

Agents' Special Surveys since the start of the financial crisis

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This article looks at the Agents' Special Surveys that have been commissioned by the Bank of England's Monetary Policy Committee (MPC) since the start of the financial crisis. Through the prism of the Special Surveys, the article discusses some key features of the recession and the puzzles faced by policymakers. And it describes how the Special Surveys have been used by the MPC to try to shed light on these issues — some of which continue to be a significant source of uncertainty today.

Introduction

The Bank of England's Agents conduct regular intelligence gathering which feeds into the monthly monetary policy decision. In addition to the regular briefing, every few months, immediately following their policy meeting, the Monetary Policy Committee (MPC) will commission the Agents to conduct a Special Survey of businesses around the country to address a particular issue. Typically, several hundred businesses participate in the surveys. The surveys involve a structured set of questions, designed to generate quantitative measures, to complement the more qualitative outputs of the regular monthly intelligence gathering.

This article begins by briefly setting out some of the benefits of the Special Surveys, and highlights why they might be particularly useful during times of economic turbulence. Through the prism of the Special Surveys commissioned over the past four years, the article then goes on to plot the course of the financial crisis, recession and subsequent recovery, exploring some of the big puzzles faced by policymakers during that time. The timeline overleaf sets out all of the Special Surveys commissioned during the period since the start of the financial crisis. A box on page 33 summarises the various intelligence gathering and representational functions carried out by the Agents, as well as the structure of the Agency network.

The Special Survey

Since the start of the world financial crisis in 2007, unprecedented economic turbulence has increased the usefulness of the Special Surveys, as they provide a unique way for the Committee to 'get under the bonnet of the economy'. There are a number of reasons for this.

When highly unusual events occur, forecasting models, which are largely based upon the averages of past relationships in the data, may be less able to provide a guide to the future than during periods of stability. Under such circumstances, it is helpful to be able to supplement these models with other types of information and analysis such as the Special Surveys.

In addition, during periods of instability, data are likely to be volatile, making it difficult to discern turning points and trends. By asking businesses about their behaviour and expectations, and, importantly, the reasoning underlying their responses, the Special Surveys can help to verify the patterns suggested by the hard data. And they offer insights across different sectors and sizes of firm.

Last, many types of economic data are uncertain, with early estimates subject to revision as new information becomes available and sampling and statistical techniques improve. This problem may be compounded when there are unusually large movements in the variables being measured. The Special Surveys can help the Committee to form a judgement about how much weight to place on the official data.

In the period since the start of the world financial crisis in August 2007, the Agents have conducted 34 Special Surveys. These are listed in the timeline overleaf (**Table A**). This article selects a subset of these surveys to discuss some of the major issues which the Committee has had to grapple with: credit conditions and investment; the depreciation of sterling and trade; and labour productivity and spare capacity. Further information on each of the Special Surveys can be found in the *Agents' summary of business conditions* for the corresponding month. The survey results in the credit conditions and

(1) The authors would like to thank Jonathan Relleen for his help in producing this article.

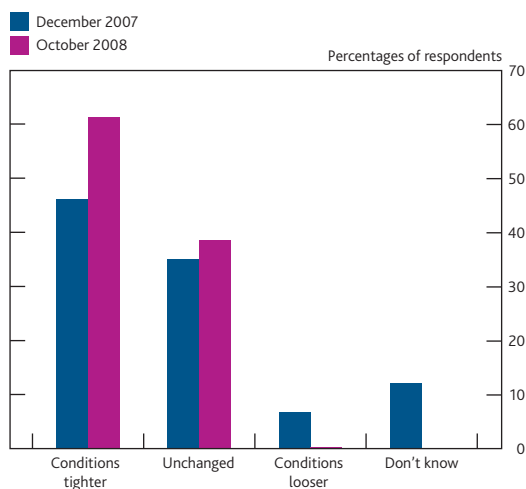
Table A Survey timeline

Publication date	Survey
October 2007	Employment
December 2007	Credit conditions
January 2008	Retail sales
February 2008	Pay and labour costs
March 2008	Cost pass-through
April 2008	Demand conditions
June 2008	Export conditions
July 2008	Migrant labour
October 2008	Credit conditions
December 2008	Finance for working capital
January 2009	Retail sales
February 2009	Pay and labour costs
March 2009	Cost pass-through
April 2009	Stockbuilding
June 2009	Credit conditions
October 2009	Employment
December 2009	Investment
January 2010	Retail sales and VAT
February 2010	Pay and labour costs
March 2010	Exports and export prices
April 2010	Spare capacity and output prices
July 2010	Profit margins
October 2010	Corporate cash holdings
November 2010	Investment
January 2011	Employment and productivity Retail sales and VAT
February 2011	Pay and labour costs
April 2011	Imports
July 2011	Employment
August 2011	Profit margins
October 2011	Exports
November 2011	Investment
January 2012	Retail sales
February 2012	Pay and labour costs

investment section and in the trade section are weighted by turnover. The results in the labour productivity and spare capacity section are weighted by employment.

Credit conditions and investment

The world financial crisis began in August 2007, when the United States sub-prime mortgage crisis spread to other countries, and led to seizures in some asset-backed securities markets. This, in turn, impacted upon a wider range of bank funding markets.⁽¹⁾ Ahead of their December 2007 policy meeting, the Committee requested a survey on credit conditions to see whether or not stresses in bank funding markets had begun to feed through to the cost or availability of credit for businesses. Nearly half of those companies surveyed reported that credit conditions had become tighter (blue bars in **Chart 1**).

Chart 1 December 2007 and October 2008 surveys on credit conditions^(a)

(a) Weighted by turnover.

Credit conditions continued to tighten throughout 2008. And the Agents were commissioned to repeat the credit conditions survey ahead of the October 2008 policy meeting. The survey confirmed that there had been a further significant tightening in credit conditions (magenta bars in **Chart 1**). Firms also reported that they had been particularly affected by a fall in the availability of trade credit. And they had continued to cut investment in response.

During the period that the survey was in the field, Lehman Brothers collapsed. It was therefore very likely that the tightening in credit conditions detected in the October survey would have intensified further still as developments unfolded. And the declining availability of trade credit was becoming a particular source of concern. For the December 2008 policy meeting the Committee requested a survey to investigate the availability of finance for working capital, to try to assess whether tighter funding conditions were affecting activity in the real economy.

Around half of those surveyed reported that it had become harder to secure trade credit insurance. And a large minority of contacts had experienced a fall in the availability of working capital. Internal finance had been squeezed by falling revenues, due to a sharp weakening in demand, rising input costs — following the depreciation of sterling — and lengthening payment times.

Given the speed of developments in the financial sector, another survey on credit conditions was commissioned ahead of the June 2009 policy meeting. The survey showed that there had been a further rise in those reporting a tightening in credit conditions, to around four fifths of the sample, with the

(1) For a fuller account of this period, see the April 2008 *Financial Stability Report*, available at www.bankofengland.co.uk/publications/Documents/fsr/2008/fsrfull0804.pdf.

The Agency network

The Bank has twelve Agencies located across the United Kingdom, with each staffed by an Agent and at least one Deputy Agent. The Bank's Agencies have two core functions: intelligence gathering and representation. (See the November 1997 and Spring 2003 *Quarterly Bulletins* for a historical perspective of the Agency network, and a more extensive discussion of the various functions of the Agencies.)

Each month the Agents and Deputies gather information from contacts around the country covering a range of economic and financial variables. Each Agency has several hundred regular contacts and the network as a whole speaks to around 8,000 businesses over the course of each year. The regular economic intelligence gathered by the Agencies is reported back to the Monetary Policy Committee (MPC) ahead of its monthly policy decision.

Along with the qualitative briefing, the Agencies produce 'scores' for a number of variables, to add a more quantitative dimension to the intelligence. The scores are published on the Bank's website (see Winter 2005 *Quarterly Bulletin* for more information on the Agents' scores. For analysis of the correlation of the scores with official data see the 2008 Q1 *Quarterly Bulletin*). The qualitative intelligence and scores are summarised in the *Agents' summary of business conditions*, which is published at the same time as the minutes of the MPC's monthly meeting.

Every few months the Committee will also commission the Agents to conduct a Special Survey to investigate a particular issue of interest. The results of the survey are reported back to the MPC one or two months later, ahead of the policy

meeting, along with the outputs of the Agents' routine monthly intelligence gathering.

Benefits of Agency intelligence gathering:

- **Timeliness:** Agents can sometimes provide information on economic variables ahead of the publication of hard data.
- **Interpretation:** Agents can help the Committee to 'look through' volatility in the data, to try to discern underlying trends and to understand why firms might be behaving in particular ways.
- **Unobservable variables:** Agents can investigate economic variables for which there are no hard data, such as capacity utilisation, or recruitment difficulties.
- **Forward looking:** Agents can provide an advance steer on where economic variables are heading.
- **Flexibility:** Interviews and Special Surveys afford the flexibility needed to explore a changing set of key issues.

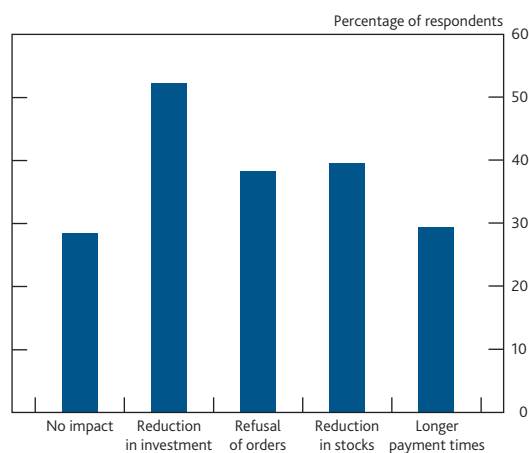
As well as fulfilling an intelligence-gathering function, the Agencies are also representatives of the Bank. By visiting firms in each of their respective regions, and engaging with the wider community, the Agents help to communicate policy to a broad audience. The Agents also have an important role in facilitating meetings between MPC members and firms around the country. Through these meetings, Committee members are able to engage directly with the general public and business community on matters of policy. And they are able to hear, first hand, about some of the issues facing businesses, and gain insights into the workings of the economy.

most common response being to scale back investment plans (**Chart 2**). Between the end of 2007 and the middle of 2009, the level of real investment expenditure was reported by the ONS to have fallen by over a fifth.

But there were a few reports of an increase in the appetite of lenders for new business. And during the second half of 2009, the Agents' regular intelligence gathering suggested that credit conditions had begun to improve for larger firms, brightening the prospects for investment.

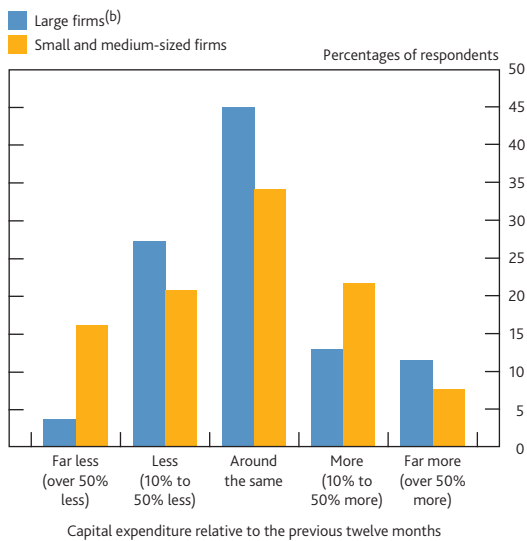
A survey on investment conducted ahead of the December 2009 policy meeting indicated that there was at that time a broad balance between those companies expecting to cut capital spending over the next year, and those expecting to increase it (**Chart 3**). But there was little sign of a robust bounceback. And smaller firms in particular continued to be constrained by a lack of external finance (**Chart 4**).

Chart 2 June 2009 credit conditions survey: responses to tighter financing conditions^(a)



(a) Weighted by turnover.

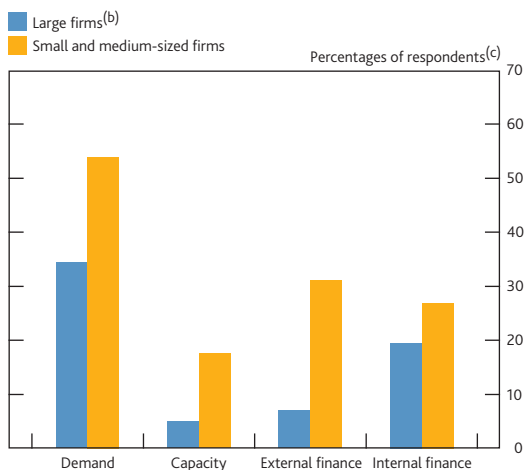
Chart 3 December 2009 investment survey: expected change in investment over the next twelve months^(a)



(a) Each category weighted by turnover.

(b) Large firms defined as those with a turnover of £400 million or more.

Chart 4 December 2009 investment survey: drivers of expected reductions in investment^(a)



(a) Each category weighted by turnover.

(b) Large firms defined as those with a turnover of £400 million or more.

(c) Respondents could select more than one option.

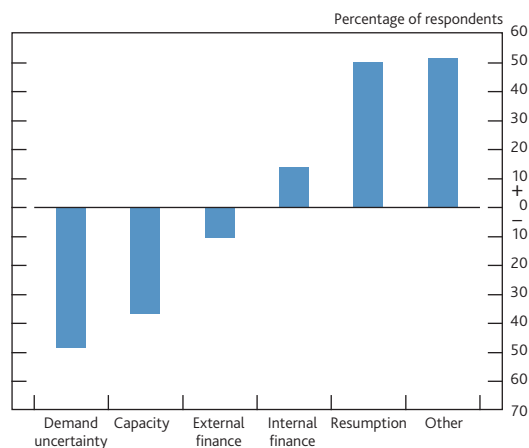
The regular intelligence gathering suggested that for many firms, especially larger ones, over the course of 2010 credit conditions continued to ease and profitability improved. But the level of investment remained low in comparison to pre-crisis levels and corporates built up substantial cash surpluses. Ahead of the October 2010 policy meeting, the Agents surveyed contacts about levels of, and plans for, cash holdings, to try to gauge whether firms intended to use some of those surpluses to fund increased investment.

Consistent with the official data, the survey showed that a majority of respondents had cash holdings that were above normal. This was especially true of large firms. A small majority of all firms expected to reduce those surpluses over the following year, largely reflecting the plans of large firms to

pay down debt, or increase investment. Small firms typically planned to continue to preserve cash.

To try to get a better feel for how strongly investment might pick up, the Committee commissioned a follow-up survey on investment in November 2010. The survey showed that capital spending was expected to rise more quickly over the coming year, compared with the previous year. This expectation was driven in large part by the resumption of plans that had been put on hold during the recession (Chart 5), along with a number of 'other' factors, such as asset replacement, regulatory compliance and efficiency gains. But demand uncertainty continued to exert a significant drag on capital expenditure.

Chart 5 November 2010 investment survey: drivers of investment plans^(a)

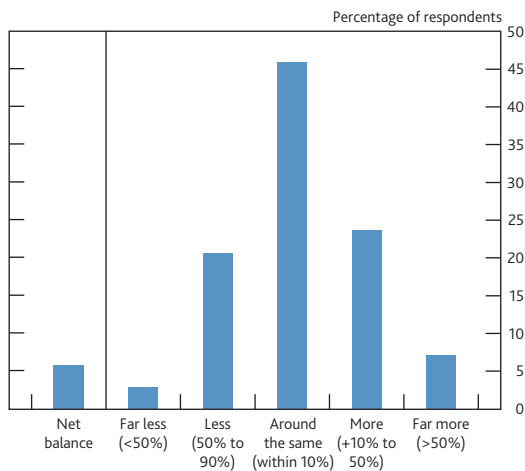


(a) Net balances weighted by turnover.

There was a modest increase in investment during 2011. But over the second half of the year, weak UK growth and rising concerns about the euro area suggested that investment intentions might have deteriorated. Encouragingly, however, despite still heightened levels of uncertainty, the most recent survey on capital expenditure, in November 2011, suggested that investment plans had not been revised down materially. The net percentage balance of firms' investment plans indicated that capital spending was likely to remain broadly flat over the coming year (Chart 6).

Firms reported that there were a number of factors underpinning their investment plans for 2012. Increased capital spending was often intended to raise productivity, for instance. And many contacts reported that continuous investment — in product innovation, developing new markets, and finding efficiencies — was absolutely necessary simply to survive in the current environment. Some service sector firms also reported that they were investing in expanding export activity, to try to offset weakness in domestic demand.

Chart 6 November 2011 investment survey: expected change in investment over the next twelve months compared with the past twelve months^(a)



(a) Weighted by turnover.

Trade and the depreciation of sterling

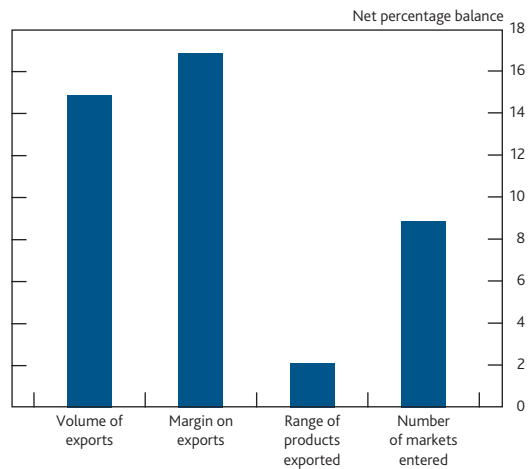
The depreciation of sterling since the start of the financial crisis should help the economy rebalance by making domestically produced goods and services more competitive. Following the decline in the exchange rate, however, data available at the time suggested that there had been less of an improvement in the trade balance than might have been expected, based on the response of trade to movements in sterling in 1992 and 1996 for example. But trade data are prone to revision, as additional information becomes available, and mature vintages of the official data can sometimes tell a different story to preliminary estimates.

Between the middle of 2007 and the middle of 2008, the sterling effective exchange rate index (ERI) depreciated by roughly 10%. The Committee commissioned a survey on exports ahead of their meeting in June 2008, to try to get a better feel for the response of trade flows to the depreciation. The survey suggested that over the previous year a large number of firms had used the boost to competitiveness from the depreciation of sterling to increase volumes of exports. But there was a broad balance between those that had allowed their foreign currency prices to fall, to expand volumes and market share, and those that had kept their foreign currency prices unchanged, to raise margins (Chart 7).

The finding that so many exporters were inclined to grow margins rather than volumes suggested that it could take longer than otherwise for the depreciation of sterling to feed through to exports, as that might rely, in part, on new firms entering the market in response to increased profitability.

The level of the sterling ERI fell further during 2008, and settled around 25% below its pre-crisis peak during

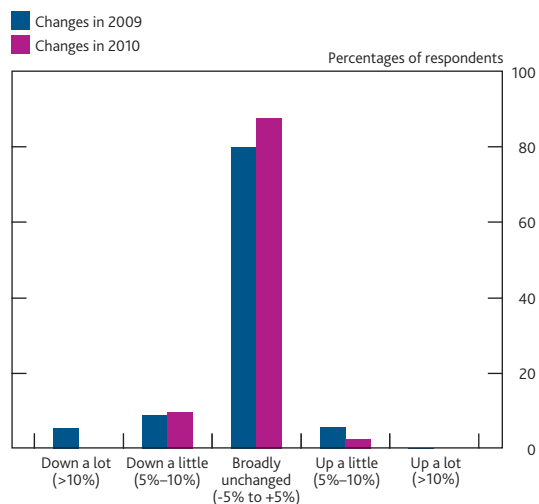
Chart 7 June 2008 survey on exports: effect of sterling's depreciation on exports^(a)



(a) Weighted by turnover.

Spring 2009. A second survey, in March 2010, found that most firms had kept their foreign currency export prices broadly unchanged over 2009 and expected them to remain steady over 2010 (Chart 8). Some contacts reported that the past depreciation of sterling had pushed up on their costs, lessening the extent to which they could afford to lower foreign currency prices. And others responded that demand for the type of high value added goods produced in the United Kingdom was relatively unresponsive to changes in price, so there was little gain to be had from lowering foreign currency prices.

Chart 8 March 2010 survey on export prices: changes in foreign currency export prices^(a)



(a) Weighted by turnover.

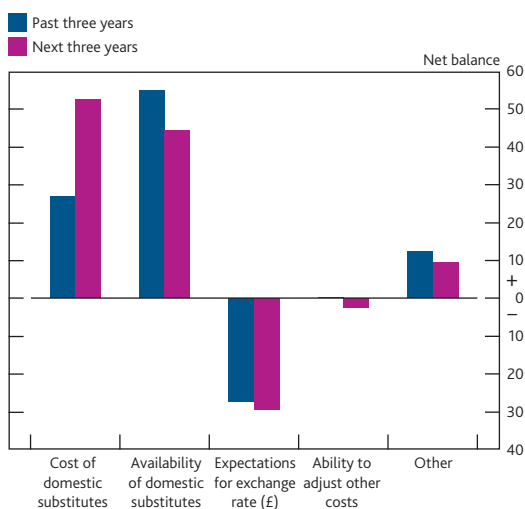
Upward revisions to exports in the 2011 *Blue Book* have since increased the contribution to GDP growth from exports significantly. As a result, based on the mature data, the response of exports to the decline in the exchange rate looks broadly in line with what might have been expected on the basis of changes in exports following previous changes in the

exchange rate. And the results of the June 2008 survey may provide a useful benchmark in the event of significant changes in the exchange rate in the future.⁽¹⁾

As well as supporting exports, the fall in the value of sterling should also improve the net trade position by encouraging a switch away from relatively more expensive imported goods and services towards domestically produced ones. But, as with exports, the response of imports to the depreciation of sterling was smaller than expected, based on data available at the time. As a result, import growth appeared stronger than anticipated, reducing the boost to growth from net trade.⁽²⁾

A survey on imports in April 2011 suggested that since the depreciation of the pound, imports of intermediate goods and services — which comprise the bulk of total imports — had stayed the same, or even increased slightly, as a share of total non-labour inputs. In many cases, domestic substitutes were still considered to be uncompetitive, despite the depreciation, or there simply were no domestic substitutes available (Chart 9).

Chart 9 April 2011 survey on imports: factors exerting upward pressure on the import share of intermediate goods and services^(a)



(a) Weighted by turnover.

There have since been some downward revisions to import growth immediately following the depreciation. But there remains some unexplained strength in imports, in particular of goods, and that may be accounted for by the factors highlighted by the survey: the continued cost advantages of foreign production, despite the fall in sterling; and the absence of domestic suppliers for some products. This highlights the importance of using a range of sources of information, in addition to contemporaneous official data.

It is worth noting, however, that more recent intelligence gathered by the Agents points to a range of factors that appear to have reduced the attractiveness of importing intermediate

goods and services further. Rapid increases in production costs abroad, particularly in Asia, have eroded their competitiveness. Natural disasters have highlighted the risks inherent in extended supply chains. Imports are sometimes of poor quality and can be subject to delays as supply is diverted to higher margin destinations. And constraints on working capital among domestic firms have led some of them to request shorter production runs from suppliers, tending to lessen the advantage of high volume foreign producers.

In addition to the fall in sterling, these developments will tend to raise the benefits of domestic production, potentially slowing the pace of import growth further. And recently, there has been a pickup in the frequency of reports from firms which have resourced imports from domestic suppliers, or brought production in-house altogether.

Labour productivity and spare capacity

During the recession, employment fell by less than might have been expected, given the size of the contraction in output. That meant that labour productivity — or output per employee — fell significantly, and suggested that there was a lot of spare capacity within firms which could be used to meet extra demand. But spare capacity in firms is impossible to observe directly, making it hard to judge the degree of potential supply in the economy.

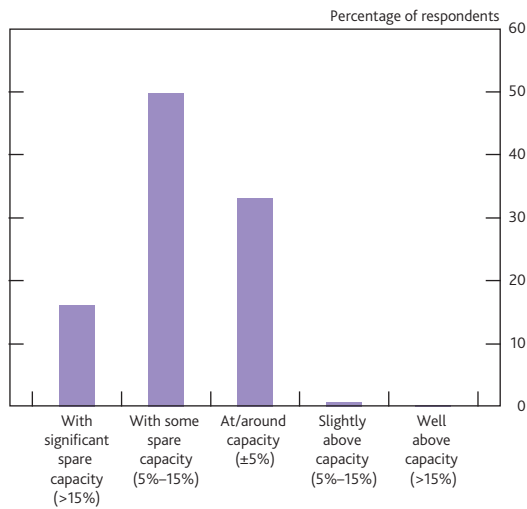
The Committee asked for a survey to investigate the relative resilience of employment ahead of the October 2009 policy meeting. Around three quarters of respondents reported that they had used changes in average hours or pay to reduce labour costs. That suggested that flexible working practices and wage flexibility might have enabled some of the labour market adjustment to come through hours and pay rather than headcount. It also suggested that firms should be able to meet a significant pickup in demand without needing to take on new staff.

Over time, however, even though activity remained weak, the regular monthly business surveys conducted by other organisations such as the BCC and CBI, as well as the Agents' own scores for capacity utilisation, indicated that the degree of slack within firms was falling. For the April 2010 policy meeting the Committee commissioned a survey to explore how much spare capacity there was within firms. The results suggested that a margin of slack did exist within most firms (Chart 10). And that was most evident in manufacturing and construction, industries where the fall in output during the recession had been particularly marked.

(1) Recent analysis points to significant relative price changes in sterling export prices versus foreign currency prices. For a full analysis of the recent behaviour of trade, see Kamath, K and Paul, V (2011), 'Understanding recent developments in UK external trade', *Bank of England Quarterly Bulletin*, Vol. 51, No. 4, pages 294–304.

(2) It is important to note, however, that imports of travel services, in particular, did fall sharply in response to the depreciation. *Ibid.*

Chart 10 April 2010 survey on capacity utilisation: current level of spare capacity^(a)



(a) Weighted by employment.

But over the following months the regular business surveys of spare capacity continued to indicate that the margin of slack within firms was closing, despite the persistent weakness of output growth. And adding weight to measures showing a decline in spare capacity, firms' own behaviour suggested that many were indeed unable to raise output with existing staff, with the official Labour Force Survey measure of employment growing during 2010 and the first half of 2011.

One possible explanation for rising employment and, at the same time, the reported decline in spare capacity in the regular surveys, was that there had been a reduction in the growth rate of underlying labour productivity during the recession. It is not obvious, however, what might have caused such a hit to the growth rate of potential output per worker.

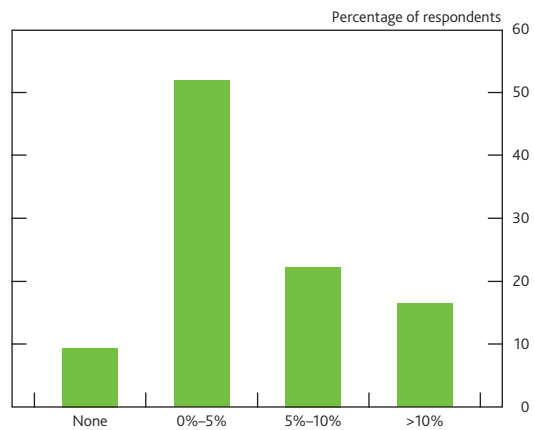
It may have been that the significant decline in activity during the recession meant that there had been much less 'learning by doing' taking place within firms, or perhaps that there had been a slowing in the growth rate of the capital stock. These factors would tend to have slowed the pace at which employees were able to produce more over time, compared with what would have been the case had there been no recession.⁽¹⁾

Under those circumstances, firms might have relatively little spare capacity, and so would have to employ more people in order to meet a pickup in demand. In turn, that would mean the output gap was smaller than had there been no slowing in underlying labour productivity. The Committee commissioned a survey to try to test this hypothesis ahead of the January 2011 policy meeting.

The survey yielded rather surprising results. Respondents reported that their activity had fallen by less than their headcount, implying that labour productivity had actually

risen since the start of the recession, in contrast to the official data on output and employment. And they also reported that they could meet a material increase in demand using existing staff (Chart 11), which tended to go against the monthly indicators of capacity utilisation.

Chart 11 January 2011 survey on employment and productivity: increase in demand that could be met using existing staff^(a)



(a) Weighted by employment.

These unexpected findings might simply have been due to sampling error, if the firms which were surveyed were not representative of businesses in the wider economy. But they might also have been partly because some of the concepts under examination — potential output and spare capacity, for example — are difficult to define.

For instance, the regular intelligence gathered by the Agents suggests that some manufacturers may have responded to the fall in demand at the start of the recession by reducing capacity temporarily in order to reduce costs, perhaps by mothballing equipment, or cutting the number of shifts. Some of those firms may then report that they are operating at normal levels of spare capacity. But at the same time they might also be able to bring mothballed capital back on stream or implement additional shifts once demand recovers.

Meanwhile, in the service sector, some firms appear to have held on to labour during the recession, even though demand remained weak. But such firms are often very busy, perhaps because they are competing over a wider range of services than usual, or over a broader geographical area. But they may not be winning much new business despite those efforts. As a result, while they might report that capacity utilisation is high — as staff are fully employed — they would still be able to meet a significant increase in demand, should it pick up.

(1) For further discussion of the possible causes of a slowing in productivity growth, see the November 2011 *Inflation Report*, available at www.bankofengland.co.uk/publications/Documents/inflationreport/ir11nov.pdf.

Clearly, then, it is difficult to know how much weight to put on the results of the regular business surveys versus the Special Surveys. And the MPC considers a range of other evidence alongside these measures. But there remains considerable uncertainty around the evolution of underlying productivity and the size of the output gap.

Conclusion

At a time of economic instability, when data are volatile, and models may be less able than usual to provide a guide to the

outlook, the Agents' Special Surveys are a useful addition to the MPC's toolkit. By asking businesses about their behaviour directly, they can help the committee to understand changes in the data and offer a guide to future activity. They also provide a means of investigating the values of important, but unobservable, variables. And while the surveys sometimes generate unexpected results, these can still help to improve our understanding of the behaviour of decision-makers in the real economy.

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