BANK OF ENGLAND

Agents' summary of business conditions

November 2014

- Growth in retail sales values and consumer services turnover had eased.
- Housing market activity had shown little sign of a significant pickup after its summer slowdown, although it had remained higher than a year ago.
- Investment intentions for the next twelve months had remained consistent with moderate growth overall, and had eased for manufacturing.
- Business services turnover growth had remained relatively strong and broad-based across subsectors.
- Manufacturing output growth for the domestic market had eased slightly. Manufacturing export growth had slowed further.
- Construction output growth had remained robust and had continued to broaden out beyond house building.
- Corporate credit conditions had continued to improve.
- Employment intentions had eased for business and consumer services, but overall remained consistent with modest headcount growth.
- Recruitment difficulties had been unchanged, remaining somewhat above normal. Staff churn had picked up.
- Capacity utilisation had remained close to normal levels. Conditions had tightened in the service sector but had eased slightly for manufacturers.
- Growth in total labour costs per employee had remained steady, reflecting modest growth in pay settlements but with some increased wage pressures in subsectors with skills shortages.
- Other than for construction goods, most materials costs had continued to fall on a year earlier. Imported finished goods price inflation had remained negative.
- Output price inflation had remained subdued, particularly for manufacturing companies. Profitability growth had been steady for services but had edged lower for manufacturers.
- Consumer price inflation had remained modest. Price inflation had weakened for retail goods and had remained broadly flat for retail services.

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 2014 and late October 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 of retail sales values had eased. Grocery sales values had been affected both by downward price pressure and by marginally weaker volumes. Unseasonably warm weather had reduced demand for some autumn lines of clothing and footwear, although there had been some signs of demand recovering during October. Demand had remained strong for furniture and household goods, despite a slowing in housing transaction growth. But new car sales growth had continued to ease back from the elevated rates seen in the first half of the year. Consumer services turnover growth had continued to ease, but had remained firmer than for retail sales. Increasingly, turnover of some services, including air travel and leisure attractions, was being sustained by greater use of promotional activity. But demand had continued to grow strongly in many restaurants and hotels.

Housing market

There had been little evidence of a significant pickup in activity after the summer slowdown, although transaction numbers had remained higher than a year ago both for the secondary market and for new homes. Demand was reported to have softened over recent months, particularly for the highest-priced properties, and had become more closely aligned with the supply of properties available for sale. As a result, house price inflation had slowed. Indeed, in London and parts of the South East, house prices had fallen in some areas. Most contacts felt that mortgage providers had now adjusted to the Mortgage Market Review, with mortgage approval times thought to have been permanently lengthened by a few weeks as a result of its introduction.

Business investment

Contacts' plans continued to point to further, moderate, growth in business investment over the next twelve months. In the service sector, the shrinking availability of office and distribution space and relaxation of some financial constraints were supporting investment in new commercial and industrial property development. And while some retailers had curtailed store opening programmes, shopping centres had increased their spending on refurbishment. Spending on energy efficiency programmes and cost-saving technology improvements were expected to remain widespread. However, among manufacturers, the expected rate of growth of capital spending had slowed (**Chart 1**). That was attributed to the completion of earlier investment projects and to a reduction in confidence about growth prospects, particularly in export markets.

Exports

Growth in manufacturing exports had continued to slow (**Chart 2**). Sales growth to the euro area had remained weak, and demand from both the Middle East and Russia had fallen back. But growth in exports to the United States had continued, and some contacts had reported the successful penetration of other, new, markets, as well as sales growth through the introduction of new — often niche — products. Automotive exports had remained relatively robust. The appreciation of sterling had increasingly begun to affect export sales volumes. Growth in services exports had eased slightly. Professional services firms had maintained their strong growth rate, inbound tourism numbers had continued to increase, and some universities were anticipating record numbers of overseas students. For some contacts, weaker European demand had been offset by increased sales to other markets. For some others, activity had slowed as trade restrictions between the European Union and Russia had taken effect. And while foreign demand for construction consultancy had remained generally strong, a number of projects in the Middle East had stalled.

Chart 1 Business investment intentions

Over the coming twelve months

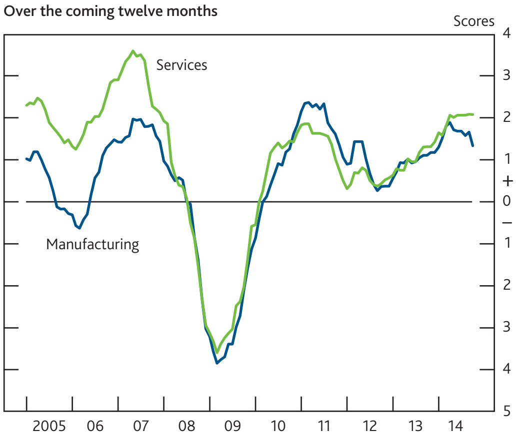
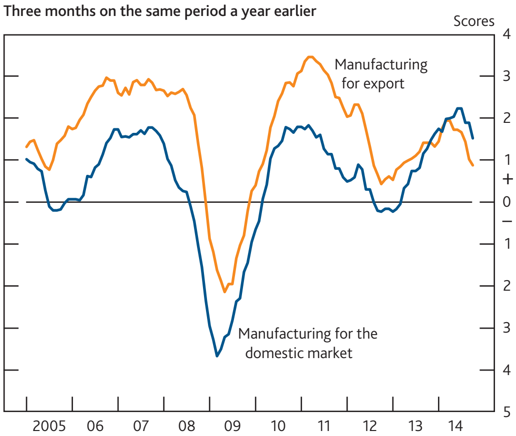


Chart 2 Manufacturing output

Three months on the same period a year earlier



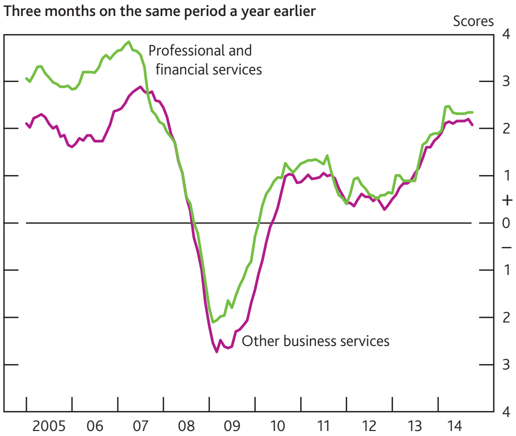
Output

Business services

Turnover had continued to grow at a robust pace (**Chart 3**). In the professional and financial services sector, activity at legal and accountancy firms was increasing across most departments, including advisory and mergers and acquisitions work in particular. Investor and occupier demand for commercial real estate had spread beyond London, increasing the demand for associated services, though some contacts had become concerned that investment flows had driven yields down to levels that were not justified by market fundamentals. Architects, surveyors and civil engineers had benefited from prospective growth in construction output. Bank lending growth had been more positive, and securities trading and investment management contacts had reported steady growth. The markets for insurance, insolvency and restructuring services had remained challenging. Growth in other business services turnover had remained firm. IT services had remained one of the strongest subsectors, as clients increased the use of cloud computing, and sought to increase digital information usage or address cyber security risks. More generally, steady growth was reported across a wide range of business areas including, travel, hospitality and marketing. Demand for facilities management services had increased as occupier demand improved. Wholesalers, transport and logistics companies also reported firm growth, although those serving the grocery sector reported more challenging conditions.

Chart 3 Business services turnover growth

Three months on the same period a year earlier



Manufacturing

Growth in manufacturing output for the domestic market had eased but remained positive (**Chart 2**). While demand for construction materials production had remained strong, broadening beyond housing, elsewhere contacts reported a slowing in output growth. In particular, there had been a slowdown in the demand for intermediate products from export supply chains. There had also been some signs of an easing in demand for steel and chemicals production.

Construction

Robust growth in construction output had been maintained and had continued to broaden out beyond house building. Reports of commercial development activity had spread from logistics and student accommodation to include industrial units and factory expansions. Office development activity had also picked up, a proportion of which was now speculative in nature. Demand from the health and education sectors and from the nuclear industry had increased. Material and labour shortages had led to some delays in house building, although house builders had not yet scaled back their build programmes in response to softening housing demand.

Credit conditions

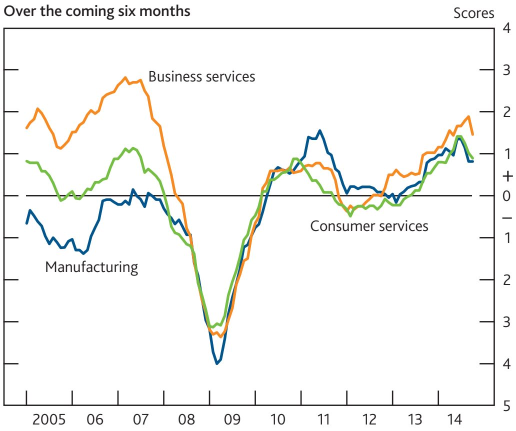
Overall, credit conditions had continued to improve. Banks were competing hard for lower-risk business lending on both price and non-price terms, although they had continued to favour larger and asset-rich businesses and higher value loans. The desire among some companies to increase capacity, either through acquisition or organic growth, had led some to consider borrowing once more, having spent several years building their cash positions instead. For some small firms, access to bank finance had remained difficult or subject to unattractive terms. But awareness of non-bank alternative funding sources had grown, and investment capital had started to feed through to smaller firms, usually through non-bank intermediaries.

Employment

Employment intentions had eased back in recent months but had continued to be consistent with modest headcount growth (**Chart 4**). Moderation in employment intentions had often reflected an increased contribution from productivity growth to meet demand and, for some, had reflected a restructuring of operations. Recruitment plans reflected expanding output, a pickup in staff churn and, in some cases, a desire to catch-up on apprenticeship and trainee programmes, where numbers had faltered since the recession. Across sectors, employment intentions were strongest for business services companies (**Chart 4**), particularly among IT, legal, accountancy and property firms. Consumer services intentions were largely being driven by the expansion of café and restaurant chains, with job creation for online retailing roles offset by headcount reductions in physical stores. Employment growth was expected to remain positive within manufacturing, though tempered by a focus on efficiency gains.

Recruitment difficulties were unchanged, remaining somewhat above normal. Skill shortages had remained most acute for IT, engineering, some professional services, haulage, and construction employers, although there continued to be a ready supply of labour for unskilled work that often included migrant workers. Some contacts, particularly in business services, had reported that staff churn was rising as employees were becoming more confident about changing employers, whether in pursuit of a higher salary or career progression.

Chart 4 Employment intentions



For the majority of contacts, however, staff turnover had remained lower than normal. Only in a small number of cases had recruitment difficulties led contacts to turn work away, although some had admitted to paring back business development activity in anticipation of future staffing constraints.

Capacity utilisation

Capacity utilisation had remained close to normal levels. In manufacturing, capital utilisation had eased slightly and labour utilisation had become more aligned with current activity, although there remained some areas of tight capacity — notably in the production of building materials. In construction, house builders had continued to report shortages of both materials and labour. Service sector capacity utilisation had increased and was tightest in professional and financial services, especially those relating to property and construction. Elsewhere both investment and recruitment had eased the pressure of activity growth. But as retail demand continued to shift from physical stores to online sales, some consumer services firms had reported a mismatch between the structure of their distribution capacity and that of retail demand.

Costs and prices

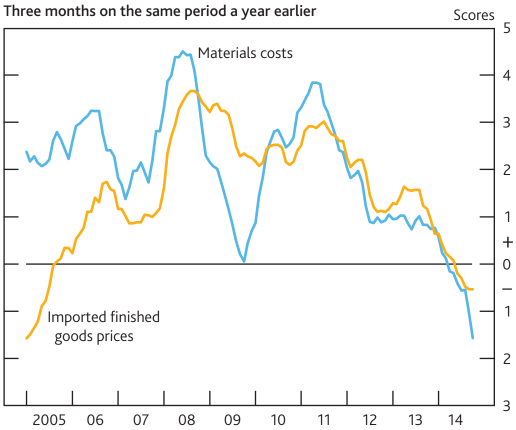
Labour costs

Pay settlements had mostly remained modest. A tightening labour market had led to some upward wage pressure in subsectors with skills shortages. In particular, in construction and some business services subsectors, contacts had reported increasing incidence of special awards or payments to retain staff. But, in some cases, a shift towards lower-skilled employees had helped to offset higher pay growth among existing staff. And where manufacturers had reduced overtime in the face of lower demand, this too had also reduced growth in labour costs. October's increase in the National Minimum Wage (NMW) would raise the pay of lower-paid staff by a rate around the top of the 2%–3% range still typical of most settlements. But other than in subsectors that were significantly affected by the NMW, there had been relatively few recent general pay decisions. Contacts looking ahead to 2015 thought that a lower rate of consumer price inflation might alleviate some of the upward pressure that had developed since the beginning of this year.

Non-labour costs

Materials cost inflation had fallen (**Chart 5**), other than for construction goods, where it had generally remained above 5%. Falling oil prices had led to lower costs for oil-based materials, such as plastics, in addition to exerting downward pressure on haulage costs. Wholesale gas and electricity costs had also moderated. Food input costs had fallen in response to good global harvests and the indirect impact of sanctions on exports to Russia, which had led to greater competition to sell into European markets, including the United Kingdom. Many imported finished goods costs had also continued to fall (**Chart 5**), although some contacts had seen inflation in goods costs from China, as suppliers had begun to pass on increased labour rates.

Chart 5 Raw materials and imported finished goods prices



Output prices and margins

Manufacturing output price inflation had remained subdued. Most manufacturing contacts had reported that it was difficult to raise prices given competitive markets and low input costs. Those supplying the retail sector had continued to experience significant downward pricing pressure. Business services output price inflation had been unchanged, with service sector companies also reporting a difficult pricing climate, particularly for more 'commoditised' services. Professional and financial services had been able to increase prices for more specialised services, however, as demand had improved. In the haulage sector, lower fuel surcharges had been offset by higher pay pressures, so that output prices had been fairly static. There had been only limited scope for price increases in sectors with excess capacity or strong competition prevalent, such as security and cleaning.

Manufacturing profitability growth had reduced slightly. For some, declining input costs and increased efficiency, coupled with higher volumes, had allowed some improvement in profit, even though margins had remained slender. But sterling's appreciation over the past year had reduced the operating margins of many exporters. Service sector profitability had continued to grow steadily largely reflecting improved volumes, efficiency gains from previous investment and, for some firms, a greater ability to accept only higher margin work. But some construction firms' margins had come under more pressure because sharp rises in labour and material costs had reduced the profitability of some previously agreed fixed-price contracts.

Consumer prices

Retail goods price inflation had weakened further. Prices for many groceries had remained under downward pressure, reflecting falls in food commodity prices and intense competition among retailers. Some department stores' autumn sales had been brought forward following disappointing clothing and footwear sales. Vehicle fuel prices had fallen further. Overall, services price inflation had remained broadly flat. Stronger summer visitor numbers in many regions had supported higher prices for some accommodation and catering services. A number of public transport providers, also benefiting from stronger demand, had increased prices, but some air fares had fallen back. Domestic utility prices had remained flat. Domestic rents, which had been increasing modestly, had shown signs of flattening off, but some household insurance bills had drifted up. Consumers of discretionary services had remained highly price sensitive, a reflection of the continued pressure on many households' budgets.