Agents’ summary of business conditions
and results from the Decision Maker Panel survey
2019 Q1

- Contacts reported a further softening in activity over the past few months compared with a year ago.
- Growth in consumer demand slowed a little further, especially for major household purchases.
- A majority of contacts in the Agents’ Brexit survey said they were making contingency plans in case of a ‘no deal’ Brexit.
- Investment intentions continued to weaken, particularly in manufacturing.

Growth in the value of retail sales weakened, as uncertainty about Brexit and the wider economy weighed on spending.

Business and financial services activity slowed a little, reflecting caution in the run-up to Brexit and wider economic and political uncertainty.

Growth in exports of services slowed, in part due to weaker demand for consultancy services.

Growth in domestic manufacturing output slowed. This reflected a fall in output in the automotive sector and weaker construction output growth, which was only partially offset by growth generated by stockbuilding. The latest Agents’ survey on preparations for EU withdrawal showed that around two fifths of all respondents have been building inventories (Box 1).

Weaker demand from Europe and China weighed on growth in exports of manufactured goods, with the Agents’ score for this measure falling to its lowest level in more than two years.

Construction output growth eased as weakening housing market conditions and business investment weighed on activity.

Investment intentions fell sharply in manufacturing, mostly due to Brexit uncertainty. There was a modest decline in investment intentions in the services sector.

Demand for credit from corporates softened. Credit availability tightened a little, particularly for contacts in the retail and construction sectors.

There was slower demand for commercial real estate from both domestic and overseas investors, but demand continued to outweigh supply.

Housing market activity weakened for new-build homes as well as for second-hand properties, but the rental market remained buoyant.

Capacity constraints remained above normal, particularly in the logistics sector, partly due to stockpiling activity.

Recruitment difficulties continued to intensify and remained widespread. Employment intentions weakened a little, however, and pay growth appeared to be levelling off.

Consumer goods price inflation slowed sharply but consumer services price inflation moderated less, partly due to wage-driven price increases in some sectors.
**Consumer demand**

Over the past three months, annual growth in the value of retail sales weakened (Chart 1), and remained below its long-run average. This mostly reflected softening activity in store-based retail. Demand for furniture and household appliances slowed, which contacts attributed to rising uncertainty related to Brexit and subdued housing market activity. Spending on essential items held up. For example, supermarket contacts reported better-than-expected food sales, possibly reflecting lower spending on restaurant dining. However, there were isolated reports of smaller basket sizes and trading down.

Annual growth in consumer services values remained modest — even compared with a year ago when activity was adversely affected by the severe winter weather.

**Business and financial services**

Business and financial services activity slowed a little but grew at a modest rate (Chart 2). Activity began to soften in some areas where growth had previously been strong, such as professional services and mergers and acquisitions. The stalling of some commercial property deals had a negative impact on businesses in the legal, consultancy and financial sectors.

Contacts said weaker demand reflected Brexit uncertainty and concerns about UK political stability as well as worries about trade tensions between the US and China, which could have a knock-on effect on professional services. However, contacts thought that activity could pick up again if Brexit-related uncertainty cleared.

To date, there has been limited evidence of business service contacts or their customers moving activity out of the UK. Where changes have been made, this has usually involved replicating a modest proportion of the UK business in continental Europe, for example distribution or regulatory approvals processing.

Some firms, such as those offering professional advice on Brexit-related planning, reported stronger activity. Employment agencies benefited from continued tightness in the labour market, corporate restructuring and the relocation of some roles to continental Europe. This had generated activity and allowed some contacts to increase their fees. Difficulties in the retail sector and corporate distress more broadly had generated some additional business for insolvency-related services.

**Exports of services**

Growth in services export values eased to below average rates, due to slower global demand and Brexit-related uncertainty.

Demand for consultancy services weakened. Higher education organisations found it harder to attract foreign students due to Brexit concerns and visa issues. There were signs that demand for UK assets from foreign investors had eased, albeit from a high level.

There has been little evidence so far of a marked shift away from UK services by EU customers, however. Indeed, some Europe-based firms have sought to secure access to UK markets post-Brexit by investing in UK businesses, infrastructure and commercial real estate, which has supported exports of services. And inbound tourism continued to grow, helped by the weakness of sterling.

**Manufacturing**

The Agents’ score measuring growth in domestic manufacturing output weakened to its lowest in around two years (Chart 3), but remained above its long-run average.

Although stockbuilding by companies provided some support to output growth, this was offset by weakness in other areas. The Agents’ latest survey on preparations for EU withdrawal showed that around two thirds of manufacturers were building inventories (Box 1).
Agents’ survey on preparations for EU withdrawal

The Agents surveyed almost 300 business contacts about their preparations for EU withdrawal between 29 January and 1 March.1 The results of this survey — referred to as the ‘March survey’ — are summarised in this box.

The March survey indicated that companies had stepped up their preparations for a ‘no deal, no transition Brexit’ and that their reported readiness for this scenario had improved compared with the previous survey in January.2

In March, around two thirds of respondents said that they had started implementing contingency plans — both agreed and in development — for a ‘no deal, no transition’ Brexit (Chart A). This compared with just under half of respondents in the January survey.

However, there was still a significant minority — just under a third of contacts — who were not making any plans. This was mostly because they did not think they would be affected by a ‘no deal, no transition’ Brexit, or were waiting for more clarity about potential outcomes.

The survey showed that businesses were taking a range of steps to mitigate risks from a ‘no deal, no transition’ Brexit (Charts B (i) and (ii)). Those steps included putting resource into Brexit planning, engaging with customers directly to manage risks and applying for certifications that may be needed to continue trading with the EU after Brexit.

Around two fifths of respondents said that they were stockbuilding, down slightly from the January survey. The scale of stockbuilding varied by sector as well as the size of the business and the size, nature and source of the components, materials or goods.

Results from the January and March surveys suggested that manufacturers were most likely to be building inventories, with

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1 The survey was conducted between 29 January and 1 March 2019. There were 286 responses from companies with 373,000 employees and with a combined turnover of £127 billion. Responses were weighted by employment and then by sector.

2 The January survey was conducted between 17 December 2018 and 28 January 2019. The results were published in the ‘Agents’ update on business conditions’ in the February Inflation Report. Results from the December 2018 vintage of the survey were published on 4 December 2018 in the ‘Agents’ survey on preparations for EU withdrawal’.
construction businesses least likely to be doing so. Wider agency intelligence suggests that contacts have been building inventories of up to three-times normal levels.

The March survey suggested that as companies have increased contingency planning for a ‘no deal, no transition’ Brexit, their reported readiness for this scenario has also increased.

The March survey showed that around 80% of companies judged themselves ‘ready’ for a ‘no deal, no transition’ Brexit scenario, compared with around 50% of companies in the January survey.

Nevertheless, many companies reported that there were limits to the degree of readiness that was feasible in the face of the range of possible outcomes in that scenario. These included issues relating to tariffs, border frictions, exchange rate movements and recognition of certifications — which many companies felt were outside their control.

Indeed, the March survey also showed that respondents — even those that felt ‘ready’ — still expected output, employment and investment over the next 12 months to be significantly weaker under a ‘no deal, no transition’ Brexit than under a ‘deal’ scenario.

On average, companies expected output and employment to fall, though to a lesser extent in March than in the January and December surveys (Chart C (i)). Investment in the UK was expected to fall more sharply in the March survey than in the previous surveys. The differences between the survey results may be partly due to sampling issues. The differences between expectations for the two scenarios were broadly similar across the three surveys.
Contacts in the automotive sector and in related supply chain businesses reported declines in output compared with a year ago. And output is expected to fall in 2019 Q2 as a result of extended shutdowns scheduled by some manufacturers.

Many producers of building materials reported a slowdown in output growth due to weaker construction activity. Suppliers to the retail sector also reported weak demand, particularly for furniture and household appliances.

In the food sector, manufacturers of low-cost products reported growth as consumers traded down. However, there was strong growth in vegan products.

Contacts in aerospace and high-tech engineering said demand remained strong.

The score for growth in the volume of manufactured goods exports was also its lowest in around two years (Chart 3). The slowdown was concentrated in the consumer goods and automotive sectors, largely due to weaker demand from Europe and China.

Suppliers to the aerospace and automotive sectors reported a small boost to demand from stockbuilding by overseas customers, but they expected it to be short-lived. In addition, some contacts reported building stocks of finished goods in continental Europe to mitigate the risk of outbound delays in the event of a ‘no deal, no transition’ Brexit.

There was little sign to date of European customers pulling away from UK products, though most contacts expected this would only become visible over the medium term.

There was robust demand from US-based customers for a range of UK-manufactured products. And demand from the oil and gas sector also continued to strengthen.
Some contacts in the logistics and transport sectors reported investing in additional capacity. But investment in the retail sector remained mostly weak.

**Corporate financing conditions**

Corporate credit demand continued to slow as contacts sought to reduce leverage and strengthen their balance sheets ahead of Brexit. Contacts said that banks remained cautious about lending to the retail and construction sectors.

Contacts in most other sectors said they had not experienced constraints on credit but felt its availability was gradually tightening. For example, there were some reports of banks applying tighter lending criteria to loan applications from companies exposed to Brexit uncertainty.

Large companies — which usually have easier access to credit — have also signalled that credit conditions have become somewhat less favourable in recent months. For example, some believed that raising bond finance might be more expensive at present due to Brexit uncertainty.

Some contacts said that availability of supplier finance was tightening and trade credit insurance cover was being reduced. However, providers of asset finance continued to compete aggressively.

**Property markets**

**Commercial real estate**

Demand for UK commercial property from domestic and overseas investors slowed more sharply than in previous months, reflecting heightened uncertainty ahead of Brexit.

The weakening in demand had become more broadly based across the commercial real estate (CRE) market and UK regions. However, there was still some appetite for UK CRE from high net-worth overseas investors and overseas funds. And overall demand for CRE continued to marginally outpace supply — supply growth had softened in recent months.

Demand continued to be strongest for build-to-rent apartment buildings, flexible office space and distribution warehousing for online retailers. By contrast, investors have tried to limit their exposure to secondary and tertiary retail property. Although valuations for retail property have already fallen, contacts believed they could fall further.

**Housing market**

Sentiment in the housing market continued to weaken a little. Contacts reported that Brexit-related uncertainty had deterred many buyers. And excess supply, particularly in southern England, had led to a widening gap between asking and offered prices.

Sales of new-build homes also slowed, causing housebuilders to offer significant incentives in order to complete sales. Lettings remained buoyant, though contacts said that some tenants had been seeking shorter leases and break-clauses.

Mortgage activity was mostly concentrated in refinancing deals for home-owners switching to fixed-rates and longer mortgage tenors in order to lock in low interest rates.

Contacts said that weaker demand for mortgages combined with high competition among lenders was keeping down mortgage rates.

**Capacity utilisation**

Capacity constraints stabilised but remained above normal across the economy as a whole. Contacts in logistics and warehouses reported tight capacity, reflecting the structural shift towards online retailing, as well as some Brexit-related stockpiling.

Contacts in professional services cited labour and skills shortages as major constraints on output. In contrast, contacts in the retail sector continued to report excess physical capacity, despite consolidation in the sector.

**Employment and pay**

Employment intentions weakened a little further and were broadly flat across the economy, reflecting caution due to slower output growth and Brexit uncertainty.

Employment intentions were modestly positive in business services, driven by job creation in IT, professional services and logistics.

But employment intentions continued to fall in consumer services, as retailers responded to weakening trading conditions and sought to mitigate the effect of the annual increase in the National Living Wage.

In manufacturing, the Agents’ employment intentions score fell to its lowest in more than two years. Job losses in sectors such as automotive were only partially offset by employment growth in aerospace and other high-tech industries.

Despite weakening employment intentions, recruitment difficulties increased a little (Chart 5). Contacts reported labour shortages across a broad range of sectors and skill levels. They continued to report particular shortages in IT, professional services, engineering and haulage. Many contacts said recruitment difficulties was one of their biggest challenges.

They also said that a lack of EU migrant workers had exacerbated conditions in some sectors, such as
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food-processing, logistics, hospitality, agriculture, horticulture and health and social care.

However, some reported that recruitment difficulties had eased in sectors undergoing consolidation or experiencing weaker demand, such as property-related services.

Pay settlements remained on average in the range 2½% to 3½%, and pay growth appeared to be flattening off after past rises. Nonetheless, contacts continued to give targeted pay awards to address skill shortages. And companies with a high proportion of low-paid staff concentrated pay increases on staff who were on or just above the National Living Wage.

Some contacts said that the increase in employer auto-enrolment pension contributions this year would add to total labour cost growth.

Costs and prices
Consumer goods price inflation slowed sharply as a result of lower fuel prices and the new cap on some energy tariffs (Chart 6).

In consumer services, contacts said that some sectors, such as leisure, tourism and private domestic care, had scope to pass through higher wage costs via price increases. However, the ability of contacts in the food and beverage sector to raise prices was limited by overcapacity in the sector.

Material cost inflation eased slightly but remained close to its long-run average. Contacts said this was mostly linked to the depreciation of sterling falling out of year-on-year comparisons and an associated slowdown in imported finished goods price inflation. It was also attributed to a slight easing in commodity price inflation.
Box 2
Results from the Decision Maker Panel survey

Overview
In August 2016, together with academics from Stanford University and the University of Nottingham, the Bank set up the Decision Maker Panel (DMP) survey to help monitor developments in the UK economy and to track businesses’ expectations and the uncertainties surrounding them. The responses from the DMP survey have been a valuable source of information, complementing the intelligence gathered from Agents’ contacts.

This box summarises results from the November 2018 to January 2019 surveys, focusing on businesses’ views about Brexit and investment.

Importance of Brexit as a source of uncertainty
Recent data indicate that Brexit is becoming an increasingly important source of uncertainty for businesses (Chart A). In the latest November to January surveys, 54% of businesses reported that Brexit is currently one of the top three sources of uncertainty for them. This proportion has increased from just below 40% in the first half of 2018 and is now at the highest value recorded since the survey was launched.

Chart A Importance of Brexit as a source of uncertainty

Brexit uncertainty appears to have had a substantial dampening effect on investment growth. Companies who view Brexit as an important source of uncertainty reported that the level of their investment was around 5% lower than a year ago in 2018 Q3 (shown by the red line in Chart C), while firms who did not view Brexit as an important source of uncertainty reported an increase of almost 10% (shown by the blue line in Chart C).

Over the period since the referendum, there appears to have been three phases to the impact of Brexit uncertainty on investment (Chart C). In the first year after the referendum, investment growth was lower for firms who reported that Brexit was an important source of uncertainty than it was for firms who reported that Brexit was a less important source of uncertainty. There was then a period when investment growth for these two groups was more similar, before a third phase since the middle of 2018 when investment growth has weakened again for firms who say that they are more exposed to Brexit uncertainty.

Investment decisions and Brexit
Official economic data suggest that investment growth has been weak in recent years, especially in the post-referendum period. DMP members are also asked about their current and past level of capital spending as well as their expectations for investment over the next year. According to the latest results, averaging across firms, annual growth in nominal capital expenditure fell back from around 4% in 2018 Q2, to around 1% in 2018 Q3. It has generally been subdued since the referendum (shown by the solid red line in Chart B). Looking a year ahead, investment growth is expected to remain modest with capital spending expected to grow by around 2.3% in the year to 2019 Q3 (the dashed red line in Chart B).

Chart B Realised and expected growth in capital expenditure

Sources: DMP and Bank calculations.

All results are weighted.

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1 This project is supported by the Economic and Social Research Council (grant number ES/P010385/1).

2 The DMP comprises Chief Financial Officers (CFOs) from small, medium and large UK companies operating in a broad range of industries. It is designed to be representative of the population of UK businesses. Around 7,300 businesses had agreed to be part of the panel at the time of the January 2019 survey. The survey runs monthly with panel members receiving one third of a quarterly questionnaire each month. The response rate has averaged around 40% in recent months. Aggregate data from surveys up to January 2019 and details on questions are available at www.bankofengland.co.uk/-/media/boe/files/statistics/research-datasets/dmp-results-march-2019.xlsx.

3 For details on the methodology please visit www.bankofengland.co.uk/quarterly-bulletin/2017/q2/tracking-the-views-of-british-businesses-evidence-from-the-dmp. All results are weighted.
Brexit may weigh on future investment decisions too. In the latest November to January surveys, panel members thought, on average, that there was a 33% chance that Brexit would reduce capital expenditure over the following year (Chart D). The probability of Brexit increasing investment spending was estimated at 8%, with a 59% chance of no impact. (4) The probability attached to Brexit reducing investment over the next year was higher in the latest survey than when the question was last asked in May-July 2018, although it was similar to the level reported shortly after the referendum in September-October 2016.

Preparing for Brexit
Responses to the most recent surveys suggested that three quarters of CFOs were spending some time planning for Brexit in November-January 2019, up from around 60% a year earlier (Chart E). The amount of time spent planning for Brexit was also reported to have increased. For example, the share of CFOs spending more than one hour a week on Brexit planning increased from 21% to 43%.

Chart C Realised and expected growth in capital expenditure by importance of Brexit as a source of uncertainty

Chart D Expected impact of Brexit on capital expenditure

Chart E Business executives planning for Brexit

(4) This question was referring to the level rather than growth of investment. Some businesses may have already reduced investment due to Brexit and their responses may be relative to their current level of investment.