BANK OF ENGLAND

Agents' summary of business conditions

September 2009

- Consumer spending had grown modestly.
- The recovery in housing market activity had continued.
- Investment intentions remained weak, though somewhat less so than at the trough of the recession.
- The rate of contraction in export volumes had slowed.
- The extent of de-stocking had continued to moderate and the majority of contacts now judged the de-stocking cycle to be drawing to a close.
- There was more evidence that manufacturing and service sector output had stabilised. Construction activity had continued to shrink.
- While some larger firms had made successful rights issues, a significant number of small firms had continued to encounter difficulties in securing bank funding.
- Employment intentions were less negative than earlier in the year — a growing proportion of contacts judged that the cuts in staffing they had already made would be sufficient so long as demand conditions did not deteriorate.
- Per capita labour costs remained lower than the same period a year earlier. Annual inflation in materials costs had eased further.
- Spare capacity had continued to press down on prices of business services and manufactured output — both of which were lower than the same period a year earlier.
- Consumer goods and services price inflation remained low but positive. Over the past few months, the scope of promotional activity had been scaled back as retailers had cleared excess stocks.

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 July 2009 and late August 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.

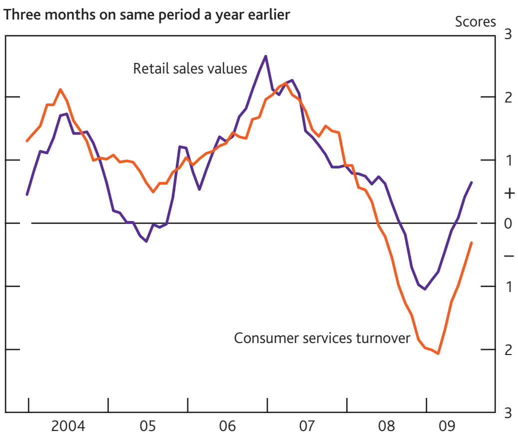
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

Growth in retail sales had strengthened in recent months (**Chart 1**). Growth in the value of food sales remained strong. And while sales of 'big ticket' items — such as furniture and white goods — remained lower than the same period a year earlier, there had been a modest pickup in demand in recent months.

Chart 1 Consumer spending



Sales of new cars had continued to grow. A number of car dealerships attributed the recent growth in demand to the government scrappage scheme. Growth in used car sales had remained at the higher levels seen in recent months, though there had been some reports of stock shortages. In part, those shortages reflected the decline in demand for new cars earlier in the year, which had led to a reduced supply of part-exchange vehicles.

Demand for consumer services had increased in recent months, leaving the level of activity broadly unchanged on the same period a year earlier (**Chart 1**). Contacts had continued to report growing spending on domestic tourism, which most attributed to increased numbers of people holidaying in the United Kingdom. Demand for housing-related services — such as mortgage finance and home removals — had also picked up in recent months, in the wake of the recovery in housing market activity through much of 2009. And applications for further education places had risen as school leavers deferred entering the labour market.

Housing market

The pickup in primary and secondary housing market activity had continued, with further growth in housing completions from the depressed levels seen earlier in the year. Growth in demand had been most marked for the cheapest properties. That reflected growth in demand from buy-to-let investors, a marginal improvement in access to mortgage finance for first-time buyers and the impact of government schemes such as HomeBuy. As demand had grown, the Agents had heard an increasing number of reports of shortages in the number of properties for sale. Estate agents described the flow of new instructions to sell as low. And house builders had largely cleared their stock of unsold properties. Low supply had led to an increase in prices in recent months.

Business investment

Most contacts had cut investment significantly over the past year. As had been the case for some months, contacts typically reported that any capital expenditure was limited to maintenance, relatively small-scale investments in IT, or projects necessary to ensure regulatory compliance.

Looking forward, investment intentions remained weak, though somewhat less so than at the troughs of the recession. Most contacts planned to keep the level of capital expenditure low relative to a few years earlier — driven primarily by the conjunction of high levels of spare capacity and expectations that demand would remain weak. Contacts expected falling occupancy of retail units, office space and warehouses to delay any recovery in investment in commercial property.

Exports and imports

There was mounting evidence that the pace of contraction in exports had eased in recent months — reflected in an increase in the Agents' score for manufactured export volumes (**Chart 2**). While exports remained lower than the same period a year earlier, exporters of durable goods had seen some recovery in demand. Sterling's earlier depreciation had led to improvements in competitiveness for many firms. And some felt that the downward impetus to demand from global moves to cut inventories had begun to ease. The modest recovery in demand had been apparent in most export markets, but especially in the Far Eastern emerging economies.

Chart 2 Manufacturing export volumes

The broad picture remained one of import volumes down relative to the same period a year earlier. Over and above any impact of weak domestic demand, the Agents had continued to hear from contacts that were switching to domestic suppliers of components and finished goods. Most attributed this to sterling's earlier depreciation. But some had switched in order to reduce the length of supply chains — thereby minimising inventories.

Inventories

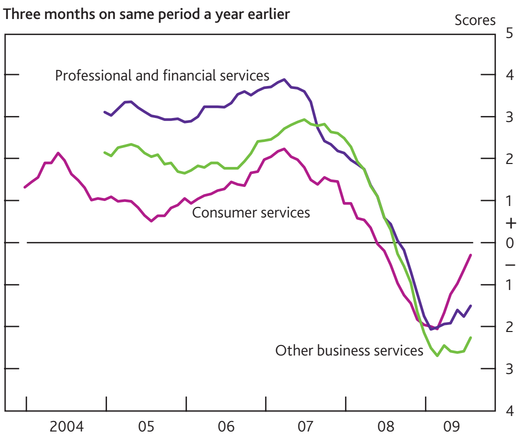
Most contacts reported that they had now unwound any excess inventories. Indeed, a few were concerned that their suppliers had cut inventories too far, with emerging signs of stock shortages. Looking forward, many contacts expected to hold stock levels below recent norms. That followed from both the weakness of expected demand and a strategic push to reduce their dependence on external finance.

Output

Services

Demand for consumer services had increased in recent months, as described above. There was some evidence that demand for business services had stabilised, with further reports that turnover had flattened off after earlier falls — though such reports remained far from universal (**Chart 3**).

Chart 3 Services turnover



A number of logistics companies had noted a slight pickup in activity from a low base. That pickup was driven by increases in orders for components and finished goods following the intense bout of de-stocking earlier in the year. While corporate discretionary spending on business travel and conferences had continued to be cut back, the rate of decline was much reduced.

In the professional and financial services sector, there was mounting evidence that demand for services related to corporate finance and property investment had stabilised after an extended period of severe decline. Public sector demand for consultancy services had strengthened further, as had corporate recovery, insolvency and restructuring work. By contrast, landlords reported declining occupancy of commercial property and a greater preponderance of rent reductions and deferrals. And public relations and advertising budgets remained depressed.

Manufacturing

Many manufacturers had reported some growth in output, albeit from depressed levels. The modest recovery in export demand is described above. Consumer-facing contacts also reported a pickup in domestic orders — car production being a notable example. By contrast, demand for capital goods — especially those with long lead times such as in aerospace and power generation — had continued to weaken. Looking forward, many contacts described the flow of orders as erratic, so that few were confident that any pickup in demand would be sustained.

Construction

The picture remained one of depressed and shrinking construction activity. Throughout 2009, contacts had described contraction in commercial property work as the pipeline of new office, retail and warehouse developments remained well down on recent years. That trend had continued. By contrast, public sector demand was a little above the same period a year earlier. While the number of healthcare projects was declining, spending on student accommodation and large civil and infrastructure projects had increased. Looking further forward, many contacts were planning on the basis of slowing public sector demand.

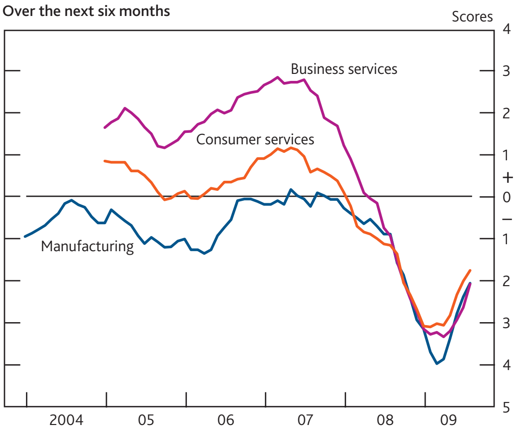
Credit conditions

There were further reports from large firms that had been able to access non-bank finance. And some contacts felt that banks had become more willing to support large firms, for example by renegotiating the covenants of highly indebted companies to avoid crystallising losses on those loans. But contacts thought that banks were reluctant to increase their exposure to commercial property, construction, retail and motor dealers — sectors that had accounted for much of their lending growth in the past. And the Agents had continued to hear from smaller firms that had encountered difficulties in securing bank finance or whose directors had been asked to put up more of their personal assets as guarantees for additional loans. Taken together, the Agents judged the availability of credit to have become marginally looser in recent months.

Employment

While there had been further reports of cuts to employment, the rate of labour shedding had eased. Looking forward, a growing number of contacts judged that the downward adjustments they had already made to the size of their workforces would be sufficient, provided there was no further contraction in demand for their goods and services. That was reflected in a further upward adjustment to the Agents' forward-looking scores for employment intentions (**Chart 4**). Despite the recent pickup, those scores remained significantly negative, in part reflecting contacts' views that corporate failures would rise further in the near term.

Chart 4 Employment intentions



Costs and prices

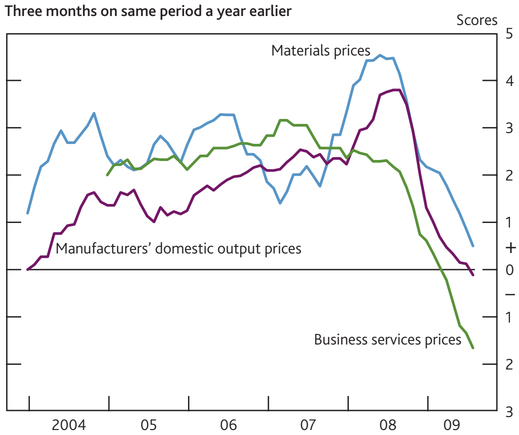
Labour costs

Per capita labour costs were widely reported to be lower than the same period a year earlier. Reports of pay freezes had become increasingly common. The number of pay cuts had also increased — albeit to a much less degree. Of those firms that had made a positive award in 2009, most expected to reduce the size of the settlement next year. As had been the case for some time, the Agents were told that total per capita labour cost inflation had been further depressed by reductions in overtime, commission payments and bonuses. An increasing number of firms were planning to close their final salary pension schemes to existing members.

Non-labour costs

Inflation in materials costs had slowed further (**Chart 5**). Contacts ascribed this to weak global demand, sterling's recent appreciation against the US dollar and the expiry of fixed-price contracts taken out during 2008's spike in commodity prices. Looking forward, however, many contacts were planning on the basis that the recent strengthening of the world economy and the pickup in oil prices would lead to increases in materials costs.

Chart 5 Input and output prices



Output prices

Spare capacity had continued to press down on the prices of business services and manufactured goods, reflected in a drift down in the Agents' scores (**Chart 5**). That had been most marked for business services, where most contacts had reported prices down relative to the same period a year earlier. Many professional service providers had cut fees and charge-out rates; hotel room rates and air travel prices had fallen; and the excess of retail and office space had led to downward pressure on rents. Manufacturers had also reported that their output prices were under downward pressure. But with very low gross profit margins, many had sought to resist that pressure, so that the trend in prices was less stark than was the case for business services.

Consumer prices

As had been the case for some time, consumer goods price inflation remained low, but positive. New car prices had continued to rise as dealers passed on manufacturers' price increases. And there had been some further reports of pass-through of higher import prices. Some contacts anticipated further pass-through in the autumn. But as in the previous report, others had scaled back plans for future pass-through having been surprised by the sensitivity of demand to recent changes in price. There was further evidence that the downward pressure from widespread promotional activity had eased as consumer demand had picked up and retailers had cleared excess stocks. A similar picture was evident in the services sector, where the slight improvement in consumer demand in recent months had ameliorated earlier downward pressure on price inflation.