BANK OF ENGLAND

Agents' summary of business conditions

November 2012

- Growth in demand for consumer goods had picked up very modestly. Gradual growth in spending on consumer services had continued.
- The seasonal pickup in housing market activity had been less than expected.
- Prospects for growth in business investment remained very modest.
- Export growth had slowed further, with weakness in demand reported to have spread further within the euro area.
- Demand for business services had continued to grow at a slow pace.
- Manufacturing output was becoming more affected by weakening international trade prospects.
- Contacts thought that the fall in construction output might have begun to bottom out.
- The Funding for Lending Scheme appeared likely to have a more immediate impact on the availability of residential mortgage lending than on business lending.
- Employment intentions were broadly unchanged, still suggesting that little net job creation was in prospect over the coming six months.
- Capacity utilisation remained a little below normal and there had been only isolated reports of constraints on output.
- Upward pressure on labour costs remained subdued.
- Non-labour input cost inflation continued to slow, assisted by slowing demand in the euro area and in Asia.
- Output price inflation remained weak, particularly for business services.
- Consumer goods price inflation was broadly flat at a moderate rate. Consumer services price inflation had edged up very slightly.

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 September 2012 and late October 2012. 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/Pages/agentssummary/default.aspx.**

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.

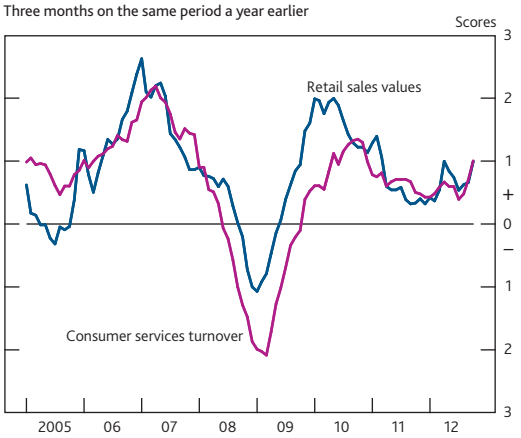
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

Demand

Consumption

Retail sales growth had picked up very modestly during the month (**Chart 1**). Shopping centres specialising in discounted fashions and some retailers of electronics had benefited from stronger demand in the weeks after the Olympic Games. There were also suggestions that sales of some higher-ticket items, such as furniture, had begun to revive as households replaced their existing durables. Demand for new cars, particularly the most fuel-efficient, was reported to have been stronger this autumn than last. But consumers were still thought to be controlling discretionary spending very carefully. Retailers remained guarded about the resilience of spending growth, given a continuing need for strong price incentives, and many planned to control stock levels very tightly in the coming weeks. Growth in demand for consumer services continued at a gradual pace. Some leisure and travel services had picked up after spending had been deferred from the main summer holiday period. Among savers, requests for financial advice were reported to be growing. But tight discretionary spending was affecting demand for some other services, including private and higher education.

Chart 1 Consumption



Housing market

The seasonal pickup in housing market activity appeared not to have been sustained and the number of transactions, particularly in the secondary market, had been less than expected. Demand for new homes, supported by incentives and part-exchange schemes, remained broadly stable, and there were pockets of relatively strong sales. Credit availability continued to restrain first time buyers; new lending, at lower interest rates or higher loan to value ratios, had not yet had a material impact on the market. In addition, stamp duty thresholds and uncertainty about the economy were said to be restraining existing home owners from trading up. Private investment for buy-to-let was steady.

Business investment

Prospects for growth in business investment remained very modest. Those manufacturers needing immediate extra capacity, or pursuing efficiency gains, were prepared to invest strongly. But, for others, uncertain domestic prospects were suppressing planned investment into UK capacity; for some, the need for off-shore investment, to facilitate entry into emerging markets, was stronger. Within the service sector, competition and the popularity of 'click and collect' retailing were expected to support further store format changes. However, new store openings had slowed and a number of retail estates were now consolidating. Business services firms' investment in new management systems was continuing but there was little immediate need for additional physical capacity. Some firms, particularly small and medium-sized enterprises (SMEs), reported holding higher cash balances than usual, either to avoid debt finance or to protect working capital, and were therefore restricting capital spending. Some were also accumulating cash either for future investment plans or in anticipation of merger and acquisition opportunities.

Exports

Slowing sales growth (**Chart 2**) had been reported from further parts of the euro area and also from some emerging markets. Slower growth in certain Asian markets, for example, had affected sales of luxury consumer goods; additionally, some orders for capital goods were slipping back. But in general, growth prospects in Asia and the Americas remained stronger than those in the euro area. Faced with weakening prospects at home, euro-area firms were reported to have become more aggressive competitors in emerging markets. The level of competition, as well as the weaker value of the euro, had begun to weigh on some exporters' margins; nevertheless, the number of firms seeking either to establish or to expand international sales had continued to grow steadily. There were, however, reports of rising food imports in substitution for disappointing UK yields.

Chart 2 Manufacturing output

Output

Business services

Reflecting intense competition and intermittent demand for some services, annual growth in business services' turnover remained muted. Professional services firms reported glimmers of a recovery in transactional business and opportunities in compliance advice, litigation and dispute resolution. Energy-related consultancy had strengthened further and the turnover of some logistics firms had risen, in part reflecting the gradual improvement in retail sales. Elsewhere, growth prospects remained mixed; although, for some, activity levels that had dipped during the Olympic Games had now recovered. Growth showed signs of becoming more focused on larger businesses, which were building market share and broadening their offering.

Manufacturing

Output for export (**Chart 2**) had continued to grow more steadily than for the domestic market, but slowing export growth had begun to affect production plans. Some firms reported that finished stock levels were already being trimmed; others, that they might maintain output at its current level only for a short period. Additionally, there were suggestions that a reduction in working capital and output would affect the supply of certain materials. There had been little change to the relative buoyancy of sectors such as aerospace or oil and gas extraction, or to the cautious order pattern seen from the public sector and the construction industry. Output from some other sectors, such as transportation, was slowing, however, reflecting weakening demand growth at home and overseas. The pickup in domestic retail sales growth, on the other hand, was supporting growth in output from a number of food processors, and from some clothing and furniture manufacturers. In part, this also reflected slow repatriation of some production to the United Kingdom.

Construction

Output was widely expected to continue to fall in the coming months, but there were suggestions that the fall in activity had begun to bottom out. Early-stage work on both residential and infrastructure schemes had picked up since the summer. A number of contacts anticipated that new home completions would rise over the next twelve months. Repair, maintenance and refurbishment work were strengthening, driven by competitive and regulatory pressures, a desire for improved energy efficiency and restricted public finance for new-build, though some educational institutions were adding more student accommodation. Demand for new industrial space remained moderate.

Credit conditions

Recent reductions in financial institutions' marginal funding costs appeared to be working through more quickly in the residential mortgage market than in corporate lending. Mortgage lending rates had begun to ease and the supply of mortgages at higher loan to value ratios was improving. Nonetheless, the number of deals on these new terms remained small. Some mortgage lenders expected lending conditions to improve well into 2013.

Some business lenders appeared still to be tightening terms. This was a particular problem for some SMEs, where the availability of overdrafts was said to be continuing to reduce, with banks preferring asset-backed lending and seeking additional personal guarantees. A number of firms had also seen a further deterioration in debtor days. Recently, some lenders had begun to make offers at lower interest rates, but firms' awareness of such improvements remained low and some smaller firms were reported to be very reluctant to borrow. Among medium-sized businesses there was growing evidence of a drift to non-bank lending, with a number of contacts, including property developers, seeking longer-term finance than banks had recently been willing to offer. Bond issuance was being considered by some, institutional finance (both domestic and foreign) was being explored and the use of private equity was growing. A significant degree of forbearance by corporate lenders had continued.

Employment

Employment intentions were broadly unchanged (**Chart 3**), with little net job creation in prospect over the coming six months. A further reduction in consumer services employment seemed possible, because of the contraction of some retailers' trading estates and shortening working hours, but several retailers were considering hiring more temporary staff this Christmas than last. Elsewhere, the outlook for employment was broadly balanced. Reasons cited by contacts for recruitment included: rising workloads; compliance requirements; a need to bolster customer service; and a need to fight harder for new contracts. But in construction and some business and public services, employers continued to allow headcount to drift down by not replacing leavers. Recruitment of trainees was increasing, to combat both current and prospective skills shortages. Recruitment difficulties remained unchanged and a reluctance to relocate or to change employers restricted the supply of some skills. A number of firms continued to hoard skilled labour in anticipation of future growth.

Capacity utilisation

Capacity utilisation remained a little below normal with only isolated reports of constraints. Some manufacturers had yet to fully deploy new productive capacity and a number reported that pressure on output had reduced a little. Consolidation and gradual growth were offsetting some of the slack in the

Chart 3 Employment intentions

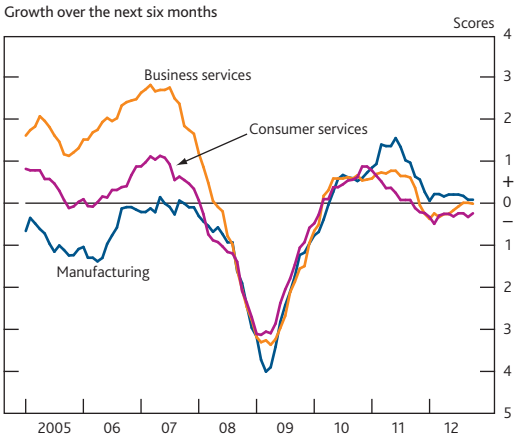
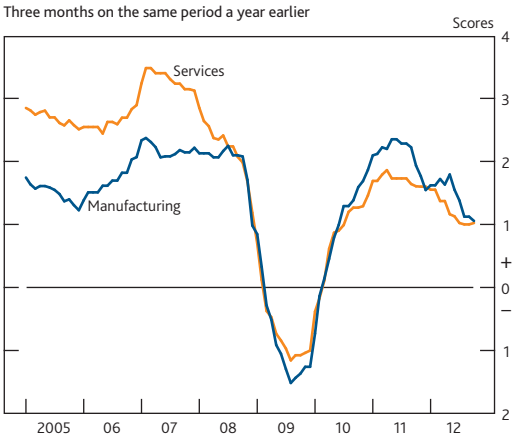


Chart 4 Total labour costs per employee



business and professional services sectors, but there remained significant under utilisation of capital assets such as secondary office space. The level of retail voids in some towns and shopping centres was growing. Some contacts judged that an upturn in output would in the first instance be absorbed by productivity growth and have only a modest impact on physical capacity utilisation.

Costs and prices

Labour costs

Labour cost inflation had remained low (**Chart 4**) reflecting subdued output growth and pressure on firms' cash flow. The number of contacts linking pay growth to company profits or to personal performance continued to rise. Reports of pay freezes had slowly increased, typically in the service sector, more commonly in smaller firms. A few engineering employers had reported above-trend regular pay growth but recently a number of other manufacturers had reduced overtime working and bonus payments. Prospects for non-pay employment costs were uncertain. There were continuing concerns about defined benefit pension scheme liabilities and some firms faced increasing pension costs. Employers generally found it difficult to estimate how many employees would remain within auto-enrol pension schemes.

Non-labour costs

Cost inflation continued at a low rate, reflecting slowing activity in both Asia and the EU and the continuing higher value of sterling. Some suppliers were said to be offering price incentives to their UK customers because of weakening demand in their other markets. Firms had continued to report recent falls in the costs of metals, timber and some soft commodities such as cotton and wool. The cost of some clothing had also eased, though existing forward orders would mean that it would take time for lower prices to work through. Increases in many food commodity prices had also yet to make significant progress along the supply chain, though they were widely expected to do so in the coming months. Tightening supply of some commodities and services was supporting price growth in certain areas. The cost of some oil and energy-intensive services, such as shipping, haulage and air travel had risen. As forward price agreements ended, many firms were experiencing a step up in the unit cost of energy, but recent investments in energy efficiency were expected to mitigate the effect.

Output prices

Output prices continued to rise slowly. Oil and grain processors had begun to pass through increased costs. Packaging prices had risen. But food processors had generally yet to secure higher prices. In export markets, slowing demand and the continuing lower value of the euro had led to greater price resistance from customers and the falls in the prices of some commodities were thought likely to add to this. In the service sector, fuel escalator clauses had allowed some hauliers' prices to rise. Banks had been increasing their charges materially to some borrowers, but elsewhere in the market there was continuing downward pressure on fees and charges for professional, financial and many other business services.

Consumer prices

Goods price inflation was broadly flat at a moderate rate. Contacts continued to expect certain food prices to rise during the remainder of the year, notably for those with a short production cycle or high grain content. Reflecting tighter stock control, promotions for some goods had reportedly been reduced or delayed, but in some sectors straightforward price discounting was becoming more productive than multibuys. Elsewhere, the greater availability of nearly-new cars was expected to depress values for genuinely used vehicles. Prices for certain consumer services had edged up very slightly in the past month. This reflected some reports of greater demand, rising prices for some food services and higher transport prices — capturing both air fare inflation and falling subsidies for domestic travel. In many regions a strong residential rental market continued to support growth in rents.