BANK OF ENGLAND

Agents' summary of business conditions

April 2015

- Consumer demand had continued to grow moderately.
- Housing market transactions had picked up modestly since the start of the year, but were lower than a year earlier.
- Investment intentions had pointed to modest growth in capital expenditure over the next twelve months.
- Business services turnover growth had been robust across a range of subsectors.
- Manufacturing output growth for both domestic and export markets had picked up slightly.
- Construction output growth had moderated a little further, but remained robust.
- Corporate credit availability had improved further.
- Employment intentions had continued to point to modest headcount growth overall, and had edged a little higher for business services.
- Recruitment difficulties had remained somewhat higher than normal.
- Capacity utilisation in manufacturing had eased somewhat and was now a little below normal, but had remained slightly above normal in services.
- Growth in total labour costs per employee had remained moderate.
- Materials costs had eased further and, along with imported finished goods prices, were lower than a year earlier.
- Output prices had fallen for manufacturers, but had increased modestly in business services relative to a year earlier. Profitability growth had eased marginally.
- Consumer price inflation had fallen further for goods, but remained moderate for 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 February 2015 and late March 2015. 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.

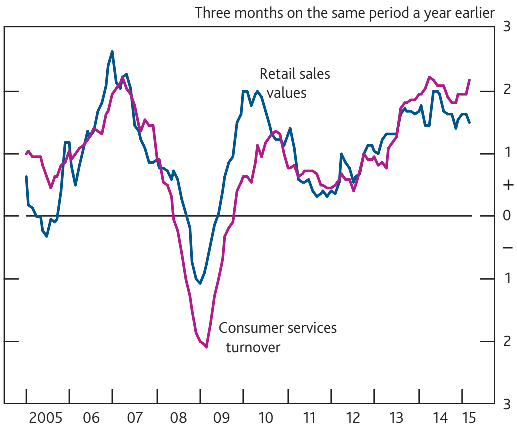
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

Demand

Consumption

Annual growth of retail sales values had eased a little (**Chart 1**), although there were some signs of a pickup in sales volumes. A slowdown in product innovation was said to be bearing down on spending growth for bigger-ticket household items such as electrical and white goods. New car sales growth had remained robust, especially for premium brands, supported by attractive finance deals. Consumer services turnover growth had picked up (**Chart 1**). Demand for leisure attractions, restaurants and hotel accommodation had been boosted by an improvement in household disposable incomes, in part as a result of lower fuel prices. Summer bookings for travel to European destinations had grown strongly on a year earlier, stimulated by sterling's appreciation against the euro.

Chart 1 Retail sales values and consumer services turnover



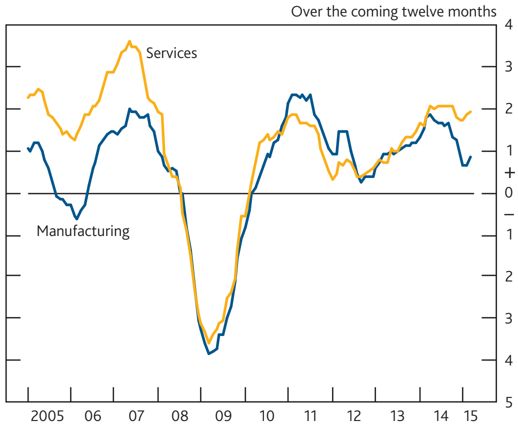
Housing market

Housing market transactions had picked up modestly over the year to date, but remained lower than a year earlier. Buyer enquiries had increased more strongly than instructions to sell, so supply was still short in some regions. Activity was expected to remain sluggish until after the general election, especially in central London, where prices had continued to fall. House price growth had remained modest in most other regions.

Business investment

Investment intentions had edged higher in recent months, and were consistent with modest spending growth in the year ahead (**Chart 2**). Intentions in services had remained stronger than those in manufacturing, with previously deferred expansion and refurbishment of premises now coming to fruition and investment in IT remaining robust. Capital expenditure growth in manufacturing had most often been targeted at efficiency or productivity gains, with significant capacity expansion seldom reported. Some contacts supplying products or services to the oil and gas sector had revised down their investment prospects as a result of slowing customer demand. Uncertainty ahead of the general election had unsettled some firms, but any changes in investment plans were largely confined to companies that were particularly exposed to government policy.

Chart 2 Investment intentions



Exports

Manufacturing export growth had edged up marginally, but remained weak overall. Demand from the euro area had remained fragile, and competition was intensifying due to the euro depreciation. US demand had continued to pick up, with growth opportunities reported across a range of sectors, including defence. Good growth prospects had also been reported in other global markets, but demand from Russia, Brazil and Turkey was slowing. The rate of services export growth had eased slightly compared with a year earlier, but it remained generally stronger than for manufacturing. Demand had continued to grow for professional services firms as a result of buoyant overseas investor activity in the United Kingdom.

Output

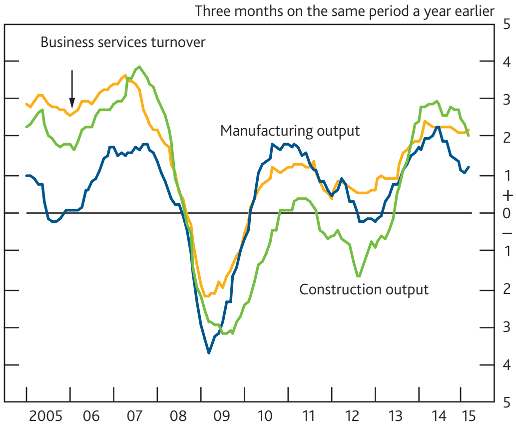
Business services

Turnover growth had remained robust across a range of business services (**Chart 3**). Growth in professional and financial services had been driven by increasing corporate finance activity and commercial real estate (CRE) transactions. Demand for commercial insurance had also increased as businesses expanded operations and employment. Demand had remained strong for suppliers of IT and construction-related services, while recruitment agencies were growing on the back of sustained employment growth and increased staff attrition. Advertising revenues had been boosted by increased demand for digital and online marketing. Improved business confidence had been reflected in higher spending on accommodation and conferencing than a year earlier. Subdued corporate credit demand, however, had continued to constrain banking sector growth. And contacts exposed to the oil and gas sector had noted a slowing in activity.

Manufacturing

Domestic manufacturing output growth had picked up slightly (**Chart 3**). Contacts supplying goods to the civil aerospace, automotive, rail, medical and construction sectors had reported sustained growth. There were signs that lower energy costs had encouraged some firms to increase capital goods orders and consumer goods producers had benefited from rising consumer confidence. Suppliers to the oil and gas extraction sector, however, had reported a further softening in demand as the impact of oil price falls filtered along the supply chain.

Chart 3 Activity



Construction

Construction output growth had remained robust, although the pace of increase on a year earlier had eased a little further (**Chart 3**). Growth had remained strong across a range of sectors, especially higher education. Speculative development was still largely concentrated around London, with limited activity in a few other geographical areas generally restricted to distribution and warehousing. Growth in private new house building had slowed on a year ago, reflecting a combination of factors, including skills shortages and large house builders concentrating on improving margins.

Credit conditions

Credit availability had increased a little further. Corporate loan rates had fallen, revolving credit facility tenors had moved out further and the availability of mezzanine finance had risen, often reflecting greater competition among credit providers. Access to finance had improved slightly for small firms, but some difficulties in borrowing from banks were still reported, and often the small sums needed precluded the use of venture capital. This had led some contacts to increasingly consider alternative borrowing options, such as crowd funding. Asset finance had also been reported to be widely available to small firms, often on favourable terms arranged by capital equipment suppliers. Trade credit insurance rates had eased back and coverage had increased significantly.

Employment

Employment intentions had continued to imply modest headcount growth. Expectations of hiring had edged a little higher within business services, particularly in accountancy, CRE, IT and distribution. Modest employment growth was expected in consumer services, such as leisure, catering and retail. Manufacturing employment intentions had slowed over recent months and were broadly flat relative to a year ago. Reports of job cuts within the oil and gas sector and its supply chain had increased, but these had been offset by moderate recruitment in more buoyant industries. Recruitment difficulties had remained somewhat above normal. Skill shortages had remained most prevalent in construction, engineering, professional services, IT, haulage and healthcare but had now spread to middle management more broadly. Alongside this, attrition had gradually picked up and there were increased reports of poaching by competitors. In response, hiring programmes for graduates, apprentices and school leavers had been expanded. Unskilled labour had remained generally more readily available than pre-recession norms, but some contacts noted fewer responses to recent job adverts. Migrants had continued to bolster the supply of unskilled staff and, increasingly, skilled staff.

Capacity utilisation

Capacity utilisation had eased in manufacturing and was now a little below normal, while it had remained slightly above normal within services. The slight reduction in manufacturing utilisation had reflected subdued export growth, while productivity improvements had augmented capacity for some firms. There had been generally less spare capacity within labour than in physical capital. In services, a shortage of both physical and labour capacity had been reported by professional and financial services contacts, as a result of strong demand growth. Elsewhere in the sector, labour had remained the principal constraint, although some firms were able to scale operations through greater use of IT and outsourcing of back-office processes. Fixed asset utilisation had increased across services, with the exception of retail, and a shortage of prime office space was becoming more evident in many centres. Scarce labour resources had persisted as the primary constraint in construction.

Costs and prices

Labour costs

Growth in total labour costs had remained moderate overall. The rate of pay growth in manufacturing had eased slightly over recent months, but had been sustained in services, reflecting greater skills shortages and increased churn within that sector. Some companies had made larger individually targeted awards to key staff, within a modest overall increase in average pay. Some others reported a small upward movement in pay awards driven by National Minimum Wage increases or pressure to move towards the living wage. Low inflation had enabled a few firms, where trading conditions had been challenging, to award lower settlements this year. Such reports, however, were limited as many employers were mindful of sub-inflation awards made in previous years. Pay freezes were generally rare, but had been more frequently reported within the oil and gas sector and its supply chain. Pay pressure had remained much higher in construction, where skills shortages were more prevalent.

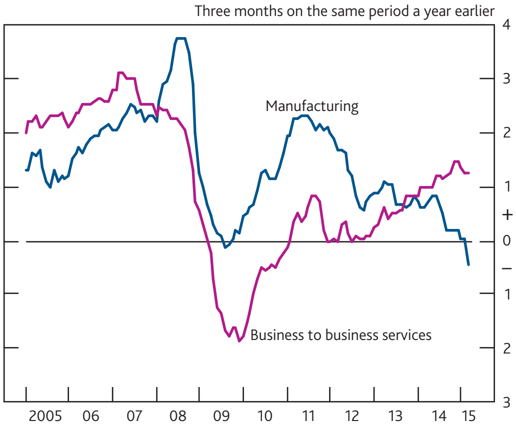
Non-labour costs

A range of materials costs had remained lower than a year ago, primarily driven by recent falls in global commodities prices, particularly those that were agriculture and oil-related. The impact of lower oil prices had been felt most immediately in contacts' distribution costs. Outside this, pass-through had continued at a relatively slow pace as existing contracts expired, and was expected to be restricted as suppliers tried to recover margins. Building materials inflation had slowed from a high level as supply constraints had abated. Imported finished goods costs had remained lower than a year ago, in part reflecting pass-through of sterling's appreciation since 2013 as forward contracts expired.

Output prices and margins

Manufacturing output prices had edged down and were now a little lower than a year ago (**Chart 4**). Price rises had become increasingly difficult to justify, and some producers supplying to supermarkets were under pressure to pass through input cost savings. Increased price competition from European producers had added further pressure, in part a result of the depreciation of the euro. Business services prices had continued to increase modestly (**Chart 4**). Professional services firms had achieved modest fee increases on the back of stronger activity levels. But in some other services sectors, such as real estate and telecoms, intense competition had hampered price rises. In transport and oil services, prices had fallen on the back of lower fuel costs. Profitability growth had eased slightly. Competitive pressures were limiting margin growth, exacerbated for some exporters by sterling's recent appreciation against the euro.

Chart 4 Manufacturing and services prices



Consumer prices

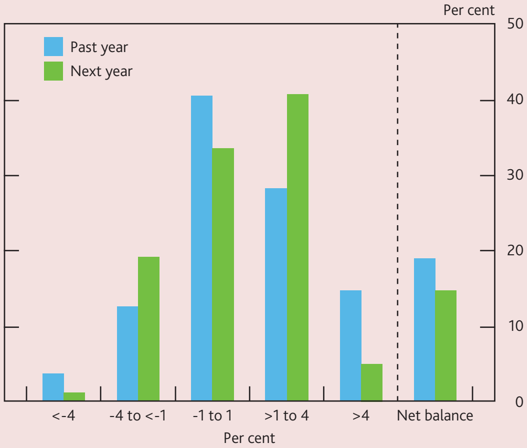
Consumer goods prices had edged down further as a result of continued falls in grocery prices. Competitive pressures, along with the continued pass-through of sterling's appreciation from around 2013, were expected to lead to further price reductions. There had been a reversal of some of the recent reductions in road fuel prices however. New car list prices had edged up, but transaction values were broadly flat as a result of promotional activity. Retail services inflation had maintained its moderate pace. Regulated fares, affordable rents and some water/sewerage charges had risen at a slower rate than a year ago because of lower RPI/CPI inflation. Many tourism and leisure services' prices had firmed, but the weaker euro was bearing down on foreign holiday price rises. Motor insurance premia had firmed, reflecting increasing repair costs.

Agents' survey on UK corporate pricing

To help assess businesses' expectations about UK sales price inflation, the Agents conducted a survey of contacts' UK corporate pricing. The Agents asked about: how output price inflation was evolving; the factors influencing price inflation; and how profit margins compared to 'normal'. The survey also asked about the use of hedging to manage input costs, including those where there was a currency exposure. A total of 424 companies responded to the survey, representing £90 billion of turnover.

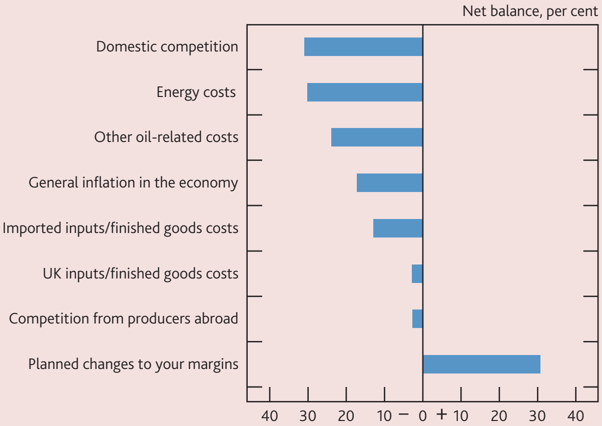
Weighting the results by turnover, the vast majority (84%) of respondents reported that prices had remained broadly stable or had increased over the past year, with a positive net balance of 19% (**Chart A**). Looking forward to the next year, expectations were also positive, although a little weaker than the past year. Across sectors, manufacturers on balance expected continued price falls over the next year while respondents in consumer and business services expected price increases. Small businesses expected slightly higher price increases over the next year than medium and large businesses.

Chart A Output price change



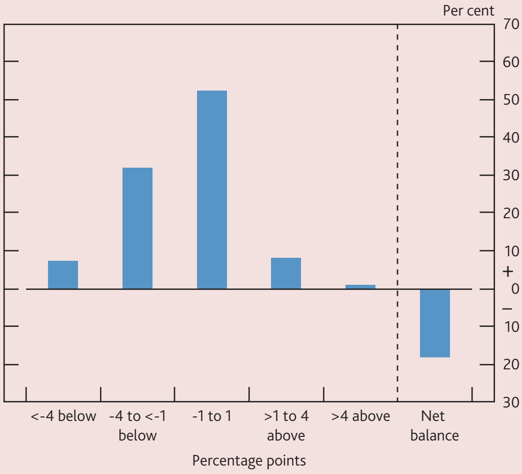
Among the factors influencing changes to output prices over the next year relative to the past year, only planned changes to margins were reported to be exerting an upward effect (**Chart B**). Energy and oil-related costs, along with domestic competition, were the factors most often cited as dragging on output price inflation, but general inflation in the economy and imported input/finished goods costs also had significant negative net balances.

Chart B Factors influencing change in output prices over next year relative to last year



Although just over half (52%) of businesses described their profit margins (operating profit as a proportion of turnover) as 'normal', around four out of ten respondents described their profit margins as below normal, resulting in a net balance of -18% (**Chart C**).

Chart C Profit margins relative to normal



Just under half of businesses responding to the survey indicated that their non-labour costs were exposed to changes in currency, and around one fifth actively hedged against input cost and currency changes. There were notable differences by firm size, with large firms more likely to hedge actively against currency changes and input cost exposures than small and medium sized firms. They were also more likely to hedge for longer durations and to hedge a higher proportion of their foreign currency and input cost exposures than smaller firms.