BANK OF ENGLAND

Agents' summary of business conditions

November 2009

- Consumer spending had grown during the third quarter, though some contacts described sales as volatile from week to week.
- Housing market activity remained above the very weak levels prevailing a year ago.
- Investment intentions remained muted — weighed down by the margin of spare capacity and uncertainty over demand.
- There had been a further slight improvement in the tone of reports from exporters.
- There was a clear sense that many contacts had completed any de-stocking needed to bring inventories down to levels commensurate with the lower level of economic activity.
- Manufacturing output had bottomed out during the summer, though some contacts found it hard to be confident of any trend in demand. While there were few reports of further contraction in business services activity, evidence of growth was patchy. Construction activity remained well down relative to the same period a year earlier.
- Availability of credit may have eased slightly — particularly for larger firms outside the property and construction sectors — but remained tighter than in mid-2008.
- Few contacts anticipated making substantial additional cuts to employment over the next few months as past cuts to headcount and average hours, coupled with lower pay settlements, had been sufficient to rein in labour costs.
- Per capita labour costs remained below their levels a year earlier and there were no signs of widespread inflation in materials costs.
- Consumer goods price inflation remained low but 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 September 2009 and late October 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.

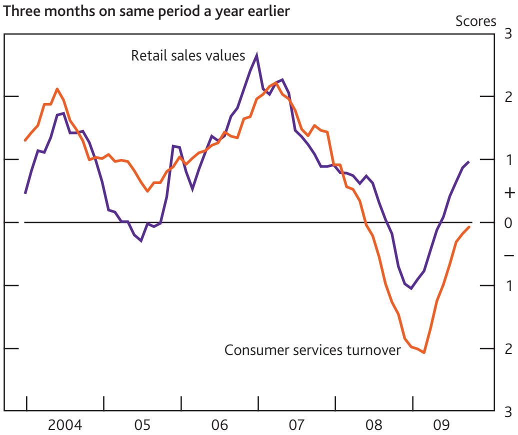
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

Many retailers reported that sales were up relative to the same period a year earlier (**Chart 1**). While twelve-month comparisons were increasingly seen to be dominated by exceptionally weak year-earlier comparators, the Agents' sense was that retail spending had grown during the third quarter. But some contacts described sales as volatile from week to week, and so regarded any recovery as fragile.

Chart 1 Consumer spending



Two themes of the weakness in consumer spending through the recession had been sharp falls in spending on big-ticket items, such as furniture, and a tendency for consumers to trade down towards cheaper brands. In recent months, there had been tentative signs that both themes may have started to unwind. Spending on big-ticket items had picked up slightly, albeit from a low base. And some discount retailers had reported loss of market share to mid-priced brands — though many retailers still regarded consumers as abnormally price-sensitive.

As had been the case for some time, demand for consumer services appeared weaker than for retail goods (**Chart 1**). More foreign tourists and UK residents had holidayed in the United Kingdom than normal — as evidenced by higher attendance at visitor attractions. But while visitor numbers were up, secondary spending at visitor attractions had fallen. And some attractions reported that demand had fallen back further than expected following the summer holidays. More generally, there was no sense of widespread growth in demand for consumer services.

New car sales had grown through the third quarter. Used car sales had not grown as fast, after having increased during the spring. And while there were very few reports of contraction in the value of used car sales, volumes may have been weaker given the rises in used car prices through the early part of the third quarter.

Housing market

As in recent months, the broad picture was one of a pickup in sales activity in new-build and secondary markets. But while activity had grown, the flow of transactions remained well down relative to levels prevailing in early 2008. First-time buyers were still described as scarce, reflecting the tightness in mortgage availability for those without substantial deposits. There were reports of growth in buy-to-let sales in some parts of the United Kingdom. But in some other areas, growth in overall demand was reported to have flattened out in recent months, as the current low level of transactions was all that could be supported by the available pool of buyers able to secure finance. Estate agents continued to describe the stock of houses for sale as small.

Business investment

Levels of capital expenditure were well down relative to pre-crisis levels. Looking forward, the majority of contacts described their investment plans as muted. But, as last month, there were more exceptions to that picture than there had been during the spring. Some contacts had reinstated plans for re-tooling to support new products. And for some, previous deferral of purchases of replacement equipment now required increased spending on maintenance.

As in recent months, the weakness of capital spending plans was widely attributed to firms' reluctance to commit to spending at a time when the outlook for demand was uncertain. Levels of spare capacity were sufficient that many saw no pressing need to invest in machinery or buildings. Financing constraints continued to be cited as a secondary factor pressing down on investment plans. Pushing the other way, low prices for physical capital and building work were cited as motivating spending.

Exports

There had been a further slight improvement in the tone of reports from exporters. The news through the third quarter had been that weakness in global demand was pressing down less strongly on sales than earlier in the year. The most recent reports from the Agents also suggested a greater impact from sterling's depreciation than had been the case earlier in the year, as some exporters saw more potential to compete for market share in an environment of stabilising, as opposed to collapsing, world demand.

Inventories

As last month, there was a clear sense that many contacts had completed any de-stocking needed to bring inventories down to levels commensurate with the lower level of economic activity. While there had continued to be exceptions — for example, in the construction equipment and materials sectors — there were also reports of re-stocking where inventories had previously been reduced too far. Looking forward, it was common to hear of plans to hold stock-sales ratios below previous norms. Consistent with such plans, manufacturers had observed their customers placing smaller but more frequent orders.

Output

Business services

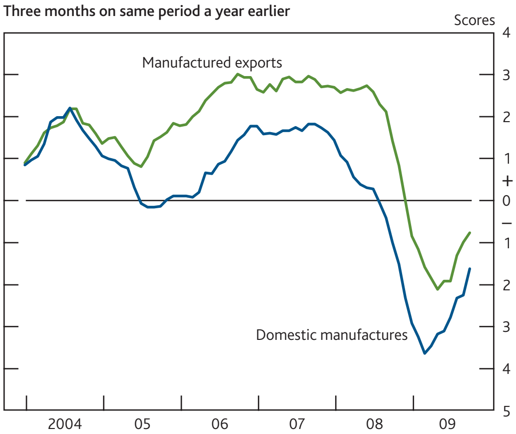
Most business services providers described demand as well down on the same period a year earlier. And for many, turnover had fallen more sharply than activity as fees had been cut. The fall in demand reflected the success of their customers' moves to cut their overheads in the wake of the sharp slowdown from Autumn 2008. Few business services providers reported any further contraction in demand through the third quarter, but evidence of growth remained patchy.

Manufacturing

The Agents' sense remained that manufacturing output had bottomed out during the summer. The improved tone of recent reports from exporters is described above. Many contacts also reported stabilisation or growth in domestic sales. And more generally, twelve-month comparisons were starting to be affected by weak year-earlier comparators — motivating sharp increases in the Agents' score (**Chart 2**).

Chart 2 Manufacturing output

Three months on same period a year earlier



But while the overall picture was one of stabilisation in output, there was a wide range of experience across contacts. In part, that reflected differences between subsectors. While food processors had seen further growth and consumer goods demand had picked up, global demand for aerospace products had only started to contract in the spring. The wide range of experience across contacts may also have reflected the volatility of orders from week to week. Several noted that customers were placing smaller, more frequent orders as part of their efforts to maintain low inventory levels. That had led to a reduction in forward order books that made it harder for manufacturers to identify trends in demand.

Construction

Construction activity remained well down relative to the same period a year earlier (**Chart 3**). While house building activity had picked up in the wake of the recovery in housing transactions, such work was described as small in scale — in line with the flow of housing transactions. Commercial property development had continued to shrink, with a negligible pipeline of new projects to replace completing work. Through 2009, public sector demand had proved critical to many construction companies. Recent intelligence suggested that such demand had continued through the third quarter.

Chart 3 Construction output

Three months on same period a year earlier

Credit conditions

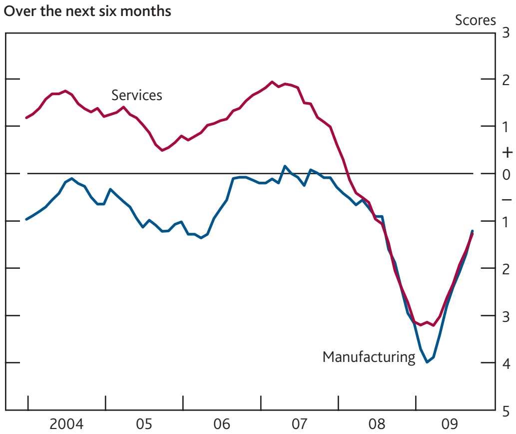
Regional banking sector contacts described their appetite for lending as having increased. And some non-bank contacts — in particular larger firms outside the construction and property sectors — felt that availability of finance had eased. But many others continued to report concerns over access to finance. The Agents' sense therefore remained that while credit conditions may have eased since the spring, they remained tighter than they had been in mid-2008.

There were very few reports of significant growth in bad debts on payments due to the Agents' contacts. Many were surprised at the relatively small increase in insolvencies through the recession so far. In part, that was attributed to support from cash-positive customers, in the form of early payment (for a discount on price). But many also attributed low insolvency rates to forbearance by creditors: banks were described as unwilling to foreclose where loan covenants were breached because collateral values were so low; some landlords had amended payment schedules to support clients; and Her Majesty's Revenue and Customs had permitted many firms to delay tax payments as part of their Business Payment Support Service. All these themes were long-standing, having been reported to the Agents over a number of months. Recently, however, contacts had raised concerns that the potential for further forbearance was limited.

Employment

There were further signs that the pace of decline in employment had eased through the third quarter. Relatively few contacts had announced significant cuts to headcount since late spring — though the Agents had heard occasional reports from firms whose redundancy programmes were sufficiently protracted that layoffs had yet to work through fully. More generally, many contacts had been able to reduce paybills temporarily through changes to average hours or cuts to expensive shifts. Looking forward, the pervading sense among contacts outside the construction sector was that any material rationalisation of their labour forces was substantially complete — so long as demand picked up in line with expectations. Many felt that any further headcount reduction could be accommodated by limits on replacement of departing staff. This mildly negative outlook is reflected in the Agents' forward-looking scores (**Chart 4**).

Chart 4 Employment intentions



Capacity utilisation

The pickup in demand through the summer had led to an increase in factor utilisation. But the overriding sense among contacts was that spare capacity remained pervasive, while those looking to recruit had not encountered any significant difficulties. Indeed, some noted that the relatively small increase in insolvencies had precluded any significant consolidation among suppliers, leaving a greater number with surplus capacity. However, despite that spare capacity, some were concerned that lack of working capital could constrain any rapid turnaround in production.

Costs and prices

Labour costs

As had been the case for some time, private sector contacts described their labour costs as down on the same period a year earlier. Most changes had been made earlier in the year, so that contacts visited in recent months simply echoed news reported earlier — namely, of pervasive cuts to average hours and widespread pay freezes. Looking forward, those contacts that were planning for their 2010 settlements expected pay growth to remain subdued in light of the prevailing low rates of inflation and labour market slack.

Non-labour costs

Recent intelligence had confirmed the Agents' impression that few contacts regarded materials costs as a significant issue for senior management at present. There was no clear trend across individual firms' reports of recent changes to materials costs. While there were some reports that sterling's recent depreciation had led to upward pressure — for example on chemicals prices — global spare capacity was widely described as offsetting much of the impact of the depreciation.

Output prices

There remained little sign of inflation in output prices. Substantial spare capacity continued to weigh against any recovery of margins to cover losses incurred earlier. As had been the case for some time, the downward pressure from spare capacity was seen most dramatically in business service pricing where rents and charge-out rates had been cut, and discounts were frequently offered to retain business. Most recently, however, higher fuel costs had led to an increase in haulage rates.

Consumer prices

The Agents' intelligence suggested that consumer goods price inflation had remained low, but positive. While there were some further reports of pass-through of higher import prices, the Agents had also heard from contacts that had opted to re-engineer products — for example, reducing product sizes — rather than shift pricing points. More generally, consumers were still widely seen to be abnormally price-sensitive so that any diminution of promotional activity in the wake of growing consumer demand had been marginal. Inflation in food prices had eased. And while twelve-month inflation rates in used car prices remained elevated, there were tentative indications that prices had stabilised over the past month.

Looking forward, some retailers expected inflation rates to pick up around the New Year as last year's deep discounting started to affect twelve-month comparisons. There was no clear message on prospects for pass-through in the wake of sterling's most recent depreciation. While some planned to be more aggressive in passing on any increase in costs at a time when stocks were tight, others argued that global spare capacity had enabled them to limit the pass-through to their own buying prices.