BANK OF ENGLAND

Agents' summary of business conditions

October 2009

- There had been little change to the picture of modest growth in consumer spending and housing market activity.

- Investment intentions remained muted, weighed down by the margin of spare capacity and uncertainty over the sustainability of any pickup in demand. But the number of exceptions to that depressed picture had grown through the summer.

- There had been a further slight improvement in the tone of reports from exporters.

- Most contacts had now completed the process of de-stocking, leaving relatively few still concerned that their inventories remained above sustainable levels.

- Manufacturing output appeared to have stabilised. And a growing number of business services providers had reported a pickup in demand. Construction activity remained severely depressed despite a small-scale increase in house building.

- Some larger firms had experienced easier credit conditions. But many other firms still perceived credit supply to be very tight.

- The pace of decline in employment had eased. A special survey of the Agents' contacts suggested that few expected to make substantial cuts to headcount over the next few months (see box).

- Per capita labour costs remained below their levels a year earlier. There was no clear directional sense to firms' reports of changes in their materials costs.

- Consumer goods price inflation remained low, but some prices had drifted up in recent months.

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 August 2009 and late September 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

Consumer spending had grown modestly over the past few months, with mounting evidence of a pickup in sales of consumer durables. One theme of the weakness in consumer spending through the recession had been a sharp reduction in sales of big-ticket items, such as furniture. While furniture sales remained well down on pre-crisis levels, the Agents had heard widespread reports that demand had ticked up. Trading down towards cheaper brands was another major theme of the recent slowdown. The Agents had continued to hear reports of relatively weak demand for premium brands. And retailers still regarded consumers as more price-sensitive than they had been prior to the crisis. But recently, there had been tentative signs that some consumers were switching back towards more expensive brands.

Demand for consumer services was weaker than that for retail items — though here too, the trend in recent months had been towards less negative reports. As had been the case for some time, there was widespread evidence of growth in domestic tourism. Outside the tourism sector, there were reports of growth in sales at pubs and restaurants and of a pickup in household demand for professional services. But such reports remained patchy and any growth was described as coming from a low base.

Housing market

There had been further modest growth in housing market activity. It had become easier to secure mortgages for those able to place a significant deposit. But estate agents felt that credit remained tight for other clients — 'headline' products at higher loan to value ratios typically required strong credit scores. As a result, the number of first-time buyers was widely regarded as low relative to pre-crisis flows.

Business investment

Contacts had continued to describe their capital expenditure as sharply down on previous years, with frequent reports of deferral or cancellation of previous plans. Looking forward, most contacts planned to keep the level of capital expenditure relatively muted — albeit with few plans for further shrinkage from current weak levels of expenditure. But the number of exceptions to that depressed picture had grown, with more reports of plans for hotel or retail refurbishment and some re-tooling by consumer-facing manufacturers. Coupled with a broader sense that there were fewer plans for further sharp cuts in capital expenditure from current weak levels, these reports had motivated an increase in the Agents' forward-looking scores for investment intentions (**Chart 1**).

Chart 1 Business investment intentions

The weak level of capital spending plans was widely attributed to the significant margin of spare capacity suffered by most firms and to their reluctance to commit to spending at a time when the outlook for demand was highly uncertain. Financing constraints continued to be cited as a secondary factor.

Exports

There had been a further slight improvement in the tone of recent reports from exporters, as weakness in global demand was pressing down less heavily on sales than had been the case earlier in the year. There were further reports of growth in demand from the Far East. And many — but not all — had seen some pickup in demand from the euro area. However, reports of stabilisation in demand were far from uniform — for example, aerospace orders had fallen off in recent months. And most exporters' sales remained below pre-crisis levels. There had been no change to contacts' perceptions of the impact of sterling's earlier depreciation on demand. Some had seen improvements in competitiveness. But a significant number reported higher sterling prices, and hence enhanced margins rather than increases in market share.

Inventories

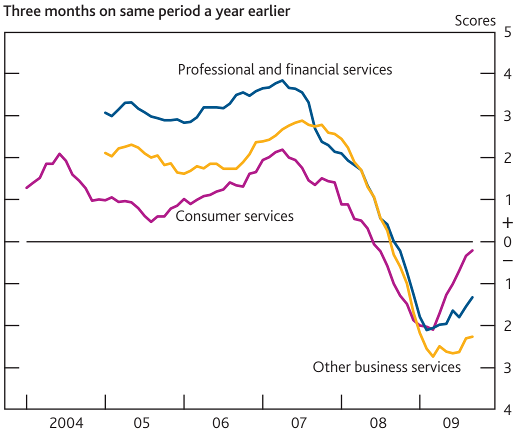
Most contacts had now completed the process of de-stocking, leaving relatively few still concerned that their inventories remained above sustainable levels. While there were a few exceptions where de-stocking remained significant — for example in the aerospace and construction materials industries — these were balanced by reports of re-stocking where inventories had fallen to uncomfortably low levels. Looking forward, many contacts planned to hold stock-sales ratios below previous norms, in light of both the cost of working capital and uncertainties over the outlook for demand.

Output

Business services

During the summer, a growing number of business service providers had described a pickup in demand (**Chart 2**). But evidence of stabilisation in business service activity appeared more tentative than was the case for consumer spending or manufacturing output.

Chart 2 Services turnover



There were some reports of increased demand for services related to corporate finance and property investment — as asset prices were now sufficiently low to be attractive to potential investors. A growing number of accounting and legal services providers reported a pickup in activity. And some haulage and logistics companies had seen growth in demand as the stock adjustment had run its course. But weighing against these reports of a pickup in demand for business services, many contacts noted that any growth had come from a low base. And sharp reductions in fees and charge-out rates were weighing down on some firms' turnover despite stabilisation in activity. There was little evidence of any growth in corporate discretionary spending, for example on conferencing.

Manufacturing

Manufacturing output appeared to have bottomed out through the summer, though activity remained well down relative to the same period a year earlier. Food processors had continued to report growth in sales. The success of European car scrappage schemes had led some of the major manufacturers to increase global production and therefore orders for components. And many others had seen a modest increase in orders as their customers were no longer looking to de-stock. The aerospace and construction materials sectors remained exceptions to the sense of stabilisation in demand.

Looking forward, contacts described forward order books as 'short'. The strategic push to minimise inventory holdings had led to more frequent but smaller orders for components and finished goods. In turn, that had left the flow of orders more volatile from week to week than had been the case prior to the crisis.

Construction

Construction activity remained severely depressed. Commercial property work had shrunk throughout 2009 as long-term projects completed with no replacement work in the pipeline. That picture had not changed in recent months. While reports of resumption of residential building work had become more widespread through the summer, such activity was still widely regarded as small in scale.

Over the past year, public sector demand had provided a backstop for some construction companies. Looking forward, however, many contacts were planning on the basis that there would be sharp cuts in public capital expenditure. There were some reports that this had led construction companies to change their own spending decisions — for example, by hiring rather than buying any new equipment.

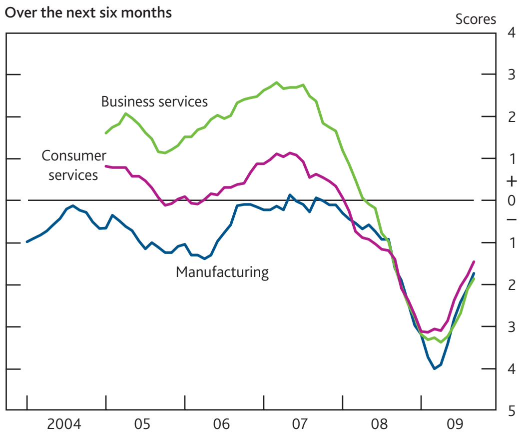
Credit conditions

There had been a further flow of reports from large firms that had successfully accessed non-bank finance. And some contacts felt that banks' appetite for renewing facilities had increased through spring and summer. But despite these tentative signs of slightly easier credit, the Agents' intelligence suggested that the net flow of bank lending had remained negative in recent months. There had been further reports from contacts that had paid down debts. And low capital spending meant little demand for project finance. One reason for low demand for finance was its perceived high cost. Over and above the cost, there was still a perception — particularly among smaller firms and those linked to the construction and property sectors — that credit was hard to access at any price. Management of working capital had continued to dominate many contacts' agendas during their meetings with the Agents.

Employment

The pace of decline in employment appeared to have eased through the summer. Looking forward, the majority of contacts did not plan to make further significant cuts to employment over the next few months. The major exceptions were the construction sector — where firms expected further falls in activity — and the financial sector, where further consolidation was expected in the wake of recent mergers. This picture of few plans for substantial cuts had been corroborated by a recent survey of the Agents' contacts — see box — and had been reflected in increases in the Agents' forward-looking scores for employment intentions (**Chart 3**).

Chart 3 Employment intentions

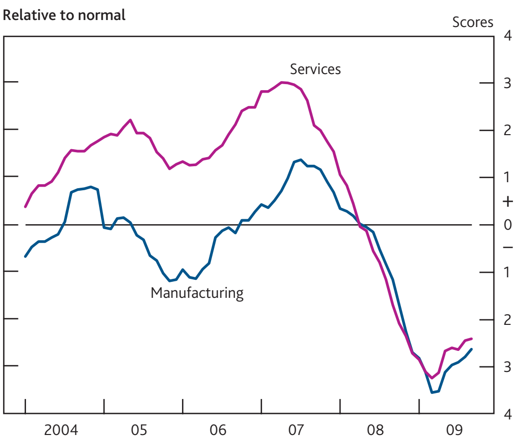


But while there were few plans for further big cuts, there were also few plans for significant expansion in headcount. Some contacts noted that they could expand their use of labour by simply unwinding earlier moves to shorter hours. Others reported tight restrictions on recruitment of permanent staff or new graduates, pending evidence that any recovery in demand will be lasting.

Capacity utilisation

There was widespread spare capacity throughout the United Kingdom. A pickup in demand through the summer had led some firms to reinstate mothballed capital or to reverse earlier cuts to working weeks. That slight increase in factor utilisation had been reflected in modest increases in the Agents' scores (**Chart 4**). But the overriding sense among contacts was that any prospective increase in demand could be met comfortably with available resources.

Chart 4 Capacity utilisation



Costs and prices

Labour costs

There had been little change to the picture painted by private sector contacts visited earlier in the year. Per capita labour costs were widely reported to have fallen during 2009. The recent Agents' survey showed that a substantial proportion of firms had cut average hours during 2009. It remained rare for contacts to report pay settlements in excess of 3% — indeed, around half had instituted pay freezes. Looking forward, some contacts had started planning for their 2010 settlements. There were few plans for above-inflation increases during 2010.

Non-labour costs

Few contacts regarded materials costs as a significant issue for senior management at present. The bulk of any impact of sterling's earlier depreciation appeared to have been passed through to material prices already as contracts had expired earlier in the year — indeed, some contacts had already seen falls in price motivated by sterling's appreciation during the spring. More generally, the Agents' recent intelligence had been dominated by idiosyncratic factors specific to particular commodities.

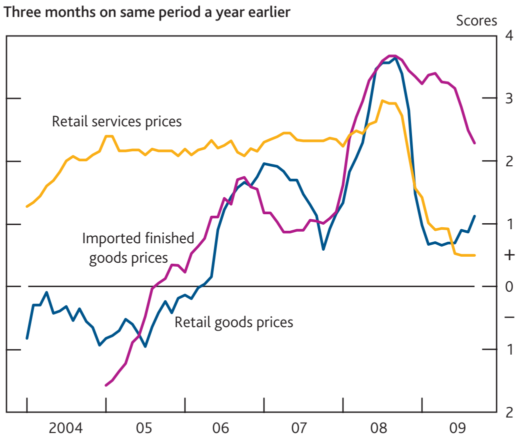
Output prices

There was little evidence of inflation in manufacturers' output prices. The substantial degree of spare capacity weighed against any recovery of margins to cover losses incurred earlier. The downward impetus from spare capacity was seen more dramatically in business services pricing. In recent months, there had been widespread reports of cuts in fees, across a range of professions. Commercial rents were widely described as under acute downward pressure.

Consumer prices

While inflation in retail goods prices had remained low, some prices had drifted up in recent months (**Chart 5**). Fuel prices were higher than earlier in the summer. Car prices had continued to increase. And reports from non-food retailers also pointed towards slightly higher inflation — some described further pass-through of higher import prices to retail prices and some had reduced the intensity of promotional activity as stocks had cleared. Promotional activity had remained significant across a range of consumer services.

Chart 5 Retail and imported finished goods prices



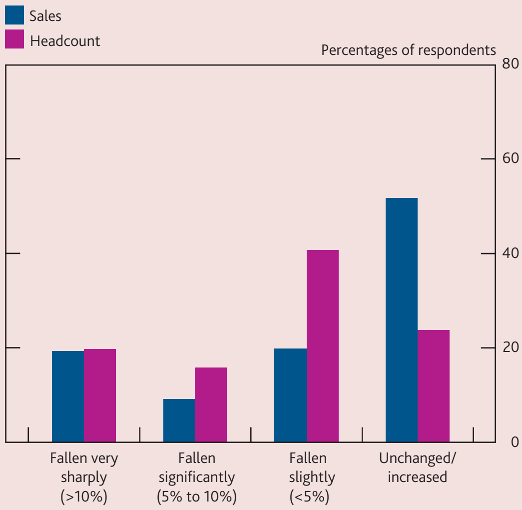
Looking forward, some retailers expected year-on-year data to show a pickup in twelve-month inflation rates early in the New Year as the impact of last year's abnormally deep Christmas sales dropped out of the calculations. But there were also signs that prospective upward pressure from higher import prices had diminished. While some retailers planned to increase prices for imported goods through the autumn, some others had scaled back their plans for pass-through in the wake of consumer resistance to earlier price increases. Inflation in imported finished goods prices had also eased — in part due to the impact of surplus capacity on foreign currency prices.

Agents' survey on employment

Official data suggest that employment has not fallen as far relative to output as it had at similar points in the 1980s or 1990s recessions. It is possible that employment is taking longer to respond to the weakness in output in the current recession. But it is also possible that adoption of flexible working practices and moderation in pay growth have helped limit the fall in employment.[1] To explore this issue, the Agents conducted a survey of more than 450 of their private sector contacts, operating in a range of industries. All figures reported are weighted by total employment.

Respondents were asked how their sales and their employment had changed over the past twelve months. Around three quarters reported cuts to their staffing levels — in one fifth of cases, these amounted to more than 10% of the total workforce (**Chart A**).

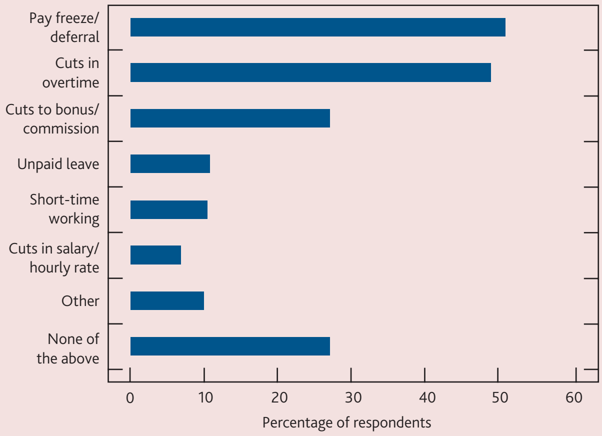
Chart A Change in employment and sales over the past twelve months



Cuts to staffing levels were reported across all industries, but appeared most significant in the construction sector, where more than 90% of the sample had made cuts. Evidence of widespread falls in employment was not surprising — during the first half of the year, the Agents had heard many reports of sharp reductions in employment. One puzzle in the responses was that fewer firms reported falls in their sales than in their headcount.

Respondents were also asked about their use of a range of changes to pay and conditions — that is, their use of flexible working practices in cutting labour costs. Around three quarters had made changes to pay or working hours (**Chart B**). Just over half the sample had implemented pay freezes — consistent with reports to the Agents throughout the year. Cuts in bonus and commission schemes were also fairly common. As well as making changes to remuneration, many firms had cut working hours — most often through cuts in use of overtime.

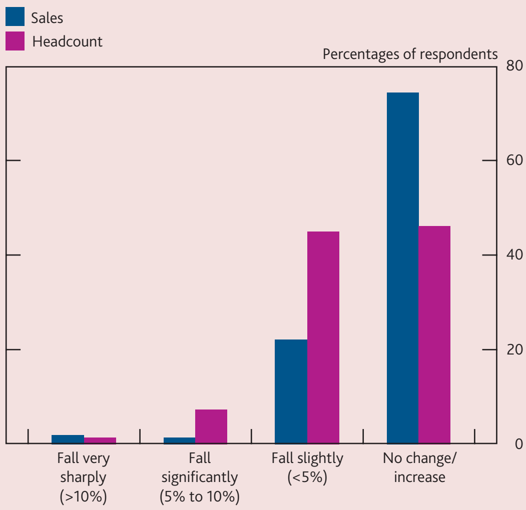
Chart B Changes to pay and conditions made over the past twelve months[(a)]



(a) Respondents could tick more than one box.

Looking forward, respondents were asked how they expected their sales and headcount to evolve over the next six months. Only a quarter expected sales to fall further — consistent with the Agents' broader intelligence that the level of output appeared to have stabilised during the summer. More respondents expected to cut employment further. But, in contrast with their reports of experience over the past twelve months, very few expected to make substantial cuts to headcount.

Chart C Changes in employment and sales expected over the next six months



(1) For a fuller discussion of the picture of employment and output painted by official data, see the box 'Employment and output in the current recession' on page 29 of the August 2009 *Inflation Report*.