Box 4
Agents' update on business conditions

The key information from Agents' contacts considered by the Monetary Policy Committee at its August meeting is highlighted in this box.[1]

Firms experienced a varied recovery in output following a significant easing of lockdown measures throughout June and July.

Agency intelligence gathered since late June indicates that economic activity is recovering across an increasing range of sectors as social distancing measures have been eased further. However, persistent caution has dampened the outlook, particularly for sectors reliant on consumer footfall. For instance, those restaurants and pubs that have reopened have often reported severely depressed sales compared to normal, even when reduced capacities due to social distancing measures are taken into account. Sectors involving social interaction have generally been severely impacted by the pandemic, and demand growth has not increased in line with expectations. In contrast, retailers of non-food goods reported that aggregate customer spending — combining online and stores sales — is now close to normal levels compared with a year ago. Continued strong growth in online sales compensated for depressed in-store activity. Taken together, sales of consumer goods and services in aggregate have only partially recovered as more sectors have reopened.

In manufacturing, the vast majority of sites are now in operation. However, activity has generally remained weak, and the majority of contacts reported operating at around 20% below capacity due to social distancing requirements. Firms supplying automotive and civil aerospace sectors continued to report subdued demand. In contrast, contacts in sectors supplying chemicals, healthcare and personal protective equipment continued to report strong demand.

Contacts that import and export reported increasing concerns about these activities once the transition period between the UK and EU has come to an end on 1 January 2021. They cite concerns about short-term delays as new rules come into force, and increased overhead costs over the long term due to new administrative procedures.

In business services, contacts reported demand recovering only gradually in June and July following a significant fall in activity in April. Demand is still substantially down on a year ago, and the scale of the recovery is mixed across sectors. In professional services, demand is strong across corporate restructuring, insolvency, audit, debt management, employment law and IT. This contrasts with weaker demand in areas such as mergers and acquisitions. Following a severe contraction in April, marketing, advertising, recruitment and office equipment wholesalers have since reported a gradual recovery in demand. Demand for business travel, hotels, conferencing and corporate entertainment has remained particularly weak.

In construction, contacts reported that activity reached 80% of pre-Covid levels during July. The introduction of the 'one metre plus' rule on sites allowed many to marginally increase their rate of activity. However, social distancing measures continued to be the primary hurdle for further increases in the near future. Contractors that are focused on public sector projects reported they expect output to increase gradually over the coming months. Some anticipate they could increase activity enough to compensate for some of the time that sites were shut during lockdown, falling only 10% short of their output targets for 2020. The pipeline of new orders for large construction projects is low, though continued high demand for distribution buildings bucks this trend.

Across the housing market, pent-up demand had resulted in high levels of activity in secondary and new home markets in June and July. Reflecting increased levels of remote working, and its likely persistence in the future, properties with gardens and space to support home working were reported to be particularly popular. Seasonal

1 A comprehensive quarterly report on business conditions from the Agents is published alongside the MPC decision in non-*Monetary Policy Report* months. The next report will be published on 17 September 2020

rental demand from university students was subdued as online teaching increased and the number of overseas students fell.

The outlook for the housing market during the remainder of 2020 is mixed. The temporary cut to stamp duty is expected to support increased activity. However, an anticipated increase in unemployment, alongside a general tightening of availability for mortgage products, is expected to slow activity by the end of the year.

Activity in commercial real estate sectors remained subdued. Demand for retail space continued to fall, with expected increases in vacancy rates throughout the remainder of 2020. Contacts reported that deliberations are underway about office space requirements in light of successful remote working, though few definitive decisions have been made. Demand for warehouse space remained strong, reflecting an accelerated shift towards online shopping.

Contacts reported that collection rates for commercial property rents were weak for the second quarter in a row, particularly among retail tenants. Pressure is reported to be growing on landlords to restructure lease terms to link future rents with the occupiers' turnover.

The majority of firms are revising investment plans significantly downwards in 2020 and 2021.
Contacts regularly reported plans for lower investment in 2020 and 2021 (**Chart A**). Many have delayed or cancelled plans outright. These decisions can primarily be explained by the majority of contacts, having experienced a significant reduction in sales during the pandemic, remaining uncertain about how demand will recover over the rest of the year.

Areas where investment plans have been maintained include large capital projects. This is particularly the case for projects focused on construction activity, where long-term commitments cannot be easily revised. Some contacts also reported redirecting some expenditure towards new IT equipment as remote working becomes embedded across a wider range of firms.

Chart A Investment plans have been revised in response to the pandemic.
Investment intentions over the next 12 months

Chart B Firms expect to make significant redundancies over the next 12 months.
Employment intentions over the next 12 months

The outlook for employment and pay has worsened, with increases in the scale of redundancies and widespread cancellation of pay awards for 2020.
Contacts reported a deterioration in the employment outlook (**Chart B**), with the rate of redundancies having increased in June and July, ahead of the start of mandatory employer contributions to the Coronavirus Job Retention Scheme (CJRS) in August. Further, even where activity has remained strong, a few contacts reported that productivity-improving changes made during the pandemic are leading to redundancies or the reduction of hiring plans. The heaviest job losses in recent weeks were reported by airline carriers, holiday operators, non-food retailers, automotive manufacturers, and firms along aerospace supply chains.

Contacts in a few sectors, including pharmaceutical, food processing, and logistics companies, reported the continued hiring of new staff. Most also reported attempts to maintain apprenticeship and graduate hiring schemes. The prospect for many of these are conditional on an improving economic outlook during the second half of 2020.

Contacts from charity and voluntary organisations reported that retail income sources had been adversely affected during lockdown. Income from corporate donations had also fallen, and contacts reported having to draw on their cash reserves. Many were concerned that they would not be able to survive a prolonged economic downturn. However, at the same time, demand for their services has increased during the pandemic, and is expected to increase further if unemployment rises as the CJRS is phased out.

On pay, the majority of contacts who reported topping up wages for furloughed staff have stopped doing so. Pay increases and bonuses are being deferred for 2020, except for legally mandated increases associated with the National Living Wage.

Credit availability increased for firms, especially SMEs, although pockets of tightness remained in sectors most affected by the pandemic.

Contacts reported a significant improvement in the availability of credit for small firms after the introduction of the Bounce Back Loan Scheme. Following exceptionally high levels of borrowing for the few weeks after its introduction in early May, demand for credit from small firms eased but remained strong. Contacts also reported widespread use of the Coronavirus Business Interruption Loan Scheme. However, in hard-hit sectors such as retail, hospitality and leisure, there has been a tightening of credit availability as expectations of business failures increase.

There was a mixed picture for larger firms. Contacts reported that many felt credit would be available if required, but also increasing availability of funding through capital markets reduced the need to draw upon credit facilities. In contrast, large non-investment grade firms found the funding environment more difficult, especially those most vulnerable to the impact of the pandemic. Take up of the new Coronavirus Large Business Interruption Loan Scheme had been limited to date.

The need to create Covid-secure environments has increased cost pressures, while there is an uncertain outlook for pricing strategies.

Contacts reported an increase in non-labour costs overall, although the picture is mixed. The need to create and maintain 'Covid-secure' environments for staff and customers increased costs, as had sterling's depreciation. Partly offsetting that, cost pressures from energy and raw material inputs eased.

Contacts reported that pricing strategies will primarily be guided by the strength of the recovery in demand during the second half of 2020. Some firms have been exploring whether consumers are more or less responsive to price discounting than they were pre-Covid. At the same time, there are pressures to at least maintain prices at pre-Covid levels to ensure margins over increased costs — in part resulting from lower productivity due to social distancing measures — do not get squeezed too much.

Reports suggest the recent temporary VAT reduction to 5% from 20% is unlikely to be fully passed on to consumers in the form of lower prices. For some firms, the cut is perceived as an opportunity to partially restore margins over the higher costs experienced during the pandemic.