BANK OF ENGLAND

Agents' summary of business conditions

August 2009

- Consumer spending had continued to stabilise.
- The recovery in housing market activity had continued.
- Investment intentions remained depressed, driven primarily by the weak and uncertain outlook for demand.
- There had been little change to the pace of contraction in export volumes.
- There were further, widespread reports that the pace of de-stocking had slowed.
- There was more evidence that manufacturing output was stabilising. Recent reports from business services providers had been more mixed. And construction activity remained severely depressed.
- Employment intentions were less negative than earlier in the year — while many firms expected to reduce head count further, there were fewer plans for large scale redundancies.
- Per capita labour costs remained lower than the same period a year earlier, while inflation in materials costs had eased further.
- There was little evidence of inflation in manufactured output prices. And many business services prices were lower than a year earlier.
- Consumer goods price inflation remained low but positive.

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 June 2009 and late July 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.

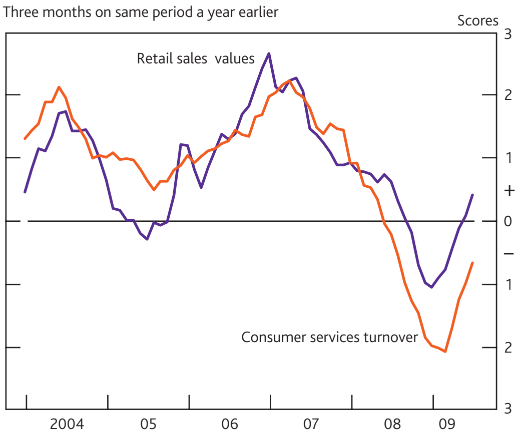
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

As in recent months, reports from retailers suggested that sales had increased through the second quarter — reflected in an upward drift in the Agents' scores (**Chart 1**). The value of food sales was higher than a year earlier. And a growing number of non-food retailers had reported year on year growth. Sales of 'big ticket' items remained well down on the same period a year earlier. But there had been some modest growth of new car sales during the second quarter. And used car sales had remained at the higher levels seen in recent months.

Chart 1 Consumer spending



The pace of contraction in demand for consumer services had eased further. Spending on domestic tourism had continued to grow through the early summer. For example, occupancy rates at campsites and self-catering accommodation were higher than normal and visitor numbers at tourist attractions had increased. Spending at pubs and restaurants remained well down relative to the same period a year earlier, though there were occasional reports that the pace of contraction had declined.

Against the backdrop of stabilising consumer spending, the Agents had continued to hear widespread reports of consumers trading down. The loss of market share by mid-market stores had been a long-standing theme of contacts' reports. And in the tourism sector, campsites and bed and breakfast accommodation had seen larger increases in demand than had more expensive hotels. Retailers still viewed consumers as more value conscious than they were a few years ago — a view reflected in their pricing decisions.

Housing market

The pickup in primary and secondary housing market activity had continued. There had been some further growth in interest from first-time buyers — though such activity remained well down on recent years. The potential supply of new homes had increased a little, as house builders released mothballed sites. But supply remained weak in the secondary market, with instructions to sell remaining at low levels. Low supply had led to some stabilisation in prices — indeed, there had been occasional reports of gazumping.

Business investment

The picture remained one of very depressed investment intentions — driven primarily by the weak and uncertain outlook for demand, and exacerbated by the tightness of corporate credit conditions. The vast majority of contacts had cut capital expenditure plans during 2009. The norm was for any capital expenditure to be limited to maintenance, small-scale investments aimed at realising near-term efficiency gains, or projects necessary to ensure regulatory compliance. But there were a few more reports of plans for retail and hotel refurbishment than there had been earlier in the year — albeit such plans remained considerably less ambitious than in previous years.

Exports and Imports

For most contacts, the pace of contraction in exports had not changed in recent months. Sterling's earlier depreciation had led to improvements in competitiveness for some firms, leading to reports of growth in market share. But shrinkage of global demand had continued to dominate. There were, however, some further reports of a pickup in demand from China and the Far East.

The broad picture remained one of import volumes significantly down on the same period a year earlier. Against that backdrop, there were tentative signs that imports of raw materials had picked up over the past month — possibly reflecting the slowing pace of de-stocking.

Inventories

There were further widespread reports that the pace of de-stocking had slowed, as an increasing number of firms had now unwound any excess inventories. There were some exceptions, as the process of de-stocking continued to work through supply chains. But these were balanced by reports from firms that were looking to re-stock. Looking forward, many contacts planned to hold stock levels below recent norms. That followed from the weakness of expected demand, exacerbated by tightness of working capital.

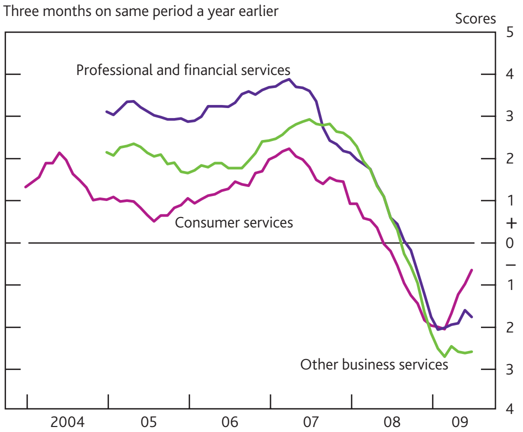
Output

Services

As described above, the pace of decline in consumer services had continued to ease, as the domestic tourism sector experienced growth in demand. Recent reports from business services providers had been more mixed (**Chart 2**).

On the one hand, there had been further signs of a small increase in commercial property and acquisitions activity in

Chart 2 Services turnover



recent months. And there were very occasional reports that demand for logistics may have bottomed as retail sales picked up and de-stocking slowed. But on the other hand, there were no indications that recent sharp cuts in corporate 'discretionary' expenditure on conferences and business travel had been reversed. Any growth had come from a low base — in contrast to the consumer services sector, it was rare to hear from contacts whose turnover was up on the same period a year earlier.

Manufacturing

There was more evidence that orders and production were stabilising — though the level of activity remained significantly down relative to the same period a year earlier. On the upside, there had been further reports from contacts that had seen a pickup in orders as their customers completed moves to de-stock and as firms switched from foreign suppliers. But on the downside, demand for capital goods remained weak and there were mounting signs that aerospace production was slowing as the pipeline of orders diminished. Looking forward, many contacts described their order books as 'short'. As a result, few were confident that there would be a significant pickup in demand during the second half of 2009.

Construction

Construction activity remained severely depressed, as private building work contracted rapidly (**Chart 3**). There had been some reports of renewed growth in house-building in the wake of the pickup in housing market activity. But the new work was typically small in scale — limited to re-opening of a few sites rather than wholesale resumption of development. Any impact on overall construction activity had been more than offset by rapid shrinkage in commercial property work as existing projects were completed and the pipeline of new work remained negligible.

For some time, work on public sector projects had provided a prop for the construction sector. While some projects had been cancelled or deferred, others had been brought forward. On average, the level of public sector demand appeared steady

Chart 3 Construction output

as the tail of previously agreed projects moved into development. But looking forward, the pipeline of public sector work was shortening.

Credit conditions

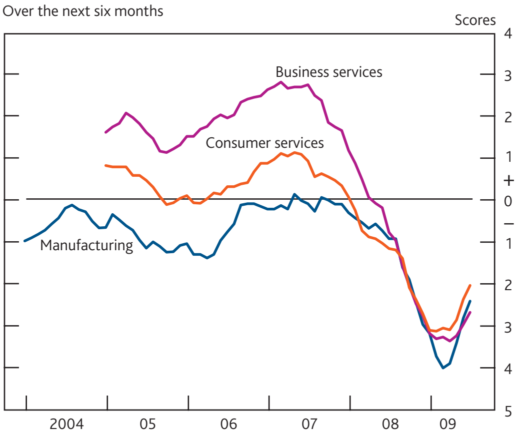
There were further reports from large firms that had made successful rights issues. And there had been a slight increase in the proportion of contacts reporting growth in bank borrowing. But the Agents had continued to hear from firms that had encountered difficulties in securing funding. Such funding difficulties appeared most prevalent amongst smaller firms. As had been the case throughout 2009, many contacts had found it hard to access trade credit insurance.

Demand for finance was low relative to previous years. In part, that reflected firms' weak investment plans. But some contacts also felt that the cost of finance was prohibitive given current demand conditions. And there continued to be occasional reports from firms that were reluctant to approach banks for new funding for fear of triggering an unfavourable review of existing terms.

Employment

There had been further reports of shrinkage in contacts' headcount, including some more announcements of significant redundancies. Looking forward, employment intentions remained weak, but less weak than earlier in the year — reflected in upward adjustment to the Agents' forward-looking scores for employment intentions (**Chart 4**). Many firms were not recruiting — aiming instead to trim head count by maintaining freezes on replacement hires. Only a minority reported firm plans for further large-scale redundancies. Some others would review the case for large-scale redundancies in the autumn, by which time the outlook for demand would be clearer. But others were comfortable now that they had made the bulk of the adjustment in headcount warranted by the weaker outlook for demand.

Chart 4 Employment intentions



Capacity utilisation

As had been the case throughout 2009, the majority of contacts reported a significant margin of spare capacity. It was very rare to hear from contacts for whom capacity constraints were binding. The majority felt that the weak outlook for demand left little prospect that capacity constraints would bind during the remainder of the year. Looking further forward, most considered the cuts they had made to production to be temporary and easily reversible. There were, however, a few concerns that the external environment might impair contacts' ability to raise production. Some worried that unemployment might lead to loss of skills — particularly in the construction sector, where redundancies and layoffs by sub-contractors had been very significant. Others raised concerns over the potential impact of future corporate failures on their supply chains — though so far, insolvencies had not risen as sharply as many contacts had feared.

Costs and prices

Labour costs

There had been little change to the picture painted by contacts visited earlier in the year. Per capita labour costs were widely reported to have fallen through 2009. For some, introduction of restrictions on overtime or shorter working weeks had led to substantial per capita savings. Bonus and commission payments had also been reduced, and a majority of contacts had reported pay freezes. Looking forward, some contacts had raised concerns over the prospective impact of asset price falls on employers' contributions to defined benefit pension schemes.

Non-labour costs

Inflation in materials costs had slowed further. In part, that reflected sharp increases in prices a year earlier dropping out of the twelve month comparison. In recent months, contacts' experience appeared broadly balanced between those for whom input costs were rising and those whose costs were falling. On the upside, pass-through from sterling's earlier depreciation was still cited occasionally as a factor leading to increases in prices when orders and contracts were renewed. On the downside, there were further reports from firms whose energy costs had fallen as fixed price contracts expired. And some had seen pass-through of earlier falls in the global price of steel and other non-food commodities.

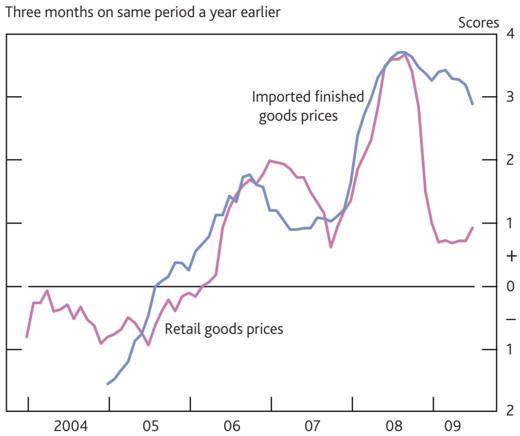
Output prices

There was little evidence of inflation in manufactured output prices. And many business services prices were lower than the same period a year earlier. The weak outlook for demand had weighed on any potential for price increases and led many customers to press suppliers for discounts. Moreover, the slowdown in materials and labour cost inflation had reduced the imperative for suppliers to press for increases in price.

Consumer prices

As had been the case for some time, consumer goods price inflation remained low, but positive (**Chart 5**). In recent months, there had been tentative indications that downward pressure from widespread promotional activity had eased. But that had been offset by a marginal diminution in the upward pressure from pass-through of sterling's depreciation.

Chart 5 Retail goods and imported finished goods prices



Through 2009, contacts had reported high levels of promotional activity, motivated by a widespread perception that consumers were more value conscious than normal. Discounting was still reported to be widespread — in both the leisure services and retail goods sectors. But some contacts had reduced the scope of their promotional activity as stronger-than-anticipated demand had enabled them to unwind excess stocks.

Over the past month, there had been further reports of pass-through of higher import prices. As in recent months, some contacts anticipated further pass-through in the autumn. But a few others had been surprised by the sensitivity of demand to recent price increases, leading them to scale back plans for future pass-through.