BANK OF ENGLAND

Agents' summary of business conditions

May 2009

- There were further reports that the pace of contraction in consumer spending had eased.
- The pickup in housing market activity had continued — albeit from a low base.
- Investment intentions remained very weak.
- Manufacturing export volumes had shrunk further, as the slowdown in global demand outweighed any gains to competitiveness arising from sterling's depreciation.
- De-stocking had continued throughout 2009, but recent reports suggested that the pace of de-stocking may have eased over the past month.
- Business services turnover remained significantly lower than the same period a year earlier.
- Construction activity had continued to contract sharply.
- While credit conditions remained tight, some contacts felt that the major British banks' appetite for lending had increased a little.
- Labour demand had continued to shrink and employment intentions remained weak. Cuts in average hours, lower bonuses and commissions, and low pay settlements had continued to reduce per capita labour costs.
- On average, there had been little change in the rate of inflation in materials prices. Weak demand conditions had continued to press down on suppliers' margins.
- Consumer goods price inflation remained positive but modest, as promotional activity and falls in domestic energy prices pushed against the impact of rising import prices.

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 March and late April 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.

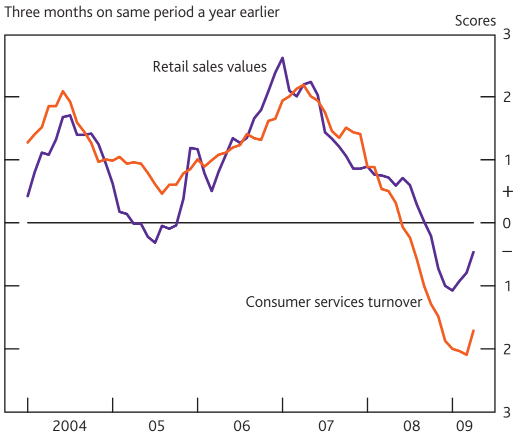
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from:
www.bankofengland.co.uk/publications/inflationreport/index.htm.

Demand

Consumption

There were further reports that the rate of contraction in retail sales values had eased (**Chart 1**). The value of food sales remained higher than a year earlier. As in the previous month, most non-food retailers' sales values were down relative to the same period a year earlier. But there were more widespread reports that sales had outperformed retailers' (depressed) expectations. Most notably, there were signs of a pickup in spending on clothing and other small-scale durables. New car sales remained much weaker than most other aspects of consumer spending. However, there were reports that sales of used cars were continuing to pick up.

Chart 1 Consumer spending



There were a few reports that the pace of contraction in demand for consumer services was easing — though the evidence was less widespread than was the case for retail sales. Spending at pubs remained particularly weak. But spending on holidays in the United Kingdom had increased; some food wholesalers had seen increased orders by large restaurant chains; and there were reports of a modest tickup in demand for personal financial services.

Looking forward, few consumer-facing contacts expected significant growth in demand over the coming months. Some contacts felt that the recent picture may have been distorted by warm weather and the late Easter in 2009. And some did not expect retail spending to be sustained were unemployment to increase later in the year. Retailers' doubts over future demand were reflected in a cautious approach to stock management.

Housing market

Across all parts of the United Kingdom, there had been further reports of growth in the number of enquiries. And there was more evidence that the increase in buyer interest had led to a pickup in sales. That said, the conversion rate from enquiries to sales was below historical norms, and any pickup in transactions had come from a low base. There was some evidence that availability of mortgage finance had improved.

Business investment

Investment intentions remained very weak. As in recent months, most contacts reported cuts to capital spending or deferral of approved projects. The broad picture remained one of capital spending being limited to projects with either a quick (and relatively certain) payback or that were necessary to meet regulatory requirements.

The weak outlook for demand and ensuing spare capacity were often cited as a prime driver of cutbacks in capital spending. Elevated levels of uncertainty over future prospects were also weighing down on investment. And many contacts were reluctant to draw down on cash balances to support investment — as firms' normal tendency to hoard cash at a time of uncertain demand was being exacerbated by concerns over the availability of working capital. The high cost of project finance was also important for some firms.

Overseas trade

Many contacts had seen a contraction in export volumes through 2009. Sterling's depreciation had led to improvements in competitiveness for some contacts — for example, in the farming and tourism sectors. However, there were further reports of exporters preferring to maintain foreign currency prices and hence preserve margins, rather than seeking a larger share of shrinking world markets. Overall, the weakness of world demand had outweighed any impact of sterling's depreciation.

Inventories

De-stocking had continued throughout 2009, as firms responded to the step down in sales experienced from Autumn 2008. However, the most recent reports suggested that the pace of de-stocking may have slowed as inventories approached planned levels for an increasing number of firms.

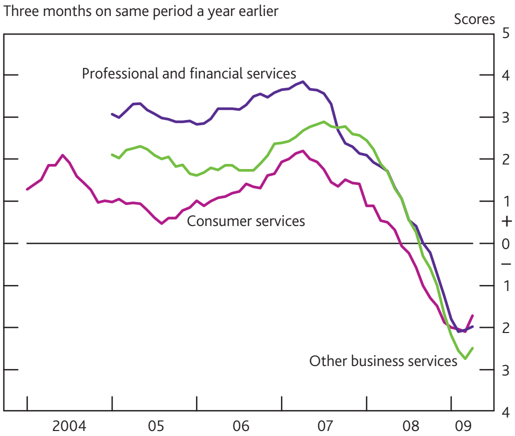
There were further signs that the process of de-stocking had been largely completed for many retailers; there had been a few reports of shortages in some manufacturing supply chains and stocks of used cars were low. However, many other contacts still felt that their inventories were excessive. Some of these contacts expected to finish any stock adjustment over the next few months. But for others — most notably in sectors such as car production where sales had fallen most sharply through late 2008 — it would take some time to draw down stocks of materials and components across the entire supply chain.

Output

Services

Tentative signs that the pace of contraction in demand for consumer services was easing are described above. Business services activity had remained significantly lower than the same period a year earlier. However, the pace of contraction did not appear to have increased (**Chart 2**). In late 2008 and early 2009 there had been a pronounced skew towards reports that activity had fallen below contacts' expectations. More recently, reports had been more balanced — on average, activity had been in line with contacts' expectations; albeit that those expectations were sharply down relative to the previous year.

Chart 2 Services turnover



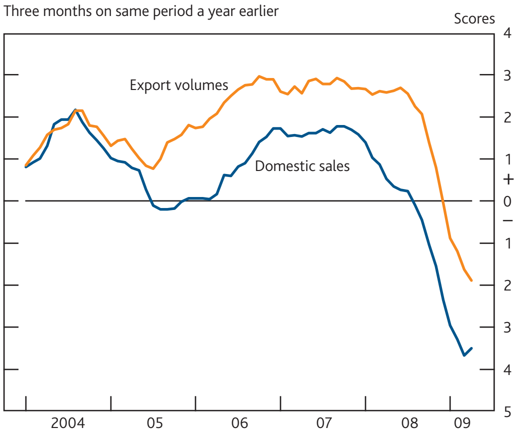
As in recent months, weak levels of demand had been experienced by a wide range of business services providers. Corporate discretionary spending — for example on business travel and advertising — had been cut back further in the wake of the step down in aggregate demand from Autumn 2008. Similarly, haulage and distribution service providers had reported sales sharply down relative to the same period a year earlier. And activity in the commercial property and corporate finance sectors had continued to be very weak. The exceptions were demand for 'core' professional services such as auditing work, which had remained relatively stable; and demand for 'countercyclical' services such as insolvency work, which was up on a year earlier.

Manufacturing

Manufacturing output remained well down relative to the same period a year earlier. Many contacts had seen significant falls in demand from Autumn 2008, and had cut production more sharply than sales had fallen in order to unwind excess stocks. As noted above, export orders had contracted further in recent months (**Chart 3**). Domestic orders remained relatively weak, though in some parts of the United Kingdom, recent reports of weaker-than-anticipated domestic demand had been broadly balanced by reports of sales above contacts' (depressed) expectations.

The broad picture of substantial differences between subsectors had continued. Across the automotive and construction materials supply chains, the level of sales remained exceptionally weak. But, as in recent months, some other sizable subsectors — defence, pharmaceuticals and food processing — had experienced stable orders, or even some growth. There were further reports of slowing export orders in the aerospace sector.

Chart 3 Manufacturing output



Construction

Construction activity had continued contracting. For some time, sharp year-on-year declines in private house-building and commercial property activity have more than offset continued growth in public sector demand. And in recent months, there had been further reports that growth in public sector work was slowing, or that projects were being delayed.

Residential construction remained at very low levels. And commercial property activity had shrunk further in recent months as existing projects were completed while the pipeline of new projects remained negligible. Looking forward, contacts did not expect any recovery in the coming months. There was an excess of retail and office space in many parts of the United Kingdom. And the viability of prospective commercial property projects remained constrained by lower property valuations and the cost and availability of external finance.

Credit conditions

Trade credit

The availability and cost of trade credit insurance had continued to be cited frequently as a significant burden — particularly among firms supplying the retail, construction and automotive industries. As in recent months, many suppliers had responded to loss of cover by taking counterparty risk onto their own balance sheets, or demanding upfront payments, rather than by refusing orders.

Bank finance

Some contacts felt that the major British banks' appetite for lending had increased a little. However, this sense was by no means universal among contacts. As in recent months, many contacts had reported high costs of finance. The Agents had continued to hear of sharp increases in spreads and fees on renewal or extension of existing facilities. And there had been further reports that charges applied to undrawn facilities had been increased.

Employment

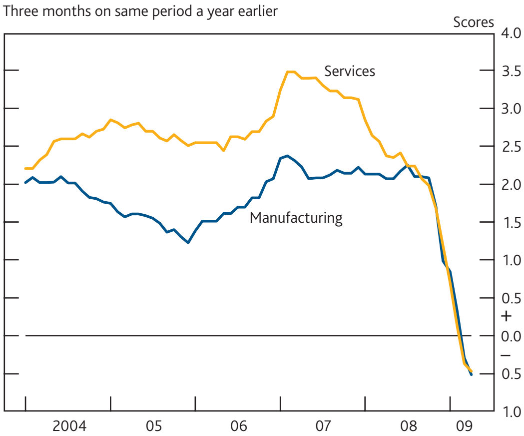
Labour demand had continued to shrink. Average hours had been cut through early 2009 — typically via reductions in overtime and the imposition of shorter working weeks. There had also been further reports of cuts to permanent staffing levels. Looking forward, some contacts felt that they had already adjusted employment levels in line with the weaker outlook for demand. And a small minority had resumed recruitment. But many others anticipated further redundancies. Overall, employment intentions remained weak.

Costs and prices

Labour costs

As in the April report, the broad picture was one of per capita labour costs being below their levels a year earlier (**Chart 4**). In part, that reflected cuts in average hours — with moves to shorter working weeks and cuts to expensive night and weekend shifts having a material impact on costs for some firms. Pay pressures had also eased, with recent evidence suggesting even weaker settlements than had been reported in the Agents' special survey on Pay Prospects earlier in the year. Reports of pay freezes had become more widespread and a growing minority of contacts had either imposed cuts to salaries or planned to do so. Settlements in excess of 3% remained rare.

Chart 4 Labour costs per head



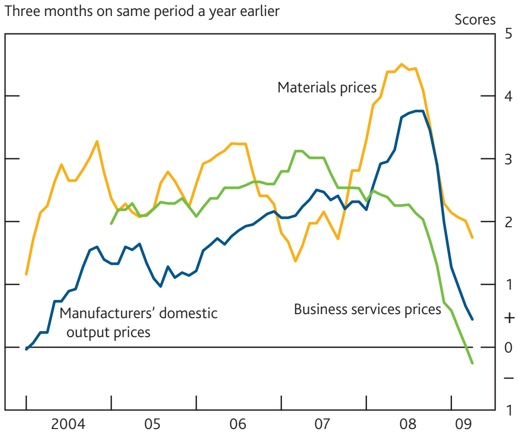
Non-labour costs

On average, there did not appear to have been much change in the rate of inflation in materials prices. Inflation in basic food prices remained elevated. But for other imported commodities the trend in price inflation was less clear, as lower global prices had pushed against the impact of sterling's depreciation. Until recently, contacts had reported year-on-year increases in energy costs as previous fixed-price contracts unwound. But in recent months, such reports had been balanced by reports of lower energy bills from firms on shorter contracts — reflecting falls in global spot prices through late 2008.

Output prices

The broad picture remained one of manufacturers' margins being squeezed, as many contacts had been unable to pass through the full impact of increases in costs in a climate of weak demand. There were, however, a few exceptions in industries where business failure had led to reductions in supply. The step down in demand through Autumn 2008 had led to downward pressure on a range of business services prices (**Chart 5**). There were widespread reports of absolute falls in fees and charge out rates. And in many parts of the United Kingdom, the excess of retail and office space had led to downward pressure on rents.

Chart 5 Input and output prices



Consumer prices

Consumer goods price inflation remained positive, but modest. On the downside, domestic energy prices had fallen through early 2009. And many retail contacts reported ongoing promotional activity — reduced in scope relative to the early part of 2009, but still significant relative to normal practice for the time of year. On the upside, inflation in imported finished goods prices remained elevated, with clear evidence of pass-through to higher food and electrical goods prices. Looking forward, some retail contacts expected upward pressure on non-food prices to intensify later in 2009, as stock purchased at exchange rates prevailing in 2008 unwound. For example, Spring 2009 fashions had been ordered in the summer of 2008 — before the sharp depreciation of sterling.