



BANK OF ENGLAND

# Agents' summary of business conditions

January 2007

- **Consumer spending growth** picked up, with many retailers seeing strong growth over the Christmas period.
- Activity in the **housing market** was relatively robust.
- **Export growth** remained strong, with buoyant demand from several parts of the world.
- **Investment intentions** rose again, with service companies looking to expand capacity.
- Domestic **manufacturing output** improved.
- **Construction output** growth was robust.
- **Professional and financial services** activity grew strongly, and other business services activity accelerated.
- **Employment intentions** were broadly unchanged; skill shortages were most pronounced in professional services.
- **Capacity pressures** were little changed.
- So far, concerns about intensified **pay** pressure have had only a limited impact on companies' pay and settlements.
- **Input price inflation** fell slightly; most of the impact from past higher energy prices had now been felt.
- **Consumer price inflation** edged higher.

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 November and late December 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](http://www.bankofengland.co.uk/publications/agentssummary/index.htm).

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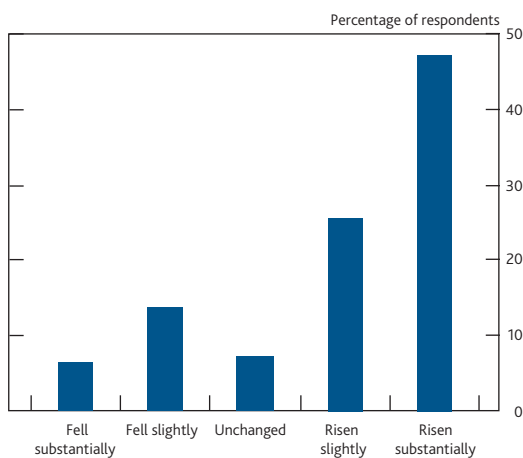
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## Demand

### Consumption and housing

Consumption growth strengthened in December. Retail sales growth picked up, exceeding retailers' expectations in most instances. **Chart 1** shows results from a small survey of Agency contacts conducted at the end of December, which asked about sales over the Christmas period. Most respondents reported that sales were higher than a year earlier, with many citing that sales were 'substantially' higher.

**Chart 1** Retail sales over Christmas



(a) Unweighted responses of 110 contacts to the question: over the Christmas/sales' period to date, compared with the same period last year, has the value of your sales fallen substantially/fallen slightly/unchanged/risen slightly/risen substantially?

As in recent years, several contacts noted that sales had picked up markedly during the month, after pre-Christmas spending had started fairly slowly. Footfall fell in some areas, but the continuing shift to internet shopping probably compensated for this. The strongest demand was again for home electrical items, particularly audio-visual equipment. However, clothing sales had been adversely affected by unseasonably warm weather.

Private car sales continued to show some signs of improvement, despite December being a typically weak month. But any pickup in demand was limited, and varied across regions. The level of sales was still relatively low, compared to the previous year.

Consumer services growth was broadly unchanged in December. Leisure spending was robust, with air travel and hotels seeing healthy demand. There were also reports from some contacts that pubs and restaurants were starting to see stronger demand, although so far this increase had been small.

Activity in the housing market was relatively robust, given the usual seasonal slowdown around Christmas. Demand from

investors was healthy, but contacts noted that first-time buyers were increasingly nervous given the recent interest rate rises. Overall, demand continued to outpace supply, with relatively few new instructions coming on to the market. So house prices continued to rise in most regions, and good properties were selling quickly. Contacts in several regions noted a difference between secondary transactions and sales of new homes: the latter were often weaker, due to planning policies resulting in some over-supply of high-density housing.

Nevertheless, house builders were generally optimistic about the outlook for next year. While many were still using incentives in order to sell completed properties, they had also benefited from the rise in demand during the past year — some contacts were once again selling developments at the planning stage, rather than when they were built. As a result, contacts generally expected to build at least the same number of units in 2007 as in 2006. But planning restrictions could impede those plans.

### Exports and imports

Export growth remained strong in December, with contacts continuing to report buoyant demand from several regions including the Middle East, Far East and Eastern Europe.

Euro-area demand was more variable: while some contacts saw healthy growth, others noted that the pickup in euro-area activity had not been reflected in stronger orders from their euro-area customers. Overall, euro-area demand was still outpaced by demand from the United States, despite concerns about the outlook for US activity and the recent moves in the dollar/sterling exchange rate.

Imports were strong from lower-cost economies, such as China, India and Eastern Europe, as companies continued to source more components and products from abroad. However, consumer goods imports were somewhat weaker than intermediate goods imports.

### Investment

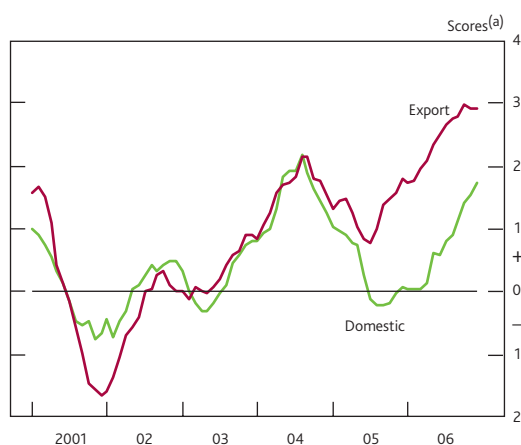
Investment intentions rose in both the manufacturing and service sectors. Service sector intentions were particularly strong, with contacts planning to invest in a range of assets to expand capacity including new office space, IT and telecoms, and transport equipment. Retailers were continuing to invest in new stores, and refurbish existing ones. Manufacturing investment was generally more focused on reducing production costs rather than increasing potential output. But there were further reports of higher value-added producers investing to expand capacity, although, across manufacturing as a whole, much expansion was still happening abroad. Utilities companies were still investing heavily.

## Output

### Manufacturing

Export sales growth was broadly steady in December, continuing the strong increases in sales seen in previous months. At the same time growth in production for domestic markets rose, although it was still somewhat weaker than export growth (Chart 2). The specialisation of UK manufacturing towards high value-added activities continued, with low-value activity moving offshore. Generally contacts were quite optimistic about the outlook for sales over the next year, although some were also concerned about the impact on output of residual margin pressure from the input (energy) cost rises seen over the past twelve months.

Chart 2 Manufacturing output



(a) A score of zero indicates that output over the past three months was broadly unchanged, compared with the same period a year earlier. A positive (negative) score indicates that output was higher (lower) than a year earlier. For more information see Ellis, C and Pike, T (2005), 'Introducing the Agents' scores', *Bank of England Quarterly Bulletin*, Winter, pages 424–30.

### Construction

Output growth was robust in December. Once again public sector demand underpinned activity: education and health projects were likely to keep some contacts' order books full for some time. But there were some signs that the overall pace of public sector demand growth was easing. However, private sector demand was strong, particularly for office developments and civil engineering projects, and construction companies were seeing high levels of enquiries.

### Services

Professional and financial services activity grew strongly. Contacts reported robust demand across a range of activities, such as consultancy, legal services, accountancy and banking. The outlook for activity in 2007 was positive, although some contacts noted that the recent strong growth in activity could ease, for example as the demand for accountancy work related to Sarbanes-Oxley weakened. Activity in other business services accelerated in December, partly due to increased spending on hotels, travel and corporate events from

professional services companies. Recruitment companies were also seeing strong demand from the business services sector, consistent with contacts' employment intentions (see later). But some other areas were still relatively weak, such as logistics and advertising. Consumer services demand was broadly unchanged (see earlier).

## Employment

Employment intentions were unchanged in December. Manufacturing employment was broadly stable, but there was a chance that small net job losses could occur in the coming months if demand growth flattened off. Consumer service contacts were looking to recruit at a relatively modest pace, while demand for new workers was still strongest in the business services sector. Skill shortages in the professional and financial services sector were widespread, despite further reports that companies were increasingly looking to migrants from a variety of countries to fill even more specialised positions. In contrast, companies were having little trouble filling unskilled vacancies, partly reflecting the continued ready supply of migrant labour.

## Capacity utilisation

Capacity pressures were little changed. In manufacturing, capacity utilisation picked up slightly in the face of the recent rise in demand. But there were still a number of industries where there was excess capacity to be shed. Capacity pressures in the service sector were unchanged, with professional services most under pressure, reflecting frequent skill shortages. A number of contacts also expressed concern about skill shortages in the construction sector, which could act as a restraint on growth going forwards.

## Costs and prices

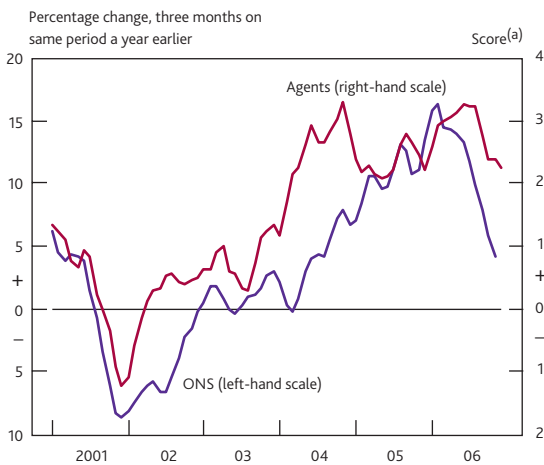
### Pay

Contacts' concern about pay pressures intensified in December, with many noting that the rise in RPI inflation could lead to higher wage demands. However, so far that pressure had been contained, with most settlements early on in the main pay round remaining close to 3%. There were some isolated sectors, such as financial services, where pay awards had been higher, reflecting a combination of skill shortages and strong profitability. Those higher pay awards often reflected rises in components of pay other than settlements; for example, more companies were using variable remuneration such as bonuses. But, overall, there was little sign yet of a widespread upturn in pay growth. And although higher wage pressure could feed into higher pay in the next few months, contacts expected any pickup in wage inflation to be less than the rise in RPI inflation over the past year.

**Input prices**

Input price inflation eased, continuing the slowdown from its recent peak (Chart 3). Some past rises in energy prices were still feeding through to companies, via higher material costs such as plastics (reflecting higher oil prices) or as fixed-term contracts were renewed (eg gas and electricity prices). However, most of the impact from the past rises in energy costs had now been felt, so input price inflation was expected to fall back in the next few months. The recent change in the dollar/sterling exchange rate had also helped to contain companies' input costs.

**Chart 3** Input price inflation



(a) See footnote to Chart 2.

**Output and consumer prices**

Manufacturing output price inflation edged higher in December, as companies continued to take advantage of strong demand to pass on past cost increases and rebuild profit margins. Yet despite continued capacity pressure and skill shortages, business to business services price inflation was stable.

Consumer price inflation also edged higher in December. While retail services price inflation was broadly unchanged, goods price inflation picked up again. That reflected retailers' increased readiness to pass on wholesale price increases to consumers, particularly for foodstuffs. However, price competition for non-food items remained intense.