LONDON CHAMBER of COMMERCE AND INDUSTRY

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Q2 CAPITAL 500

London Quarterly Economic Survey

April – June **2023**

In partnership with

Savanta:

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JAMES WATKINS

Head of Policy and Public Impact, London Chamber of Commerce and Industry

LCCI COMMENTARY – THE BUSINESS VIEW

Our latest Capital 500 survey points to an encouraging rise in domestic demand for London businesses in Q2, with the balance for orders increasing for the first time in five quarters. Export sales were up too, while labour market expectations remained stable for the coming quarter.

Cost pressures remain for London businesses, with firms seeing higher bills from their supply chains. While energy and fuel costs have – somewhat – eased, most firms are still seeing increases compared to the previous quarter. London businesses pointed to several costs, including utilities, labour and energy, putting pressure on them to raise prices. Companies are still struggling with cashflow, with two-fifths seeing a decline in Q2 compared to the previous three months.

Business confidence has nevertheless continued to recover, with firms clearly more optimistic about their own prospects for the coming year. Company outlooks for the London economy have improved too, albeit at a slower pace.

It is however important to note that our survey was conducted before the Bank of England raised rates again, with signs that inflation is not falling at the pace it was expected to. Businesses will want to see concrete policy steps that could help to reduce the upward pressures on inflation, which in turn would reduce the need for further monetary policy tightening.

James Watkins, Head of Policy and Public Impact, London Chamber of Commerce and Industry

ABOUT THE 'CAPITAL 500'

For over a decade London Chamber of Commerce and Industry (LCCI) has conducted a Quarterly Economic Survey (QES) of members to gauge business performance and general confidence levels across the capital. This is part of the biggest and longest running national private business survey, conducted by regional chambers of commerce across the UK every quarter.

Savanta surveyed a total of 510 London business leaders between 26 April to 30 May 2023. All data were weighted to be representative of all London businesses by company size and broad industry sector. Savanta is a member of the British Polling Council and abides by its rules. Full data tables are available at www.savanta.com.

The net balance figures represent the percentage of firms that reported an increase minus the percentage that reported a decrease. Two categories are used for business size segmentation: micro businesses with fewer than 10 employees (including sole traders), and larger (small, medium and large) businesses with 10 or more employees. Any data reproduced from the report should be fully referenced.

ABOUT HAYSMACINTYRE

haysmacintyre is an award-winning firm of chartered accountants and tax advisors, providing specialist advice to entrepreneurs, fast-growing and owner-managed businesses, and not for profit organisations across the UK and internationally.

VICKY PRYCE

Chief Economic Advisor and Board Member, Centre for Economics and Business Research (Cebr)

GUEST COMMENTARY – THE ECONOMIST'S VIEW

These remain tumultuous times on the economic front. Since the last QES, the UK economy proved more resilient than anticipated and escaped recession by growing slightly in Q1. Monthly GDP data showed a further 0.2% rise in April, partly reversing the 0.3% fall in March. Forecasts for the UK were revised upwards by the IMF, the OECD, the Bank of England and others, whereas the Eurozone slipped into a technical recession, largely due to a slump in German and Irish GDP in the first three months of the year. UK unemployment also remained near record lows. Though pressure in the labour market seems to be easing, the QES showed that employment demand remains high, particularly in London. Overall pay has almost caught up with inflation, rising 7.2% year-on-year across the economy in the three months to May, while the squeeze in real incomes has been easing. This is good news as far as it goes.

But this is precisely the problem at present. What was a supply side price shock with huge energy and food price increases that followed the Russian invasion of Ukraine has now turned into wage induced, cost-push inflation that seems to be becoming embedded in the economy. While inflation has been cut by a third and in some cases halved in many large, developed countries – down to 4.0% in the US, 6.1% in Germany, 5.1% in France and 3.2% in Spain – it has remained stubbornly high at an unchanged 8.7% in the UK prompting a sharp 50 basis points hike in interest rates by the Bank of England (BoE) on 22 June 2023.

This brought Bank Rate in the UK to 5%, almost the same as the US where the Federal Reserve left rates unchanged in its meeting in mid-June. The gap with the European Central Bank (ECB), which did increase its rates by 25 basis points to a range of 3.5-4.25%, has widened. Sterling has been strengthening for a while in anticipation and mortgage rates are now back to where they had been briefly after Liz Truss' and Kwasi Kwarteng's mini budget back in September 2022.

However, at that time the BoE stepped in by temporarily restarting quantitative easing and bringing long-term yields back down. They do not seem inclined to do so this time. The Government is also not showing any intention of intervening with a cap as it did for energy costs given the continued pressure on public finances. They are relying instead on mortgage providers being more lenient towards the most vulnerable households.

Businesses will once again be exposed to higher borrowing costs. The number of insolvencies has been on the rise, especially amongst smaller firms. The growth areas – and those where prices are rising most – are services, particularly retail, hospitality, entertainment and tourism, which is where the biggest staff shortages are, and EU workers are missed most post-Brexit. Manufacturing has continued its decline with output contracting month after month since August last year according to the reliable Purchasing Managers Index. The markets meanwhile are pencilling in further interest rate increases ahead. Although the housing market has been reasonably resilient so far, prices in London are registering their first falls.

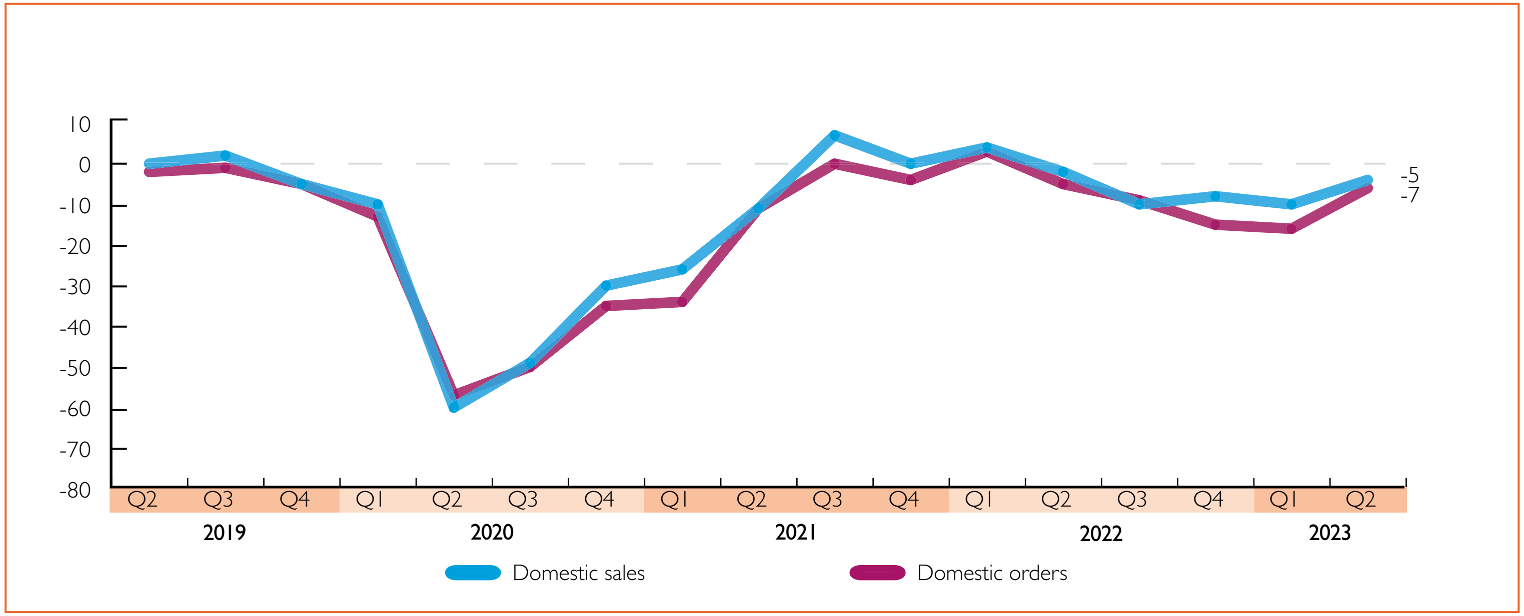
Before the latest interest rate hike the OECD in early June was forecasting growth of 0.3% this year and just 1% next. However modest, both of these are now in doubt.

Vicky Pryce, Chief Economic Advisor and Board Member, Centre for Economics and Business Research (Cebr)

DOMESTIC DEMAND

24% of London businesses reported an **increase** in domestic sales last quarter

22% of London businesses reported an **increase** in domestic orders last quarter



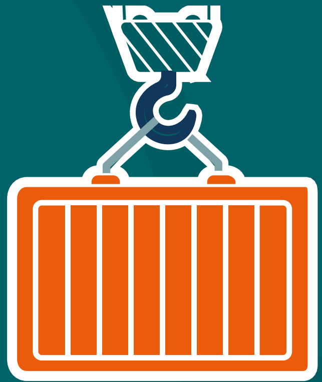
The second quarter of 2023 saw an improvement in domestic sales for London businesses. A quarter (24%) of companies in the capital said sales had risen in Q2, up slightly from 21% in Q1. The share of firms who reported a fall in domestic sales also shrank slightly from 32% to 29%: the net balance (the percentage of firms who report an increase minus the percentage who report a decrease) climbed 6 points to -5 in Q2.

Both micro and larger businesses saw a rise in domestic sales last quarter. The net balance for micro firms (0-9 employees) climbed from -13 to -8, with just over a fifth (22%) noting an increase in sales compared to Q1 2023 (20%). For larger companies (10 or more employees), the net balance jumped 12 points to +26 in Q2, with more than two-fifths (42%) saying that sales had risen.

This improvement in sales was driven by service sector companies, as businesses in 'arts, entertainment, recreation and other services' and 'information and communication' reported stronger activity in Q2. By contrast, for manufacturing firms sales growth weakened last quarter, with the net balance falling from -4 to -10.

Domestic orders also rose in Q2 2023 for the first time in five quarters. One in five (22%) London firms said their orders had increased compared to the previous three months, up from 15% in Q1. The net balance for domestic orders climbed from -17 to -7 in Q2, a one-year high.

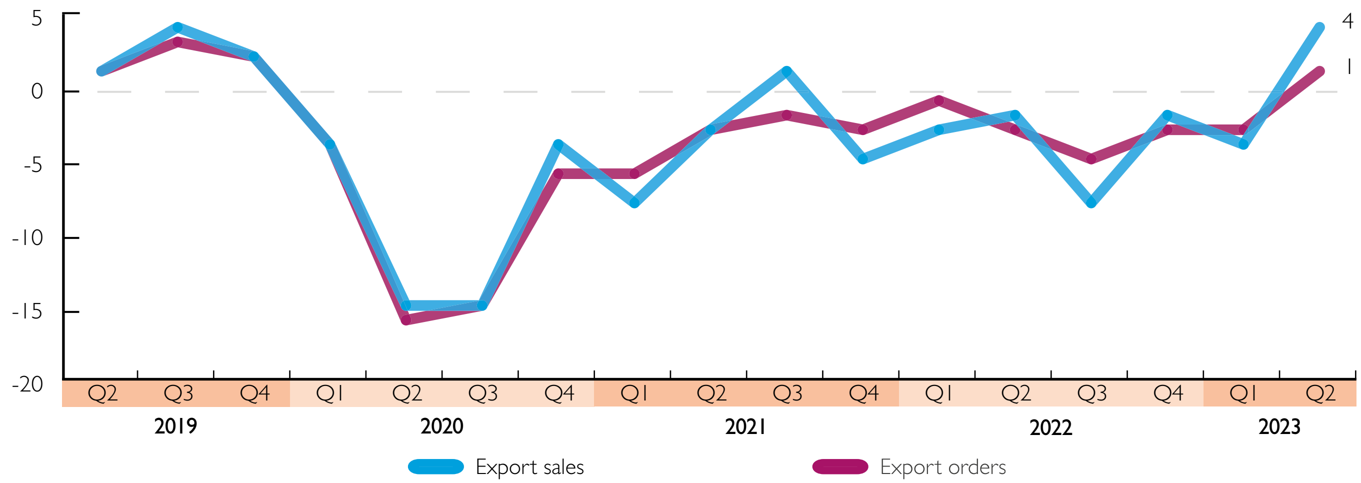
As with sales, the growth in orders was noted by firms of all sizes. For micro companies, the net orders balance rose from -19 to -10 in Q2, while for larger businesses the balance jumped 19 points to +20. Orders improved across multiple service sectors, including hospitality, information and communication, and professional services. However, for manufacturing firms orders were slightly lower in Q2 compared to the previous quarter.



13% of London businesses reported an **increase** in export sales last quarter

11% of London businesses reported an **increase** in export orders last quarter

EXPORT DEMAND



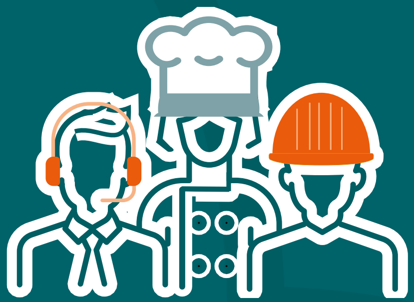
London companies also reported stronger demand from overseas in Q2. The net balance for export sales jumped from -4 to +4, with 13% of companies saying sales had increased compared to Q1 2023. Only 9% of firms reported a decline in export sales last quarter.

The improvement was due entirely to micro companies: the net balance for export sales rose 9 points to +3 in Q2. More than one in ten (12%) micro firms said export sales had risen compared to the previous three months, the highest share since Q1 2016. For larger companies, the export sales balance dipped 2 points to +14 in Q2 2023. Both manufacturing and service sector companies reported stronger export sales demand last quarter.

Export orders grew strongly in Q2 2023, with the net balance climbing 4 points to +1: this was the first positive reading since Q4 2019. Roughly one in ten (11%) London firms said their export orders had increased in Q2, compared to 10% who reported a decline in orders.

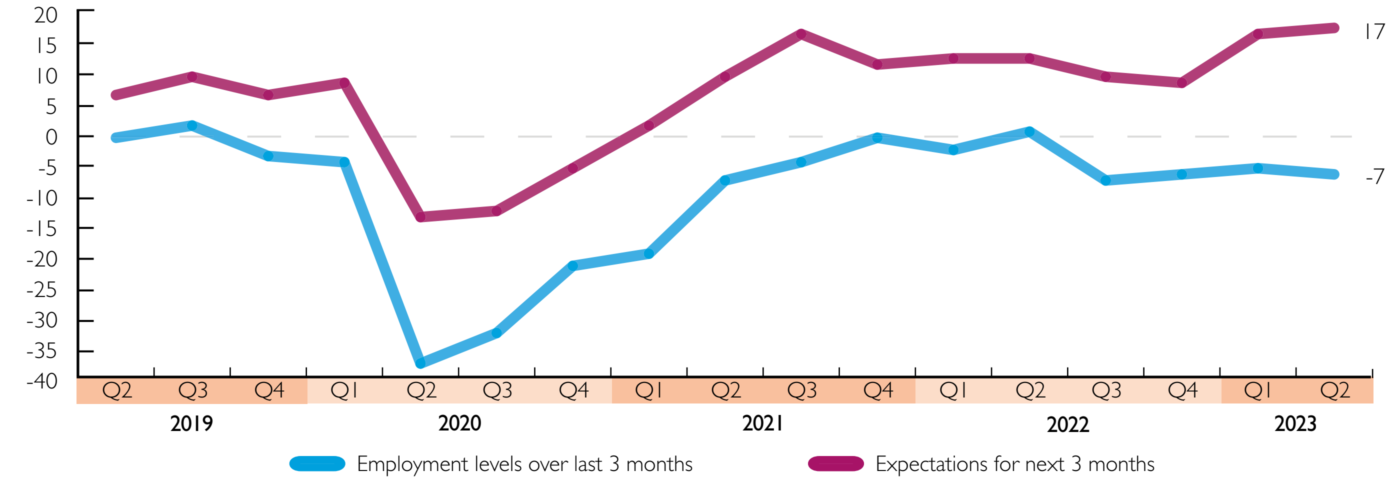
As with sales, the growth in export orders was driven by micro businesses: the net balance climbed from -5 to +1 in Q2. By contrast, the export orders balance for larger companies fell 7 points to +8, due to a higher share who reported a decline in sales.

LABOUR MARKET



13% of London businesses reported an **increase** in their workforce size last quarter

22% of London businesses expected their workforce size to **increase** over the coming three months



The latest data from the Office for National Statistics indicate that London's unemployment rate fell to 4.5% in the three months to April 2023, having remained around this level since October 2022.

Figures from the Capital 500 also point to a relatively stable labour market in London. The employment balance (reported workforce levels in the previous three months) dipped 1 point to -7 in Q2, with 13% of companies saying their workforce levels had increased. This was outpaced by a fifth (20%) of firms who said their workforce levels had fallen in the previous three months. For the majority of companies, workforce levels were unchanged (67%).

For micro companies, the employment balance slipped 2 points to -10 in Q2. However, for larger firms the balance rebounded from +6 to +18: a greater share of larger businesses said their workforce levels had increased (30%, up from 27% in Q1), while the proportion who saw a decrease shrank.

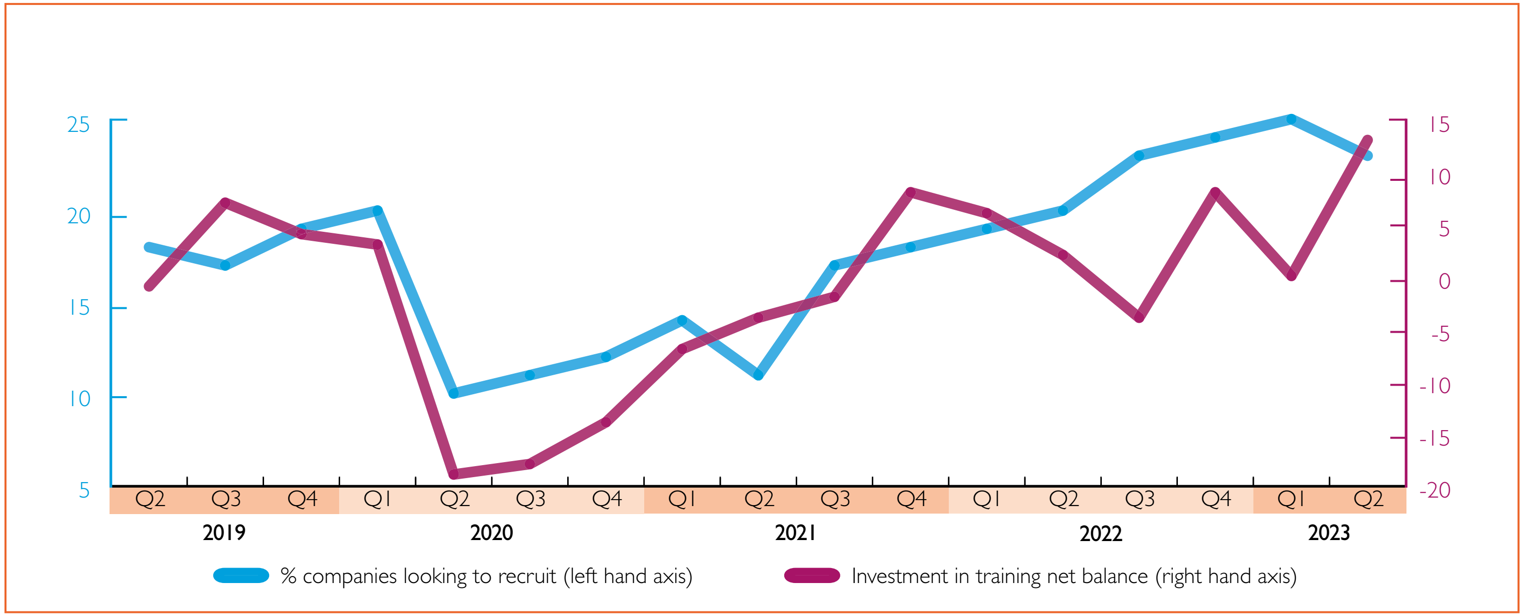
Businesses remain positive about their workforce levels in the coming three months, with the net balance nudging up 1 point to +17 in Q2. Around one in five (22%) London firms expect their workforce to grow in the next three months, unchanged from the Q1 2023 Capital 500. Encouragingly, only 5% think their employment levels will shrink.

Larger businesses continued to be more upbeat on their staffing numbers in Q2 compared to micro firms (19%), with half of larger companies (51%) expecting their employment levels to grow in the coming three months.

RECRUITMENT AND TRAINING

23% of London businesses reported that they had looked to recruit in the last quarter

22% of London businesses reported an **increase** in investment in training last quarter



Recruitment efforts by London businesses stalled for the first time in two years in Q2 2023, according to the latest Capital 500. The percentage of firms who said they had tried to recruit last quarter shrunk slightly from 25% to 23%, due to a smaller share of micro businesses seeking to hire new staff (19%). By contrast, two-thirds (66%) of larger companies sought to recruit in Q2, up from 61% in the Q1 2023 Capital 500.

The small slowdown in recruitment activity was primarily focussed in manufacturing, with the percentage of firms who tried to hire in related industries falling from 43% to 27% in Q2. The share of service sector firms who sought to recruit in Q2 was unchanged at 23%, although businesses in the hospitality and retail industries saw stronger recruitment activity compared to Q1.

Considering all London firms who tried to recruit in Q2, the majority still had difficulties doing so (67%). This was down slightly from Q1, but remains close to the record highs.

Investment in training rebounded sharply in Q2, with the net balance jumping from 0 to +13: this was the highest reading since Q1 2016. Two in ten (22%) London firms said spending on training had increased in Q2, up from 15% in Q1.

Both micro and larger companies upped their investment in training in Q2. For micro firms, the net balance climbed back into positive territory (from -2 to +11), while for larger businesses, the balance increased by 11 points from +22 to +33.

59%

of London businesses reported an **increase** in their fuel costs last quarter

69%

of London businesses reported an **increase** in their energy costs last quarter

BUSINESS COSTS

Signs of domestic and export demand improving will be encouraging for businesses. Nevertheless, they still face immense cost pressures. More than two-thirds (69%) of London companies said their energy costs rose in Q2 2023 compared to the previous three months. This was down from 74% in the Q1 2023 Capital 500, although only 4% of businesses in the latest survey said their energy costs had fallen. Companies' fuel cost pressures remain, with 59% saying their fuel costs had grown in Q2 2023: this is on par with results from Q1 (60%).

Supply chain costs remain elevated as well for firms. More than half (54%) of London businesses said their domestic raw material costs had risen in Q2, with only 2% reporting a fall compared to the previous three months. A similar share of companies said their international raw material costs had increased last quarter (48%).

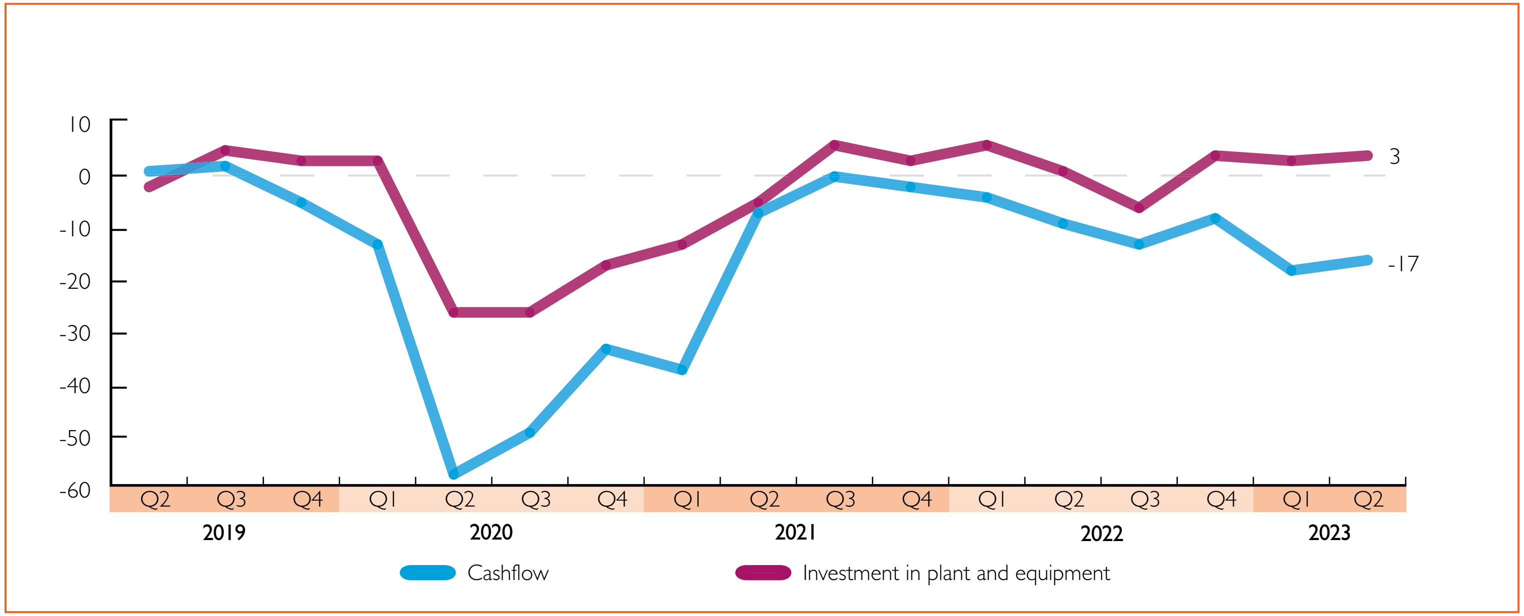
Businesses will be keeping a close eye on the Bank of England's upcoming interest rate decisions: 45% of London businesses saw their borrowing costs increase in Q2, with just 2% reporting a fall. The central bank has made clear that stubborn inflation figures, and high wage growth, could require further monetary policy interventions. Just under half (46%) of firms in London said pressure from employees to raise wages had grown last quarter.

Despite the cost pressures, there was a smaller share of firms who said they expect the prices of their goods and / or services to rise in the next three months (43% in Q2, compared to 50% in Q1). The main upward pressure on companies to raise their prices is coming from utilities (50%), followed by labour costs (39%) and finance costs (32%). Three fifths (59%) of manufacturing companies said that raw material costs were putting pressure on them to raise their prices.

22% of firms reported an **increase** in cashflow last quarter

16% of firms reported an **increase** in investment in plant and equipment

CASHFLOW AND INVESTMENT



There was a minor uptick in the cashflow balance in Q2, nudging up from -19 to -17. The share of London businesses who said their cashflow had increased in the previous three months grew from 19% in Q1 to 22% in Q2. However, the proportion of firms who said their cashflow declined also rose (from 38% to 39%). Roughly two-fifths (41%) of firms were operating at full capacity in Q2, similar to Q1 (42%).

Four in ten (41%) micro businesses reported a fall in cashflow in Q2 2023, compared to 20% who said cashflow had increased: the net balance nudged up from -23 to -21, but remains firmly in negative territory. Larger companies, by contrast, saw a bigger improvement in the cashflow net balance in Q2 (from +13 to +22).

For manufacturing businesses, the cashflow balance climbed from -28 to -18 in Q2 2023, while there was a smaller increase for service sector businesses (net balance rose 3 points to -16).

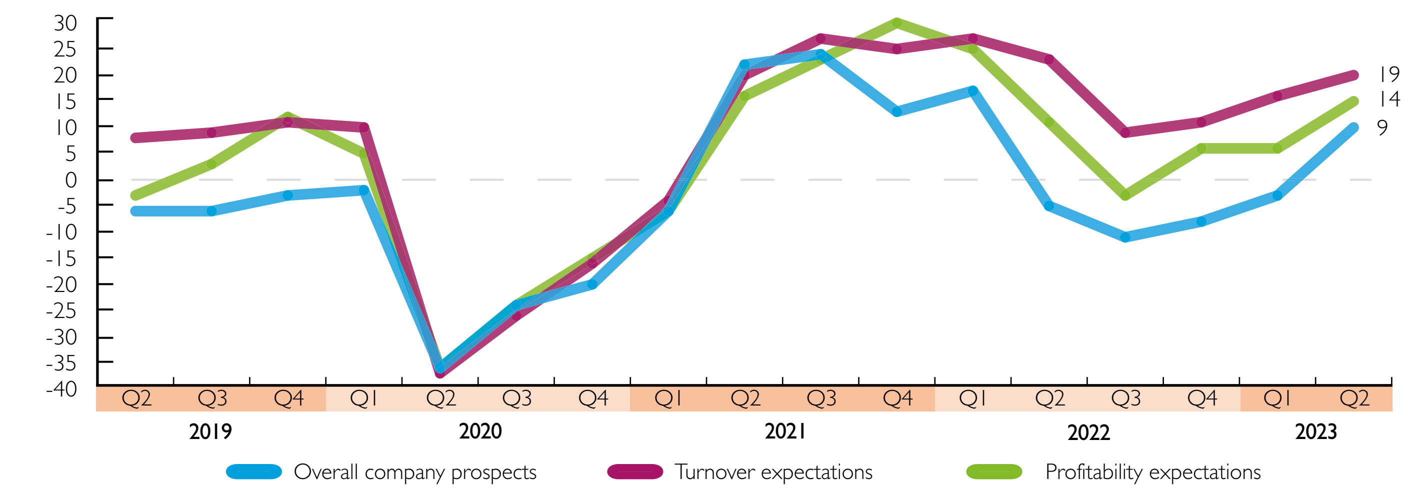
The improvement in cashflow within services industries was concentrated in the finance / business support sectors, and the information and communication sector. Companies in professional and business services, and the agriculture, forestry and fishing / production industries, reported weaker cashflow last quarter.

The net balance for investment in plant and equipment edged up 1 point to +3 in Q2, with 16% of companies saying they had raised capital spending last quarter: this was down slightly from the Q1 2023 Capital 500 survey (17%).

There was a divergence based on business size. For micro companies, the net balance for investment in plant and equipment dipped 1 point to 0 in Q2. Larger firms however saw a sharp increase in reported capital investment, with the net balance jumping 26 points to +29 last quarter: 36% of larger companies said they had increased investment in plant and equipment in Q2, up from 21% in Q1.

BUSINESS CONFIDENCE

39% of London businesses expect their profitability to **improve** over the coming 12 months



39% of London businesses expect their turnover to **improve** over the coming 12 months

Business confidence continued its recovery in the latest Capital 500. Turnover expectations improved for a third consecutive quarter in Q2, as two-fifths (39%) of London businesses think their turnover will increase in the coming 12 months. The share who expect turnover to worsen also shrunk from 24% to 20%, pushing the net balance up 4 points to +19 last quarter.

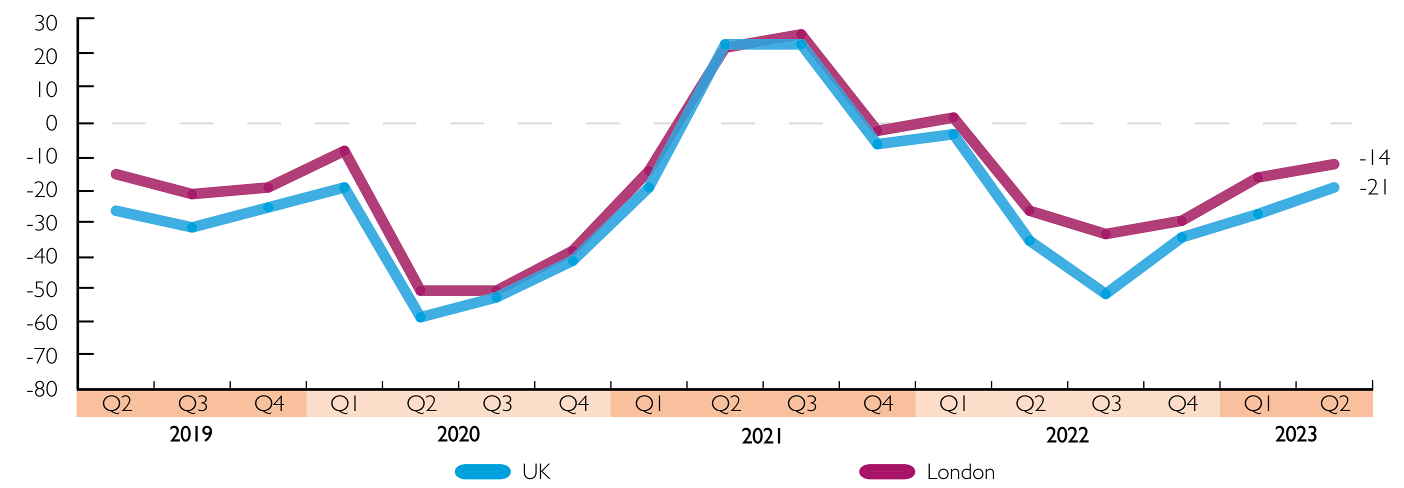
Both micro and larger companies were more upbeat on their turnover in Q2, with the net balance for larger firms climbing to the highest since Q3 2021, and the highest since Q2 2022 for micro companies.

Firms' expectations for their profitability in the coming 12 months also improved in Q2, with 39% anticipating an increase: this was up from 36% in the Q1 2023 survey. The proportion of companies who feel their profitability will worsen dropped from 31% to 25%. The net balance for profitability expectations rose 9 points to +14 in Q2.

For micro companies, the profitability expectations balance rose from +2 to +11 last quarter, with 37% expecting profitability to improve in the next 12 months. The increase was even bigger for larger businesses: the profitability balance jumped 16 points to +48 in Q2. Three-fifths (61%) of larger firms anticipated an increase in profitability, the highest share in more than three years.

Overall company prospects were up sharply as a result, with the net balance rising 13 points to +9 in Q2. A third (33%) of London firms think their own company's prospects will improve in the next 12 months, while 24% anticipate a deterioration. Larger and micro businesses alike were more upbeat on their prospects in Q2.

ECONOMIC OUTLOOK



Businesses' outlooks for the London and wider UK economies also improved in Q2, albeit in a less pronounced way.

The net balance for the outlook of London's economy rose from -18 to -14 last quarter, with a quarter (24%) of companies expecting the capital's economy to grow over the coming 12 months. However, a larger share thought London's economy would contract in Q2 (38%, although this is down from 43% in the Q1 2023 Capital 500).

Micro and larger businesses were both more optimistic about London's growth prospects in Q2. For larger firms, the net balance climbed 12 points to +11, the first positive reading since Q1 2022. The net balance for micro companies edged up 4 points to -16 last quarter.

Turning to the wider UK economy, the net balance rose from -29 to -21 in Q2, with 23% of London companies expecting UK GDP to improve in the next 12 months. The share of firms who think the UK's economy will worsen also shrunk from 54% in Q1 to 44% in Q2.

As with the capital outlook, it was larger companies who were more upbeat on the UK's economy in Q2: the net balance for larger firms climbed 18 points to +7, turning positive for the first time since Q3 2021. Nevertheless, micro businesses were more upbeat too, with the net balance rising from -31 to -23 in Q2.

24% of London businesses expect London's economy to **improve** in the next 12 months

23% of London businesses expect the UK's economy to **improve** in the next 12 months

James Watkins
Head of Policy and Public Impact
jwatkins@londonchamber.co.uk

Stephen Jones
Policy and Research Manager
sjones@londonchamber.co.uk