BANK OF ENGLAND

Agents' summary of business conditions

January 2010

- Over the Christmas period, most retailers had experienced stronger demand than during the same period a year earlier (see box).
- In most parts of the United Kingdom, the gradual pickup in housing market activity had continued.
- While investment intentions remained muted, few firms planned a second round of sharp cuts following last year's sizable reductions in spending.
- An increasing number of contacts had reported growth in exports relative to the same period a year earlier.
- Many contacts planned to maintain their inventories at low levels after a bout of de-stocking earlier in the year.
- Business services and manufacturing output remained down on the same period a year earlier. While there were few reports of further contraction in recent months, there was no consistent sense of robust recovery in activity. Construction remained severely depressed.
- Credit conditions had eased during the second half of 2009, though that loosening had not been experienced uniformly across contacts.
- Few firms were planning actively for further material cuts in employment. But few were looking to recruit significant numbers of permanent staff — the typical response to any growth in activity being to reverse previous cuts to average hours or make use of temporary staff.
- Pay growth was expected to remain subdued through 2010. Inflation in materials costs remained low, but was expected to rise over the next year.
- Consumer goods price inflation remained low, but positive. Looking forward, most retailers planned to pass at least a part of the 1 January 2010 increase in VAT on to their customers (see box).

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 November and late December 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

Retailers had continued to report sales ahead of their levels a year earlier. In part, that reflected last year's weak comparators, with twelve-month growth rates further flattered by gains to market share in the wake of retail failures earlier in the recession. Looking through seasonal variation, many Agents sensed that sales had grown through the second half of 2009. And a number of contacts had reported strong sales in recent weeks — an impression reinforced by the results of an Agents' Special Survey on retail trading over the Christmas period (see box).

There were widespread reports of growth in sales of big-ticket items — such as white goods and home furnishings — corroborating the impression given by earlier reports. Some retailers attributed this growth to the pickup in housing market activity through much of 2009. But some also felt that customers had brought spending forward in anticipation of the forthcoming rise in VAT. That had contributed to retailers' concerns that sales could fall back during early 2010.

New car sales had continued to grow. The increase in sales was widely attributed to 'transient' factors — the scrappage scheme and customers bringing spending forward ahead of the VAT rise. Used car sales had been broadly stable in recent months.

Consumer services turnover appeared less weak than earlier in the year. Demand for housing-related services — such as removals work — had picked up as the number of housing market transactions had risen. Many leisure services providers reported growth in footfall, though spending per visit was described as down relative to pre-recession levels. The profile of demand for consumer services remained weaker than that of retail sales.

Housing market

The gradual increase in housing market activity had continued in most parts of the United Kingdom. But that growth had come from a low base so that transactions remained well down on pre-crisis levels. As had been the case throughout the year, first-time buyers were widely described as scarce and the stock of properties for sale as low. While the Agents had continued to receive reports of marginal easing in mortgage availability, many estate agents still regarded the availability of finance as a drag on activity.

Business investment

Recent intelligence on investment plans had been in line with the picture painted by last month's Agents' Special Survey on capital spending. On the upside, some major retailers planned to maintain their programmes of store expansion and refurbishment. And some utility companies expected to raise capital spending in line with the new regulatory investment cycle. More generally, while most contacts described their investment plans as muted, few planned a second round of sharp cuts following last year's sizable reductions in spending. As a result, base effects were increasingly seen to be influencing twelve-month comparisons — motivating further increases in the Agents' scores, to less negative levels (**Chart 1**).

Chart 1 Business investment intentions

Spare capacity and concerns over the sustainability of any growth in demand continued to be cited frequently as factors holding investment below 'normal' levels. Indeed, where firms did plan to grow their capital spending, investment was typically focused on improving efficiency rather than supporting increased output. Reluctance to draw on cash reserves had continued to be cited fairly often as a secondary factor pressing down on investment.

Exports

An increasing number of contacts had reported growth in exports. There were, however, significant differences in experience between sectors and markets. As had been the case through much of 2009 H2, demand from developing economies had grown. But reports of trends in demand from the euro area and the United States had been more mixed. Moreover, any growth in external demand had come from a low base — the level of world demand was still seen to be well down on pre-recession levels.

It had become more common to hear reports of sterling's depreciation leading to growth in export orders. This reflected a number of factors. For some, fixed-price contracts had delayed price adjustment earlier in the year. Additionally, some saw more potential to compete for market share than they had when global demand was 'collapsing'. For example, some exporters had increased spending on marketing, after sharp cuts earlier in the recession.

Inventories

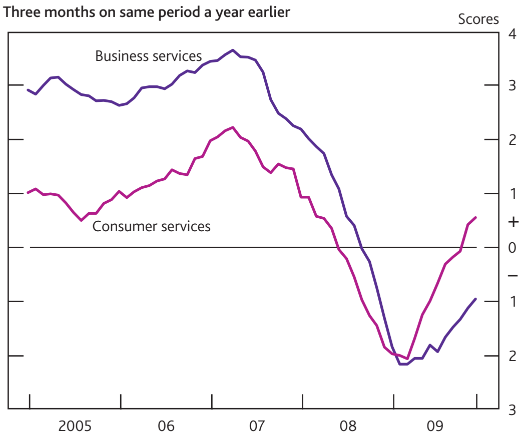
Many contacts described their inventory levels as lower than normal, after a bout of de-stocking earlier in the year. Most planned to hold stocks at low levels — either because of improvements in inventory management put in place during the recession, or because pressures on working capital remained intense and the outlook for demand uncertain.

Output

Business services

The broad picture had not changed materially during the fourth quarter. It had been rare to hear of significant further falls in demand through the second half of 2009. And the Agents had heard further reports from contacts whose activity had grown over the past few months. But there was no consistent sense of robust recovery in demand across any subsectors. The overarching impression was of patchy and volatile demand, with customers managing their overheads extremely tightly. Turnover appeared more subdued in the business services sector than the consumer services sector, reflected in a divergence between the Agents' scores (**Chart 2**).

Chart 2 Services turnover



Manufacturing

Throughout the second half of 2009, reports from manufacturers had painted an increasingly clear picture of demand having bottomed out during the summer. In recent months, the Agents' sense was that reports of quarter-on-quarter growth had outweighed those of shrinkage. But there was still no sense that growth had picked up at all strongly or consistently, with contacts continuing to complain of short order books and volatility in demand. Reports of growth in activity were most common among consumer goods manufacturers, food processors, and those in the automotive supply chain.

Construction

Construction activity remained well down relative to the same period a year earlier — the sector was the most depressed by some margin. Commercial property activity remained particularly weak, with no material pipeline of replacement work for projects that were completed. However, spending on repair and maintenance work had grown. And some house builders had resumed land purchase programmes. But while there had been further widespread reports of growth in house building, such growth was from a low base, with some reports of activity below half of pre-recession levels.

Throughout 2009, public sector construction projects had provided a key source of revenue for many firms. While many were concerned about prospects for public spending, there were few reports of any slowdown as yet.

Credit conditions

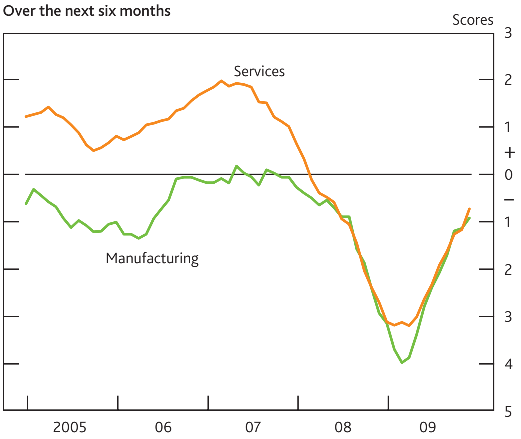
The Agents' sense was that the availability of finance had improved slightly through the second half of 2009. A growing number of firms had been able to raise funds in capital markets. And, on balance, the availability of bank credit had increased marginally. But, as had been the case for some time, contacts' experiences (and expectations) of credit conditions varied markedly according to their sector and size. For example, reports of improved access to finance were more prevalent among larger companies, particularly those with lower levels of gearing. By contrast, reports of improved credit conditions from smaller businesses, and those operating in the construction and property sectors, were less common. Demand for bank finance had remained muted as many firms chose to pay down debts.

Employment

There had been little change to the broad picture of a slowing rate of decline in employment. While there continued to be sporadic reports of significant redundancies, such reports were rarer than they had been earlier in the year. There were, however, few reports of growth in employment — where firms' sales had picked up, it was more common to hear of moves to hire temporary staff or reverse earlier cuts to average hours than of recruitment of permanent staff.

Looking ahead, the outlook for employment continued to improve slightly, as reflected in a further tickup in the Agents' scores (**Chart 3**). Barring a further fall in demand, few firms were planning significant additional cuts to staffing levels. But at the same time, there were very few plans for any substantial recruitment of permanent staff — the majority of contacts expected headcount to remain broadly stable over the coming months, with any growth in activity supported by use of temporary employees and increases in average hours.

Chart 3 Employment intentions



Capacity utilisation

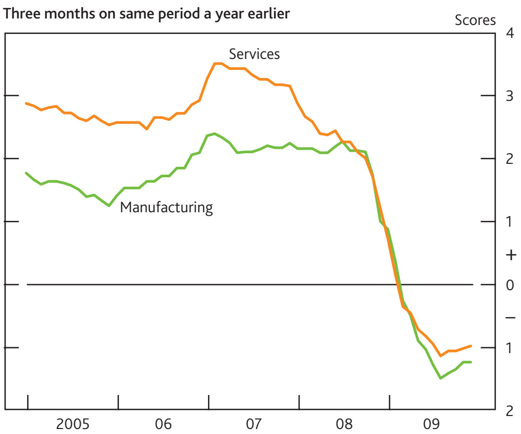
The recent pickup in some firms' sales had led them to increase capacity utilisation — for example by relaxing overtime bans, or unwinding short-time working arrangements. But the broad picture remained one of widespread spare capacity. Looking forward, few contacts anticipated any marked increase in demand over the next few months. As a result, capacity constraints were rarely expected to bind in the near term.

Costs and prices

Labour costs

Private sector contacts continued to describe their per capita labour costs as down relative to the same period a year earlier. Many had frozen pay during the year. And many had restricted overtime or introduced short-time working arrangements — for them, per capita labour costs had fallen sharply as a result. While some had responded to growth in demand by reversing earlier cuts to average hours, there were still plenty of examples of short-time working. As a result, the Agents' scores remained negative (**Chart 4**).

Chart 4 Labour costs per head



Looking forward, those that were planning for their 2010 settlements expected pay growth to remain subdued. But the Agents' sense was that a marginally greater number of contacts planned to offer positive awards than had been the case a few months earlier. Nevertheless, many still expected to freeze pay — in some cases, offering one-off payments to recognise improved demand, rather than committing to permanent increases in pay. And where positive awards were planned, it was very rare to hear of moves to make awards in excess of 2%.

Non-labour costs

On average, inflation in materials costs was muted. On the downside, many contacts had reported lower energy bills than a year earlier, while inflation in basic foodstuffs had eased. On the upside, diesel prices had risen through the second half of 2009, as had the price of oil-based products such as plastics. And cutbacks in global supply had reportedly led to increases in the price of some commodities, including metals and Scandinavian timber. The incidence of such reports had increased in recent months.

Looking forward, many contacts expected inflation in materials costs to rise as recovery in global demand impacted both on spot commodity prices and on suppliers' incentives to negotiate on pricing. However, sterling's depreciation was widely regarded as being already passed through to materials prices.

Output prices

Substantial spare capacity continued to push down on output prices. That pressure remained most clearly evident in the construction sector and for business services providers — where reports of discounting and fee negotiations were widespread.

Consumer prices

The Agents' intelligence continued to suggest that inflation in consumer goods prices remained low but positive. On the upside, petrol prices had risen and the Agents had continued to hear reports of pass-through of higher imported goods prices. On the downside, twelve-month inflation in food prices had eased.

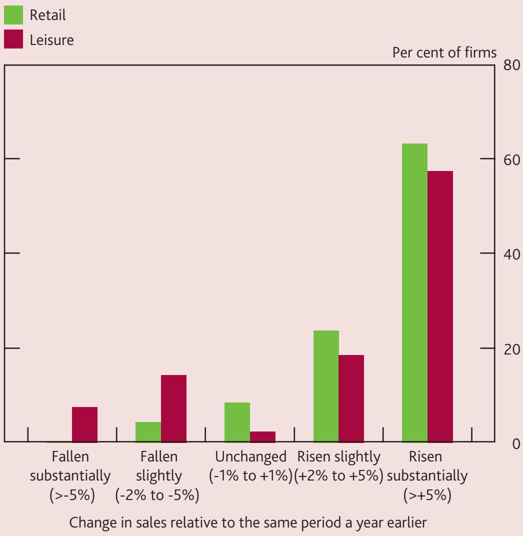
Looking forward, many retailers expected post-Christmas discounting to be either less pervasive (applied to a smaller proportion of product lines) or shallower than in early 2009 — a result of the relatively low stock levels that they had ordered in the run-up to the Christmas period. An Agents' Special Survey of retail and leisure services providers suggested that the majority of contacts expected to pass on at least a part of the 1 January 2010 rise in VAT (see box).

Agents' survey on retail trading over the Christmas period

Given the importance of seasonal trading, the Agents contact a broad range of retailers and leisure services providers in late December each year, to get an early view of sales over the Christmas period. In the 2009 Survey, the Agents contacted around 170 of their contacts during the last two weeks of December. The sample size was small relative to other Agents' Special Surveys run during 2009 — reflecting the compressed timescale and the focus on a single sector — but nevertheless covered a substantial proportion of the Agents' retail and leisure services contacts. All figures reported are weighted by UK turnover.

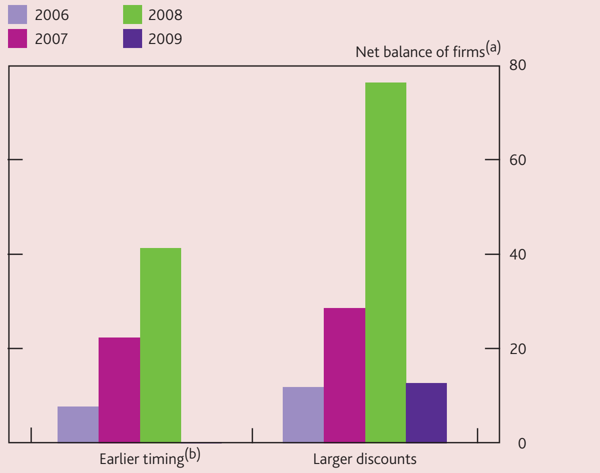
Respondents were asked how their sales had changed relative to the same period a year earlier. A large majority of retailers reported growth in sales — almost two thirds having seen growth in excess of 5% (**Chart A**). Most felt that their Christmas trading had exceeded expectations — notwithstanding any disruption caused by adverse weather conditions. That said, several commented that growth had been flattered by last year's weak comparators, with retail sales remaining below 2007's levels. Most leisure services providers also reported growth in sales.

Chart A Sales over the Christmas period



Respondents were also asked about the timing and magnitude of their promotional activity. In the 2008 survey, many had reported having started promotional activity earlier than in the previous year and having offered more and deeper discounts. In 2009, most had started their promotional activity no earlier than the previous year and had offered broadly similar discounts (**Chart B**). In part, that may have reflected the strong sales many had recorded. Additionally, many retailers had entered the Christmas period with a lower level of inventories than last year, and hence had less stock to shift.

Chart B Timing and magnitude of promotional activity relative to the previous year



(a) Proportion of firms engaging in earlier/larger discounting less those engaging in later/smaller discounting.
(b) The net balance of respondents reporting earlier promotional activity was close to zero in 2009.

Looking forward, contacts were asked whether and how far they planned to pass the 1 January 2010 rise in VAT through to their prices. Around 80% planned to pass through at least a part of the VAT rise, with almost half planning to pass it through in full (**Chart C**).

Chart C Plans for pass-through of the 1 January 2010 VAT increase