BANK OF ENGLAND

Agents' summary of business conditions

February 2009

- Consumers' expenditure had continued to contract. There were signs that the pickup in non-food sales in the period immediately after Christmas had been short-lived.
- Investment intentions remained at the weak levels reported in recent months.
- External demand had continued to slow sharply, with the volume of manufactured goods exports now lower than a year earlier.
- Contacts' concerns over the cost and availability of working capital remained elevated.
- Employment intentions had been scaled back further across all sectors. Average hours had been cut. And permanent staffing levels had also been reduced, with further redundancies expected during early 2009.
- Growth in per capita labour costs had slowed. Respondents to a special survey on pay prospects expected 2009's wage settlements to be markedly lower than those made during 2008, with many planning pay freezes (see box).
- Annual input and output price inflation had fallen further.
- Inflation in imported finished goods prices remained elevated. So far there had been only tentative signs of pass-through to retail goods prices. There, the picture had continued to be dominated by the depth and persistence of discounting. Looking forward, however, a number of retailers and distributors planned to raise prices if sterling remained at its current level.

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 December 2008 and late January 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.

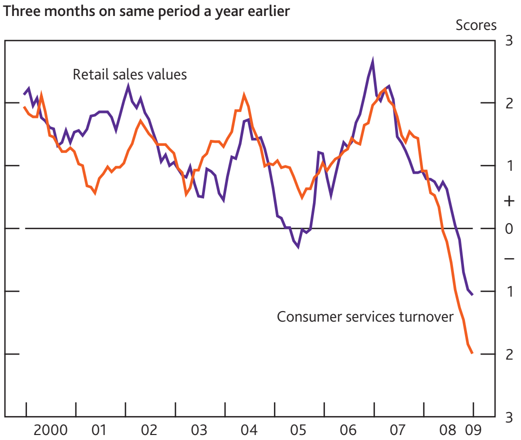
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

Consumers' expenditure had continued to contract, with the Agents' scores reduced slightly from the previous month's low levels (**Chart 1**). While many retailers reported some pickup in non-food sales in the period immediately after Christmas, there were signs that the recovery had since petered out despite the maintenance of deep discounting. The value of food sales had continued to grow, in part due to ongoing inflation in food prices. This had contributed to supermarkets' strong performance relative to the retail sector as a whole.

Chart 1 Consumer spending



Many contacts expected consumer demand to weaken further during 2009 Q1. This had been reflected in some further cutbacks in retailers' orders for consumer goods. Contacts' expectations reflected a widespread anticipation of a pickup in precautionary savings in the face of concerns over job security. Indeed, some described a growing reluctance among consumers to commit to large purchases, or instalment payments. That was consistent with the sharp fall in new car sales seen in recent months and with falling renewal rates for annual gym and club membership.

Housing market

The volume of housing transactions had remained at very low levels. While reports of increases in enquiries had become more widespread, there was little evidence (yet) that these would translate to a marked increase in activity. Difficulties in securing mortgage financing continued to be the most widely reported driver of weak housing demand; primarily because deposit requirements remained elevated relative to the experience of recent years.

Business investment

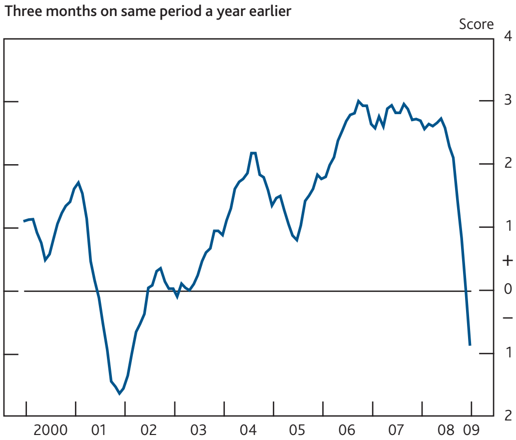
Investment intentions remained weak, with many firms seeking to prolong the life of existing assets. Some firms had introduced capital spending freezes — though most planned some limited capital expenditure, where paybacks were quick or to cover essentials such as satisfying health and safety requirements.

For many contacts, the outlook for demand had worsened in recent months; as order books had shortened, major customers had cut production, and the macroeconomic climate had deteriorated. Moreover, some contacts reported that uncertainties over demand had made forward planning more difficult, leading them to defer major decisions (including on capital expenditure). Concerns over the outlook for demand remained the prime driver of weak capital expenditure plans. But concerns over the availability of working capital and external project financing also remained important factors for many firms.

External demand

The Agents' score for the volume of manufactured goods exports was reduced sharply, following the marked step down during 2008 Q4 (**Chart 2**).

Chart 2 Manufacturing export volumes



Many contacts reported that the slowdown in world demand had, so far, more than offset the impact of any improvements in competitiveness arising from sterling's depreciation. For many firms, sterling's depreciation had led to an increase in margins, at least relative to home sales. For some, this was because export contracts embodied fixed foreign currency prices. But for others, the rise in margins reflected an active decision not to cut foreign currency prices.

Inventories

During the latter part of 2008, manufacturers had experienced a mounting excess of stocks over planned levels, in the wake of unexpectedly sharp falls in demand. Despite significant cuts in production and component orders, stocks remained elevated in those sectors where the drop in demand had been most acute — that is, the automotive supply chain and construction-related industries. Where falls in demand had not been so marked, for example in aerospace, there was less evidence of excess stocks. And retailers reported that stock levels were not higher than seasonal norms, as consumer demand had been no weaker than anticipated over the Christmas period.

Output

Business services

The ongoing contraction in aggregate demand and output had been reflected in falling demand for a wide range of business services. Spending on haulage and distribution had been reduced further as consumer demand and production had fallen. And weakening labour demand had led to reductions in recruitment agencies' fee income. The Agents had continued to hear reports of reductions in firms' non-contractual (discretionary) spending, such as demand for business travel and marketing. For a number of accountancy and legal services providers, workload had fallen as some long-term contracts had not been renewed in the wake of the sharp step down in economic activity during 2008 Q4.

Manufacturing output

Production had slowed sharply through 2008 Q4 and into 2009. However, this aggregate picture masked material differences between subsectors. Across the automotive and construction-related supply chains, orders had collapsed. Other sizable subsectors — such as food processing and aerospace — had not seen such a sharp change in demand. But even in those sectors, growth in orders had slowed.

Construction

The level of construction activity remained lower than the same period a year earlier. The broad themes mentioned in recent reports had continued. Private house-building activity remained materially down relative to the start of 2008. Looking forward, the pipeline of new work was negligible and was expected to remain so given the sizable stocks of unsold new housing and tightness of financing conditions. Commercial property work had also contracted. The sharp decline in private activity had more than offset continued growth in public sector project work. Indeed, there were reports of slowing public sector demand, with some small schemes being cancelled.

Credit conditions

Contacts' concerns over the availability of working capital remained elevated. There were widespread reports that the cost of banking facilities had risen over the past few months, most notably through increases in arrangement fees. A significant minority also felt that the availability of bank lending had declined. Some contacts reported that unused facilities had been withdrawn — in some cases, removing a potential cushion for cash-flow management. And there continued to be reports that firms were reluctant to approach banks for finance, due in part to concerns that doing so might trigger an unfavourable review of existing terms.

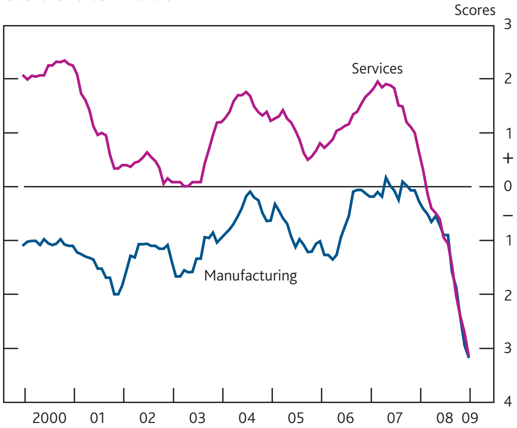
Reductions in the availability of trade credit insurance remained a concern for many contacts. This had led some to refuse orders. But many other suppliers had been able to maintain business either by successfully requiring upfront payments or by taking counterparty risk onto their own balance sheets. More generally, there had been a further increase in debtor days — the time taken to receive payment for goods and services provided.

Employment

The broad picture remained one of rapidly shrinking demand for labour, with the Agents' scores reduced further across sectors (**Chart 3**). There were reports that some supermarkets planned to increase recruitment. But these were more than offset by lower demand elsewhere in the retail sector and in other sectors. There had been further reports of redundancies.

Chart 3 Employment intentions

Over the next six months



As the recession had deepened, an increasing number of firms had faced difficult decisions over staffing levels. In light of the shrinkage in labour demand, the Agents had focused their discussions with contacts more tightly on employment decisions than was normally the case. **Chart 4** summarises the Agents' views of the broad decision-points faced by typical firms across different sectors of the economy. There was, of course, some variation in experience across firms — with some continuing to recruit throughout 2008, while others had faced difficult decisions over staffing earlier than the typical firm in their sector.

The chart shows that early in 2008, firms in most sectors were considering whether to cease expansion of staffing levels — in anticipation of slowing demand. In the construction sector, however, a number of house builders were already facing more acute decisions over their permanent staffing levels, reflecting

Chart 4 Type of employment decisions being made by typical firms across different sectors(a)

Decision-point reached by typical firm	Construction	Manufacturing	Professional and financial services	Other business services	Retail/consumer services
Cease net recruitment	Late 2007	Early 2008	Early 2008	Early 2008	Early 2008
Cut hours or shifts	Early 2008	Early 2008	n.a.	Mid-2008	Mid-2008
Consider cutting non-permanent employees	Early 2008	Mid-2008	n.a.	Late 2008	Mid-2008
Consider trimming permanent headcount	Early 2008	Late 2008	Late 2008	Late 2008	Late 2008
Consider significant cuts to permanent headcount	Mid-2008	Current	Current	Current	Current

(a) The chart describes the Agents' views of the decision-points reached by typical firms in each sector. There was some variation in experience across firms within each sector.

the early slowdown in that sector. By late 2008, it had become increasingly common for contacts in all sectors to report that they were reviewing permanent staffing levels — considering options for trimming. That was reflected in downward adjustments to the Agents' scores for employment intentions. But until a few months ago, very few firms outside of the construction sector had reached the more extreme decision-points over whether to adjust permanent staffing levels substantially.

In recent months, however, a growing number of firms had been forced to consider whether to make significant cuts to staffing levels — in the wake of the intensification of the contraction in economic activity during 2008 Q4. In some cases, such reviews had been followed by introduction of redundancy programmes. More were either planning to do so during 2009 Q1 or would review staffing again if demand did not pick up over the next few months.

Against this backdrop, firms had made further cuts to average hours. There had continued to be reports of reductions in overtime. And some firms had sought to inject flexibility into hours through changes to working practices, such as introduction of short-time working.

Costs and prices

Labour costs

Labour cost inflation had slowed further in recent months. This reflected falls in hours worked, lower bonuses and slowing growth of regular pay. The results of a special survey on prospects for pay and labour costs are reported in the box. The majority of respondents expected labour costs to grow significantly more slowly during 2009 than they had a year earlier. And a material number of contacts had either imposed pay freezes or were planning to do so.

One major driver of the expected slowdown in wage growth was the worsening outlook for demand. Rising insecurity about employment prospects and expectations of lower inflation had both increased employees' willingness to accept lower wage settlements. However, there was less scope to reduce per capita labour costs in sectors where a significant proportion of employees were paid the National Minimum Wage.

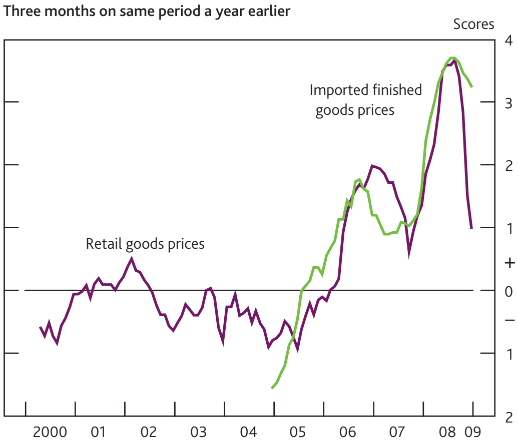
Prices

Inflation in many materials costs had eased further as falls in global prices had not yet been fully offset by the impact of sterling's depreciation. There were, however, some exceptions such as the price of imported timber which had increased. Further down the supply chain, there were widespread reports that weakening demand had shifted the balance of negotiating power towards purchasers. The need to cover fixed costs had led some manufacturers to take on orders at margins that were too low to sustain in the medium term.

Inflation in the price of imported finished goods remained elevated (**Chart 5**). As yet, there were only tentative signs of pass-through to retail goods prices. There, the picture continued to be dominated by the depth and persistence of discounting activity. Looking forward, however, a number of retailers and distributors planned to raise prices if sterling remained at its current weak levels. These plans were most prevalent among food and clothing retailers.

Chart 5 Retail goods and imported finished goods prices

Three months on same period a year earlier



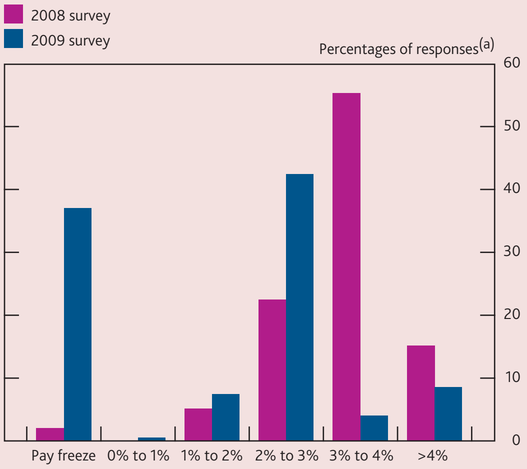
Agents' survey on prospects for pay and labour costs

A significant number of private sector pay settlements take place in the first four months of the year. To provide an early read on prospects for pay in the year ahead, the Agents therefore conduct a survey of their contacts each January. This year, just over 350 private sector firms from all sectors of the economy responded. All figures reported are weighted by total employment.

One feature of this year's survey was that around a quarter of respondents were unsure about their likely settlement for 2009. That was higher than in previous years and is consistent with more general reports from contacts that elevated uncertainties about the economic outlook were complicating planning.

For the three quarters of respondents that had reported plans for wage settlements, the average settlement was 1.9% — markedly lower than the results of the 2008 survey (3.5%). More than a third of those respondents expected to apply a pay freeze. And very few planned settlements in excess of 3% (**Chart A**). Reports of lower settlements were broad-based across sectors.

Chart A Expected pay settlements in 2009 and 2008

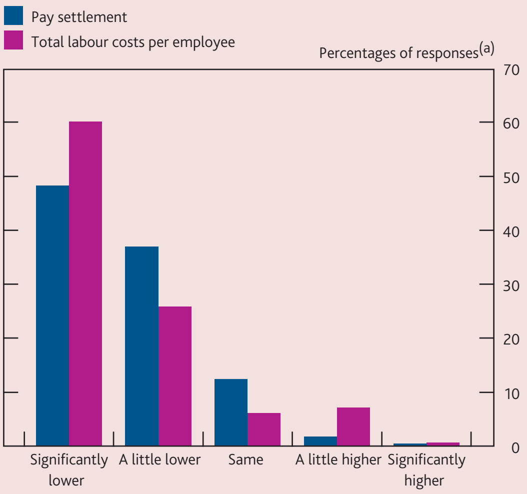


(a) Weighted by employment, excludes firms that were 'uncertain' about prospective settlements.

Basic pay is only a part of firms' total labour costs. Other payments — such as bonuses, commissions, merit pay and pension contributions — also play a role. Taking these factors into account, the majority of firms expected total per capita labour costs to grow significantly more slowly than during 2008 (**Chart B**).

Many respondents attributed the downward pressure on labour cost growth to factors relating to the weakening outlook for demand — that is to prospects for profitability,

Chart B Expected difference between growth of total labour costs in 2009 and 2008



(a) Weighted by employment.

easing recruitment conditions and lower performance-related pay. Lower inflation expectations and concerns over job security were seen to be increasing employees' willingness to agree to lower settlements.