BANK OF ENGLAND

Agents' summary of business conditions

December 2008

- Consumers' expenditure had contracted further, with both retail sales values and consumer services demand falling in recent months.
- Investment intentions had been cut back sharply, driven by both the weakening outlook for demand and concerns over financing.
- Many contacts reported a tightening in the cost and availability of working capital relative to the position a few months earlier (see box).
- Export orders had continued to grow, but at a slower rate than experienced earlier in the year.
- Manufacturing and business services output was reported to be falling more rapidly than earlier in the year. Construction output was also contracting as substantial falls in private sector building work more than offset demand from public sector projects.
- Employment intentions had been reduced further across all sectors.
- Growth in per capita labour costs had slowed as average hours were cut and bonus payments were scaled back. Looking forward, most contacts expected next year's settlement would be lower than this year's.
- Annual input and output price inflation had fallen back sharply as falling foreign currency prices more than offset the impact of sterling's depreciation for many materials.
- Retail goods and service price inflation had also fallen amidst reports of increased promotional activity.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with contacts in the period between late October and late November.
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' scores for both retail sales values and consumer services turnover were reduced further. New and used car sales remained particularly weak, despite sharp discounting.

Across most parts of the United Kingdom, the value of retail sales was lower now than it had been a year earlier. Key themes flagged in recent months had persisted. Consumers had continued to shift towards cheaper, unbranded products in the face of budgetary pressures, leading to loss of market share among mid-range stores. Sales of furniture and white goods were still falling particularly rapidly as consumers deferred replacement expenditure. However, for many contacts, weaker sales had been anticipated — leading to cutbacks in orders earlier in the year. There were only sporadic reports of unplanned increases in retailers' stocks.

Demand for a range of consumer services had continued to shrink. Most notably, there were widespread reports of lower spending on services associated with housing, financial services, and on entertainment outside the home. There was some evidence of trading down in leisure expenditure with, for example, increased demand for fast food relative to other restaurants.

Housing market

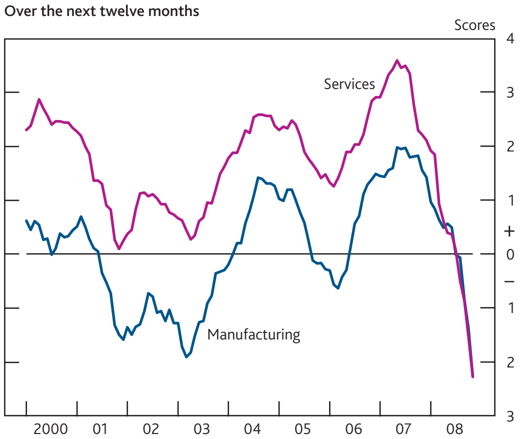
Activity remained very weak. Contacts reported few transactions in the markets for both new and established homes. The key drivers of the weakness in demand were seen to be expectations of further falls in price and difficulties in securing mortgage funding. There were signs that financing difficulties were now affecting sales of social housing as prospective tenants were less able to borrow to fund shared ownership. While there were tentative signs that the rate of contraction in demand was flattening off in some parts of the United Kingdom, most contacts expected the level of activity to remain weak through much of 2009.

Investment

The Agents' scores for manufacturing and service sector investment intentions were reduced sharply (**Chart 1**). That followed material reductions in scores over the past few months.

As in recent months, contacts described investment as having been pared back to essentials. Where feasible, businesses were prolonging the use of existing assets. And in some cases, capital expenditure was expected to fall below levels normally associated with depreciation. Among service sector contacts, there were reports of falls in retail and hotel refurbishment expenditure, lower demand for new warehouse development, and cutbacks in IT spending and commercial vehicle fleet sizes.

Chart 1 Investment intentions



The outlook for demand continued to be cited as a significant factor driving cutbacks in investment plans. But concerns over availability of working capital and external project financing were cited by a growing number of contacts. The results of a special survey on the availability of trade credit are reported in the box. The majority of respondents had experienced a tightening in the availability of working capital. And around 45% had cut capital expenditure as a result of that tightening.

Overseas trade

Export orders had continued to grow, but at a slower rate than experienced earlier in the year. While most contacts reported weakening demand, there were more exceptions to that picture than was the case for other aspects of economic activity. However, many contacts reported that the slowdown in world growth had — so far — more than offset the impact of sterling's recent depreciation on export orders. Exports of steel and automotive components had fallen sharply. And there were some reports of orders for capital goods being cancelled in the wake of tighter credit conditions in some developing countries. There were also occasional reports that difficulties in accessing trade credit insurance were affecting sales.

Imports of finished goods continued to shrink, reflecting the downscaling of retailers' orders. And shipping and logistics firms continued to report a contraction in freight volumes.

Inventories

In recent months, retailers had scaled back orders — primarily in anticipation of weaker-than-normal Christmas sales, but also in the face of pressures on working capital. There were signs that this had led to an involuntary build-up of stocks further down the supply chain. For example, distribution companies reported that warehouses were fuller than normal for the time of year. Stocks of new and used cars had also increased sharply, following the material contraction in demand experienced in recent months.

Output

Business services

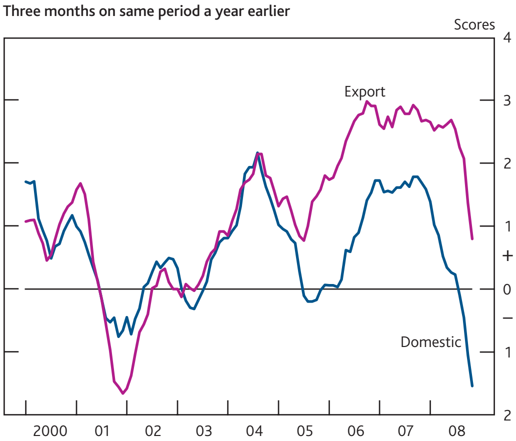
Business services turnover was materially lower than it had been a year earlier. There were widespread examples of falling expenditure on professional services — ranging from cutbacks in use of recruitment agencies, through demand for corporate finance and property-related services. Growth in spending on IT consultancy had slowed. And there had been a contraction in demand for transport and logistics, reflecting the falls in aggregate demand and output seen in recent months. This weakness more than offset growth in demand for countercyclical services — such as business advisory work and corporate litigation.

Manufacturing output

There were further reductions in the Agents' scores for manufacturing output (**Chart 2**). That followed material reductions in scores the previous month. Automotive production had fallen particularly sharply in the wake of very weak demand for new vehicles in the United Kingdom and abroad. A number of contacts in the automotive sector reported temporary cuts in shifts. Construction-related businesses had continued to see reductions in orders. Elsewhere, orders for capital and consumer-facing goods had fallen — mirroring recent trends in investment and consumer demand. There were, however, a few exceptions to the picture of falling output: for example, food processors and the aerospace industry.

Chart 2 Manufacturing output

Three months on same period a year earlier



Construction

Construction output was lower than a year earlier. Substantial falls in private house-building and commercial property activity were now reported to be more than offsetting demand from public sector projects. Looking forward, many contacts expected construction output to contract more rapidly next year. Much of the ongoing private sector activity represented completion of existing projects: the pipeline of new projects had slowed to a trickle.

Employment

Demand for labour had contracted further. There were more reports of falls in average hours, for example through cutbacks in shifts. And the majority of contacts were looking to reduce head count over the next few months. For many, this could be achieved without redundancies — for example by cutting back on graduate recruitment and on the use of agency staff. But for a substantial and growing proportion, reduction in head count would require redundancies.

Capacity utilisation

The Agents' scores for capacity utilisation and recruitment difficulties were reduced further. It was very rare for contacts to mention recruitment difficulties or capacity as prospective constraints on activity. That was perhaps unsurprising, given the recent significant reductions in Agents' scores for output and contacts' expectations that weak demand conditions would persist next year. The scores might, however, mask a reduction in the capacity to meet any future growth in demand. Some of the recent reduction in output has been achieved without impairment to capital stock — for example, by temporary mothballing of production lines. But in recent months, there have also been reports of disinvestment, for example through closure of retail outlets, offices and production lines. Moreover, as noted above, capital spending plans had been scaled back sharply across the second half of 2008. On the labour supply side, very few firms remained in a position to hoard labour in an environment of falling orders and tight financing conditions.

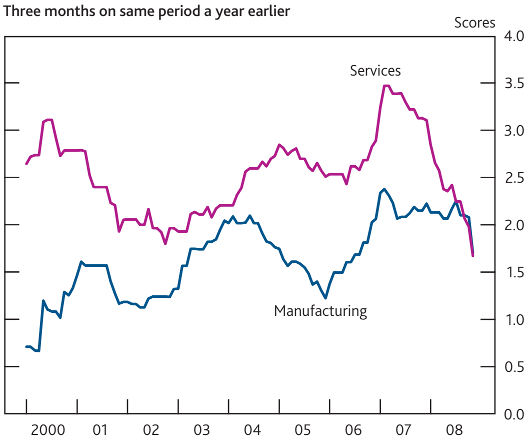
Costs and prices

Labour costs

There were reductions in the Agents' scores for labour costs in both the services and manufacturing sectors (**Chart 3**).

Chart 3 Labour costs

Three months on same period a year earlier



Growth in per capita labour costs had slowed further as average hours were cut back. And there were widespread reports of falls in elements of flexible pay, with some contacts reporting cancellations and cutbacks in bonus plans while for many others bonuses were tied to (falling) sales or profits.

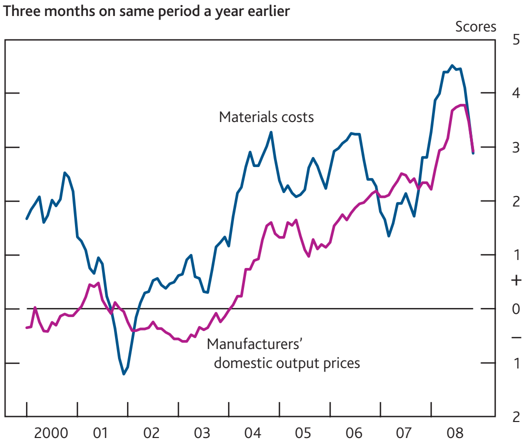
Looking forward, most contacts expected next year's settlement would be lower than this year's. In part, that reflected the anticipated profile for inflation. But there were also more widespread reports of plans for wage freezes. Those contacts that had retained defined-benefit pension schemes said that they might have to increase contributions in the wake of recent falls in equity prices.

Input and output prices

Inflation in sterling materials costs has fallen sharply in recent months (**Chart 4**), with falling foreign currency prices more than offsetting the impact of sterling's recent depreciation. The most notable falls in price were seen for construction-related materials — such as steel and concrete — where global demand had contracted. Shipping rates had also fallen.

Chart 4 Manufacturers' input and output prices

Three months on same period a year earlier



The Agents' score for manufacturing output prices was also marked down (**Chart 4**). At all stages in the supply chain, the desire to avoid any build-up of stock levels was having a downward effect on goods prices. Consumer-facing firms and food processors reported themselves to be under pressure from retailers to reduce prices. And construction tenders were at materially lower rates, reflecting the sharp slowdown in construction activity.

Consumer prices

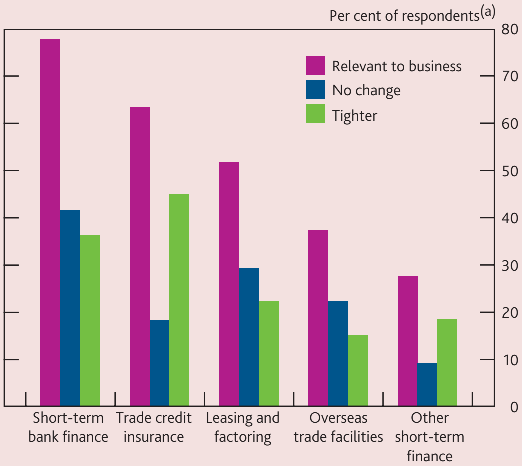
Agents' scores for both retail goods and services prices were reduced. New and used car prices had fallen significantly. More generally, discounting of retail goods was running above seasonal norms, in the wake of falling demand and a continued shift towards cheaper, unbranded products. Looking forward, contacts expected food prices to fall as more retailers positioned themselves to compete on price with discount stores.

Agents' survey of the availability of trade credit

During November the Agencies undertook a survey of their contacts, asking how they were being affected by changes in the availability of trade credit. The survey followed a broader review of corporate credit conditions conducted in September 2008.[1] It covered around 300 companies from all sectors of the economy and a range of firm sizes. All figures reported are weighted by respondents' turnover.

Respondents were asked about the availability of a range of types of working capital or 'trade credit'. The most widely used were short-term bank finance and trade credit insurance (**Chart A**).

Chart A Recent changes in the availability of working capital

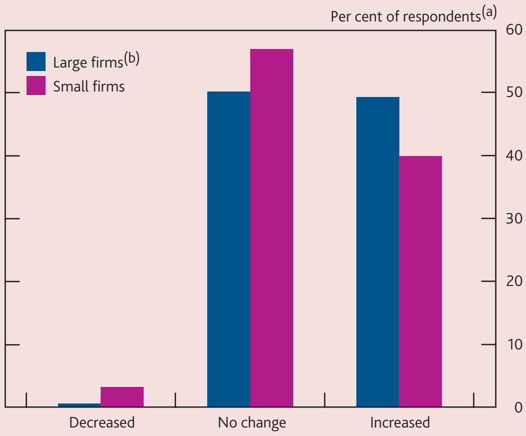


(a) Responses weighted by respondents' turnover.

Around a quarter of respondents had not been directly affected by tightening in any types of trade credit. Focusing on the most widely used forms: just over a third had experienced a tightening in the availability of short-term finance, while almost 50% reported tighter trade credit insurance. Contacts reported that where trade credit insurance had become harder to access, it had often been withdrawn at short notice. Moreover, 15% of all respondents had experienced tightening of both trade credit insurance and short-term financing, which may leave them unable to absorb any impact of lost insurance cover through short-term borrowing.

Respondents were also asked about trends in the time taken to receive payment for the goods and services they provide to other firms. Payment periods had increased for a substantial minority of both large and small firms — potentially amplifying the impact of any tightening in the availability of working capital (**Chart B**). Around 45% also reported some increase in bad debts.

Chart B Recent trends in payment times for goods and services provided

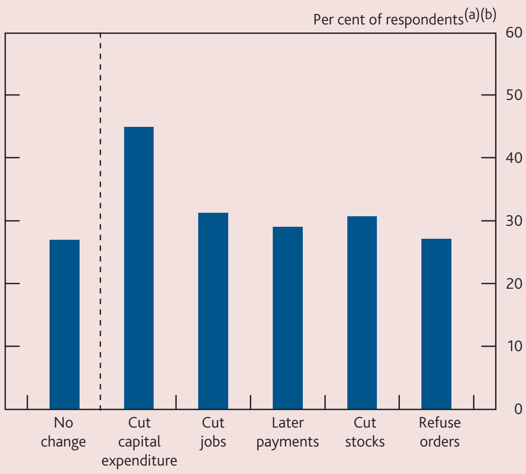


(a) Responses weighted by respondents' turnover.
(b) Large firms defined as those with annual turnover in excess of £50 million.

Respondents were asked what changes to strategy had been adopted as a direct result of any tightening in trade credit. Around a quarter had taken no action (**Chart C**). That suggested that the credit crunch was having a wider impact than in the September survey, when a majority of respondents reported that they had taken no action.

The most common response was to cut back on capital expenditure plans. For many contacts, concerns over the prospective availability of working capital have led them to focus on cash management — reducing their appetite for internally funded investment projects. It was also striking that around a quarter of firms had chosen to refuse potentially profitable orders as a direct result of tighter trade credit.

Chart C Responses to tighter working capital



(a) Responses weighted by respondents' turnover.
(b) Some respondents selected multiple options.

(1) See October 2008 *Agents' Summary of Business Conditions*, www.bankofengland.co.uk/publications/agentssummary/index.htm.