BANK OF ENGLAND

Agents' summary of business conditions

May 2014

- Annual growth in retail sales values had been little changed and growth in consumer services turnover had edged higher.
- Housing market transactions had risen strongly on a year earlier, though some contacts reported that the implementation of new rules resulting from the Mortgage Market Review appeared to have been associated with a slowing in mortgage approvals.
- Investment intentions had increased, reflecting growing confidence in the strength of demand and, for some contacts, an improvement in the availability of finance.
- Growth in business services turnover had remained strong, especially for professional and financial services.
- Manufacturing output for the domestic market and for export had continued to grow at a steady pace.
- Construction output had continued to grow strongly, driven by house building.
- Corporate credit conditions had continued to improve.
- Employment intentions had increased further, particularly in business services. Recruitment difficulties had remained slightly above normal.
- Capacity utilisation had remained close to normal, though had risen a little further above that level in manufacturing.
- Growth in total labour costs per employee had edged up further, remaining moderate.
- Materials costs and imported finished goods prices had been little changed on a year earlier.
- Output prices and profitability had continued to increase modestly.
- Consumer price inflation had remained moderate, with services inflation having edged lower.

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 March 2014 and late April 2014. 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

Annual growth in retail sales values had been little changed, remaining fairly modest. Consumers had continued to keep a tight rein on day-to-day retail purchases, though recent warm weather had stimulated spending on seasonal lines, such as clothing and footwear and at garden centres. Demand for housing-related durable goods, such as furniture and homeware, had accelerated a little, but less than might have been implied by the pace of housing transactions. Growth of new car sales had remained buoyant, with demand still stimulated by the ready availability of finance leases at relatively low cost. Growth in consumer services turnover had edged higher, remaining somewhat stronger than for retail sales. Household spending in restaurants, visits to cinemas and other leisure attractions had picked up further. Spending on road and rail travel was accelerating, possibly associated with increased numbers of commuter journeys as employment had risen. Hotel occupancy rates had also increased.

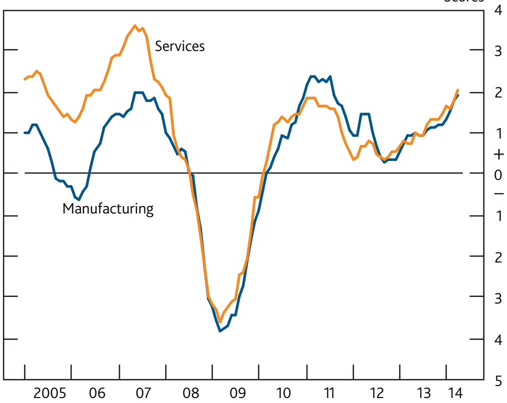
Housing market

Housing market transactions had continued to rise strongly on a year earlier. That had also been reflected in strong demand for housing-related services such as conveyancing, mortgages and removals. But there were concerns among estate agents about shortages of stock for sale, as growth in new sales instructions had lagged demand. Some contacts had noted that the implementation of new rules resulting from the Mortgage Market Review had appeared to have been associated with a tightening of mortgage availability and a lengthening of mortgage processing times. Outside London, activity was often concentrated in low to mid-price brackets, with first-time buyers having benefited from improved mortgage availability and buy-to-let investors still very active in that segment of the market. The Help to Buy equity loan scheme had continued to drive new house sales.

Business investment

Investment intentions had increased (**Chart 1**), reflecting growing confidence in the strength of demand and, for some contacts, an improvement in the availability of finance. For some companies, however, there remained an expectation that they would seek to increase mergers and acquisitions activity rather than capital spending. In manufacturing, intentions indicated steady investment growth, but were tempered by firms' abilities to meet current demand with existing capital — in some cases following heavy investments to update equipment and expand capacity over recent years. In services, businesses were increasing investment in IT, with the aim of raising efficiency and/or improving online sales. Investment in property was picking up, including for some consumer services firms who were seeking to expand into new commercial developments and conversions. This contrasted with the focus on refurbishment seen over the past year or so.

Chart 1 Investment intentions



Exports

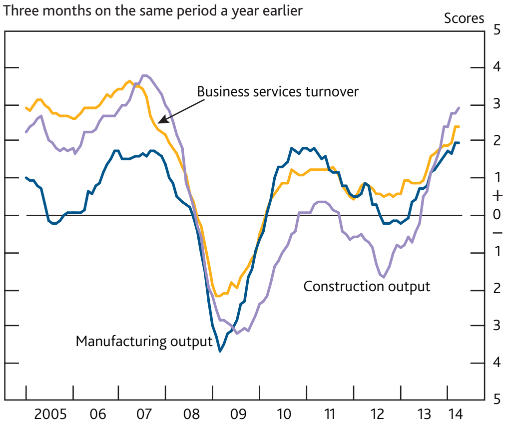
The value of manufacturing exports had continued to grow steadily. Sterling's appreciation had yet to affect volumes significantly, but had compressed exporters' profit margins. Demand from the euro area had edged up and sales to the United States had continued to improve, offset to some extent by a slowing in demand from some emerging economies and from Russia in particular. Exports growth in sectors such as automotive, aerospace, oil and gas, power generation and branded consumer goods had remained strong. But there were areas where goods exports had weakened, including in defence and healthcare exports to the United States. Services exports had also continued to grow, in part reflecting continuing strength in demand related to major infrastructure construction projects in the Middle and Far East, as well as oil and gas activity globally. Increasing inward investment to the United Kingdom from overseas had increased demand for professional and commercial property-related services.

Output

Business services

Growth in business services turnover had remained strong (**Chart 2**), especially for professional and financial services. Contacts reported strengthening demand across a range of

Chart 2 Output growth



sectors, including business insurance, corporate finance, banking, legal and accountancy services, recruitment, advertising and marketing agencies. There had been a further rise in commercial real estate activity, weighted towards London and the South East, but with demand for industrial and warehousing space nationally having also risen. Among other business services, IT services growth remained robust, driven by investment in new and existing systems, the additional IT needs arising from employment growth and rising demand for cloud computing. Outsourcing activity related to property, consulting and financial services had risen. Wholesalers and logistics companies reported further steady rises in turnover, especially among those in the construction supply chain. Business travel had increased.

Manufacturing

Manufacturing output for the domestic market had continued to grow at a steady pace (**Chart 2**), and the pipeline of forward orders suggested similar growth to come over the next six months. Output in automotive, aerospace, energy and medical supply chains had continued to grow. Construction product manufacturers had seen the strongest growth, with many brick kilns at full capacity and some capacity that had been mothballed gradually being brought back into production. Some consumer-facing companies were being affected by shifts in household spending patterns away from 'mid-market' purchases, as well as the potentially adverse impact on volumes of shifts in food retailers' discounting patterns towards 'single product' offers rather than 'multibuy' promotions. Falls in output on a year earlier were limited to a few manufacturing subsectors, including paper and printing and defence goods.

Construction

Construction output had continued to grow strongly (**Chart 2**), driven by house building. The spread of contacts reporting a strong upturn had become more widespread over recent months, with builders' merchants, architects, and even some smaller construction firms, previously restricted by poor credit availability, reporting significant growth in activity. Shortages of materials and labour had remained a concern, but were rarely preventing developments from progressing. In some cases, planning delays were seen to be a more pressing constraint on growth in the sector. The gradual return of confidence to the commercial property market had continued, with more contacts talking about prospects for a return of speculative development outside London. Apart from projects in rail and port infrastructure, large infrastructure schemes had remained thin on the ground in most areas.

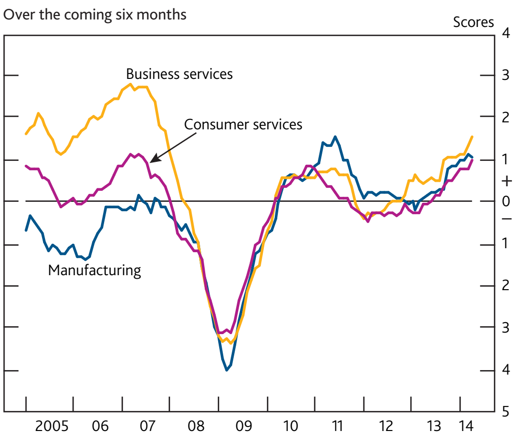
Credit conditions

Improved business confidence, sustained economic growth and lower bank funding costs had driven further improvements in credit conditions. Demand for credit had increased, though it remained sluggish, especially among small and medium-sized enterprises, as trust in banking relationships remained weak. Large firms typically had the widest choice of lenders, but medium and smaller firms also now had more options. Funding for real estate development continued to improve, but lenders were still reluctant to finance speculative developments, especially outside London, and a few lenders were seeking to run down their commercial and real estate exposures with the aim of strengthening their balance sheets. More generally, existing and challenger banks reported increasing competition and non-bank lenders remained active. Banks were more willing to syndicate larger deals and loan maturities had increased a little. Non-bank sources of finance remained attractive, especially to larger companies. And infrastructure firms, housing associations and other companies were taking advantage of attractive bond market rates, especially at longer maturities.

Employment

Employment intentions had increased further, particularly in business services (**Chart 3**). Much of the growth of employment was reported to reflect additional capacity, the need to fill skills gaps to exploit new markets or to address succession issues. Employment intentions in business services had become increasingly broad-based, consistent with trends in turnover growth. Intentions in consumer services overall had also strengthened on the month, but were more mixed across subsectors: discount supermarkets, estate agents and some hotels, restaurants and visitor attractions had increased employment, while companies in insurance and travel services had cut jobs as more spending moved online. Manufacturing employment had been rising steadily, especially in automotive and other transport sectors. Recruitment difficulties had remained slightly above normal, due to shortages in a number of skilled occupations, but with less-skilled labour remaining readily available across the economy. The availability of IT experts, quantity surveyors, real estate professionals and engineers had remained relatively tight, and shortages in construction trades such as bricklayers, plasterers and carpenters were causing problems for construction firms, reflecting the loss of supply over the recession.

Chart 3 Employment intentions



Capacity utilisation

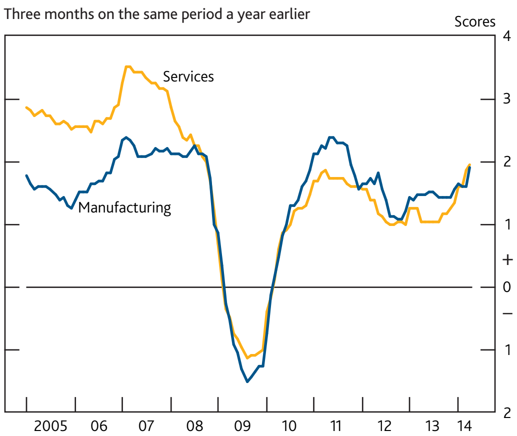
Capacity utilisation had remained close to normal, though had edged a little further above that level in manufacturing. In general, labour utilisation was typically higher than that of capital assets. Where spare capacity had largely been used up, most firms were optimistic that expected output growth could be met, in the near term, through productivity growth and modest increases in investment and employment without a sharp pickup in costs. In manufacturing, there was typically sufficient capital to allow for an increase in output, although this often necessitated an increase in average hours and/or additional shifts. In services, the utilisation rate for capital assets had increased rapidly in recent months, but also remained slightly below its historic average. Capacity constraints were more marked in construction, where contacts had continued to report shortages of both materials and skilled labour.

Costs and prices

Labour costs

Growth in total labour costs per employee had edged up further, though the rate of increase remained moderate (**Chart 4**). Wage settlements had continued to be muted, with the majority remaining in a range of 2% to 3%. But pay growth overall had risen, albeit only modestly outside construction, as the number of pay freezes had fallen, the use of targeted defensive awards to retain key people had risen, and as variable pay had increased alongside stronger activity. Those factors had more than offset downward pressures from recent falls in inflation, businesses recruiting more junior staff, and reductions in starting salaries. Labour costs for smaller businesses were also rising as auto-enrolment of their employees into pension schemes came into effect, with few reports of companies reducing pay awards to mitigate the impact of such changes. Looking ahead, some contacts noted that the prospective increase in the national minimum wage could have a wider effect on wages at the lower end of the pay spectrum.

Chart 4 Total labour costs per employee



Non-labour costs

Materials costs and imported finished goods prices had remained little changed on a year earlier. Reports of cost pressures had remained largely confined to construction materials, where increased costs of bricks, blocks and tiles were widely reported. Prices of other construction-related products, such as timber and insulation materials, had also increased over the past few months. Other commodity prices, including oil and its derivatives had fallen back, and there was little evidence yet that issues in Ukraine — a major wheat producer — were feeding through to higher food price inflation. Sterling's appreciation had depressed both material cost inflation and imported finished goods inflation over recent months. Looking forward, some upside risks were reported, however, notably from the potential effects of events in Russia and Ukraine on gas and cereals prices and from rising wage costs in Asia.

Output prices and margins

Manufacturing output prices had continued to rise only slowly. Competitive pressures were reported to be limiting many firms' ability to raise prices, although lower input cost inflation had also reduced the pressure to do so. Food manufacturers reported ongoing pressure to lower prices in response to the intensification again of supermarket price competition. In contrast, manufacturers in the materials supply chain for house building reported much stronger inflation as a result of the strengthening in housing market activity. Construction tender prices had also started to pick up. Business services price inflation had remained modest. Inflation was weak in some sectors such as some compliance-related accountancy services, business travel and distribution. But for more differentiated services or where demand was stronger, such as real estate transactions and corporate finance, firms' pricing power had strengthened slightly. Both services and manufacturing profitability had continued to rise modestly alongside rising activity.

Consumer prices

Retail goods price inflation had remained subdued. Restrained household spending growth, as a result of weak real income growth, was reported to be suppressing goods price inflation. Competition for market share among the supermarkets had put further downward pressure on the prices of some groceries. More generally, retailers had remained very cautious about implementing price increases in response to any rises in costs — often instead maintaining current prices by introducing new products or re-engineering existing ones. Retail services price inflation had edged lower. Index-linked prices had risen more slowly than a year earlier, and falls in oil prices were feeding through to transport and foreign holiday prices. However, as demand had grown, inflation had risen a little for other discretionary services, such as hotel rooms, restaurant meals, car servicing and private healthcare.