BANK OF ENGLAND

Agents' summary of business conditions

January 2009

- Consumers' expenditure had contracted further during late November and early December. And for most retailers, sales over the Christmas period had been lower than in the previous year.
- Investment intentions had been reduced sharply during 2008 Q4.
- Exports had slowed sharply. More industries were now experiencing shrinkage in export demand.
- Output had contracted more rapidly than earlier in the year. During 2008 Q4, the slowdown had been most marked in the manufacturing sector, as firms cut production in the wake of a mounting excess of stocks over planned levels.
- Contacts' concerns over availability of working capital remained elevated. This reflected both an ongoing tightening in availability of bank funding and trade credit and the pressures on corporate cash flow arising from the deteriorating macroeconomic outlook.
- Employment intentions had been scaled back further, with an increase in redundancies. Further redundancies were planned for 2009.
- Growth in per capita labour costs had slowed. Looking forward, there had been a material increase in the proportion of firms planning for a settlement freeze.
- Annual input inflation had fallen back sharply for many imported raw materials, as falling foreign currency prices more than offset the impact of sterling's recent depreciation.
- Retail goods and service price inflation had also fallen sharply. The VAT cut had been widely implemented. And pre-Christmas discounting had been deep.

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 November and late December. 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.

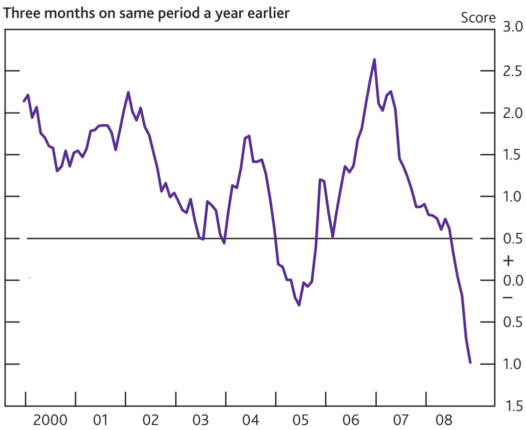
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

For most contacts, retail sales values were down relative to the same period a year earlier (**Chart 1**). In some parts of the United Kingdom, the rate of slowdown in retail sales *volumes* appeared to have stabilised during late November and early December after particularly weak sales earlier in the quarter. However, sales *values* had continued to fall as many retailers had offered deep discounts in the run-up to Christmas.

Chart 1 Retail sales values



Demand had continued to shrink for a wide range of consumer services. Most notably, there were further reports of reduced demand for financial services and lower sales at restaurants and pubs. Consumer demand for foreign travel had weakened. And despite sharp discounting, new and used car sales remained particularly low.

Given the importance of seasonal trading, the Agents contact a broad range of retailers in late December and early January each year, to get an early view of sales over the Christmas period. For the majority of retailers, sales values had fallen substantially relative to the previous Christmas. But this experience was not universal — a significant minority reported some increase in sales values.

Looking forward, many contacts expected consumer demand to weaken further during 2009 Q1, with some anticipating a pickup in precautionary savings in the face of mounting concerns over job security. The number of retailers in financial distress had increased, with some reports of difficulties in meeting up-front rental payments.

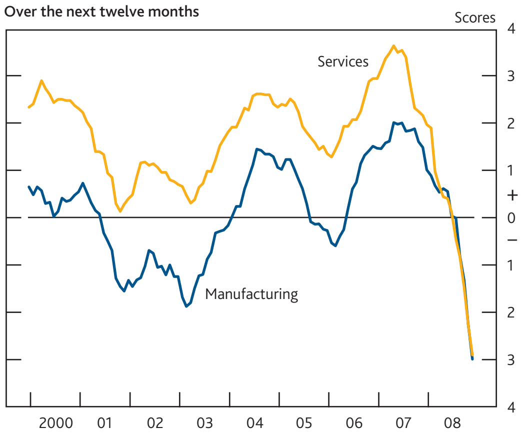
Housing market

There had been little change from the picture of very weak activity painted in recent months. In all parts of the United Kingdom, transactions in the markets for new and established homes had remained at low levels. Where there were reports of increases in pockets of activity, these were not seen as representative of any broader turnaround: for example, increases in sales at auction were attributed to a pickup in repossessions. Difficulties in securing mortgage finance remained the most widely reported driver of weak housing demand. But expectations of future price falls and heightened concerns over job security were also seen to be depressing demand.

Business investment

Throughout 2008 Q4, there had been widespread reports of substantial reductions in investment intentions, with the Agents' scores reduced significantly (**Chart 2**). Cutbacks and deferrals in capital expenditure plans had become the norm for contacts visited in recent months.

Chart 2 Business investment intentions



Contacts' expectations of future demand had weakened materially, and the outlook for demand was cited frequently as a prime driver of reductions in investment plans. Concerns over availability of working capital and external project finance remained important factors for many firms. There were also reports that some commercial property investments had been shelved in anticipation of future falls in property values.

Overseas trade

The Agents' score for goods export volumes was reduced sharply again, following material reductions in the score earlier in the quarter (**Chart 3**). Indeed, the fall in scores through 2008 Q4 was, by some margin, the largest quarterly reduction since the Agents started scoring in 1997. While export demand was still seen to be stronger than domestic demand for manufactured goods, more industries were now experiencing shrinkage in exports.

Many contacts reported that the slowdown in world growth had, so far, more than offset any improvements in competitiveness arising from sterling's depreciation. In part, however, this was because some exporters had taken advantage of the depreciation to improve margins — by raising their sterling export prices.

Chart 3 Manufacturing output

Inventories

Throughout the second half of 2008, manufacturing contacts have described a build-up in stocks across the supply chain. Weakening consumer demand and widespread cutbacks in capital expenditure had impacted on orders. This had been most marked in the automotive sector, where the collapse in demand had led to a material build-up in stocks. But the trend towards involuntary stockbuilding had been pervasive throughout the production sector. Manufacturers' concerns over the mounting excess of stocks over planned levels had been exacerbated by doubts over the availability of working capital — a picture that had become more acute over the past month. That had led many contacts to cut production aggressively (see below).

Output

Manufacturing output

There were further material reductions in the Agents' scores for the output of manufactured goods (**Chart 3**). During 2008 Q4, the deceleration in manufacturing output appeared more extreme than that experienced in the service sector, where the slowdown in output had started earlier.

Orders for construction-related goods, consumer goods and capital goods were all lower than a year earlier. And many contacts had cut their production even more sharply than orders had declined. Looking forward, few contacts expected a rapid bounceback in output, with widespread reports of plans to cut production further to manage stock levels down and many contacts anticipating persistently weak orders. There were, however, some exceptions to that picture in sectors such as medical equipment, rail and environmental products.

Business services

The decline in demand for business services appeared broad-based, with a further fall in the Agents' score. As in recent months, demand for 'countercyclical' services — such as insolvency and employment advice — had continued to grow. But even within the accountancy and legal sectors, this growth had not been sufficient to offset shrinkage in demand for other activities. More generally, there were widespread reports of falling expenditure on professional services, such as financial services and recruitment services. Demand for transport, logistics and distribution services had also contracted, in line with the shrinkage in aggregate demand and output.

Construction

Construction output was significantly lower than a year earlier, with a further reduction in the Agents' score. As in recent months, contacts reported that substantial falls in house building and commercial property development were more than offsetting growth in public sector work. Looking forward, the pipeline of new private sector projects was negligible. As a result, the majority of contacts had seen order books shortening and expected the decline in construction output to accelerate early in 2009, as existing projects complete.

Credit conditions

Contacts' concerns over the availability of working capital remained elevated — if anything, more acute than at the time of the previous report. In part, that reflected a further tightening in the availability of bank funding and trade credit. But contacts' concerns also reflected the deterioration in the macroeconomic outlook, with attendant pressures on corporate cash flow. In particular, where firms relied on invoice discounting, falling orders would reduce cash flow as there were fewer sales to discount.

Availability of trade credit insurance was a material financing concern for a significant number of contacts. Some had seen blanket reductions in cover for some sectors, at little notice. There were also widespread reports of increases in payment periods for goods and services supplied — with no clear differentiation in experience between large and small firms. Bad debts from customers had increased through 2008 Q4, but remained at modest levels.

Employment

The broad picture remained one of shrinking demand for labour, with the Agents' scores reduced further across sectors (**Chart 4**).

There had been some reduction in hours per head, with a number of firms introducing or extending short-time working or extending normal Christmas shutdowns. However, many contacts had sought to reduce head count. As in recent months, some retail contacts had made lower-than-normal use of temporary seasonal workers. There had also been a

Chart 4 Employment intentions

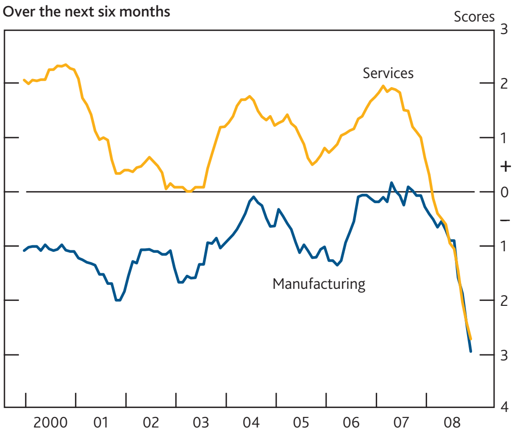
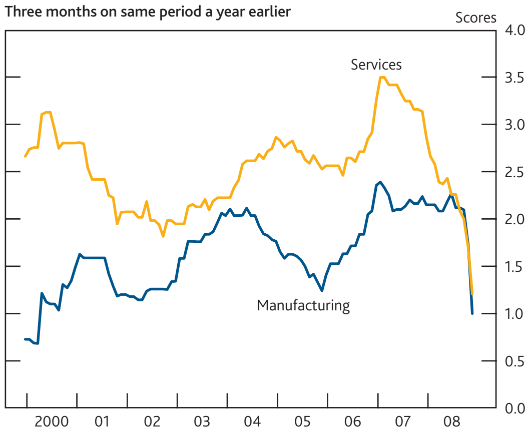


Chart 5 Labour costs per head



further increase in the flow of redundancies — most markedly in the manufacturing sector. Looking forward, redundancies were expected to increase during 2009, across many sectors.

Capacity utilisation

The Agents' scores for capacity utilisation and recruitment difficulties were reduced further. Contacts felt that the worsening outlook for demand left little prospect of capacity constraints binding during 2009. Efforts had been made to retain capacity as production fell: so far, the norm had been to cut shifts, extend Christmas shutdowns and mothball plant, rather than scrapping capital or closing sites more permanently. That said, there were reports of disinvestment by a minority of contacts — for example through closure of retail and leisure outlets.

Costs and prices

Labour costs

Growth in labour costs per head had slowed further, leading to significant reductions in the Agents' scores (**Chart 5**). The prime drivers remained reductions in hours per head and lower bonus and commission payments.

Looking forward, there was mounting evidence that 2009's settlements would be lower than 2008's for the majority of contacts. Across the United Kingdom, there had been a material increase in the proportion of contacts planning settlement freezes. And there were some reports of plans for wage cuts. However, for a minority of firms, the impact on labour cost inflation would be at least partially offset by the need to increase contributions to defined benefit pension schemes.

Input prices

Inflation in materials costs had fallen sharply, leading to further reductions in the Agents' score. For many firms, falling foreign currency materials prices had more than offset the impact of sterling's recent depreciation. The trend was less marked for imports of finished goods. The most notable falls in price were seen for construction-related materials. And there had been some pass-through of lower oil prices to the price of oil-based products. However, for many contacts, lower spot energy prices had yet to impact on their own energy costs — indeed, some were still seeing price rises as (long) fixed-price contracts unwound.

Consumer prices

The Agents' scores for retail goods and services prices were marked down significantly. This reflected widespread reports of deep discounting as retailers sought to shift stock through December — though for many, discounting had been targeted on specific 'discount days' and hence might not be picked up by official measures of inflation. The VAT cut had been widely, but not universally implemented. The exceptions were typically smaller stores. The VAT cut had also affected some services prices, and there were also reports of discounting in the leisure sector.