BANK OF ENGLAND

Agents' summary of business conditions

November 2013

- Growth in the value of retail sales and consumer services had been unchanged, in the past three months on a year earlier. However, retail sales growth had appeared to soften in recent weeks.
- Demand for house purchase had continued to strengthen, outpacing the increase in supply.
- Investment intentions had remained modestly positive.
- Manufacturing output growth had edged higher.
- Growth in business services turnover had risen slightly, with a broadening of growth across subsectors.
- Annual growth in construction output had continued to recover, driven by new housebuilding.
- Corporate credit availability and demand had continued to increase gradually.
- Employment intentions had edged higher and were consistent with modest employment growth over the next six months.
- Reports of recruitment difficulties for skilled labour were becoming more widespread across the economy.
- Capacity utilisation was approaching normal levels in manufacturing and services.
- The annual rate of growth in labour costs had remained moderate.
- Inflation in materials costs had continued to be modest.
- Output price inflation had remained subdued, though had edged up for business services.
- Consumer prices had continued to rise at a moderate annual rate, largely driven by administered and regulated prices.

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 September 2013 and late October 2013. 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.

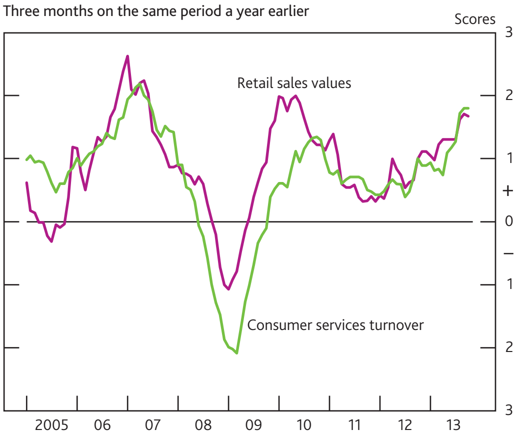
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from: **www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.**

Demand

Consumption

Growth in the value of retail sales and consumer services, in the past three months on a year earlier, had been unchanged (**Chart 1**). However, retail sales growth had appeared to soften in recent weeks, in part as mild weather in autumn had adversely affected sales of seasonal ranges of clothing and footwear. That had followed a summer when spending had been boosted by good weather. Contacts reported a gradual increase in consumer confidence, though consumption growth continued to be restrained by tight disposable incomes. There had been signs of increasing growth for some household durable goods, potentially related to rising housing transactions. Growth in new car sales remained robust, reflecting discounting and cheap finance deals with low monthly payments. Consumer services turnover growth had remained steady, buoyed by good weather and a gradual increase in consumers' discretionary spending.

Chart 1 Retail sales and consumer services turnover



Housing market

Housing market activity had picked up significantly, though remained below pre-crisis levels. Demand for housing had continued to gain momentum due to improved mortgage availability, rising household confidence and the Help to Buy scheme. Buy-to-let demand was said to have remained firm, given the low yields available on other investments and inflows of investment from overseas buyers, sometimes seeking a safe haven for funds. There were reports of transactions being delayed by capacity constraints within firms of surveyors, mortgage brokers and conveyancing solicitors. House price inflation was said to have remained modest across most parts of the United Kingdom, though there had been some spread of house price rises from London to a number of surrounding areas in the South of England, and a few wealthy locations elsewhere.

Business investment

Investment intentions in both manufacturing and services had continued to point to modest growth in capital spending over the next twelve months. Manufacturing investment had often remained aimed at efficiency gains, or the replacement of ageing assets, though there were increasing reports of capacity expansion, for example in the energy, automotive and construction sectors. In services, investment continued to be dominated by IT spending, as systems were renewed or the interface with customers improved. Some consumer-facing businesses were reported to be increasing investment to improve their branding or to refurbish stores, though in less profitable parts of the sector, stores were being closed. Across sectors, there were reports of contacts looking to expand through acquisitions activity, rather than organically, though that process might lead to some increase in investment in due course as operations were merged.

Exports

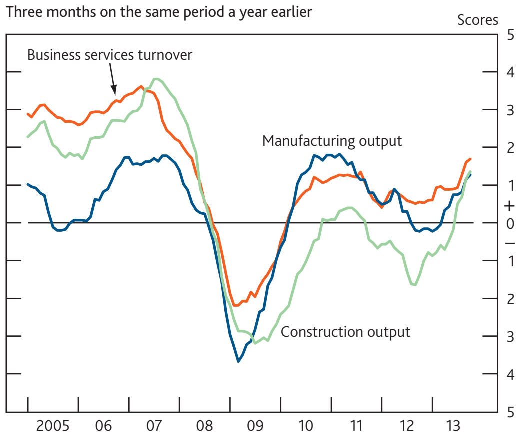
Growth in manufacturing exports continued at a steady rate. There were further reports of growth in manufacturing exports to the United States, with only isolated reports of adverse effects from the federal government shutdown. Export demand from the Middle East and emerging markets continued to grow. Euro-area demand was said to have stabilised overall, but at a low level. A balance of contacts expected limited impact on exports from the recent appreciation of sterling, either because they were not directly competing on price or because efforts to build stronger export networks were providing a greater positive impetus. However, a minority reported a dampening effect on the pace of their exports growth. Growth in services exports was reported to have continued, often led by demand for consultancy services related to construction and energy projects in the Middle East, or from rising tourism from overseas.

Output

Business services

Growth in business services turnover had risen further (**Chart 2**), with a broadening of growth across subsectors. Demand for professional advisory services related to mergers

Chart 2 Manufacturing, business services and construction activity



and acquisitions, corporate finance and property transactions had risen, in some cases said to be based around clients' preparations for future business growth. Wealth management activity was reported to have picked up as investors sought higher returns than savings rates offered by banks. Strengthening demand in the economy was translating into higher usage of IT service providers, marketing companies and recruitment consultants. A range of other service providers related to the construction industry, such as hauliers and builders merchants, reported increased rates of turnover growth as construction activity picked up. Growth in business travel had also picked up, though spending on corporate hospitality had remained constrained.

Manufacturing

Output growth for the domestic market had edged higher (**Chart 2**). The recent strengthening had partly reflected increased growth in the manufacture of construction products related to the building and 'fitting out' of new homes. Manufacturers of consumer durables also reported some strengthening of output growth. That, alongside strong domestic and export growth of automotive products, had started to feed through to the output of some metals and plastics producers. The level of steel production, however, had remained weak. Export growth in aerospace, food, pharmaceutical and energy-related products had continued to contribute positively to output growth in domestic supply chains.

Construction

Annual growth in output had continued to recover from a prolonged period of weakness (**Chart 2**). Private house-building activity had accelerated, and social housing starts as well as new student accommodation were also supporting growth. Housebuilding rates were expected to rise further as supply responded to increased demand, though the response would come with a lag, in part reflecting constraints said to include shortages of construction skills, capacity limits in construction material production, staff shortages in local authority planning departments, and difficulties in accessing credit for some smaller housebuilders. Smaller scale refurbishment of commercial premises had continued to grow. But commercial development activity outside London remained subdued overall. A number of infrastructure projects had continued to provide support to the sector.

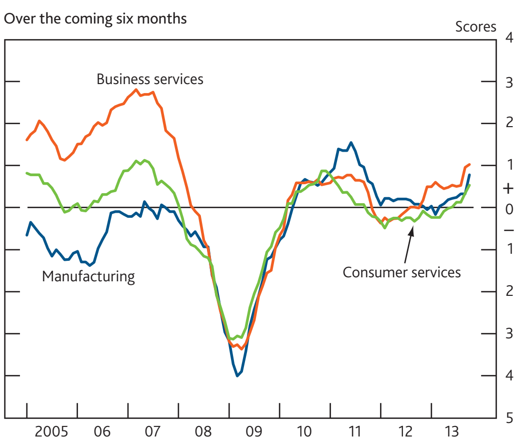
Credit conditions

The availability of credit to companies continued to increase gradually. Credit was readily available to large corporates, either through bank lending or capital markets. Availability had eased a little for medium and small-sized businesses, in some cases with greater competition reported between lenders and with some evidence of new entrants to the market from overseas. But many small companies continued to report high collateral requirements — or loan pricing that was high given levels of collateralisation. There were reports of some improvement in access to finance for residential and other property developers, often from non-bank sources, including private investors, insurance companies or overseas funds. Credit demand was also reported to be gently rising to help fund mergers and acquisitions and management buyout activity. However, many contacts remained reluctant to approach banks for new funds, given a continuing lack of trust in banking relationships. Non-bank finance continued to grow, including a rising use of supply chain finance. However, there were continuing reports of lengthening payment times, putting some smaller companies' cash flow under pressure.

Employment

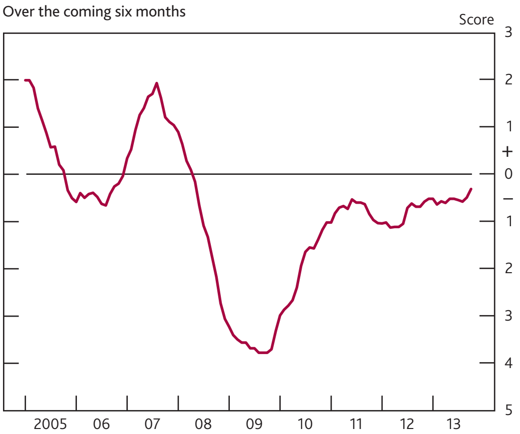
Employment intentions had edged higher and were consistent with modest employment growth over the next six months (**Chart 3**). Employment intentions remained weaker than turnover or output growth across sectors, indicating rising productivity. The majority of manufacturing firms were not intending to make significant increases in their headcount, partly reflecting the scope for productivity gains through increased efficiency or automation. For professional services, increasing employment was often concentrated among new entrants or junior staff, aimed at restraining labour cost growth. But the scope for productivity gains in the short term appeared somewhat more limited than for manufacturing, as the aftermath of the crisis had seen a persistent step up in the amount of labour required to win business in the sector — for example due to tighter procurement processes. In consumer services, estate agents were reported to be starting to increase staff numbers, often from 'skeletal' levels, and some retail chains were hiring sales staff, albeit partly offset by reductions in back-office staffing. Reports of recruitment difficulties for skilled labour were becoming more widespread across the economy, including in construction trades, for conveyancing solicitors, mid-ranking professional and managerial staff and drivers of large commercial vehicles, in addition to long-standing difficulties in IT and engineering. Churn in

Chart 3 Employment intentions



employment was reported to have risen, albeit from a low level. However, the ease of recruiting unskilled and administrative staff meant overall difficulties had remained slightly below normal (**Chart 4**).

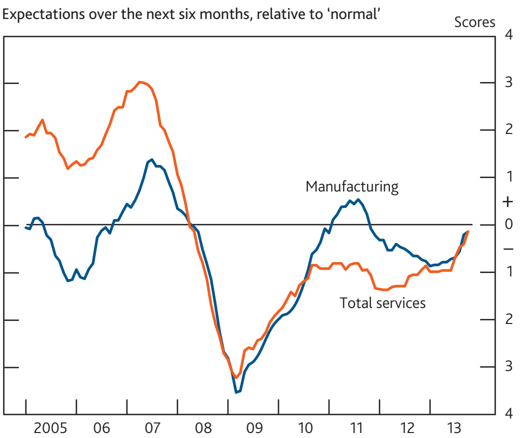
Chart 4 Recruitment difficulties



Capacity utilisation

Capacity utilisation was approaching normal levels in manufacturing and services, as activity in the economy increased (**Chart 5**). In manufacturing, most companies thought they could respond readily to higher demand from existing capacity, increased agency labour or the use of additional shifts. Within services, the degree of spare capacity was greater in consumer services than for business services, where little slack was often reported. Capacity constraints were generally yet to bite in manufacturing or services. In construction, however, skills and materials were said to be acting as a mild brake on the rate of growth of output. Shortages in materials were expected by some contacts to be relatively short-lived, though producers needed to be sufficiently convinced of a sustained recovery before incurring the sizable costs of restarting mothballed capacity or adding new capacity. Some contacts expected increasing immigrant labour to help meet shortfalls in construction skills over time, although the lags in response were uncertain and there had been little evidence of such inflows so far.

Chart 5 Capacity utilisation



Costs and prices

Labour costs

The annual rate of growth in labour costs remained moderate and unchanged, but there were continued reports of building pressure on pay for some skills in short supply. Pay rises continued to remain clustered around the 2%–3% range, with manufacturing and professional services often at the top of the range and consumer services employees towards the bottom. In some skills, there were localised pay awards notably above that range, including for some construction workers, in oil and gas expertise, IT and engineering. Auto-enrolment was reported to be a potential source of future upwards pressure on labour costs, though a minority expected to bear down on pay increases in response.

Non-labour costs

Inflation in materials costs had remained muted. With price pressures for most materials generally subdued, contacts' concerns often centred around growth in overhead costs — most notably utilities and business rates. There were also reports of upwards pressure on the price of some construction materials, such as bricks, as growth in demand outstripped growth in supply. Imported finished goods price inflation had remained modest, with price rises often reflecting the impact of rising Chinese labour costs, offset to some extent by the resourcing of products by importers.

Output prices and margins

Output price inflation had remained subdued, though had edged up for business services. Rising demand for some higher value added business services — such as advisory work — had allowed a modest increase in prices in that sector. But more generally, companies reported that they were reluctant to raise prices beyond passing on modest cost increases, due to the risk of either losing customers or triggering new tender processes. Growth in profitability had edged up from a low base, reflecting rising sales volumes and efforts to reduce costs.

Consumer prices

Consumer prices had continued to rise at a moderate annual rate. Administered and regulated prices, such as energy and transport prices, continued to be significant contributors to inflation. Food price inflation had persisted for some products but was expected to slow next year following stronger global harvests. There were reports of overhangs of autumn fashion stocks, reflecting the mild weather, which might lead to early sales discounting. More generally, retailers reported that the high price sensitivity of consumers continued to restrain their ability to raise prices.