BANK OF ENGLAND

# Agents' summary of business conditions

March 2010

- Consumer spending had been volatile in recent months, in part reflecting the impact of the inclement weather. But the Agents' sense was that the underlying trend in retail sales growth appeared to ease back slightly at the start of 2010.
- The gradual recovery in the housing market appeared to have slowed.
- Investment intentions picked up a little, but remained subdued. Spending plans continued to be mostly targeted at improving efficiency rather than increasing capacity.
- There was a further, albeit slight, improvement in export growth. A majority of contacts reported that they have used the fall in sterling to boost margins, rather than increase volumes.
- Inventories were reported to be close to desired levels, with businesses keen to keep stocks low relative to sales.
- Business services activity continued to pick up gradually, with signs of improving demand for professional services. Manufacturing output also continued to recover.
- Prospects in the construction sector remained bleak, reflecting the dwindling pipeline of commercial projects and expected cuts in public spending.
- The availability of bank credit continued to improve marginally, although price and non-price terms on lending remained little changed.
- Employment intentions were little changed on the month. Few businesses were planning either to cut or increase headcount significantly.
- Pay settlements remained subdued. Per capita labour costs were expected to rise slightly during 2010.
- Materials costs moved a touch higher, with pressure from metal, commodity and imported goods prices.
- Annual consumer price inflation picked up further, mainly reflecting the rise in VAT and increases in fuel 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 January 2010 and late February 2010. 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.

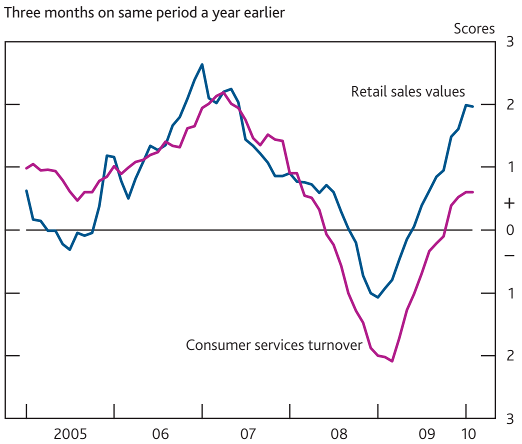
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

## Demand

### Consumption

Retail spending had been volatile in recent months. The inclement weather had depressed footfall and sales during January, and the temporary cut in VAT, which had boosted spending during late 2009, had been reversed. Abstracting from these transitory influences, the Agents sensed that the underlying trend in retail sales growth appeared to ease back slightly through early 2010. As a result, the Agents' scores were unchanged on the month, following significant increases over the past year (**Chart 1**). Many contacts expressed concerns that the slowdown in sales might reflect the start of a weaker underlying trend in spending, prompted by household expectations of future tax rises, and concerns about future job security.

**Chart 1** Retail sales and consumer services




The Agents reported that growth in consumer services turnover had picked up slightly in recent months, although it remained weaker than growth in retail spending (**Chart 1**). The snowy weather depressed sales during early 2010, particularly among pubs, hotels and restaurants. But other sectors fared better. For example, forward bookings of summer holidays had reportedly picked up.

### Housing market

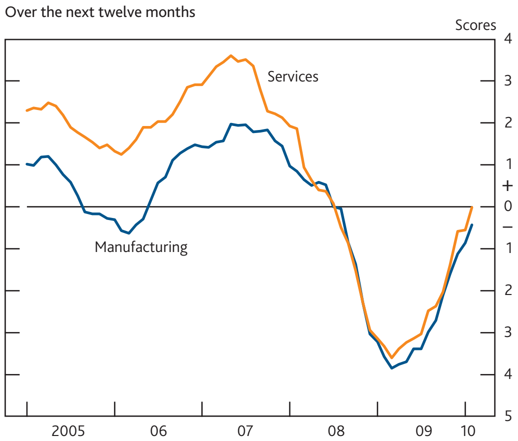
The gradual recovery in the number of housing market transactions reported through the second half of 2009 appeared to have slowed in recent months. Again, part of that had reflected transitory influences. The cold weather depressed viewings and enquiries in early 2010. And in some parts of the United Kingdom, the reintroduction of stamp duty on properties valued between £125,000 and £175,000 in January 2010 had reportedly boosted transactions towards the end of 2009, and reduced them subsequently.

Abstracting from these temporary factors, the Agents' contacts reported little underlying change in the main factors influencing the housing market. The availability of mortgage finance continued to constrain demand, particularly among first-time buyers. And the supply of new instructions also remained low. Overall, the imbalance between demand and supply had persisted, leading to modest upward pressure on prices.

### Business investment

Investment intentions remained subdued, as the significant margin of spare capacity, uncertainty about future demand and the restricted availability of credit continued to weigh on contacts' spending plans. But investment intentions did pick up a little, which combined with weak year-on-year comparators, motivated further increases in the Agents' scores (**Chart 2**). Notwithstanding the impact of the lower exchange rate on the price of imported capital, some contacts reported that capital equipment was cheap, and were keen to take advantage to invest at low cost in advance of the recovery. But, as in previous months, spending plans were mostly targeted at improving efficiency rather than increasing capacity.

**Chart 2** Business investment intentions




### Exports

Export volumes continued to pick up slightly. Although external demand had recovered further, growth in the United Kingdom's major trading partners had been sluggish. For example, while demand had recovered strongly in Asian economies, enquiries and orders from the euro area and the United States remained subdued. The lower exchange rate appeared to have provided only a limited boost to export volumes so far, with the majority of exporters using the fall in sterling to rebuild or boost margins rather than expand output. Looking ahead, contacts expected a rise in exports during 2010 (see box).

### Inventories

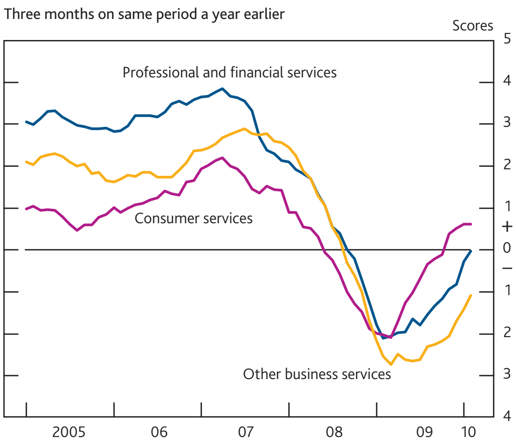
As had been the case throughout 2009 Q4, the majority of contacts reported that stocks were close to desired levels. Looking ahead, businesses were planning to operate with lower stock levels (relative to sales) than in the past, given their desire to conserve working capital, and their expectations of subdued demand growth.

## Output

### Business services

There were further signs of a pickup in demand for professional and financial services which, coupled with weak year-ago comparators, led to a further rise in the Agents' scores (**Chart 3**). Legal and accountancy firms continued to report improvements in demand. Advertising and marketing, which had been cut sharply during 2009, also picked up a little. And commercial property contacts also reported an increase in demand for their services, notably from overseas investors looking to capitalise on low valuations and the weak currency.

**Chart 3** Services output




The recovery in other business services output had been more patchy. Haulage and distribution firms, who experienced marked reductions in output during 2009, reported that demand had stabilised, or even increased slightly in recent months. But corporate spending on hotels and travel continued to decline, and demand for business conferences remained subdued.

### Manufacturing

The modest recovery in manufacturing output continued through early 2010. Some of that improvement reflected a gradual rise in exports (see above), but it also reflected stronger demand for food and consumer goods. Reports from those manufacturers servicing the construction industry, however, remained very downbeat.

### Construction

Output in the construction sector remained extremely depressed. Activity continued to be supported primarily by the public sector, where a number of projects had been brought forward and where, despite the expected fiscal consolidation, there had been only isolated incidents of projects being cancelled or postponed. In private sector construction, there had been some recovery in residential homebuilding, but that was offset by weakness in commercial property construction, where the pipeline of projects continued to dwindle. Overall, contacts were very downbeat about prospects for the sector, with a number expecting the trough in activity to come in 2011.

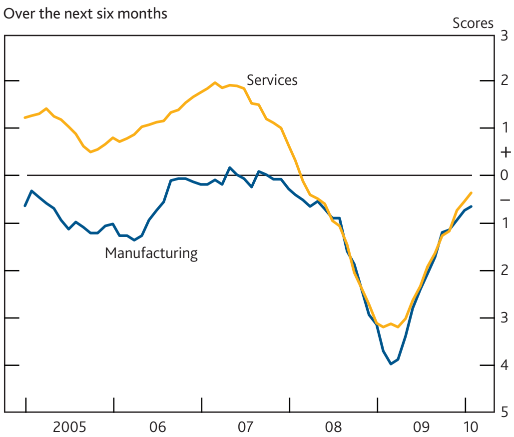
## Credit conditions

Credit conditions remained tight, although the availability of corporate credit continued to improve through early 2010. But, as had been the case for some months, reports of improved access to bank finance were more common among larger businesses than their smaller counterparts. And despite the improved availability of credit, spreads and fees remained elevated relative to pre-crisis levels. That, combined with corporates' continued desire to repay debt, meant that demand for finance remained weak. The availability of trade credit insurance had also improved a little in recent months, with some providers taking solace from the stability of insolvencies so far through 2010. But looking ahead, contacts remained concerned about increases in bad debts.

## Employment

There was little change in businesses' employment intentions over the past month. Most manufacturing and service sector contacts expected employment to remain broadly stable (**Chart 4**). Redundancy programmes were reported to have been largely completed, and many businesses expected to meet any increase in demand by reinstating 'normal' working hours, or through the use of temporary staff, rather than by increasing recruitment. The outlook for employment in the construction and public sectors (neither of which are captured by the Agents' scores), was bleaker, with a number of public sector redundancies already announced.

**Chart 4** Employment intentions



## Capacity utilisation

The economy continued to operate with a significant margin of spare capacity. Nonetheless, labour utilisation rose gently, as businesses met increases in demand using their existing workforce. The majority of businesses recruiting additional staff reported little difficulty in filling any vacancies.

## Costs and prices

### Labour costs

The outlook for pay and labour costs remained subdued, consistent with the findings of last month's special survey. Many businesses were planning pay freezes, with some choosing to reward employees' effort and loyalty using one-off bonus payments. Most other companies were planning to make small positive settlements (0%–2%).

Total labour costs were reported to have picked up slightly, however. For many manufacturing companies, that reflected the reinstatement of shifts and hours that were cut this time last year, as the scale of the recession became apparent. But it also reflected increasing pension costs, with many defined benefit pension funds in deficit following falls in gilt yields.

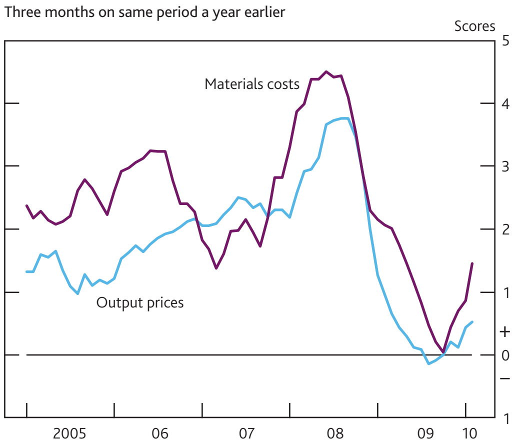
### Non-labour costs

Materials costs rose over the past month, motivating a further rise in the Agents' score (**Chart 5**). Commodity prices were reported to have risen, reflecting both a rise in world demand and an earlier reduction in global supply capacity. Metals prices (aluminium and steel) had risen, as had the prices of oil and associated derivatives (such as plastics). The Agents' contacts also reported higher imported finished goods prices, driven by the lagged effects of the sterling depreciation. Utility prices, however, were reportedly lower, as businesses renegotiated their rates based on 2009 wholesale energy prices, which were significantly lower than those prevailing in 2008.

### Output prices

Manufacturing output prices ticked up slightly over the month. Together with weak year-on-year comparators, that led to a further slight increase in the Agents' score (**Chart 5**). For a number of contacts, recent increases in output prices reflected their efforts to rebuild margins, which had been squeezed following the sharp rise in input costs during 2008. The desire to preserve margins was reported to have largely offset the impact of widespread spare capacity on manufacturing output prices.

**Chart 5** Materials costs and manufacturing output prices




In the services sector, business-to-business prices remained under intense downward pressure. In part, that reflected the limited incidence of insolvencies, which had supported supply, contributing to the decline in services output prices. Some contacts, however, noted that the rate of deflation in services output prices had begun to stabilise.

### Consumer prices

The Agents' score for annual retail goods price inflation picked up further, reflecting the rise in VAT, increases in petrol prices and some continuing impact of the lower level of sterling on the prices of imported consumer goods. The rise was also driven by less widespread discounting than a year earlier: retailers had purchased sufficiently little stock that not much discounting was required to clear it. Annual retail services price inflation also rose, albeit to a lesser degree.

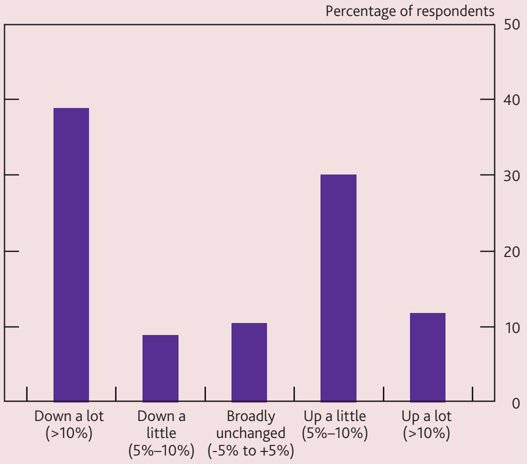
## Agents' survey on exports and export pricing

The sharp and synchronised fall in global economic activity bore down on UK exports during 2009. Looking ahead, the path of UK exports will depend on the timing and strength of the global recovery, and on exporters' reactions to changes in the sterling effective exchange rate, which had fallen by around 25% since the middle of 2007. Over time, that depreciation should encourage an increase in exports, by making UK goods and services more competitive relative to their foreign counterparts. To date, however, UK exporters appear to have used much of the fall in sterling to boost their margins, rather than cutting foreign currency prices and increasing the volume of goods and services they export.

This month, the Agents asked export contacts about their experiences over 2009 relative to 2008, and about their expectations for exports in 2010 relative to 2009. 225 businesses responded to the survey, with the sample heavily skewed towards goods exporters. All figures shown are weighted by export turnover.

A significant number of contacts confirmed that the value of their sterling exports had fallen significantly during 2009 (**Chart A**). The declines were more acute among goods exporters than their service sector counterparts.

**Chart A** Changes in sterling export values in 2009




Looking ahead, businesses expected the sterling value of their exports to rise a little during 2010. Consistent with recent reports from the Agents, those businesses who primarily export to Asia and the Middle East were more optimistic than those who mainly export to the United States and the euro area (**Chart B**).

On prices, the vast majority of contacts reported that they had left foreign currency export prices unchanged over the past year. Looking ahead, a similar proportion of contacts expected to make little change to their foreign currency export prices during 2010 (**Chart C**).

**Chart B** Expected changes in sterling export values in 2010

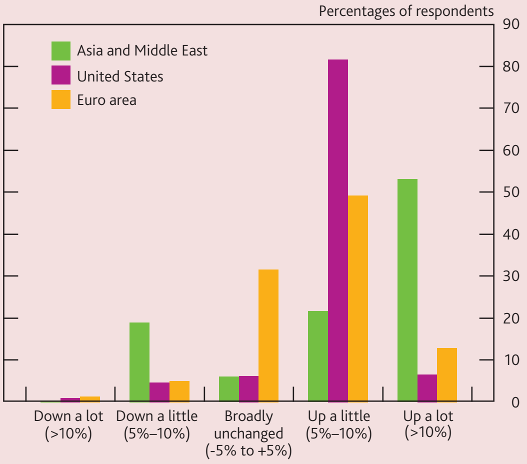
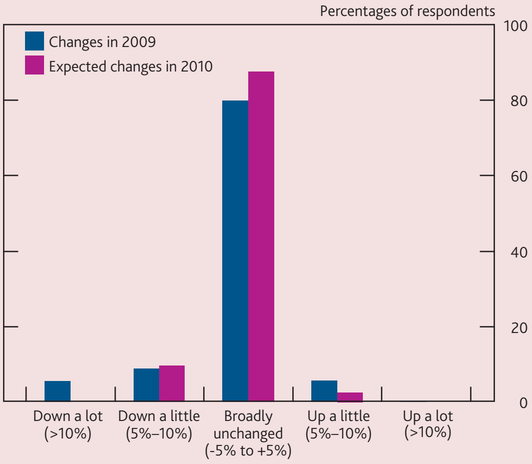



**Chart C** Past and expected changes in foreign currency export prices




Many contacts ascribed the stability of their export prices, despite the steep sterling depreciation, to the globalisation of supply chains and rise in imported raw material prices, which had put upward pressure on their costs over the past year. And a number of contacts reported that they were producing high value-added goods for niche markets, such that demand for their products was relatively inelastic, limiting the benefit of cutting foreign currency export prices.

Other contacts offered different explanations for the stability in their foreign currency export prices, including: a desire to rebuild cash flow and profit, rather than gaining market share; the prevalence of long-term pricing contracts, agreed prior to the sterling depreciation; and the lack of sufficient (trade) credit, which rendered the risk of expanding into new markets prohibitive, particularly for small and medium-sized businesses.