Agents' summary of business conditions - 2022 Q1

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.

Output

Rising costs and supply shortages continued to hold back growth in output; contacts said the Russia-Ukraine conflict had lowered their expectations for growth.

Employment and pay

Labour demand appeared to be stabilising but recruitment difficulties remained intense, pushing up pay settlements.

Costs and prices

Energy and commodity prices picked up further as the Russia-Ukraine conflict escalated; companies expected to raise prices to protect margins.

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Content

Overview

This publication summarises intelligence that was gathered by the Bank's Agents mostly between mid-January and late February – before the invasion of Ukraine. The Agents' scores published alongside this document generally represent developments over the past three months compared with a year ago.

Agency contacts in most sectors reported that demand was strong, and that impacts from the Covid-19 Omicron variant had subsided. However, rising materials and labour costs, and supply shortages continued to hold back growth in output. Contacts said that the escalation of the Russia-Ukraine conflict had lowered their growth expectations, as it was putting further upward pressure on input costs, was expected to exacerbate shortages of some tradable goods, and weigh on sentiment.

Contacts said that they had already begun to see further increases in the price of energy and of some inputs as a result of the conflict. And shortages of certain goods, such as semiconductors, were expected to become more prolonged, due to the importance of Ukraine as a producer of the raw materials required to make them.

Contacts in retail and consumer services said that consumer spending continued to grow at a robust pace. But there were concerns about the outlook for demand over the coming months, as rising energy and goods prices were expected to weigh on households' disposable income.

Companies expected their demand for labour to stabilise, but recruitment difficulties remained intense and the labour market was expected to remain tight throughout 2022. Pay settlements picked up sharply due to recruitment difficulties, higher inflation and the impact from the upcoming rise in the National Living Wage.

In response to increased cost pressures, many contacts said they expected to raise prices to rebuild or protect margins, which on average remain below normal. But the extent to which these cost pressures will become embedded in wages and prices is unclear.

Consumer demand

Consumer spending picked up in early 2022, having weakened in December due to Omicron; contacts expect squeezed household incomes to weigh on demand in the coming months.

Companies reported solid demand for durable consumer goods, such as furniture and household appliances, supported by robust housing market and home improvement activity.

Shopping centre contacts said that customer numbers remained below pre-Covid levels but had increased in recent weeks. Actual spend in shops was reported to have increased, and online sales also remained strong. Demand for new and used cars also continued to be solid.

However, contacts expected demand for goods to ease in the coming months as higher energy and goods prices weighed further on already squeezed household incomes, or if consumers switched to more social forms of consumption.

Supermarket food sales were slightly weaker than a year ago, reflecting base effects from lockdown restrictions in early 2021 which had boosted sales. And sales growth is expected to remain weak in the coming months as consumers begin to socialise and dine out more often.

Indeed, contacts in the hospitality, entertainment and leisure sectors reported a rapid pickup in demand in recent weeks as concerns about the Covid-19 Omicron variant dissipated. Nonetheless, lower-priced pubs and restaurants generally outperformed their mid-market counterparts, possibly reflecting tighter household budgets.

Providers of domestic accommodation were optimistic about staycation demand over Easter and in the summer, though demand among leisure and hospitality venues in major cities was generally lower than in smaller towns and rural locations. And airlines did not expect demand to return to pre-pandemic levels until next year at the earliest.

Business and financial services

Contacts reported robust annual growth in turnover, but said that growth continued to be constrained by labour shortages.

Contacts in professional and financial services reported buoyant demand, supported by corporate transactions. Demand for corporate restructuring work also increased, though insolvencies remained low. Contacts offering advisory services relating to environmental sustainability and property also reported increased activity. Recruitment consultants reported very strong levels of activity, reflecting the tight labour market.

Demand for IT services continued to be strong, with growth held back by lack of staff. Logistics companies said growth was constrained by vehicle shortages, though the shortage of drivers was abating.

Exports of services continued to grow at a moderate pace, supported by the easing of some international travel restrictions. However, revenues from international tourism remained well below pre-pandemic levels.

Manufacturing

Shortages of goods and labour continued to hold back output growth. Contacts were concerned that the war in Ukraine could lead to shortages of some tradable goods.

Manufacturing output grew at a modest pace in the past three months compared with a year ago, with growth constrained by shortages of goods and labour, in particular among manufacturers of automotive and electronic goods. However, most contacts reported strong order books, in particular those in the food and beverage, pharmaceutical, and chemicals sectors. And demand was gradually recovering in the oil and gas and aerospace sectors.

Contacts expected output constraints to persist until the second half of 2022 and, in some cases, 2023, though there were some early signs of shortages of some goods easing. Some companies reported building or maintaining higher levels of inventories to mitigate supply issues.

Though few companies have direct trade links with Russia and Ukraine, many have indirect exposure to them via supply chains. Contacts said that the conflict was likely to affect the availability of raw materials and components from both countries as well as from neighbouring ones. For example, supplies of some agricultural products from Belarus have also been disrupted.

Contacts said they expected to be able to sustain output for a number of weeks using existing stocks, but a prolonged conflict could lead to difficulties sourcing some inputs – for example, semiconductors, seeds and seed oils, and materials and components for the automotive and aviation sectors.

UK goods exports increased slightly over the past three months compared with a year ago, reflecting stronger demand from non-EU countries. For most contacts, exports to the EU had returned to 2019 levels, though the increased complexity and cost of exporting goods to the EU had led some smaller firms to reduce or stop selling to the region.

Construction

> **Output growth remained modest as rising costs, and materials and labour shortages continued to weigh on activity, though order books remained strong.**

Contacts said that rising material and labour costs had caused delays to some projects as customers waited for costs to come down, or had made some projects unviable.

Lead times for many materials continued to be lengthy, though availability had improved since Summer 2021, when shortages were at their most severe. Companies reported placing orders early and buying larger quantities of materials in order to limit the effect of shortages, though this was easier for larger firms than for smaller companies, because larger firms have more buying power with suppliers and generally have stronger financial positions.

Nonetheless, contacts expected output growth to remain positive this year, with demand supported by public sector infrastructure spending, strong housebuilding activity and plans to reconfigure office and commercial space.

Capacity utilisation

> **Early signs that global bottlenecks may be stabilising, but some shortages were expected to persist into 2023 and labour shortages remained acute.**

Contacts reported long lead times for a range of goods and materials, though a few companies reported some improvement in the availability of selected items, for example of construction materials.

Contacts said that disruption to the availability of semiconductors could be more prolonged as a result of the Russia-Ukraine conflict, because both countries supply raw materials needed for their manufacture.

Covid outbreaks in some parts of Asia continued to affect the availability of imported goods from those areas, resulting in production delays – in particular in the automotive sector. And a wide range of raw materials and inputs remained in short supply, leading some companies to hold higher stock levels to guard against delays.

Contacts expected disruption to sea freight to persist well into 2022 and potentially into next year. There were also reports of some disruption to shipping routes due to the Russia-Ukraine crisis.

Contacts in a wide range of sectors said that labour shortages continued to be the biggest constraint on growth and expected them to persist over the coming year. Labour shortages were particularly acute in the hospitality, leisure and tourism sectors.

Investment

Investment intentions remained strong, though current investment spending was held back by rising costs and ongoing shortages of goods and labour.

Investment intentions improved across a range of sectors in response to increased demand, and as companies restarted projects that had been paused during the pandemic. However, a few contacts thought that the Russia-Ukraine conflict would weigh on sentiment and could lead to investment decisions being delayed.

Because of the tight labour market, companies have increasingly sought to invest in automation to raise output, rather than expanding headcount. Companies also reported investing in technology, logistics, online sales platforms and in measures to achieve net-zero emissions. Investment among consumer services firms was improving from a low base.

However, contacts also said that their ability to implement investment plans was being constrained by high materials and goods costs and supply issues.

Corporate financing conditions

Demand for new bank credit remained subdued, but growing input cost pressures have led to strong demand for working capital finance.

Demand for new bank credit was weak among companies of all sizes, reflecting large cash reserves. However, there was strong demand for other forms of credit, in particular working capital finance, to cover rising materials and labour costs. Demand for asset-based finance also increased.

Medium-sized and large corporates continued to report good access to market finance, with investor appetite for high-yield bonds remaining high.

Companies in stable or growing sectors said that bank credit had become more readily available. But banks remained cautious about lending to companies in vulnerable sectors that had been most severely affected by the pandemic, such as retail, hospitality, construction, travel, education and social care. Challenger banks were reported to be more willing to lend to companies in these sectors, and contacts reported ongoing interest from overseas banks to lend, in particular to technology and healthcare firms.

Business failures remained low in aggregate, though there were reports of an increase in insolvencies in the construction and hospitality sectors. The removal of Covid-related government support measures during 2022 is expected to lead to a modest increase in small business failures. Trade credit insurance premia were expected to fall in most sectors, except in the construction and consumer-facing sectors, where the outlook was more uncertain.

Property markets

Demand for housing continued to outstrip supply; rents stabilised for retail premises, and rose sharply for industrial and warehousing space.

Housing market

Demand in the housing market remained strong, in particular among first-time buyers, and outstripped the supply of available properties. Contacts said that planning delays and labour shortages had also constrained the supply of new-build houses. As a result, house price inflation remained elevated in some areas, though contacts said there were early signs that house price growth may be slowing.

Demand for rental properties also outweighed supply, leading to continued upward pressure on rents.

Commercial real estate

Demand for industrial premises among investors and tenants continued to outstrip supply, pushing rents and valuations significantly above pre-pandemic levels. There are growing concerns among tenants about the affordability of rents once leases come up for renewal, which could put upward pressure on output prices.

Demand for office premises remained below pre-pandemic levels. However, for those seeking office space, demand was focused on flexible space in city centre locations, as well as on more energy efficient premises. Demand for older, non-urban premises remained low among investors and tenants, leading to concerns about the viability of such assets.

In retail, occupancy rates, rents and valuations for high street and shopping centre premises had stabilised somewhat recently, having fallen sharply during the pandemic. Rent collection rates continued to improve, though they remained below pre-pandemic levels.

Employment and pay

> **Employment intentions stabilised but recruitment difficulties remained severe and pay settlements were much higher than a year ago, reflecting the tight labour market.**

Employment intentions remained strong, though contacts said this mainly reflected high levels of staff attrition and existing vacancies, rather than plans to increase headcount even further.

Recruitment difficulties continued to be intense across almost all sectors and skill levels, with many contacts reporting unusually high rates of job churn and vacancies. Contacts expected little improvement in labour availability over the next year. EU migrant workers who had returned home during the pandemic were not expected to return to the UK and labour market participation in general had decreased, in particular among older workers or people wanting to work more flexibly. However, a few contacts thought that the rising cost of living might encourage some people back into the workforce.

Contacts said that pay settlements were much higher than a year ago, driven by the tightening in the labour market over this period. Increased energy costs and high consumer price inflation were also reported to be a factor in pay negotiations. In addition, the planned rise in the National Living Wage from April was already pushing up wage growth, particularly in the hospitality and retail sectors, where increases had been implemented early in order to retain staff. Companies said they expected pay awards in 2022 to be between 4% and 6%, compared with 2.5% to 3.5% in 2021.

Costs and prices

> **Input prices picked up further following the invasion of Ukraine; and companies expected to continue to raise consumer prices to protect margins.**

Contacts reported large increases in prices of oil, gas and raw materials, such as metals, grain and seed oils as a result of the Russia-Ukraine conflict. And many contacts expected further upward pressure on prices in the coming months.

In manufacturing, output price inflation picked up as companies passed through higher wage costs and energy prices to protect margins. In business services, fee inflation remained elevated and was expected to rise further to reflect pay increases in April.

Retailers also reported elevated inflation. Food price inflation was expected to pick up further as supermarkets passed on increases in wholesale and producer costs as well as higher transport, energy and wage costs. Some supermarket contacts said they had reduced promotional activity.

In non-food retail, some fashion retailers expected to increase prices for their summer collections by around 5% and to raise prices again in the autumn season by a similar amount. Some contacts said retail prices of electronic equipment had increased by around 7%.

Consumer services contacts also expected to put up prices to cover the increase in the National Living Wage from April. In addition, contacts in the hospitality sector said they planned to pass through the planned restoration of Value Added Tax to prices in order to rebuild margins, despite strong competition in the sector.

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Next publication date 16 June 2022

Bank of England Agents' scores (XLSX 0.9MB)

Definitions for the Agents' scores

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