

Bank of England

Agents' summary of business conditions



May 2006

- **Consumer spending growth** may have started to stabilise following the volatility seen in recent months.
- The **housing market** recovery continued, but contacts were nervous about its fragility.
- **Investment intentions** picked up slightly; services firms expected to increase investment spending over the next six months.
- Domestic **manufacturing** sales were broadly unchanged on a year earlier, while export sales accelerated.
- **Construction** output accelerated.
- Growth in **business services** turnover picked up.
- **Employment intentions** were unchanged, with staff levels falling in manufacturing and rising in business services.
- **Capacity pressures** remained generally muted; only professional and financial services companies were experiencing significant difficulties.
- **Pay settlements** were similar to the levels seen last year, with little sign of upward pressure from employees following the recent energy price rises.
- **Input price inflation** stayed high, reflecting a further pass-through from energy prices.
- **Output price inflation** rose, but competitive pressures held down **consumer price inflation**.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with over 740 businesses in the period between late March 2006 and late April 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

There were signs that consumer spending growth has started to stabilise, following volatility in recent months. Retail sales growth picked up slightly during April, following a lull in the aftermath of the strong spending seen over the Christmas and New Year period. Contacts reported a modest increase in sales over Easter, although this was based on a limited amount of feedback.⁽¹⁾ A number of Agencies noted some polarisation across retailers, with luxury goods and items aimed at higher income groups performing more strongly than other items. There were further signs that demand was improving in areas close to the housing market, such as carpets and furniture. But generally retailers remained cautious, and were continuing to hold 'thin' levels of stock.

The recent pattern of spending on cars was similar to that of retail sales, with 'luxury' models outperforming less prestigious brands. There were some signs that total new car sales in March may have exceeded dealers' cautious expectations, although some of this may have reflected late pre-registrations to meet manufacturers' sales targets. Overall, new car sales were still fairly weak.

Consumer services growth edged higher in April, but remained close to levels seen since the turn of the year. Spending on holidays and air travel was strong. Restaurants, hotels and pubs generally reported weaker demand, although there were some reports that spending may have picked up a little recently.

Housing market activity rose, continuing the pickup since the autumn of last year. But some contacts expressed concern about the fragility of the recovery, citing affordability as a concern that was deterring first-time buyers. The demand for new apartments in city centres continued to fall short of supply. Elsewhere there was a shortage of housing stock for sale, but this was starting to ease following an improvement in instructions. As such, contacts expected the recent modest rises in selling prices to tail off gradually over the coming months.

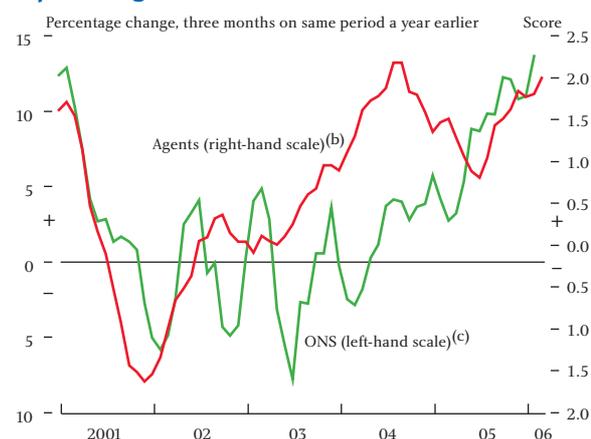
Exports and imports

Export sales continued to accelerate (Chart 1), particularly to Asia and the Middle East. Contacts reported increased demand from overseas for high-tech capital products and luxury consumer items. There were also signs that demand was recovering in the euro area, with several reports of a pickup in orders from Germany. Contacts were generally bullish about the prospects for exports.

(1) This month's reports were written immediately after the Easter weekend, so information on spending over that weekend was more uncertain than usual.

Chart 1

Exports of goods^(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) The score is for manufacturing exports. A score of zero indicates that sales or turnover were changed 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).
- (c) Includes missing trader intra-community (MTIC) fraud.

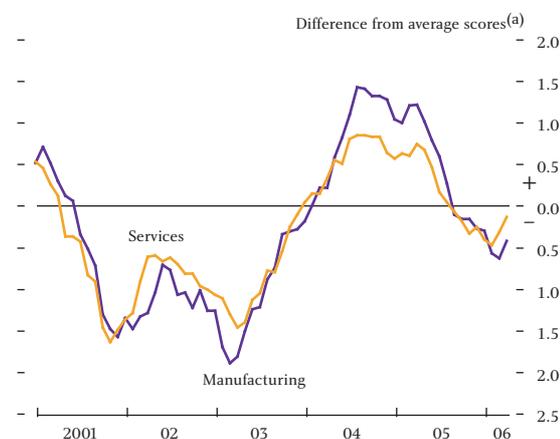
Imports of consumer goods were a little weaker in April, reflecting the recent weakness in retail spending. But the trend to increasingly source these goods from abroad continued.

Investment

Investment intentions picked up in April. Manufacturing firms were continuing to scale back on investment in the United Kingdom, but the pace of decline eased. Services firms continued to increase investment spending, and their planned spending over the next six months rose a little. The focus was still on reducing costs rather than expanding capacity: the exceptions were retailers, who were continuing to expand and refurbish stores despite the recent slowing in demand. Overall, investment spending was still somewhat subdued, with the scores for intentions remaining a little below their averages

Chart 2

Investment intentions



- (a) Averages calculated since July 1997. For more information on the scores see Ellis and Pike (2005).

(Chart 2). There were some reports that the requirement to reduce pension fund deficits continued to inhibit companies' investment spending.

OUTPUT

Primary production

Poultry production was declining, a fall that pre-dated the discovery of avian influenza in the United Kingdom, although there were signs that demand had weakened since. Contacts were watching developments closely, but for some the risks were not considered to be much greater than they were prior to the discovery. There were a few reports that crop yields and demand have improved recently. North Sea oil and gas production has picked up since the start of the year, although production was still expected to decline in the longer term.

Manufacturing

Contacts report that manufacturing production rose in April. Output for domestic sale picked up slightly, and was now just above last year's levels. Exports also accelerated, with growth matching the recent peak in 2004. In both markets high-tech producers such as pharmaceuticals and aerospace companies were performing the strongest. In contrast, lower value-added production continued to move overseas.

Construction

Construction output accelerated, reflecting robust demand across a variety of areas. Government-sponsored projects on education and infrastructure were strong, and order books were pointing to further strength over the next twelve months. The pace of commercial activity was also increasing, and more housebuilders were starting new projects after last year's lull.

Services

Growth in business services turnover rose, with demand especially strong in professional and financial services. That partly reflected work arising from regulatory requirements, but mergers and acquisitions and other banking activity were also robust and IT companies continued to experience strong demand. Contacts in other business services such as marketing, advertising and logistics reported more modest growth, which had been broadly steady since the end of 2005. Once again consumer services saw the weakest increase in turnover, but growth did edge higher, with estate agents and mortgage suppliers benefiting from the ongoing revival in the housing market.

EMPLOYMENT

There was little change to contacts' employment intentions this month, with the manufacturing sector planning to lay off staff, consumer services companies expecting broadly unchanged employment over the next six months, and business services firms looking to recruit more staff in the face of strong demand. But public sector recruitment slowed. Across different sectors, professional and financial services were experiencing the most pronounced shortages in skills, leading to more in-house training. Companies were also continuing to recruit from abroad, and there were more examples of migrants filling higher-skilled roles.

CAPACITY UTILISATION

Capacity pressures picked up a little, but were broadly steady at the levels seen since Autumn 2005. There was enough spare capacity in most sectors to meet expected demand over the next year, with the main exceptions being professional and financial services companies who were facing the aforementioned skills shortages.

COSTS AND PRICES

Pay

Pay pressures were subdued, with most settlements similar to those seen in the previous year. Contacts reported little sign of pay pressure, despite the recent rises in petrol and household utility prices. There were some signs of wage drift in professional and financial services, but otherwise sharp rises in pay were only occurring in isolated instances where companies faced specific skill shortages. There appeared to be a general appreciation by employees of the margin pressures that businesses were facing.

Input prices

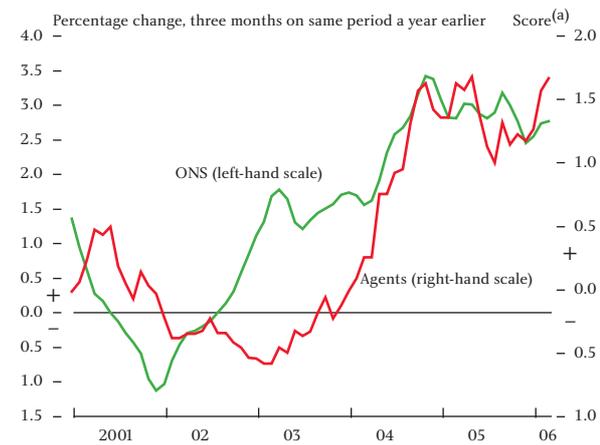
Input price inflation stayed high — the direct upward pressure on costs from fuel, electricity and gas prices continued to feed through as supply contracts were renewed. Energy costs were still the biggest concern for most businesses, and were encouraging contacts to source other inputs increasingly from abroad. The prices of these imports were also rising, albeit at a more subdued pace. The prices of energy-intensive materials, such as plastics and some chemicals, were also increasing, as were a range of metals.

Output and consumer prices

Manufacturing output price inflation edged higher (Chart 3), as more of the recent rises in oil and energy prices were passed through the supply chain. The extent of pass-through varied from company to company, depending on competitive pressure and the ability to

Chart 3

Domestic manufacturing output prices



(a) For more information see Ellis and Pike (2005).

offset the rises in input costs by sourcing materials from cheaper suppliers or other efficiencies.

However, these rises in output prices were generally not being passed on to the consumer, with contacts reporting that both retail goods and services price inflation were unchanged in April. Competition in the retail sector was intense, which was restraining any price rises. Meanwhile, consumer service providers' experience was mixed, with some contacts able to post price increases in the face of robust demand, while others reported discounting to encourage consumer spending.