



Agents' summary of business conditions

2017 Q1

- Moderate rates of activity growth had continued overall. Retail sales volumes growth had eased. It was expected to slow further during the year ahead as the fall in sterling fed through to higher prices, reducing households' purchasing power. In contrast, export volume growth had picked up. That was due to the fall in sterling and stronger world growth.
- Investment intentions had picked up, pointing to modest growth in spending in the year ahead. That reflected continued moderate demand growth and less uncertainty about economic prospects, particularly in the near term. But a lack of visibility of the United Kingdom's future trading arrangements was weighing on longer-term plans for some contacts.
- The fall in sterling was being passed through into higher manufacturing output and consumer goods price inflation. Business and consumer services price inflation had edged higher.

Growth in the value of **consumer spending** had remained moderate. But retail sales volumes growth had eased. A survey pointed to a slowdown in consumer demand growth in the year ahead (see Box 1 on page 4). That was concentrated in goods rather than services.

Business services turnover had grown moderately. Some contacts in the sector remained cautious about longer-term prospects.

Growth in **manufacturing** output remained modest. Some suppliers had benefited from increased domestic sourcing. The fall in sterling and a stronger world economy had led to a marked rise in **export volume growth**.

Construction output growth had changed little.

Investment intentions had picked up. That reflected continued steady demand growth and some reduction in uncertainty about economic prospects, particularly in the near term. A lack of visibility around the United Kingdom's future trading arrangements continued to weigh on longer-term investment plans for some contacts.

Bank **credit availability** had remained stable. There had been a small pickup in the demand for loans. A targeted survey of companies suggested little change in the availability or cost of foreign exchange hedging products since the EU referendum (Box 2 on page 5).

Occupier demand for **commercial real estate** had remained resilient overall. That had driven some modest rental growth.

But downward pressure was reported on rents on some properties in the City of London.

Housing market activity had been little changed. There were signs of gently rising demand for housing, outstripping the number of properties available for sale overall. Strong competition was reported in mortgage lending.

Capacity utilisation had risen in manufacturing alongside increased demand, and to a lesser extent in services. Slack in companies was close to normal overall.

Employment intentions pointed to very slight growth in staffing over the coming six months. **Recruitment difficulties** had increased and were moderately above normal.

Growth in **labour costs** per employee had remained subdued. Settlements were clustered around 2% to 2½%.

Materials costs and **imported finished goods** price inflation had risen further. That was largely due to the fall in sterling.

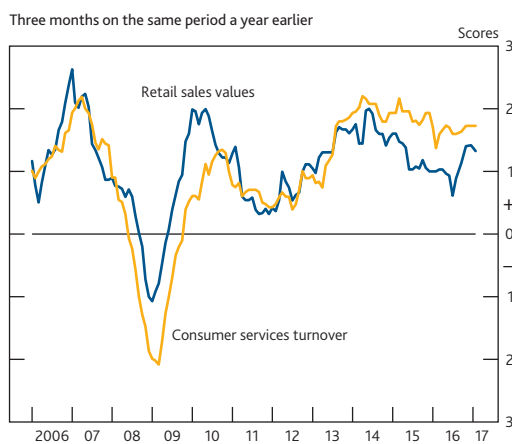
Manufacturing **output price inflation** had risen sharply. Higher costs were being passed on to prices. Business services price inflation had edged higher, but it remained moderate.

Consumer goods price inflation had picked up markedly following the fall in sterling. **Consumer services price inflation** had edged up. That partly reflected continued steady demand growth.

Consumer services and retail sales

Retail sales values growth had slowed slightly (**Chart 1**). And higher price inflation implied a larger easing in volumes growth. In contrast, private new car demand growth — and growth in the associated consumer finance — had risen. That perhaps reflected some consumers bringing forward purchases, ahead of vehicle tax changes. Demand growth for consumer services had been little changed. Restaurants, bars, hotels and tour operators had reported fairly robust growth. The weaker pound had boosted overseas tourist numbers and spending. It had also encouraged greater domestic tourism. An Agents' survey on consumer demand pointed to slowing consumption growth over the year ahead (see Box 1 on page 4). That reflected reduced consumer purchasing power, as the fall in the exchange rate fed through to higher prices. Consumer credit growth was expected to slow alongside weaker spending growth. Consumer credit arrears were reported to be very low.

Chart 1 Retail sales values and consumer services turnover



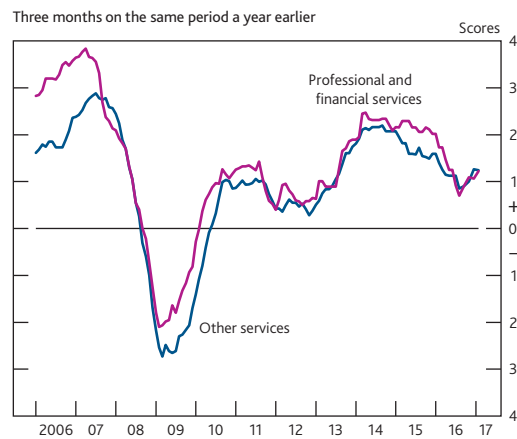
Business and financial services

Business services turnover had grown moderately overall, at a broadly similar pace to 2016 Q4 (**Chart 2**). But firms remained cautious about business prospects. A range of financial services companies reported strong growth. An improving pipeline of infrastructure investment projects was boosting growth for architects and consulting engineers. Demand for IT services was especially buoyant. That reflected upgrades to software and hardware, growing concern about cyber security issues and increased use of cloud-based services. Sales growth was mixed among law firms and advertisers. Cost cutting by some firms was adversely affecting corporate spending on hotels and conferencing. Business service exports had been boosted by a pickup of global demand growth and the fall in sterling. The response had been muted in some sectors though, such as engineering and IT services, where foreign demand was less responsive to lower prices.

Production

Manufacturing output growth for the domestic market had risen a little further (**Chart 3**). Demand growth was strongest in the automotive, aerospace, industrial chemicals,

Chart 2 Professional and financial services and other services turnover



pharmaceuticals and construction products subsectors. A large proportion of that reflected activity in export supply chains. Goods export volumes growth had increased further (**Chart 3**). That reflected the fall in sterling and stronger world demand growth. The pickup continued to broaden across subsectors. Domestically, many manufacturers were benefiting from increased price competitiveness compared with overseas firms. Some firms reported increased domestic sourcing, especially in the food and drink sector. Suppliers into the oil and gas sector continued to see weak demand.

Chart 3 Manufacturing output — domestic and exports



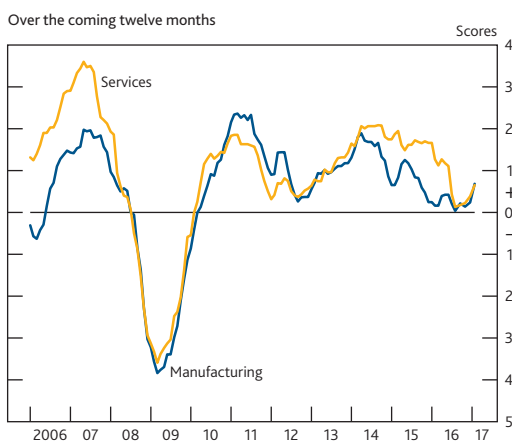
Construction

Growth in construction output had remained modest. There was steady demand growth for construction work from utilities. The Government's commitment to major infrastructure projects was expected to generate more work as those came on stream. However, some smaller-scale projects were restrained by tight local authority budgets. There was some modest rise in commercial development activity. Residential construction output had continued to grow overall. That was less the case for social housing than for private housebuilders. Looking ahead, there were some fears that further housebuilding growth could be capacity constrained, notably by skills shortages.

Investment

Investment intentions had edged higher. They pointed to modest growth in spending over the next year. The pickup reflected stronger demand and an easing in uncertainty around the likely returns of projects, particularly shorter-term plans (Chart 4). Firms had been going ahead with plans designed to mitigate increased energy, labour and materials costs. That typically entailed investment in technologies such as renewables, robotics, or enhanced business systems. Increased R&D spending on new products was seen as vital for many firms. And there were some signs of investment in additional capacity in automotive, defence, food and drink, and construction equipment. Resilient consumer demand and UK tourism growth was supporting retail and leisure refurbishment projects. The shift to e-commerce was encouraging investment in online capacity and logistics. The low cost of credit was seen as helpful but the sterling cost of some equipment had risen. A lack of visibility of the United Kingdom's future trading arrangements continued to weigh on longer-term plans for some contacts.

Chart 4 Investment intentions



Corporate financing conditions

Credit availability had generally remained higher than normal. There was robust competition between banks. This was leading to pressure to ease non-price terms and conditions. However, banks' credit assessments were reported to be more rigorous than before the financial crisis. Banks were said to be reluctant to fund management buyouts by smaller firms. Funding choices were reported to be more limited for some groups, including smaller developers and construction companies. Challenger banks were increasingly active in these sectors. Non-bank finance, such as peer-to-peer funding, had become a major part of some small and medium-sized enterprises' (SMEs') funding. Private equity firms and debt funds had continued to provide funds for larger corporate finance deals. They were willing to lend at higher gearing than banks. Lenders reported some rise in demand for loans. That

reflected continued activity growth and slightly higher business investment intentions. Invoice and asset finance were reported to be growing strongly by some contacts. A targeted survey on companies' access to foreign exchange hedging products, focusing on SMEs, reported little change either in their ability to access those products or the costs of doing so, since the EU referendum.

Property markets

Commercial real estate

Occupier demand for commercial property was mostly resilient. There was a shortage of modern industrial and logistics space. Demand was strongest for offices in most major city centres; and also for prime retail space, particularly in large regional centres. That was supporting some rental growth for such properties. But occupier demand was weaker elsewhere. In the City of London, some rents had fallen as additional space had come on stream against a backdrop of heightened business uncertainty. Investor demand continued to be supported by the low exchange rate, and sustained demand from UK funds, local authorities, and individual investors looking for yield. However, some caution was evident from a focus towards prime property assets, and away from assets perceived as higher risk.

Housing market

Housing market activity had been little changed. There were signs of gently rising demand for housing, outstripping the number of properties available for sale overall. Some estate agents noted the number of properties on their books was less than half pre-crisis norms. Modest excess demand was supporting low-level house price inflation. There was significant variation, however, even within localities. In London, house price inflation had eased significantly and properties were taking longer to sell. More generally, activity was relatively stronger in lower price segments. This was especially the case among first-time buyers, and in new-build. But activity was depressed for houses over £1 million.

Contacts reported that the mortgage market remained highly competitive, with a further increase in credit availability, including at higher LTVs. Lending activity was being sustained by higher levels of remortgaging as borrowers looked to lock in low rates. New buy-to-let lending had slowed, due to weaker demand and a tightening of underwriting conditions by some lenders.

Capacity utilisation

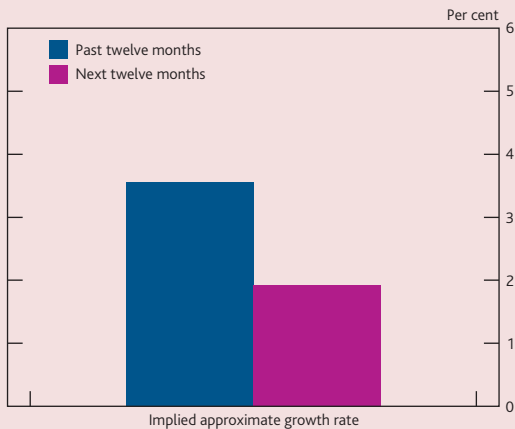
Capacity utilisation had increased slightly due to rising demand. In manufacturing, constraints were greatest in automotive and construction product supply chains and among exporters. Labour was more often cited as a constraint

Box 1 Agents' survey on consumer demand

The Agents surveyed business contacts about changes to consumer spending over the past twelve months and their expectations for the year ahead. The survey also asked firms about how a range of factors were expected to affect consumer demand and about their pricing intentions for the coming year. A total of 275 businesses responded to the survey, with a combined turnover of £102 billion. The survey results were weighted by turnover.

Firms had seen strong growth in volumes over the past year, but expected a slowdown in growth in the year ahead (Chart A). That slowing was entirely accounted for by firms selling consumer goods (Chart B). In contrast, consumer services firms (including for example hotels, restaurants and transport operators) overall expected no change in volumes growth.

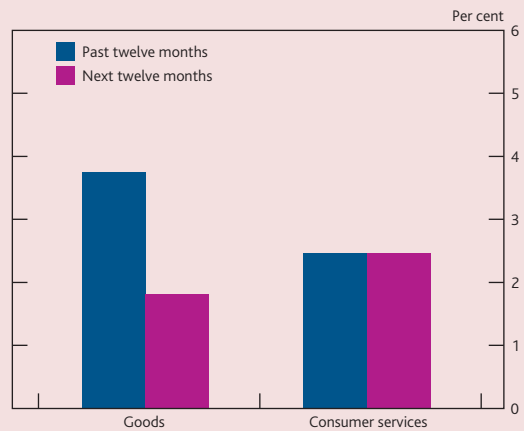
Chart A Estimated sales volumes growth,^(a) past three months versus a year ago and expectations for next twelve months



(a) Implied growth rates are calculated from broad response buckets, rather than point estimates of growth, so are broad approximations only.

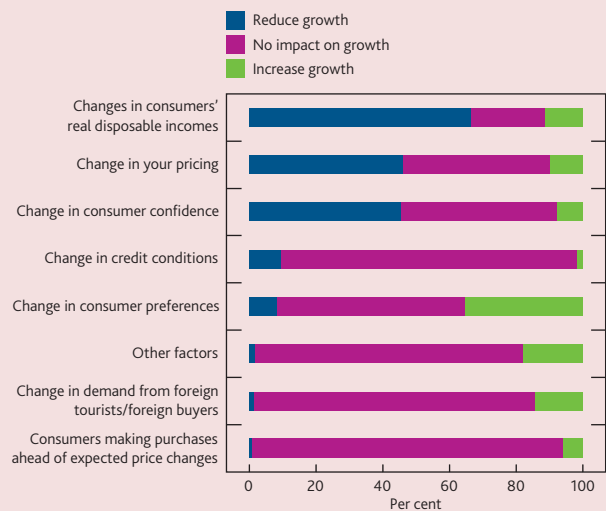
The main factors expected to reduce consumer demand growth were expected changes in consumers' real disposable incomes and changes in firms' own pricing — both linked to the impact of the weaker pound (Chart C). A fall in consumer confidence was also thought likely to be a drag on growth. Several factors were expected to push up modestly on demand, the most significant of which was changing consumer preferences — including a 'staycation' effect as households shift some leisure spending to the United Kingdom.

Chart B Approximate sales volumes growth, past three months versus a year ago and expectations for next twelve months, broken down by goods^(a) and consumer services



(a) The 'goods' category includes retailers (store-based and online) as well as consumer-facing goods producers and wholesalers.

Chart C Factors driving the expected change in consumer demand growth over the next twelve months



The chart shows, for each factor, the turnover-weighted percentage of firms for whom the factor will reduce growth, have no impact on growth or increase growth.

Box 2

A targeted survey on foreign exchange hedging

Companies may hedge exposures to changes in the exchange rate by using hedging products or may be naturally hedged by the nature of their business. Agents ran a targeted survey in January and February of some 80 companies who use foreign exchange (FX) hedging products, focusing on small and medium-sized enterprises. The aim of the survey was to help assess whether any vulnerabilities arising from the fall in sterling — either from higher import costs or foreign currency debt service costs — had been exacerbated by changes in companies' hedging behaviour or reduced access to FX hedging products.

than physical capital. There was plenty of spare capacity in manufacturers exposed to the oil and gas sector. In services, more capacity was being added in the logistics/warehousing sector, where there were constraints. Labour utilisation had increased in accountancy, legal services, IT service providers, distribution and leisure, but elsewhere the picture was mixed. Firms reported that margin pressures were making it harder to sustain any underutilisation of staff. As a result, some retail businesses had taken action to reduce staffing. Headcount had also been lowered in some parts of banking.

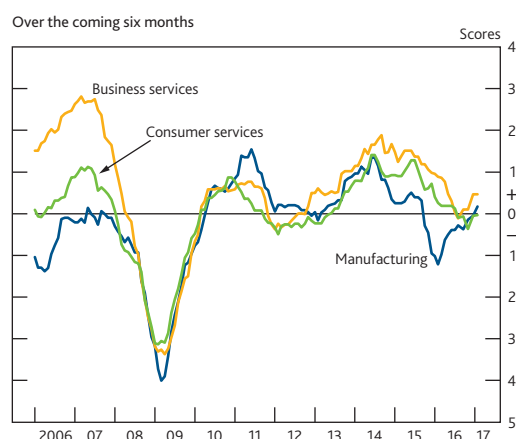
Employment and pay

Manufacturing employment intentions had edged a little higher. They were now slightly positive (**Chart 5**), largely reflecting expectations of expanding output. But that was partly offset by job reductions due to greater automation or weak demand in specific subsectors, such as oil and gas supply chains. Employment intentions within services were unchanged. In business services, intentions pointed to limited headcount growth. That reflected steady activity growth. Consumer services employment intentions were broadly flat. Some firms were creating jobs where they planned to open new premises. But that was offset by a more general rationalisation to mitigate higher labour costs associated with the National Living Wage (NLW).

Recruitment difficulties were slightly above normal and had tightened a little further. Shortages of skilled and experienced staff had risen. That reflected slightly increased labour demand. Contacts in construction, engineering, distribution, IT, healthcare and catering most often reported hiring difficulties. There was little evidence of EU migrant workers leaving the United Kingdom due to its plans to leave the European Union. Some had left though, as the fall in sterling had reduced the value of their repatriated earnings. However, there were more reports of difficulties recruiting new EU migrant workers, due to a shrinking pool of candidates.

A majority of companies in the survey reported using FX hedging products to hedge supply chain costs. Only a few used those products to hedge FX debt obligations. While some firms had increased their FX hedging, relative to normal, before the referendum, most had not done so. That suggested there was not an unusually large 'hump' of re-hedging to come. Companies reported little change in their ability to access FX hedging products since the EU referendum or in the cost of doing so, despite the fall in sterling. And few companies reported any obstacles in accessing the market for FX hedging products. Overall, the survey indicated little reason to think that companies' FX hedging practices around the EU referendum, or their access to FX hedging products since, had materially increased any vulnerabilities associated with the fall in sterling.

Chart 5 Employment intentions

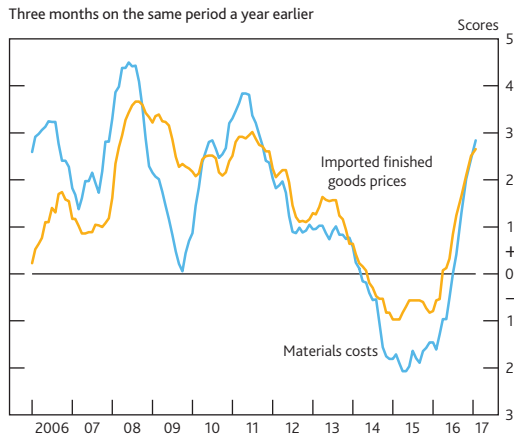


Growth in labour costs remained subdued. Settlements were largely clustered around 2% to 2½%. Higher awards were mostly targeted to address particular skill shortages or, for firms most affected by the NLW, skewed towards lower-paid workers. For most firms, pay awards were related to company and/or individual performance. Some contacts were concerned that higher inflation might lead to upward pay pressures. Many contacts had exceeded the statutory requirements concerning the NLW last year, for example by extending the NLW to include staff under 25. That had provided a temporary boost to wage inflation that would not be repeated in 2017.

Pricing

Supply chain pricing

Manufacturers' output price inflation had risen. Customers were more willing to accept price increases. However, price rises were often below those of imported goods and raw materials costs (**Chart 6**). Business services price inflation had edged up. For some companies with more low-paid staff price increases were not enough to cover the extra costs of implementing the NLW.

Chart 6 Material costs and imported finished goods**Consumer prices**

Consumer goods price inflation had risen sharply. Fuel price inflation had increased further. Higher food and drink and household goods prices were starting to push up inflation. That was mostly due to the fall in the pound. There was some evidence that pass-through of that fall to groceries prices had been slower than expected. That was due to supermarkets' concerns about losing market share. List prices for new cars had picked up a little. But effective purchase prices were hard to gauge given the finance packages through which most cars were bought. Inflation in consumer services prices had edged higher. That partly reflected continued moderate demand growth and the passing on of increasing costs — either import costs or in some cases labour costs — in some subsectors such as hotels, pubs and restaurants.