BANK OF ENGLAND

Agents' summary of business conditions

January 2015

- Retail sales values growth had edged higher and consumer services turnover growth had picked up slightly.
- Housing market activity had been subdued relative to levels a year earlier.
- Investment intentions for the next twelve months had continued to ease slightly, but were consistent with moderate growth overall.
- Business services turnover growth had edged down slightly, but remained relatively robust.
- Manufacturing output growth for the domestic market had eased slightly, and manufacturing export growth had slowed further.
- Construction output growth had remained strong.
- Corporate credit conditions had continued to improve, with evidence of increased competition among lenders.
- Employment intentions had eased for manufacturers, but were consistent with modest headcount growth overall.
- Recruitment difficulties had been little changed at a level somewhat above normal.
- Capacity utilisation was at broadly normal levels in manufacturing, but slightly above normal for services.
- Growth in total labour costs per employee had been steady, though there were signs of increasing wage pressures in some subsectors with skills shortages.
- Materials costs and imported finished goods prices had remained lower than a year earlier.
- Output prices were little changed on a year earlier in manufacturing, though had increased moderately in business services.
- Consumer price inflation had turned negative for goods. Moderate rates of inflation in services prices had continued.

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 November 2014 and late December 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 in retail sales values had edged higher, largely reflecting 'Black Friday' sales promotions at the end of November that had covered a wider range of goods than last year. Some retailers, especially those of electrical goods, had witnessed somewhat softer demand growth in the first half of December. Supermarkets reported that food sales values growth had slowed due to further price discounting. But, overall, most retailers expected solid growth in sales values over the seasonal trading period. Consumer services demand growth had picked up slightly. Hotels and visitor attractions reported strong growth, possibly assisted by seasonally mild weather. Restaurants, pubs and coffee bars had sustained steady growth in sales, with Christmas restaurant bookings higher than a year ago. Passenger numbers for road, rail and domestic flights had continued to grow, although there were some recent reports of a slowing in holiday bookings for 2015.

Housing market

Activity in the housing market had remained subdued relative to levels a year earlier. That was partly ascribed to an earlier release of pent-up demand that had run its course, a shortage of properties for sale and, in London and parts of the South East, to high house prices, which were said to be deterring some potential homebuyers. On balance, contacts expected that Stamp Duty changes announced in the Autumn Statement would provide modest support to housing market activity. House builders provided mixed reports about demand for newly built homes, but reservations generally had been lower than a year earlier.

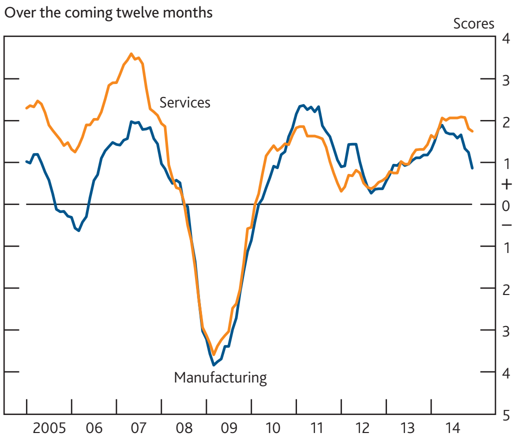
Business investment

Investment intentions for the next twelve months had continued to ease slightly, but remained consistent with moderate growth overall (**Chart 1**). Manufacturing intentions had weakened as existing investment projects approached completion and as uncertainty about the global outlook had risen. Some firms had adopted a more cautious approach to investment, with spending on efficiency, productivity and replacement being prioritised. Service sector firms' intentions indicated steady growth in capital spending. Investment in the refurbishment of premises was widely reported, although tightness in the supply of prime commercial space had also encouraged investment in new development in some areas. UK oil and gas firms had become reluctant to commit to new capital expenditure plans following the sharp fall in the price of oil. However, contacts expected this effect on capital spending to be offset over time as lower energy costs for other companies generated additional funds for investment.

Exports

Manufacturing export growth had slowed further. Weak euro-area demand was cited as the principal driver, although

Chart 1 Investment intentions



there were some reports of a pickup in growth in Spain and Ireland. The volume of exports to Russia had also fallen, largely reflecting trade restrictions and payment problems. Exports to China had eased. Middle-East demand had remained robust, although falling oil prices were seen as a risk to growth there going forward. Companies that exported to the United States had continued to report strong sales growth. Although services export growth remained stronger than for goods, it had also eased. Professional services firms had maintained strong growth in work for overseas clients, notably legal and architectural services. Growth in export sales of IT services had remained robust. Overall, both leisure and business tourism had continued to grow. But consultancy services in oil and gas reported a sharp fall in demand as investment plans in the sector were shelved.

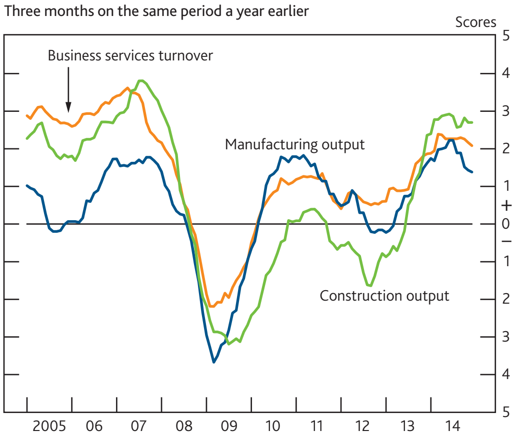
Output

Business services

Business services turnover growth had edged down slightly, but remained relatively strong overall (**Chart 2**). Corporate finance, real estate and M&A activity had continued to act as drivers of growth in accountancy, law and banking. Workloads for advertising, marketing and PR firms had risen further, as a result of larger corporate marketing budgets. Growth in activity at architects and engineering services firms had continued to be driven by strengthening domestic construction activity, although some contacts reported that workloads could be adversely affected by a weaker global outlook and reduced demand from the oil and gas sector. Wholesalers reported that growth in volumes had been robust over the past three months, with building materials the strongest subsector. IT services continued to be supported by robust demand, especially for cloud-based services. Demand for hotel nights, conferencing and travel had continued to increase, but companies' travel budgets remained tighter than pre-recession.

Chart 2 Output growth

Three months on the same period a year earlier



Manufacturing

Growth in manufacturing output for the domestic market had eased slightly (**Chart 2**). Companies supplying construction, civil aerospace and automotive sectors reported strong growth. But output growth in some export supply chains had eased, and some capital goods manufacturers also reported that orders had softened following cuts to UK oil and gas investment. Contacts across the engineering sector reported an increase in uncertainty about the outlook for growth.

Construction

Growth in construction output had remained robust (**Chart 2**), although demand had remained variable across regions. Where activity was particularly strong, some firms had preferred to maintain activity at current levels, rather than expand, due to widespread skills shortages. Repair and maintenance work, infrastructure projects and commercial development activity had picked up. House builders continued to increase output, although some had moderated plans for next year and the demand for land had eased a little from the first half of the year.

Credit conditions

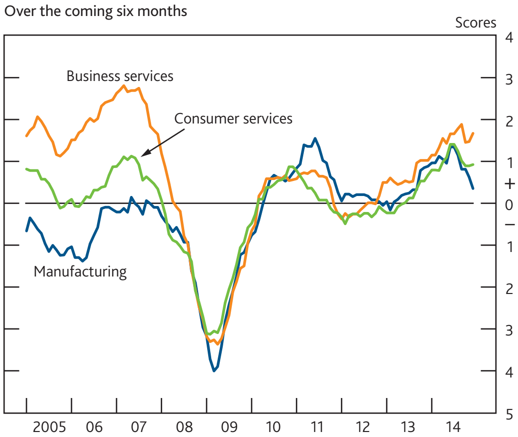
Credit availability had continued to improve, with banks competing to lend to larger firms or lower risk companies. Competition among funding providers appeared to have intensified. Fees and margins had fallen and loan maturities had lengthened, but there was little evidence of any widespread weakening of covenants. Smaller businesses reported an increase in refinancing activity, often at lower margins and improved terms, but conditions were reported to be markedly less competitive than those reported for larger firms. Companies with weaker profitability or less collateral continued to struggle to access bank finance, but there were increasing reports that banks were lending again to companies in sectors that had previously found access to finance difficult, such as construction and hospitality. Lending by challenger banks, peer to peer and alternative lenders had continued to increase strongly, but still represented only a small share of corporate lending.

Employment

Employment intentions had remained consistent with modest headcount growth overall (**Chart 3**). In manufacturing, employment growth had eased, reflecting a combination of slower global demand growth, consolidation of recent headcount growth, and a focus on gains in efficiency or productivity. Intentions in business services had picked up slightly as robust activity growth had boosted recruitment plans, especially in professional services and IT. Consumer services intentions continued to point to modest growth. Recruitment difficulties had been little changed at a level somewhat above normal. Skill shortages were reported across a wide range of sectors, although they had remained most pronounced in engineering, IT, construction and haulage. A number of contacts had responded by increasing recruitment at junior and trainee levels, alongside using IT or automation to deskill some work, while some looked overseas to source skills. Difficulties had eased recently for some manufacturers alongside a weakening of their employment intentions. Few issues had been reported in sourcing unskilled labour, and migrant workers continued to bolster supply.

Chart 3 Employment intentions

Over the coming six months



Capacity utilisation

Capacity utilisation had continued at broadly normal levels in manufacturing, but was slightly above normal in services overall. Manufacturers' capacity utilisation had eased a little as output growth had slowed and as earlier investment had increased physical capacity. Service sector capacity utilisation had continued to edge up. Professional and financial contacts reported high levels of staff utilisation, with a rising proportion of contacts identifying skills as the main capacity constraint. Strong online sales had led to a sharp reduction in spare capacity among delivery and courier firms. Leasing companies reported a high level of utilisation of trains and rolling stock. Elsewhere in services, spare capacity persisted, most notably in retailing where the growth in online trading had left some national chains with excess floorspace. Across sectors, construction had continued to experience the most notable capacity constraints, with building delays caused by the shortage of skills, although delays caused by material shortages had eased.

Costs and prices

Labour costs

Growth in total labour costs had been steady. Some pressures had been building where there were skills shortages including in construction, some parts of professional services and for some IT specialists. But overall, those had been met by carefully targeted increases without having a large impact on overall pay growth. Despite falls in retail price inflation, many contacts expected settlements in 2015 to be similar to, or only slightly higher than, those awarded in 2014, although the balance of risks was often thought to be to the upside. Shifts in the composition of workforces towards less-experienced staff had reduced average earnings growth for a number of firms, although it was uncertain how long those effects would continue. Acting in the other direction, pension contributions had continued to add to labour cost growth for some contacts, either because of auto-enrolment or the need to address pension fund deficits.

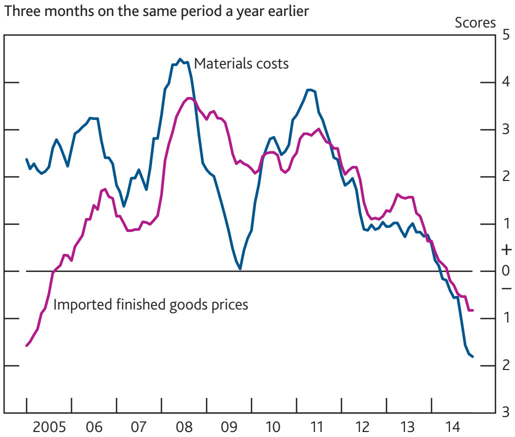
Non-labour costs

Material costs had continued to be lower than a year earlier (**Chart 4**). Metals prices were significantly lower as a result of increased production capacity and weakening global demand. Oil prices had fallen sharply, but there had been little direct feed through to businesses' costs — high oil-intensity manufacturers aside — as many major users of fuel had hedged some months or in some cases, years, ahead. Some manufacturers were looking to lock in lower energy costs by renewing contracts with suppliers well in advance of expiry of existing deals. The main reported area of upward cost pressure was in construction materials, although future cost increases were expected to be more modest as supply capacity had increased. The rise in sterling since early 2013 was feeding through in lower costs for imported finished goods as fixed term contracts were renewed.

Output prices and margins

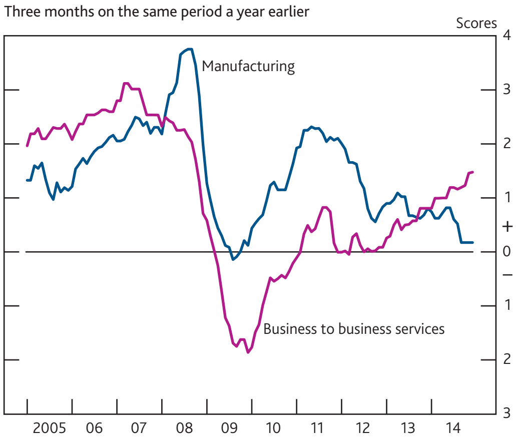
Manufacturing output price inflation had remained subdued. Contacts reported that falls in input costs and strong competition had made it difficult to justify price rises, except where products had been redesigned. Many suppliers to the supermarket sector had needed to pass through falls in ingredient costs in full. Business services price inflation had remained steady and at a stronger rate than for manufacturing

Chart 4 Raw materials and imported finished goods prices



(**Chart 5**). Some companies had started to increase prices modestly as demand improved, particularly for more specialised services. Those supplying the construction sector had seen slightly higher increases as activity had strengthened and capacity had been reduced. However, upward pressure on haulage rates had eased as fuel prices had fallen, offsetting the effects of increased pay inflation from driver shortages. Profitability growth remained modest in both manufacturing and services. Exporters' margins had remained squeezed because of sterling's appreciation, although a recent fall against the US dollar had eased the pressure for some. Retail and consumer services companies reported that margins were under pressure as intense competition had led to heavy discounting.

Chart 5 Manufacturing and services prices



Consumer prices

Retail goods inflation had turned negative driven by falls in food and fuel prices (**Chart 6**). Contacts in the grocery market expected further price reductions in early 2015, in part due to falls in the cost of some goods, but also in response to continuing intense supermarket competition. Heavy discounting of non-foods — including electrical goods, clothing and footwear — during 'Black Friday' had been much more extensive than for last year. Some retailers also reported short-term discounting of winter clothing due to the effect of mild weather on sales. Consumer services inflation had remained steady and stronger than for goods. As demand had increased and capacity had tightened, the prices of a range of travel, leisure and catering services had increased. Private rents had continued to edge up. But for some services where competition had remained intense, such as estate agency and insurance, prices had remained broadly flat. The slowing in RPI inflation was expected to result in lower increases in regulated public transport prices than in 2014.

Chart 6 Retail goods and consumer services prices