BANK OF ENGLAND

Agents' summary of business conditions

2015 Q3

- Activity had generally grown solidly on a year earlier, with contacts attributing increased demand to rises in real incomes and credit availability. Growth among export-oriented companies had been subdued overall.
- In property markets, demand for commercial property had increased alongside economic activity, and investment into the sector had remained strong. Housing market activity had picked up by less than many contacts had expected.
- Recruitment difficulties had increased in recent months, with signs of building pressure on labour cost growth in the service sector. But services price inflation had remained modest and goods prices were lower than a year ago.

Consumer spending had continued to grow at a moderate rate, supported by rising real incomes and increasing availability of low-cost finance.

Business services turnover growth had remained firm, with a range of professional services buoyed by increasing corporate finance and mergers and acquisitions activity.

Manufacturing output growth had been modest overall, partly reflecting weak export demand due to sterling's appreciation and subdued world demand growth.

Construction output growth had edged up as commercial development activity had risen alongside robust house building activity.

Investment intentions remained consistent with modest growth in capital spending. Services companies' intentions were generally stronger than manufacturers'.

Corporate credit availability had increased slightly, with pricing and terms of credit reported to have eased.

Occupier demand had risen further in the **commercial real estate market**, and investor demand had remained strong.

Housing market activity had increased, but remained constrained by a shortage of properties available for sale (see Box 1 on page 4).

Capacity utilisation was slightly above normal in services firms and slightly below normal for manufacturing.

Employment intentions pointed to continued modest growth in staffing numbers, but **recruitment difficulties** had risen. Growth in **labour costs** had remained moderate, although there were signs of building pressure in services.

Materials costs were lower than a year ago, though the pace of decline had eased. **Imported finished goods prices** were slightly lower than a year earlier.

Manufacturing **output prices** were lower than a year earlier but, as for materials costs, the rate of decline had eased. Business services price inflation had eased slightly.

Consumer price inflation for goods had remained negative, having stabilised after sharp declines earlier in the year. Consumer services price inflation had edged higher but remained modest overall.

This publication is a summary of monthly reports compiled by the Bank of England's Agents between late May 2015 and late August 2015. It generally makes comparisons with activity and prices a year earlier. The report does not represent the Bank's own views, nor does it represent the views of any particular company or region. More information on the Bank's Agencies can be found at www.bankofengland.co.uk/publications/Pages/agentssummary/default.aspx.

Consumer services and retail sales

Annual growth in retail sales values had remained modest, and had eased over the past three months. Annual comparisons for some goods had been adversely affected by poor weather relative to a year earlier and the boost from the 2014 World Cup at that time. More generally, the rate of sales values growth had remained depressed by falls in prices of some retail goods. Within the total, food sales had remained broadly flat, but sales growth of some larger household durables, including furniture and cars, was reported to be fairly robust, supported both by rising real incomes and increasingly available low-cost credit. Consumer services turnover growth had continued at a somewhat stronger pace than retail sales. Contacts reported robust growth persisting across a range of leisure services, including hotels, restaurants, visitor attractions, theatres and cinemas. Early bookings for Summer 2016 holidays were generally ahead of earlier expectations.

Business and financial services

Growth in business and financial services turnover had remained firm overall (**Chart 1**). Steady growth in accountancy, legal and consultancy services had been driven by increasing corporate finance and mergers and acquisitions activity. That activity had been associated with a modest increase in demand for bank lending. Some professional and financial services contacts had reported a rebound in activity following a pre-general election softening. IT services growth had remained robust, driven by systems upgrades, cloud computing and cyber security. Marketing, advertising and recruitment agencies reported continued growth. There had been significant delays for some transport and logistics firms as a result of channel port and rail disruption, but that had not appeared to affect overall growth in business activity significantly. Growth in exports of business and financial services had eased, in part reflecting sterling's appreciation against the euro and a decline in demand for oil and gas related services exports.

Production

Growth in manufacturing output for the domestic market had slowed a little, remaining modest overall (**Chart 1**). Automotive and aerospace companies had continued to report solid output growth. But the impact of weakening demand from the oil and gas sector had continued to feed through related manufacturing supply chains, even though UK oil and gas output itself had risen as previous investment in capacity came on stream. The appreciation of sterling against the euro had led to increasing competition from other European manufacturers in domestic and export markets. Alongside weak global demand growth, that had contributed to subdued manufacturing export growth. For some contacts, export volumes into continental Europe had started to decline. Demand from China had weakened over recent months for a range of goods, including capital equipment, infrastructure products, pharmaceuticals and cars. But exports to the United States had continued to grow.

Construction

Construction output growth had edged up (**Chart 1**). Private house building had been robust and was expected to remain so, although contacts reported increased uncertainty about prospects for social house building following government announcements of Right to Buy proposals and social housing rent reductions. Rising demand for office and industrial space had encouraged more commercial development, including some speculative projects in prime locations. Older office space had increasingly been converted into residential or student accommodation. Growth in retail construction had remained relatively subdued, however, due to reductions in larger superstore projects.

Investment

Investment intentions had remained consistent with moderate growth in spending over the coming year. Service sector intentions had strengthened a little over the past three months (**Chart 2**). Increasing investment in IT to

Chart 1 Activity

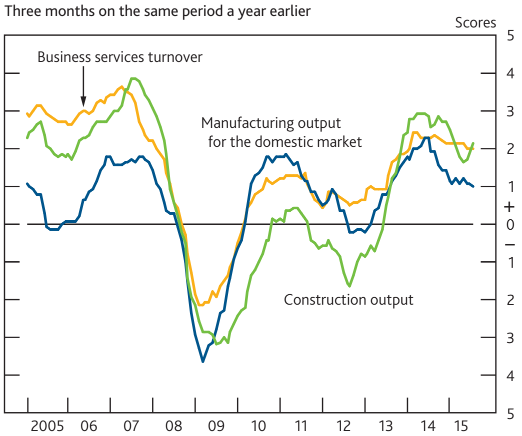
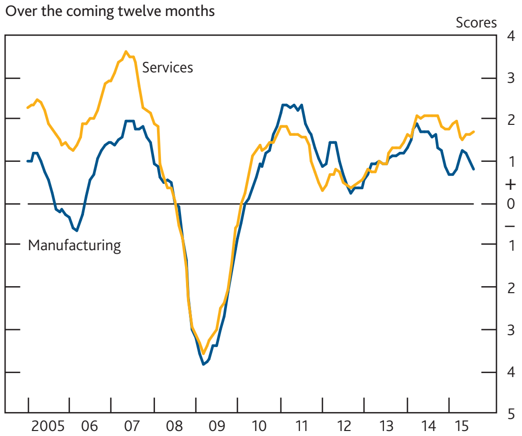


Chart 2 Investment intentions

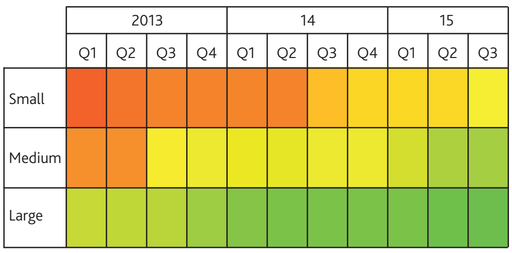


improve security, productivity and competitiveness continued to be reported. A boost to profits from the low oil price had encouraged spending by transportation companies, for example on new vehicles. In contrast, manufacturers' intentions had eased (**Chart 2**). Companies in several subsectors, including food processing and the oil and gas supply chain, reported increased caution about investing. Sterling's appreciation had dampened intentions for some exporters.

Corporate financing conditions

Credit was reported to be readily available for large and medium-sized corporates, with terms and rates having eased alongside rising competition. Contacts at larger companies reported that availability was above normal. For those firms, current borrowing conditions were often said to be comparable to those before the crisis, although lenders' credit assessment was reported to be more robust than at that time. Credit availability for smaller firms had improved and was approaching normal, although it remained tighter than for other firms (**Chart 3**). Peer-to-peer lending and crowd funding were reported to be providing funds to some smaller companies that banks were reluctant to lend to. Demand for credit had been fairly subdued, but was reported to be rising alongside a gradual pickup in confidence and investment. Refinancing activity was reported to be particularly strong, with companies being able to reduce the cost of their finance or ease covenants on lending.

Chart 3 Agents' assessment of corporate credit availability by company size[(a)]



(a) This mapping is based on individual Agencies' national assessments of corporate credit availability, weighted by the gross value added of their regions or countries. 2015 Q3 uses Agents' latest assessment as of August. 2013 Q1 uses assessment as at end-2012. The greater the intensity of red, the tighter credit availability; the greater the intensity of green, the looser credit availability. Yellow indicates normal conditions. Includes bank and non-bank credit. For more details, see England, D, Hebden, A, Henderson, T and Pattie, T (2015), 'The Agencies and 'One Bank', *Bank of England Quarterly Bulletin*, Vol. 55, No. 1, pages 47–55, available at www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q104.pdf.

Property markets

Commercial real estate

Occupier demand for commercial property had continued to strengthen overall. That, combined with low levels of new development over recent years, had led to emerging shortages of good quality space, particularly in the office market. Some rents had risen as a result, but were yet to reach the levels required to stimulate speculative development outside prime locations. Take-up of industrial space had increased further, but there were fewer imbalances between demand and supply than in the office sector, as capacity had started to grow earlier. Demand for existing prime retail space had been strong and the secondary and tertiary retail market had also shown some signs of rising occupier interest, from a lower base. Investor demand had remained strong and had spread further outside London, with both UK and overseas institutional funds active. While bank funding had been generally available for property investment, average loan-to-value ratios offered by UK banks had remained below pre-crisis levels.

Housing market

Housing transactions had picked up slightly over the past three months, but by less than many contacts had expected, reflecting a continued low level of properties available for sale (see Box 1 on page 4). Price inflation had remained generally modest, aside from localised hot spots where bids could sometimes rise above asking prices. Activity had been relatively weak among the highest-value properties, leading to some price falls. Activity in the new build market was generally stronger than the secondary market, with builders reporting strong demand and improved planning conditions and land availability. Rental demand had remained strong, although investor sentiment towards the buy-to-let (BTL) sector had become more mixed following tax reforms announced in the Budget.

Activity in the mortgage market had been buoyed by strong remortgaging activity, against a background of high levels of competition among lenders and low fixed rates. Mortgage availability was reported to be good overall, including at loan to value (LTV) ratios at 80% or higher. Some continuing impacts of the Mortgage Market Review were reported, such as longer transaction times and tighter affordability criteria. Competition to lend to BTL landlords/purchasers had pushed down rates on BTL mortgage products and had led to higher LTV ratios being offered by some new entrants.

Capacity utilisation

Capacity utilisation had been little changed, remaining slightly above normal in services and slightly below normal in manufacturing. Professional services firms reported high rates of labour utilisation and a scarcity of office space to accommodate their rising staff numbers. Shortages of suitable warehousing space had constrained growth at some logistics companies. Hotel occupancy had risen further. But excess capacity was reported in some other parts of the service sector, for example among those servicing the oil and gas industry and in the retail sector.

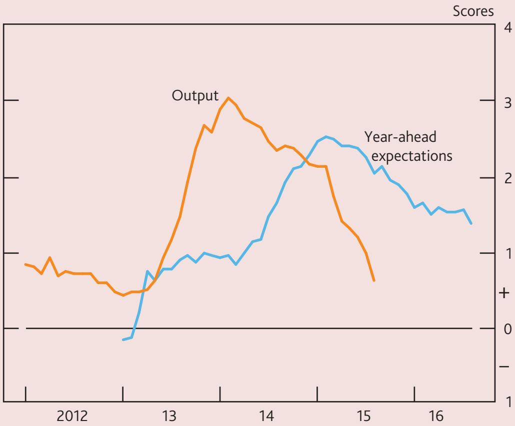
Box 1
Recent developments in housing market activity

One focus of Agents' recent discussions with housing market contacts has been the reasons for continuing subdued levels of housing transactions. Over the past quarter, estate agent contacts have cited shortages of properties for sale as the single biggest constraint on housing market activity across the country, whereas reports were much more variable across regions earlier in the year. These shortages — combined with increased pressure on estate agents' fees as competition has risen — have also been reflected in slowing growth in estate agents' reported turnover (**Chart A**).

The most common explanation provided for low levels of properties for sale has been householders' reluctance to put their homes on the market until they can find a property they want to buy, such that a shortage of properties has been self-reinforcing. The high cost of moving home was also reported as a disincentive for some. Longer-term factors such as the growing popularity and availability of rented accommodation were also reported to be depressing transaction levels. And in some cases, the failure of wage growth to keep pace with house price inflation over recent years had restricted the ability of some existing homeowners to move up the housing ladder.

Estate agents' continuing uncertainty as to what will generate a pickup in properties for sale has dampened their expectations of transactions growth. Nonetheless, they generally indicate expectations of a gradual increase in housing activity over the coming year, consistent with reported expectations for turnover growth that are somewhat higher than that seen over the past year (**Chart A**).

Chart A Estate agents' current and projected turnover[(a)]



(a) Six-month moving averages of Agents' company visit scores. Scores are for turnover for the past three months relative to a year earlier. Expectations have been moved forward twelve months.

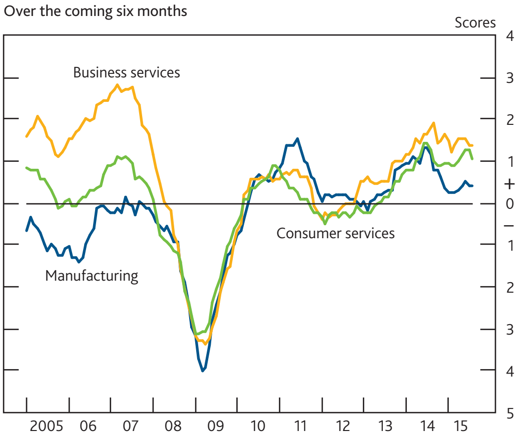
Manufacturers overall reported a little more slack than normal. Some companies reported retaining employees in anticipation of a rebound in orders and due to skill shortages. In the automotive and aerospace industries, however, companies were often operating above normal levels of utilisation.

Employment and pay

Employment intentions had edged down marginally but remained consistent with modest employment growth. The use of new technology and automation was said to be contributing to productivity growth and had softened the employment outlook slightly across sectors. Employment was reported to be rising across a broad range of business services, with the strongest growth in property and construction-related services, IT, accountancy, legal, and regulatory compliance. An easing in consumer services intentions had partly reflected some planned cuts in retail-sector management and head office roles aimed at lowering costs. Manufacturing employment intentions had remained marginally positive overall, due largely to expectations of further hiring in the aerospace and automotive sectors (**Chart 4**).

Chart 4 Employment intentions

Over the coming six months



Recruitment difficulties had increased over the past three months, and were above normal. Skill shortages were said to be constraining employment growth at the margin, mainly for some companies around London and the South East. Recruitment difficulties had spread further in skilled and semi-skilled positions across sectors. Job-to-job flows were reported to be picking up gradually, though they remained lower than pre-recession for most contacts. A tightening labour market had led companies to recruit more trainees, graduates and apprentices rather than seek to hire experienced staff; and to focus on productivity improvements. Lower skilled roles had remained relatively easy to fill, however.

Growth in total labour costs had remained moderate. Outside sectors where the availability of skills was tightest, the majority of pay awards had been around 2%. While there were signs of wage pressure building in the service sector, higher pay awards had continued to be largely limited to specific recruitment or retention issues, rather than increases across the board. Labour cost growth in manufacturing had softened, reflecting a reduction in overtime and shift working. Some intensive employers of lower-skilled labour were concerned about the potential impact on their future labour costs of the Budget announcement on the National Living Wage (NLW). Those concerns were less where younger employees, not subject to the NLW, accounted for a high proportion of staff, such as in parts of the tourism industry.

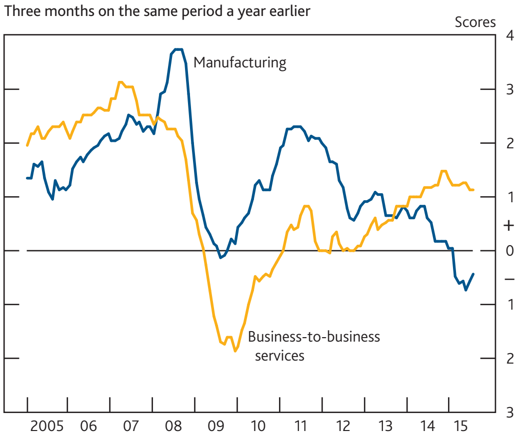
Pricing

Supply chain pricing

Materials costs had generally remained lower than a year ago, though the pace of deflation had eased a little during the quarter. A wide range of commodities had fallen in price on a year earlier, including foods, metals and oil. In contrast, construction materials prices were higher than a year earlier, although the pace of increase had moderated as supply increased. Imported finished goods prices were slightly below levels a year earlier, in part reflecting recent sterling appreciation. Some contacts reported being reluctant to pass on those cost reductions as changes in prices would be difficult to reverse, for example if sterling fell back.

Manufacturing output prices had remained slightly lower than a year ago although, as for materials costs, the rate of decline had eased (**Chart 5**). Sterling's rise against the euro had led to increased competition from European producers in domestic and export markets, putting output prices and margins under downward pressure. In construction, companies had generally been able to pass through their cost increases to new tender prices, but margins on existing contracts agreed prior to recent

Chart 5 Output prices



cost inflation had continued to be squeezed. Business services price inflation had eased on the quarter, remaining modest (**Chart 5**). Strong competitive pressure was reported in parts of the sector, sometimes linked to internet trading. But prices in a number of business services had risen, notably hotel room rates and services related to construction. And while commoditised professional services prices were often reported to be broadly flat, fees on more bespoke work had risen. Overall, a trend towards higher-value work had contributed towards moderate growth in business services profitability.

Consumer prices

Annual consumer goods price inflation had remained negative, but there had been signs that price falls were reaching their trough. That partly reflected base effects from falls in commodity prices in late 2014 dropping out of the annual comparison, although contacts noted that more recent declines in commodity prices indicated a quick rebound to positive annual goods price inflation was unlikely. There was mixed evidence on the timing and extent of discounting in the summer sales. New car prices had remained broadly stable. Consumer services price inflation had edged up slightly over the past three months, but remained modest. Prices for hotel stays and leisure attractions had risen moderately in response to rising demand. Private housing rents appeared to be rising gently overall, although conditions varied widely across the country.