BANK OF ENGLAND

# Agents' summary of business conditions

April 2014

- Annual growth in the value of retail sales had eased, with growth in consumer services turnover little changed.
- Housing market transactions had continued to rise strongly.
- Investment intentions had continued to strengthen.
- Growth in business services turnover had increased, largely due to rising activity among professional and financial services firms.
- Growth in manufacturing output had picked up further, both for the domestic market and for export.
- Growth in construction output had remained robust, led by house building.
- Corporate credit availability had continued to ease, though it remained tight for small companies.
- Employment intentions had edged up further. Recruitment difficulties had remained slightly above normal.
- Capacity utilisation had remained close to normal.
- Annual growth in labour costs per head had remained moderate, though had edged higher in the service sector.
- Materials costs and imported finished goods prices had been little changed on a year earlier.
- Output price inflation had remained unchanged. Profitability had continued to improve gradually as turnover had risen.
- Consumer price inflation had been unchanged, remaining higher for services than for goods.

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 February 2014 and late March 2014. 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.

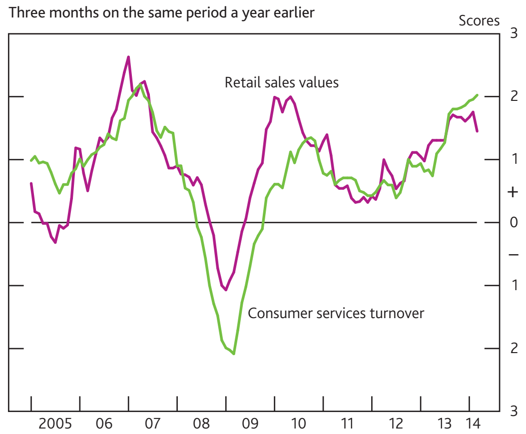
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

## Demand

### Consumption

Annual growth in the value of retail sales had eased (**Chart 1**) although contacts had suggested this was likely to be temporary, due to special factors such as Mother's Day and Easter falling later in 2014 than in 2013. Food sales values had slowed, partly reflecting a weakening of prices for some foods and a shift towards purchasing at discount stores. By contrast, durable spending had picked up, with contacts reporting an upturn in sales of kitchens, bathrooms, furniture and home improvement products. Sales of new cars had continued to grow strongly, with dealer contacts generally achieving challenging March targets for new registrations set by manufacturers. Growth in consumer services turnover had been more resilient than retail sales. Consumers had become increasingly willing to spend on leisure activities, eating out, home services via broadband and holidays.

**Chart 1** Retail sales and consumer services turnover




### Housing market

Transaction volumes had continued to rise strongly in the housing market, with many contacts reporting double-digit percentage increases on a year ago. That was leading to continuing growth in activity for estate agents, residential conveyancers and mortgage brokers. Estate agents reported that new instructions were rising, but were lagging the increase in home sales. Widespread shortages of stocks for sale were reported, with levels significantly below those of a year earlier in many cases. Reports of double-digit annual rises in house prices were restricted to London, where overseas investment remained an important factor driving prices. Elsewhere, house price inflation had remained more modest.

### Business investment

Contacts' investment intentions had continued to strengthen as confidence increased, though a cautious approach persisted. Many contacts reported increasing spending in non-capital intensive areas, such as product development, branding, training, and new media. Manufacturing contacts were investing for productivity gains, energy efficiency and to some extent to add capacity in growth areas. In consumer-facing sectors, the focus was principally on refitting and upgrading existing space to enhance customer experience; the main exception was value stores where new-build programmes were adding to capacity. More generally, investment in IT had continued to strengthen, driven by the need to open up new digital customer channels, the pursuit of efficiency and, increasingly, by the integration of merged entities. However, some multinational enterprises had continued to prioritise investment in faster growing world markets in preference to the United Kingdom.

### Exports

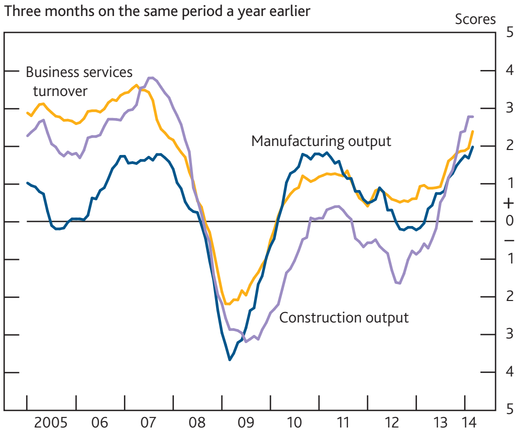
Growth in manufacturing export volumes had increased, supported by recovering global economic activity. The effect on volumes of the recent appreciation of sterling had been limited to date as exporters had largely held their local currency export prices flat. US demand had grown, as had exports of niche products to the Middle East, while European demand had steadied. There were no reports of any major impact to date on exports to Russia arising from political uncertainties in Ukraine. Automotive goods had remained a source of export growth. More generally, export demand for industrial components had risen, suggesting the world economy was growing more strongly than last year. Services exports growth had continued, in part reflecting efforts by UK companies in recent years to widen their client base to markets further afield. In particular, consultancy related to infrastructure development in the Middle and Far East had continued to grow. Increasing inward investment to the United Kingdom from overseas had increased demand for commercial property-related services.

## Output

### Business services

Business services turnover growth had increased (**Chart 2**). Growth in financial and professional services turnover had risen and had broadened to a wider range of subsectors. Commercial real estate investor demand had increased, supporting related services, such as architects, surveyors and conveyancing. Initial public offering (IPO) and mergers and acquisitions activity had been buoyant, as had consultancy work preparing businesses for sale. Spending on marketing and public relations services had increased as business confidence had improved, and recruitment agency activity continued to strengthen. The rate of growth in other business services had also picked up, though activity levels were uneven across subsectors and regions. IT services had continued to grow robustly, driven by demand for software and system upgrades. The recovery in construction had bolstered workloads for contacts in a variety of subsectors, including hauliers, builders'

**Chart 2** Manufacturing, business services and construction output




merchants and plant hire firms. Corporate travel bookings and conferencing had remained well below pre-recession levels, but hotels had reported signs of improvement on a year earlier as companies had started to increase discretionary spending.

### Manufacturing

Growth in manufacturing output for the domestic market had picked up further (**Chart 2**). Among subsectors, output of construction products had grown particularly strongly. Growth in aerospace and automotive supply chains had remained robust, driving output growth in a diverse range of other subsectors. There had remained a few exceptions to this strengthening outlook, however. In particular, defence output was reported to be affected by cuts in military spending internationally, and paper and printing output had fallen due to the ongoing shift towards electronic media.

### Construction

Growth in construction output had remained robust (**Chart 2**), led by house building but with a modestly increasing contribution from commercial development. Housing starts and completions had risen strongly on a year earlier, though smaller builders had continued to cite concerns about funding constraints and difficulties obtaining materials. Commercial activity outside London had started to rise, but continued to be predominantly focused on the industrial and warehousing sectors, alongside the refurbishment of retail premises. By contrast, speculative development of offices had remained very rare outside London. There had been a growing trend for vacant office space to be converted to student and other residential use.

## Credit conditions

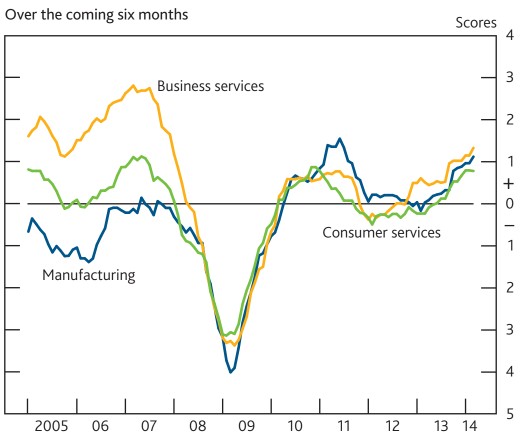
Credit conditions had continued to ease. Many larger companies described themselves as well-funded and able to access a range of borrowing options. Bond issuance and IPOs had become increasingly popular sources of financing and challenger banks had come into the lending market.

In contrast, small firms, particularly those short of unencumbered assets, had continued to find the availability of bank lending tight. However, asset finance was reported to have become increasingly available across companies. Lenders' appetite had continued to vary across sectors, with speculative property development, consumer services and retail sectors seen to be relatively unpopular. Loan demand had remained fairly subdued. Some companies reported strategies that avoided a reliance on bank borrowing, even at the cost of some reduction in their growth. Property-related demand for finance was said to be picking up, often as a result of businesses seeking to purchase premises. The results of an Agents' survey of credit conditions are reported in the box on pages 5–6.

## Employment

Employment intentions had edged up further outside the consumer services sector (**Chart 3**). Intentions were generally growing at a lower rate than output, suggesting some expected improvement in productivity. Employment growth appeared strongest in IT, professional services, and construction and related services, with those increases partially offset by consolidation in other areas, such as consumer financial services. The main driver of recruitment was reported to be the improving economic outlook, but some contacts were expanding apprenticeship and graduate programmes in response to anticipated skill shortages, or for succession planning. Recruitment difficulties had remained marginally above normal. Skill shortages were most evident within IT, engineering, haulage and construction, but reports of a broadening to other areas, largely senior management positions, had continued.

**Chart 3** Employment intentions



## Capacity utilisation

Capacity utilisation was little changed on the month and remained close to normal. Constraints had remained most evident in construction, where shortages of materials and skills had persisted. Physical capacity in manufacturing was seen to be sufficient to allow companies to respond to increased demand in the near term through the use of overtime or productivity improvements. Capacity utilisation in business services had not risen in line with the recent pickup in activity due to a wave of recruitment in the sector. Within consumer services, spare capacity had remained evident in underutilised staff and vacant retail premises, though there were signs that the occupation of unused retail space had started to rise.

## Costs and prices

### Labour costs

Annual growth in labour costs per head had remained moderate, though had edged higher in the service sector. Pay settlements had remained subdued in the vast majority of cases. There were continuing reports of companies having to pay more than expected to recruit new staff or retain key skills, alongside some modest increase in labour market churn, though that was not as yet spreading into higher pay awards more generally. Some service sector contacts noted that the prospective 3% increase in the national minimum wage in October could have a wider effect on wages at the lower end of the pay spectrum.

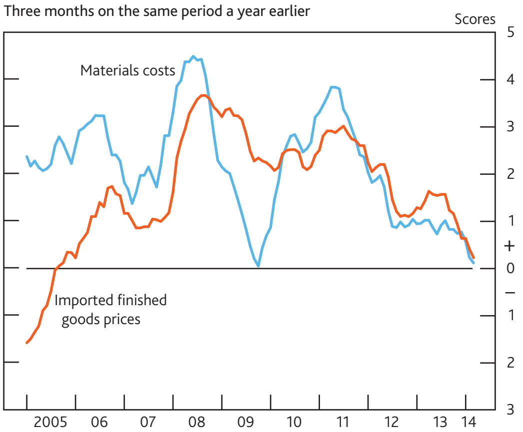
### Non-labour costs

Materials costs inflation had edged lower (**Chart 4**). Costs were broadly unchanged on a year earlier, though within the total, fuel and oil-based materials costs had fallen on a year ago while there had been significant inflation in some construction materials. Energy costs were also higher on a year earlier. Imported finished goods inflation had continued to fall and was close to zero. The appreciation of sterling had helped to offset the impact of rising labour costs in the Far East. Looking forward, contacts were concerned about the impact on availability and costs of oil, gas and wheat were there to be an escalation of tensions in Ukraine.

### Output prices and margins

Output price inflation had remained modest. Most manufacturing companies had been relatively constrained in their ability to raise prices as customers were aware that cost inflation on domestic and imported materials was weak (**Chart 4**), and for those supplying supermarkets there was

**Chart 4** Raw materials and imported finished goods prices




downward price pressure. Building materials production had remained an exception as increased housing activity had resulted in some substantial year-on-year price increases. In professional and financial services, fees for commoditised work, such as audit, were still under pressure, but as volumes had started to increase, contacts reported some ability to increase fees on transactional and other value-added work. Rising starting salaries were reported to be leading to some fee inflation for recruitment companies. Modest growth in companies' profitability had continued, in part reflecting increased volumes, reductions in some materials costs and efforts to improve efficiency.

### Consumer prices

Retail goods price inflation had remained modest. Retail contacts reported being cautious of raising prices given that consumers were highly price sensitive and adept at comparing prices on-line. Downwards pressure on inflation had been evident in lower petrol and heating oil prices on a year earlier. Food price inflation was expected to fall back further as a result of announced forthcoming price cuts by major supermarkets. Looking forward, farming contacts did not anticipate any impact on food prices from the exceptionally wet winter weather in the United Kingdom, but noted possible impacts on wheat and energy prices if there were any escalation in the Ukrainian situation. Retail services price inflation had remained somewhat stronger than goods price inflation. There had been some inflation in prices for visitor attractions and UK holiday accommodation. Conveyancing fees had also increased modestly in response to higher demand. Conversely, though, competition for housing instructions had led to downward pressure on some estate agents' fee rates.

## Agents' survey on credit conditions

The Agents surveyed their contacts during February and March to test the extent to which non-bank businesses had experienced any easing of credit availability over the past year, as well as to assess the impact that this might have had on firms' behaviour. Some 470 firms responded, and results are shown in an unweighted form to highlight any differences in experience by firm size.

The survey found that credit availability had increased over the past year, and by more than in the preceding year (**Chart A**). Reports of increased availability of credit were common to firms in all sectors and of all sizes.(1) In contrast, little change in the cost of credit was reported in the survey (**Chart B**), despite frequent reports from a range of contacts over recent months of strong competition among banks to lend and increased switching between lenders.

### Concerns over credit availability

Respondents to the survey were asked to identify 'major' or 'minor' business concerns from a specified list. Responses suggested that access to finance was not currently among the most pressing issues for businesses. The regulatory environment and ongoing pressure on profit margins were both mentioned almost twice as frequently than credit, while staffing issues such as retention or recruitment difficulties and the weakness or uncertainty of demand also featured more prominently.

### Demand for finance

A positive net balance of respondents reported growth in demand for finance over the past year (**Chart C**). This pattern was common across sectors and most pronounced among construction contacts. But the increase was not materially greater than in the previous survey, suggesting that demand for finance had not accelerated recently.

**Chart A** Availability of credit

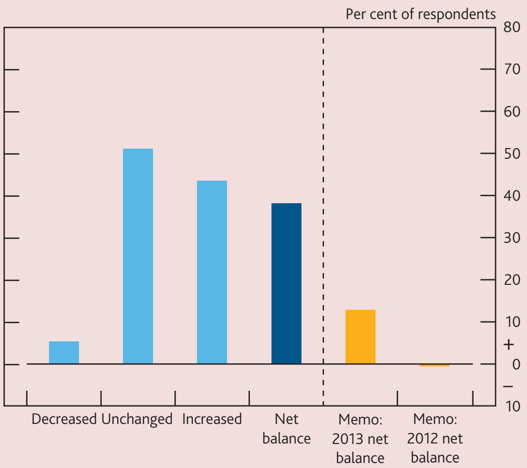



**Chart B** Cost of finance

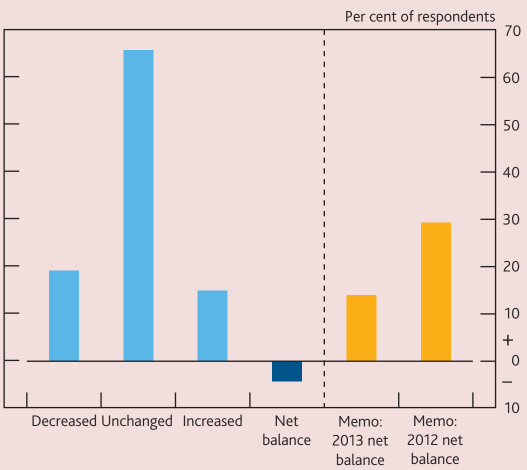



**Chart C** Demand for finance

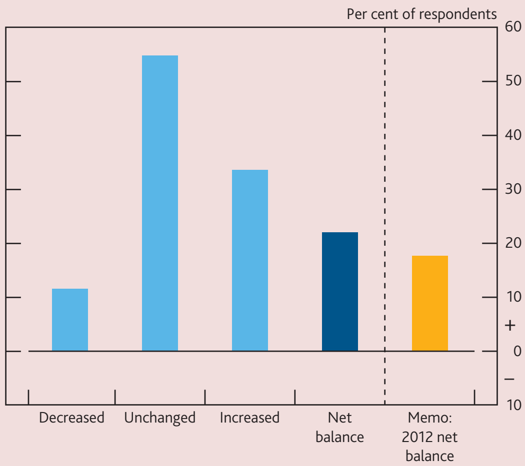
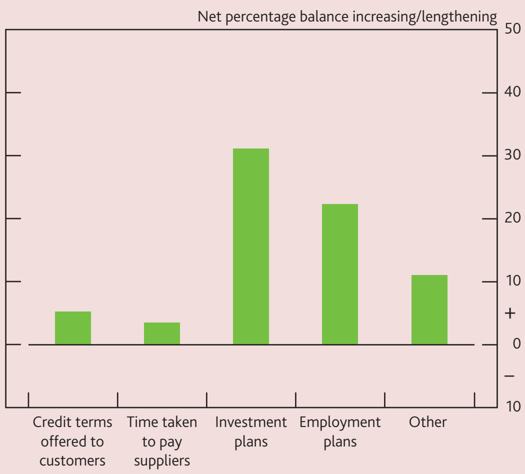



**Chart D** Impact of changes to credit conditions



### Effect of changes to credit conditions

Firms that had experienced changing credit conditions were asked if this had caused any changes to their behaviour. A net balance of around a third reported increased investment plans (**Chart D**), a stronger response than in 2012 and 2013 when trends in credit availability were considered more mixed. Taken at face value, this could indicate upside news relative to the picture of modest growth in investment expectations painted by the Agents' capital expenditure survey in October 2013. But some caution should be exercised in interpreting these results. Respondents may have thought about 'investment' in the credit conditions survey in broader terms than capital expenditure alone, to include, for example, acquisitions activity and investment in training. In addition, capital spending tends to be dominated by large firms, many of whom have not been credit constrained for some time, whereas these survey results focus equally on firms of all sizes.

(1) For purposes of firm-size analytics, firms were split into large (turnover >£50 million), medium (£10 million–£50 million) and small (<£10 million).