BANK OF ENGLAND

Agents' summary of business conditions

August 2013

- Annual growth in the value of consumer spending had remained moderate. There were signs of increasing consumer confidence, though disposable incomes had remained tight.
- Activity in the housing market had picked up further in recent months.
- Investment intentions had continued to point to only modest growth in capital spending.
- Growth in manufacturing output had been unchanged for the domestic market, though it had increased a little for exports.
- Sentiment in business services had improved further, alongside continued growth in turnover.
- Construction output had strengthened, as house building had increased over recent months.
- Corporate credit availability had continued to improve gradually.
- Employment intentions pointed to a slight increase in staffing over the coming six months.
- Capacity utilisation had remained slightly below normal both in manufacturing and services, though the margin of spare capacity in services had narrowed a little.
- The annual rate of growth in labour costs per employee had been little changed.
- Annual growth in materials costs had remained subdued and moderate inflation in imported finished goods prices had continued.
- Inflation in manufacturers' output prices had edged lower and had remained very subdued for business services prices.
- The rate of consumer price inflation had been unchanged.

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 June 2013 and late July 2013. 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.**

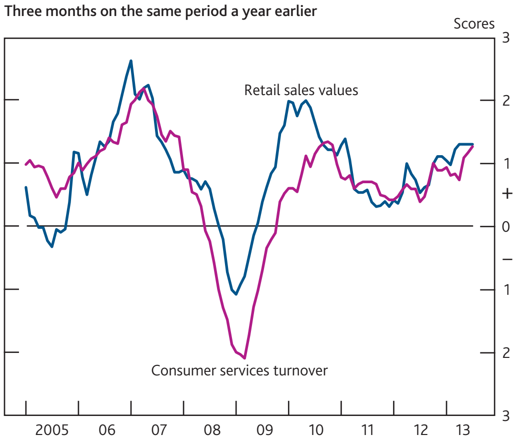
Demand

Consumption

Moderate annual growth in the value of retail sales had continued (**Chart 1**). Consumers were generally reported to remain cautious about spending, reflecting tight disposable incomes, but there were signs of increasing consumer confidence. There were some tentative indications of increased housing market activity leading to rising sales of some larger household durable goods. New car sales had continued to rise, focused on fuel-efficient models and supported by finance deals that allowed for low monthly payment schedules. And improved weather conditions had boosted sales relative to a year earlier of some seasonal lines in food, drink and outdoor goods. Growth in consumer services turnover had edged up a little (**Chart 1**), partly reflecting a rise in demand for leisure activities and for travel and tourism, both domestic and foreign.

Chart 1 Retail sales and consumer services turnover

Three months on the same period a year earlier



Housing market

Housing market activity had risen further in recent months, both in terms of enquiries and transactions. In the new-build market, improving conditions were partly ascribed to the effects of the new Help to Buy scheme (applying to England only) and to a continued easing of mortgage availability, though some contacts reported stringent conditions on higher loan to value loans. The Help to Buy scheme was also said to be boosting demand in the market for existing homes, by raising expectations of future house prices. Buy-to-let investors had remained highly active. On the supply side, a shortage of properties for sale was said by estate agents to be restraining transaction volumes and to be putting upwards pressure on house prices.

Business investment

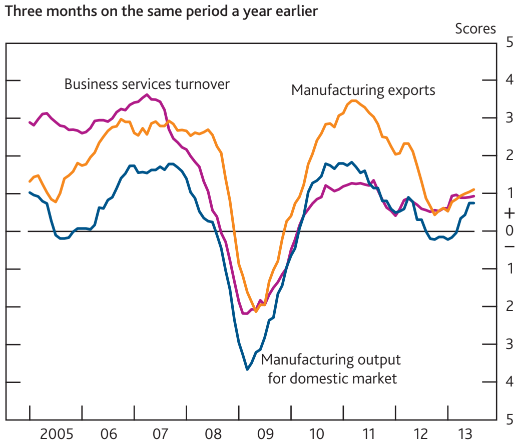
Investment intentions continued to point to only modest growth in capital spending. Investment had remained dominated by smaller-scale efficiency-enhancing or capital replacement expenditures, with very little large-scale capacity expansion. Some contacts reported ongoing concerns about demand uncertainty and that a more sustained pickup in activity would be required before significant capacity-raising expenditures became necessary. Investment in oil and gas extraction had remained strong, however, which had been reflected, in turn, in investment spending by manufacturers supplying that sector. Investment had also stayed relatively robust in automotive and aerospace production. In the services sectors, investment was often still concentrated on IT spending, though some retailers also reported increasing their capital spending budgets with the aim of refurbishing stores.

Exports

A gradual increase in growth in the volume of manufactured exports had continued (**Chart 2**), with weakness in euro-area demand more than offset by growth in sales to the United States, the major emerging markets and increasingly the Middle East. Export growth was often reported to be concentrated in products for the oil and gas industry, in premium brands with a broad international reach and in high value-added niche products. Growth in aerospace and automotive exports had also remained robust. Defence exports had weakened in recent months, however, following the US sequester. Services exports had continued to rise, including by IT companies, by some law firms delivering work in global markets, as well as by engineering and construction consultancy service providers to the Middle East in particular. There had been an increase in inbound tourism on a year earlier, perhaps partly related to the effects of the Olympics on overseas perceptions of the United Kingdom. That, alongside rising sales through internet platforms, was reported to have led to growing retail exports.

Chart 2 Manufacturing output and business services turnover

Three months on the same period a year earlier



Output

Business services

Sentiment across a range of business services companies had improved slightly in recent months, as moderate growth had continued (**Chart 2**). There were reports of modestly rising professional services activity around corporate transactions, often from sales of private small and medium-sized enterprises to other corporate buyers rather than large-scale mergers and acquisitions. Fund management activity had increased, with increased inflows from institutional investors and sovereign wealth funds. And some consultancy and advisory activity related to construction had increased as activity in parts of that sector had risen. Growth in other business services turnover had edged higher, in part reflecting an increase in transport services, partly related to the growth of internet sales but also with a slight pickup in corporate accommodation and travel, albeit from a low level. Continued growth in the turnover of IT and outsourced services providers was reported, as companies had continued to seek efficiency improvements and cost reductions.

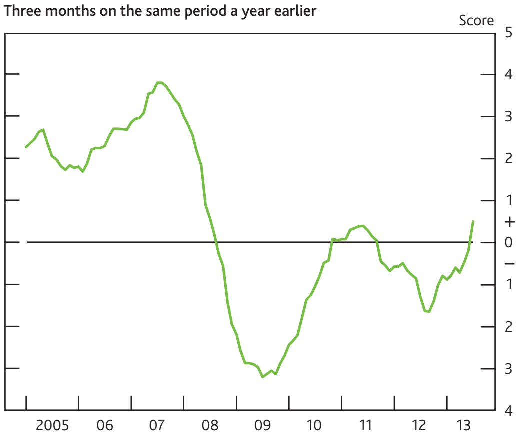
Manufacturing

Modest growth in manufacturing output for the domestic market had continued (**Chart 2**). Growth was reported to be strongest in supply chains feeding into the energy industry or into exports. Aerospace and automotive production had remained areas of strength, though parts of the supply chain to the European motor industry had been affected by weak demand. There had been some further signs of strengthening in the production of some construction materials and aggregates used in the early stages of house building, albeit in many cases from a low base, but production for non-housing construction remained weak. Many areas of production aimed at the domestic consumer had remained subdued, reflecting weak disposable incomes. A gradual stream of production relocation to the United Kingdom from abroad and of import substitution had provided a slight positive contribution to domestic manufacturing growth, in part reflecting rising labour costs in some overseas markets — notably China. There remained, however, examples of production moving outside the United Kingdom as well.

Construction

Construction output had strengthened in recent months (**Chart 3**). Private house building had increased, with expectations of stronger growth to come. In some cases, house builders reported that a shortage of sites was beginning to develop or that build rates were being constrained by planning delays. Some contacts reported a tentative increase in activity in commercial development within the leisure and accommodation sectors and in pre-let industrial development, though the level of private development remained low and there was little or no speculative development outside London. Significant utilities investment had continued. Public sector construction activity was reported to be concentrated in smaller-scale education and health projects and well below pre-crisis levels.

Chart 3 Construction output



Credit conditions

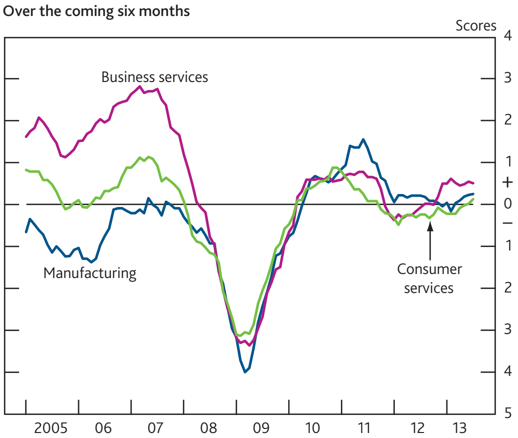
Credit availability had continued to improve gradually. Availability of finance remained polarised between very easy conditions for large companies, both for bank and capital market finance, and tight conditions for smaller companies holding few assets or operating in riskier sectors. For smaller companies, however, access to non-bank financing had increased further, and there were reports of greater activity by some 'challenger' banks albeit often in 'lower-risk' lending, such as asset finance. Demand for bank credit had remained weak, in part reflecting continued deleveraging and a search by some businesses for alternative means of finance in order to reduce their reliance on banks. However, there were some reports of increasing demand to fund the purchase of commercial property or industrial buildings. Within the corporate sector, large companies' invoice payment times had risen further, though bad debts were reported to be low.

Employment

Employment in the economy was reported to be rising modestly (**Chart 4**), but at a slower rate than output as companies sought to bear down on costs. Companies often reported using their existing staff more flexibly to meet increased demand, including some rebalancing of staff to production or sales roles from 'back-office' functions. In the manufacturing and consumer services sectors, employment intentions had edged higher in recent months as activity had gently risen, though in both cases implied only marginal increases on existing staff levels. A gradual increase in employment in business services was reported, in part reflecting the growth of IT services companies, increased outsourcing activity more widely, and as those gaining market share took on more employees while those losing share remained reluctant to lose specialist staff. Employment in house building was reported to be increasing more materially, however, particularly through the increased use of sub-contracted labour. Recruitment conditions had remained easy for unskilled labour, but continued to be tight for some specialised occupations. Those continued to be largely concentrated in IT and engineering, though there were a range of localised reports of skills shortages outside those sectors, including, most recently, in house building. More generally, there were some reports of employees becoming more willing to move between employers as job insecurity had eased.

Chart 4 Employment intentions

Over the coming six months



Capacity utilisation

Capacity utilisation remained slightly below normal in both manufacturing and services, but had edged higher as output had risen, particularly in the service sector. The utilisation of staff was often said to be somewhat higher than of physical capacity, though in some sectors there had been continued reports of considerable numbers of staff who could be moved back to 'frontline' roles from the back-office positions to which they had been transferred when demand was particularly weak. There were reports of concerns about capacity constraints in house building — some for the future, others already being felt. It was unclear, however, to what extent a shortage of skills in the industry could be met by migrant labour or a return of skills and whether some production capacity had been mothballed, rather than lost, during the period when activity had been particularly weak.

Costs and prices

Labour costs

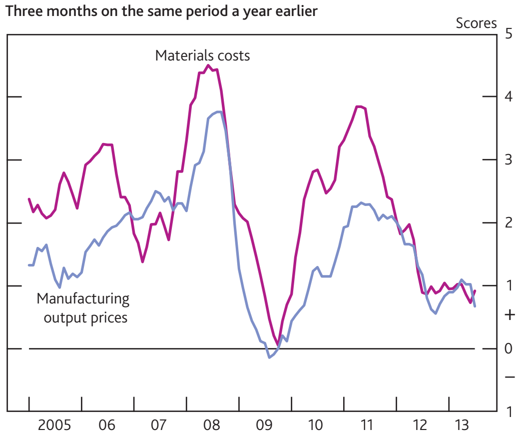
The annual rate of labour costs growth per employee had been unchanged. Pay awards in manufacturing firms had largely remained in the 2%–3% range, though some awards for specialist engineering skills were higher. And wage growth had strengthened for IT skills and in certain house building trades, reflecting the shortage of skills in those areas. Pay growth in services firms had remained below that in manufacturing firms overall, with a larger number of staff on pay freezes, though some services subsectors had started to see an increase in variable pay alongside rising activity. More generally, a greater use of profit or merit-related pay had continued to be reported. A range of companies reported lower starting salaries than a year earlier, alongside a wider shift in the composition of recruitment towards more junior staff. There continued to be a mix of reports on the effect of auto-enrolment, but pension costs overall were reported to be increasing, either directly or through added administrative costs.

Non-labour costs

Annual inflation in material costs had remained subdued (**Chart 5**). Many materials costs were reported to be little changed or lower than a year ago. The main exceptions to that pattern were higher energy costs, which were also feeding through into the price of some energy-intensive materials, and increases in the cost of a range of foods. The price of some construction materials, such as speciality bricks and aggregates, had also risen. Moderate inflation in imported finished goods prices had continued, despite subdued global demand, as the depreciation of sterling since late 2012 had continued to pass through gradually and as wage costs in China had risen.

Chart 5 Materials costs and manufacturing output prices

Three months on the same period a year earlier



Output prices and margins

The rate of inflation in manufacturers' output prices had edged lower in recent months, as an easing in input cost pressures had fed through (**Chart 5**). Business services price inflation had remained subdued, and in some subsectors offering 'commoditised' services, such as audit, recruitment, property management and some parts of advertising, fees were reported to be lower than a year earlier, reflecting strong competitive pressures. But in some professional and financial services, rising demand had allowed for some — often long-delayed — pass-through of cost increases. More generally, where output prices were rising, that was often reported to reflect the pass-through of energy or food price rises or to be confined to niche high value-added areas. Profitability in manufacturing and services had edged higher over the past year. That had largely reflected increasing business volumes, companies' efforts to increase efficiency and productivity, or in some cases the introduction of new products and/or a shift towards more profitable lines of work. Overall, however, profitability remained somewhat lower than pre-crisis norms.

Consumer prices

Retail goods and services price inflation had remained unchanged. Increases in food prices had continued to contribute moderately to goods price inflation, though recent falls in global grain prices were likely to ease food price pressures over the second half of the year. Discounting on clothing and footwear prices had been little changed on a year earlier and prices over the coming year were expected to be flat or to increase only modestly. There were reports of an easing in the discounting of new cars, though prices were at most only slightly up on a year earlier. Inflation in consumer services prices was often reported to have remained limited outside administered and regulated prices, such as those for utilities, social housing rents and public transport. More generally, retail goods and services companies reported difficulty in passing on price increases, except in luxury sectors catering to wealthy individuals, reflecting tight disposable incomes among most consumers and a high price sensitivity of demand.