footwear. Sales of more traditional household goods such as furniture were also subdued. And new car sales remained weak: although it was normally a quiet time of year for sales (ahead of the March registration plate change), some contacts noted that forward orders for cars with the new plate were lower than a year ago.

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 showed more resilience than retail sales, but growth also eased (Chart 1).[1] Overall, demand for leisure travel was strong, especially overseas, but UK hotels and restaurants generally reported a weak start to the year.

Housing market activity continued to increase. Estate agents reported more interest from first-time buyers and a sustained pickup in sales. Some estate agents reported that instructions were currently weaker than sales, and they were having some difficulty finding good enough quality properties to meet demand. Prices generally remained stable, or were starting to rise gently.

Housebuilding activity was a little firmer, and contacts were more optimistic following an improvement in new reservations and the recovery in the housing market as a whole. But there were still some causes for concern. Apartment sales were once again weaker than house sales and, in places, there was still an over-supply of new flats.

Exports and imports

Exports continued to rise at a healthy rate in February, with demand again strongest from the United States and the Middle and Far East. In addition, sales to newer overseas markets such as Eastern Europe were continuing to rise. There were further reports of a modest improvement in demand from the euro area, although the picture was patchy. Apart from the stronger manufacturing sectors, professional and financial service contacts also reported increased business from overseas.

Import growth continued to strengthen, with goods and components increasingly bought from China and other Asian economies. Many contacts were outsourcing to Eastern Europe as companies continued to try and reduce the cost of intermediate goods in the face of strong price competition and higher energy bills.

Investment

Investment intentions eased in February, and overall contacts expected investment spending to increase modestly over the next six months. The easing in investment intentions was most apparent in the manufacturing sector, where contacts' future investment plans were increasingly focused on shifting production abroad. So investment in the United Kingdom for these companies was expected to fall. What UK investment has taken place was mostly focused on reducing cost and raising efficiency rather than expanding physical capacity. Service sector intentions held up better, but remained at a relatively subdued level, with contacts expecting only moderate increases in investment spending. Within services, professional and financial services firms and retailers continued to invest to expand capacity. Overall, contacts were cautious about committing to large investment plans in the face of uncertain demand prospects and high energy prices.

OUTPUT

Manufacturing

Output for domestic sale was broadly unchanged on a year ago, while export sales continued to perform rather

(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.

more strongly. Alongside the aerospace and chemical sectors, manufacturers of capital goods have also seen strong sales, both from overseas, but also more generally for energy-saving equipment. Where possible, manufacturers were trying to move into producing more advanced products in terms of design and technology. However, some manufacturers were less concerned with volume growth and were more focused on coping with recent cost increases and rebuilding profitability.

Construction

Construction output grew steadily, underpinned by the strength of government-sponsored work. Based on the current state of order books, growth was likely to remain healthy for much of this year. But further ahead, contacts expected a significant easing in public sector demand. The recent upturn in private commercial activity was sustained in February, but industrial construction was more mixed. Housebuilding was a little firmer, as optimism continued to improve on the back of higher turnover.

Services

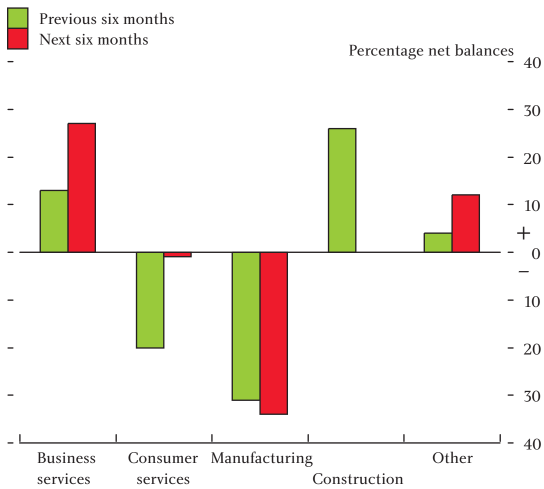
Business services turnover grew strongly. This was particularly pronounced in professional and financial services, where the healthy growth seen in 2005 has persisted into the new year. Apart from the ongoing work arising from new financial regulations, strong mergers and acquisitions also boosted activity. Demand for other business services, such as PR, advertising, training, haulage and marketing, was more subdued, but growth in turnover was still reasonably firm. Generally the outlook among contacts was positive for 2006. Consumer services growth remained somewhat weaker, following the slight easing in growth in February.

EMPLOYMENT

There was little change in the state of the labour market in February. Overall private sector employment was fairly steady, with declines in manufacturing jobs offset by increased employment in services. And aside from a slight easing in the consumer services sector, contacts' employment intentions were broadly unchanged: manufacturers expected to shed jobs and business services companies were looking to recruit. Recruitment difficulties were generally subdued, with migrant labour an important resource for filling both skilled and unskilled job vacancies. Shortages were again most prevalent in professional and financial services. There were some signs that the recent deceleration in productivity may have reflected labour hoarding, with employees working less intensively. As activity has picked up in recent months, employment has been broadly unchanged, reflecting higher labour utilisation.

During February, the Agents carried out a survey of their contacts regarding the prospects for employment during 2006. The survey covered around 220 companies employing a total of over 450,000 workers. The results from this survey suggested that, having reduced the size of their workforce over the past six months, contacts expected to employ more workers over the next six months. The expected increase in employment was driven by high recruitment intentions in the business services sector, and fewer job losses in consumer services (Chart 2). Strong demand was the main reason for higher employment, although in several sectors this was offset by the need to reduce costs by shedding labour.

Chart 2
Changes in employment(a)



(a) Net balances of firms in each sector reporting that employment over the past six months (over the next six months) was (likely to be) higher or lower. Individual responses have been weighted by numbers employed.

CAPACITY UTILISATION

The slight pickup in capacity pressure seen last month reversed in February. Capacity pressures in the service sector eased a little, to around normal levels. Most service companies had sufficient spare capacity to meet current demand, the exception being professional and financial services. Capacity pressures in the manufacturing sector also eased in February; more generally there was a considerable amount of spare capacity in the sector as a whole. In the longer term, consolidation and off-shoring were slowly eroding the degree of that capacity remaining in the United Kingdom. Many contacts, both in manufacturing and services, were able to flex capacity in response to changes in demand.

COSTS AND PRICES

Pay

The majority of contacts reported little pressure on pay, with settlements and overall wage inflation very similar to that seen last year. Companies were continuing to bear down on pay increases in the face of pensions and energy costs. There have been few reports of resistance by employees, with some reports that workers were aware of the pressure on firms' margins and in some cases were nervous about job security. The main sign of strong earnings growth was bonuses in professional and financial services, which were high following strong profits in 2005.

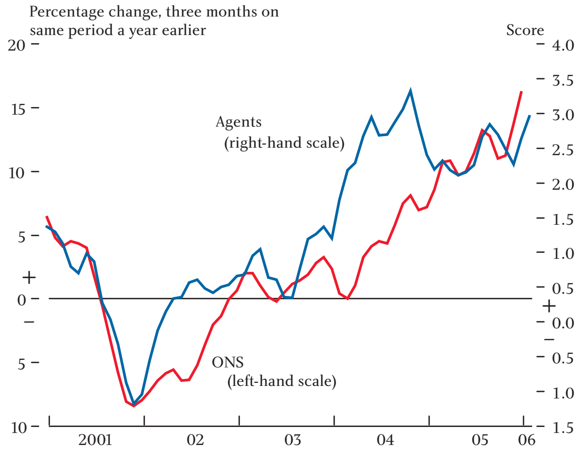
Input prices

Input price inflation rose in February (Chart 3), reflecting higher energy prices. In particular, gas prices faced by contacts continued to rise as more long-term contracts came up for renewal. Energy prices were the biggest concern for contacts, with many having to accept smaller margins due to a lack of pricing power. However, other contacts had no choice but to try and pass on the price rises. Higher gas and electricity prices have been compounded by the rise in the oil price since December, which also affected distribution costs and related products such as plastics. Aside from energy costs, other materials prices were generally more subdued, and were less of a concern for contacts.

Output and consumer prices

Output price inflation rose in February, as companies passed on some of the recent increase in input prices to their customers. Contacts had varying success in doing so, but more companies managed to raise prices than in previous months, as customers were more willing to concede price increases that reflected higher material and energy costs.

Chart 3
Input prices(a)



(a) Agents' score refers to material costs.

Despite this rise in output prices, and the continued increase in imported inflation, retail goods prices continued to fall in February. This was partly due to strong competition, particularly on the High Street. Consumer services inflation was broadly unchanged; although some companies were starting to cut prices in order to stimulate demand, other prices, such as travel, had picked up. Overall, consumer price inflation in February was similar to its level in recent months.