BANK OF ENGLAND

Agents' summary of business conditions

September 2013

- Overall, the recovery in demand and output growth had strengthened a little further.
- Early feedback from contacts about forward guidance had been broadly positive, with a number of contacts indicating an increase in confidence that interest rates would remain low, providing some support to the recovery.
- Annual growth in consumer spending had increased, in part due to a period of good weather, but with underlying consumer confidence also reported to have risen.
- Activity in the housing market had continued to rise.
- Investment intentions had edged higher, though continued to point to modest growth in capital spending overall.
- Growth in manufacturing output had edged up a little, both for the domestic market and for export.
- Business services turnover growth had picked up, largely due to increasing activity within professional and financial services.
- Construction output had continued to strengthen as house-building activity rose.
- Corporate credit availability had been little changed.
- Employment intentions pointed to a slight increase in staffing over the coming six months.
- Capacity utilisation was expected to increase slightly in coming months, though a margin of spare capacity remained.
- The annual rate of growth in labour costs per employee had been broadly unchanged.
- Annual growth in materials costs had remained subdued and moderate inflation in imported finished goods prices had continued.
- Inflation in manufacturers' output prices and business services prices remained muted.
- Consumer price inflation had remained moderate.

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 July 2013 and late August 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.

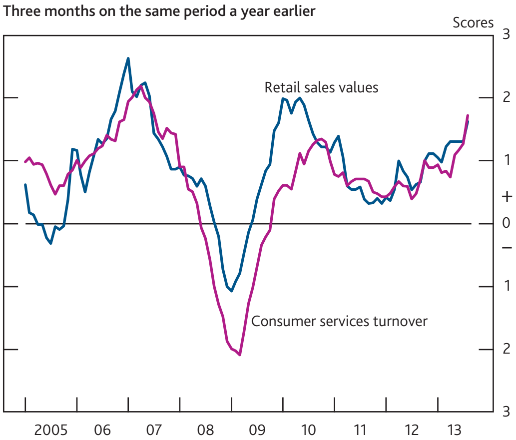
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the *Inflation Report*, obtained from:
www.bankofengland.co.uk/publications/Pages/inflationreport/default.aspx.

Demand

Consumption

Annual growth in the value of retail sales and consumer services had risen (**Chart 1**), largely reflecting growth in sales volumes. That partly reflected a run of good weather, though contacts also reported a slight increase in underlying consumer confidence and willingness to spend, notwithstanding tight disposable incomes. Demand had increased for seasonal and home-improvement goods, as well as for a range of leisure and outdoor attractions, restaurant meals and domestic travel. Growth in new car sales had remained strong, supported by finance deals that allowed for low monthly payment schedules, though some contacts were concerned about the extent to which recent sales levels were sustainable.

Chart 1 Retail sales and consumer services turnover



Housing market

Housing market activity had risen further, both in terms of enquiries and transactions. In the new-build market, improving conditions were partly ascribed to the effects of the Help to Buy scheme (applying to England only) and a continued improvement in mortgage availability. Rising demand for new and existing homes was reported to be concentrated among first and second-time buyers and buy-to-let investors. Transactions for more expensive properties remained more subdued, in part reflecting high levels of stamp duty, though were also starting to increase. Estate agents and house builders reported that housing demand was running ahead of the available supply of existing or newly built homes, leading to rising house price expectations.

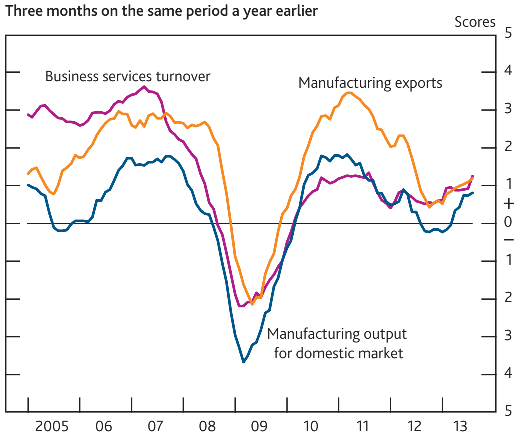
Business investment

Investment intentions had edged higher in the services sector, though continued to point to modest growth in capital spending overall. Across manufacturing and services, investment had remained dominated by smaller-scale efficiency-enhancing or capital replacement expenditures, with little large-scale capacity expansion. In services, investment in IT had increased as businesses upgraded aging systems or developed e-commerce platforms. In addition, spending on premises refurbishment and on the replacement of haulage vehicles had risen, the latter ahead of the introduction of new emissions regulations. Within manufacturing, investment spending remained strongest in export industries, such as automotive and civil aerospace production. Capital spending in energy extraction and utilities had remained relatively robust and the outlook for construction investment had improved.

Exports

A gradual increase in manufacturing exports growth had continued (**Chart 2**), with demand rising across a range of markets — particularly in Asia and parts of the Middle East — and with some signs that euro-area demand was starting to stabilise. Manufacturing exports growth remained concentrated in products for the oil and gas industry, premium brands with a broad international reach, high value-added niche products, or within the civil aerospace and automotive industries. Rising growth in services exports was reported, often related to overseas energy production or construction projects. Services exports were also reported to be rising as a result of increased inbound tourism.

Chart 2 Manufacturing output and business services turnover



Output

Business services

Growth in business services turnover on a year earlier had edged higher (**Chart 2**), though the annual rate of growth remained below its long-term average. A range of advisory work was said to be rising, reflecting growing activity around corporate, commercial property and land transactions, and a greater focus among companies on strategic direction or raising productivity. Recruitment agencies reported rising turnover alongside increased economic activity. Growth in other business services was somewhat slower than for professional and financial services, but had also edged up. That partly reflected some increase in warehouse and distribution activity. Continued growth in the turnover of IT and outsourced services providers was reported, as companies sought to improve efficiency and reduce costs.

Manufacturing

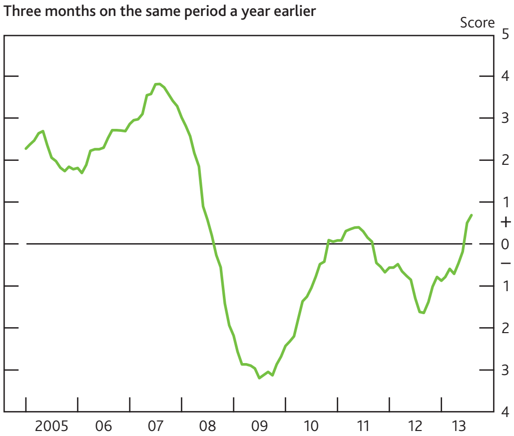
Annual growth in manufacturing output for the domestic market had edged marginally higher (**Chart 2**), and sentiment about future demand was gradually improving. Growth remained strong in the automotive and civil aerospace sectors, as well as in the oil and gas supply chain, often linked to export markets. Output of a range of construction goods was reported to have risen alongside increased house building. There were also reports of rising production for transport infrastructure. Output in some seasonal and home-improvement goods had picked up with improved weather. The printing sector remained weak, though some contacts reported a gradual improvement in orders as spending on marketing started to rise.

Construction

Construction output had continued to strengthen (**Chart 3**). House builders reported increasing new-build activity in response to rising demand, which was feeding through to activity along the construction supply chain. Construction activity in utilities and transport infrastructure also remained relatively robust. There were reports of rising activity related to increased refurbishment spending by some consumer-facing services. Public sector construction activity was reported to be steady, and concentrated in smaller-scale education and health projects. But private sector commercial development outside of London remained at low levels.

Chart 3 Construction output

Three months on the same period a year earlier



Credit conditions

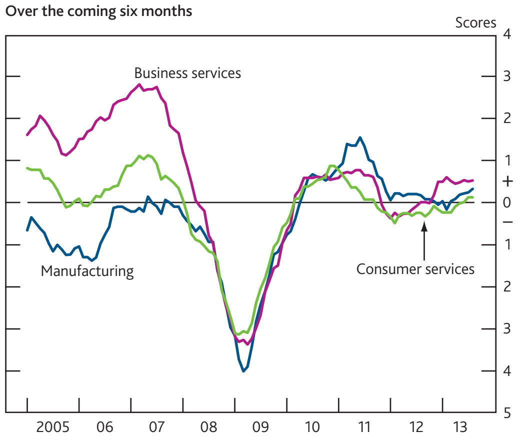
Credit availability had been little changed in recent months. Competition among lenders was reported to have increased, which had led the price of credit to edge down further. But for small businesses with few assets or those operating in riskier sectors, the availability of bank finance remained tight outside of asset finance or invoice discounting. Demand for bank finance remained subdued, notwithstanding an increase in business confidence. For large companies, that partly reflected the easy availability and cheap price of capital market finance. More generally, many companies reported that they were seeking to reduce their reliance on banks or were already holding sufficient funds internally. However, there was some increase in reports of pressure on cash flow among smaller companies, often reflecting larger customers' extended payment times.

Employment

Employment in the economy was reported to be rising only modestly (**Chart 4**), and by less than output, so that productivity was gradually rising. Contacts often reported that they expected their existing employees to become more productive as demand rose or that they were waiting for spare labour capacity to be more fully utilised before increasing employment. Employment intentions were weakest in consumer services. Contacts in that sector reported that, having pared staff numbers back to the minimum, their initial reaction to increased demand would be an increase in average hours worked rather than heads. Employment intentions were strongest in house building, reflected in growing reports of recruitment difficulties in that subsector, though it remained unclear to what extent needs could be met from other sources, such as from those who had left the trade in recent years or from overseas. Otherwise, skills shortages remained largely confined to IT and engineering.

Chart 4 Employment intentions

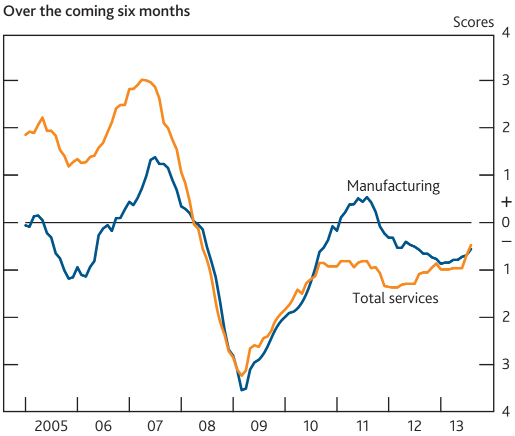
Over the coming six months



Capacity utilisation

Capacity utilisation was expected to increase a little over the coming six months (**Chart 5**) as output rose, but to remain slightly below normal. Most contacts across the economy reported that a moderate pickup in demand could be met readily from existing capacity, particularly in some parts of the business services sector where there remained scope to move staff back from 'business development' roles and to reduce time spent winning business. Within manufacturing, however, a small number of contacts in the automotive, aerospace and oil and gas supply chain reported capacity constraints. Contacts continued to express concerns about a shortage of capacity in the construction sector supply chain — such as for bricks — as demand increased, given that some plants had previously been closed or mothballed in a way that would be costly or slow to reverse.

Chart 5 Capacity utilisation



Costs and prices

Labour costs

The annual rate of growth in labour costs per employee had remained broadly unchanged in recent months. In manufacturing, pay awards often remained in the 2%–3% range, though some awards for specialist engineering skills were higher. Pay growth was reported to be more divergent within services than for manufacturing, with some reports of pay growth strengthening in parts of professional services, but with near-zero wage growth at many consumer services firms. An increased use of profit or merit-related pay in the economy more widely was leading some contacts to expect rising pressure on wages as demand recovered, and there were some localised reports of demand for a 'catch up' in pay after real wage cuts in recent years. Some contacts reported having to increase pay to fill vacant positions with experienced staff, alongside a slight rise in labour market churn. However, other contacts reported a continuing shift in the overall composition of recruitment towards more junior staff to contain wage bill growth. Pay pressures were reported to be strengthening in certain house-building trades.

Non-labour costs

Annual inflation in material costs had remained subdued. The main exceptions to that pattern were energy costs and some food prices, which had continued to show significant inflation, though a softening of global agricultural commodity prices indicated easing pressures from the latter source. The price of a number of construction materials had also risen, though some contacts reported being protected by annual contracts. Moderate inflation in imported finished goods prices had continued as the depreciation of sterling since the end of 2012 continued gradually to pass through and as wage costs in China had risen. Those effects were expected to continue to place upward pressure on import prices in coming months as hedging unwound and new seasonal ranges were ordered.

Output prices and margins

The rate of inflation in manufacturers' and business services' output prices had remained subdued. That reflected continued weak input cost inflation combined with strong competitive pressures, though in some parts of professional and financial services rising demand had allowed for some, often long delayed, pass through of cost increases. Profitability had increased slightly in both sectors, however, as business volumes had risen faster than costs and as some companies — in professional and financial services in particular — had been able to shift towards more profitable lines of work. Many contacts expected a gentle rise in profitability to continue as demand — and so productivity — gradually rose.

Consumer prices

Consumer price inflation had remained moderate, albeit slightly higher than the previous month. Earlier increases in food prices had continued to pass through to goods price inflation, though the upward pressure from this source was expected to ease as global agricultural price falls started to feed through. But road fuel and energy prices had increased and retailers reported shallower discounting of seasonal clothing and footwear than a year earlier, partly reflecting tight stock control. New car prices remained flat, partly reflecting overseas manufacturers targeting sales in the United Kingdom to offset weak demand on the continent. Inflation in consumer services prices was often reported to remain limited outside administered and regulated prices, though there were reports of a slight increase in pricing at some hotels, restaurants and visitor attractions. More generally, contacts continued to report that consumer demand remained price sensitive, particularly for those whose customers' incomes were at the lower end of the earnings spectrum.