BANK OF ENGLAND

Agents' summary of business conditions

July 2016 Update

- This Update generally covers business conditions in the month preceding the EU referendum, but also provides a summary of intelligence gathered following the vote to leave the EU.
- The annual rate of activity growth had remained moderate and little changed in the month up to the EU referendum. Consumer spending and construction output growth had eased a little, offset by a pickup in manufacturing growth from a low base. There had been further signs of uncertainty leading to delays in decision-taking, including on capital spending, hiring and property investment.
- Following the EU referendum, business uncertainty had risen markedly. Many firms had only just begun to formulate new business strategies in response to the vote and, for the time being, were seeking to maintain 'business as usual'. A majority of firms spoken with did not expect a near-term impact from the result on their investment or staff hiring plans. But around a third of contacts thought there would be some negative impact on those plans over the next twelve months. As yet, there was no clear evidence of a sharp general slowing in activity. A box on page 3 provides more details on intelligence gathered since the referendum.

Annual growth in **consumer spending** had eased slightly during the month up to the referendum (**Chart 1**), with a slowing in demand growth for larger value household goods and for hotel stays.

Business services turnover growth had remained modest (**Chart 2**). There were further reports of clients delaying major business decisions ahead of the EU referendum.

Growth in **manufacturing** output for the domestic market had increased, with output modestly higher than a year earlier (**Chart 3**). The annual rate of contraction of manufacturing exports had moderated slightly further.

Construction output growth had eased a little, remaining moderate.

Investment intentions for the year ahead were little changed and pointed to modest growth in investment (**Chart 4**). There were some reports of delays in decision-taking on corporate spending until after the EU referendum.

Bank **credit availability** had improved a little across all sizes of company, largely reflecting increased competition. Businesses' demand for credit had remained subdued.

Investor demand for **commercial real estate** had continued to decline, largely reflecting a deferral of decisions until after the EU referendum. Occupier demand growth had been steady.

Housing market activity had remained subdued and lower than a year earlier.

Capacity utilisation was slightly above normal in services and below normal in the manufacturing sector.

Employment growth intentions had slowed a little further, partly reflecting deferrals of some recruitment decisions prior to the EU referendum. **Recruitment difficulties** had eased, though remained above normal (**Chart 5**).

Growth in **labour costs** per employee had edged lower, largely reflecting some reduction in bonus and commission payments as activity growth had eased over recent months.

The annual rate of decline of **materials costs** had eased further and **imported finished goods price inflation** had edged up.

Manufacturing **output price inflation** had remained modestly negative and business services price inflation modestly positive.

Consumer price inflation had edged slightly higher (**Chart 6**), with the annual rate of decline in goods prices having eased a little further as the decrease in sterling since late 2015 started to be reflected in some prices, such as fuel. Services price inflation had remained moderate.

This Update covers intelligence gathered from business contacts between late May 2016 and late June 2016. This report generally makes comparisons with activity and prices over the past three months on a year earlier. It 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.

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

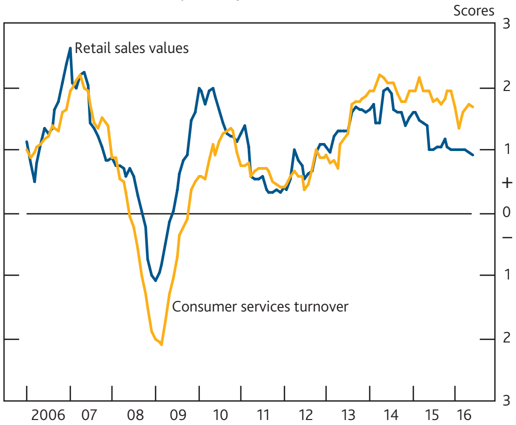


Chart 2 Business services turnover

Three months on the same period a year earlier

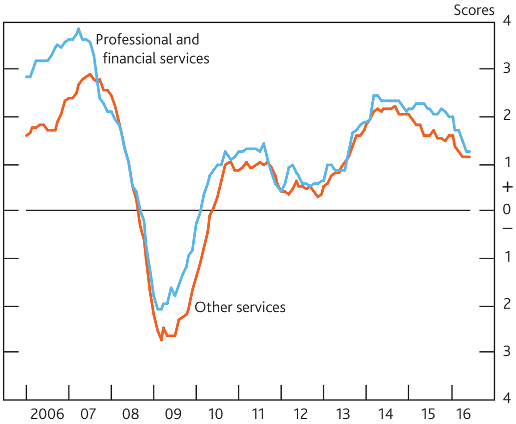


Chart 3 Manufacturing output

Three months on the same period a year earlier

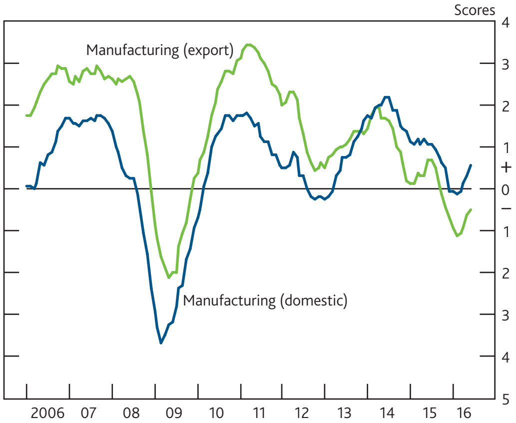


Chart 4 Investment intentions

Over the coming twelve months

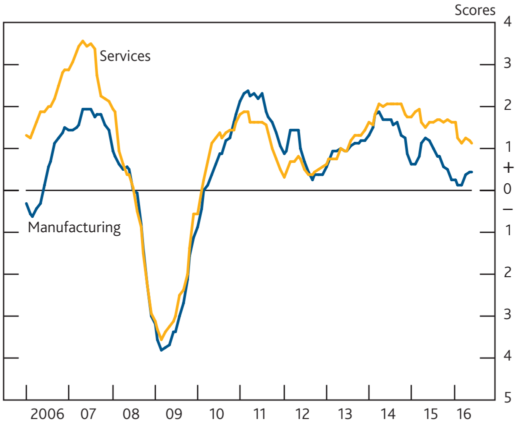


Chart 5 Recruitment difficulties

In the past three months, 'relative to normal'

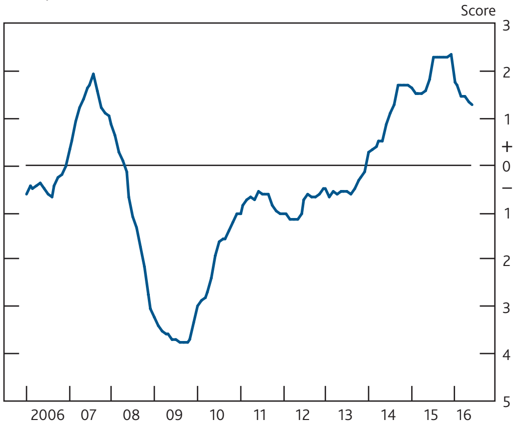
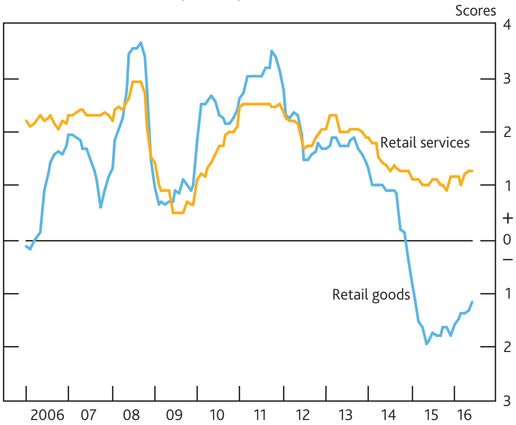


Chart 6 Retail goods and consumer services prices

Three months on the same period a year earlier



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

Box 1
Intelligence on business conditions following the result of the EU referendum

The Agents have increased the intensity of their intelligence gathering following the EU referendum — in particular by speaking with contacts at larger companies — to understand how businesses are responding, or plan to respond, to the result. This box summarises the intelligence gathered so far.

Many contacts planned to undertake **strategic reviews** of their operations over the coming months in light of the vote. For many, the result of the referendum was a shock; few had contingency plans and so for the time being were in a mode of seeking to maintain 'business as usual'. Uncertainty had risen and many felt there was a lack of information on which to base major decisions and that information might only become available with a considerable lag as future trading relations became clearer. As yet, there were few suggestions of disinvestment, such as exiting the United Kingdom in the near term, but there were a few reports of planned foreign direct inward investment being postponed. A number of companies were considering alternative European locations for aspects of their business, and some contacts within large international firms expected their continental European operations to receive a greater share of future investment than their UK ones. But some contacts mentioned the possibility of moving production back to the United Kingdom, or increasing the domestic sourcing of products, in light of sterling's fall.

The outlook for **investment** was uncertain. The majority of firms spoken with did not expect a near-term impact from the referendum result on their capital spending. But around one third expected some negative effects over the next twelve months, with reports of a 'risk off' approach to expenditures and some imminent plans for spending slipping. Business services contacts reported reductions overall in corporate deal-making activity, as some planned mergers and acquisitions and corporate finance activity had been paused or cancelled. CRE investment activity had already fallen ahead of the referendum and there were further reports of a reduction in investor demand. Housebuilding companies had become more cautious in their approach to land acquisition. More generally for construction firms, there were expectations that output growth would slow over the coming year as companies became more cautious about initiating projects.

There had been little evidence of any impact on **consumer spending** on services and non-durable goods, although there were some reports of consumers becoming more hesitant around purchases of higher-value goods. However, consumer confidence and spending were thought to be vulnerable to a weakening of disposable incomes as the fall in sterling was passed onto higher consumer prices and to any increase in unemployment or correction to housing values. There were reports of a dip in housing market sentiment in the days immediately following the referendum, but transactions had so far been more resilient than some contacts had expected.

As yet, there had been few reports of major alterations to businesses' **employment intentions**. But the vote to leave was expected to have a negative effect overall on hiring activity over the coming twelve months. Fewer contacts made any reference to the vote affecting pay decisions. Some contacts' pension deficits were likely to have increased as the discounted value of liabilities had risen, potentially raising future pension costs. In terms of the supply of labour, there was substantial concern about potential reductions in the availability of Eastern European labour among companies whose staffing was heavily reliant on those employees.

The referendum result was expected to have a positive effect on **export turnover** over the coming year, particularly for manufacturers, as the **depreciation of sterling** boosted export earnings. Companies' prices were likely to increase, as the fall in sterling passed through to higher import costs. Farmers had begun to see agricultural commodity prices rise, affecting both costs and prices. Manufacturing and some construction **input costs** were expected to rise over an extended period, lasting beyond a year. The cost of retail goods was expected to increase over a year or more, with fresh food costs beginning to rise within the next three months. Non-food costs could take somewhat longer to pick up however, as forward contracts expire. Given intense competition, retailers reported seeking to minimise increases in **consumer prices**, with a view to protecting their market share. But in some services, such as catering, there were expectations that prices could rise relatively quickly.

Credit conditions were thought to have tightened slightly in financial markets. But the early evidence indicated that banks' appetite to lend had been maintained following the referendum decision. There were reports that demand for credit was easing alongside lower expectations for investment spending.