BANK OF ENGLAND

Agents' summary of business conditions

May 2008

- Consumption growth remained well down on rates of six months ago.
- Weakness in housing demand intensified.
- Investment intentions fell sharply further in the services sector, and eased across most industries. Tighter credit conditions continued to weigh on investment plans, with more companies being directly affected by changes to the cost or availability of finance.
- Demand for exports remained robust, though there was a slight easing in orders growth.
- Growth in domestically orientated manufacturing fell, as did growth in construction and services sector output.
- Labour demand softened noticeably, with a marked fall in employment intentions in the services sector. The inflow of migrant labour was reported to be slowing and recruitment difficulties eased.
- Capacity pressures lessened and were expected to be below average for the next six months.
- Growth in total labour costs remained well contained, though there were more reports of modest upward pressure on settlements in response to increases in the cost of living.
- Annual input price inflation rose sharply and annual output price inflation increased as manufacturers sought to restore margins.
- Annual consumer price inflation also increased.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with around 650 businesses in the period between **late March and late April**. 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.**

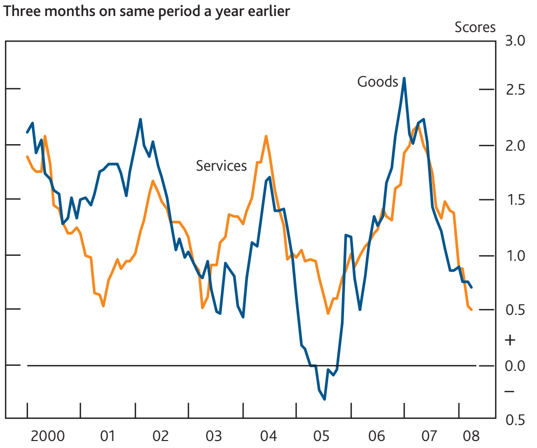
Demand

Consumption

Agents reported no material change in consumption growth in April, but confirmed that the pace of spending was well below that of six months ago (**Chart 1**).

Chart 1 Consumption values

Three months on same period a year earlier



While the Agents' score for spending on retail goods was little changed in the month, it had been on a downward trend since early 2007. The slowdown remained sharpest for spending on fashion, homewares, and leisure goods, with particular weakness in spending on durables. For these non-food items, discounting was still prevalent. In contrast, growth in the value of food sales was firm, boosted by rising prices.

The Agents' score for spending on consumer services was also little changed in April, but had fallen markedly over the past six months (**Chart 1**). Households had curtailed their discretionary spending on services provided by domestic tourism operators, hotels, clubs and restaurants. The early Easter had significantly reduced the seasonal element of spending on services, and businesses reported that households were increasing the share of sales paid in cash.

Housing market

The weakness in housing demand intensified. In the market for established homes, estate agencies reported a further reduction in enquiries. Sale periods continued to lengthen and there was a rise in the cancellation of sales, attributed to tighter credit conditions. Vendors were commonly accepting sizable discounts on asking prices. Reflecting these developments, price inflation for established homes fell further and there were reports of estate agencies shedding staff.

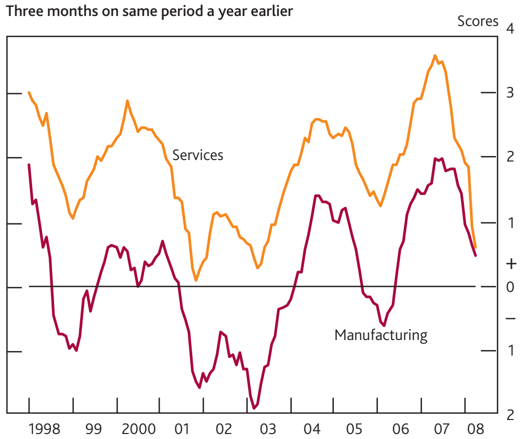
Demand for new housing also continued to weaken, compounded by tighter credit conditions. Home builders were offering more incentives and discounting heavily to dispose of stock. This had seen price inflation for new homes slow by more than for established homes. Developers were selling land to maintain cash flows which was, in turn, contributing to falling land prices in some regions.

Investment

Agents' scores for investment intentions fell again in April, having decreased sharply over the past six months (**Chart 2**). The fall was most pronounced in the services sector, and was geographically broad based. Investment intentions also fell in manufacturing and in other sectors for which Agents do not assign scores. This was especially so in commercial property, and there were more reports of retailers scaling back their store expansions. While investment intentions had been easing since April 2007, the recent sharp slowdown was attributed to uncertainty about growth prospects and, increasingly, tighter credit conditions.

Chart 2 Investment intentions over the next twelve months

Three months on same period a year earlier



For some time Agents had been reporting that the main effects of tighter credit conditions were indirect. That is, companies were anticipating that tighter credit would induce slower economic growth and were adjusting their investment intentions accordingly. Few direct effects on investment intentions had been reported, other than by companies in the commercial property and finance sectors, or with high leverage. But in April, there were reports of a wider range of companies being directly affected. Credit rationing was more evident, and credit providers were adhering strictly to lending guidelines, with fewer customers being granted preferential arrangements. Some companies had self-imposed borrowing restrictions, as they were concerned about future debt obligations if tight lending criteria, or weak demand, persisted.

Overseas trade

Overall, external demand remained firm in April. Weaker demand from the United States continued to be offset by strength in the volume of sales elsewhere. This was evident for exports of both goods and services. The depreciation of sterling had enhanced margins on exports, particularly those to Europe, but was yet to have a significant effect on volumes. It was, however, encouraging some exporters to consider entering new markets. Orders remained supportive of near-term strength in external demand, though some contacts reported that the growth of their orders had eased slightly.

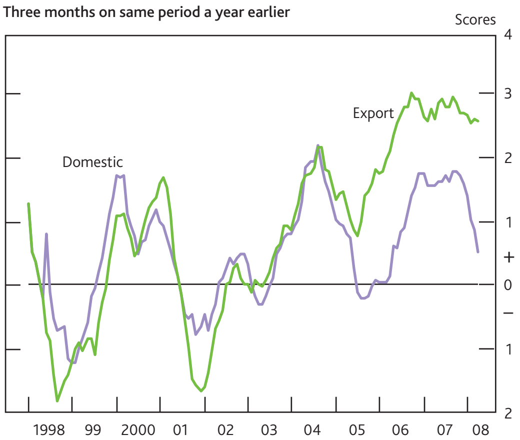
Demand by UK companies for intermediate imports remained solid. But growth in orders of consumer goods continued to ease, consistent with the slowdown in household spending and the depreciation of sterling.

Output

Manufacturing

Manufacturing output growth slowed in April (**Chart 3**), driven by an easing in production for domestic markets. Manufacturers of building materials and consumer goods reported the most pronounced easing in activity. In contrast, manufacturers of exports experienced continued buoyant conditions. Orders pointed to these trends being sustained over the near term.

Chart 3 Manufacturing output



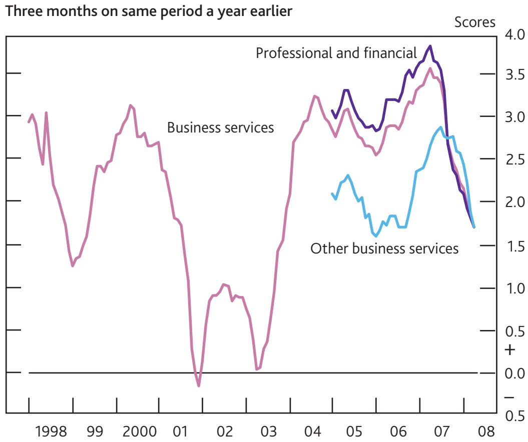
Construction

Growth in construction output edged down again in the month, though the level of activity remained high. Recent trends in construction output masked divergent conditions for residential and non-residential builders. Residential construction was weakening markedly, as earlier backlogs of work had largely been completed and commitments to build were falling. In contrast, non-residential construction was strong, and it was expected to remain so in the near term, given large amounts of pre-committed work. But looking further ahead, fewer private sector developments were progressing to the construction stage owing to funding problems or uncertainty about the outlook.

Services

The Agents' score for business services output fell again in April to its lowest level in over four years (**Chart 4**). The slowdown had been under way for some time, but had been amplified by financial events. Scores for professional and financial services had fallen most since the onset of financial turmoil. Recently, there had also been a reduction in scores for other business services (like logistics and business catering), pointing to a broader slowdown in the sector and some strengthening of spillover effects from tighter credit conditions.

Chart 4 Business services output



Capacity utilisation

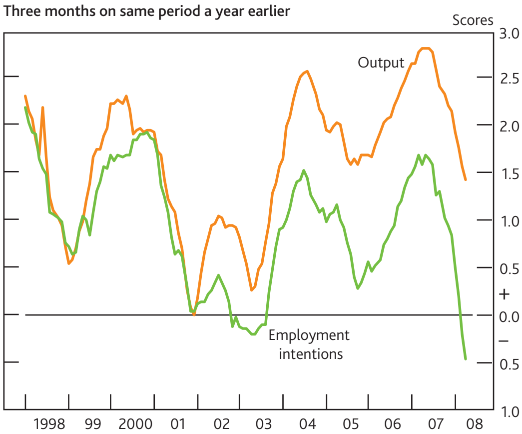
Capacity pressures were expected to ease significantly over the next six months. This partly reflected earlier additions to capacity, but a larger factor was the current and projected slowing in activity. Capacity pressures were expected to ease most in the services sector, where the fall in demand had been pronounced. They were also expected to ease in manufacturing. Residential builders were already operating well below capacity, as were many retailers.

Employment

The slowdown in activity, and associated easing in overall capacity pressures, has resulted in a clear softening in labour demand (**Chart 5**). The score for total employment intentions was now at its lowest level since scores commenced in mid 1997. Weakness in labour demand was most evident in the services sector, with sharp falls in employment intentions in both business and consumer services. A further modest fall was also evident in manufacturers' employment intentions.

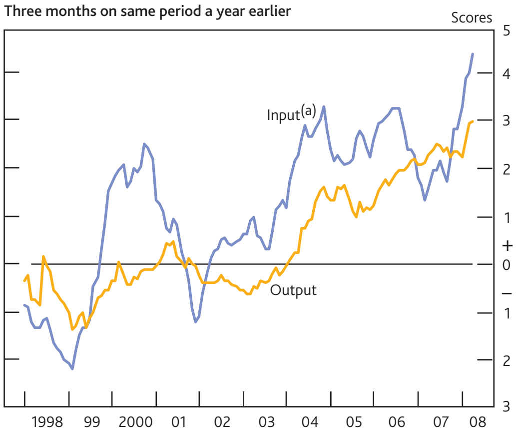
The reduction in employment intentions was slightly sharper than the slowdown in current output growth, consistent with contacts' heightened uncertainty about the outlook and concerns that difficult conditions might persist. Contacts were

Chart 5 Employment intentions and output[(a)]



(a) Employment before January 2005; total employment is the weighted average of scores for manufacturing and services employment; ouput is the weighted average of output scores for services, construction and manufacturing.

Chart 6 Manufacturers' input and output prices



(a) Non-labour input prices.

achieving desired levels of labour input by reducing the number of hours of paid work and increasing their reliance on temporary workers (even in management roles). Many contacts were also leaving vacancies unfilled, allowing headcount to be reduced through natural attrition.

Consistent with the easing in labour demand, recruitment difficulties eased further in April. In part this reflected a reduction in staff turnover, as employees became less confident about seeking alternative positions. And given a softer labour market, there were further reports from contacts providing services to migrants that the inflow of workers from A8 countries had slowed. The effect of sterling's depreciation on the home currency value of earnings was also said to be accelerating the return of some migrants.

Costs and prices

Labour costs

Agents reported that across-the-board pay settlements remained fairly stable in April. There were some reports of a tick-up in settlements in response to rises in the cost of living (and perceptions of higher inflation than recorded in either the CPI or RPI). However, outcomes remained well contained, given recent increases in job insecurity.

Input and output prices

The Agents' score for manufacturers' input prices climbed again in April to its highest level since scores were first recorded in mid 1997 (**Chart 6**). As had been the case for much of the past year, this reflected increases in the world prices of basic inputs (energy, oil derivatives, building materials and food) combined with the effects of sterling's depreciation. And contacts continued to report increases in the cost of importing finished and intermediate goods from Asia, where domestic price pressures were becoming more pronounced.

The Agents' score for manufacturing output prices was little changed in the month, but had stepped up sharply since the start of the year. Given the escalation of input costs, and consequent compression of margins, manufacturers had become more active in passing on cost increases in recent months. Food and beverage manufacturers remained the most successful in raising their prices, though more producers of other goods were also now able to pass on commodity-based cost increases.

Price inflation for business-to-business services was unchanged in the month. Increased prices for specialist business services and transport services had been offset by downward pressure on prices of more commoditised services.

Consumer prices

The Agents' score for retail goods prices increased again in April, reflecting ongoing increases in the prices of energy and food. With the score for service prices little changed in the month, overall consumer prices were higher.

The outlook was for further upward pressure on consumer price inflation in the near term. Retailers were becoming more active in passing on commodity-based cost increases to consumers. The cost of imports being ordered by contacts was increasing and was being reflected in higher retail prices. And there were expectations of further increases in utilities prices by the summer. More large retailers indicated a reluctance to continue the depth of discounting of recent months, claiming that customers were becoming 'immune' to such discounts. But while these factors were putting upward pressure on consumer prices in aggregate, many retailers remained keen to alter the composition of their product offerings in an effort to offset higher price inflation for some products with lower price inflation for others.