BANK OF ENGLAND

Agents' summary of business conditions

May 2016 Update

- Annual output growth had eased slightly on the month, in part reflecting the effects of increased uncertainty on business services activity. There was some evidence of businesses delaying investment expenditure decisions on account of the uncertainty around the outcome of the EU referendum.
- The pattern of housing market activity had been affected by the bringing forward of buy-to-let transactions ahead of the introduction of the rise in stamp duty on additional properties in April. Commercial real estate investment transactions had slowed markedly on a year ago in London.
- Labour cost growth had edged higher, following the introduction of the National Living Wage. Price inflation had remained negative for goods and modestly positive for services.

Annual growth in **retail sales** values had remained modest (**Chart 1**). **Consumer services** turnover growth had edged higher. Spending had grown robustly in restaurants and cinemas, and there were some reports of leisure spending being boosted by reduced overseas tourism.

Business services turnover growth had slowed a little further (**Chart 2**), partly reflecting increased uncertainty. Professional services turnover growth had been negatively affected by slower mergers and acquisitions, initial public offering and commercial real estate investment activity.

Manufacturing output for the domestic market was similar to a year earlier (**Chart 3**). The annual pace of decline in manufacturing export volumes had eased slightly, as euro-area demand had improved a little and some companies — such as food manufacturers — had started to benefit from sterling's recent depreciation.

Construction output growth had edged lower. Demand growth had remained strong across the commercial and private residential sectors, but there were reports that skills shortages were constraining growth rates.

There was some evidence of businesses delaying **investment** expenditure decisions on account of the uncertainty around the outcome of the EU referendum. Intentions for investment growth over the next twelve months had stabilised, however, having fallen since the turn of the year (**Chart 4**).

Credit availability had increased for small and medium-sized enterprises. Large companies continued to report strong credit availability, with most being able to choose between a range of funding sources and providers.

Commercial real estate investment transactions had slowed markedly on a year earlier in London. Occupier demand had strengthened further and was particularly strong for industrial space.

The pattern of **housing market** activity had been affected by the bringing forward of buy-to-let transactions into Q1, ahead of the introduction of the rise in stamp duty on additional properties in April. A box on page 2 summarises the results of a series of meetings on prospects for the housing market.

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

Employment growth intentions had become less negative in the manufacturing sector, reflecting a slight improvement in demand prospects. Business services intentions had eased slightly, but remained consistent with modest growth (**Chart 5**). **Recruitment difficulties** had remained above normal, but had fallen back since late 2015.

Labour cost growth per employee had edged higher following the introduction of the National Living Wage.

The annual rate of decline in **materials costs** had started to ease. **Imported finished goods prices** had flattened on a year ago, after a period of deflation, as sterling's recent depreciation had started to feed through.

Manufacturing **output prices** had remained slightly lower than a year ago. Business services price inflation was modest.

Consumer price inflation had risen slightly for services and remained negative for goods (**Chart 6**).

This Update covers intelligence gathered from business contacts between late March 2016 and late April 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.

Housing market prospects

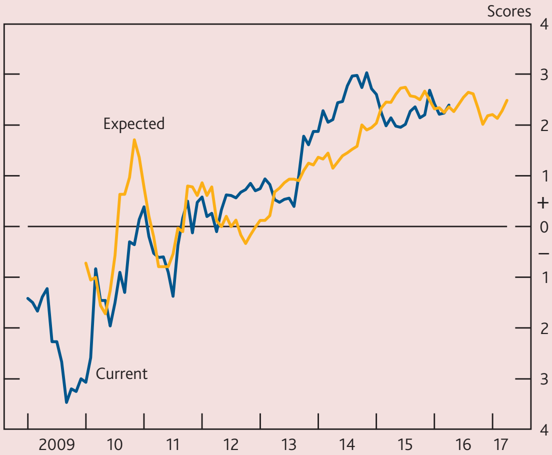
Agents held a round of meetings with over 100 housing market contacts during March and April to gather intelligence on the outlook for the housing market, including buy-to-let (BTL) investor activity. This box provides a summary of the findings from those meetings.

One focus of discussions was on the likely impact of tax changes on BTL activity, including the increase in stamp duty introduced in April 2016 and the planned reduction of tax relief on BTL mortgage interest payments from April 2017. Contacts had generally seen a pickup in house purchases by BTL investors in Q1 as they sought to complete purchases ahead of April's changes, and expected activity in Q2 to be correspondingly subdued. Over a longer horizon, the majority of contacts did not expect the tax changes on their own to lead to a substantial reduction in BTL purchases. That reflected positive expectations of rental growth and of the continuing attractiveness of BTL relative to alternative investments. However, contacts saw a risk that some landlords did not fully appreciate the implications of reduced interest relief from April 2017 — which was seen as the more significant of the tax changes. That could lead to downside risks to activity in the sector further out, if it subsequently led landlords to make a sharper adjustment to their portfolios.

More generally, contacts expected strong housing market activity in Q1 to be followed by muted activity in Q2, with transaction numbers in 2016 overall likely to be comparable with 2015. In the medium term, contacts expected transactions to remain below levels prevailing before the financial crisis. That reflected a range of factors, including a shortage of newly built and secondary market housing supply, especially of alternative homes often sought by older homeowners. Those effects were being compounded by an ageing population. Affordability constraints had increased the age at which first homes were bought, which was also pushing down on transaction numbers as people tended to move homes less frequently as they became older. More generally, contacts noted a reduced tendency among homeowners to move unless required to by their circumstances.

In terms of house-building activity, expectations were generally for the current rate of growth of new building to be maintained (**Chart A**). A number of constraints were said to be preventing stronger growth, most notably from skills shortages, planning issues and for some, a tendency for surveyors' valuations to lag market values, which complicated the finance of building. However, materials constraints had eased markedly during the past year. Some downside risks to the outlook were noted, from slowing growth in new build by SME firms, who were still a smaller proportion of the market than pre-crisis; possibly weaker growth in social housing; fragile conditions in the prime London market; and more generally from a recent increase in economic uncertainty.

Chart A Average company visit scores for house builders' current and expected turnover growth(a)



(a) Current scores measure turnover for the past three months relative to a year earlier; expectations are for turnover a year ahead, relative to the past three months. Both series are three-month moving averages of scores.

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

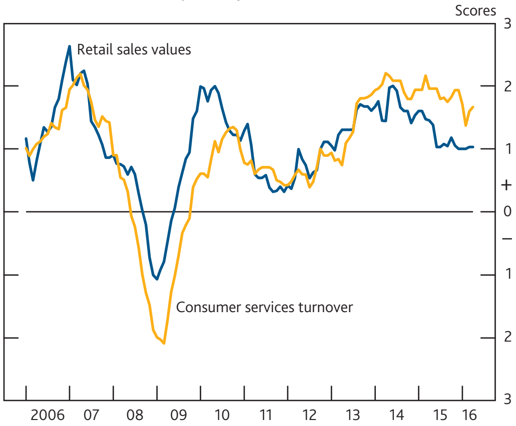


Chart 2 Business services turnover

Three months on the same period a year earlier

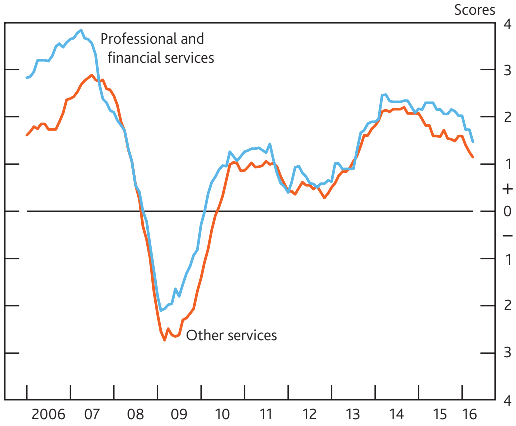


Chart 3 Manufacturing output

Three months on the same period a year earlier

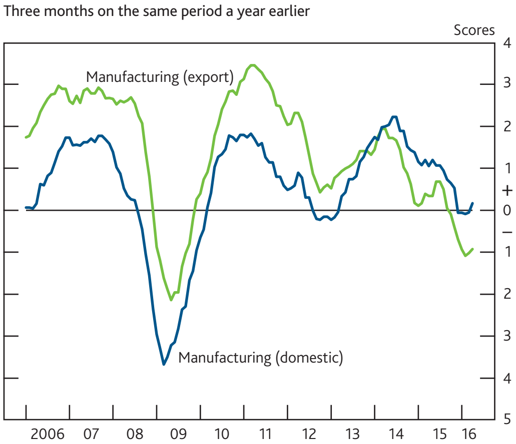


Chart 4 Investment intentions

Over the coming twelve months

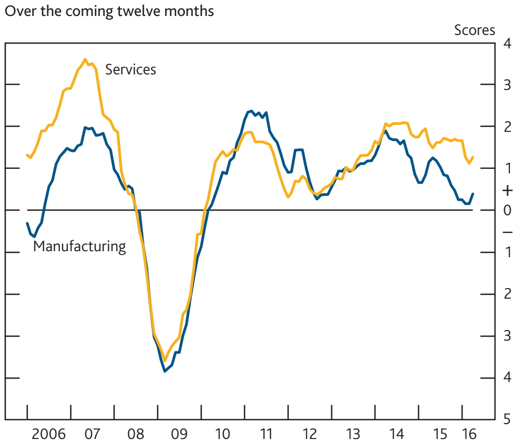


Chart 5 Employment intentions

Over the coming six months

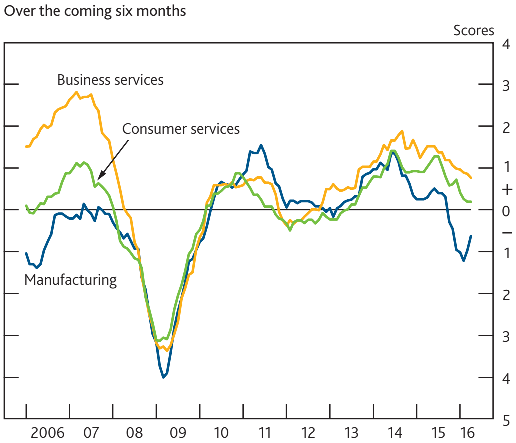
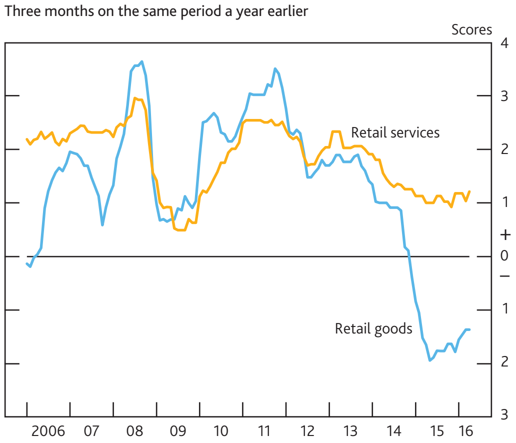


Chart 6 Retail goods and consumer services prices

Three months on the same period a year earlier



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