BANK OF ENGLAND

Agents' summary of business conditions

August 2008

- Consumption growth eased further, reflecting weakness in demand for consumer services.
- The slowdown in housing demand continued.
- Investment intentions declined. With regard to credit conditions, the costs of finance and trade credit insurance had risen and availability had diminished.
- Growth in the demand for exports was broadly stable.
- Growth in domestically orientated manufacturing output was steady, having fallen sharply in previous months. But there was a further pronounced deceleration in construction and services output.
- Labour demand softened. Recruitment difficulties were little changed, partly reflecting reduced labour supply.
- Capacity pressures continued to ease.
- Growth in total labour costs remained well contained.
- Annual input price inflation was little changed but annual output price inflation increased.
- Annual consumer price inflation continued to rise.

This publication is a summary of monthly reports compiled by the Bank of England's Agents, following discussions with nearly 700 businesses in the period between late June and late July. 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/agentssummary/index.htm.**

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.

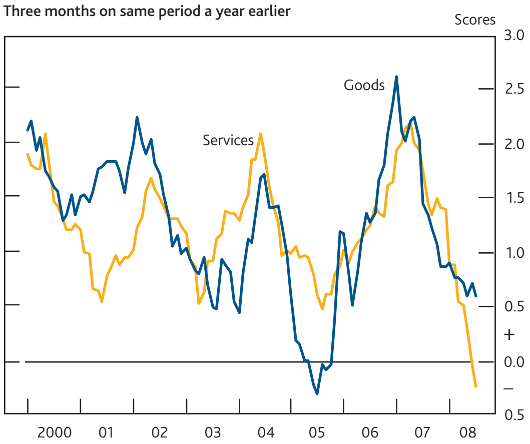
The Bank's assessment of current monetary and economic conditions, and the outlook for inflation, are contained in the Inflation Report, obtained from: **www.bankofengland.co.uk/publications/inflationreport/index.htm.**

Demand

Consumption

The Agents' score for growth in retail sales values was little changed this month but the score for consumer services fell again (**Chart 1**).

Chart 1 Consumption values



Growth in spending on consumer goods appeared to have stabilised recently, following previous sharp declines. But the regional picture was mixed. In London, stronger inbound tourism had helped to maintain steady growth. But several other regions reported a slowdown in consumer demand for goods in July.

Rising food and fuel prices in recent months had diverted spending away from the non-food sector, while falling consumer confidence had depressed spending on big-ticket durable goods. In July, the deceleration in non-food volumes abated, with some retailers, for example in clothing, discounting surplus inventory more heavily in the summer sales. But demand for bigger-ticket items such as furniture remained depressed, while the volume of sales of flat-screen TVs and other electrical goods had also started to wane. New and used car sales weakened further in July.

The Agents' score for spending on consumer services continued to fall. Recent trends persisted, especially the decline in the growth of spending on food and drink at pubs, clubs and restaurants. Tour operators continued to report brisk demand for overseas summer holidays, but stays were shorter and with fewer bookings for long-haul destinations. Late cancellations of package holidays had increased, which contacts ascribed to some households reassessing their affordability in the light of budgetary pressures. The further contraction in housing transactions had continued to reduce demand for conveyancing and other housing-related services such as removals.

Housing market

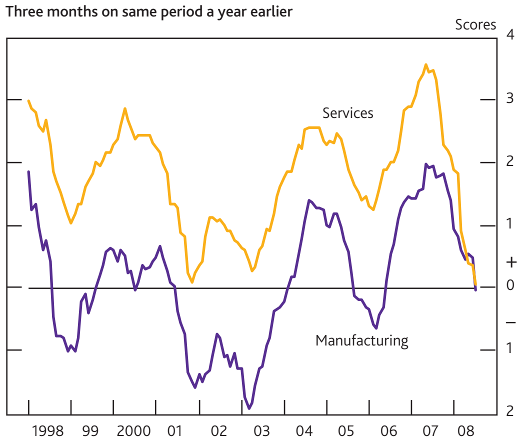
The slowdown in housing demand had continued. The growing shortage of mortgage funds, especially for first-time buyers, had contributed to a lack of liquidity in the market for established homes. That had made valuing property increasingly difficult. Uncertainty regarding valuations was, in turn, discouraging potential buyers, some of whom were reported to require discounts of at least 10%–20% off the asking price to proceed. Mostly only forced sellers would accept discounts of that magnitude. Repossessions had increased slightly and had started to depress prices. Estate agents and mortgage brokers continued to close offices and lay off staff.

The market for new housing was similarly depressed and there were more reports of national house builders closing regional offices to reduce overheads. Builders reported very little demand for residential land and the values of their land banks had been written down. Despite the availability of large price discounts, housing associations had not entered the market for new town-centre apartments, since they were typically not suitable for housing families.

Investment

Agents' scores for investment intentions declined. The score for the service sector fell to its lowest level since the series began in 1997 (**Chart 2**).

Chart 2 Investment intentions



With declining valuations being placed on companies, firms looking to expand were more likely to consider acquiring assets through M&A activity than investing directly in fixed capital. Contacts with the greatest exposure to the slowdown continued to cut back investment plans and/or divest assets. In the service sector, examples included hauliers cancelling orders for new trucks, car rental companies deferring fleet purchases, airlines leasing fewer aircraft and retailers either postponing expansion plans or attempting to sub-let surplus floor space. Some motor traders had closed branches. In manufacturing, there were increasing reports of contacts cancelling investment projects for new plant and equipment, mostly reflecting the deteriorating outlook for demand.

The impact of tighter credit conditions was still mostly confined to a few sectors and to individual companies with high gearing. Many contacts were more concerned about the direct impact of the tightening credit conditions on their customers rather than themselves. Nevertheless, the Agents reported generally more pervasive effects of tighter credit conditions this month. Some house builders were under pressure from bank covenants. Finance for commercial property developments was increasingly expensive or scarce. Faced with sharply declining capital values, some investors had chosen to relinquish non-returnable deposits of as much as 10% on planned commercial and residential property projects. Banks had reduced their lending to pubs and restaurants, partly reflecting the recent decline in profitability of that sector.

Some contacts were faced with higher costs of borrowing as their lenders passed on their own higher cost of capital. Others reported a significant increase in delays receiving payment from debtors. There was also a significant tightening in the provision of trade credit insurance. Cover was being cut back or removed and the cost of insurance had risen sharply. Finally, some large firms had unilaterally extended the period between receiving and paying for supplies, in some cases from 30 to 90 days.

Exports and imports

Most Agencies reported fairly steady growth in external demand. But some noted that demand had weakened recently in the euro area, and were nervous of further deterioration in that region going forward.

Growth of imported finished goods continued to weaken in response to the slowdown in domestic demand. There were some reports of increased substitution from imported to domestically produced goods, reflecting sterling's depreciation against the euro and increased transport costs.

Output

Manufacturing

Manufacturing output growth was little changed in July. Domestic demand had weakened for UK manufactured consumer durables and products used by the construction industry. By contrast, manufacturers of capital and intermediate goods used by the domestic power generation and aerospace industries reported stronger domestic demand.

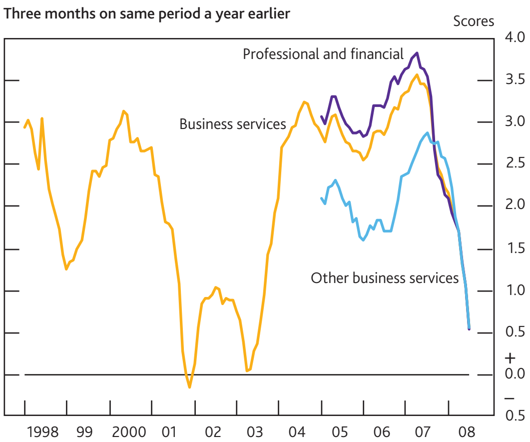
Construction

The score for construction output fell further in July. The sharp fall in housing starts that had began around Easter had yet to have its maximum impact on output, and some Agencies expected further score reductions in the months ahead. Activity in the commercial property sector had also weakened, albeit only slightly. Public sector commissioned construction of infrastructure, schools, hospitals and prisons continued to grow steadily.

Services

The Agents' score for business services output fell sharply in July, its largest monthly decline for nearly seven years (**Chart 3**). Within business services, the scores for professional and financial services, and for other business services such as logistics, declined by similar magnitudes. The deceleration in professional and financial services was fairly broad based, consistent with a reported general loss of business confidence within the sector. Even so, some sectors continued to flourish. That included accountancy firms specialising in corporate restructuring and insolvency work, and some IT service providers who reported increased demand from customers looking to implement improvements in efficiency. In other business services, contacts reported a further slowdown in corporate discretionary spending, including on travel, banqueting and conferences. Logistics companies reported weaker demand growth, mostly reflecting the slowdown in consumption and residential investment.

Chart 3 Business services output



Capacity utilisation

Capacity constraints in manufacturing and services declined. Overcapacity in parts of the service sector had become pronounced. That included housing-related services, retail, air travel and parts of investment banking. In some cases that had resulted in part of the spare capacity being eliminated through a reduction in staffing and or closure of premises. There were also an increasing number of reports of excess capacity in the manufacturing sector. A few contacts had resorted to a temporary shutdown, especially those exposed to the retail and house building sectors.

Employment

Labour demand continued to weaken in July, particularly in construction and housing-related services. Many firms were looking to reduce the volume of labour inputs as product demand slowed. In most cases that had so far been achieved by the non-replacement of staff lost to natural wastage, reduced use of agency workers and reductions in average hours. With the exception of the housing sector, redundancies had so far been rare but were expected to pick up going forward. Recruitment difficulties were little changed in July. While labour demand had weakened, so had the supply of new labour. That was partly because employees had become more risk averse about changing employers, and partly due to a reduced supply of migrant labour.

Costs and prices

Labour costs

In July, the Agents' scores for labour costs declined in services, but rose fractionally in the manufacturing sector.

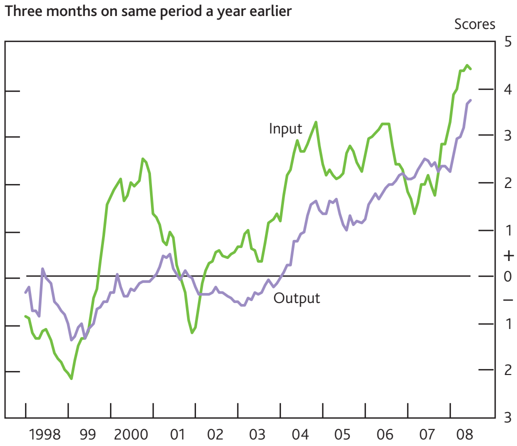
The deceleration in service sector labour costs was mostly attributable to lower commission payments to staff, particularly in housing-related businesses. The slowdown in demand for business services this year had resulted in some reduction in pay settlements for those firms who had made annual reviews recently. In manufacturing, there was modest upward pressure on settlements, mostly emanating from RPI-linked pay agreements.

Input and output prices

The Agents' score for manufacturers' input prices was little changed in July (**Chart 4**). News on input prices was more balanced this month. Some base and precious metals prices (including zinc, nickel and platinum) had declined sharply. Prices of some soft commodities such as wheat had fallen, in part reflecting upward revisions to world harvests this year. Finally, fuel prices had eased a little by the end of the period. By contrast, rising costs of utilities remained a concern for many contacts, and earlier sharp rises in oil prices continued to feed through to higher costs of oil-based materials such as plastics and fertilisers.

The cost of imported finished and intermediate goods continued to accelerate, partly reflecting increasing cost pressures in Asia. The sustained strength of the euro was having a growing impact on import prices. That was because forward cover had expired for an increasing number of firms, who had hedged at much higher sterling-euro exchange rates than the current rate.

Chart 4 Manufacturers' input and output prices[(a)]



(a) Non-labour input prices.

The Agents' score for manufacturing output prices rose in July (**Chart 4**). Some Agencies reported that in the current climate of rising inflation, businesses were anticipating price increases from their suppliers and were more relaxed about accepting them. Even so, most manufacturers were unable to pass on all of their higher input costs, so margins continued to be squeezed. The Agents' score for manufacturing profitability declined sharply in July.

The score for business-to-business services price inflation was unchanged this month and had been steady for much of the year. Some sectors of business services (for example haulage) reported rapid material cost and output price inflation recently, largely due to higher fuel costs. However, most service providers had proportionately fewer material inputs than their manufacturing counterparts. Furthermore, the deceleration in demand for business services this year had restricted firms' ability to pass on higher costs. The Agents' score for service sector profitability continued to decline rapidly, mostly reflecting the slowdown in demand and, to a lesser extent, the squeeze on margins.

Consumer prices

The score for retail goods price inflation increased a little in July, reflecting emerging news about the scale of energy cost increases offset somewhat by weaker price inflation in the non-food sector. The latter included discounts in the summer sales (especially by fashion and department stores) that were larger than last year. Also, growing oversupply of new and used cars had put downward pressure on prices, particularly for used cars with high fuel consumption. Food price inflation was stable this month, but remained at a high level. Retail services price inflation rose further in July, largely reflecting increased transport prices. Tour operators and airlines had increased fuel surcharges, particularly for long-haul destinations.