BANK OF ENGLAND

Agents' summary of business conditions

December 2011

- Nominal consumer spending continued to grow slowly, but volumes were thought to be lower than a year earlier.
- Estate agents reported a further softening in the housing market.
- Investment intentions continued to weaken, because for many firms the general improvement in activity expected earlier in the year had not materialised.
- There had been some slowing in the growth rate of goods exports over recent months, reflecting softening in the pace of growth of world demand.
- Business services turnover growth had slowed quite sharply, reflecting weaker activity and renewed downward pressure on fees.
- Manufacturing output for the domestic market continued to grow at a modest rate but the pace of expansion had slowed since the summer.
- The level of activity in the construction sector had declined slightly compared with a year earlier.
- Credit conditions remained tight for many small businesses, while larger firms generally had access to credit if required. At the same time, contacts tended to report little appetite to take on additional debt.
- Private sector employment intentions had weakened further, and now suggested that employment would remain broadly flat over the coming year.
- Capacity utilisation in manufacturing had eased back slightly over the past few months and was now broadly normal. There was still a fair amount of spare capacity in the service sector.
- Labour costs continued to grow at a moderate pace. And contacts expected that situation to persist into next year.
- Inflation in raw materials costs has slowed further, with a range of commodities prices beginning to level off or decline.
- Import price inflation remained elevated, reflecting past increases in raw materials prices, as well as rising production costs in some emerging markets.
- Manufacturing output price inflation was still fairly high, reflecting past increases in the cost of non-labour inputs. In business services there had been renewed downward pressure on professional fees.
- Annual inflation for consumer goods and services remained elevated.

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 October 2011 and late November 2011. 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

The nominal value of consumer spending continued to grow slowly, but volumes were lower compared with a year earlier. Discounts remained essential to drive sales growth, and households continued to trade down in quality and do more of their shopping online in the hope of finding bargains. Mild weather had hurt sales of autumn and winter clothing and spending on big ticket items was still very weak. Some contacts thought that the full week's trading period before Christmas would lead more people than usual to leave gift buying till the last minute, in the hope of finding a bargain. But many retailers had trimmed stock levels compared with last year, to avoid having to discount heavily to clear surplus inventory.

Spending on consumer services was also rising gradually, compared with a year earlier. That was largely due to higher expenditure on essential consumer services, which had been driven upwards by price increases. Rising rent for housing had increased expenditure on accommodation, while spending on transportation had been pushed up by higher fares. That had squeezed the available income left over for discretionary services, leading to a switching in the pattern of demand. For instance, contacts in leisure and tourism reported that footfall tended to be heavier during cheaper, off-peak, periods. Secondary spending at visitor attractions had become weaker. And fewer people were now taking second holidays than in the past. Households were also taking out lower levels of insurance, choosing to bear a greater proportion of risk themselves.

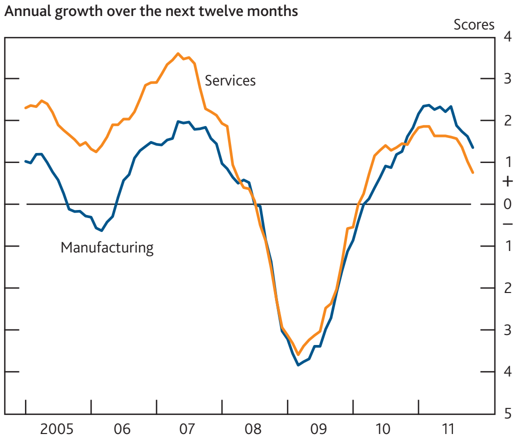
Housing market

Estate agents reported a further softening in much of the housing market. First-time buyers remained constrained by the need for a sizable deposit to secure a mortgage, although they had received some support from shared equity schemes. Meanwhile, existing homeowners were increasingly reluctant to trade up, for fear of falling house prices and concerns about refinancing at higher interest rates, contributing to a reduction in the stock of properties for sale. Activity at the higher end of the market was a bit more buoyant, as buyers were typically less financially constrained. Any available prime sites were typically used to build homes targeted at this section of the market. Buy-to-let investors continued to provide a source of demand for smaller properties favoured by would-be homeowners unable to buy.

Business investment

There had been a further decline in the Agents' scores for investment intentions, pointing to slowing in the growth rate of spending on capital over the next twelve months (**Chart 1**). For some firms, the general improvement in activity expected earlier in the year had not materialised, and that had reduced the need for further capital spending. For others, renewed pressure on working capital had led them to switch their focus back to cash preservation. But investment plans remained strong among exporters, although there was rising caution due to uncertainties surrounding the euro area. And spending continued to be supported by the resumption of replacement cycles and the need for additional IT for compliance purposes. Firms were also still investing in projects yielding rapid cost reductions, such as improved waste management and energy efficiency, and labour-saving technology, as well as in projects which offered the possibility of rapid growth, particularly those targeting the online market.

Chart 1 Investment intentions



Exports

There had been some slowing in the growth rate of goods exports over recent months, reflecting softening world demand growth, particularly in the euro area. Demand continued to grow quickly in many emerging markets. And some firms were trying to shift their focus towards such rapidly expanding economies. Producers of many luxury consumer goods were seeing rapid growth due to rising household spending in some developing countries, although the global market for consumer electronics was particularly weak. Exporters in the mining, transport and energy industries were benefiting from efforts to build up infrastructure in a number of emerging economies. In turn, the need of those exporters for supporting service functions was encouraging some professional and financial services firms to expand into these growth areas as well.

Output

Business services

Business services turnover growth had slowed quite sharply over the past few months, reflecting weaker activity and renewed downward pressure on fees. Work related to mergers and acquisitions had fallen as transactions had been discouraged by rising uncertainty and difficulties raising finance. Spending on corporate travel and hospitality had fallen back as rising caution had begun to weigh on non-essential outlays. Contacts in construction-related services, such as surveyors and architects, reported a slowdown in the sector. Recruitment companies had also seen a fall in activity, as employment intentions softened. But providers of IT services continued to report rapid growth. Regulation and compliance-related activity, along with a pickup in insolvency and recovery work, was supporting some legal and accountancy firms.

Manufacturing

Manufacturing output for the domestic market continued to grow at a modest pace, but the growth rate had slowed since the summer. Growth was often driven by suppliers in the export supply chain, for instance in the automotive and aerospace industries, as well as those in the energy sector. Producers of consumer durables for the home market typically reported that activity was declining, although food production was still showing some resilience. Firms supplying the construction industry and the public sector had also seen a decline in output. So far, most contacts reported that there had been little disruption as a result of the flooding in Thailand, although a small number were concerned that there could be acute shortages of specific electronic components to come. That had contributed to concerns about the security of supply chains which had come to the fore after the earthquake and tsunami in Japan.

Construction

The level of activity in the construction sector had declined slightly compared with a year earlier. Some firms reported that large public sector contracts had come to an end, while private sector projects were sometimes stalled because of planning uncertainty and funding difficulties. The level of activity continued to be supported by some large infrastructure projects, in transport, energy and utilities, and commercial developments in London, although work on the Olympics was now declining. There was some residential construction underway, but house builders were keen not to outpace growth in demand. Looking ahead, public sector work was expected to fall further, and indicators of future private activity also pointed to a slowing in activity. The coming reduction of incentives for the fitting of solar panels was expected to push down on this source of work as well.

Credit conditions

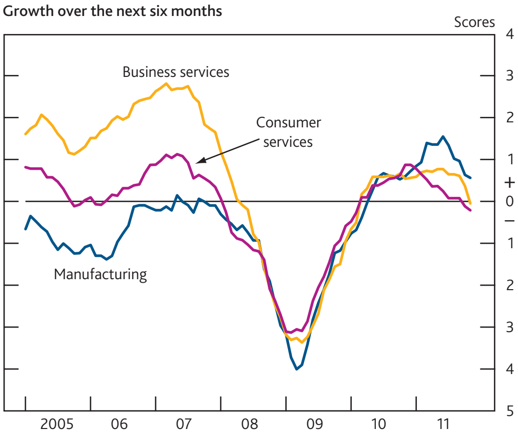
A few firms thought that conditions had tightened recently, although such reports were not widespread. Credit conditions remained tight for many small businesses. Larger firms and those with strong financial accounts typically reported that credit was available if required, although conditions were not as loose as immediately prior to the recession. The demand for loans was generally low, however, and contacts themselves often confirmed that they remained focused on paying off outstanding debt, or would prefer to finance investment from internal sources of finance, rather than use the banks. That reflected continuing concerns about unexpected changes to existing borrowing arrangements on their renewal. Along with growing pressure on working capital due to rising input costs and extended payment times, that had led some businesses to return their focus to the preservation of cash flow, rather than borrowing for the future.

Employment

Private sector employment intentions had been steadily weakening and now suggested that employment would remain broadly flat over the coming year (**Chart 2**). Disappointing growth and rising uncertainty about the outlook had led to a fairly sharp weakening in the recruitment plans of many business services contacts, particularly among professional and financial services exposed to property and construction. That was offset by continued recruitment of key individuals with skills in IT, sales, and regulatory compliance. Meanwhile, consumer-facing firms expected headcount to decline slightly over the coming year, as demand continued to soften. Many contacts in manufacturing still planned to increase employment, particularly among exporters and those in food production. But for some manufacturers of engineered products, recruitment difficulties were becoming a constraint on growth. And firms were increasingly taking on apprentices to address shortages of staff with the requisite technical skills. Producers of durable goods for domestic households, and those exposed to construction and the public sector were typically not planning to recruit, reflecting weak demand and rising uncertainty.

Chart 2 Employment intentions

Growth over the next six months



Capacity utilisation

Capacity utilisation in the manufacturing sector had eased back slightly in recent months, reflecting slightly slower demand growth combined with improved supply potential due to past recruitment and investment. Overall, levels of spare capacity were reported to be around normal, although there was variation between sectors. Exporters were typically working closest to full capacity, while those facing domestic consumers often had significant scope to expand output. Relatively weaker demand conditions in the service sector meant that firms usually exhibited rather more spare capacity than in manufacturing. But, again, the distribution of that slack was uneven. In standardised professional and financial services, there was still considerable over capacity across the sector as a whole, whereas suppliers of specialist services, for instance in IT, were often flat out.

Costs and prices

Labour costs

Labour costs continued to grow at a moderate pace. Settlements were usually between 2%–3% in both manufacturing and services, although there were some higher awards in areas where profitability and labour productivity had been growing strongly, for instance in the export sector and among providers of IT services. The need to retain individuals with particular skills had also pushed up on settlements for some. By contrast, in consumer services and construction, awards tended to be rather weaker, and were often related to increases in the national minimum wage. Overall, there was little upward pressure on pay growth, due to the weakness of activity. And contacts expected that situation to persist into next year, with a similar rate of increase in settlements likely in 2012. Total labour costs were growing slightly more quickly than regular pay, due to bonuses paid for rising profitability last year. But this was expected to reverse next year, in light of disappointing performance more recently. Rising pension contributions had also pushed up on total labour costs.

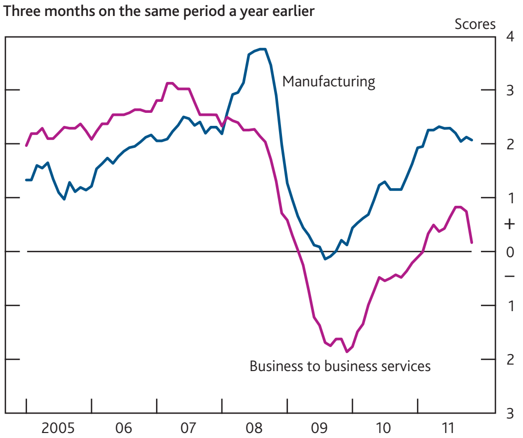
Non-labour costs

Inflation in raw materials continued to slow, with a range of commodities prices beginning to level off, or decline — as with some metals and agricultural commodities prices, for instance. And a few firms had been able to negotiate away some of the past increases in the price of raw materials, as world demand growth had slowed. But there continued to be upward pressure from higher energy prices as fixed-term contracts ended. That was, in turn, feeding through to the prices of energy intensive products. Import price inflation remained elevated, reflecting past increases in raw materials prices, as well as rising production costs in some emerging economies. Flooding in Thailand had also resulted in a fall in supply of some electrical components, such as hard drives, causing their prices to rise quite sharply. Partially offsetting that, there had been a significant fall in shipping costs, reflecting slowing world activity and increased capacity.

Output prices

Manufacturing output price inflation was still fairly high, as firms passed on some of the past increases in the cost of non-labour inputs (**Chart 3**). But firms typically expected not to be able to pass on those costs completely, given the weakness of domestic demand, and continued to try to eliminate any unnecessary costs, to restore lost margin. Contacts expected output price inflation to fall over the coming year, due to slowing non-labour cost inflation. In business services there had been renewed downward pressure on fees for standardised professional and financial services, reflecting fierce competition in the sector (**Chart 3**). Nevertheless, some niche services continued to be able to raise prices, while higher charges for fuel had pushed up on the price of travel and distribution compared with a year earlier.

Chart 3 Manufacturing and services output prices



Consumer prices

Annual retail goods inflation remained elevated. Some contacts suggested that food price inflation would fall back next year, however, as supermarkets were likely to push suppliers to pass on recent reductions in the cost of some agricultural commodities. Unseasonably mild weather had led to some early discounting of unsold stock of autumn and winter clothing lines. Reflecting the weakness of demand, a wider range of retailers than usual was reported to be making use of promotional devices. But there were still some pockets of upward pressure on prices. For instance, jewellery prices were rising quickly, due to increases in the cost of precious metals.

Retail price inflation in the service sector was also still high, due to increases in the prices of essentials, such as transport and rent. By contrast, prices for discretionary services, for instance in the leisure and tourism sectors, were under downward pressure. And services firms were increasingly adopting promotion models used in goods retail, with bundled or heavily discounted offers becoming more common, particularly in the restaurant and hotel industries. The price of car servicing was falling as dealerships had been forced to compete with independent garages. Estate agents reported continued downward pressure on fees.