BANK OF ENGLAND

Agents' summary of business conditions

June 2009

- There was further evidence that the rate of contraction had eased for both retail sales and consumer services.
- There were further reports of a pickup in housing market activity in both the new build and secondary markets, albeit from a low base.
- Investment intentions remained exceptionally subdued.
- In manufacturing, export volumes had contracted further, but there was evidence that the pace of contraction in domestic activity had started to ease.
- The pace of de-stocking was reported to have slowed.
- The rate of decline in business services activity had started to stabilise for some contacts.
- Construction activity remained significantly lower than in the same period a year earlier.
- Credit conditions remained tight overall. Difficulties accessing trade credit insurance remained a significant issue for many contacts (see box).
- Labour demand had continued to shrink although some firms had stopped reducing staff numbers.
- Contacts had continued to report higher materials prices than a year earlier although the rate of inflation had eased.
- Consumer price inflation remained 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 April 2009 and late May 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.

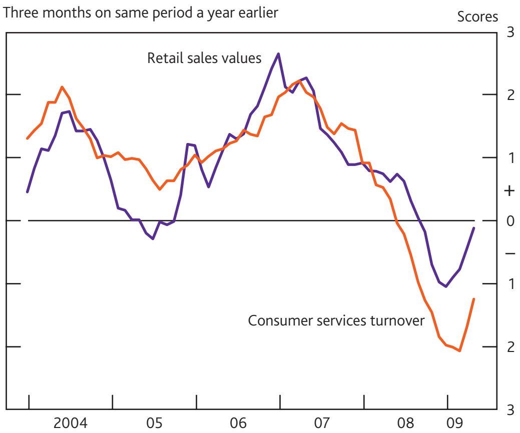
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

The rate of contraction in retail sales values had eased markedly since the start of the year (**Chart 1**). The value of food sales remained higher than a year earlier. And there were an increasing number of reports that the rate of decline of non-food sales, particularly clothing and smaller value electronic goods, had eased. However, sales of 'big ticket' items remained subdued. New car sales remained weak, but there were widespread reports that the introduction of the Government financed scrappage scheme had resulted in an increase in enquiries, particularly about smaller cars. Demand for used cars was reported to have exceeded expectations in recent weeks.

Chart 1 Consumer spending



There was further evidence that the pace of contraction in demand for consumer services had eased. Contacts across the United Kingdom reported that spending on domestic holidays had increased, particularly at venues with budget accommodation. Some contacts had also highlighted an increase in the number of overseas tourists. However, spending in pubs and restaurants remained low.

Retail sales had exceeded some contacts' expectations. But many consumer-facing contacts had also expressed concerns that the recent improvement in demand may prove to be temporary. Contacts had suggested that rising unemployment may result in weaker demand than in recent years.

Housing market

There had been further reports of growth in enquiries, viewings, reservations and sales, albeit from a low base. This pickup had occurred across all parts of the United Kingdom, and in both the new build and secondary markets. Cash buyers had been active purchasers, particularly at auctions. Contacts had started to report a slight improvement in the availability of mortgages, but in many cases lenders' requirements for higher deposits and conservative valuations (sometimes below the agreed sale price) had hindered the progression of enquiries into sales.

Business investment

Contacts had continued to cite uncertainty over prospects for demand as the key factor underpinning weak investment intentions in the manufacturing and services sectors. For some contacts, weak demand coupled with excess spare capacity, had obviated the need to undertake substantial investment. Moreover, many contacts had continued to highlight a preference for preserving cash which had the benefit of reducing reliance on bank finance. Larger projects were also faced with financing constraints. However, projects with a quick payback, or that were necessary to meet regulatory requirements, continued to be progressed.

Overseas trade

While sterling's depreciation had led to improved competitiveness, export volumes had nevertheless continued to fall. There were some reports that the pace of the fall in demand from the euro area had started to ease and that there had been a pickup in demand from Chinese markets. Contacts had also continued to report that the rising cost of imported goods had encouraged some substitution towards domestic suppliers. Import volumes remained sharply below the levels seen over the same period a year earlier.

Inventories

De-stocking had continued as firms had sought to reduce the amount of working capital tied up in stock and had been adjusting to lower demand. But the pace of de-stocking was reported to have slowed. Some contacts had expressed concern that the reduced availability of trade finance and credit would be a constraint when firms begin to rebuild stocks.

Retailers in particular had reduced their inventory levels. But suppliers further down the retail supply chain and contacts in other sectors had highlighted that stocks remained above desired levels and would take several months to fully adjust. And there were increasing reports that demand had eased in the aerospace sector and that de-stocking had started to occur.

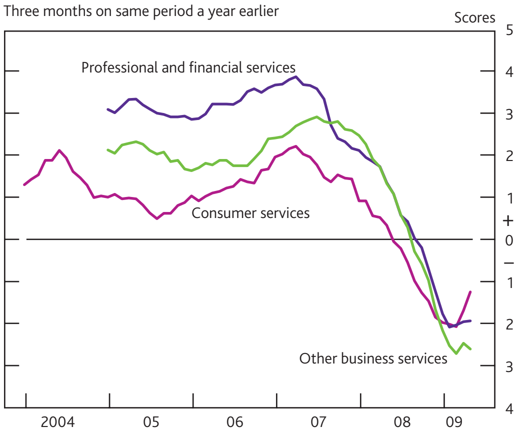
Output

Services

As described above, the pace of decline in consumer services had eased further. Contacts in the business services sectors continued to report that activity remained below levels seen a year ago. But for some contacts the rate of decline had started to stabilise (**Chart 2**).

Contacts continued to report weakness in residential and commercial property, which had reduced demand in a number of related sectors (eg conveyancing, valuations). Firms had also continued to cut back on discretionary spending, for example, training, business travel, corporate functions and use

Chart 2 Services turnover

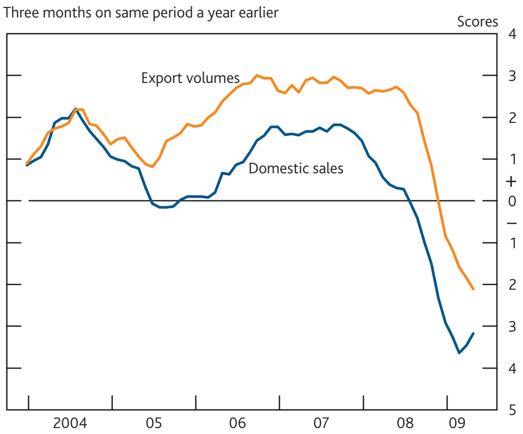


of hotels, as well as advertising and corporate entertainment. And contacts in the logistics sector had continued to report reduced activity levels compared to the same period a year earlier. However, demand for 'core' professional services such as auditing and compliance work had remained relatively stable. This had been complemented by increased demand for services linked to insolvencies and litigation. Public sector demand for professional business services was also reported to have been robust.

Manufacturing

Manufacturing output remained significantly below its level in the middle of last year. And many contacts had noted that their forward order books remained weak. But, for an increasing number of contacts, the rate of decline in domestic activity had started to ease (**Chart 3**). However, despite some positive news on activity in the United Kingdom's main export markets, exports had continued to contract.

Chart 3 Manufacturing output



Demand in the automotive and construction subsectors had remained exceptionally weak. However, some other sizable subsectors, for example food processing and parts of the oil and gas industries, had been able to maintain activity levels or even generate some growth. There had been some reports that growth in the defence and aerospace sectors was now starting to ease although these were mixed.

Construction

Construction activity remained significantly lower than in the same period a year earlier and many contacts expected activity to fall further. The pipeline of activity in the commercial property sector remained exceptionally weak. Contacts reported that few potential speculative developments were viable — because of a lack of finance, lower valuations, and an oversupply in many commercial and industrial markets. The imposition of business rates on empty buildings was a further negative factor that had also led owners to demolish some vacant properties. There were a few signs of a resumption of residential construction, albeit from an extremely low base and only for selected types of properties, for example, small family homes.

As in recent months, public sector demand for schools, hospitals and other healthcare buildings had helped to offset some of the declines in demand from the private sector. However, many contacts had observed that additional spending on public sector projects had yet to be brought forward as indicated by earlier Government announcements. Some contacts had also become increasingly uncertain about the financing prospects for these public sector projects. But firms had reported continued fierce competition for these contracts.

Credit conditions

Credit conditions remained tight. The box describes the results of a special survey of Agency contacts on corporate credit conditions. Over 80% of respondents to the survey reported that external finance, including bank finance and trade credit insurance, had become more expensive and harder to obtain over the past year.

Bank finance

Although the majority of non-bank contacts had continued to cite difficulties in securing finance, some had reported an improvement in the major UK banks' appetite for lending. However, there had been further reports that lenders were taking longer to process financing requests, and were undertaking greater due diligence, than in recent years. Although the absolute cost of financing had fallen for some firms, there were further reports of sharp increases in spreads and fees on existing borrowings at the time of renewal or extension.

Trade credit

As in recent months, the availability and cost of trade credit insurance remained a burden, particularly among firms supplying the retail, construction and automotive industries. Most contacts were reluctant for the withdrawal of trade cover to break customer relationships. Instead, they had responded by making extra efforts to assess the creditworthiness of customers, and some were now demanding payment before delivery or tightening credit terms. Notwithstanding these measures, many firms had also increased the time taken to pay for goods and services.

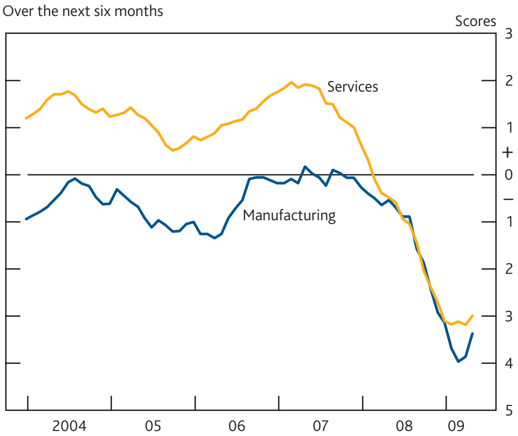
Employment

Although employment intentions remained weak (**Chart 4**), a growing minority of contacts reported that they were now implementing plans to recruit staff. For example, supermarkets and value retailers — whose market share had increased — were recruiting in line with new store openings. And there were signs that some other firms had stopped reducing staff numbers. However, there were further reports of cuts in shifts, overtime and working days suggesting that, overall, labour demand had continued to shrink.

If demand conditions weakened further, a majority of contacts expected that they would have to reduce staff numbers again through recruitment freezes or further redundancies. If that were to occur, some contacts had expressed concerns that they would have to lose some of their more highly skilled staff.

Chart 4 Employment intentions

Over the next six months



Costs and prices

Labour costs

Pay pressures had eased further. Earlier in the year, a third of respondents to the Agents' survey on pay settlements and labour costs had reported a pay freeze. More recently, a majority of contacts had reported pay freezes. And a significant minority had implemented sharp cuts in the pay of senior employees. Reductions in bonuses were also widespread. This weakness in pay, coupled with the reductions in hours, overtime and working days seen in recent months, meant that per capita labour costs continued to fall on a year earlier. Pay awards in excess of 3% remained rare.

Non-labour costs

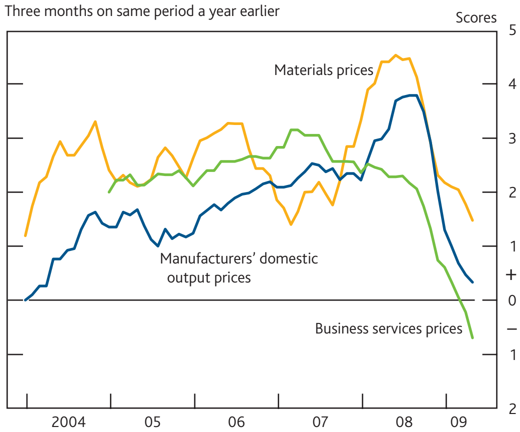
Contacts had reported higher material costs than a year earlier, although the rate of inflation had eased. Inflation in basic foodstuffs remained elevated. The prices of many globally traded inputs had fallen, but sterling weakness had largely offset these falls. Contacts with forward currency contracts had previously been protected from sterling weakness. But, as those contracts were increasingly coming to an end, a growing number of contacts had reported increased import costs. At the same time, shipping and energy costs for some contacts had fallen as contracts negotiated when energy prices were substantially higher came to an end.

Output prices

Except for niche products, contacts remained unable to increase prices significantly due to weak demand (**Chart 5**). The downward pressure on business services prices had intensified, and there were further reports of falls in fees and charge out rates as firms competed aggressively for business, often agreeing fees at (or even below) cost. Firms with established brands and reputation had reported the least pressure to keep prices low. Across the United Kingdom, downward pressure on rents had persisted due to the oversupply of retail and office space. And tender prices remained under pressure in the construction sector.

Chart 5 Input and output prices

Three months on same period a year earlier



Consumer prices

Consumer price inflation remained positive. Many retail and service sector contacts had continued to report promotional activity in excess of seasonal norms. Retailers were seeking to accommodate consumer preferences for budget or value items. But, as in recent months, many contacts held the view that the second half of 2009 would see substantial price pressure from imported goods as existing stocks were replenished at significantly higher import prices. This had already been in evidence for new car list prices which had strengthened due to sterling's weakness against the euro. Used car prices were also reported to have risen from recent low levels due to higher demand and, for some models, a shortage of supply.

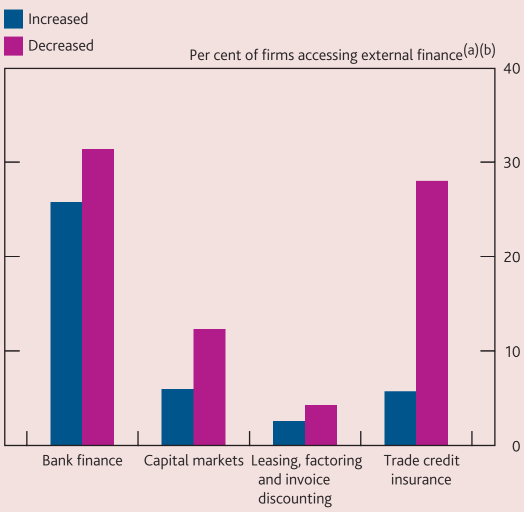
Agents' survey on credit conditions

Recent business surveys had suggested that companies still faced difficulties accessing credit, constraining their ability to invest and, in some cases, meet demand. To explore this issue, Agents conducted a survey of around 300 of their contacts, across all sectors of the economy. The survey updated similar exercises conducted in September 2008 and November 2007. All figures reported are weighted by turnover.

As in the earlier Agents' surveys, respondents were asked to assess whether the cost and availability of external finance had changed over the past year. Since the previous survey in September 2008 there had been a 4.5 percentage points fall in Bank Rate and other lending reference rates had also fallen. Financing costs for some firms could therefore have fallen even if lenders' margins and charges such as non-utilisation fees had risen. Nevertheless, over 80% of respondents considered that external finance had been more expensive and harder to obtain over the past year. This compared to around 60% reporting that credit conditions had tightened in recent months in the September 2008 survey.

Respondents were asked how their use of various types of finance had changed over the past twelve months. The sharpest decreases in usage had occurred for trade credit insurance and bank finance (**Chart A**). The fall in usage of trade credit insurance was in line with reports that the Agents had been receiving over the past few months.

Chart A Change in corporate use of external finance

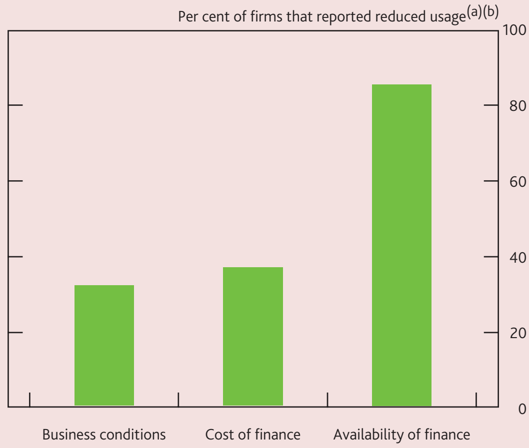


(a) Responses weighted by respondents' turnover.
(b) Respondents could select more than one option.

However, a significant number of respondents had also reported higher usage of bank finance. In part this may reflect firms' reaction to loss of trade credit insurance: increasing borrowings to fund suppliers' demands for upfront payments on uninsured deals. Lenders may also have been seeking to change the composition of their borrower base by shifting their lending towards less risky customers.

More than half of respondents had reported a decline in usage of at least one form of external finance. These firms were asked what had led to that decline. It could have been demand driven — business conditions had worsened — or the cost of finance could have become prohibitive. It may also have been because of supply-side constraints, reflecting reduced availability. In the event, most firms reported that they had reduced their usage of external finance because of lower availability (**Chart B**).

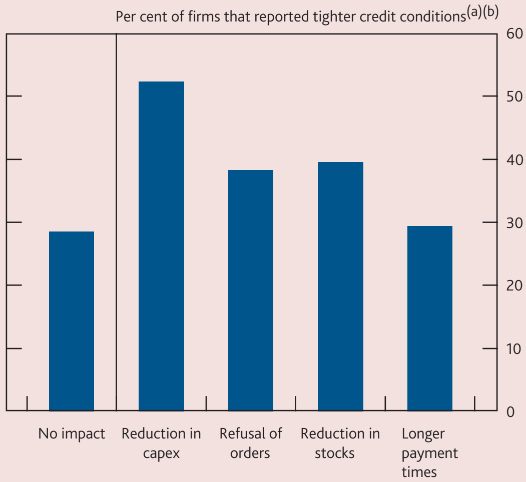
Chart B Factors behind reduced use of external finance



(a) Responses weighted by respondents' turnover.
(b) Respondents could select more than one option.

Around half of those respondents facing tighter credit conditions reported that they had responded by reducing investment, and around a third had reduced stocks, refused orders or increased the time taken to pay for goods and services (**Chart C**).

Chart C Response to tighter credit conditions



(a) Responses weighted by respondents' turnover.
(b) Respondents could select more than one option.