BANK OF ENGLAND

Agents' summary of business conditions

May 2018 Update

- Consumer spending growth slowed markedly, in part due to adverse weather.
- Recruitment difficulties became more broad-based; total labour cost growth rose.

The adverse weather in February and March contributed to a marked slowdown in **retail sales values** and **consumer services growth** (**Chart 1**). Store-based retailers reported significant sales declines. **Consumer services**, such as restaurants, cinemas and hotels, were also badly affected, and most did not expect to recoup sales lost as a result of the weather disruption. Car sales had fallen in March, mainly due to strong year-ago comparisons and uncertainty about the tax policy for diesel cars.

Business services growth remained moderate (**Chart 2**). There was a slight pickup in insolvency and restructuring work, robust growth in asset management and firm demand for IT services. However, discretionary spending by corporates, eg on events and hospitality, remained weak. **Services exports** continued to be boosted by inward tourism and growth in UK retailers' overseas online sales. UK-based professional services firms saw growth in demand for Mergers & Acquisitions (M&A) advice from overseas clients. Demand for services from the oil and gas sectors edged up.

Domestic **manufacturing output** growth had been affected by the weather and weaker activity in the construction and automotive sectors (**Chart 2**). Some manufacturers benefited from some reshoring of sourcing to the UK, exporters generally outperformed firms focused on the domestic market. **Goods export** volumes to the EU remained strong, with limited evidence of reluctance to award longer-term contracts to UK companies. There were concerns about a rise in trade protectionism.

Construction output growth had slowed further (**Chart 2**). That was largely due to the poor weather, but some projects had been delayed following the collapse of Carillion. Contacts expected to make up weather-related delays, but some would not be able to do so until after Q2 due to capacity constraints.

Investment intentions remained modest, reflecting continued uncertainty around Brexit (**Chart 3**). Investment intentions were positive in business services and manufacturing, and some firms planned to invest in expanding capacity for exports, as well as in automation to counter rising labour costs. Consumer services firms' intentions remained weak.

Corporate **demand for credit** remained subdued, reflecting strong cash balances and/or heightened uncertainty. There had been demand for finance to support M&A activity, and some firms had undertaken pre-emptive refinancing ahead of Brexit. **Supply of credit** had tightened slightly for small firms.

Investor demand in **commercial real estate** had continued to outstrip supply, particularly for logistics premises. Retailers had continued to reduce their shop premises and the resulting increase in vacant units had depressed valuations in the sector.

Housing market activity remained subdued overall. Demand had softened in the secondary market, where supply was also weak, whereas demand had been robust for new-build homes, supported by the Help to Buy scheme. There was some excess supply in the south and excess demand in the north: on balance there was a modest excess of supply overall. Lending conditions continued to be very favourable. However, slim margins on standard mortgage products had led some lenders to focus on more profitable niche segments of the market.

Capacity utilisation in manufacturing had risen (**Chart 4**), following increases among exporters and some domestic manufacturers, particularly where demand for substitutes for imports had increased. Business and professional services firms reported some capacity constraints but there was excess capacity in the retail sector.

Recruitment difficulties had broadened across skills and sectors, which was reported to be partly due to reduced availability of EU migrant workers. **Employment intentions** had ticked up in manufacturing but remained weak in consumer services, due to higher labour costs and weak sales.

Growth in **total labour costs** had edged up (**Chart 5**), reflecting slightly higher pay settlements than in 2017 and the increase in employers' pensions auto-enrolment contributions. Pay settlements had typically been in the 2½–3½% range, with higher awards targeted at retaining staff with key skills.

The effect of past sterling depreciation on **imported goods and material costs** had been waning but was being partially replaced by global commodity price inflation. **Consumer goods price inflation** had eased slightly (**Chart 6**), and **consumer services inflation** was broadly stable.

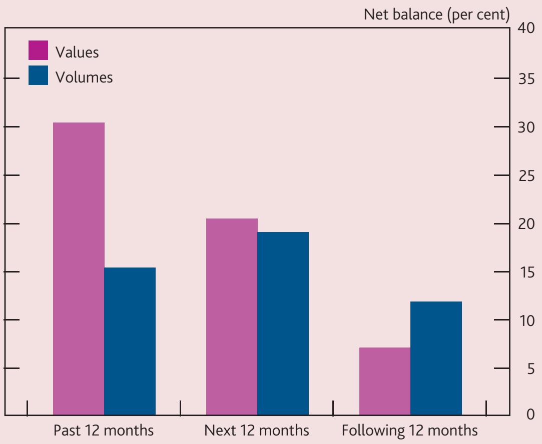
This publication generally covers intelligence gathered from business contacts between late February and mid-April 2018. It generally makes comparisons with activity and prices over the past three months on a year earlier.

Agents' survey on exports

The Agents surveyed business contacts about how the sterling volumes and values of their UK exports had changed in the past 12 months, how they would evolve over the next 12 months and also in the following year (the year to March/April 2020). Contacts were also asked how different factors would affect the sterling value of their exports over the coming 12 months and how export margins had changed since November 2015. Around 260 companies responded. Results were weighted by export turnover and, for the headline results, reweighted by the goods and services shares of UK exports.

The survey showed that over the past 12 months, respondents had seen an increase in both the sterling value and volumes of their UK exports, as companies benefited from the depreciation of sterling and strengthening global activity. The net balance was stronger for values than volumes (**Chart A**).

Chart A Export volumes and values

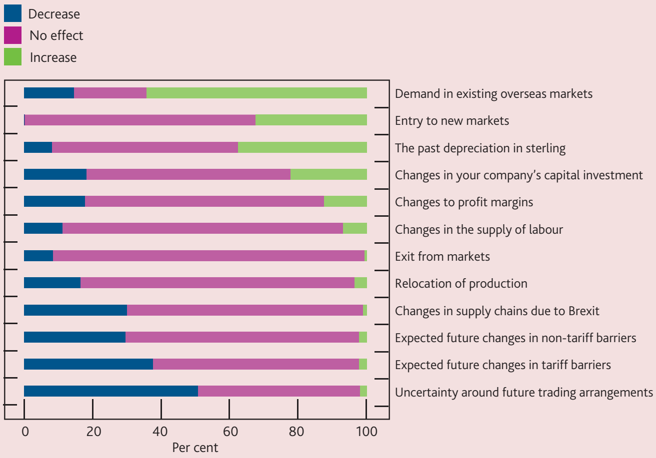


The net balances for expected values growth over the next 12 months were lower than those for the past 12 months, as the more immediate price effects from sterling depreciation dissipate. Growth in export volumes was expected to hold up though, with the net balance slightly higher compared with the past 12 months. However, looking ahead to the year to March/April 2020, net balances for both export values and volumes growth were lower, but still positive.

Of the factors likely to affect export values over the next 12 months (**Chart B**), demand in existing overseas markets was expected to provide the biggest boost to exports growth, with almost two thirds of weighted respondents expecting this to help increase export values. Entry into new markets was also seen as supporting exports growth, in line with reports of companies exploring markets beyond the EU to mitigate the impact of Brexit.

Uncertainty around the UK's future trading arrangements was expected to have the largest negative effect on exports. And

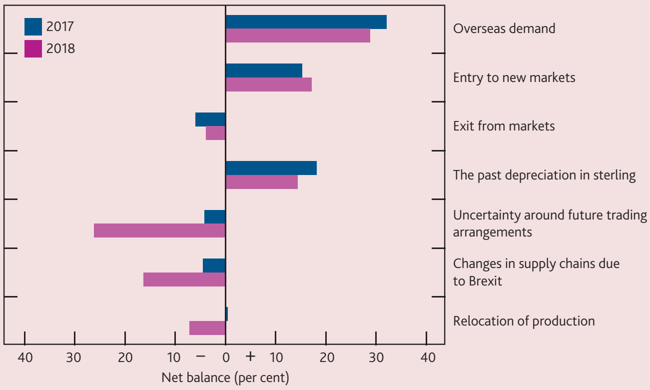
Chart B Factors effecting export values over next 12 months



potential future changes to tariff and non-tariff barriers, as well as changes to supply chains due to Brexit were also expected to weigh on export values over the next 12 months.

Compared with results from last year's survey (**Chart C**) when a similar question was asked, the effect of uncertainty around future trading arrangements, changes to supply chains due to Brexit, and relocation of production were expected to weigh more heavily on export values over the next 12 months. By contrast, the net balances for the factors expected to have a positive effect on export values were similar to last year.

Chart C Factors affecting export values over the next 12 months — 2018 survey compared 2017 survey results[(a)]



(a) In last year's survey (March/April 2017) respondents were asked how they thought various factors would affect the sterling value of UK exports over the next 12 months (ie the year to March/April 2018). In this year's survey a similar question was asked regarding the year to March/April 2019.

Companies were also asked about their export margins. On balance, exporters reported that margins had improved since November 2015 when sterling began its depreciation. However, just over a third of goods exporters reported reductions in their export margins as higher input costs partially offset the benefit of weaker sterling, with some finding it hard to pass on cost increases to customers. This compared with 5% of services exporters whose margins were reduced.

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

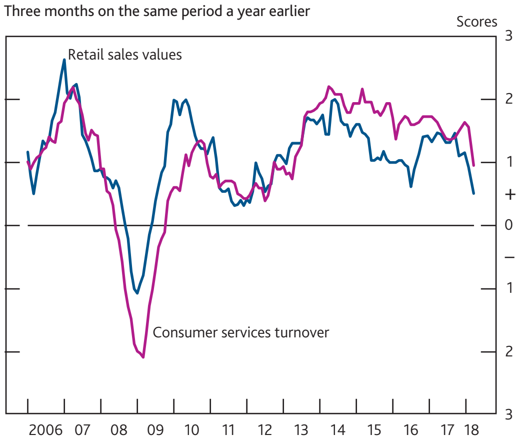


Chart 2 Manufacturing, business services and construction activity

Three months on the same period a year earlier

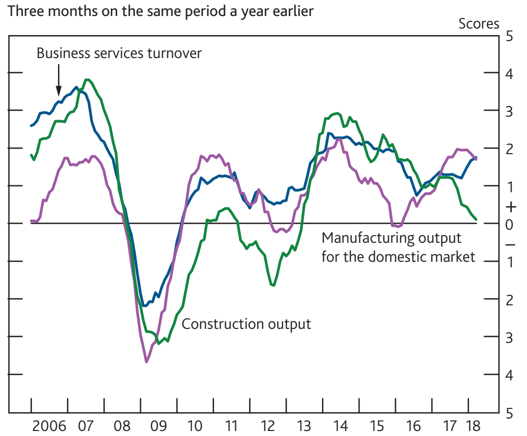


Chart 3 Investment intentions

Over the coming 12 months

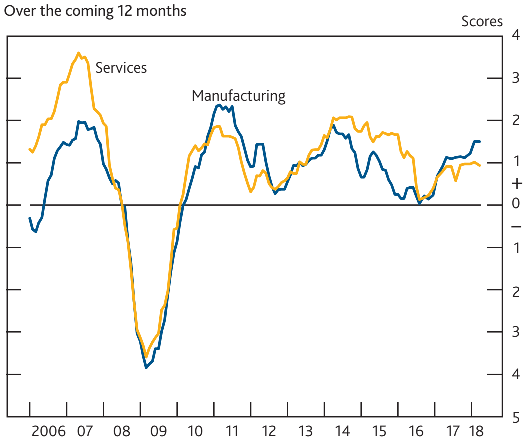


Chart 4 Capacity utilisation

Over the coming six months, 'relative to normal'

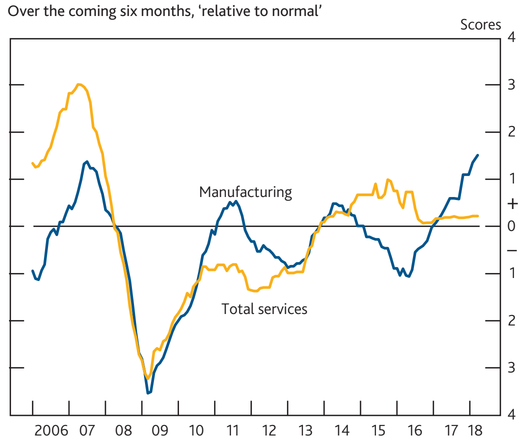


Chart 5 Total labour costs per employee

Three months on the same period a year earlier

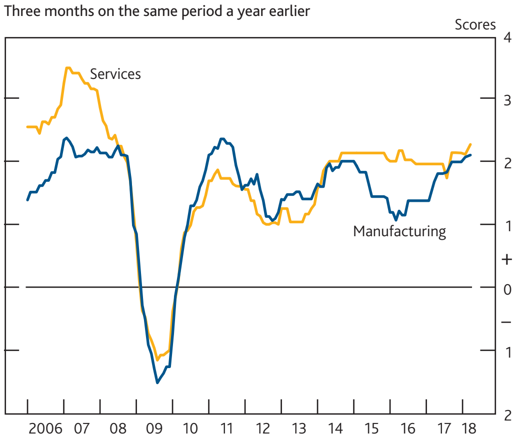
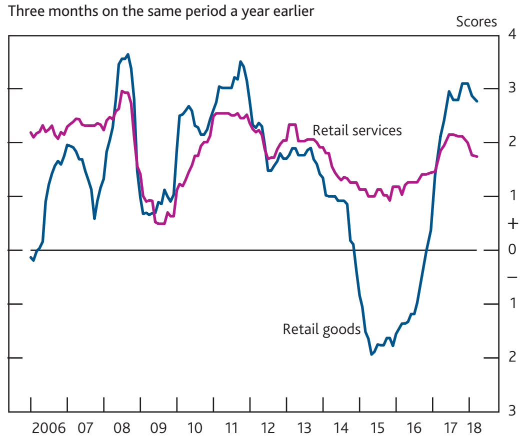


Chart 6 Retail goods and consumer services prices

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.