BANK OF ENGLAND

Agents' summary of business conditions

June 2015

- Consumer services and retail sales turnover had continued to grow moderately.
- Housing market transactions remained lower than a year earlier, with some contacts reporting shortages in the supply of homes for sale as the driver of this weakness.
- Investment intentions had pointed to moderate growth in capital expenditure over the following twelve months.
- Business services turnover growth had remained robust and broad-based.
- Manufacturing output growth had edged higher for the domestic market. Growth in goods exports had remained subdued overall.
- Construction output growth had eased further, but pointed to moderate growth.
- Corporate credit conditions had remained at a level somewhat above normal, though they continued to vary by firm size and sector.
- Employment intentions had continued to edge higher and were consistent with modest headcount growth.
- Recruitment difficulties had increased slightly, becoming somewhat more broad-based.
- Capacity utilisation had eased slightly in manufacturing, but remained slightly above normal for services.
- Growth in total labour costs per employee had been steady.
- Materials costs had continued to fall overall. The rate of decline in some imported finished goods prices had eased.
- Output prices had continued to fall on a year earlier for manufacturers, but had risen moderately for business services firms.
- Profitability growth had edged down for manufacturers, and remained modest for services.
- Consumer price inflation had remained negative for goods; retail service prices had continued to increase modestly.

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 April 2015 and late May 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 in retail sales values had remained moderate. For some retailers, sales volumes growth was outpacing sales values growth, reflecting falls in retail prices. There had been further reports of consumers trading up in value terms, for example to aspirational brands or premium car marques. However, some contacts reported a slowing of sales growth of some higher-priced goods in the run-up to the general election. Consumer services turnover growth had been steady. Restaurant visits, hotel stays and holiday bookings had continued to show robust growth. Some leisure attractions had reported increasing spending by visitors. Independent Financial Advisors had experienced a sharp increase in enquiries, in part reflecting recent pension reforms.

Housing market

The number of transactions had remained lower than a year ago. Sales of new homes had held up better than those in the secondary market, where shortages of properties for sale were the most frequently cited cause of weakness in activity. Contacts reported that those shortages had partly reflected vendors' reluctance to offer properties for sale prior to the general election. Since then, the London market had showed signs of stronger activity, most notably in the highest price bands. Contacts now expected strengthening price inflation in the capital, in contrast to recent trends.

Business investment

Investment intentions had changed little, and pointed to moderate growth. Manufacturers' capital expenditure plans often focused on new technology, seeking to reduce either energy or labour costs: spending on extra capacity was relatively uncommon. In services, plans centred on expanding, updating or reconfiguring property after a period of under-investment. Intentions to spend on IT systems, for more efficient service provision, also remained prominent. Consumer-facing firms' spending plans were concentrated on logistics, to support online retailing, rather than on generating additional retail space. Across sectors, few companies cited the availability of funding as a constraint on capital spending.

Exports

Export volumes growth had remained subdued. For some, euro-area economic conditions and sterling's rise against the euro had led to a decline in European sales volumes, although the effect had been more pronounced for sales values. Demand had strengthened for some more technologically advanced products sold in US dollars. More generally, UK firms were increasingly investing in production facilities close to their foreign customers, rather than expanding domestic production. Growth in exports of services had continued at a steady pace. Professional services firms, for example, had seen robust growth in demand from overseas investors in UK commercial real estate (CRE) and in corporate transactions. But service provision to the overseas oil and gas sector had been adversely affected by the fall in oil prices, particularly in locations where costs of extraction were high. A box on page 5 provides the results of an Agents' survey on exports over the past year and expectations for the next twelve months.

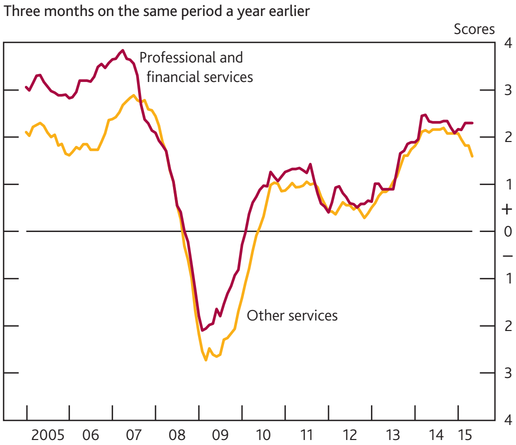
Output

Business and financial services

Growth in professional and financial services turnover had remained robust (**Chart 1**). Consultancy services were experiencing healthy growth as client companies focused on expansion and restructuring. CRE-related services had also continued to expand, as transactions increased and a strengthening of occupier demand had spread out from prime space to parts of the secondary office market. Insurers had reported stronger growth in demand, and spending on marketing, recruitment and training had picked up. Demand had grown for cloud computing, e-commerce and social media services, as well as cyber security advice. A wide range of transport and distribution businesses reported rising volumes. And corporate demand for hotel services had continued to grow steadily, though it remained restrained relative to the pre-recession period. Earlier falls in oil prices had begun to slow activity throughout the oil and gas supply chain, and there had been signs that the pass through of lower oil prices to some other services, such as transport, had been associated with slower turnover growth.

Chart 1 Services turnover

Three months on the same period a year earlier



Manufacturing

Growth in manufacturing output for the domestic market had remained modest. Among subsectors, growth in output of construction products had remained robust, although some suppliers to the housing sector had reported a softening of demand from builders. While food processors supplying the major supermarkets had reported very modest output growth, output of some specialist food products had strengthened.

Manufacturers supplying the oil and gas sector had spoken of falling order books, with existing projects subject to delay, respecification or occasionally outright cancellation.

Construction

Construction output growth had continued to ease. House building growth had been more modest than a year ago, partly due to skills shortages. There were reports that election-related delays had affected construction output in some public sector related projects. But, overall, steady growth in commercial construction and infrastructure was reported. There had been some signs of a shift of activity away from major schemes in London and the South East towards smaller projects in other regions.

Credit conditions

There had been a further slight increase in credit availability over recent months. Banks, including some from overseas, were competing hard on both price and non-price terms for good business. Across companies, credit had remained most readily available for the largest firms and those with strong cash flow and security more generally. For large companies in particular, the capital markets had remained a good source of competitively priced finance. There had been a slight increase in demand for credit, reflecting investment intentions, corporate transactions, and companies refinancing existing facilities to take advantage of current low interest rates and attractive terms.

Employment

Employment intentions had edged up a little. Across sectors, intentions were strongest within business services, particularly in professional services and distribution. Manufacturers' employment growth had continued to be mildly positive, largely due to job creation in the construction products, defence and automotive subsectors. Consumer services employment intentions were modest and mainly evident within labour-intensive leisure services and online retail. Recruitment difficulties were gradually becoming more broad-based. The most acute skill shortages continued to be within professional services, IT, construction and engineering, but were also increasing for middle management positions, and even some lower-skilled roles. Migrant labour, however, was bolstering labour supply for low-skilled jobs and increasingly for some higher-skilled roles. Increased confidence among employees was leading to a pickup in staff churn.

Capacity utilisation

Contacts reported a slight easing of capacity utilisation in manufacturing, while in the service sector it had remained slightly above normal. The easing across manufacturing had reflected investment in new capacity as well as softening demand; where there were constraints those were generally labour-related. Manufacturing capacity utilisation was expected to tighten again later this year. Within the construction sector, capacity had remained tight, with the availability of skills a persistent concern. In the service sector, industrial space had become scarcer. Prime city-centre office space was also in short supply, with new building starting in locations where rental values warranted the build costs. In retail, hotel and transport services, investment had kept up with demand growth so that some spare capacity had remained.

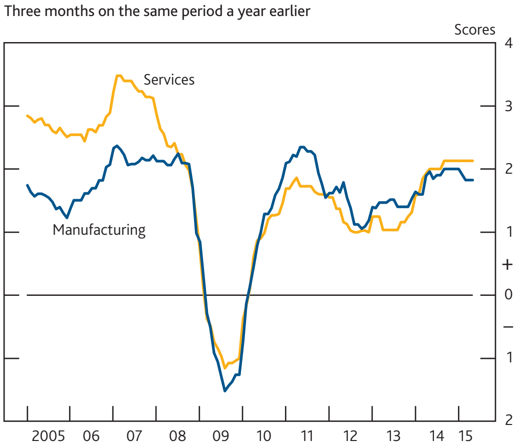
Costs and prices

Labour costs

Growth in total labour costs (**Chart 2**) had remained modest, the major determinants still being company performance, skills shortages and industry comparators. Most contacts were still planning for moderate future pay awards, sometimes including an element of catch-up after subdued real pay growth in recent years. Recruitment and retention issues were leading to some higher increases in pay, particularly in construction and professional services. But in some other cases, the need to control costs was leading to awards of below 2%. In the oil and gas sector, pay freezes had become more common.

Chart 2 Total labour costs per employee

Three months on the same period a year earlier



Non-labour costs

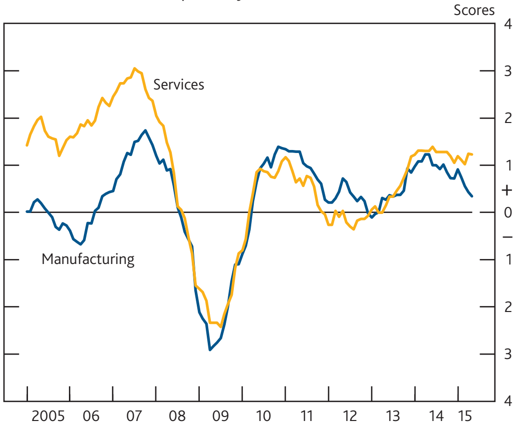
Material costs had remained lower than a year ago. Annual price declines were reported for many metals, and for oil based products including plastics. Various food ingredient costs had also fallen as a result of good harvests and competition from imports. Overall, few firms outside of construction had reported increases in materials costs. The rate of decline of imported finished goods costs had lessened, as the appreciation of the US dollar fed through to import prices for some consumer goods from the Far East.

Output prices and margins

Manufacturers' output prices had fallen slightly on a year ago, as firms passed through falling input costs and reacted to increased competition from the euro area. But prices had picked up for some goods less exposed to European competition or where supply growth had lagged demand. Business services prices inflation had edged up, with increased activity enabling modest fee growth at some firms, including in professional and financial services and recruitment consultancy. In some areas, skill shortages had also resulted in stronger annual output price inflation. And increased occupier demand had been reported as supporting gradual rent inflation, especially for prime space. Manufacturing profitability growth had eased further (**Chart 3**). Margins had increased for companies able to retain some of the benefit of lower input costs, but a weak domestic pricing environment was constraining profitability, and the rise in sterling against the euro had continued to restrain some exporters' margins. Service sector profitability growth had remained steady. Benign input cost inflation, and greater opportunity to increase fees as demand conditions had improved, had helped to support margin growth. However, the main supermarkets had continued to face pressure on margins from the strength of competition in the sector.

Chart 3 Pre-tax profitability

Three months on the same period a year earlier

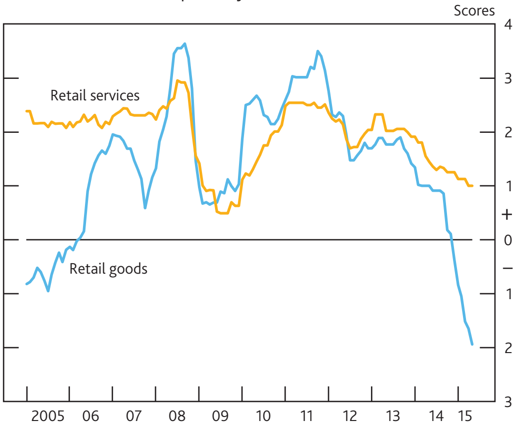


Consumer prices

Consumer goods prices had continued to fall on a year ago (**Chart 4**). That largely reflected weakness in grocery prices, which was expected to continue in the coming months. But discounting of clothing and footwear prices had eased somewhat. Sales incentives had held the price of new cars broadly flat. Retail service price inflation had remained modestly positive. Although inflation in services such as car repair and casual dining had remained restrained by consumers' price sensitivity, increasing demand had meant that there was less downward pressure on the prices of leisure activities such as hotel stays, holidays and admission to visitor attractions. Motor and other personal insurance premia had continued to firm.

Chart 4 Consumer goods and services prices

Three months on the same period a year earlier

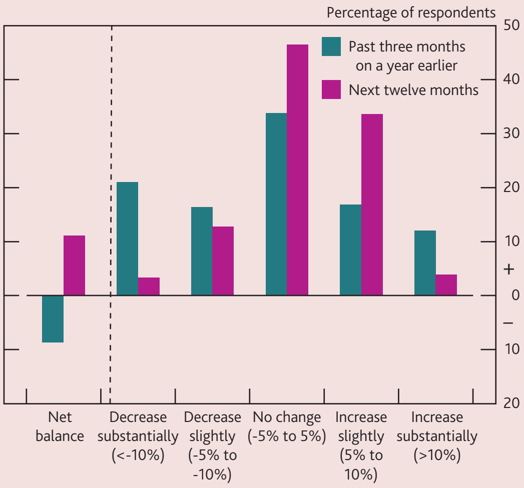


Agents' survey on exports

The Agents conducted a survey of business contacts to ask: how the sterling value of their UK exports had changed over the past three months on a year earlier; their expectations for the next year; and the factors likely to affect the sterling value of exports. Some 310 companies responded. The results were weighted by export turnover and, for aggregate results, reweighted by sectoral shares of UK exports.

On balance, respondent firms reported a decline in the sterling value of exports over the past three months compared to the same period a year ago. In contrast, respondents on balance expected a modest increase in export values over the coming twelve months (**Chart A**). That expectations balance was, however, lower than those in the previous Agents' exports surveys conducted since the recession.

Chart A Export values growth

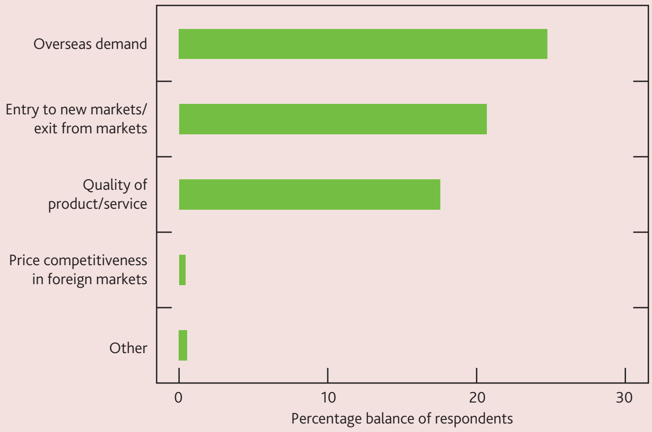


Among those whose main market was the euro area or Asia, exports had, on balance, declined over the past year, while among those whose main market was the United States or 'other', exports had, on balance, increased. In contrast, expectations for export value growth during the year ahead were generally positive across markets, albeit only weakly so for the euro area, and with firms whose main market was the United States expecting slower growth than during the past year.

Across sectors, goods exporters accounted for the decline in export values reported over the past year, with services exporters recording a slightly positive net balance. Expectations of growth in export values were strongest among services companies, with goods exports expected to be fairly flat.

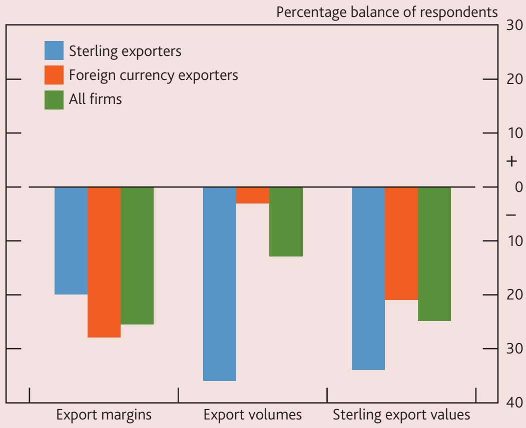
Overseas demand, entry to new markets and the quality of the products/services sold were all expected to boost export values over the next twelve months. In contrast, price competitiveness was not, on balance, expected to support or detract from exports (**Chart B**).

Chart B Factors affecting export values over the next twelve months



Contacts were also asked about the impact of the appreciation of the sterling exchange rate since early 2013 on export margins, volumes and sterling values. In aggregate, a negative effect was more commonly reported on export margins than on export volumes (**Chart C**).

Chart C Impact of movements in sterling exchange rate since early 2013



The aggregate results mask differences between contacts who sell their exports in a foreign currency or sterling (some 70% of respondents priced in a foreign currency and 30% in sterling). Among the latter group, the impact of movements in the sterling exchange rate had mainly been seen in reduced volumes, probably reflecting lower competitiveness. For the former group the impact had been mainly on margins (**Chart C**). Looking forward, there were indications that, over time, more firms in both groups would change prices in response to the pressure on margins or competitiveness.