BANK OF ENGLAND

Agents' summary of business conditions

July 2009

- There was further evidence that levels of consumer spending had started to stabilise during the second quarter.
- The recovery in housing market activity had continued.
- Investment intentions remained very weak.
- Export volumes had continued to fall.
- There were widespread reports that the pace of de-stocking had slowed. An increasing number of contacts had now unwound any excess inventories.
- Contacts' reports continued to point to some stabilisation in manufacturing output, albeit at levels well below the previous peak. Professional services activity may also have started to stabilise. But demand for haulage and corporate spending on discretionary activities remained very weak.
- The availability and cost of finance remained a key concern for many firms.
- Employment had continued to decline. Many firms expected to trim staffing levels further, but a growing number felt that they had now completed the bulk of any adjustment to head count in the wake of weak demand.
- Per capita labour costs remained lower than the same period a year earlier. Business services prices were also falling, while inflation in materials prices had eased.
- Consumer goods price inflation remained low but positive, as ongoing promotional activity pushed against rising import prices. There were, however, occasional reports that promotional activity was becoming less aggressive as retailers' concerns over excess stock levels receded.

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 May 2009 and late June 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.

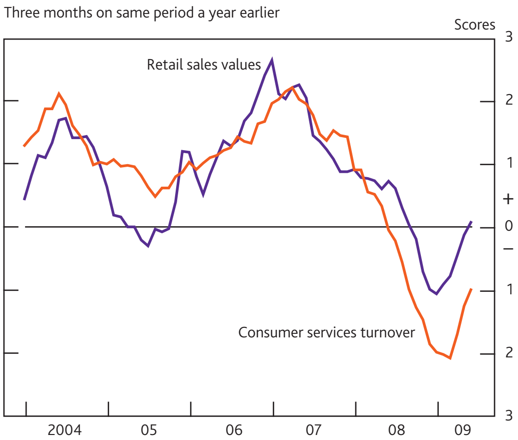
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from:
www.bankofengland.co.uk/publications/inflationreport/index.htm.

Demand

Consumption

There was further evidence that levels of consumer spending had started to stabilise during the second quarter (**Chart 1**).

Chart 1 Consumer spending



As in recent months, the value of food sales was widely reported to be higher than a year earlier. And most contacts felt that non-food sales had started to stabilise. But while there was a clear sense that sales were running ahead of the weak levels retailers had anticipated earlier in the year, by no means all contacts felt sales were growing consistently from week to week. For some, the most recent weeks' trading had not matched the strong sales seen earlier in the quarter.

On average, the pace of contraction in demand for consumer services had eased. But this masked significant differences between day to day leisure spending and domestic tourism. Pubs, restaurants and gyms had continued to see sharply reduced demand relative to the same period a year earlier. By contrast, many contacts had reported increased spending on holidays in the United Kingdom.

Used car sales had continued to pick up. And the pace of contraction in new car sales appeared to have eased slightly from earlier very sharp rates of shrinkage. A number of car dealerships felt that the government scrappage scheme had resulted in an increase in enquiries and sales (largely of cheaper models).

Housing market

Housing market activity had continued to pick up, with further reports of growth in enquiries, offers and completed transactions — albeit from a low base. Looking forward, some estate agents were concerned that the flow of new instructions to sell remained well below recent norms and that this would limit scope for further recovery in activity. On the demand side, there were more reports of activity by first time buyers. But tightness in availability of mortgages was still cited widely as a constraint on activity.

Business investment

Investment intentions remained very weak. That weakness typically reflected the outlook for demand, exacerbated by the tightness of corporate credit conditions. Few contacts expected a pronounced recovery in activity in the near term. And many were reluctant to draw down cash balances at a time of elevated uncertainty over future demand and the availability of working capital. Taken together with concerns over the likely cost and availability of external project finance, these factors had led some firms to increase the hurdle rate applied to candidate projects.

Exports and imports

Export volumes had continued to contract, as the weakness of global demand dominated the impact of any changes to the terms of trade. Recently, however there had been some reports of a pickup in demand from China. Import volumes were down sharply relative to the same period a year earlier. Over and above any impact of weak domestic demand, there had been further reports that firms were switching to domestic suppliers of components and finished goods. Most attributed this to sterling's earlier depreciation. But for some, import substitution had been driven by a strategic push to minimise inventories — as shipping times were shorter for domestically sourced items.

Inventories

There were widespread reports that the pace of de-stocking had slowed. And an increasing number of contacts had now unwound any excess inventories. While there were some exceptions — for example, in the aerospace sector, where demand had recently slowed — many manufacturers were now comfortable with their inventory levels. That had led to some resumption of orders for components to meet sales. The Agents' sense was that some contacts had completed de-stocking slightly faster than they had expected earlier in the year. Looking forward, contacts planned to hold stock levels well down on their levels a year earlier — reflecting both the outlook for demand and concerns over the cost and availability of working capital.

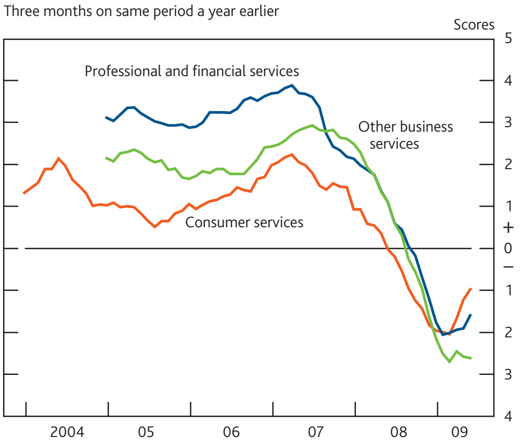
Output

Services

As described above, the pace of decline in consumer services had continued to ease. There were also further signs of stabilisation in demand for some professional services (**Chart 2**). For example, there had been small increases in commercial property and mergers and acquisitions activity in recent months. And print media had recently seen a pickup in revenues from residential property and used car advertisements (reflecting the recent trends in consumer spending and housing market activity). In both cases, however, any growth had come from a very low base so that activity remained well below the levels seen during the first half of 2008.

Chart 2 Services turnover

Three months on same period a year earlier



In contrast to professional services, many other business services had continued to suffer falling turnover. Haulage and distribution companies reported very weak activity. And corporate demand for hotel and conference facilities had fallen during 2009, as many firms had embarked on a further round of cuts to 'discretionary' expenditure in the wake of the falls in their own sales during late 2008 and early 2009.

Manufacturing

As last month, there was some evidence that orders and output were holding stable — albeit at levels that were significantly down relative to the same period a year earlier. On the upside, a few contacts had seen a pickup in orders as their customers completed moves to de-stock or as firms switched from foreign suppliers. But on the downside, there was mounting evidence that activity in the previously robust aerospace sector had slowed.

Construction

Rapid shrinkage in private building activity had continued to more than offset work on public sector projects. That shrinkage had been most obvious in the commercial property sector. There, the pipeline of new projects remained negligible so that activity was shrinking rapidly as existing projects were completed. There had been further reports of a resumption of residential construction, as the pickup in housing market activity had been sufficient to clear the overhanging stock of new houses in some localities. But any recovery in growth remained small in scale — it was typical for house-builders to report activity at around half normal rates.

Credit conditions

Availability of credit remained a key concern for many contacts, notwithstanding any impact of the scaling back of capital expenditure plans on demand for finance. Some felt that banks' appetite for lending had increased, and a number of larger firms had been able to make successful rights issues. But many others had continued to encounter difficulties in securing finance. The Agents' sense was that contacts' experience was becoming increasingly polarised as lenders sought to focus their activities on the least risky credits. That would be consistent with ongoing reports of tight limits being applied to banks' exposures to some sectors — notably, the property and construction sectors and some retail activities. There were further widespread reports that spreads and fees were being increased sharply on renewal or review of facilities.

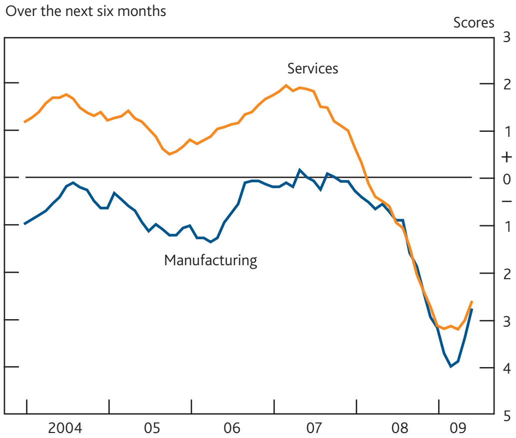
Employment

As in recent months, a significant number of contacts reported that they had cut employees' hours in response to the slowdown in demand from late 2008. Many had also cut permanent staffing levels so that the level of employment was significantly lower than a year earlier. And a number had further cuts to headcount in the pipeline — announced redundancies that were working through the consultation process.

Looking forward, many firms expected to trim headcount a little further — for example, by maintaining freezes on replacement of retiring staff. And construction companies continued to expect job cuts as the commercial property pipeline empties. But a growing number of contacts felt that they had now made the bulk of the adjustment in headcount warranted by the weaker outlook for demand. And some had stepped back from contingency plans for significant cuts to staffing levels, in light of a better-than-feared trading performance. The increased flow of 'non-negative' reports has been reflected in upward adjustment to the Agents' forward-looking scores for employment, to less negative levels (**Chart 3**).

Chart 3 Employment intentions

Over the next six months

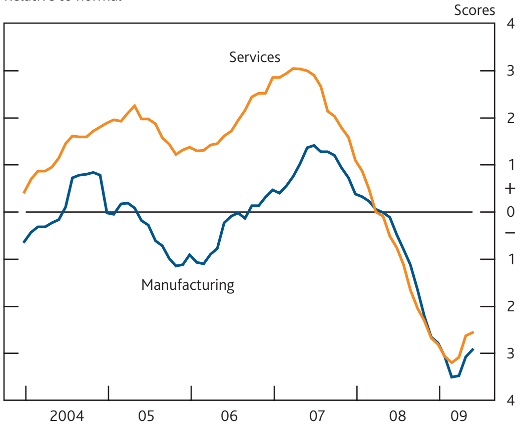


Capacity utilisation

The Agents' scores for capacity utilisation remained at low levels (**Chart 4**). It was very rare to hear from contacts for whom capacity constraints were binding. And the majority felt that the weak outlook for demand left little prospect that they would bind during 2009. One issue was how far this near-term perception masked a reduction in supply potential. The Agents had therefore focused their questions to contacts more tightly on issues of supply than would normally be the case.

Chart 4 Capacity utilisation

Relative to normal



Most contacts considered the cuts they had made to production to be temporary and easily reversible. As described elsewhere, many had used cuts to hours and take home pay to minimise any reductions in staffing levels. Reports of mothballed plant were considerably more prevalent than reports of scrapping or sale of capital. Indeed, a few contacts had used extended shutdown periods to bring forward maintenance work. The transport industry was an exception, with an ongoing flow of reports of reductions to fleet sizes.

There were, however, some concerns that the external environment might impair contacts' ability to raise production. For some, lack of working capital could make it hard to fund purchases of sufficient components and re-employ sufficient staff to satisfy any sharp increase in orders. And others raised concerns over the potential impact of future corporate failures on their supply chains.

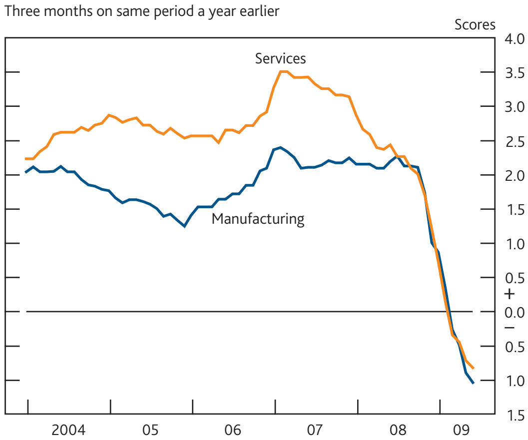
Costs and prices

Labour costs

Per capita labour costs were widely reported to be lower than their levels a year earlier (**Chart 5**). In part, that reflected cuts in average hours made during 2009. Bonus and commission payments had also been reduced, while pay pressures had continued to ease. For some time, a majority of contacts have reported freezes to pay and very few have reported settlements in excess of 3%.

Chart 5 Labour costs per head

Three months on same period a year earlier



Non-labour costs

Inflation in materials costs had eased. In part, that reflected sharp increases in prices a year earlier dropping out of the twelve-month comparison. There were further reports from firms whose energy costs had fallen as fixed price contracts expired. But pass-through from the depreciation of sterling during 2008 was still cited as a factor leading to increases in prices when orders and contracts were renewed. As yet, there were very few reports of prices falling as a result of sterling's most recent appreciation.

Output prices

The broad picture remained one of suppliers' margins being squeezed in the wake of weak demand. There were, however, some exceptions — manufacturers of niche products and those for whom the cost of key materials had risen sufficiently far that maintaining previous prices was not viable. The downward pressure on business services prices had intensified further. There were widespread reports of absolute falls in fees and charge out rates. And the excess of retail and office space had led to downward pressure on rents.

Consumer prices

Consumer goods price inflation remained low, but positive. Food price inflation was easing, and non-food prices had been affected by the continuation of promotional activity. There were, however, occasional reports that discounting was becoming less aggressive than in previous months as retailers' concerns over excess stock levels receded. Indeed, shortages of stock had already led to upward pressure on used car prices. Inflation in imported finished goods prices remained elevated. And looking forward, a number of retail contacts planned to raise clothing and consumer durables prices in the autumn — in part, reflecting the lagged pass through from sterling's depreciation during 2008.