BANK OF ENGLAND

Agents' summary of business conditions

September 2007

- Consumption growth slowed further, particularly spending on consumer services.
- Demand for housing also eased in most regions, as did house price inflation.
- In contrast, companies maintained healthy investment intentions.
- Total demand for exports was buoyant overall.
- Growth in manufacturing was solid, and construction output remained exceptionally strong. However, service sector activity seemed to have passed its peak.
- Employment intentions eased, largely owing to developments in the consumer service sector, but overall intentions remained elevated and recruitment difficulties continued to rise.
- Capacity pressures lessened in consumer service industries, but persisted elsewhere.
- Growth in pay awards remained well contained and that in total labour costs eased slightly, though pointed to stronger earnings growth than official data.
- While changing little in the month, annual output price inflation outstripped input price inflation so that the process of margin rebuilding by manufacturers continued.
- Annual consumer price inflation ticked down. Despite the impact of recent floods and rising commodity prices, aggressive discounting by major retailers was restraining final goods price inflation.

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 July and late August**. 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.

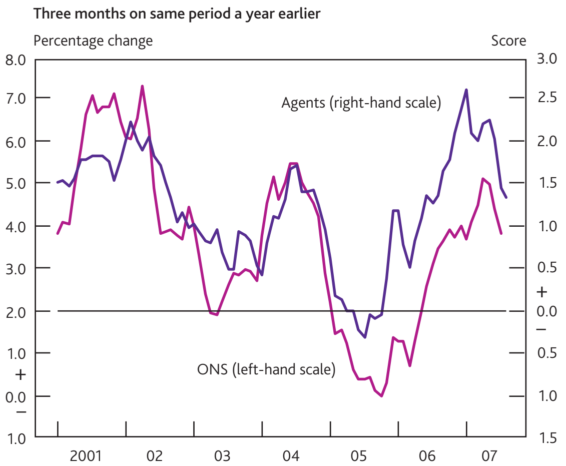
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

The Agents' score for the value of retail sales ticked down in August, having fallen in the two preceding months. Consequently, the pace of growth in retail spending was well below its peak at the beginning of the year (**Chart 1**).

Chart 1 Retail sales values



Agents reported a further easing in discretionary spending, with subdued sales of consumer durables (such as furniture and major appliances). And there were reports in most regions of weaker spending on consumer services (including catering, personal and tourism-related services). Compounding the effects of softer discretionary spending was the unusually wet weather, which depressed sales of summer clothing and those goods and services typically consumed outdoors. Given these developments, there were reports of a further build-up of stocks, and efforts by retailers to stimulate demand through price discounting. Consequently, growth in sales volumes slowed by less than that in values.

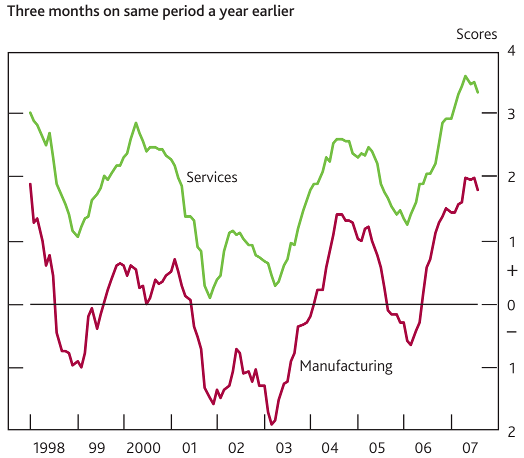
Housing market

Housing demand also eased again in the month. In the market for established housing, estate agencies reported lower levels of enquiries and another fall in transactions growth. The number of new instructions remained higher than a year ago, as homeowners had brought forward sales to avoid the introduction of HIPs. Sale periods were reported to be lengthening, and price inflation for established homes eased in most regions.

Investment

Despite softer household spending, spending by businesses generally remained robust. Investment intentions remained high in August, though were slightly below their peak of mid-year (**Chart 2**). Companies continued to invest in IT to enhance efficiency or facilitate on-line sales. Investment in buildings and structures was supported by business service companies expanding their premises, and by retailers' refurbishment plans. Investment in transport and utilities remained strong, as did investment designed to achieve environmental goals. Nonetheless, there were a few reports that some investment decisions were being reviewed or deferred given the rising cost of finance and tighter credit conditions. It was, however, too early to gauge the extent to which this reflected the impact of recent turmoil in financial markets.

Chart 2 Investment intentions over the next twelve months



Overseas trade

External demand for both capital goods and business services remained strong. While the high value of the pound relative to the dollar continued to erode margins and orders for companies exporting to the United States, demand elsewhere strengthened. This was most evident in exports of goods and services to Europe and to the Middle East. Service exports also expanded rapidly to emerging economies in Asia and Africa. Demand by UK companies for intermediate imports remained high, reflecting the strength of the currency and solid growth in domestic production.

Primary production

In some key growing districts, agricultural production remained affected by recent flooding and earlier unseasonably heavy rain, which had inhibited the harvesting of vegetables and new plantings. However, more recent improvements in weather facilitated satisfactory grain harvests, though yields had been lower than usual.

Manufacturing

Manufacturing output growth remained firm in August, buoyed by strong external demand for manufactured exports, particularly high-value capital goods. Domestic production was also firm, most notably among those manufacturers benefiting from the current boom in non-residential construction activity.

Construction

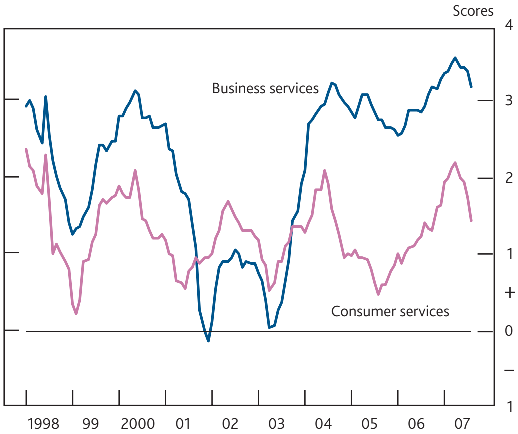
Construction output continued apace, with all Agents observing exceptional growth in this sector. Many contacts claimed that the industry was close to full capacity. Activity continued to be supported by infrastructure projects, health and education, and demand for new retail, industrial and commercial space. Numerous companies reported full order books for extended periods. Consequently, Olympics-related projects were expected to exacerbate capacity pressures.

Services

There were clearer signs in August that service sector activity may have passed its peak (**Chart 3**). Following a protracted period of very strong growth, Agents' scores for professional and financial services had fallen steadily since April. This reflected a slight easing in the demand for services related to mergers and acquisitions, accounting standards and property. Scores for other business services had been little changed over this period. However, the Agents' score for consumer services fell conspicuously in August, consistent with recent developments in household spending.

Chart 3 Service sector output

Three months on same period a year earlier

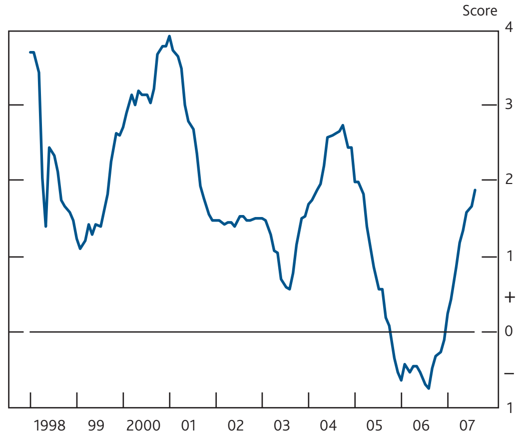


Employment

Reflecting developments in demand and output, employment intentions eased in August, though remained elevated. This outcome was driven by weaker employment intentions in the service sector, especially consumer services, though employment intentions in manufacturing had also ticked down. Nonetheless, demand for skilled labour continued to exceed supply, especially in the business service, manufacturing and construction industries. Consequently, recruitment difficulties rose further in August (**Chart 4**). Contacts emphasised the structural nature of skill shortages for key occupations. In contrast, there was an adequate supply of less-skilled labour, given the abundance of migrant labour.

Chart 4 Recruitment difficulties[(a)]

Relative to normal



(a) Skill shortages before January 2005.

Capacity utilisation

Consistent with the modest easing in activity, capacity pressures also eased somewhat in August, but remained at a high level. Alleviation of capacity pressures was concentrated in the consumer service sector, where a slowing in activity was most apparent. In contrast, capacity pressures remained pronounced in business services and manufacturing, and were acute in much of the construction sector. These pressures mainly reflected shortages of professional staff, though some shortages of materials and equipment were reported.

Contacts in the capacity-constrained sectors reported an increase in completion times and deferral of projects. In response to capacity pressures, companies were increasing investment and average working hours. In some cases they were also turning away lower-margin work or increasing prices.

Costs and prices

Labour costs

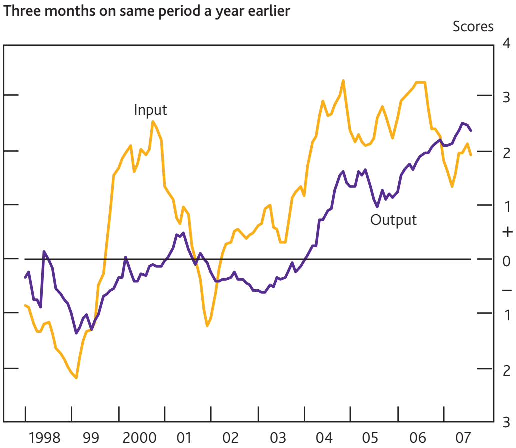
The Agents' score for labour cost growth ticked down again in August, partly reflecting a reduced need for employers to make capital contributions to pension schemes. But despite this moderation, Agents' scores continued to provide a stronger signal than official data. That reflected ongoing reports of greater use of non-wage forms of employee compensation, including leave benefits that raised unit labour costs but were not captured in all official measures of earnings. In areas of skill shortages, there were reports of an increase in starting salaries, along with benefits designed to retain existing workers. Across-the-board pay settlements, however, remained well contained.

Input and output prices

Renewed strength in manufacturers' input costs has been evident for much of this year (**Chart 5**). Despite recent falls in spot prices, many contacts had faced increases in their contract prices for food inputs, oil or oil-related products, metals, and building materials. Freight rates had also risen. The rise in these input costs had more than offset recent falls in utilities prices and insurance premiums. And while the strength of sterling had contained the domestic price of imported inputs, many contacts noted that their contract prices for goods imported from China continued to rise, amplified by China's recent removal of some tax concessions on exports.

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 August, though was well up on its level of a year ago. Furthermore, inflation of output prices continued to outstrip that for input prices, consistent with margin recovery and observations by some Agents of increased pricing power by manufacturers, especially non-food manufacturers. Also reflective of margin recovery, the Agents' scores on pre-tax profitability edged higher for manufacturers in the month, having increased steadily during the past year.

Business-to-business service price inflation persisted at a high rate, but was lower than in recent months. Contacts attributed this recent fall to increases in the tendering for 'commoditised' services.

Consumer prices

According to the Agents' scores, annual goods price inflation ticked down again in August, reflecting the path of utilities prices over the past year. Annual service price inflation was static, but remained higher than for goods. Consequently, while overall consumer price inflation edged down, it still exceeded the average of recent years.

Rising global commodity prices and supply disruptions from local floods had placed significant upward pressure on the wholesale prices of fresh food. The impact of diminished supply of produce on retail food prices was expected to become more evident in September. But while the pricing power of food suppliers was said to have increased, contacts reported that retail price increases would be less pronounced, given fierce competition between the major supermarkets, and considerable scope for imports.

In contrast to developments in food price inflation, retail price inflation for other goods was under downward pressure, as retailers engaged in aggressive discounting of summer stock to avoid unwanted inventories.