BANK OF ENGLAND

Agents' summary of business conditions

February 2018 Update

- Growth in activity had held steady at a modest pace. Professional services firms had reported a pickup in growth; goods export volumes had strengthened, construction output growth had continued to slow.
- Investment intentions had remained positive, but mainly reflected investment to maintain business activity.
- Recruitment difficulties had remained at an elevated level, and pay growth had picked up.

Consumer spending growth had changed little (**Chart 1**). Growth in retail sales values had been broadly steady, but within that there was downward pressure on sales of furniture and homewares. In addition, the market for new cars remained challenging. Consumer services turnover growth continued to be helped by strong growth in inbound tourist spending, though there were some signs of a softening in discretionary spend by domestic consumers.

Growth in business services turnover had picked up slightly, but remained moderate (**Chart 2**). Growth was supported by an increase in mergers and acquisitions activity, property transactions, and continuing strength in overseas demand for professional services. Spending on IT services also remained strong.

Manufacturing output growth had remained moderate (**Chart 3**). Export volumes growth had increased, supported by strong global demand and the fall in sterling. The latter had led to some, albeit still limited, switching from overseas to cheaper, domestically produced goods. Activity in the oil and gas sector had picked up. **Construction output growth** had eased (**Chart 4**), with growth in housebuilding offset by flat or falling activity in other parts of the sector.

Investment intentions remained positive (**Chart 5**), but mainly reflected the investment needed to maintain business activity and improve efficiency. This included investment in automation, artificial intelligence and robotics.

Finance remained readily available, particularly for medium-sized and larger corporates, though banks' risk appetite towards construction and retail had fallen slightly. Provision of trade credit insurance had tightened for some firms in these sectors. Insolvencies had increased, albeit from a very low base, and there were reports of strains in payment along supply chains, particularly in construction and retail.

Outside London, investor demand for UK **commercial real estate** remained broadly unchanged, with demand modestly above supply. There was strong demand for distribution space, while demand for non-prime retail property had softened. Investor sentiment remained comparatively weaker in London, weighed by concerns about stretched property valuations.

Housing market activity remained subdued with transactions steady at a low level, reflecting weak supply and demand. Within that, the new-build and rental sectors were buoyant, pushing up prices and rents. Housing demand was particularly weak in London and the South East, especially for the most expensive properties. The rise in Bank Rate had little discernible impact on demand as mortgages remained cheap and readily available.

Overall **capacity utilisation** held steady at a slightly higher level than normal, particularly in services. Companies cited labour availability as one of the main constraints to activity.

Employment intentions continued to point towards modest headcount growth, except in consumer services, where headcount was expected to continue falling. **Recruitment difficulties** remained at elevated levels.

A survey showed that companies expected the average pay settlement rate to increase to 3.1% in 2018 from 2.6% in 2017 (see the box on page 2). **Total labour cost** growth continued to pick up, largely due to a combination of recruitment difficulties, the rising cost of living and the increase in the National Living Wage.

Materials cost inflation remained elevated, driven by commodity price increases (**Chart 5**). **Business services price inflation** remained a little below normal.

Consumer price inflation held steady, reflecting the ongoing impact from the fall in sterling (**Chart 6**). Retailers had sought to recover higher input costs gradually in the face of cautious consumer demand. Consumer services price inflation had edged down, but remained under upward pressure from increases in regulated prices, such as rail fares, in addition to firms passing on higher input and labour costs.

This publication generally covers intelligence gathered from business contacts between late November 2017 and mid-January 2018. It generally makes comparisons with activity and prices over the past three months on a year earlier.

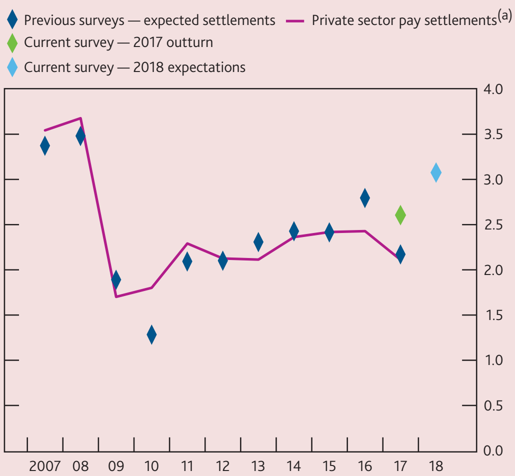
Agents' survey on pay and labour costs

The Agents surveyed business contacts about changes to pay and labour costs over the past 12 months and their plans for the 12 months ahead. The survey also asked how a range of factors were affecting the rate of growth in total labour costs per employee.

A total of 368 businesses responded to the survey, accounting for 845,000 UK employees. Results were 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 that companies expected an average pay settlement rate of 3.1% in 2018, compared with 2.6% in 2017 (**Chart A**). The 2017 outturn was higher than the 2.2% that had been expected in last year's survey, reflecting larger settlements across a broad range of sectors. The increases in pay settlements in 2018 are also expected to be broad-based, with only the construction sector expecting pay settlements in 2018 to be the same as in 2017 (**Chart B**).

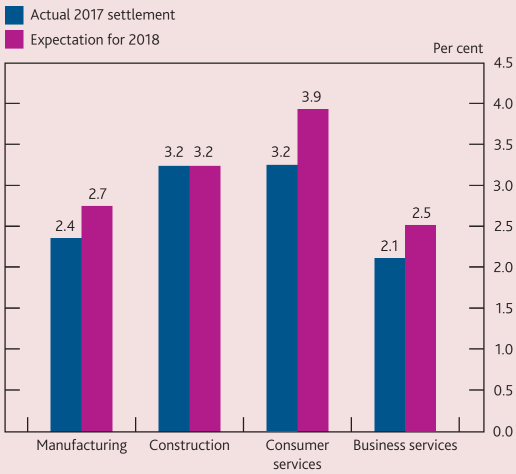
Chart A Private sector pay settlements



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

(a) Average over the past 12 months, based on monthly data.

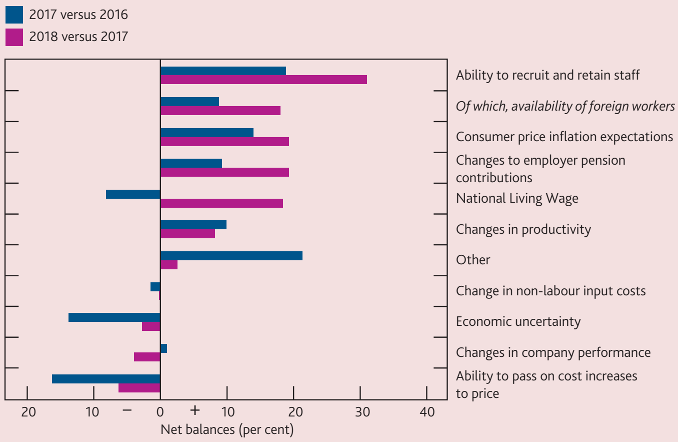
Chart B Private sector pay settlements by industry sector



The biggest expected increase in pay settlements is seen in consumer services. That is because many firms in this sector will have to increase pay to meet the National Living Wage (NLW). Companies also reported an increased tendency to pay above the NLW, due to competitive pressures. However, many firms were planning to limit management pay increases to 1%–2% in order to hold down their overall pay settlement.

Respondents were also asked about the factors expected to drive changes in the rate of total labour cost growth in 2018 relative to 2017 (**Chart C**). Among the factors pushing up growth were staff recruitment and retention, employer pension contributions, higher consumer price inflation, the NLW and the availability of foreign workers.

Chart C Factors driving the change in the rate of growth of total labour cost per employee in 2018 versus 2017



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

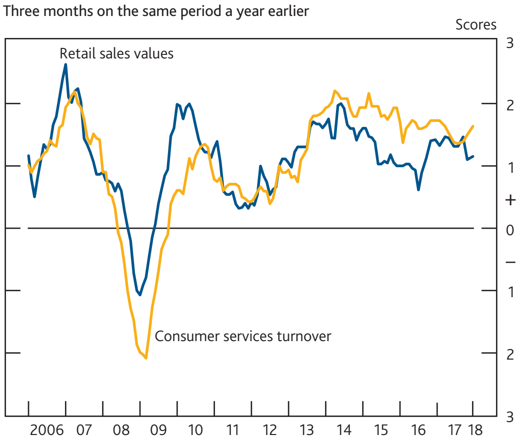


Chart 2 Business services turnover

Three months on the same period a year earlier

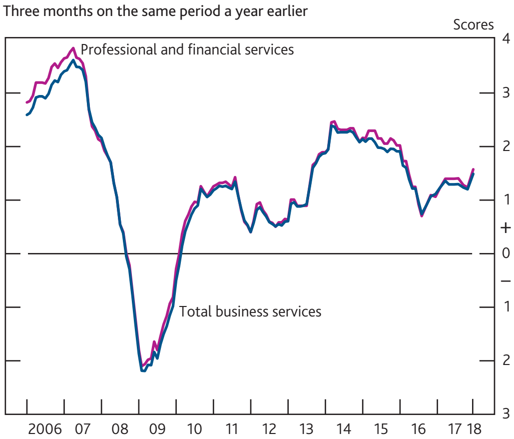


Chart 3 Manufacturing output

Three months on the same period a year earlier

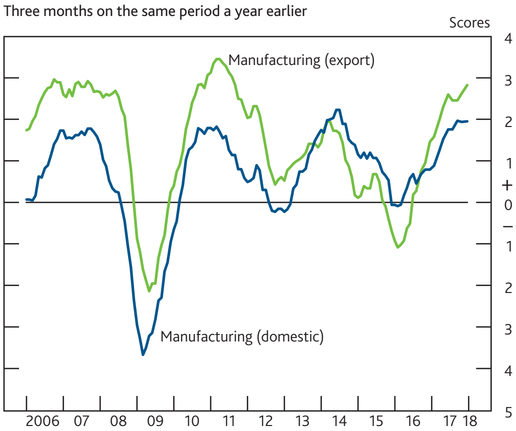


Chart 4 Construction output

Three months on the same period a year earlier

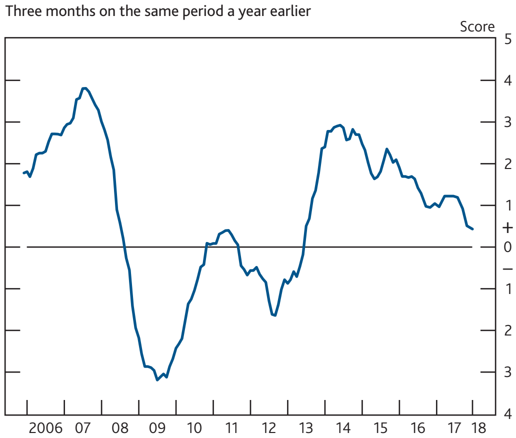


Chart 5 Investment intentions

Over the coming 12 months

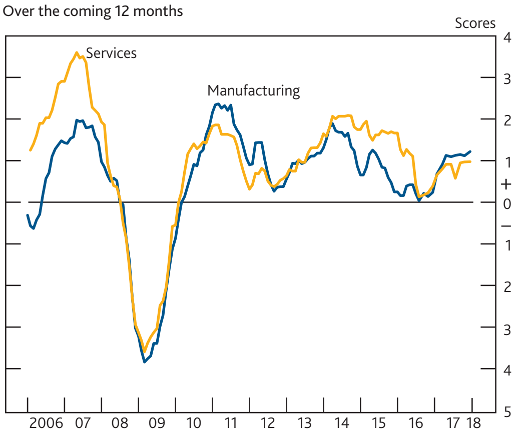
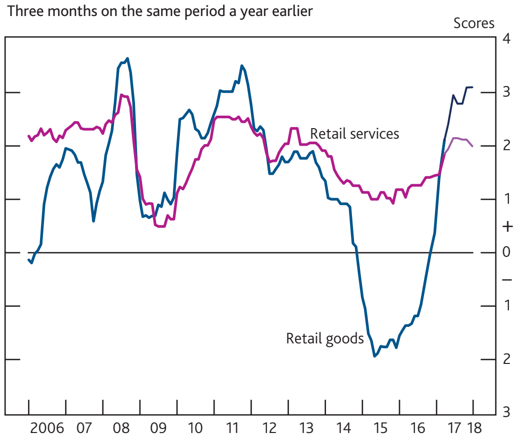


Chart 6 Retail goods and consumer services prices

Three months on the same period a year earlier



For data on the full set of Agents' scores see www.bankofengland.co.uk/-/media/boe/files/agents-summary/agentsscores.xlsx.