BANK OF ENGLAND

Agents' summary of business conditions

May 2013

- Annual growth had edged higher for retail sales values but had fallen slightly for consumer services values, continuing a pattern seen since the turn of the year.
- There were further reports of gradually improving housing market activity, both for new home sales and secondary market transactions, reflecting an easing of mortgage conditions and the effects of existing government incentive schemes.
- Investment intentions for the coming twelve months had remained subdued but positive.
- Manufacturing output growth had edged higher, both for export and for the domestic market.
- Annual growth in business services turnover had been little changed overall, remaining higher than at the start of the year.
- Construction output had remained slightly below levels a year earlier, though there were continued reports of an increase in early-stage activity among larger private housebuilders.
- Corporate credit conditions had remained broadly unchanged, albeit with some further pass-through of reduced bank funding costs and some tentative signs of improvement in credit availability and demand.
- Employment intentions pointed to a slight rise in staffing levels in business services companies over the coming six months, but a flat workforce in manufacturing and consumer services.
- Capacity utilisation had remained a little below normal in both manufacturing and services.
- The annual rate of growth in labour costs per employee had remained subdued, and had edged lower for services.
- The rate of inflation had remained unchanged for materials costs, but had increased slightly for imported finished goods as sterling's recent depreciation had started to feed through.
- Manufacturers' and business services' output price inflation had edged higher but remained muted.
- The rate of inflation in retail goods and services prices had been unchanged.

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 March 2013 and late April 2013.
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.

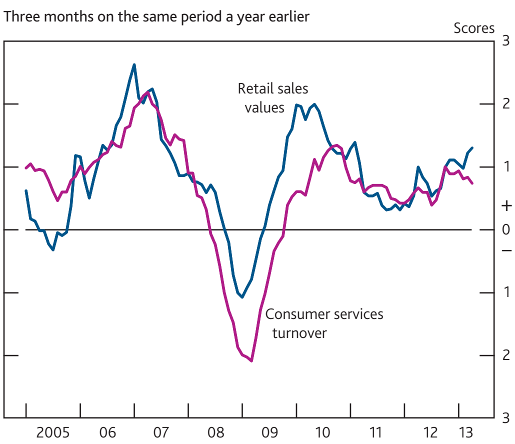
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from:
www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.

Demand

Consumption

Annual retail sales values growth had edged higher (**Chart 1**), though any growth in volumes remained modest. Underlying consumer demand was reported to remain subdued, consistent with tight disposable incomes for many. In addition, unseasonably poor weather had negatively affected sales of fashion and outdoor goods and equipment, only partly offset by a more recent recovery as the weather had improved. Outside retail sales, new car sales had remained strong, with demand focused on prestige brands on the one hand, or on models with low maintenance costs and high fuel efficiency on the other. Consumer services demand was reported to have edged lower as households sought to economise on discretionary spending to offset the effect of price rises on some essential services, such as utilities. Cold weather had also affected demand for outdoor attractions and hotel bookings, though had contributed to a rise in foreign holiday bookings. There were reports of strengthening housing activity positively affecting demand for some related services, such as estate agency and, sporadically, for durable goods, such as furniture.

Chart 1 Retail sales and consumer services turnover



Housing market

There were further reports of gradually improving housing market activity, both for new home sales and secondary market transactions. That had reflected strengthening demand due to lower mortgage rates and improved mortgage availability, including for first-time buyers, though some contacts reported credit criteria remained tight for high loan to value ratios. Government-backed incentive schemes were also seen as contributing to the gentle rise in demand for new home purchase over recent months. And there were tentative reports that the introduction of the equity loan element of the Help to Buy scheme was encouraging more potential buyers to enter the market. It was too early for contacts to reach firm judgements about the scale of the scheme's effects on either new housing demand or supply — particularly for the mortgage guarantee element to be introduced in January 2014, further details of which were awaited.

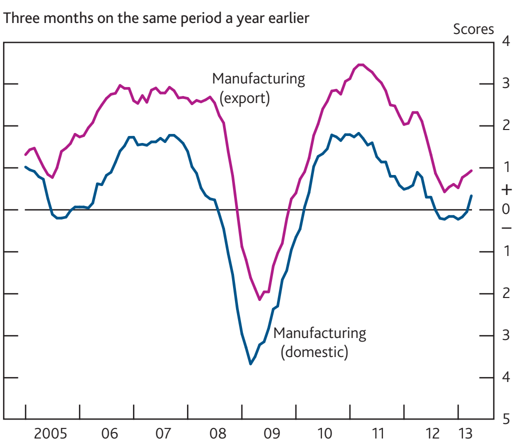
Business investment

Investment intentions had remained muted, notwithstanding a slight increase in business confidence in recent months. In part, subdued intentions reflected continuing uncertainty about future demand. For manufacturing, investment was said to be often driven by efficiency gains, and a desire to maintain competitiveness, though there were a few more reports of companies in export supply chains investing to expand capacity or introduce new products. Among services firms, modest investment intentions were largely related to IT spending, to improve efficiency or often to establish or develop e-commerce platforms. There were also reports of rising investment in distribution vehicles, in part reflecting tightening emissions standards. Contacts reported some pickup in the refurbishment of retail stores, hotels and bars, to improve their attractiveness to consumers in the face of strong competitive pressures. Looking across firm size, some contacts reported a recent slight increase in small and medium-sized enterprise (SME) investment, in part reflecting increased capital spending allowances introduced at the start of the year. Some very large firms reported a preference to invest closer to overseas markets where growth was more rapid.

Exports

Manufacturing exports (**Chart 2**) had continued to pick up gently on a year earlier, as a result of growth in demand outside the euro area, with more contacts noting rising demand from the United States in addition to continued growth in emerging markets. Among sectors, growth was often reported in aerospace, automotive and mining-related production. Some services exports were also said to be rising. Those exports were often related to infrastructure projects, or the extraction of oil and gas, in emerging markets, though increased exports of legal and IT services were also reported. Across sectors, smaller companies reported difficulties in penetrating overseas markets, partly reflecting constraints in

Chart 2 Manufacturing output



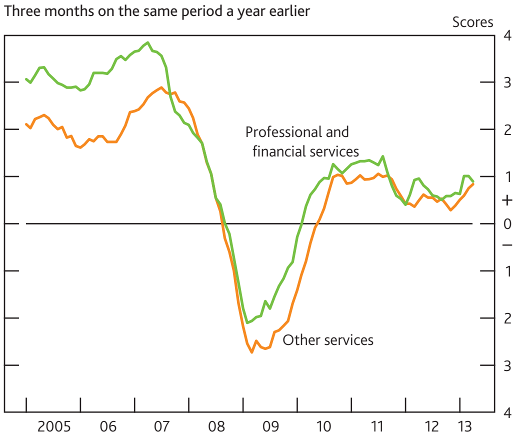
their ability to access finance. That was also reflected in the results of an Agents' survey of exports (see pages 6–7), which more generally found that respondents' export values had grown over the past year and were expected to rise at a similar pace over the coming twelve months. In the other direction, food imports were reported to be rising due to the effects of poor weather on UK food production, albeit offset partly by increased domestic sourcing of meat products. More widely, euro area companies were increasingly targeting UK sales given weak demand conditions in continental Europe.

Output

Business services

Growth in professional and financial services turnover had remained modest (**Chart 3**), though had increased during 2013 so far. A gradual increase in advisory work related to corporate mergers and acquisitions activity, as well as asset disposals, had continued. That reflected pressures to consolidate within the economy, as well as some increased interest in asset purchases among venture capital, private equity and foreign buyers as risk appetite had recovered somewhat in recent months. Commercial property related work was said to be rising slightly alongside some increase in transactions. But audit and tax were reported to be flat, with intense competition between providers for the available business. Annual growth in other business services turnover had edged up further. That was often reported to reflect rising demand for IT services associated with the development of e-commerce, with digital marketing and software providers also benefiting. For many other companies — such as providers of corporate hospitality and conferences — turnover had remained subdued, though there had been some signs of a strengthening in business-related travel.

Chart 3 Business services output



Manufacturing

Manufacturing output for the domestic market was reported to have edged higher, to levels slightly above a year earlier (**Chart 2**). Growth was largely confined to aerospace, automotive and energy supply chains, often destined ultimately for export outside of the euro area. But there were also reports of rising car production for the domestic market and of some strengthening in luxury goods production. In some cases — such as furniture production — retailers were said to be re-sourcing away from overseas suppliers to UK-based manufacturers. However, with domestic demand still subdued, and with strong competition from continental European producers facing overcapacity, the output of many producers aiming at domestic consumption was said to be weak.

Construction

Construction output remained slightly lower than a year earlier, though in some areas contacts suggested that activity in Q1 had been adversely affected by unusually poor weather conditions. There had been some increase in optimism in parts of the sector in recent months, particularly so among larger house builders, with signs of increased pre-planning and planning activity. There were also signs of more optimism among smaller house-building contacts, though many continued to report their activities remained constrained by funding and planning constraints. Some contacts reported that social housing build rates were starting to rise, though there were questions about how sustained any increase would be beyond the current year. In the wider construction sector, small-scale activity in the education and health sectors was said to be providing some support to activity, and activity on infrastructure projects (rail and energy) remained robust. Elsewhere, there remained little sign of improvement in publicly-funded activity, however, and private sector commercial construction was subdued.

Credit conditions

Corporate credit conditions had remained broadly unchanged, albeit with some tentative signs of improvement in both availability and demand. There were continued reports by businesses of banks passing on reduced costs of funding into loan pricing where lending was available and of increased competition to lend to lower credit risk companies as banks aimed to meet lending targets. With bond finance or US private placements providing a cheaper source of finance for many large firms, that was leading to some increase in the availability of bank credit to mid-tier corporates and to some larger SMEs with strong balance sheets. But many smaller firms without suitable collateral found their access to finance remained constrained, with little change in banks' risk appetite reported — sometimes exhibited in protracted decision-making processes around loan applications. More generally, firms that were seeking to enter new markets reported that access to bank finance remained difficult.

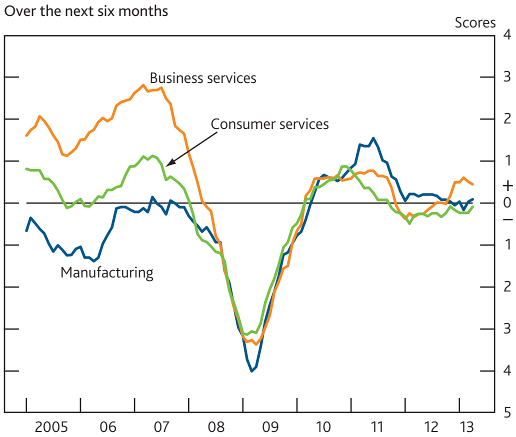
There were some signs reported of a slight rise in credit demand, due to modest plans to increase investment. Overall, though, loan demand had remained subdued as many companies looked to reduce debts or build up cash reserves, in part reflecting a desire to reduce their reliance on banks in future. A growing use of non-bank finance was reported by SMEs, albeit from low levels, including from peer to peer lending, crowd funding, venture capital funds and insurance companies and pension funds. Within the corporate sector, there were continued reports that customers were extending the periods over which they settled invoices. Bad debts, however, had remained at low levels.

Employment

Employment intentions pointed to a slight rise in staffing levels in business services over the coming six months, but flat employment in manufacturing and consumer services, broadly consistent with the relative pattern of demand (**Chart 4**). There were also differing patterns within sectors — for example in manufacturing there were reports of increasing employment in export supply chains but falls in employment at some companies focused on the domestic consumer. In the retail sector, employment levels were often said to be at the lowest levels consistent with acceptable customer service standards. The growth of e-commerce was said not to be leading to lower employment as greater staff numbers were required for distribution and websites, while outlets still needed to be staffed for 'click and collect models', offsetting job losses from the gradual closure of unprofitable stores.

Chart 4 Employment intentions

Over the next six months



More generally, where firms' output was contracting, they were reported to be reluctant to cut staffing levels. That reflected a number of factors including: expectations that any decline in output would be short-lived; the large one-off costs of redundancy, which meant that natural attrition was the preferred response; and the increased use of less experienced staff, which had alleviated pressure on wage costs. It was also commonly reported that staff levels needed to be maintained for bidding and tendering processes, which had become more intensive over recent years.

Recruitment difficulties had not materially tightened in recent months, though there had been a slight widening in reports of skills shortages beyond IT and engineering to include sales and marketing staff in some regions, reflecting strong competition for available business. Reports of localised skills shortages had also increased slightly, sometimes related to constraints on labour mobility such as differences in house prices across regions. For the majority of firms, however, recruitment was said to be relatively easy by historical standards.

Capacity utilisation

Capacity utilisation had remained slightly below normal in both manufacturing and services. In manufacturing sectors where some tightness of capacity was reported, such as aerospace, automotive and energy supply chains, it was reported that some new capacity was being created. Elsewhere, sizable spare manufacturing capacity was often reported, leading to some mothballing of production facilities for construction materials in particular. Professional services firms reported only limited amounts of spare capacity, though the picture often remained one of staff working hard to maintain output in an environment of weak demand, and of gradual consolidation within the sector. Service sector capacity constraints were most notable in IT services, while the greatest degree of slack was in the retail sector, retail commercial property, and heavy construction sectors.

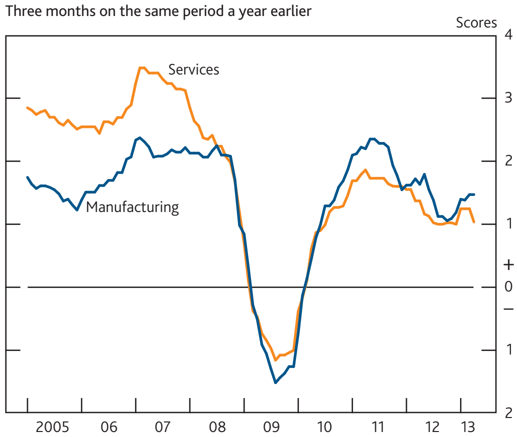
Costs and prices

Labour costs

The annual rate of growth in labour costs per employee had remained subdued, and had edged lower for services (**Chart 5**). Pressures on wage inflation had been muted and in some cases were reported to have decreased as the effect of lower CPI inflation relative to a year earlier had started to feed

Chart 5 Total labour costs per employee

Three months on the same period a year earlier



through, and because of weak profitability. Bonuses and overtime payments were generally flat or lower than a year earlier and there continued to be a significant minority of employees on pay freezes. There were, however, some further reports of skills shortages in IT and engineering, putting upward pressure on pay in those specialisms. Pension costs were reported to be increasing, in part reflecting auto-enrolment, although the costs of that would vary across businesses depending on their employees' opt-out rates. Increased contributions to cover deficits on legacy liabilities in defined benefit pension schemes were said to be raising pension costs for some, though that was rarely reported to be affecting companies' wage setting.

Non-labour costs

The rate of inflation was unchanged for materials costs, remaining modest, though had edged higher for imported finished goods. For many contacts, cost increases continued to be driven by the direct and indirect effects of increases in energy and agricultural commodity prices. However, some easing of other cost pressures was reported recently, with oil prices having fallen back and the prices of some non-specialist metals — such as steel — said to be lower than a year earlier, albeit offset a little by the depreciation of sterling. Imported finished goods price inflation was reported to have edged up, as the effects of sterling's recent depreciation had started to be felt. On the assumption that sterling remained at current levels, some further pickup in import price inflation was expected by contacts as the year progressed.

Output prices and margins

Manufacturers' and business services' output price inflation had edged higher, though was still subdued. Manufacturers reported some pass-through of cost increases, albeit often only partial. For some exporters, however, stronger demand and sterling depreciation had allowed for some increase in export prices, and some niche manufacturers also reported a slight increase in pricing power. That, combined with efficiency improvements and moves by some to a more profitable product mix, was reported to have slightly improved manufacturing margins. For services, a strengthening in demand over recent months had allowed a slightly greater pass through of cost increases. Profitability in the sector overall was reported to be flat.

Consumer prices

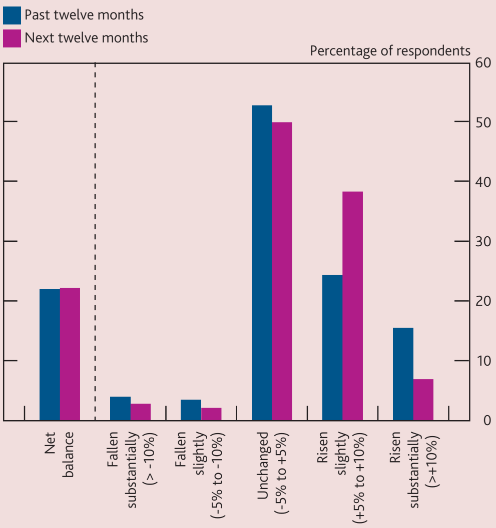
The annual rate of consumer price inflation had remained unchanged for both goods and services. Contacts expected food and beverage price inflation to continue at current levels or to increase further over the coming months as supply-chain pressures fed through. For consumer goods, some upwards price pressures were also expected through the year as currency hedges on imported goods unwound. However, some of those effects were expected to be tempered by strong discounting of clothing and footwear during the summer sales, as retailers attempted to clear stocks of spring clothing unsold because of poor weather. And the heavy discounting on new car sales was reported to have continued, partly reflecting European producers targeting UK sales in the face of weak demand on the continent. Elsewhere, inflation was seen as remaining largely concentrated in administered and regulated prices, including in energy, where further price rises were expected during the year and concerns about capacity persisted. More generally, the high price-sensitivity of consumers was seen as restraining companies from passing through price rises in both goods and services sectors.

Agents' survey on exports

As a box in the February 2013 *Inflation Report* discussed, UK export performance over recent years has been disappointing given sterling's depreciation and a recovery in world trade. In April, the Agents conducted a survey of business contacts to ask how the value of their UK exports had changed over the past year and their expectations for the next year. Firms were also asked to indicate how a range of factors had affected exports and about significant obstacles that were constraining exports. 284 companies participated, including 70 services firms, with export destinations that were broadly representative of UK trade patterns. The results were weighted by export revenues.

A net balance of respondent firms reported a modest increase in export values over the past year, and expectations of growth were similar for the next twelve months (**Chart A**).

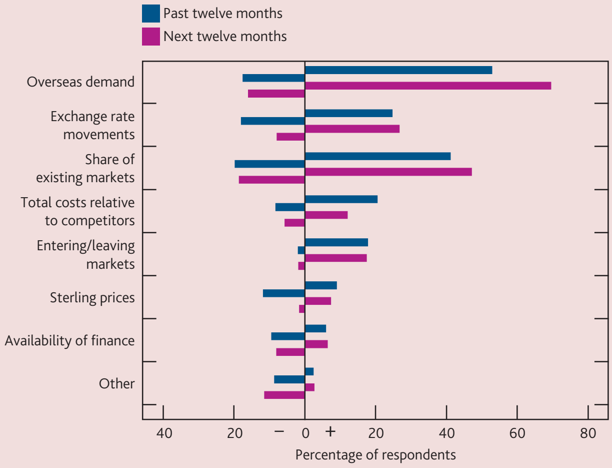
Chart A Export growth over the past year and expectations for the next year



Among firms whose main export market was the United States, there was a lower balance of firms expecting export growth in the coming year compared with the balance for the past year. Firms principally exporting to other markets generally expected stronger growth in the next year. More generally, goods exporters' expectations for the next year were similar to the past year, while services firms expected growth to be slightly stronger.

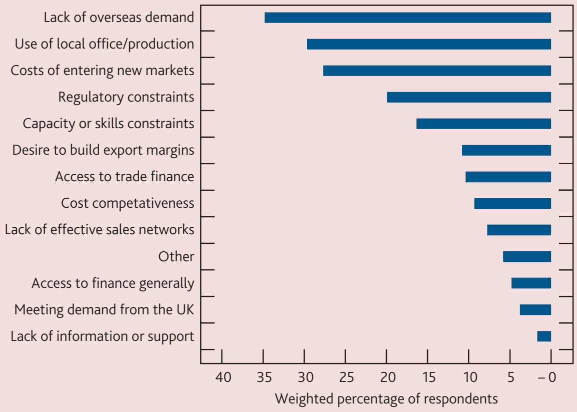
Looking at the drivers of export values, export prices were reported to have had little impact over the past year, suggesting that the reported rise in values largely reflected higher volumes. Taken together, overseas demand and exchange rate movements had driven much of the reported growth over the past year (**Chart B**). Market share gains and the relative competitiveness of UK exports were also helping to boost export revenues for many respondents. For the coming year, the positive effect of overseas demand and exchange rate movements on export values was expected to increase, while the impetus from cost competitiveness was expected to wane slightly.

Chart B Factors affecting exports



Contacts were also asked about the main factors holding back exports. A lack of overseas demand, the use of local offices or production and high costs of market entry were cited most frequently by contacts (**Chart C**), while regulatory or legal concerns and capacity or skills constraints were also material. Looking across export destinations, overseas demand was most commonly cited as an obstacle by firms exporting mainly to the euro area. Access to trade finance was more of an issue for exporters to the euro area and the Middle East than other markets.

Chart C Factors holding back exports



There were some notable differences in responses across firm size. Large firms were much more likely to make use of local offices or production, rather than exporting directly from the United Kingdom. Smaller exporters in contrast cited their lack of effective sales networks overseas and cost competitiveness as more significant issues. The availability of finance was much more likely to be an issue for smaller firms.