BANK OF ENGLAND

Agents' summary of business conditions

and results from the Decision Maker Panel Survey

2018 Q1

- Robust growth in goods exports had tightened capacity and, together with improving profit margins, strengthened investment intentions in manufacturing slightly.
- Recruitment difficulties remained a primary concern, though the impact on pay growth had been limited.
- Some evidence of financial distress in retail and leisure, reflecting weak consumer spending growth.

Growth in **retail sales values** had slowed, reflecting weaker spending on white goods and homewares. This was potentially associated with subdued housing market activity, consumers bringing forward spending to the Black Friday sales in November, and the continued squeeze on household incomes.

Consumer services turnover growth had held up, though there were some signs of a slowdown in Q1, for example in casual dining.

Business services turnover growth had been modest but had strengthened, reflecting growth in demand for legal, accounting and advisory services, as well as work related to insolvency and restructuring which has picked up from a low base.

Domestic manufacturing output growth had eased slightly, though exporters continued to report strong growth, and demand from the EU had picked up.

Growth in **construction output** slowed further, with the overall level of activity little changed on a year earlier.

Investment intentions remained modest, but had picked up slightly among manufacturers, reflecting expansion to cope with strong export demand and investment in automation to relieve recruitment difficulties and improve productivity.

Overall growth in corporate **credit demand** remained subdued, reflecting a persistent aversion to gearing following the financial crisis. However, there was some demand among firms to borrow to facilitate growth and enhance efficiency.

In **commercial real estate**, capacity had tightened, reflecting a lack of properties coming onto the market combined with a modest rise in demand from investors. Across the UK, there continued to be appetite from foreign investors, most notably from Asia. In London, however, many institutional investors continued to view the market as overvalued, and were less active as a result.

Housing market activity had remained subdued. Lack of stock in the secondary market was depressing demand by limiting choice for prospective buyers. However, demand for new-build property was robust, supported by the Help To Buy scheme. Mortgage activity was dominated by remortgaging deals as homeowners looked to lock-in low fixed-rate deals in anticipation of further interest rate rises.

Capacity utilisation had increased slightly in manufacturing, and constraints were beginning to bite among exporters. Capacity utilisation remained around normal in services.

Employment intentions continued to point to modest headcount growth. At sectoral level, hiring intentions in accountancy, legal and logistics had picked up slightly, but had edged down in consumer services. Recruitment difficulties remained elevated and were a primary concern raised by many contacts.

Growth in **total labour costs** remained modest, though average pay settlements this year were a little higher than in 2017 for many contacts, at between 2½% and 3½%.

Input cost inflation eased slightly and firms regarded the inflationary impact of sterling's depreciation on input and imported finished goods costs as having largely peaked, except for in energy, where forward-contracting meant there was further pass-through to come. A survey on corporate pricing by the Agents showed that firms expected output price inflation to fall back this year as import price inflation eased (see Box 1 on page 4).

Consumer goods price inflation had eased but remained elevated, though contacts expected it to abate over the coming year, especially for imported goods such as clothing and cars, as the effect of sterling's depreciation wanes. Consumer services firms had been able to implement small price rises in order to partially cover cost increases.

This publication includes a summary of economic reports compiled by the Bank of England's Agents between late December 2017 and late February 2018. It generally makes comparisons with activity and prices a year earlier. The report does not represent the Bank's own views, nor does it represent the views of any particular company or region. More information on the Bank's Agencies can be found at www.bankofengland.co.uk/about/people/agents.

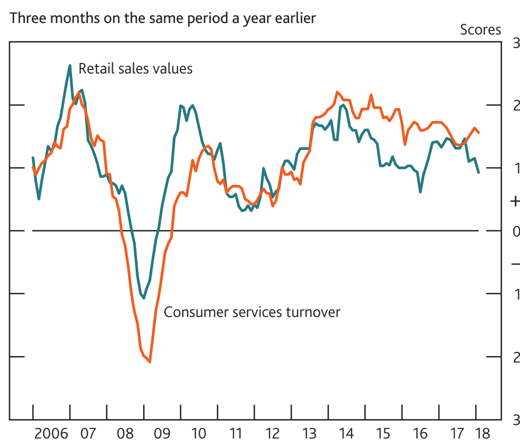
This publication also includes a summary of information gathered by the Bank's recently established Decision Maker Panel Survey. Further background is provided in Box 2 on pages 7–9.

Consumer services and retail sales

Growth in retail sales values had eased a little further in Q1, reflecting weaker spending on white goods and homewares (**Chart 1**). This may have been in part associated with subdued housing market activity. The slowdown in Q1 may also have reflected a change in seasonality, with the Black Friday sales in November attracting a growing share of spending on big-ticket items at the expense of the January sales. Store-based retailers continued to lose share to online retailers, putting some at risk of failure. Budget retailers had been gaining market share, helped by the continued squeeze on household incomes, though high-end brands also reported strong growth. Demand for new cars had continued to weaken. Growth in spending on consumer services had remained relatively resilient (**Chart 1**), although here too there were some signs of a slowdown in Q1, for example in casual dining. By contrast, growth in spending on holiday flights and cruises remained buoyant.

Chart 1 Retail sales values and consumer services turnover

Three months on the same period a year earlier

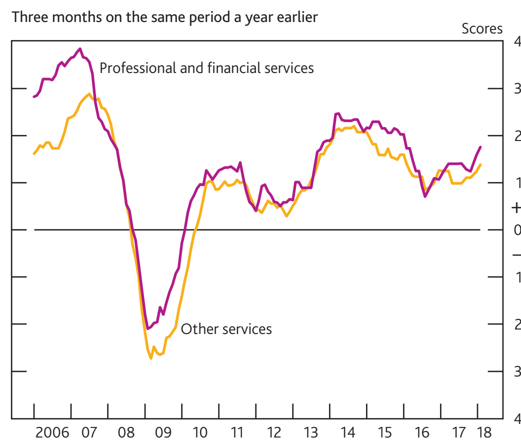


Business and financial services

Growth in business services turnover had been modest but had strengthened (**Chart 2**). Professional services contacts reported a broad increase in activity, particularly in legal and accounting or advisory services. These firms were benefiting from clients outsourcing both ongoing work, such as payroll services following the introduction of pension auto enrolment, and one-off pieces of work such as General Data Protection Regulation (GDPR) and gender pay gap analysis. There was further growth in mergers and acquisitions activity, and advisory work related to insolvency and restructuring had picked up, albeit from a low base. Recruitment firms generally reported being busy, indicating growing pressure on the labour market. Growth in IT services remained strong, particularly for work relating to GDPR and cyber security. There was also strength in warehousing and distribution, driven by online retailing, and among providers of support services to manufacturing exporters.

Chart 2 Business services turnover

Three months on the same period a year earlier



Services export values had been growing at a steady pace and around trend. Exports had improved across professional services, such as legal and accountancy, where firms had provided support for foreign investment. Demand for UK expertise on foreign projects had also been strong, notably in IT consultancy. Business conference attendance by overseas visitors had also picked up. The stronger global economy was boosting demand for support services provided by shipping ports, and for engineers to assist with equipment installation overseas, for example in the mining sector. By contrast, demand for oil and gas services had yet to materially improve, despite some recovery in oil prices. Within consumer services exports there were signs of slower growth in tourism following strong growth rates last year.

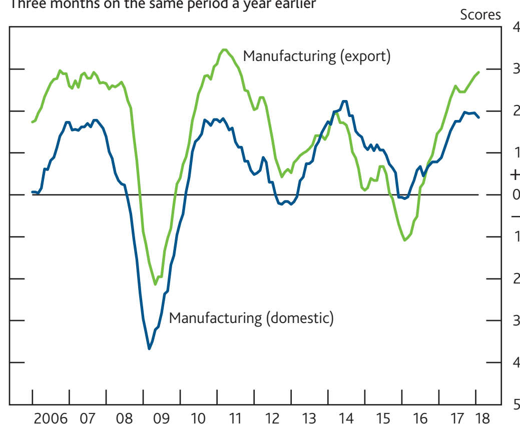
Production

Domestic manufacturing output growth had eased slightly and remained modest (**Chart 3**). Manufacturers involved in export supply chains continued to report the strongest growth, especially for engineered products and equipment. A very modest pickup in activity had been reported in the oil and gas sector. There was evidence that substitution away from imports had provided some benefit to firms in soft furnishings and brewing. And growth remained positive for those supplying automotive components and housebuilding materials. Packaging suppliers reported buoyant demand, in part supported by continued growth in online retailing. They also reported a shift away from plastics to more environmentally friendly materials.

Growth in export volumes of manufactured goods had remained strong (**Chart 3**), supported by the pickup in global activity as well as by the past depreciation of sterling. Demand from the EU had picked up further, with little sign to date of customers switching away from UK suppliers. However, as products were often tied to multi-year supply contracts and model runs, there was a risk this would impact growth in the future. Higher global commodity prices had also supported demand for mining equipment to increase capacity from

Chart 3 Manufacturing output

Three months on the same period a year earlier



commodity-exporting countries such as Australasia. Demand from the Middle East, however, was more mixed. Exports of high value-added products in the pharmaceuticals, aerospace and automotive sectors generally continued to perform strongly.

Construction

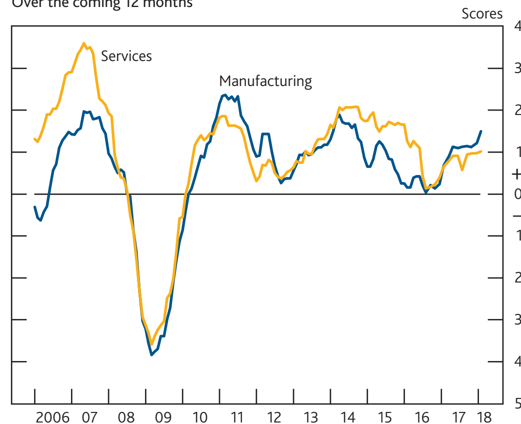
Construction output growth had slowed modestly, suggesting activity was only a little higher than a year ago. Housebuilding remained the strongest segment, although growth in that sector had slowed too. Within the commercial sector, there had been continuing demand for construction of logistics and warehouse premises but much less demand for retail space. Infrastructure activity was falling back as there was not enough new work to replace projects that were finishing, reflecting a combination of slow decision-making and budgetary constraints in the public authorities. There was likely to be a hiatus in some projects following the failure of Carillion, but a lot of this work was being picked up by other firms, including joint-venture partners. Recent intelligence had been consistent with an earlier assessment that the failure of Carillion was likely to have a limited impact on activity, and there had so far been little evidence of a significant impact on the supply chain or on the availability of credit to the sector.

Investment

Overall, investment intentions remained modest and dampened by economic uncertainty. Nonetheless, investment intentions had picked up slightly in manufacturing (**Chart 4**), reflecting expansion by some exporters to cope with strong overseas demand, and by some domestic-facing firms benefiting from import substitution. A few companies were considering investing in infrastructure to gain or maintain Authorised Economic Operator status for UK facilities after EU withdrawal, or setting up new distribution hubs in the EU to protect future access to European markets. A number of firms reported investing in increased automation to relieve recruitment difficulties and improve productivity. Business services firms were investing in their IT and digital capability, refurbishing workspaces to increase flexibility, or considering automation, for example Artificial Intelligence, to improve productivity or create the capacity to focus on higher value-added activities. Investment intentions remained subdued for consumer services firms. Investment in store-based retailing was declining.

Chart 4 Investment intentions

Over the coming 12 months



Corporate financing conditions

Overall growth in demand for corporate credit remained relatively subdued, reflecting high corporate cash balances built up in recent years and a persistent aversion to gearing following the financial crisis. However, there was some demand among firms to borrow to facilitate growth and enhance efficiency. For the majority of contacts access to bank and non-bank finance was not reported as a constraint on business. Competition among lenders for creditworthy borrowers remained intense, reflecting a greater appetite among incumbent banks, competition from challenger banks and growth in non-bank finance. But banks' lending appetite had softened towards areas of perceived risk, such as store-based retail, consumer goods wholesalers, car dealerships and care services, where there had also been reports of financial stress. There were signs of a small increase in corporate financial distress, with many contacts reporting greater demand for extended payment terms.

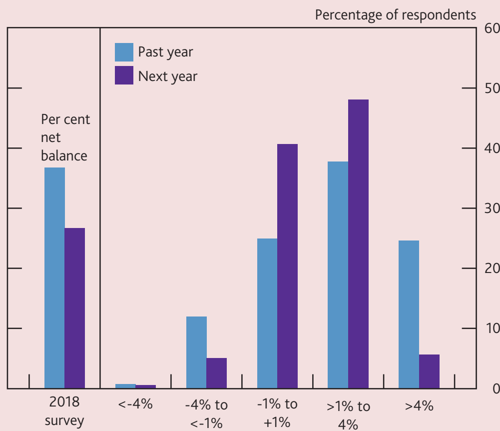
Following Carillion's collapse, contacts expected tighter credit conditions in construction and facilities management — especially for cash flow and working capital. So far, there had been little distress reported by Carillion's suppliers, supported in part by an accommodative stance from UK banks.

Box 1
Survey: corporate pricing

The Agents surveyed business contacts about the factors affecting their output prices over the past 12 months and over the next 12 months, and the time profile of the pass-through of higher import prices into output prices that they expected to achieve. A total of 308 businesses responded to the survey, employing 435,580 staff and with a combined UK turnover of £70.3 billion. The survey results were weighted by turnover.

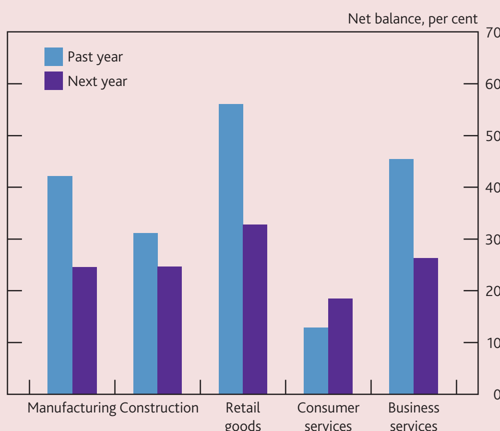
Overall, firms expected output price inflation to fall back in 2018 (**Chart A**), and this was the case for all sectors except consumer services (**Chart B**), reflecting easing pressure from import price inflation (**Chart C**).

Chart A Price changes in the past and next year(a)



(a) Double-weighted by turnover.

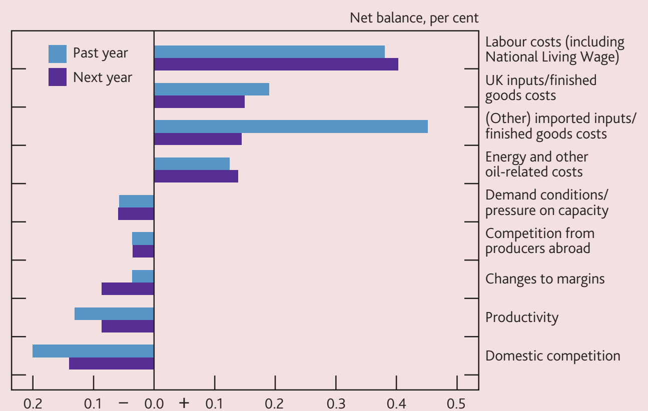
Chart B Sector prices changes in the past and next year(a)



(a) Weighted by turnover.

Among the factors driving pricing decisions, labour cost inflation was expected to contribute slightly more to output price inflation in 2018 than in 2017, consistent with the pickup in pay growth indicated by the Agents' survey on pay in January.

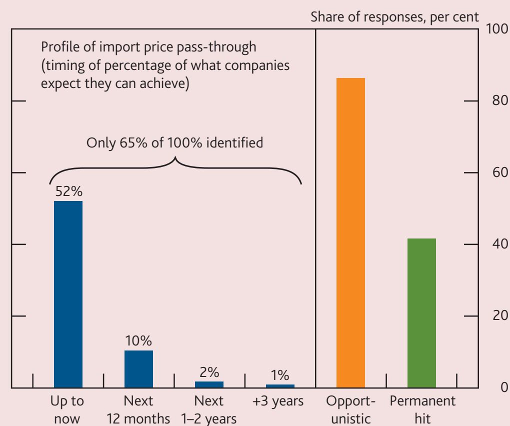
Chart C Factors expected to affect changes in prices next year relative to factors that affected prices in the past year(a)



(a) Double-weighted by turnover.

Respondents who had experienced higher import prices were asked to estimate the time profile over which they expected to be able to pass through these higher input costs (**Chart D**). Firms responded that they had so far been able to pass through 52% of what they expected to be able to pass through in total, with a further 10% expected to be passed through over the coming year and a further 3% beyond that — a total of 65%. This means they were unsure of the time horizon over which they would be able to pass through the remaining 35% that they expected to be able to pass through.

Chart D Import price pass-through profile, opportunists and expected permanent margin hit(a)(b)(c)



(a) Blue bars show the double-weighted average responses over four-time horizons.
(b) Orange and green bars show the proportion of respondents that expected to opportunistically pass-through more if conditions allowed and expected a permanent hit to their margins respectively.
(c) All percentages are relative to the population who responded to this question.

Some 86% of respondents said they would pass through 'if conditions allowed' (the 'opportunistic' in **Chart D**) and around 40% of respondents expected to take a permanent hit on their margins. Along with the 'unallocated 35% pass through' these answers suggest that residual inflationary pressure from earlier import price inflation remains. The survey's findings are broadly consistent with data from the Decision Maker Panel Survey (see Box 2).

Property markets

Commercial real estate

Capacity in the UK commercial real estate market had tightened, reflecting a lack of properties coming onto the market combined with a modest rise in demand from investors. Investor demand was becoming slightly more focused on higher-quality assets, such as prime industrial, office and retail premises.

Across the UK, there continued to be appetite from foreign investors, most notably from Asia. In London, however, many institutional investors continued to view the market as overvalued, and were less active as a result.

Valuations on distribution sheds and warehouses had continued to increase in response to the shift towards online retail. Investor demand for office space had been mixed. New and more flexible ways of working have been leading to greater occupier demand for smaller office premises, rendering older buildings less attractive. The lack of new office stock, however, had helped to support valuations. Occupier demand for prime retail space had remained decent. However, in secondary retail property, investor demand had continued to decline, reflecting the challenging retail environment.

Housing market

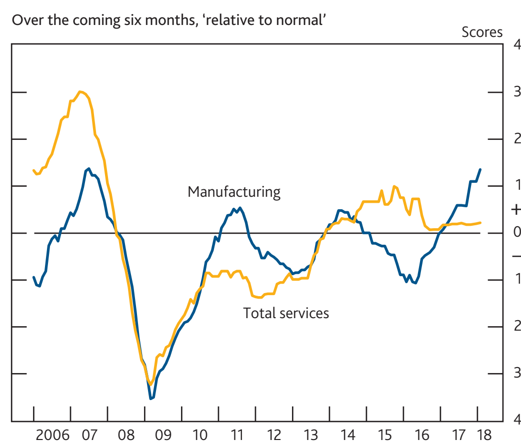
The housing market had been subdued overall, with both demand and supply weak, and activity steady at relatively low levels. In the secondary market, estate agents had continued to report that lack of stock was their biggest challenge. Rather than generating significant house price inflation, this had tended to depress already muted demand by limiting choice for prospective buyers. Demand for new-build property was relatively robust, remaining heavily supported by the Help to Buy scheme. Housebuilders had reported a good start to 2018. Output from smaller builders was increasing, although there were a few reports of supply-side constraints biting on activity. In relatively buoyant markets, such as the Midlands and North West, prices were typically rising by up to 5% a year. The market in London and the South East remained weak, with prices relatively flat and greater discounting needed to secure sales. The strong rental market was stimulating further investment in build to rent, especially in cities such as Manchester and Birmingham, and rents were rising steadily.

The mortgage market remained highly competitive, with activity dominated by remortgaging as existing homeowners looked to lock-in low fixed-rate deals in anticipation of further interest rate rises. Although demand from movers remained muted, there was strong demand for loans from first-time buyers. Intense price competition for standard mortgage products was driving some smaller lenders, notably building societies, into more specialist areas such as buy-to-let.

Capacity utilisation

Capacity utilisation in manufacturing had increased, while it remained around normal in services (**Chart 5**). In manufacturing, capacity constraints were beginning to bind among exporters, producers of capital goods, automotive suppliers and chemicals processors. Investment in equipment was delivering additional capacity for some, but others had been deterred from large-scale investment by Brexit-related uncertainty. In services, constraints were easing in the hotel, distribution and warehousing sectors as new capacity was added, and there remained considerable excess supply of physical retail space.

Chart 5 Capacity utilisation



Employment and pay

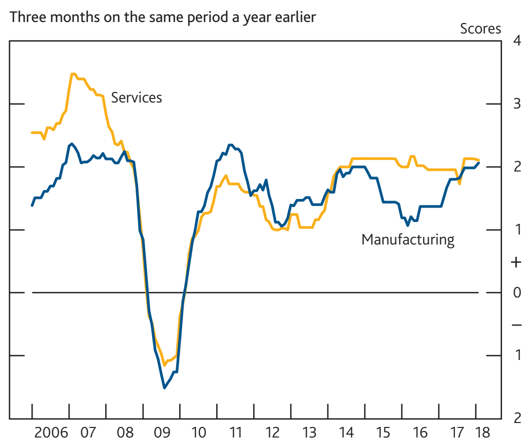
Overall employment intentions were little changed, with the picture remaining one of modest headcount growth. But the outlook within sectors had altered slightly. Intentions in business services had picked up slightly, reflecting stronger activity in areas such as accountancy, legal and logistics. In contrast, employment intentions in consumer services had edged down a little due to cost-cutting in retail amid slowing consumption growth, rises in the National Living Wage (NLW), pension auto-enrolment contributions, and the shift towards online retail. Manufacturing intentions had weakened marginally but remained positive. Headcount growth had been driven primarily by exporters but offset to a degree by a slightly weaker employment outlook within some domestic-facing sectors.

Recruitment difficulties had remained elevated and were one of the primary concerns raised by many contacts. In a small but growing number of cases, the inability to fill positions was constraining growth. The list of regularly reported skill shortages was broadening out from construction, engineering, software development, professional services and logistics to hospitality, warehousing, agriculture and food. This often

reflected the reduced availability of EU migrant labour on which such sectors are heavily reliant. Overall, there had been relatively few issues with staff attrition, although it was reported to be driving up wages in some sectors, including construction and accountancy.

Growth in total labour costs had remained modest, although average pay settlements this year were a little higher than in 2017 for many contacts (**Chart 6**). Most settlements were between 2½%–3½%, driven by a combination of improved profitability among exporters, the annual NLW increase and higher consumer price inflation. Where higher awards had been made, contacts said this was for the recruitment or retention of key staff or skills. Often employers and staff considered the broader reward package, including non-pay elements, such as flexible working and healthcare, which allowed some companies to limit pay increases. Growth in total labour costs was expected to be boosted this year by an increase in the minimum auto-enrolment pension contribution.

Chart 6 Total labour costs

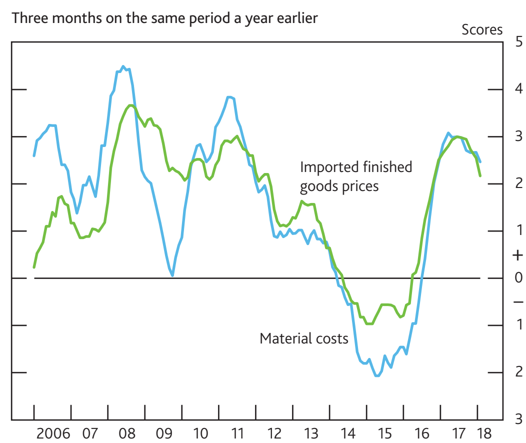


Pricing

Supply-chain pricing

The inflationary impact of sterling's depreciation on input and imported finished goods costs was widely regarded as having peaked (**Chart 7**). One exception to this was in energy, where widespread forward-contracting meant there was further pass-through to come. Moreover, although the effect of sterling's depreciation had waned, price rises in a range of commodities, notably oil and metals, were now affecting materials cost inflation. Further down the supply chain, firms facing commodity price rises saw this as an opportunity to renew pressure on customers for fuller recognition of the import cost inflation they had borne to date. By contrast, in markets where there was excess capacity, such as retail, contacts were pushing suppliers for cost reductions with a view to reversing past price increases.

Chart 7 Raw materials costs and imported finished goods prices



In business services, there had been signs of slightly higher inflation in fees for specialist skills and for service providers that employ a high proportion of staff on the NLW, for example cleaning firms. But there was intense price competition among other more commoditised services, such as audit, exacerbated by the trend towards automation and offshoring of some services.

Consumer prices

Agents' scores for consumer price inflation had inched down but remained elevated. However, contacts expected consumer price inflation to abate over the coming 12 months, especially for imported products such as clothing and cars, as the effect of sterling's depreciation wanes. Contacts described conditions as challenging, particularly for supermarkets and sectors with a high online presence, and so there was little opportunity to rebuild margins. Consumer services firms had been able to implement small price rises in order to partially recoup cost increases.

Box 2
Results from the Decision Maker Panel Survey

Overview

Together with academics from Stanford University and the University of Nottingham, the Bank has developed the Decision Maker Panel (DMP) Survey to help monitor the implications for UK businesses of the United Kingdom's withdrawal from the European Union.(1) The Survey provides direct insight into businesses' expectations, complementing the broader intelligence gathered from Bank Agents' contacts.

The panel comprises Chief Financial Officers (CFOs) from small, medium and large UK companies operating in a broad range of industries. It is designed to be representative of the population of UK businesses, with only a small number of sectors, such as finance, being excluded. Over 3,000 members were part of the panel at the time of the February DMP Survey. The average monthly response rate has been around 50% since the DMP was launched in August 2016.

Aggregate-level data from the DMP Survey are available on the Bank's website.(2)(3) This box summarises the latest findings.

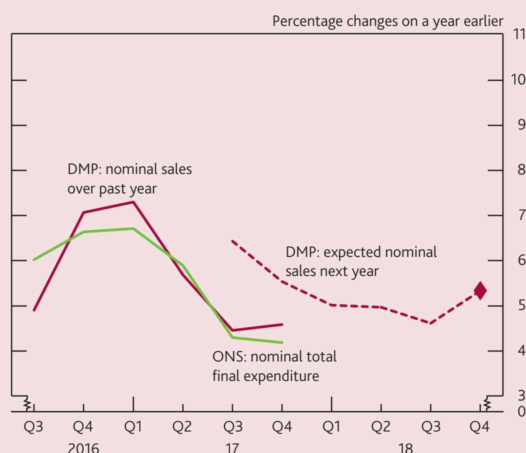
Sales expectations

Average four-quarter growth in nominal sales among panel members has slowed during the course of 2017 from 7.3% in 2017 Q1 to 4.6% in Q4 (solid red line on **Chart A**). Sales growth in the second half of 2017 was lower than expectations reported in 2016 H2 (as shown by the solid red line on **Chart A** being below the dashed red line). Reported nominal sales growth from the DMP closely corresponds to aggregate total final expenditure from the National Accounts, which is the nearest equivalent measure (solid red line versus the green line on **Chart A**), indicating that the DMP data are providing a representative view.(4)

Panel members expect a modest strengthening in sales growth over the next year. Annual nominal sales growth is expected to pick up from 4.6% in 2017 Q4 to 5.3% in 2018 Q4 (shown by the red diamond on **Chart A**).

External factors appear to have been an important factor in explaining recent trends in sales growth. **Chart B** shows that companies who export experienced higher sales growth than domestically focused firms in 2017 H1. That is likely to reflect the exchange rate depreciation boosting the growth of nominal exports. Among exporters, sales growth in 2017 H1 was slightly stronger for companies whose largest export market is outside of the EU than for those who export more to the EU. In the second half of 2017, the nominal sales growth of exporters has slowed as the effects of the exchange rate have begun to dissipate, although exporters still reported annual sales growth around a percentage point higher than domestic firms in 2017 Q4. A similar difference is expected to persist over the year to 2018 Q4.

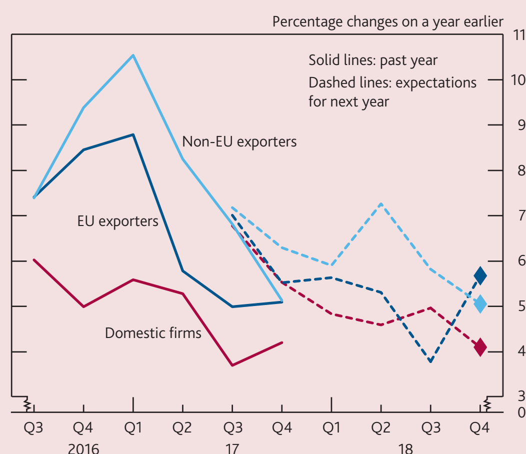
Chart A Realised and expected growth in nominal sales(a)



Sources: DMP, ONS and Bank calculations.

(a) Questions about sales refer to the last complete quarter. Data for year to 2017 Q4 and expectations for year to 2018 Q4, shown by the diamond, are based on responses for one third of the sample that were collected in February only.

Chart B Realised and expected growth in sales of exporters and non-exporters(a)



Sources: DMP and Bank calculations.

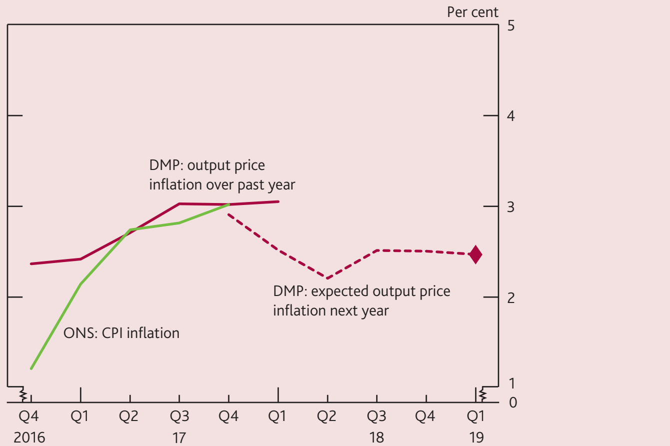
(a) Data for year to 2017 Q4 and expectations for year to 2018 Q4, shown by the diamonds, are based on responses for one third of the sample that were collected in February only. Firms that did not sell abroad prior to the EU referendum are defined as domestic companies. EU and non-EU exporter definitions are based on largest export market prior to the EU referendum.

Price expectations

DMP members reported that annual output price inflation rose slightly to 3% in 2018 Q1, but they expect inflation to slow to 2.5% over the year ahead (**Chart C**). An easing in output price inflation is consistent with the results from the Agents' latest pricing survey reported in Box 1.

(1) This project is supported by the Economic and Social Research Council (grant number ES/P010385/1).
(2) For details on the methodology, see www.bankofengland.co.uk/quarterly-bulletin/2017/q2/tracking-the-views-of-british-businesses-evidence-from-the-dmp. All results are weighted.
(3) For aggregate data and details on questions asked to panel members please refer to the Bank of England website; www.bankofengland.co.uk/-/media/boe/files/statistics/research-datasets/dmp-results-march-2018.xlsx.
(4) Total final expenditure is defined as GDP before imports are deducted.

Chart C Realised and expected output price inflation(a)

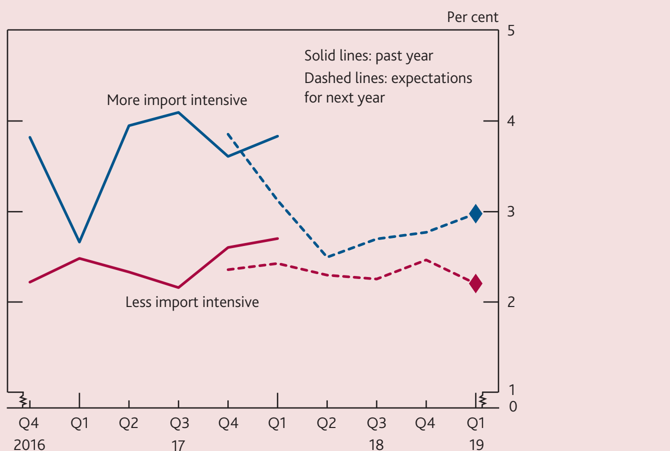


Sources: DMP, ONS and Bank calculations.

(a) Data for year to 2018 Q1 and expectations for year to 2019 Q1, shown by the diamond, are based on responses for one third of the sample that were collected in February only.

The main reason why companies expect output price inflation to fall appears to be a diminishing effect from imported cost pressures. **Chart D** shows that companies who rely more on imported goods and services have seen larger price increases over the past year than firms who are less reliant on imports. However, this difference is expected to narrow over the next year as price inflation is expected to fall back by more for more import-intensive companies.

Chart D Realised and expected output price inflation for more and less import-intensive companies(a)



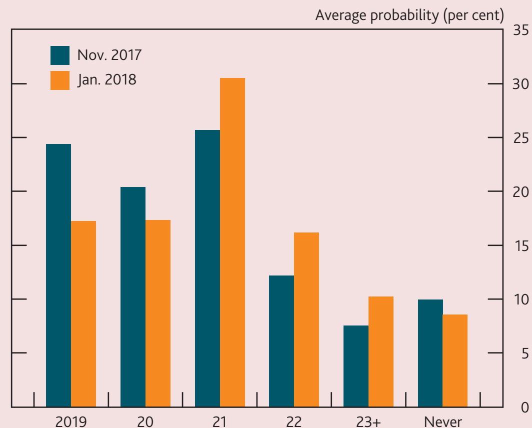
Sources: DMP and Bank calculations.

(a) Data for year to 2018 Q1 and expectations for year to 2019 Q1, shown by the diamond, are based on responses for one third of the sample that were collected in February only. Firms for whom imports accounted for more than 20% of total costs prior to the EU referendum are defined as more import intensive (around 30% of the sample). The remainder are defined as less import intensive.

Planning ahead of Brexit

To help better understand the scenarios that companies are basing their planning for Brexit on, DMP members have been asked when they think that the UK will leave the EU, after taking into account any transition period. **Chart E** shows how companies attach probabilities to a wide range of possible

Chart E Expected timing of EU withdrawal after any transition period(a)



Sources: DMP and Bank calculations.

(a) Question: 'What do you think is the percentage likelihood (probability) of the UK leaving the EU (after the end of any transitional arrangements) in each of the following years?'. One third of the panel were asked this question in November 2017 and the remaining two thirds were asked in January 2018.

outcomes, indicating that they are very uncertain about how Brexit will be implemented. In November 2017, the highest probabilities were attached to the UK leaving the EU in 2019 and 2021. However, the results in January 2018 were a little different, with companies attaching more weight to the UK leaving in 2021 and less in 2019, indicating that the December summit of EU leaders had some impact on companies' views about when the UK will leave.(5)

In February, panelists were also asked a slightly different question about the probability that they attached to a disorderly Brexit where no deal is reached in negotiations by the end of March 2019. The median probability of a disorderly Brexit was 40%.(6)

Table 1 Number of hours a week spent on preparing for Brexit (share of respondents)(a)

	CEO	CFO
None	41%	38%
Up to 1 hour	37%	39%
1 to 5 hours	14%	18%
6 to 10 hours	3%	3%
More than 10 hours	1%	1%
Don't know	4%	2%

Sources: DMP and Bank calculations.

(a) Question: 'On average, how many hours a week are the CEO and CFO of your business spending on preparing for Brexit at the moment? Please select one option: i) None, ii) Up to 1 hour, iii) 1 to 5 hours, iv) 6 to 10 hours, v) More than 10 hours, vi) Don't know'. One third of the panel were asked this question in November 2017 and the remaining two thirds were asked in January 2018.

(5) The differences for 2019, 2021 and 2022 were statistically different from zero at 5% significance level as indicated by a two-sided t-test.
(6) This figure is based on responses for one third of the sample that collected in February. The exact question was: 'What probability, in per cent, do you attach to a disorderly Brexit, whereby no deal is reached by the end of March 2019?'.

As well as being asked about the outcomes that they expect, companies have also been asked about the amount of time they are spending on preparing for Brexit. Panel members were asked how many hours a week, on average, the Chief Executive Officer (CEO) and CFO in their business are currently spending on preparing for Brexit. Around 40% of CEOs and CFOs are spending no time preparing for Brexit, with a further 40% spending no more than one hour a week (**Table 1**). However, for around 20% of respondents it is taking up more time. CFOs and CEOs in larger or exporting companies tend to spend more time preparing for Brexit compared to executives of smaller and non-exporting firms.