Agents' summary of business conditions - 2023 Q1

We regularly publish a summary of reports compiled by our 12 regional Agents following discussions with at least 700 businesses across the UK every reporting period.

Demand and output

Economic activity was subdued overall, but demand was more resilient than expected in some sectors.

Employment and pay

The labour market remained tight and pay settlements stayed at around 6%.

Costs and prices

Input cost and output price inflation eased for some goods and sectors, but upside risks remain.

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Content

Overview

This publication summarises intelligence gathered between mid-January and early March. The Agents' scores published alongside this document generally represent developments over the past three months compared with a year ago.

Economic activity remained subdued overall: output in the manufacturing and construction sectors contracted, while demand for business services held up. Contacts said consumer demand was more resilient than they had expected, in particular for services.

Employment intentions overall remained flat and most firms said that if demand weakened they would respond by reducing hours or via attrition, rather than by making staff redundant. Recruitment difficulties eased further, though remained above normal.

Pay settlements continued to average 6% – in line with the Agents' pay survey, published in the **February 2023 Monetary Policy Report**. Some firms anticipated that pay settlements in 2023 H2 would be lower than in 2022.

Inflationary pressure from raw materials and tradable goods prices as well as from UK manufactured goods abated further as energy and commodity price inflation eased and supply-chain issues faded. Consumer goods and services price inflation also slowed, though contacts said that risks remained to the upside.

Consumer spending

> **The nominal value of consumer spending continued to grow even as inflation eased, supported by demand that was more resilient than expected, in particular for consumer services.**

Contacts reported solid demand for lower-priced goods, as consumers traded down from higher and mid-priced ranges. Demand for energy-efficient goods also remained robust.

Supermarket contacts continued to report customers switching down to the discount chains, as well as customers doing more frequent shops and spending less per visit, reflecting continuing pressure on household incomes.

Clothing and footwear retailers reported having increasingly to resort to discounting, with shoppers trading down to cheaper items.

Demand for durable goods, such as furniture, furnishings and household appliances continued to weaken, and contacts reported that consumers were choosing to repair rather than replace items. By contrast, contacts said demand for new and used cars was holding up well.

Contacts in the hospitality sector said that demand had been better than expected, and price increases had also continued to support revenue growth.

In the travel sector, firms said that accommodation bookings for the summer holiday season were broadly in line with last year's strong levels, though bookings were being made somewhat later than usual, and there were ongoing concerns about the strength of demand in off-peak periods.

Business services

Growth in business services turnover held up overall, but demand was mixed within the sector.

Companies in audit, IT and insurance reported robust volume and price growth. And firms specialising in corporate events, travel, office furniture and equipment, insolvency and debt restructuring reported modest growth. Exports of services also grew, in particular for construction and financial services.

By contrast, contacts that specialise in mergers and acquisitions and other corporate transactions said activity continued to decline. Companies in logistics and wholesale that are exposed to consumer-facing firms also reported weaker demand, as did firms offering recruitment and advertising services.

Manufacturing

Manufacturing output continued to fall, as the squeeze on households' real incomes weighed on demand for goods.

Contacts reported a modest contraction in output volumes compared with a year ago, in particular for durable goods, such as furniture household appliances and home improvement products.

Food and beverage producers said that while output volumes were stable, consumers' preference for cheaper products was weighing on revenues. Demand for construction products also fell and car production remained subdued.

However, some sectors, such as aviation and defence, continued to report strong growth, and machinery and equipment producers said output was supported by order backlogs.

Contacts reported that supply chains were returning to normal, though lead-times remained above pre-Covid levels.

Goods exports volumes were flat on the year, with increased demand from the US and China for machinery parts and consumer goods partially offset by weaker demand from the EU.

Construction

> **Construction output volumes contracted further, driven by softer demand for housing and as higher costs continued to weigh on activity.**

The fall in output volumes compared with a year ago came as larger house builders slowed build rates in response to weaker demand. Construction of social housing also weakened. Contacts said rising costs and delays relating to planning and utility connection continued to constrain output. And spending on home improvements also fell, reflecting squeezed household incomes.

Construction of office and commercial property continued to be weak, though demand for office refurbishment remained good. And most public infrastructure projects were reported to be going ahead as planned.

Investment

> **Investment intentions improved as uncertainty about the economic outlook diminished slightly, and companies sought to improve efficiency.**

Contacts said investment decisions were motivated by a desire to increase automation in light of high labour costs, and to improve energy and production efficiency to counter high energy price inflation. This was particularly the case for manufacturing firms, some of which also reported investing in research and development.

Companies in business and financial services often mentioned increasing digitisation to improve operational efficiency and competitiveness.

Some contacts in transport and infrastructure reported increasing investment to replace worn or leased assets, in some cases catching up on previously planned investment that had been delayed.

By contrast, the investment outlook was more uncertain among consumer services firms, though around half of contacts reported increasing investment for example in IT, automation, refurbishment and vehicles.

Contacts in the construction sector were also more cautious about investment, particularly in plant and machinery, due to higher costs, availability of equipment and financing conditions.

Corporate credit conditions

> **Demand for credit remained weak as firms sought to reduce leverage; credit was readily available to firms with strong financial positions.**

Contacts said demand for credit was subdued, reflecting higher borrowing costs and the uncertain economic outlook, which encouraged some companies to pay down debt.

Credit was readily available for companies in strong financial condition, even in sectors that were more exposed to uncertainty, such as hospitality.

For lower-rated firms, access to credit remained weak. Small and medium-sized firms were generally able to access credit for working capital or equipment purchase, but conditions were still reported to be tight for activities such as property investment or corporate acquisitions.

Contacts said that insolvencies had risen among the smallest firms, though there was only a modest deterioration in credit quality among medium-sized and large firms.

Employment and pay

> **Employment intentions remained flat as activity held up a little better than expected, while recruitment difficulties eased but remained above normal. Pay settlements averaged 6%.**

Contacts expected to keep headcount stable over the coming year and most said that if demand fell they would reduce hours or allow headcount to fall through attrition rather than make redundancies. Only a few firms said they planned to cut jobs, while a sizable number of companies planned to expand their workforce, either due to higher demand (for example in professional services, IT and in some parts of manufacturing) or to address labour shortages (in particular in hospitality, travel and tourism).

Companies said recruitment difficulties remained elevated, though they had continued to ease slightly, and staff turnover had slowed. However, recruitment and retention remained a challenge for many firms, and labour shortages continued to constrain output in professional services, IT, engineering, hospitality and healthcare.

Pay settlements for 2023 continued to average 6% – consistent with the Agents' pay survey published in the **February 2023 Monetary Policy Report**. Contacts said pay awards were mostly driven by current or past rates of consumer price inflation, though recruitment and retention issues, increases in the National Living Wage and Real Living Wage, and union activity also influenced settlements.

However, some companies with pay reviews due in the second half of this year thought that pay settlements could be lower than last year, reflecting lower inflation and a looser labour market. There were also fewer reports of companies making one-off payments to compensate employees for the higher cost of living.

Costs and prices

> **Input cost inflation continued to ease for some goods, though risks remain on the upside in some sectors, in particular those where labour costs are elevated.**

Input cost inflation continued to abate, reflecting a levelling off in commodity prices and easing demand for some tradable goods, which also weighed on prices. In addition, there was a substantial fall in freight rates.

Consequently, manufacturing output price inflation also eased further. Contacts said they had passed on most of their increased costs, and that price increases in the second half of 2023 were likely to be much smaller than a year ago.

For business services firms, fee inflation remained elevated, reflecting rising staff costs – particularly in professional services, IT and insurance. But fee inflation was more muted in property-related services, and prices for transport services fell.

Contacts said food price inflation had picked up to around 17% and was likely to subside only gradually this year, as past increases in the cost of agricultural commodities continue to be passed through, as well as labour costs and margin rebuild. Prices of durable goods, such as household appliances and furniture, slowed and contacts said they expected to have to use promotions and discounting to stimulate demand this year.

Consumer services inflation eased slightly, but remained elevated in some sectors, such as accommodation, catering and leisure as firms passed through some of their higher labour, energy, food and services costs. Even so, profit margins remained squeezed for many in the sector.

Property markets

Housing market activity improved slightly but remained weak; commercial property transactions remained subdued.

Housing market

Contacts reported a modest pick-up in secondary market activity and requests for valuations but said that demand was broadly equal to the supply of properties available.

House builders reported scaling back construction plans and said they were having to offer more incentives to secure sales. Buyers were reported to be opting for smaller properties due to higher borrowing costs.

In the rental market, contacts said supply continued to contract, as smaller buy-to-let landlords continued to exit the market, while demand for rental properties continued to rise, leading to double-digit rent inflation.

Commercial real estate

Transaction volumes for investor purchases were reported to be significantly lower compared with a year ago, reflecting uncertainty about valuations and increased funding costs. However, contacts expected valuations to level off in 2023 H2, which they said should help to boost transaction volumes.

Contacts said investor demand to finance development was focused on certain types of property, such as laboratory premises and elderly care homes – which were considered likely to yield high rates of rental growth over the medium term; ‘green’ projects – in particular office buildings in prime city locations, and conversion projects, particularly from retail and office to residential use.

Contacts said lender forbearance was expected to limit the extent of distressed sales and therefore the impact on broader values, in particular for properties in retail, hospitality and leisure.

Outreach engagement

Concerns over high inflation were still elevated among members of the public. Charities supporting those with debt issues were seeing an increase in low-income households unable to cover their bills and food costs, even after intervention.

Cost of living concerns dominated discussions with members of the public. Those on low or fixed incomes were particularly aware of the high cost of energy, food and transport. People had made a range of behavioural changes, including to spending, saving and employment decisions.

Charities supporting those suffering financial hardship had been particularly busy. There had been a shift since the turn of the year from helping people to manage bills to dealing with problem debts. Mortgage repayments were being raised as a concern by some households. Charities noted that many clients did not have the income to cover their living expenses, even after intervention. They reported that those in work were becoming more dependent on loans, credit cards, overdrafts and 'buy now pay later' schemes to try cover their monthly shortfall. Some smaller third sector organisations were reported to be increasingly dependent on loans to continue operating.

More details can be found in the recent **Outreach report**.

Related contents and downloads

Latest results from the Decision Maker Panel survey – 2023 Q1

One year ahead CPI inflation expectations have fallen from a peak of 9.5% in September to 5.9% in February.

Next publication date 22 June 2023

Bank of England Agents' scores (XLSX 0.9MB)

Definitions for the Agents' scores