Agents' summary of business conditions - 2023 Q2

We regularly publish a summary of reports compiled by our 12 regional Agents following discussions with at least 700 businesses across the UK every reporting period.

Demand and output

Economic activity recovered modestly and demand was stronger than expected.

Employment and pay

Employment intentions improved marginally. Labour market loosened a bit further and pay settlements broadly stayed at 6%–6.5%.

Costs and prices

Input cost inflation continued to decline, but supply chain lags and desire to rebuild margins will slow down the pass-through into consumer prices.

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Content

Overview

This publication summarises intelligence gathered between mid-April and late May. The Agents' scores published alongside this document generally represent developments over the past three months compared with the same three months a year ago.

Economic activity recovered modestly with slightly improved consumer and business confidence.

Input cost inflation continued to decline. Food price inflation remained high but is expected to come down. Lags in the pass-through of price changes along the supply chain and a desire to rebuild squeezed margins will delay the moderating impact of lower material and energy costs on consumer prices. Companies expect to make fewer and smaller price increases over the next year as input costs ease.

Business and financial services activity was moderately better. Contacts said consumer demand was more resilient than they had expected across goods and services. Manufacturing output activity stabilised.

Employment intentions were marginally positive with varying trends across sectors. Recruitment difficulties continued to ease in particular for less skilled positions but were still above normal levels.

Pay settlements continued to average 6%–6.5% – broadly in line with the **May 2023 Monetary Policy report**. Contacts anticipated that pay settlements will fall in 2023 H2.

Housing activity stabilised. Investment intentions, corporate credit conditions and activity in the commercial property sector continued to be subdued. Construction activity continued to fall, owing to uncertainty about the economic outlook and higher costs.

Consumer spending

> **Consumer spending growth was driven by high price inflation, as expected. Sales volumes across goods and services proved more resilient than anticipated.**

Contacts reported very strong growth in grocery sales, driven by higher prices. Discounters continue to do well, although the scope for consumers to trade-down may be approaching its limit.

Clothing retailers reported mixed demand reflecting shoppers trading down to cheaper items. Additionally, poor weather weighed on sales of spring and summer lines.

Demand for durable goods remained subdued. For home improvement retailers, demand continued to fall owing to cost of living pressures, a decline in pandemic-related demand and higher interest rates.

For new cars, supply is improving, but buyers are still facing relatively long lead times, which is discouraging some buyers from placing orders. This is, in turn, supporting demand for used cars.

Sales growth was generally driven by prices while volume was relatively flat.

Contacts in restaurants and pubs reported strong nominal consumer spending as prices have risen, despite slower footfall trends. Demand for accommodation was generally strong. Contacts in the tourism sector expected a strong summer and any loss of demand from fewer staycations is likely to be offset by higher numbers of foreign tourists.

Business services

> **Business services stayed resilient. Price inflation continued to drive higher turnover. Overall activity continued to recover owing to improved confidence about the economic outlook.**

Contacts in less cyclical businesses such as litigation, audit, IT, communications, and insurance continued to report robust performance with strong demand and increased pricing. Corporate events/tourism continued to recover with improved demand and higher pricing. Wholesale contacts supporting the retail market saw better than expected demand levels.

Recruitment contacts reported fairly flat volume levels though higher salary levels supported revenue growth.

By contrast, contacts that specialise in mergers and acquisitions and other corporate transactions continued to report weaker revenue levels owing to higher funding costs weighing on the number of such corporate decisions.

Companies in construction and logistics also reported subdued domestic demand.

Manufacturing

Manufacturing output stabilised with improving demand and easing supply constraints.

Contacts reported stable growth in manufacturing output, supported by a modest improvement in exports, particularly to the US and China. Revenue growth continued to improve as prices increased.

Demand in the defence sector remained positive, while aerospace continued to recover. At an aggregate level, UK automotive production benefitted from an easing of supply chain constraints. Output in the UK semi-conductor sector grew strongly.

Contacts in the food and drinks sector reported stable volumes, although consumers were trading down for lower-value products, while durable consumer goods reported weaker demand.

Demand for construction materials continued to fall, led by housing.

Construction

Construction output volumes continued to fall, driven by softer demand from the public sector and in housing. Higher costs and planning constraints also affected output.

The decline in output volumes continued as homebuilders slowed build rates in response to weaker demand. Construction of social housing was also slow owing to the increased cost of upgrading the existing housing stock. Contacts continued to report a fall in home improvement spending reflecting the squeeze on household incomes.

Construction of office and commercial property remained weak as both high funding and building costs reduced potential returns, even as the demand for office refurbishment remained good. Public sector demand has slowed as project budgets were constrained by higher costs.

Investment

Investment intentions continued to be subdued. This owed to higher investment costs, some reduction in returns to capital investment and on-going uncertainty about the economic outlook.

Contacts said return on some types of investment had reduced, partly reduced due to lower energy costs, higher construction cost and tighter financial conditions. Some contacts preferred using cash or existing credit to invest, rather than taking on more debt, while some are seeking to reduce debt as cost of finance increases, further constraining investment spend.

There was variation in appetite to invest and the nature of investment across sectors and size of business.

Buildings and construction related investment was held back by higher material costs and planning delays, while machinery and vehicles investment was often subject to delays in delivery. But investment in IT and wider digital investment continued across several sectors, particularly business and professional services, and consumer services.

The cost and availability of labour continued to incentivise investment in automation, although a shortage of certain skills (eg, engineering, contractors and IT specialists) held back some investment plans.

Corporate credit conditions

Demand for credit remained subdued. No spillover of US banking troubles on UK corporate funding was reported by our contacts. Banks were more cautious on new advances to small and medium-sized enterprise borrowers.

Contacts reported that markets and banks remained willing to fund prime corporates. Banks had been supporting existing borrowers with working capital finance though there was more caution about issuing new credit owing to the fall in the value of property collateral and the impact of cost inflation on firms' profitability.

Credit demand remained subdued, especially across property development, mergers and acquisitions, and investment. But working capital needs remained high. Contacts reported seeking short-term, floating-rate debt since there was uncertainty around future interest rates and lending conditions remained volatile.

There were some signs that trade credit availability had tightened. Among smaller firms in vulnerable sectors (retail, hospitality and construction) trade credit insurance remained tight.

Insolvencies, among the smallest firms, had picked up to a high level relative to pre-Covid years, and were expected to continue to rise.

Employment and pay

> **Employment intentions were marginally positive with varying trends across sectors. Recruitment difficulties have continued to ease back for less skilled labour but are still above normal levels for more skilled positions. Pay settlements averaged 6%–6.5% broadly around the level reported in the May 2023 Monetary Policy Report.**

Overall firms expect to increase headcount modestly. While contacts in housing, construction and consumer facing firms are reducing headcount to manage costs, large retailers are considering reducing hours rather than cutting headcount to contain overall wage costs. Headcount continues to expand in business services and parts of manufacturing such as automotive and electrical engineering.

Companies said recruitment is still more difficult than normal for less-skilled positions and it remains particularly tough for specific skills (IT, engineering and finance). Vacancies have continued to fall back from a high level given improved worker availability and higher retention levels. Labour shortages continued to constrain output in some firms.

Pay settlements for 2023 continued to average 6%–6.5% – broadly consistent with **May 2023 Monetary Policy report**. Contacts said there was a wide range of awards around this average. Pay awards above this average were driven by the April increase in the National Living Wage, inflation, retention challenges and Union pressure.

However, some companies with pay reviews due in the second half of this year thought that pay settlements could be somewhat lower, largely reflecting expectations of lower inflation and a looser labour market. There were also fewer reports of companies expecting to make one-off payments to compensate employees for the higher cost of living.

Costs and prices

> **Input cost inflation continued to decline. However, lags in the pass through of cost increases along the supply chain and a desire to rebuild squeezed margins will delay the moderating impact of lower raw material and energy cost on consumer prices.**

Companies still expect to make fewer and smaller price increases over the next year as input costs ease.

Input cost inflation continued to fall with decreasing raw material cost inflation leading to reducing imported goods inflation and shipping costs falling to normal levels.

Aggregate profit margins remained squeezed as cost increases have not fully passed through in manufacturing, construction and consumer facing businesses.

Manufacturing domestic price inflation peaked but is now starting to come down. Differing supply chain contracts meant some businesses were yet to see the benefits of lower costs.

For business services firms, professional fee inflation mostly remained high but weaker demand in some markets meant pricing had become more competitive, putting some downward pressure on pricing.

Food price inflation remained high but is expected to come down. However, lags in the pass through of cost increases along the supply chain and a desire to rebuild squeezed margins will delay the moderating impact of lower cost inflation on consumer prices.

Inflation eased across durable goods, clothing, and footwear, reflecting lower input cost inflation and increased discounts as demand falls. Used car prices stabilised but remained high.

Consumer services price inflation remained high. Companies reported absorbing some pressure of increased cost to keep the price reasonable, while passing a fair proportion of rising labour, energy and food cost on into their output prices.

Property markets

Housing market activity stabilised following the recovery seen in 2023 Q1. Commercial property transactions remained subdued.

Housing market

Contacts reported weaker demand and stronger supply than a year ago, bringing supply and demand closer to balance. This led to more stable prices relative to recent months.

Home builders continued to report scaling back of construction plans. This was driven by higher building costs, higher mortgage rates, slow planning processes and lower confidence among developers. Home builders continue to offer incentives to secure sales. Buyers were reported to be switching from fixed to variable mortgage rates.

In the rental market, contacts continued to report increasing demand leading to double digit rent inflation. Housing associations saw an uptick in demand as households struggle to afford private market rates.

Commercial real estate

> **Transaction volumes for investor purchases continued to remain subdued reflecting higher finance costs and uncertainty around valuations.**

Contacts in the office sector reported an ongoing oversupply relative to demand as hybrid working became more common.

Contacts in the industrial and logistics market reported stabilising trends across valuation, supply and demand.

In retail, contacts said shopping centre valuations continued to fall but at a slower rate.

Trends of repurposing property were seen in both secondary office space and shopping centres to address over-supply.

Contacts reported banks were generally supportive of existing commercial property borrowers, however, uncertainty around valuations drove reluctance to revalue collateral or support high leverage.

Outreach engagement

> **Concerns over food inflation were elevated among members of the public. Charities have seen an increase in demand and expect that trend to continue over the rest of the year and into 2024.**

Members of the public had continued to feel the squeeze on their household budgets. Energy prices were still a significant concern, but food inflation was now reported as having the biggest impact. Households had continued to change their shopping and spending habits to reduce costs, including buying more of retailers' own-brand products, eating out less and reducing social and leisure outings to save money. Some were regularly using savings or credit cards to cover everyday spending.

A national advice charity had seen an increase in the number of first-time service users in need of crisis support, as well as a high number of people returning for support as the cost of living increases meant they were facing challenges again. Debts were reportedly arising from spending on essential household costs such as energy, housing, council tax and groceries.

Foodbanks from various parts of the UK reported a significant increase in new users since the start of 2023, some quoting rises of 200%–400%. They stated that many people using foodbanks were in work and did not have enough income to cover basic expenses.

Charities raised concerns about the sector's sustainability due to rising service demand and staffing pressures related to recruitment, retention and pay. Income was also a challenge owing to reduced funding flowing into the sector and high levels of competition.

More details can be found in our **Outreach report**.

Related contents and download

Latest results from the Decision Maker Panel survey – 2023 Q2

In May, firms expected their own prices to increase by 5.1% over the next year, down from a peak of 6.7% in July 2022.

Next publication date 21 September 2023

Bank of England Agents' scores (XLSX 0.9MB)

Definitions for the Agents’ scores

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