BANK OF ENGLAND

Agents' summary of business conditions

February 2017 Update

- Consumer spending growth had remained resilient, but was expected to ease during the year as prices rose. Investment intentions had edged higher and pointed to small increases in spending during 2017. Export volumes growth had risen due to the fall in sterling and stronger world growth.
- Hiring plans had edged up, but pointed to little change in staffing overall in the next six months. A survey indicated a modest rise in total labour cost growth in the year ahead (see box on page 2). That was partly due to difficulties in hiring and holding on to staff and costs from the forthcoming apprenticeship levy.
- Price pressures had continued to build through supply chains following sterling's fall. So far, the main effect on consumer prices had been higher food and fuel prices. But a wider range of goods prices were expected to be affected over the coming year, causing inflation to rise further.

Annual **consumer spending** growth had remained resilient (**Chart 1**), but volumes growth was expected to ease during the year as prices rose. Some retailers had seen stronger sales growth than expected. Demand growth for new cars had eased. Growth in spending on leisure activities had remained solid.

Business services turnover growth had been little changed, remaining moderate. Activity at IT, logistics and transport companies had benefited from firm demand growth.

Manufacturing output growth for domestic markets had been unchanged at modest rates (**Chart 2**). Some contacts reported increased sourcing from domestic suppliers due to the fall in sterling. That decline, along with stronger global demand, had led to a rise in export volume growth.

Investment intentions had edged up, pointing to a small rise in spending in 2017 (**Chart 3**). Increasing exports and resilient consumer demand had encouraged a little more investment in new capacity. But uncertainty had continued to weigh on investment spending plans.

Corporate credit availability had been little changed, remaining above normal overall. Demand for finance was muted.

Investor demand for UK **commercial real estate** had risen from a low level. That reflected increased interest from foreign investors. Commercial rents were flat or rising modestly across the United Kingdom.

Housing market activity had been sluggish overall, and was expected to remain so over the coming year.

Capacity utilisation was broadly normal in both manufacturing and services. In manufacturing, increased activity had taken up some remaining slack.

Employment intentions had edged up in business services, but pointed to little change in staffing overall in the next six months (**Chart 4**). **Recruitment difficulties** had been little changed.

A survey pointed to a slight rise in total **labour cost** growth in the year ahead (see box on page 2). That was partly due to difficulties in hiring and holding on to staff and costs from the forthcoming apprenticeship levy. Economic uncertainty and difficulty in passing on cost increases were expected to drag on labour cost growth. Basic pay settlements were, on average, expected to ease in 2017.

Input cost inflation had risen further as sterling's fall fed through (**Chart 5**). Manufacturing output price inflation had also risen. It was expected to rise further as foreign exchange hedges expired.

Consumer goods price inflation had increased as the fall in sterling started to be felt, particularly in higher food and fuel prices (**Chart 6**). A wider range of goods prices were expected to be affected during the year, causing inflation to rise further.

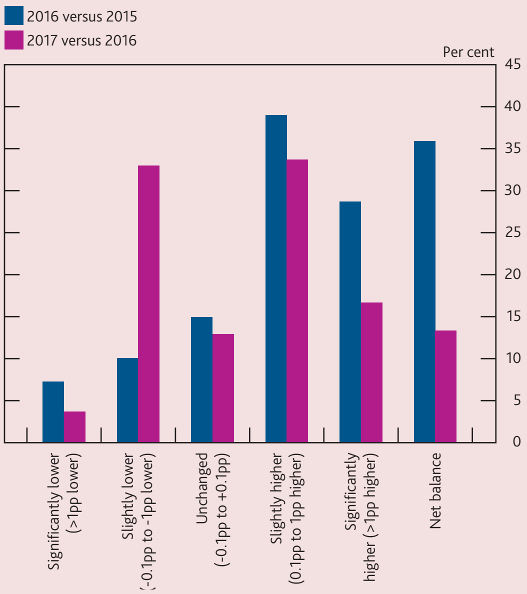
This publication generally covers intelligence gathered from business contacts between late November 2016 and mid-January 2017. It generally makes comparisons with activity and prices over the past three months on a year earlier. The Update represents the aggregate view offered from business contacts across the whole of the United Kingdom. More information on the Bank's Agencies can be found at www.bankofengland.co.uk/publications/Pages/agentssummary/default.aspx.

Agents' survey on pay and labour costs

The Agents have conducted an annual pay survey since 1998. The survey assesses private sector contacts' pay settlements in the past year and expectations for the year ahead, along with key drivers behind expected changes to the annual rate of growth in total labour costs per employee. This year 341 firms responded, with a combined employment of around 530,000 staff. Results have been weighted by employment and adjusted for differences in the sectoral employment composition of the survey compared with the economy as a whole.

The survey indicated expectations overall of a slight increase in the growth of total labour costs per employee in 2017 (**Chart A**). Slower growth in consumer services and construction was expected to be more than offset by faster growth in manufacturing and business services.

Chart A Expected changes in total labour cost growth



Respondents were asked about the factors expected to drive changes in the rate of total labour cost growth in 2017 relative to 2016 (**Chart B**). Among the factors pushing up growth were difficulties in recruiting and retaining staff, higher consumer price inflation, increases in pension contributions and improving productivity. The apprenticeship levy was commonly cited as a factor expected to push up labour cost growth, driving the positive net balance for the 'Other' category. The costs of the apprenticeship levy would, however, not show up in official measures of employee compensation.

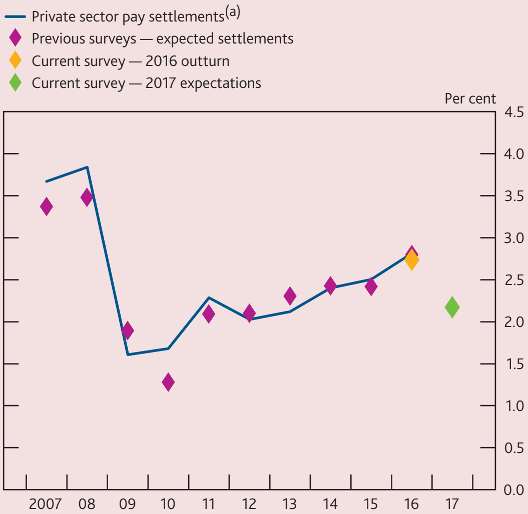
A number of factors were acting in the opposite direction. In particular, companies' ability to pass on cost increases to prices and economic uncertainty were expected to pull down labour cost growth per employee. The National Living Wage (NLW) was also expected to push down total labour cost

Chart B Influences on expected growth in total labour costs per employee, 2017 relative to 2016

inflation in 2017, relative to 2016, as its rate of increase slowed.

Some of the factors expected to push up total labour costs growth would be unlikely to be reflected in higher pay settlements — a narrower measure that excludes elements such as employer pension contributions, benefits, bonuses and pay increases targeted at particular members of staff. Indeed, the average pay settlement was expected to ease in 2017 to 2.2% from 2.7% in 2016 (**Chart C**), with the number of pay awards between 3% and 4% expected to fall significantly. Settlements were expected to moderate in all sectors, with the largest decline anticipated in consumer services, where some companies had made pay awards in 2016 that were beyond those strictly necessary to meet the NLW at that time.

Chart C Pay settlements



Sources: Bank of England, Incomes Data Services, the Labour Research Department, XpertHR and Bank calculations.

(a) Average over the past twelve months, based on monthly data.

Selected charts of the Agents' national scores

Chart 1 Retail sales values and consumer services turnover

Three months on the same period a year earlier

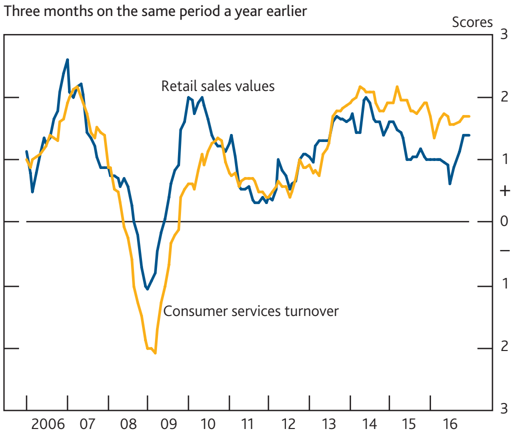


Chart 2 Manufacturing output

Three months on the same period a year earlier

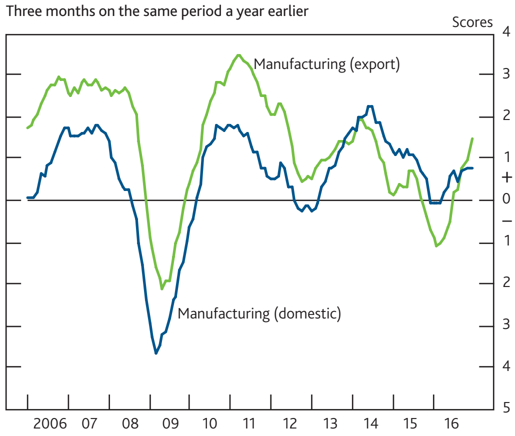


Chart 3 Investment intentions

Over the coming twelve months

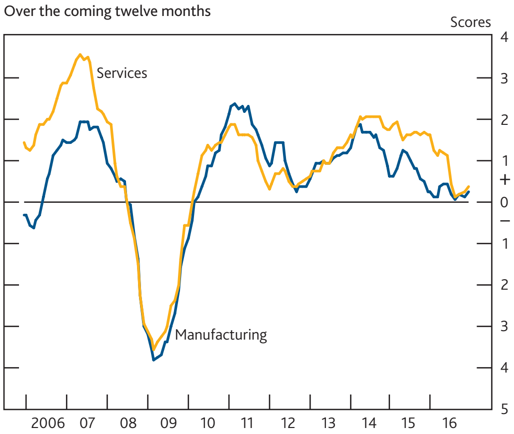


Chart 4 Employment intentions

Over the coming six months

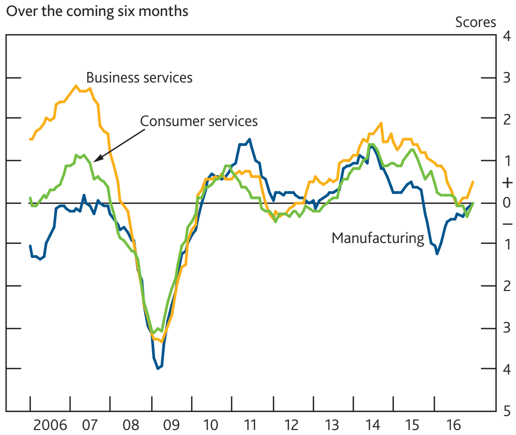


Chart 5 Materials costs and imported finished goods prices

Three months on the same period a year earlier

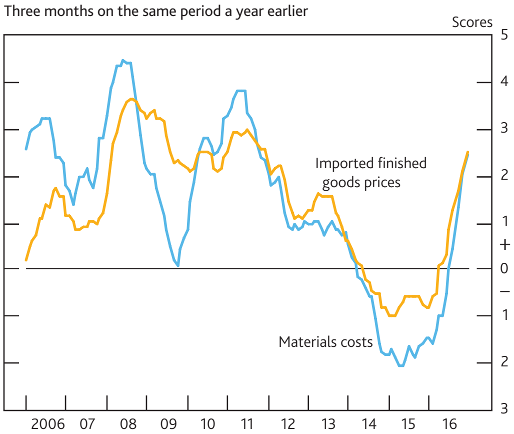
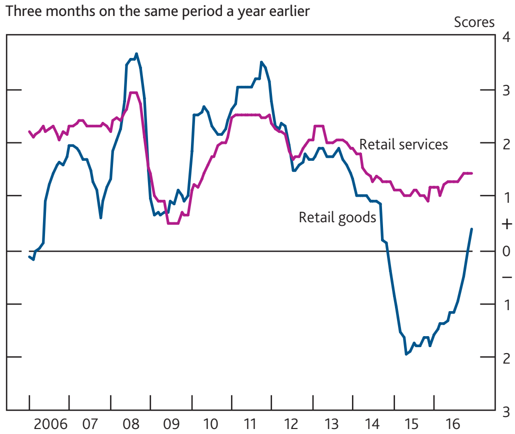


Chart 6 Retail goods and services prices

Three months on the same period a year earlier



For data on the full set of Agents' scores see www.bankofengland.co.uk/publications/Documents/agentssummary/agentsscores.xlsx.