



BANK OF ENGLAND

# Agents' summary of business conditions

August 2015

- Growth of **consumer services turnover** had eased slightly. **Retail sales values** growth had been steady.
- **Housing market** activity had been stronger than at the start of the year, despite a continued shortage of properties available for sale.
- **Investment intentions** had edged down for manufacturing, but remained consistent with moderate growth overall.
- **Business services** turnover growth had remained robust and broad-based.
- **Manufacturing** output growth had been steady.
- **Construction** output growth had edged up slightly.
- **Corporate credit conditions** had been little changed.
- **Employment intentions** had eased slightly, but remained consistent with moderate growth.
- **Recruitment difficulties** had risen, and were at their highest level since 2007.
- **Capacity utilisation** had remained slightly above normal in services, and marginally below normal in manufacturing.
- Growth in **total labour costs per employee** had changed little in services, although there were signs of building pressures. Manufacturing pay growth had edged lower.
- The rate of decline in **materials costs** had eased. **Imported finished goods prices** had remained slightly lower than a year earlier.
- **Manufacturing output prices** had remained slightly lower than a year earlier. **Business services price inflation** had fallen slightly.
- The rate of decline of **consumer goods prices** had eased slightly, and **retail services inflation** had edged higher.

## Changes to the Agents' summary of business conditions

Following a review of the Agents' published output, some changes are planned to the content and frequency of the *Agents' summary of business conditions (ASBC)*. In future, the Agents will publish a Quarterly ASBC, with an improved executive summary and a greater amount of macrofinancial content to complement its traditional focus on the macroeconomy. This quarterly publication will be supplemented by shorter Update editions after the

monetary policy rounds in between. The results of any special topic surveys conducted by the Agents will be included in Quarterly or Update editions, depending on which is most timely. The Agents' scores will be published alongside each Quarterly and Update ASBC.

The first Quarterly edition will be published on 16 September, with Updates to follow on 14 October and 11 November.

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 June 2015 and late July 2015. 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](http://www.bankofengland.co.uk/publications/Pages/agentssummary/default.aspx).

## Demand

### Consumption

Annual growth in retail sales values had been unchanged, remaining moderate. In the food sector, sales values had shown signs of stabilising, as downward pressure on some prices had eased. Sales growth in household goods was generally reported to be stronger than for food — often reflecting sales made on-line — and assisted by a recovery in real incomes. Contacts continued to report that consumers were increasingly looking to make purchases of aspirational brands or indulgent items: for example, premium car marques reported strong sales activity but sales of mid-market vehicles had flattened off. Growth in consumer services turnover had remained stronger than for retail sales, although it had eased slightly. Independent financial advisors reported high levels of activity related to changes in pension rules and interest in wealth planning. Restaurants, hotels and transport providers continued to report robust growth. But some contacts reported that recent overseas holiday bookings had been affected by events in Tunisia and uncertainty in Greece.

### Housing market

Activity in the housing market had generally been stronger than at the start of the year, but the post-election rebound in activity had been patchier than many contacts had hoped. Outside London and other higher-value property markets, there had been few signs of a significant upturn in secondary market activity, although most contacts continued to expect strengthening later in the year. A continuing shortage of properties available for sale had appeared to be self-perpetuating, as potential vendors were reluctant to put their homes on the market if they could not see properties they wanted to buy. In some areas, this was reported to be pushing up prices. Elsewhere, limited past house price inflation had resulted in limited equity for some home owners, which was reported to be hindering housing transactions. Activity in the new-build market had generally been stronger than the secondary market, supported by the government's Help-to-Buy scheme. Some contacts thought it was likely that the Budget reforms to tax relief for buy-to-let landlords were likely to dampen the appetite of some property investors, but it was too early to say to what extent.

### Investment intentions

Investment intentions had remained consistent with modest growth overall. Manufacturing investment intentions had weakened slightly overall, which for some firms reflected a consolidation of spending following a period of growth. Within that, intentions remained relatively robust in automotive supply chains and construction materials production. But investment by manufacturing companies involved in steel production or producing equipment for oil and gas exploration/production or agriculture was reported to

be weak, reflecting wider conditions in those markets. Investment growth by firms in the service sector was somewhat stronger than for manufacturing, and was often focused on physical premises, IT systems and distribution facilities. In some cases, premises investment was being motivated by a need to attract staff in a tightening labour market. The results of a survey on investment intentions, including the key drivers of spending and the main sources of finance, can be found on page 5.

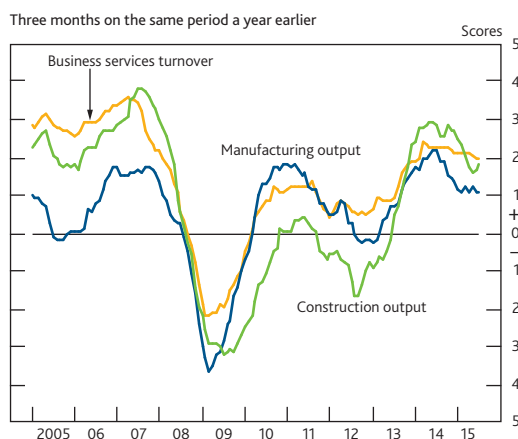
### Exports

Manufacturing export growth had remained modest. Sterling's appreciation against the euro had negatively affected volumes for a minority of exporters so far, with margins affected more significantly. Export volumes to Europe were expected to slow more markedly, however, as the effects of reduced competitiveness came through with a lag, for example as contracts expired. Contacts had remained more positive about US dollar-linked markets — such as the United States, Asia and the Middle East — especially in sectors such as aerospace. But demand from China and Russia had continued to moderate across a range of products. In the service sector, growth was reported across a range of professional and financial services exports. Some tourism contacts reported reduced visitor numbers from the euro area, although tourism from outside Europe appeared to be strengthening.

## Output

### Business and financial services

Business services turnover growth had remained robust overall (**Chart 1**). There were signs that activity had rebounded in some areas of professional and financial services where growth had softened ahead of the election. Rising confidence and the steady increase in corporate finance, mergers and acquisitions and real estate transactions had continued to underpin robust growth in a range of legal and advisory services. And demand for commercial and industrial space had continued to rise. Recruitment agencies reported further growth in activity in response to increased staff churn and skills shortages among their clients. Demand in logistics had remained strong, underpinned by the recovery in construction output and growth in online sales. The pace of growth in IT services had been sustained, with a wide range of businesses investing in new or upgraded customer-facing and back-office systems, and increasingly cyber security. Advertising spending was said to be increasing as firms made use of a wider range of marketing channels. Spending on hotel overnight stays, conferences and training had continued to rise steadily. In the oil and gas sector, however, demand for a range of associated engineering, advisory and equipment services had continued to fall.

**Chart 1** Activity

### Manufacturing

Manufacturing output growth for the domestic market had remained positive but lower than at the end of 2014 (**Chart 1**). Contacts reported relatively strong demand growth in construction materials and automotive supply chains. And a period of destocking, associated with easing growth in aerospace supply chains, appeared to have been completed. But a greater number of sectors — including food, metals and capital goods — reported output as flat, however. Demand for equipment related to the oil and gas sector had remained weak.

### Construction

Construction output growth had edged up (**Chart 1**). Commercial activity had continued to strengthen, particularly warehouse construction, but new office building was also increasingly reported in regional centres. The number of infrastructure projects reported was increasing and was set to rise further, although there were some concerns about delays to major rail projects. Steady growth in private house building had continued.

### Credit conditions

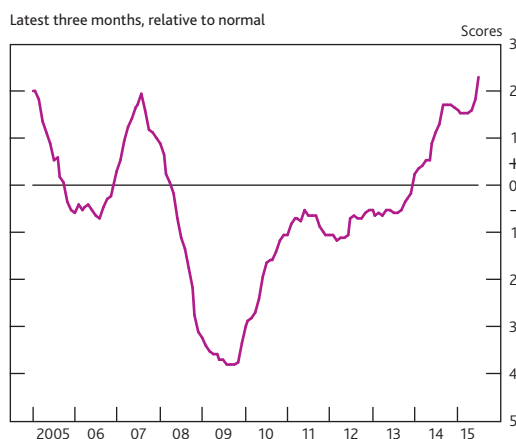
Credit availability had changed little overall. Large firms reported that credit remained readily available, and in some cases was comparable to pre-crisis conditions. Availability for small and medium-sized enterprises had remained more variable. Banks' risk appetite had continued to increase, and the cost of bank credit had fallen further for lower risk businesses. Asset-based finance was reported to be readily available for most firms. But access to unsecured lending, such as overdrafts for working capital, had continued to be difficult to obtain for some small firms.

### Employment

Employment intentions had edged down marginally, but remained consistent with modest headcount growth. The use

of new technology and automation were said to be contributing to productivity growth and softening the employment outlook across all sectors. Intentions had remained stronger in services than manufacturing. In business services, employment growth had been driven by expanding workloads and a related tightening supply of skills within firms. Consumer services jobs growth had been primarily in labour-intensive leisure services, warehousing and logistics. Manufacturing employment had remained flat overall.

Recruitment difficulties had picked up quite markedly (**Chart 2**), with the range of skill shortages broadening. Shortages were pronounced in IT, engineering, construction trades and property-related skills, professional services, HGV drivers, and middle/senior management. Difficulties were often attributed to a legacy of headcount reductions, limited recruitment and staff progression, and cuts to training budgets and programmes. Recruitment agencies reported difficulty in filling semi and unskilled positions and that reliance on migrant workers was increasing in a range of areas. As unemployment had fallen, competition for scarce resources had led to increased staff turnover and poaching. Although attrition rates had often remained below pre-recession norms, that was said partly to reflect the use of pre-emptive or counter pay offers to retain key staff.

**Chart 2** Recruitment difficulties

### Capacity utilisation

Capacity utilisation had remained slightly below normal in manufacturing and slightly above normal in services. Although some spare capacity was reported in manufacturing overall, utilisation remained elevated in automotive and aerospace supply chains, with shortages of skills — mainly engineers — and in some cases a lack of suitable industrial space. Production of some construction materials remained constrained by available capacity. Capacity utilisation in services had edged lower. Excess retail space in the groceries sector and on the high street had persisted. Service providers

to the oil and gas sector reported increased slack as activity had fallen back sharply. For the most part business services reported high levels of staff utilisation and constraints were said to be rising in some sectors, such as distribution. Utilisation rates for hotels, airports and rail infrastructure had continued to rise across most regions.

## Costs and prices

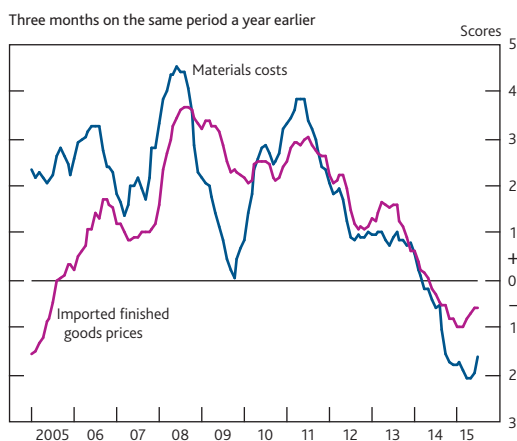
### Labour costs

Steady growth in total labour costs had continued. There were however increasing signs of wage pressure building in the services sector, largely reflecting recruitment and retention difficulties. Bonuses and commission payments had risen, often driven by increased profitability and, in some cases, a desire to retain key skills, so that total earnings had grown faster than average pay settlements. And for lower-skilled service sector staff, there had been some upwards pressure on earnings growth from above-inflation increases in the National Minimum Wage and its impact on pay differentials. In manufacturing, however, lower profitability for some businesses was putting some downwards pressure on pay growth, with low inflation helping to make low settlements more palatable. A reduction in overtime and shift working had also reduced total labour cost growth in manufacturing.

### Non-labour costs

Materials costs had generally remained well below their level a year earlier (**Chart 3**). That had partly reflected sterling's appreciation against the euro and weaker demand in some emerging markets. Domestically, the rate of inflation in construction materials had fallen, as their availability had increased. The costs of imported finished goods had remained slightly lower than a year earlier, in part reflecting recent sterling appreciation. Prices of dollar-denominated imports from the Far East had increased recently, however, as the earlier decline in sterling against the dollar fed through.

**Chart 3** Raw materials and imported finished goods prices



### Output prices and margins

Manufacturing output prices had remained lower than a year earlier, although the pace of decline had slowed a little. Downward pressures on output prices had included intense competition from euro-area competitors, domestic grocery sector competition, low commodity costs and weaker activity in the oil and gas sector. Manufacturers of construction materials were able to achieve price rises, but the rate of inflation had fallen. Business services price inflation had eased, with strong competitive pressures reported, sometimes linked to growth in internet-based trading. Output prices had declined in telecoms, freight transport and commoditised financial services. Professional services firms had increased their fees as activity had improved, especially in areas related to property transactions or recruitment activity. Commercial property rents had risen for industrial premises, particularly warehousing, city centre offices and prime retail shopping centres, although inflation in other retail rents remained weak. Growth of profitability in the manufacturing and service sectors had been broadly unchanged, although sterling's appreciation against the euro had reduced manufacturers' margins on sales to the euro area and increased margin pressure in some domestic markets.

### Consumer prices

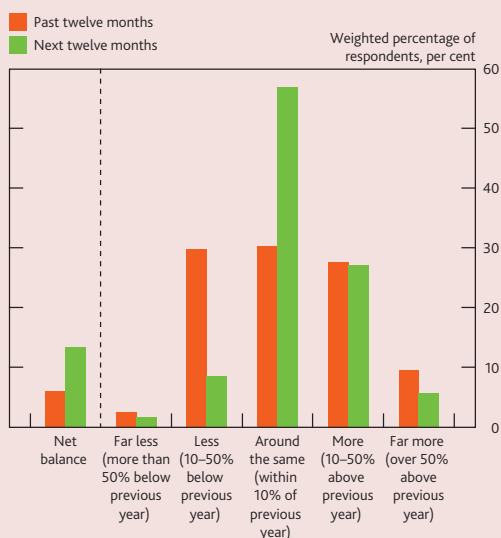
The pace of decline in consumer goods prices had moderated slightly. Although further falls in dairy and some fresh food prices were reported, a number of contacts thought that the rate of food deflation had reached its trough. More generally, consumer cost-consciousness, internet price competition and the strength of sterling had continued to put downward pressure on inflation across a range of household goods. Consumer services price inflation had edged up slightly, in part reflecting rising demand. Across the leisure sector, including hotels, theatres and visitor attractions, prices were reported to be increasing moderately. In parts of the private residential property market, rental growth had increased. In contrast, inflation for RPI-linked services, including domestic passenger transport, social rents and water bills, had fallen.

## Agents' survey on investment intentions

The Agents conducted a survey to ask business contacts about the change in their capital investment over the past twelve months, relative to the previous year, and their plans for the twelve months ahead. The survey also explored the factors acting as drivers of firms' investment spending. In addition firms were asked to indicate their expectations of mergers and acquisitions spending and the primary source of finance for investment over the coming twelve months. Some 400 firms responded to the survey, with a combined turnover of £114 billion and total employment of around 722,000 staff. The results were weighted by employment, and then reweighted according to ONS sector employment weights to adjust for differences in the composition of the survey compared with the economy as a whole.

Overall, firms reported a modest increase in capital investment over the past twelve months, with expectations consistent with stronger spending over the coming year (Chart A).

**Chart A** Investment over the past twelve months and intentions for the next twelve months

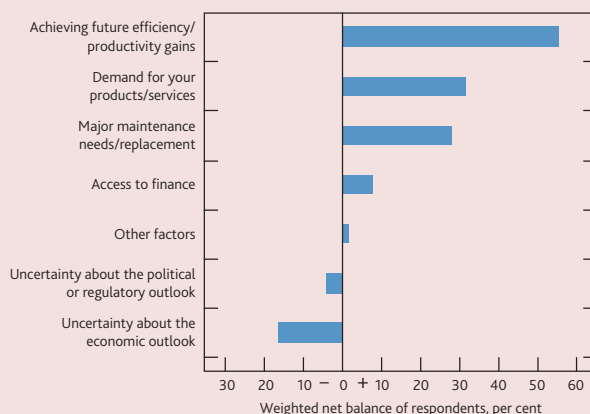


The survey indicated expectations of broad-based investment growth across sectors over the coming year. The strongest intentions for growth were in utilities and extraction, following a reported fall in investment over the past year. Investment intentions were also relatively strong for business services, despite an expected weakening of spending for those firms providing services to the oil and gas sector. The weakest expectations for growth were in manufacturing, although these were positive.

The most commonly reported driver of investment growth over the next year was achieving future efficiency and productivity gains, with a weighted net balance of over half of

respondents citing this as important (Chart B). Demand for products and services, and major maintenance/replacement needs were also factors pushing up investment for a net balance of around a third of firms in each case. Access to finance was a positive influence on intentions for the coming year overall, although not for small firms, for whom access to finance was a modestly negative factor. Uncertainty about the economic outlook was reported to be the greatest drag on firms' investment intentions over the year ahead.

**Chart B** Drivers of investment intentions



In terms of mergers and acquisitions activity, a net balance of some 17% of respondents expected a rise in their spending over the coming year, compared with the previous twelve months. Across sectors, business and consumer services contacts were the most acquisitive.

Looking at the sources of finance for investment — either capital spending or mergers and acquisitions activity — the majority of respondents expected to utilise internally generated funds. This was true of firms of all sizes (Chart C). Medium-sized firms planned to use bank borrowing more than smaller or larger firms did, with larger firms being more likely to use capital market finance instead.

**Chart C** Primary source of investment finance over the next twelve months

