Agents' summary of business conditions - 2021 Q3

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

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Output continued to rise overall, but was constrained by materials and labour shortages in some sectors

Labour shortages became more widespread and acute; pay settlements crept up

Growing reports of rising costs being passed through to prices; some costs seen nearing their peak

Content

Overview

This publication summarises intelligence gathered by the Bank's Agents between mid-July and early September.

The Agents' scores published alongside this document generally represent activity over the past three months compared with a year ago. During the early stages of the pandemic in 2020, the Agents' scores fell sharply, reflecting the unprecedented declines in economic activity.

In recent months, some of the Agents' scores have rebounded sharply. In most cases this reflects a combination of recovery in economic activity and comparison with low levels of activity a year ago.

Consumer demand

Consumer spending continued to grow, supported by online sales and domestic tourism.
Contacts reported continued growth in retail sales following the reopening of non-essential stores around the UK, though footfall was still markedly below pre-pandemic levels. Online spending remained robust.

Spending on household goods and furniture, sports and outdoor equipment, technology and jewellery was particularly strong, as were sales of used cars and new car orders. However, supply-chain issues such as materials shortages and haulage bottlenecks were reported to be restricting the availability of some goods – such as furniture, new cars and electrical items – resulting in longer lead times. Some contacts reported being obliged to streamline product ranges as a result of shortages, and some expressed concern about the impact of supply-chain issues on the availability of goods in the run-up to Christmas.

Contacts also said that demand for footwear and clothing was starting to pick up – possibly in response to the reopening of the hospitality sector, and as people prepared to return to office working.

Supermarket food sales were slightly lower than a year ago, but remained significantly above pre-pandemic levels, possibly reflecting consumers spending more time in the home.

In the services sector, contacts in hospitality and leisure reported record levels of demand in July and August, particularly in coastal and rural locations, boosted by staycation effects.

By contrast, contacts in large cities said demand remained very subdued due to a lack of international tourists. Bad weather in some parts of the UK over the summer had also kept some customers away, though in general contacts operating outdoor attractions reported stronger demand than those running indoor activities, such as gyms and bingo halls.

Personal care businesses, such as hairdressing salons, reported sales returning to more normal levels following an initial boost after restrictions were lifted.

Business and financial services

Business services activity grew at a broadly steady pace, some contacts turned down business due to staff shortages.
Contacts in accountancy, legal and consultancy continued to report good levels of demand across a range of activities including for employment, corporate finance and mergers and acquisitions. Some of that business had been delayed from last year. Demand for IT services continued to be strong, in particular activity related to remote working, cyber security, and digital infrastructure. Recruitment consultants also reported strong levels of activity, though many said that a lack of candidates was constraining business.

Many contacts in these sectors reported activity being back at or even exceeding pre-Covid levels, which resulted in some starting to refuse lower margin work. Contacts in a range of business services said that ongoing labour shortages could constrain growth.

Logistics firms continued to be very busy, with many companies reporting operating close to or at full capacity. This was exacerbated by driver shortages, which some contacts said had resulted in them having to turn work away.

As the hospitality sector reopened, demand for supporting services, such as cleaning, laundry and waste management, increased strongly. Spending on conferences and domestic business travel and accommodation picked up slightly, albeit from a very low base.

Contacts providing services to the construction sector, such as surveyors and property consultants, reported good demand, but some said there had been knock-on effects from construction projects being delayed by material and labour shortages.

Exports of services were constrained by international travel restrictions, which weighed on revenues from overseas tourism and made it more difficult for UK-based companies to provide services abroad, such as maintenance of machinery.

Manufacturing

Demand remained strong, but output growth slowed due to shortages of materials, components and labour.
A combination of strong worldwide demand for goods, global supply-chain issues, transportation issues and labour shortages constrained output and stretched lead times for many contacts, especially in the automotive sector. Contacts also reported lengthening lead times for home furnishings.

Demand for manufactured food products continued to be supported by the easing of restrictions in hospitality, but labour shortages posed challenges in some parts of the industry.

Contacts reported an increase in demand for components used in the repair and maintenance of motor vehicles, trains and ships. Others noted that long lead times and shortages of materials for the construction industry were exacerbated by some companies stockpiling materials.

Supply-chain issues were reported to have constrained growth in exports. And there were some ongoing reports of EU customers rotating away from UK suppliers following Brexit, but only limited evidence of UK producers substituting away from EU imports.

Construction

Construction output remained above pre-pandemic levels, but there were reports of materials and some labour shortages limiting activity.
Contacts said activity was above pre-pandemic levels but was curtailed by supply-chain issues that affected the availability of materials and, to a lesser extent, by labour shortages. As a result, there were some reports of companies having to turn down work.

Construction of private housing remained strong, with home improvement and repair and maintenance activity also supporting output. However, contacts said that materials shortages were causing delays to projects being started and completed.

Private commercial development activity was mixed: demand was weak among sectors that had been adversely affected by the pandemic, such as retail, hospitality and higher education, where construction activity was mostly focused on essential repair and maintenance work. By contrast, construction activity was strong in logistics and warehousing and IT-related sectors. There were some signs of demand increasing for office refurbishments.

Public infrastructure projects continued to support construction output, but there were reports of some delays in contracts being awarded, while budget constraints weighed on demand from local authorities.

Contacts said that order books in general were strong, but uncertainty over materials costs and shortages were deterring some construction firms and clients from competing for tenders or from putting out contracts to tender, which could weigh on future output.

Capacity utilisation

Materials and labour shortages constrained supply in some sectors, but sectors most affected by Covid reported that they had spare capacity.
A growing number of contacts reported activity being constrained, by labour shortages as well as by shortages of materials and components.

Contacts said that the shortage of drivers was particularly acute and had deteriorated over the past couple of months, resulting in product shortages at supermarkets and in restaurants. Staff shortages were also affecting the hospitality and construction sectors, though absences due to Covid-related self-isolation were reported to have eased since mid-August, following a change in government guidance.

In addition to staff shortages, contacts in manufacturing and construction reported output being constrained by shortages of raw materials, components and finished goods, partly due to shipping delays and a surge of Covid cases in some other countries. As a result, lead times had lengthened considerably and in some cases contacts had been forced to reduce production, for example in the automotive sector.

Manufacturers of household goods reported operating at full capacity, resulting in longer lead times for products. But contacts said they were reluctant to increase capacity as they expected demand to return to more normal levels eventually. However, contacts in some other sectors expected demand to increase so were trying to address supply shortages.

A number of contacts said they expected skills shortages to persist – in particular for haulage drivers – as training and other measures aimed at addressing shortages were likely to take time to have any effect. Contacts in some sectors were also concerned that materials shortages could persist for some quarters, especially if Covid cases rise in countries that were important exporters of goods, affecting their supply.

Some contacts reported that they still had significant amounts of spare capacity, however, including companies reliant on business from overseas tourism, corporate travel or office commuters.

Investment

Investment intentions continued to be positive, supported by new spending as well as paused projects being reinstated.
In manufacturing, contacts reported investing in automation, upgrading machinery and in research and development. In some cases, this was to address skills and labour shortages, though some contacts said that labour and materials shortages and the associated cost increases had caused delays and revisions to investment projects.

In business services, investment was mostly focused on technology, such as back-office systems relating to human resources, finance and resource management and cloud service provision. In addition, contacts continued to invest in facilitating remote working. Some contacts increased investment in office refurbishment as employees returned to onsite working.

In consumer services, strong demand since social distancing restrictions were lifted had encouraged companies to resume investment plans that had been put on hold during the pandemic. However, some contacts in sectors that continued to be adversely affected by Covid continued to limit investment to essential repair and maintenance. And some contacts were scaling back investment, having already carried out additional work during lockdown periods over the past 12 months.

Transport contacts that continued to be adversely affected by Covid, such as airports, said they did not expect investment to return to pre-pandemic levels this year, due to weak demand and high costs.

Corporate financing conditions

Demand for new bank credit was subdued, but supply-chain issues and rising input costs have led to increased demand for working capital finance among small companies.

Demand for new bank credit among small companies was reported to have been subdued, reflecting large cash reserves and a limited appetite among firms to take on more debt. Demand for the Government's Recovery Loan Scheme remained subdued.

However, there was strong demand for other forms of credit, such as asset-based finance – in particular among firms in agriculture and construction. There was also increased demand for working capital finance, due to supply-chain issues and the rising cost of raw materials.

Medium-sized and large corporates continued to report strong investor appetite for issuance in debt and equity markets. As a result, demand for bank credit from large corporates remained subdued.

Contacts reported some caution among banks to increase lending to small companies, particularly those with high levels of existing debt, due to uncertainty about the economic outlook. But non-bank lenders that specialise in providing finance to small companies were reported to be re-entering the market. And there was reported to be increased competition among asset management funds in lending to start-ups – in particular to companies in technology, healthcare and life sciences.

Medium-sized companies in stable or growing sectors said that bank credit was readily available. However, contacts in sectors that had been most affected by the pandemic, such as retail, hospitality, travel, construction and office real estate, said that credit availability remained tight. Credit continued to be readily available to large corporates.

Trade credit payment terms were similar to pre-pandemic levels. And contacts said that corporate insolvencies continued to be lower than expected, though some anticipated a pickup when Covid-related government support measures were fully withdrawn.

Property markets

Demand for housing continued to outstrip supply; further recovery in investor demand for commercial property.

Housing market

Agency contacts reported ongoing strong demand for housing and a shortage of properties for sale in most parts of the UK. However, demand was reported to have eased slightly following the end of the property transaction tax holiday.

Demand for homes continued to be supported by homebuyers seeking more living space, an accumulation of savings during the pandemic, and favourable lending conditions, including low mortgage rates and an increased availability of high loan to value mortgages.

Demand for rental property also remained strong in most parts of the UK, causing rents to increase.

Commercial real estate

Investor appetite for commercial property continued to recover, in particular for industrial and logistics-related property, where demand from tenants was also strong. However, contacts reported a shortage of these properties relative to demand because of planning processes and construction sector shortages.

Tenant demand for office space was mixed, as some tenants reassessed their requirements in anticipation of hybrid and remote working continuing in future. There were a few reports of rents easing a little for some types of offices.

Tenant demand for retail property continued to fall, though appeared to be holding up for smaller units in favourable locations. There were increasing reports of larger retail premises, or of premises in secondary locations, being repurposed into housing or leisure developments.

Contacts said that rental arrears were building in the retail and hospitality sectors, which could lead to business failures after the moratorium on commercial property evictions is lifted in late March 2022.

Employment and pay

Employment intentions picked up, and recruitment difficulties increased sharply and became more widespread, leading to some upward pressure on pay.
Contacts in most sectors of the economy reported a pickup in hiring and staff turnover. Demand for staff was particularly strong in professional services, hospitality, logistics distribution and warehousing, construction and engineering. In hospitality, some contacts reported needing to recruit workers to replace furloughed staff who had switched jobs during closed periods.

Recruitment difficulties were reported to have become more widespread and acute in recent months, with contacts reporting increasing numbers of unfilled vacancies. Companies in a wide range of sectors reported severe shortages of staff.

Contacts attributed labour shortages to a combination of factors, such as demand recovering more quickly than expected and having shed too many workers in the early stages of the pandemic. Some companies reported a reduction in the availability of EU workers due to travel restrictions relating to EU withdrawal and Covid. In some sectors, like haulage, an ageing workforce had meant that more workers had left jobs than could be replaced in the short term. And some contacts reported workers switching to jobs that offered better working conditions, more flexibility or greater security.

To address skills shortages, contacts said they were: launching or expanding apprenticeship programmes; hiring remote workers; increasing in-house training; investing in automation; streamlining product lines; increasing hours of existing staff or redeploying staff; and improving non-pay benefits and offering flexible working.

Companies have also increased pay settlements somewhat on average, with awards now typically around 2%–3%. Increases have been significantly higher for skills in particularly short supply, ranging from 10% to 40%. One-off bonuses to retain staff were also reported to have become more commonplace for those with such skills.

Costs and prices

Growing reports of rising costs being passed through to prices, though some costs seen nearing their peak.
Commodity and land, sea, and air transport costs have been increasing for some time. Contacts also reported that costs for a wide range of materials and components were elevated. Such past cost rises were reported to be increasingly passed through into prices. This was particularly the case for supplies for the manufacturing and construction sectors, where customers were more willing to accept higher prices in order to avoid supply-chain disruption.

Some contacts thought that costs for many materials and for container transportation were at or close to their peak, and that some materials prices were starting to reduce. Haulage costs were expected to increase further due to driver shortages and rapid pay inflation, however.

Contacts selling retail goods reported increasing prices of items in high demand – such as household goods – or limiting discounts – such as for some clothing and footwear. Car prices remained elevated. Supermarket contacts expected food price inflation to increase to around 3% by the end of this year.

Overall, reports from consumer services contacts were consistent with moderate increases in prices on average. Many contacts in the hospitality and leisure sector reported increasing prices in response to high demand and rising costs. Looking ahead, price rises could also be driven by a desire to maintain margins, and some would rise when the temporary cut in Value Added Tax is reversed. By contrast, the outlook for prices in some other sectors such as domestic and overseas travel was more uncertain and dependent on demand.

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12%

In the August DMP survey, UK businesses expected sales to grow by 12% on average over the next year.

Sales growth expectations over the next year have improved during 2021 Q2 as final Covid restrictions have eased and the economy has reopened.

Next publication date 16 December 2021

- Bank of England Agents' scores (XLSX 1MB)
- Definitions for the Agents' scores

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