BANK OF ENGLAND

Agents' summary of business conditions

July 2014

- Retail sales and consumer services values had continued to grow at a steady rate.
- Activity in the housing market had eased, reflecting the effect of the implementation of the Mortgage Market Review and a shortage of properties for sale.
- Contacts' capital expenditure plans suggested steady growth in investment over the next twelve months.
- Business services turnover growth had been little changed.
- Growth in manufacturing output for the domestic market had increased slightly. Manufacturing export values had continued to grow at a moderate rate, although sterling's appreciation had negatively affected export margins.
- Construction output had continued to grow strongly, with growth widening out beyond house building.
- Corporate credit conditions had continued to improve, with few reports of companies not being able to access finance.
- Employment intentions had risen, pointing to moderate growth in the next six months. Recruitment difficulties had increased further, remaining modestly above normal levels.
- Capacity utilisation had been little changed, remaining marginally above normal.
- Growth in total labour costs per employee had remained moderate.
- Materials costs and imported finished goods prices were both lower than a year earlier, partly reflecting the effects of sterling's appreciation.
- Output prices had increased only modestly, despite rising demand. Manufacturing and services profitability had risen further.
- Consumer price inflation had remained subdued.

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 May 2014 and late June 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.**

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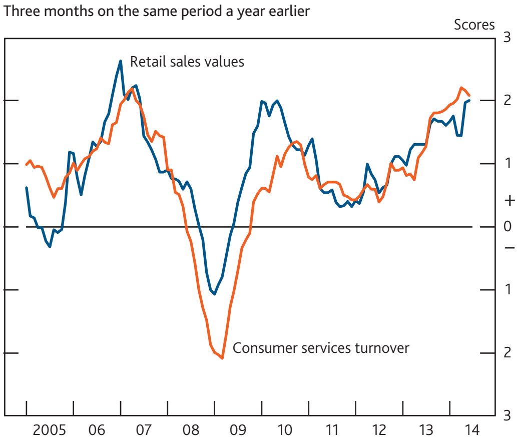
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

Demand

Consumption

Retail sales values growth had been steady, having picked up sharply last month (**Chart 1**). Growth in food sale values had weakened, as competition for market share had led some supermarkets to reduce prices. Across retailers, sales growth continued to be strongest for discount and convenience retailers, and online. Spending on bigger-ticket items, such as fitted kitchens and white goods, had increased, but there were a few reports of sales growth slowing as housing market activity eased. Growth of new car sales had also slowed. Consumer services growth was little changed (**Chart 1**). The better weather had stimulated demand for leisure attractions, hotels, pubs and restaurants. Growth had also been seen in some areas of discretionary spending, such as healthcare. Commuter train journeys had increased further, reflecting employment growth.

Chart 1 Retail sales values and consumer services turnover



Housing market

The slowdown in housing market activity had become more widespread, although transactions were still up on a year ago. Demand for housing-related services, such as estate agents and conveyancing had also slowed. Implementation of the Mortgage Market Review and a shortage of new properties coming onto the market were seen as the main factors behind easing activity. The slowdown in activity was most evident in the secondary market. The new-build market had remained more buoyant, in part due to the boost to first-time buyer transactions from the Help to Buy equity loan scheme. Despite easing activity, there was little sign as yet of a generalised slowdown in annual house price inflation, though contacts in London thought price inflation there had peaked, especially at the top end of the market. Elsewhere, significant price inflation was typically restricted to the most desirable neighbourhoods where multiple bidders were often competing for only a few properties.

Business investment

Contacts' capital expenditure plans suggested steady growth in investment over the next twelve months. Greater confidence in demand was generating growth in capital spending, though some caution remained. Investment growth intentions were a touch weaker in manufacturing than in services, mainly reflecting some strong investment in new industrial production capacity over the past year. Only a minority of manufacturers were now investing to add significant capacity. In services, activity around refurbishment of existing premises, relocation, and expansion into new premises had picked up, supporting investment in commercial real estate. Investment to replace vehicles and IT equipment had remained high. However, for many services firms there was often more focus on intangible investment, for instance brand and product development and staff training, rather than capital spending. Large discount retailers had stepped up the pace of new retail openings and the associated logistics capacity.

Exports

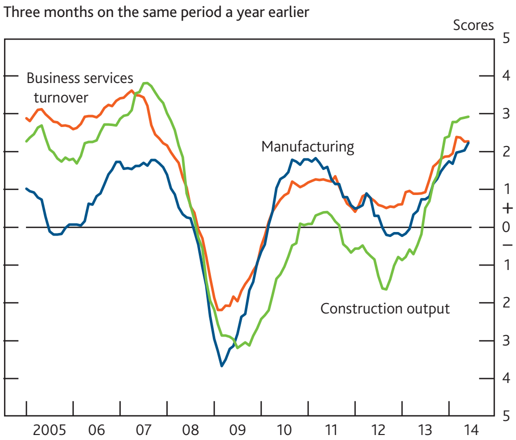
Manufacturing export values growth had remained moderate. The effect of sterling's appreciation over the past year on export volumes had been limited to date, with most of those exporters that had not been hedged absorbing the impact by lowering margins. Further appreciation would potentially have a greater effect on export volumes as exporters felt there was little scope to lower margins further. And even if sterling remained at its current level, some contacts expected a negative effect on volumes to feed through over time as they would need to respond by raising export prices. Export growth had continued to be maintained in the automotive sector and for prestige UK brands. Demand from Europe had edged up overall and exports to the United States had continued to strengthen. Appetite for exporting to emerging markets had eased a little as demand was generally weaker, and the effects of political instability in Ukraine had started to restrain exports to both there and Russia. Services exports had strengthened further. Business travel into the United Kingdom had increased on a year ago, as had foreign tourist numbers. Demand for architectural design and engineering consultancy services continued to be strong, and software businesses reported buoyant global activity.

Output

Business services

Business services turnover growth had been little changed (**Chart 2**). Activity was reported to be growing across a wide range of subsectors. In professional and financial services, corporate finance had remained one of the strongest areas. The recent surge of pent-up demand for initial public offerings and mergers and acquisitions activity had eased, but contacts reported a strong pipeline ahead. Activity in a range of property-related services had risen strongly alongside strengthening commercial real estate investment and construction activity. Reports of activity growth in legal services were more mixed. Other business services turnover growth had been steady. Demand for IT, creative media and telecommunication services had increased as corporate budgets had loosened and the shift towards online retailing had continued. In contrast, more traditional media publishers had continued to report declining volumes. Conference and corporate entertainment spending was reported to be increasing.

Chart 2 Output growth



Manufacturing

Manufacturing output for the domestic market had continued to grow steadily (**Chart 2**), and forward order books had remained healthy. Growth was strongest in automotive, energy, rail infrastructure, homeware goods (furniture and furnishings) and the construction supply chain. The pace of aerospace orders growth had slowed, but there remained a large backlog to fulfill. Food and drink volumes had risen, as retailers and pubs stocked up in anticipation of World Cup sales. Growth was weakest in defence, paper and printing and the supply chain for truck manufacture — the latter having previously been boosted by purchases ahead of new emissions regulations.

Construction

Construction activity had continued to rise strongly (**Chart 2**), with the pickup widening from house building. Public sector investment in health, education, roads, rail, energy and other infrastructure had been stronger than many contacts' expectations. Private sector investment in buildings was also stronger, particularly in warehousing and distribution, hotels and student accommodation. However, construction activity in new office capacity had remained weak in many cities outside London. In house building, output continued to grow strongly with evidence that smaller builders had become increasingly active as credit conditions had eased. Materials and labour shortages were regularly cited as a constraint by builders, along with the availability of land with planning consent in some areas. Some contacts also noted that plant and machinery were in short supply.

Credit conditions

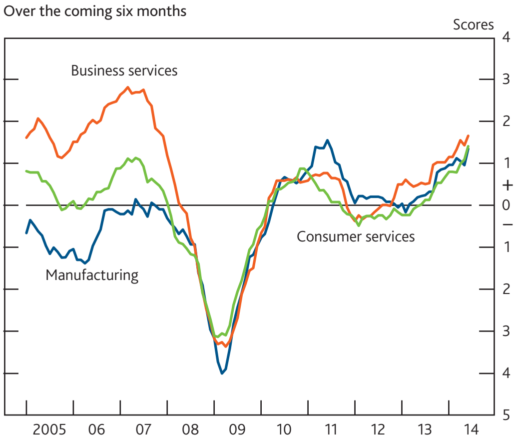
Credit conditions had continued to improve with few reports of companies not being able to obtain finance. Corporate and bank contacts reported increased competition to lend to companies with strong balance sheets, with some noting a further easing of loan pricing and covenants. More generally, most firms reported being able to borrow from banks, although the rates and terms available still deterred some from seeking funds or led them to look for alternative sources. Loan application processes were widely reported by contacts to be drawn out, and potentially a deterrent to some, especially micro businesses. Net lending growth had continued to be adversely affected by the unwinding of legacy positions by some banks, but gross lending had strengthened, especially to some higher-risk small and medium-sized enterprises, and there was now more appetite to lend against smaller-scale commercial property collateral. Challenger banks were seen by some contacts to be growing in significance, and non-bank alternatives, such as peer-to-peer lending and crowdfunding, were reported to be an increasing source of finance for some firms. There were reports of early refinancing of facilities in order to lock in current low interest rates. In commercial real estate there were some reports of borrowers increasing debt levels after a prolonged period of debt reduction.

Employment

A pickup in employment intentions had gathered momentum across all sectors this month and implied moderate workforce growth (**Chart 3**). Recruitment of apprentices and graduate trainees to combat existing and anticipated skill shortages was increasingly reported, as was recruitment ahead of expected demand growth. In recent quarters some contacts had raised employment by more than they had previously intended, in light of the stronger-than-expected economic recovery. Intentions in business services were strongest, particularly in IT, property and construction-related services. Recruitment in consumer services had largely reflected increasing retail floorspace, but in some cases had been driven by growing online business or was aimed at improving customer service. Manufacturing employment intentions had in many cases been boosted by new product development and plans to address the prospective retirement of some older workers, offset to some extent by a continued focus on automation. Recruitment difficulties had picked up on the month, but remained only modestly above normal. Skill shortages were still most widely reported in IT, engineering and construction.

Workforce turnover had picked up and recruitment bottlenecks were broadening to some other areas as the economy strengthened. Immigration had continued to help meet labour demand in some semi-skilled and low-skilled positions.

Chart 3 Employment intentions



Capacity utilisation

Capacity utilisation had been broadly stable at rates that were slightly above normal. In manufacturing, investment had added capacity in line with rising demand. In some sectors, such as automotive and electronics, capacity constraints were pressing, pointing to a need for further investment. More generally, it was expected that productivity growth, together with plans for additional staffing, would be sufficient to meet demand in the short term. In the service sector, the overhang of retail, warehousing and prime office space was now falling, supporting a modest pickup in investment in new developments. Hotel occupancy rates had continued to rise. Capacity in IT services had remained tighter than normal due to skills shortages, which were reported to be constraining some activity and leading to the subcontracting of work to Eastern Europe. Skills shortages were also a problem for the haulage sector, where levels of utilisation were reported by some contacts to be high.

Costs and prices

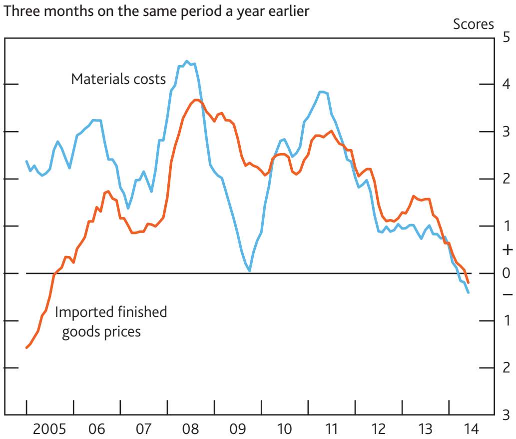
Labour costs

Growth in total labour costs per employee had remained moderate. The majority of pay settlements had continued to be in the range of 2%–3%, although some contacts reported increasing overtime and profit/performance-related pay. Where there were difficulties in attracting new recruits, or concern about staff turnover, some contacts had made higher pay awards to certain employees, though these were only having a modest impact on pay growth overall. More pronounced skills shortages in construction were leading to reports of significantly higher awards in that sector, however. The increase in the National Minimum Wage (NMW) scheduled for October continued to cause concern among some contacts, given the possibility that pay for those close to the NMW would need to rise by a similar amount to maintain existing pay differentials. Some contacts noted a continued shift in workforce composition towards more junior staff, for example through the increasing use of apprentices, which was restraining the growth of their total pay bill.

Non-labour costs

The costs of raw materials and imported finished goods were lower than a year earlier (**Chart 4**), partly reflecting sterling's appreciation over the past year. Downward pressure on import costs from sterling's appreciation was expected to continue as forward contracts and hedging arrangements expired. Global commodity price inflation had remained subdued, although there had been some reports that suppliers planned to post increases in metal and meat prices.

Chart 4 Non-labour input costs



Output prices and margins

Output price inflation had remained modest despite rising demand. In manufacturing, some companies reported output price rises, but the scale of those was limited given a lack of raw material and wage cost pressures to justify price rises. Companies supplying supermarkets and other retail outlets had continued to see little prospect of price increases given competitive pressures. But construction materials, the bulkier of which tend to be UK-produced, were seeing upward cost pressure. Business services output price inflation had increased marginally on the month. Professional fees were rising slowly in high value added, specialist sectors such as IT, engineering services and architecture. There had been further evidence of commercial property rents bottoming out, and for prime space small rental increases had been realised. But in some more commoditised services such as audit, basic accounting and legal services, competitive pressures had remained intense and price increases difficult to achieve. Manufacturing profitability growth had remained positive but had eased back, in part reflecting the effect of sterling's appreciation on exporters' margins. Service sector profitability growth had edged higher, as firms felt increasingly able to refuse low price/low margin work and as output and capacity utilisation rose.

Consumer prices

Consumer price inflation had remained subdued. Retail goods price inflation had edged lower due to competition among supermarkets and discount retailers. Price competition had intensified and there was a move away from vouchers and multi-buy discounts to lowering prices on a wider range of items. Non-food price inflation, notably in clothing and household goods, had been restrained by internet retailing. However, given the more normal seasonal weather, clothing retailers' stock levels were lower than a year earlier and there was less need to discount in the summer sales. New car prices had eased. Consumer services price inflation had also edged lower, although remained higher than for goods. Outside London, many bus operators had moderated fare increases to help stimulate demand. Restaurants, hotels and package holiday providers had increased prices modestly. Contacts generally reported that consumers remained highly sensitive to price increases, which was acting to restrain inflation.