BANK OF ENGLAND

# Agents' summary of business conditions

April 2009

- Consumer spending had remained weak, but there were some further reports that the rate of contraction of retail sales had eased.
- There had been a further pickup in housing market activity — albeit from a very low base.
- Investment intentions remained weak.
- Export volumes had shrunk further, as the slowdown in global demand outweighed any gains to competitiveness arising from sterling's depreciation. Imports had continued to contract sharply.
- Destocking had continued throughout the first quarter.
- There was little change to the picture of sharply contracting output across the manufacturing, construction and services sectors.
- Credit conditions had continued to be a major concern for many firms, with no signs of easing in recent months.
- Labour demand had continued to shrink. While many firms had made further cuts to average hours, headcount had also contracted. Cuts in average hours, lower bonuses and low pay settlements had left per capita labour costs lower than a year earlier.
- On average, there had been little change in the rate of inflation in materials prices. Inflation in output prices had slowed further as weak demand conditions had continued to press down on suppliers' margins.
- Consumer goods prices: promotional activity had continued to push against the impact of rising import prices, and of increases in the prices of some products to pricing points seen before the VAT cut.

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 February and late March 2009. 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.**

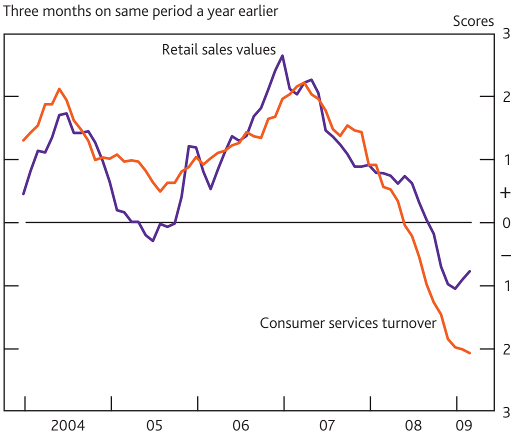
## Demand

### Consumption

While retail sales had remained weak, there were some tentative indications that the rate of contraction had eased. Most non-food retailers reported that sales values were down relative to the same period a year earlier. But there were some further reports that the rate of decline had stabilised, or that sales had outperformed expectations. There were widespread reports that the value of food sales had continued to grow — in large part, reflecting inflation in food prices. Overall, the news on retail sales values had motivated a tickup in the Agents' score (**Chart 1**).

**Chart 1** Consumer spending

Three months on same period a year earlier




Demand for consumer services had continued to contract. As in recent months, pubs and restaurants had seen particularly weak spending. But as with retail sales, there were tentative signs that demand for some services had stabilised or even picked up — most notably with reports of increased spending on domestic holidays. Car sales remained much weaker than most other aspects of consumer spending. But even here, there were reports that the rate of decline in spending was easing — particularly in the market for used cars.

### Housing market

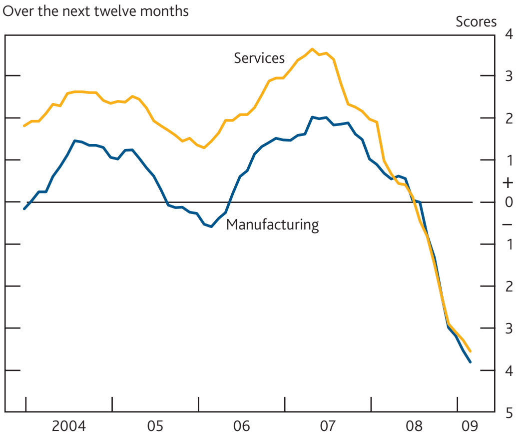
Across all parts of the United Kingdom, there had been further reports of growth in enquiries and viewings. And there were now more signs that the increase in buyer interest had led to a pickup in sales. However, any turnaround had come from a low base so that the volume of transactions remained very depressed. And there was little indication that any pickup in activity had broadened far beyond investors with substantial liquid assets. Reports of activity from first-time buyers had remained rare, with financial constraints widely seen to be binding.

### Business investment

There was little change to the picture of extremely depressed investment intentions (**Chart 2**). It remained rare for contacts to approve any capital expenditure that did not either have a quick payback or support compliance with regulatory requirements.

**Chart 2** Business investment intentions

Over the next twelve months




As in recent months, pessimism and uncertainty surrounding the outlook for sales were described as a significant deterrent to capital expenditure. The cost and availability of project finance was also important for some firms. For many others, concerns over the availability of working capital remained acute, leading to reluctance to draw down on cash balances to support investment.

### Overseas trade

External demand was still seen to be stronger than domestic demand for manufactured goods. But most contacts reported shrinkage in export volumes during 2009 Q1. Weakness in world demand had continued to outweigh any impact of sterling's depreciation — most notably in the automotive sector where the trend of destocking was global. Sterling's depreciation had led to improvements in competitiveness for some firms. However, there were further reports of exporters preferring to maintain foreign currency prices and hence raise margins, rather than seeking higher volumes. And for some others, the rising cost of imported components had limited the scope to cut foreign currency prices.

Import volumes had continued to contract sharply, as evidenced by much reduced shipping and freight forwarding activity. In part, the contraction reflected cutbacks in retail orders and lower sales of capital goods. Destocking had also led to cuts in imports of components. There were further reports that the rising cost of imported intermediate and finished goods had led to substitution from foreign towards domestic suppliers.

### Inventories

In light of ONS estimates of substantial destocking during 2008 Q4, the Agents had focused their discussions with contacts more closely on inventories than was normally the case. Many firms had revised their expectations of future sales down in the wake of the sharp fall in demand experienced in late 2008. Taken alongside concerns over the availability of working capital, that had led many to scale down planned stockholdings.

The process of adjustment had continued into the first quarter of 2009, with widespread reports of destocking. Stocks were being run down aggressively in those manufacturing subsectors that had seen the most acute falls in demand during late 2008. And work in progress in the construction sector had fallen as building activity had contracted.

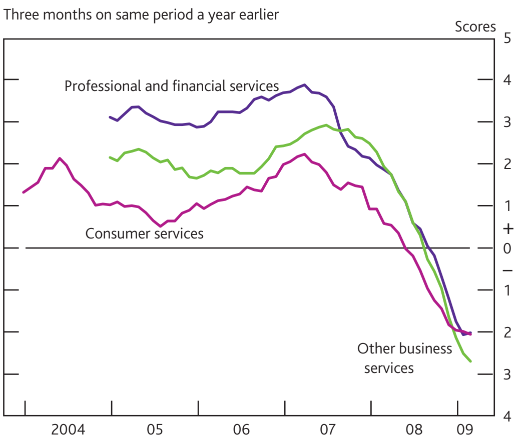
Looking forward, many contacts still regarded current stock levels as too high. Where sales had fallen most sharply, it would take some time to draw down stocks of materials across the entire supply chain. There were, however, signs that the process of destocking had been completed in some consumer-facing sectors. Notably, car dealers reported that stocks of used cars were now low, while many non-food retailers had succeeded in shifting stock through promotional activity.

## Output

### Services

Services output had continued to fall. The ongoing shrinkage in demand for consumer services is described above. Many business services providers had also reported declining turnover — most markedly outside the professional services arena (**Chart 3**).

Chart 3 Services turnover




Demand for haulage and distribution services had fallen sharply. And cutbacks in a wide range of corporate discretionary expenditure had continued. As in recent months, demand for 'countercyclical' professional services, such as insolvency work and employment advice, had continued to grow. And the Agents had not heard many further reports of declines in demand for 'core' professional services such as auditing. But other aspects of professional services were still experiencing sharp falls in demand — most notably in the corporate finance, advertising, property and recruitment sectors.

### Manufacturing

There was little change to the picture of sharply reduced manufacturing output. Both external and domestic demand were well down on the same period a year earlier. Destocking had led to cuts in orders for intermediate goods. And many firms had cut production more sharply than sales had fallen in order to unwind their own excess stocks.

As in recent months, the aggregate picture masked material differences between subsectors. Across the automotive, construction materials and capital goods supply chains the fall in output was exceptional. While these supply chains account for a substantial part of total manufacturing output, some other sizable subsectors — defence, pharmaceuticals and food processing — had experienced stable orders or even some growth.

### Construction

Construction activity had contracted further during 2009 Q1. Residential construction had remained at very low levels — though in a few localities the recent tickup in housing market activity had stimulated a resumption of building work. Commercial property activity was also weak and the pipeline of new projects remained negligible. For some time, sharp declines in private house-building and commercial property activity had more than offset continued growth in public sector demand. There was little evidence (yet) that public sector projects had been bought forward.

## Credit conditions

Credit conditions had continued to be a major concern for many firms, with no signs of easing in recent months.

### Trade credit

The availability and cost of trade credit insurance had continued to be cited frequently as a significant burden. As in recent months, many suppliers had responded to loss of cover by taking counterparty risk onto their own balance sheets or demanding up-front payments, rather than by refusing orders. Notwithstanding such demands for early payment, the general trend was towards increasing delays between delivery and payment for goods and services provided.

### Bank finance

There had been little change in contacts' views of the cost and availability of bank finance. For many, the cost of existing facilities had not fallen anything like in line with Bank Rate, as spreads were typically widened and fees increased when facilities came up for review. There were few reports of growth in new lending. In part, that was due to low demand for credit as investment intentions remained extremely depressed and as some firms remained wary of approaching banks for finance for fear of triggering changes in the terms attached to their existing borrowing. Some non-banking contacts perceived banks' appetite for lending to have remained low.

## Employment

Labour demand had continued to shrink. There had been further reports of firms seeking to reduce labour costs without making substantive cuts to headcount, with many firms cutting average hours. In some cases, this had been achieved through reductions in use of overtime. But others had taken more drastic steps, such as imposing shorter working weeks or introducing unpaid leave programmes. Nevertheless, there were widespread reports of actual and planned cuts to headcount, and employment intentions remained depressed. In some cases, cuts to headcount were being achieved through freezes on recruitment. But there had continued to be widespread reports of new redundancy programmes.

## Costs and prices

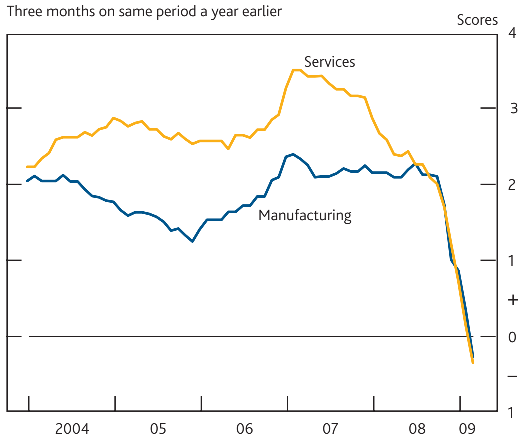
### Labour costs

Across all sectors of the economy, per capita labour costs were widely reported to be lower than a year earlier — leaving the Agents' scores negative for the first time since scoring began in 1998 (**Chart 4**). In part, that reflected the cuts in average hours that had been instituted to minimise the need for job cuts (see above). Additionally, bonus and commission payments were well down on the previous year. Pay pressures had also eased. Reports of settlements in excess of 3% were rare, while pay freezes were widespread. And a few contacts had either imposed cuts in salaries or were planning to do so.

### Other input costs

On average, there did not appear to have been much change in the rate of inflation in materials prices. But that average masked significant differences in the pricing profiles of imported intermediate goods, commodities and domestically sourced components. Many contacts had reported sharp increases in the price of imported intermediate goods and in the price of basic foodstuffs. But the trend was less clear for imported commodities, where falls in global prices had pushed against the impact of sterling's depreciation. Inflation in domestic component prices had fallen.

**Chart 4** Labour costs per head




### Output prices

Last month's Agents' special survey on cost pass-through had revealed an asymmetry between pass-through of falls and rises in costs: where costs had fallen, many suppliers had already reduced prices, while most of those whose costs had risen expected to pass on less than half of any increase. Recent reports suggested that that asymmetry had persisted, as weak demand had led to pressures on suppliers' margins. So domestic output price inflation had slowed further.

### Consumer prices

Contacts had reported a range of upward and downward pressures on consumer goods prices. On the upside, used car prices had risen as any stock overhang was unwound; a number of retailers had restored prices of VAT-able goods to the pricing points that had prevailed prior to the VAT cut; and there were widespread reports that higher imported finished goods prices had been passed through to retail prices. On the downside, many retail contacts had described ongoing promotional activity. While such activity appeared less prevalent than in recent months, it was still significant relative to normal practice for the time of year. The challenge in assessing the overall profile of inflation in consumer goods prices lay in gauging the breadth of promotional activity across product lines. On balance, the Agents' sense was that consumer goods price inflation was little changed.