BANK OF ENGLAND

Agents' summary of business conditions

August 2007

- Consumption growth slowed, with an easing in expenditure on both goods and services.
- Demand for housing also eased in most parts of the United Kingdom.
- In contrast, investment intentions remained robust in the service and manufacturing sectors.
- Overall, demand for exports was again buoyant.
- Recent flooding had affected agricultural output and disrupted production in local economies. But growth in manufacturing was solid, and construction output continued to expand rapidly. Service sector output growth also remained strong, though may have peaked.
- Employment intentions were elevated, with labour demand remaining strongest in the service sector. Recruitment difficulties became more pronounced.
- Capacity pressures persisted in the construction and service sectors and also rose in manufacturing.
- Growth in pay awards remained well contained. Total labour costs continued to increase more rapidly than the official earnings data, but had eased slightly.
- Annual input price inflation increased again in the month, as did output price inflation, and the process of margin rebuilding by manufacturers continued.
- Annual consumer price inflation ticked down, but remained higher than the average of recent years. Despite discounting by retailers, recent floods created uncertainty about the outlook for food prices.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with nearly 700 businesses in the period between **late June and late July**. It provides information on the state of business conditions, from companies 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 company 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.

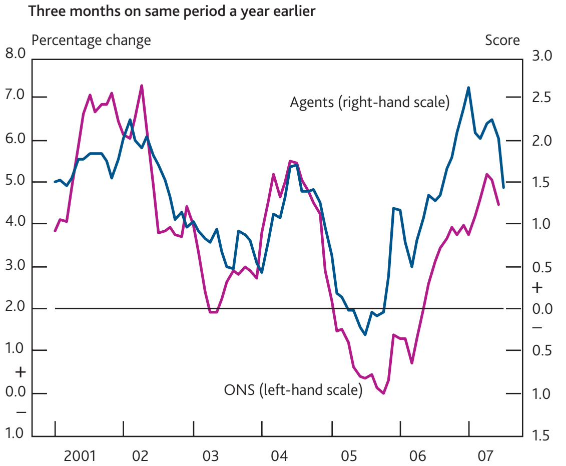
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

The Agents' score for the value of retail sales fell further in July, with the pace of spending growth well below its peak at the beginning of the year (**Chart 1**).

Chart 1 Retail sales values



An easing in sales growth was evident for both goods and services. Most Agents reported an easing in sales of consumer durables (such as furniture and household fittings) and disappointing sales of summer fashion. Outside London, a similar easing was evident for sales of consumer services. Contacts claimed that the slowdown in spending, while most evident for discretionary items, was amplified by the effects of adverse weather. Reflecting these developments, there were reports of an unintended build-up of stocks and active price discounting.

Housing market

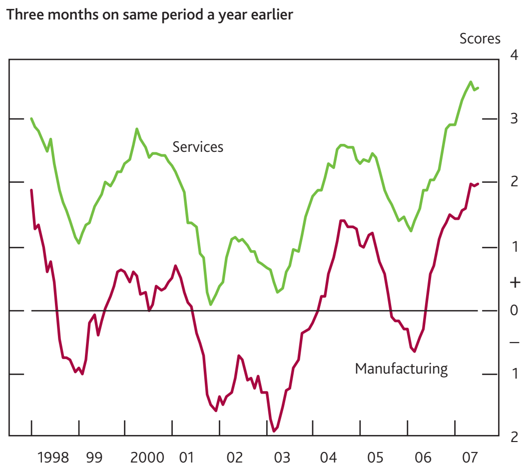
Housing demand also eased again in the month, with indications of this cooling extending to London and Northern Ireland. In the market for established housing, estate agencies reported another modest fall in transactions growth. The number of new instructions remained higher than earlier this year, and there was a further downward revision to sellers' asking prices, so that price inflation for established homes moderated in most parts of the United Kingdom.

Demand for new housing also eased, though supply-side issues remained the key constraint on additions to the dwelling stock. Discounts were prevalent, and builders' margins were tightening, weighing on price inflation for new dwellings.

Investment

In contrast to softer household spending, spending by businesses remained robust. Investment intentions stabilised at a high level in July and pointed to continued growth in business investment over the coming year (**Chart 2**). Firms in all sectors continued to report intentions to invest in IT. Investment in buildings and structures increased, especially in the business service and retail sectors, as did investment in transport and utilities. And there were ongoing reports of investment designed to achieve environmental goals.

Chart 2 Investment intentions over the next twelve months



Overseas trade

Overall, external demand remained strong. While the high value of the pound relative to the dollar weighed on margins and orders for firms exporting to the United States, demand in other markets continued to strengthen. There was growth in exports of goods and services to Europe (particularly eastern Europe) and the Middle East. Service exports also expanded rapidly to emerging economies in Asia and Africa. Demand for both final and intermediate imports remained high, consistent with the appreciation of sterling and healthy domestic production.

Output

In the United Kingdom as a whole, output growth remained firm in July. But recent floods greatly disrupted some local economies. Companies in flood-affected counties faced damage to property, and limited access to labour and non-labour inputs. Within these counties, output growth in many industries was temporarily restricted, though construction companies experienced a partially offsetting increase in demand for repair work. At this stage, beyond agriculture, there had been little effect on economy-wide production. The effects on agriculture would become clearer as the harvesting and cropping season proceeds.

Primary production

In key growing districts, floods caused significant damage to crops, and difficulty in both harvesting and planting for the next season. The resulting shortages of local supply encouraged increased importation of a range of fresh produce.

Manufacturing

Manufacturing output growth remained solid in July. The impetus to manufacturing growth was greatest from exports (particularly of capital goods) but domestic production was also firm. Manufacturers competing in domestic markets with imports were increasingly engaging in higher value-added production, and in activities where they could offer more reliable delivery or follow-up service than foreign suppliers. And the current boom in non-residential construction activity remained supportive of manufacturing activity.

Construction

Construction output growth rose further in July, having increased sharply for much of the past year. Many contacts reported that the industry was close to full capacity. Activity continued to be supported by infrastructure projects, along with demand for new retail, industrial and commercial space. Spending on health and education was also stimulating growth. With many firms reporting full order books for the year ahead, Olympics-related projects were expected to exacerbate capacity constraints.

Services

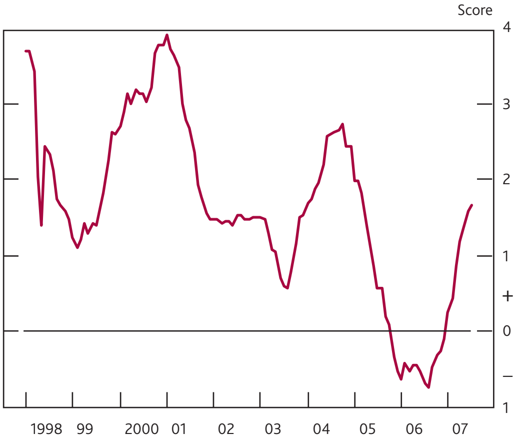
Activity in the service sector remained strong, though there were signs this month that it may have peaked. Agents' scores for professional and financial services ticked down for the second month, reflecting a slight easing in merger and acquisitions activity, and in demand for compliance and property-related work. This induced a small fall in the score for total business services, after a period of protracted strength. The Agents' score for consumer services fell again in July, consistent with evidence of an easing in households' discretionary spending.

Employment

Employment intentions remained elevated, but had flattened out in recent months. Labour demand was still strongest in the service sector, while employment intentions in manufacturing had hovered around an unchanged level for much of this year, after an extended period of labour shedding. Demand for skilled labour continued to exceed supply, especially in the business services and construction industries. Consequently, recruitment difficulties rose further (**Chart 3**),

Chart 3 Recruitment difficulties[(a)]

Relative to normal



(a) Skill shortages before January 2005.

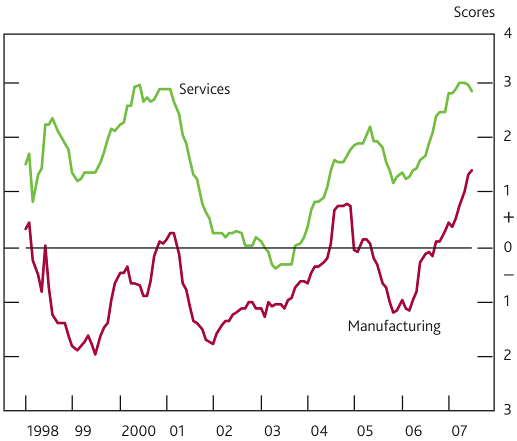
and became more geographically widespread. Contacts emphasised the global nature of skill shortages for professionals, and the likelihood of these persisting. However, the influx of migrants continued to alleviate shortages of less-skilled labour in a range of industries.

Capacity utilisation

Consistent with recruitment difficulties, capacity pressures were expected to persist in coming months (**Chart 4**). Scores remained highest in the service sector, where they had plateaued close to levels at the turn of the decade. However, those for the manufacturing sector rose to their highest level since the late 1990s. And capacity remained tightly constrained in the construction sector. These pressures mainly reflected shortages of professional staff, though there were some reports of shortages of materials and equipment which were delaying the completion of work.

Chart 4 Capacity constraints expected over the next six months

Relative to normal



Costs and prices

Labour costs

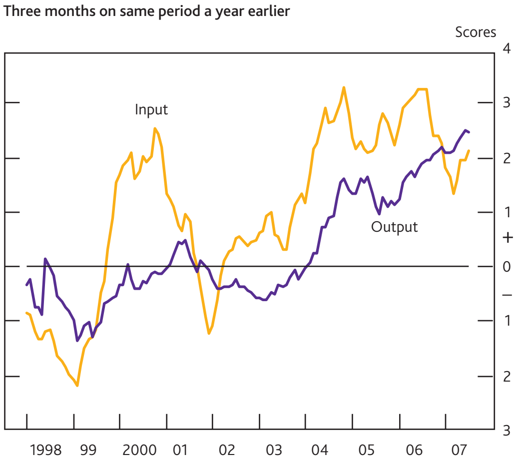
The Agents' score for labour costs remained high in July, though was below its peak at the beginning of the year. Agents' scores continued to provide a stronger signal than official data, with firms reporting increased use of incentive payments and other forms of employee compensation, particularly leave benefits. There were also more reports of payments designed to attract and retain staff in a tighter labour market. Across-the-board pay settlements remained well contained, but some contacts expected them to increase in the year ahead given greater tightness of the labour market.

Input and output prices

Annual input cost inflation rose again in July (**Chart 5**), with firms reporting renewed increases in the prices of a broad range of commodities and goods used in the early stages of production. Prominent among the cost increases were sharp rises in the price of food inputs, oil, oil derivatives, metals, timber and other building materials. The rise in these input costs more than offset recent reductions in utilities prices. And despite the high value of sterling, some contacts reported that their contract prices for goods imported from China had risen in recent months.

Chart 5 Manufacturers' input and output prices[(a)]

Three months on same period a year earlier



(a) Manufacturers' non-labour input and output prices.

The score for manufacturing output price inflation was little changed in July, but remained well up on its level early in the year. During the course of the year, some firms had taken advantage of stronger demand to raise prices and recover costs. Consistent with this process of margin recovery, the Agents' scores on pre-tax profitability for manufacturers rose further in the month.

Business-to-business service price inflation also persisted at a high rate, reflecting ongoing strength in labour costs in the sector and buoyant demand for business services. However, there were tentative signs that price inflation had stabilised in response to increased competition between large service providers and smaller, less established firms.

Consumer prices

Annual goods price inflation ticked down again in July as earlier sharp increases in energy prices fell out of annual comparisons and recent price cuts took effect. Service price inflation also edged down from its rates earlier in the year, but remained high, so that overall consumer price inflation exceeded its average of recent years.

Global commodity price movements and local floods had placed upward pressure on the retail prices of fresh food. The sharpest increases were for root vegetables, and those vegetables in scarce supply in Europe at this time of year. Nonetheless, fierce competition between major supermarkets was said to be restraining growth in retail food price inflation overall. And non-food price inflation was expected to fall, with reports of aggressive discounting as retailers sought to avoid holding excess stock, given the recent slowdown in sales growth.