BANK OF ENGLAND

Agents' summary of business conditions

October 2008

- Consumers' expenditure contracted during the third quarter.
- The weakening in housing demand continued in September.
- There had been a widespread slowdown in capital spending, primarily reflecting falling capacity constraints and the weaker demand outlook.
- Many firms had also experienced a further tightening in their own credit conditions, according to a special survey carried out this month (see box). But this was still seen to be less critical to investment plans than the outlook for demand.
- Inventories of consumer durables and new cars increased. In other sectors, however, firms had reduced stocks in response to prospective weaker demand and to conserve cash.
- Demand for exports weakened slightly.
- Growth in domestically orientated manufacturing fell and there was further deceleration in services output.
- Employment intentions had fallen sharply and recruitment difficulties had declined.
- Capacity pressures continued to fall.
- Growth in total labour costs remained well contained.
- Annual input price inflation eased slightly, but output price inflation remained elevated.
- Annual consumer price inflation was steady.

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 August and late September.
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 and consumer services fell in September (**Chart 1**).

Chart 1 Consumption values

The Agents' score for spending on consumer services became significantly negative. That reflected a contraction in demand for a broad range of services: from financial services to pubs, restaurants and leisure attractions. In contrast, tour operators reported steady demand, with an increasing number of households switching towards holidays in the United Kingdom.

Retail sales had slowed further as households reacted to mounting budgetary pressures. There had been a slowdown in demand for smaller-ticket discretionary purchases such as clothing and footwear. And consumers appeared to have switched spending towards lower-priced unbranded products, discount supermarkets and internet sales. Sales of furniture and big-ticket items associated with housing moves had also contracted further, as had spending on housing-related services such as home removals. Demand for cars with the new registration plate was well below sales a year earlier.

Housing market

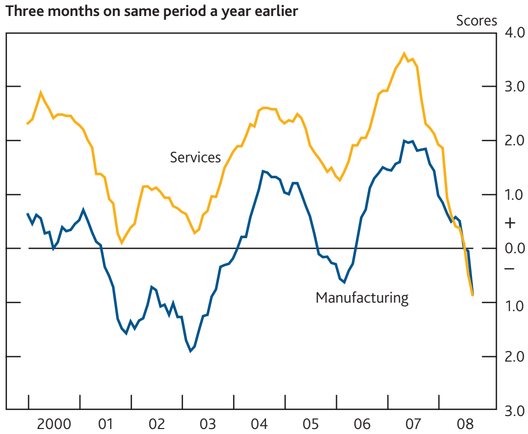
Activity in the market for established homes had slowed further. Widespread expectations of further house price falls, tighter credit conditions and the decline in consumer confidence had all curtailed demand.

Investment

The Agents' scores for investment intentions fell further in September (**Chart 2**).

The slowdown in capital spending was widespread, affecting most industries and asset classes. Plans for investment in commercial property had been cut back, with some major retail development schemes being delayed and office-building activities slowing as existing projects were completed. An

Chart 2 Investment intentions over the next twelve months



increasing number of firms in other sectors had deferred investment plans — though investment in utilities and telecommunications infrastructure remained robust.

The reduction in investment plans was due principally to falling capacity constraints and to elevated uncertainties surrounding the macroeconomic environment. While many firms had experienced a tightening in their own credit conditions in recent months, this was still not seen to be as critical to investment plans as was the outlook for demand. The results of a special survey on corporate credit conditions are reported in the box.

Inventories

There were further reports of growing stocks of consumer durables and of new cars. Looking forward, many retailers were planning to hold lower stocks than normal in the lead up to Christmas. However, firms in other sectors had generally reduced inventories in anticipation of weaker demand, and in order to conserve cash.

Exports and imports

External demand growth fell slightly during the third quarter, with exports of consumer durables and their components slowing most markedly. Nevertheless, external demand remained substantially more robust than other components of aggregate demand. The current weakness of sterling had improved the profitability of exports, but there was little evidence yet among contacts of foreign currency prices being reduced to gain market share.

The recent slight deceleration in exports was largely due to weakening demand from euro-area customers, with demand growth from the Middle and Far East remaining strong. Looking forward, however, contacts had become more pessimistic about the outlook for demand.

Import growth slowed markedly, reflecting falling volumes of imported consumer and capital goods.

Output

Manufacturing

Manufacturing output growth had slowed. Construction-related demand for products such as bricks continued to contract. Production of consumer durables also fell, partly reflecting a number of recent plant closures by manufacturers. And both car and commercial van manufacturers had started to curtail production to avoid further stockbuilding. In contrast, manufacturers of equipment used in the pharmaceuticals, medical equipment, aerospace and energy industries continued to report robust demand.

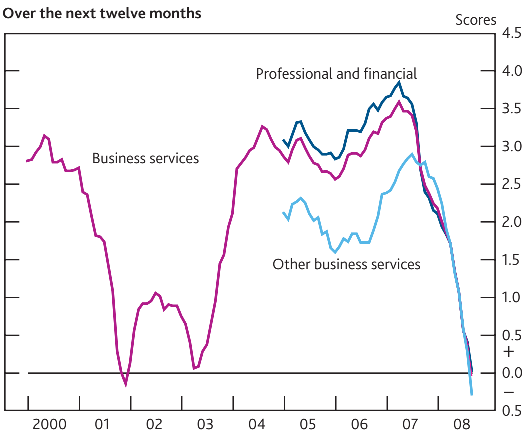
Construction

Construction output had fallen. With little demand for new housing, builders were mothballing many of their sites — completing houses only where there was a known buyer. And commercial property activity eased further, in part reflecting changes to firms' investment plans. The aggregate impact of this slowdown continued to be ameliorated by steady growth of public-commissioned construction projects.

Services

The Agents' scores for business services output fell further in September (**Chart 3**). In professional and financial services, a reduction in the number of corporate transactions had weakened demand for the services of banks, accountants and lawyers. This was partially offset for some of these firms by a countercyclical increase in demand for business recovery and insolvency services.

Chart 3 Business services output



The Agents' score for other business services also fell. That reflected a broad-based slowdown in corporate discretionary spending on travel, hospitality, conferencing and telecommunications. Logistics companies continued to report weaker demand growth, mostly reflecting the slowdown in consumption and residential investment.

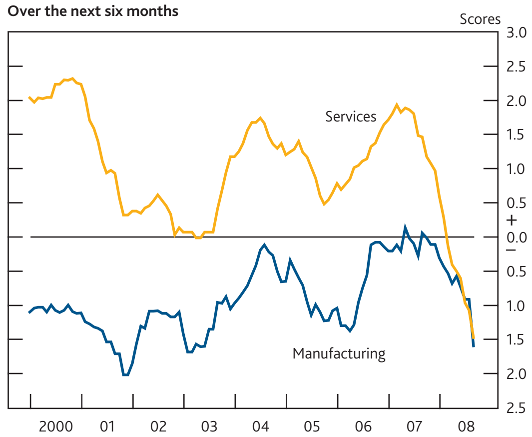
Capacity utilisation

Capacity constraints declined. In the service sector that was reflected in, for example, lower hotel occupancy rates and aircraft load factors and in vacant commercial properties. Contacts had taken a range of actions to reduce spare capacity, including temporary plant shutdowns by some manufacturers and shorter working hours in the retail sector.

Employment

The Agents' scores for employment intentions fell further in September (**Chart 4**).

Chart 4 Employment intentions over the next six months



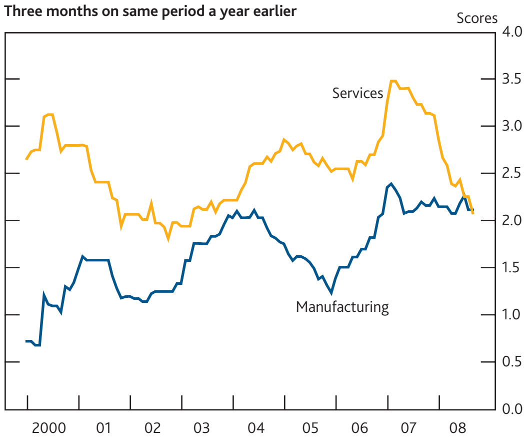
Labour demand softened in September. While most firms were still relying on natural wastage to reduce staff numbers, redundancies had increased in some parts of the country. Contacts expected further labour shedding in the months ahead. A growing number of manufacturing workers had been put on short time (for example in the motor and building materials industries) and service providers had reduced opening times. Staff turnover had continued to fall, largely reflecting the perceived risks to employees of changing employers. Recruitment difficulties had declined across the economy as a whole.

Costs and prices

Labour costs

The Agents' scores for growth of labour costs were little changed in September (**Chart 5**). Over the past year, inflation in manufacturing labour costs has been little changed. But the score for the service sector has declined steadily, largely reflecting a decline in commission and other performance-related payments.

Chart 5 Labour costs per employee



The majority of contacts anticipated offering below-inflation pay rises next year, with a few expecting either to delay their next settlement by up to six months or to impose a pay freeze. There was little reported evidence of employee resistance to below-inflation pay awards, reflecting heightened perceptions of job insecurity.

Input and output prices

The Agents' score for manufacturers' input price inflation eased. While contacts reported that input price inflation remained elevated, there was a growing belief that the inflation rate may have peaked. That reflected the recent sharp fall in oil prices and the weakening world economy. But the picture was mixed. Prices of oil derivative products, such as plastics, had not yet started to fall. And some further increases in utility prices were anticipated as fixed contracts expired.

Cost inflation of imported finished and intermediate goods was steady. Some contacts had switched the sourcing of inputs away from the Far East to other regions where domestic inflation was better contained, such as parts of Eastern Europe.

The Agents' score for manufacturing output price inflation remained elevated. Nevertheless, many manufacturers had been unable to pass on higher material costs in their entirety. A number of manufacturers had re-engineered production methods to reduce the input content of products.

There had been a broad-based easing in business-to-business services price inflation. Growth of fees charged by professional firms had weakened in response to the slowdown in demand, as had the pricing of hotel and conference facilities. Hauliers' fuel surcharges had been reduced.

Consumer prices

The Agents' scores for retail goods and services price inflation were little changed in September, with both remaining at elevated levels. For retail goods, increases in annual utility price inflation were broadly offset by lower fuel prices. Annual food price inflation was little changed. In the service sector, Agents' reports suggested that retail price inflation had continued to level out, largely reflecting the sharp slowdown in consumer demand.

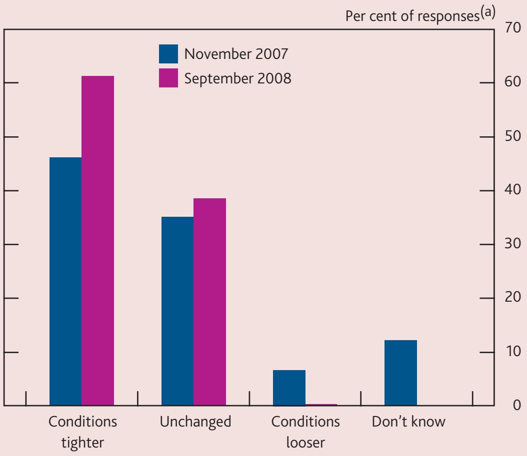
Agents' survey of corporate credit conditions

During September the Agencies undertook a survey of their contacts asking how they were being affected by changes in credit conditions. The survey updated a similar exercise conducted in November 2007 and covered around 260 companies from all sectors of the economy and a range of firm sizes.[1] All figures reported are weighted by respondents' turnover.

Most respondents made some use of external finance — as opposed to relying exclusively on internal funds. And for those whose *primary* source of funds was external, borrowing from banks was much more common than use of capital markets.

Respondents were asked whether the price, terms or availability of credit had changed in recent months. For those firms making at least some use of external funds, the majority reported that conditions had tightened (**Chart A**). That was a material change from the November 2007 survey, in which a majority had not reported tighter conditions.

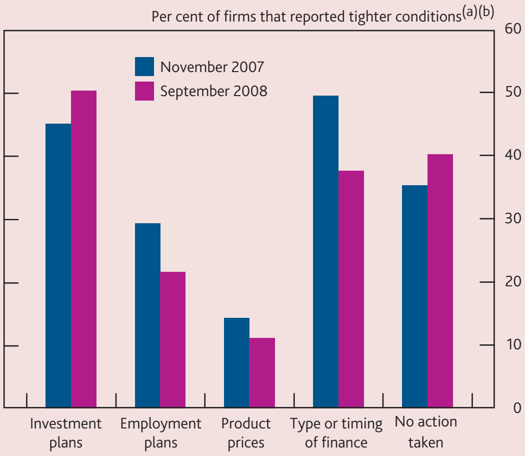
Chart A Corporate credit conditions experienced by firms using external finance



(a) Responses weighted by respondents' turnover.

The implications of tighter credit conditions for firms' behaviour were mixed, however. Around half of those for whom credit conditions had tightened had reduced or deferred investment plans as a result. But around 40% had not changed investment or other plans in the face of tighter credit conditions. That was similar to the results of the November 2007 survey (**Chart B**). Moreover, a sizable minority of respondents had not experienced any tightening of external credit conditions. Adding these respondents back in, over 60% of all respondents to the survey did not report changes to plans as a direct result of shifts in credit conditions. That was consistent with the more general observation among Agents' contacts that the outlook for demand has been the prime driver of any scaling back in investment plans.

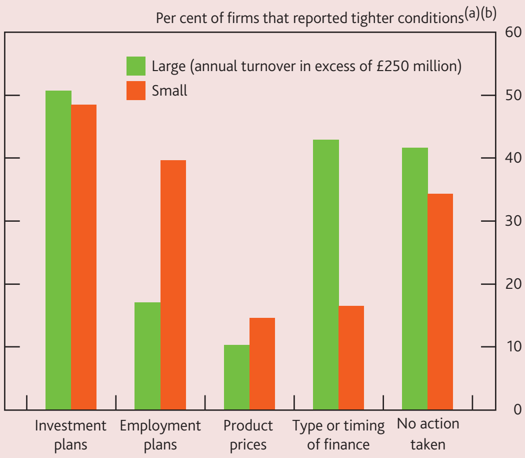
Chart B Response to tighter credit conditions



(a) Responses restricted to those firms reporting tighter credit conditions; weighted by respondents' turnover.
(b) Some respondents selected multiple options.

In both surveys more large firms than small firms reported tighter credit conditions. But the general finding — of a sizable proportion taking no action as a direct result of tighter credit — held true of firms of all sizes (**Chart C**). Relative to larger firms, a higher proportion of small firms reported reductions in their employment intentions as a direct result of tighter credit conditions. Larger firms were more likely than small firms to have changed the type or timing of their finance — consistent with their greater ability to access a more diverse range of financing sources.

Chart C Response to tighter credit conditions, by firm size



(a) Responses restricted to those firms reporting tighter credit conditions; weighted by respondents' turnover.
(b) Some respondents selected multiple options.

(1) See December 2007 *Agents' Summary of Business Conditions*: www.bankofengland.co.uk/publications/agentssummary/index.htm.