BANK OF ENGLAND

Agents' summary of business conditions

January 2014

- Annual growth in the value of retail sales had eased, but consumer services turnover growth had edged higher.
- Housing market activity had continued to strengthen.
- Investment intentions in both manufacturing and services had continued to point to modest growth in capital spending over the next twelve months.
- Annual growth in business services turnover had edged higher.
- Manufacturing output growth for the domestic market had risen further. Moderate growth in the value of manufactured exports had continued, though the pace of growth had eased very slightly.
- Annual growth in construction output had increased further, with signs that growth was spreading beyond house building.
- Credit availability had continued to improve gradually, including for small and medium-sized enterprises, with evidence of increasing competition to lend.
- There were widespread reports of growth in employment, albeit often incremental. Recruitment difficulties had edged higher and were now close to normal levels.
- Spare capacity had continued to be eroded gradually as output rose.
- The annual rate of growth in labour costs per employee had edged higher, though remained moderate.
- Inflation in materials costs had remained subdued and imported finished goods price inflation had edged lower.
- Output price inflation had remained muted, but profitability had edged higher alongside rising business volumes.
- Inflation in consumer prices had fallen back over recent months, largely reflecting a slowing rate of increase in the price of retail 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 November 2013 and late December 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.

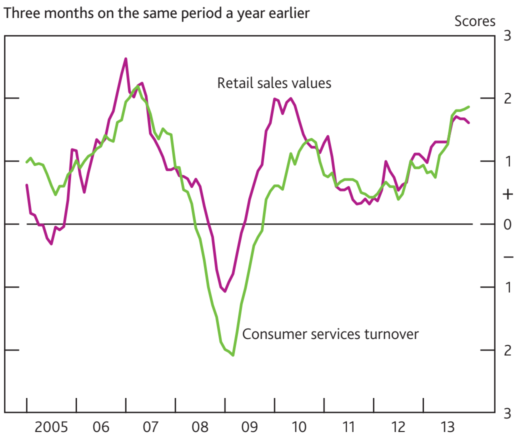
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

Demand

Consumption

Annual growth in the value of retail sales had eased a little (**Chart 1**). Contacts had reported some 'reining in' of retail spending ahead of the festive season, in part reflecting expectations of discounting to come nearer to Christmas and that the mid-week timing of Christmas Day had caused purchases to be delayed until the few days before (a box on page 5 summarises an Agents' survey of consumer spending over the Christmas period). The volume of food sales was reported to be broadly flat on a year earlier. But spending on a number of household durables was reported to be gradually strengthening, partly linked to stronger housing market activity. Annual growth in new car sales had remained robust, though some contacts reported an easing in the pace of that growth in recent months. Consumer services growth had edged higher (**Chart 1**). A gradual increase in appetite for leisure spending was reported, reflected by steady growth in hotel, restaurant and coffee shop activity, as well as rising demand for visitor attractions and domestic travel. Looking across the consumer-facing sector, expectations were generally for moderate growth in sales to continue overall, restrained by tight disposable incomes.

Chart 1 Retail sales values and consumer services turnover



Housing market

Housing market activity had continued to strengthen both for newly built and existing homes. Demand for house purchase was being buoyed by rising household confidence, improved mortgage availability, and the effects of the Government's Help to Buy scheme. Activity had picked up most at the lower end of the property scale, reflecting rising first-time buyer and buy-to-let activity. Estate agents reported falling levels of stocks of homes for sale, albeit in some cases from previously elevated levels, as sales outpaced new instructions. That was contributing to some upwards pressure on selling prices, though house price inflation outside London was generally reported to have remained modest.

Business investment

Investment intentions had edged higher in the service sector and, for both manufacturing and services, had continued to point to modest growth in capital spending over the next twelve months. Investment was reported to be mostly small-scale and largely driven by: a desire to increase efficiency; long-delayed replacement of equipment; or, in a growing minority of cases, modest increases to capacity. There were some early signs of an increase in the number of companies considering larger-scale investment plans, though these were still tentative and unlikely to impact on spending for some time. Corporate spending plans were often reported to be focused on property or mergers and acquisition (M&A) activity, though that might be followed by rising capital spending in due course.

Exports

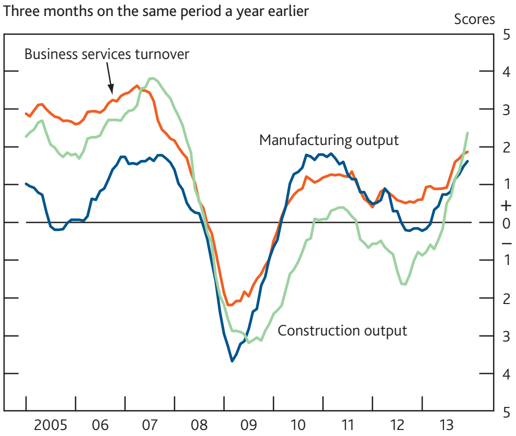
Moderate annual growth in the value of manufactured exports had continued. The pace of growth had eased very slightly, however, reflecting slowing demand growth in some emerging markets and a dampening effect from sterling's recent appreciation among some companies, particularly producers of basic goods. Among the major industrial economy markets, growth in exports to the United States was often reported to have remained robust, while demand from the euro area had stagnated overall, with some contacts expressing concerns about weakening demand in France, albeit offset partially by improving demand from Ireland. Moderate goods exports growth was generally expected over the coming year. Among service companies, growth in exports on a year earlier were reported by engineering and consultancy firms operating in the Middle East.

Output

Business services

Annual growth in business services turnover had edged higher (**Chart 2**). Marketing, public relations and advertising spending was reported to have picked up somewhat against a backdrop of economic recovery. Demand for a range of professional advisory services had risen further, alongside increases in the number of corporate finance transactions, initial public offerings and mergers and acquisitions deals. Recruitment agency and training activity had also picked up further as churn in the labour market had risen. IT services growth had remained strong. Property-related activity had picked up further alongside growth in housing market activity and some recovery in commercial property investment. Among other business services, haulage and distribution was reported to have been boosted by rising construction activity, and business travel and corporate hospitality had risen modestly over the past year.

Chart 2 Manufacturing, business services and construction output



Manufacturing

Output growth for the domestic market had risen further (**Chart 2**). Areas showing robust growth included aerospace, automotive and energy-related supply chains. Construction materials production was showing rapid growth, alongside rising house-building activity and some pickup in general construction. However, defence output growth had weakened, reflecting shrinkage in military spending internationally. Steel production and printing output had also remained weak. As a whole though, manufacturing contacts were positive about prospects for output growth in 2014.

Construction

Annual growth in output had increased further (**Chart 2**). That had largely reflected accelerating private house building. The pace of recovery in that subsector had led to recruitment difficulties and shortages of certain building materials (bricks, blocks), though views were mixed about how quickly those potential constraints would ease. There were also signs of growth starting to pick up in commercial construction activity, with increasing construction of small-scale industrial units alongside increased demand for warehousing and manufacturing space. Growth in smaller-scale refurbishment activity had also picked up, both in the residential and commercial sectors. Office construction activity remained robust in London, though subdued outside the capital.

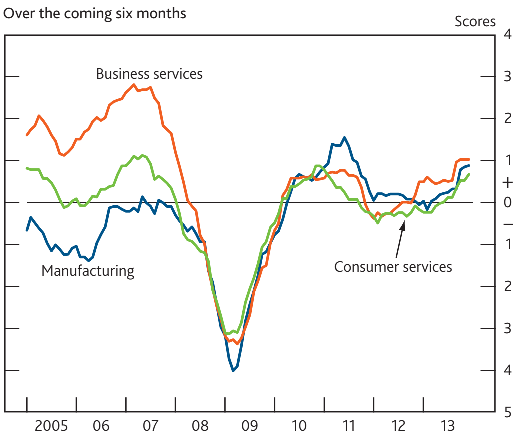
Credit conditions

Credit availability had continued to improve gradually, including for small and medium-sized enterprises (SMEs), with evidence of increasing competition to lend. The number of contacts identifying access to finance as an impediment had declined, and increasing competition was leading to some reduction in the cost of corporate credit. Credit was reported to be readily available for large firms and in most cases for medium-sized firms. But credit availability for small companies remained tighter than it had been on average before the recession, particularly where companies lacked tangible assets to provide as security or had previously breached covenants. Some larger companies were reported to be raising funds from capital markets to provide finance for future M&A opportunities. More generally, credit demand had remained subdued, though there were signs of some gradual increase, including in SMEs' use of asset finance to replace aging equipment.

Employment

Employment intentions had continued to point to modest employment growth over the next six months (**Chart 3**). Recent growth in contacts' workforces had often been incremental, in response to increased activity or expectations of further growth in activity to come, but those increases had been broad-based across the economy. Productivity was often reported to be rising, but typically by less than the growth in demand. In some cases, contacts reported increased productivity of back-office staff as activity had risen, but that more front-line staff were being taken on to win business in a highly competitive market. Across sectors, employment intentions were little changed on the previous month, though had edged higher in consumer services. Increased housing market activity was leading to rising employment in related areas, including estate agency and conveyancing.

Chart 3 Employment Intentions



Recruitment difficulties had edged higher and were now close to normal levels. For lower-skilled occupations, recruitment conditions had remained easier than normal. But there were increasing reports of problems in recruiting skilled labour across a range of occupations. Those reports had extended recently to include some senior sales staff, management and HGV drivers, in addition to IT, engineering and a widening range of trades and professions related to the housing market. Staff attrition was reported to be rising, albeit from a relatively low base, with companies often seeking to replace departing staff by recruiting and training more junior staff, such as apprentices. In some cases, that had had adverse effects on company productivity in the short term.

Capacity utilisation

Output growth had continued to erode gradually spare capacity. Overall, capacity utilisation was close to normal levels in manufacturing and services, albeit with marked divergences between different subsectors of the economy. Across manufacturing and service sectors, utilisation of labour was reported to be greater than that of plant and equipment, and companies often reported that they would be likely to respond to rising demand by increased staffing ahead of strengthening investment, though they remained focused on raising the productivity of their existing resources. In house building, supply chain utilisation was rising rapidly, which in some cases was being reflected in lengthening lead times. Views on the extent to which constraints might bind on house building growth in the short term were mixed, with some contacts suggesting that potential bottlenecks could be eased by plans to sustain higher materials production through winter months and by a return of skilled workers to the sector as construction wages rose. But others expected that the underlying growth in activity would cause constraints to impinge increasingly on construction output.

Costs and prices

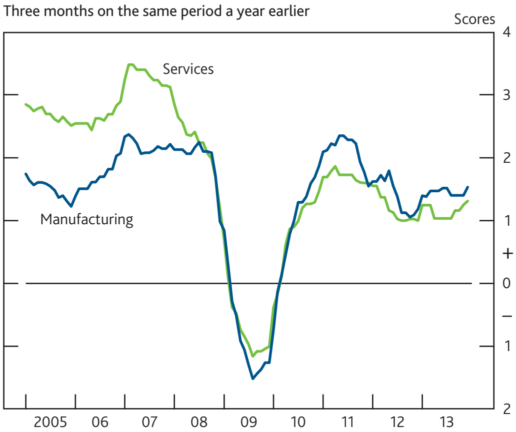
Labour costs

The annual rate of growth in labour costs per employee had edged higher, though remained moderate (**Chart 4**). That rise had reflected a pickup in the number of reports of pay creep for some skills where recruitment was difficult, as companies sought either to retain or attract key staff, though as yet the labour costs of only a minority of contacts had been significantly affected. More generally, fewer pay freezes were now being reported across the economy. Some contacts noted that wages had become more closely tied to profitability during the downturn, potentially strengthening the relationship between pay and productivity going forward. Among firms that had transitioned to auto-enrolment pensions, employee opt-out rates were often reported to be low, contributing to labour cost growth in excess of the rate of wage inflation.

Non-labour costs

Inflation in materials costs had remained subdued. Upwards pressure on non-labour input costs had remained largely confined to energy prices, though in the construction sector, there were reports of some significant increases in a range of basic house building materials prices. Imported finished goods price inflation had edged lower, largely reflecting the downward effect from weaker growth in emerging markets and in some cases, from sterling's recent appreciation.

Chart 4 Labour costs per employee



Output prices and margins

Output price inflation had remained muted. Companies reported strong resistance from buyers to price rises unless there had been a clear rise in the cost of the principal component of their business. In general, companies were concerned that a price rise may lead customers to look elsewhere, given clients' continued focus on their cost base and highly competitive markets. Profitability growth was little changed for manufacturing, but had edged higher for services companies as stronger activity had reduced average costs and allowed some contacts to shift away from lower margin work. Some exporters reported that the recent rise in the value of sterling was putting downwards pressure on their margins.

Consumer prices

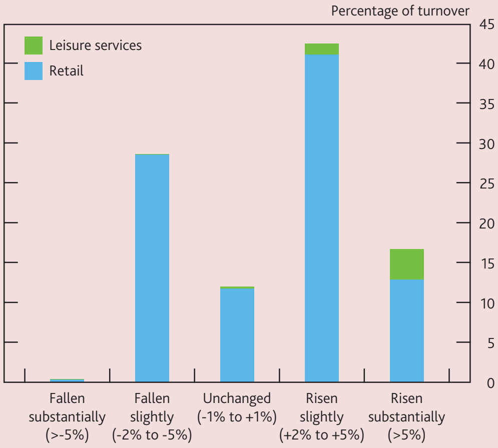
Inflation in consumer prices had fallen back over recent months, particularly for retail goods. That had primarily reflected lower road fuel prices, and an easing of food price inflation following improved harvests in 2013, though some contacts also reported an intensification of competition among retailers. Scheduled energy price rises would provide some upward pressure on inflation to come. But there were expectations of downwards pressure on inflation in public transport prices linked to retail prices index (RPI), as earlier falls in RPI inflation fed through with a lag. More generally, contacts reported that inflationary pressure was generally subdued and that consumers remained highly sensitive to price increases.

Agents' survey of consumer spending over the Christmas period

As in previous years, the Agents conducted a survey of retailers, shopping centres and leisure service providers in late December and early January to get a view of sales over the Christmas and New Year period. Two hundred and thirteen businesses responded this year.

Contacts were asked about trading relative to the same period a year earlier. Weighted by turnover, around 60% reported growth in sales values (**Chart A**), with a little under 20% seeing growth in excess of 5%. By comparison, in the 2012/13 survey 75% of respondents reported growth in sales values and around 15% recorded growth in excess of 5%. For leisure services respondents, some 95% of contacts when weighted by turnover reported stronger growth in sales than a year earlier.

Chart A 2013 seasonal turnover versus 2012

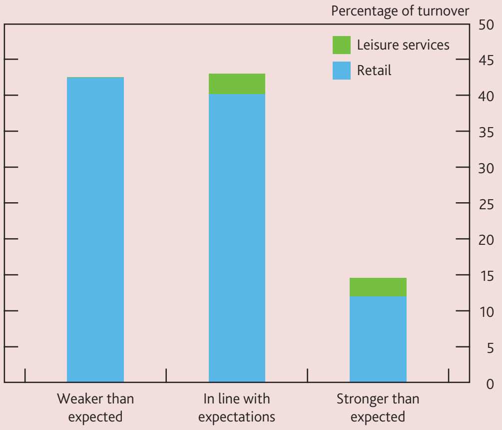


A key theme from contacts' reports was a further movement towards online retailing this year. In particular, those retailers combining a strong online offer with a good physical presence benefited from robust 'click and collect' sales growth, albeit sometimes at the expense of their sales in store.

Within total spending, consumer electronics had sold well, particularly tablets and gaming. But clothing retailers noted that the sale of winter clothing in December had been held back by particularly mild weather compared with a year earlier and food retailers reported some difficulty in growing underlying volumes this year. Most contacts reported stronger trading in the final week/weekend before Christmas and at the subsequent start of their main discounting period. For leisure services, a combination of volume growth and price inflation had led to positive outcomes for most businesses surveyed, with hotels, coffee shops and restaurants experiencing good growth.

On balance, sales were below expectations. Around 40% of contacts reported sales below expectations, compared with around 15% above (**Chart B**). Again the picture was more positive for leisure service providers, for whom trading was stronger than expected.

Chart B Sales versus expectations



Respondents were also asked about the timing and magnitude of promotional activity. Around 85% of contacts reported the timing of discounting as broadly similar to a year ago. A balance opted to discount earlier in a bid to limit stock overhang. The level of discounting was, overall, a little deeper than a year ago with more sophisticated non-price promotional techniques, such as loyalty schemes and vouchers, used extensively. The majority of retailers maintained a tight control on stock management.

Finally contacts were asked about expected sales for the next three months relative to a year earlier (**Chart C**). Around two thirds of contacts, when weighted by turnover, expected a rise in sales, though most were anticipating low, single-digit growth. Leisure services providers were the most optimistic, with almost all expecting sales growth. Nonetheless, many contacts reported that pressure on disposable incomes from higher energy bills, public transport fare rises, and sluggish wage growth were acting as a drag on their expectations for sales.

Chart C Sales expectations for 2014 Q1 versus 2013 Q1