LONDON CHAMBER of COMMERCE AND INDUSTRY

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Q4

CAPITAL 500

London Quarterly Economic Survey

October – December **2022**

In partnership with

Savanta:

Sponsored by

haysmacintyre

JAMES WATKINS

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

LCCI COMMENTARY – THE BUSINESS VIEW

The start of a new year should normally herald a wave of optimism, but unfortunately the challenges facing London's business community appear to be dampening confidence in our most recent Quarterly Economic Survey. Domestic demand picked up slightly in the final three months of 2022, and cashflow showed marginal improvements for the first time in several quarters. Nevertheless, whilst it was conducted in October and November 2022, our QES pointed to half of London firms still expecting a decline in the capital's economy in 2023.

Key challenges facing London firms, such as the continued cost of doing business and living crises, the seemingly unending industrial action, and the effects of Russia's war in Ukraine, have not gone away. LCCI's mission is to be the voice of London's businesses, from sole traders and micro companies to the multi-nationals, and we will endeavour to continue this work in 2023. London remains the UK's engine, and it is the capital's businesses that drive that economic growth.

London's businesses have time and again shown their resilience and determination to weather storms, and LCCI stands ready to continue supporting the capital's firms as they look to recover from the pandemic and thrive.

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 500 London business leaders between 20 October and 9 November 2022. 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.

GUEST COMMENTARY – THE ECONOMIST'S VIEW

VICKY PRYCE

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

The latest QES for London businesses is reasonably encouraging as we start 2023. Firms in general seem to be working closer to full capacity and although domestic orders seem to be down, there is more investment and training being contemplated and recruitment is holding up. However, this is coming at a time when world growth forecasts are being revised downwards. The IMF is warning of a global recession, concerned about the slowdown already visible in the US, the EU, and a post zero-Covid policy China. and the impact on the rest of the world which is dependent on those big regions growing strongly. The WTO expects merchandise trade to rise by just 1% this year and there is an increasing scope for trade wars to escalate. Similarly, the war in Ukraine does not seem to have an end point, which is adding to the uncertainty. There is the worry that synchronised interest rate increases currently taking place by major central banks, though perhaps necessary, are likely to make a slowdown coming from a squeeze in real living standards more intense. And yet there are some positives. International food prices have been coming down for several months now, though that will take time to be reflected in final consumer prices as producers are still passing earlier cost increases through. At the same time, energy prices have fallen considerably: oil prices remain comfortably below $100 a barrel and that is already being reflected at the petrol pumps. Gas prices in Europe, although around twice the levels of a year ago, have come down substantially over the last few months. Europe seems to have been able to fill up its gas reserves and is feeling confident about meeting winter needs. A milder winter is helping, and things could change if the war in Ukraine escalates. Nevertheless, inflation is beginning to come down from double-digit levels in many regions, though some of that is due to extensive energy subsidies and there is always a concern about how long those might last. At the same time Europe is doing a lot to constrain energy consumption and this is likely to reduce some of the energy-intensive industries' output, which may affect other sectors too. Growth in the Eurozone and the EU overall is likely to be around 0.3% in 2023 and some big countries such as Germany and Italy may well see small declines in GDP for the year.

The prospects for the UK cannot be too divorced from what is going on elsewhere. However, the worrying aspect of forecasts is that on current projections, the UK may end up worse off in relation to comparable countries. For example, in late 2022 UK GDP was still below pre-pandemic levels while all other G7 countries were above. And while the Q3 2022 fall in UK GDP has been revised downwards (to -0.3%), the EU grew by 0.2% in the summer months. The last quarter of 2022 may prove negative too in the UK, confirming a technical recession. For 2023 the horizon is clouded by continuing widespread strikes. For the next 12 months the OECD expects a Russian gas-starved Germany and the UK to contract at roughly the same pace, by some -0.2% or -0.3%. However, the two trends are then likely to diverge markedly for 2024 when Germany and the rest of the large OECD countries recover but the UK stagnates. One reason is that the UK is one of the few developed economies tightening both monetary and fiscal policy at the same time, something reinforced by further stealth taxes in the November budget. A sharp fall in real household disposable incomes, in addition to wages failing to keep up with inflation, is made worse by higher interest rates, which have now been raised nine times in consecutive MPC meetings since December 2021 to stand at 3.5%, a 14-year high.

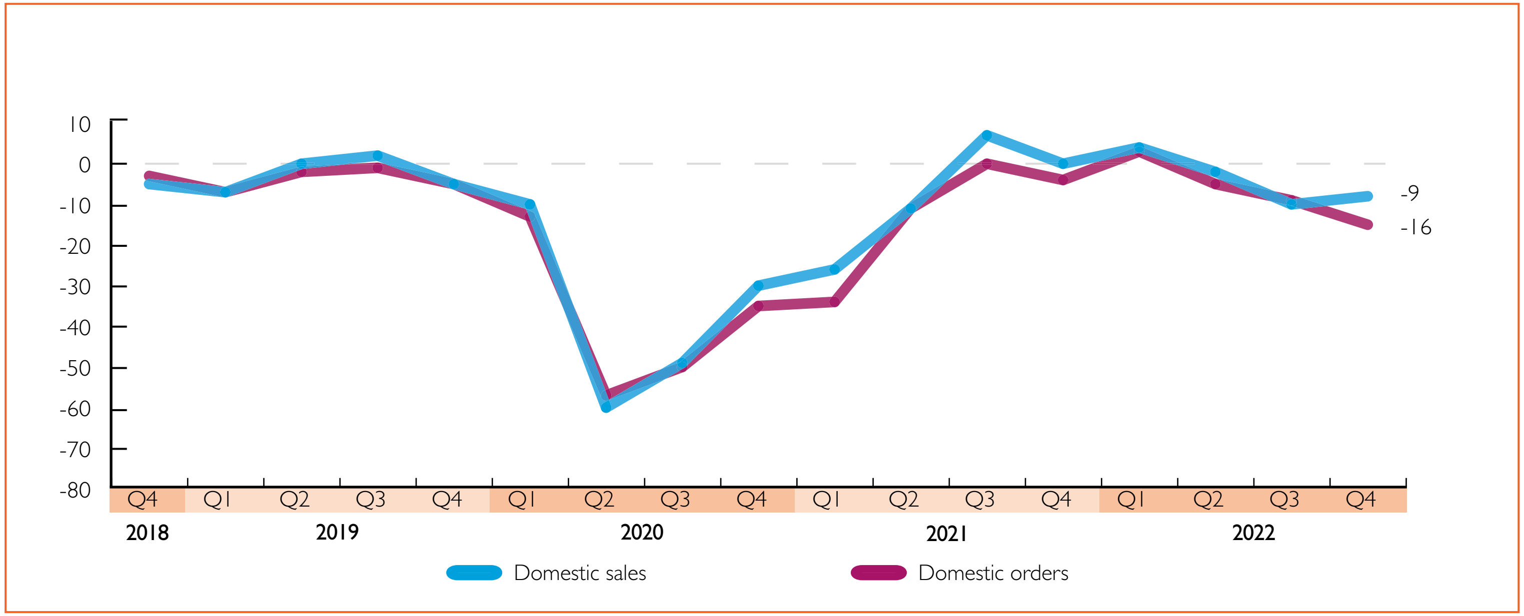
Inflation could well halve by the end of the year, as the Prime Minister has just pledged. That will be due mostly to international price trends barring an escalation of the war in Ukraine, rather than domestic policy. The path of that decline in the UK may not be particularly smooth as a planned rise in the household electricity price cap in April could lead to a temporary uptick in inflation, as will an expected reduction in direct energy price support for businesses. However, inflation is still forecast to drop sharply. Whether that will in itself be the magic potion the nation needs to recover remains to be seen.

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

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

16% of London businesses reported an **increase** in domestic orders last quarter

DOMESTIC DEMAND



There was a small uptick in domestic sales reported by London businesses in the final quarter of 2022. The domestic sales net balance (i.e. the percentage of firms reporting an increase minus the percentage reporting a decrease) nudged up from -11 to -9 in Q4, with a small increase in the share of businesses who said sales had risen (from 18% in Q3 to 22%). However, a bigger proportion of companies also said sales had fallen (31% in Q4, up from 29% in Q3).

The minor rise in Q4 2022 was driven by larger companies (defined as firms with 10 or more employees): two in five (39%) of larger businesses said domestic sales rose in Q4, up from 28% in Q3. The proportion who said sales had fallen also shrunk slightly from 21% to 18%, pushing the net balance for larger companies up from 7 in Q3 to 21 in Q4. By contrast, the net balance for micro businesses (0-9 employees) improved slightly from -13 in Q3 to -12, but remains firmly in negative territory. There was also a significant geographical split for domestic sales in Q4. For inner London companies, the net balance jumped 10 points to -2, with 26% of companies seeing an increase in sales compared to Q3. In outer London, the balance fell to an 18-month low of -16.

While there was a small improvement in sales, domestic orders continue to trend lower. In Q4, the net balance fell for a third consecutive quarter from -10 to -16, with only 16% of firms saying orders had risen compared to Q3 (down from 18%). One in three (32%) companies said domestic orders had fallen.

This drop was due to micro firms, with the net balance falling 7 points to -19. Larger companies reported stronger orders (net balance rose from 11 to 18). On a sectoral basis, the decline in orders was concentrated in the professional, finance and information services sectors.

9%

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

8%

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

EXPORT DEMAND

Export sales rebounded in Q4 2022, with the net balance climbing 6 points to -2. The proportion of firms who said export sales had increased in Q4 more than doubled (from 4% to 9%). While the jump in sales was encouraging, it is worth noting that the net balance remains in negative territory.

This rise in export sales was seen across manufacturing and services, with the biggest increases seen in the arts, entertainment and recreation industries, and motor trades, wholesale, and retail sectors.

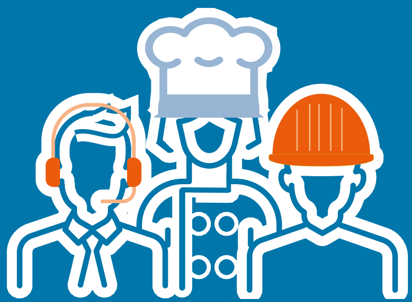
Both micro and larger businesses reported a rise in overseas sales, with the net balance for micro companies rising from -9 to -3. Just under one in ten (8%) micro firms said their sales had increased in Q4, up from 3% in Q3. The export sales balance for larger businesses increased from 8 to 17, with 22% seeing a rise in sales in the last three months of 2022: there was also a much smaller proportion who said sales had decreased (5%, down from 13% in Q3).

There was a smaller gain in export orders in Q4: the net balance nudged up 2 points to -3, as 8% of London firms said export orders had grown compared to Q3.

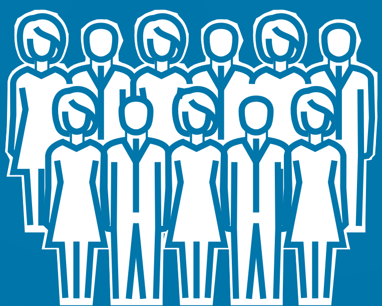
Larger companies drove this increase, with the net balance climbing 5 points to 11 last quarter, the highest since Q3 2021: 21% of larger firms said orders had risen. For micro firms, the net balance was unchanged at -5.

Manufacturing firms reported a drop in orders in Q4, but for services firms, the net balance rose from -6 to -3 after stronger reported demand in the hospitality and retail sectors.

LABOUR MARKET



10% of London businesses reported an **increase** in their workforce size last quarter



17% of London businesses expected their workforce size to **increase** over the coming three months

The latest figures from the Office for National Statistics suggest the unemployment rate (for 16-64-year-olds) remains close to record lows, while there has been a big decline in the number of Londoners who were 'economically inactive'. More than 4.6 million Londoners aged 16-64 were employed in the three months to October 2022, up 40,000 from the same period a year ago.

According to the Capital 500, the employment net balance edged up from -8 to -7 in Q4 2022, after dropping in Q3. This was driven by a higher share of businesses who said their workforce levels had increased in the past three months (10%, up from 7% in Q3). There was a small rise in the proportion of businesses who said employment levels had declined in Q4 (from 15% in Q3 to 17% in Q4). Employment grew in the public sector, arts, entertainment and recreation, and information services, which offset a small dip in manufacturing workforce levels.

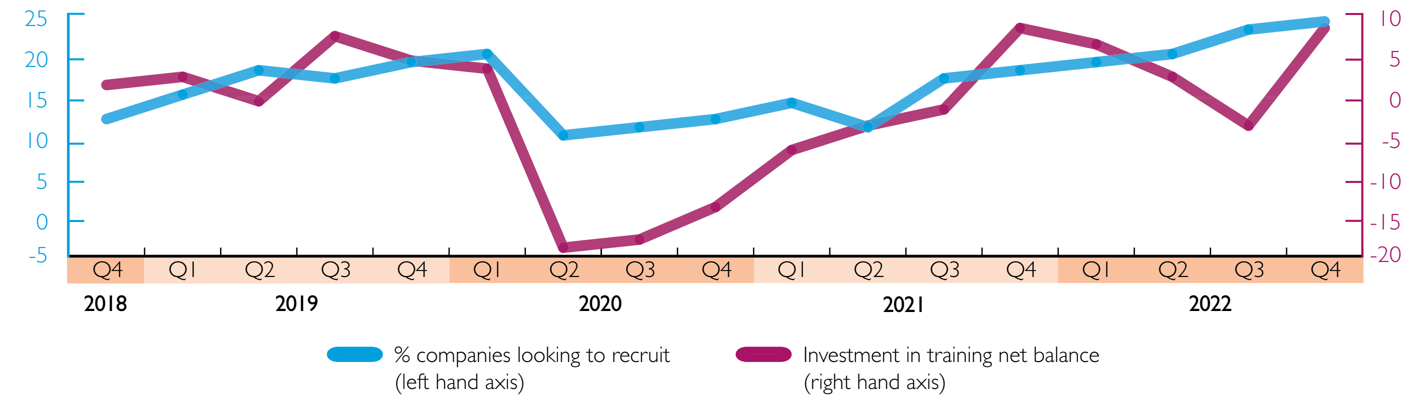
For micro businesses, the employment net balance rose from -11 to -9 in Q4. Larger companies also reported an increase in hiring, with the net balance climbing 5 points to 19, the highest since Q3 2021. A third (33%) of larger firms said their workforce had grown in Q4. As with domestic sales, there was a geographic split in Q4: in inner London, the net balance for employment rose from -9 to -2, with more than one in ten (13%) of firms saying their workforce levels had increased. By contrast, the employment balance for outer London businesses fell to -13, the lowest in 18 months.

Intentions for the next three months were stable in Q4. The net balance for workforce level expectations in the next three months nudged down from 9 to 8, but the proportion who expect employment levels to rise in Q1 2023 was unchanged (at 17%).

RECRUITMENT AND TRAINING

24% of London businesses reported that they had looked to recruit in the last quarter

21% of London businesses reported an **increase** in investment in training last quarter



Recruitment activity continued its steady rise in the final three months of 2022, with a quarter (24%) of firms having sought to hire: this was a fresh record for the Capital 500. Around two-fifths (43%) of London firms who were looking to recruit were trying to fill current gaps in their workforce, while close to three in ten (28%) were trying to fill new roles. A similar share of businesses were recruiting for a combination of new roles and current gaps (28%).

The rise in Q4 hiring was due to larger businesses, with 72% having said they had tried to hire in Q4. Larger firms were predominantly recruiting to fill a combination of gaps in their current workforce and new roles (40%), with roughly similar shares looking to exclusively hire for new roles (27%) or current workforce gaps (32%).

The vast majority of London businesses who tried to recruit in Q4 had difficulties doing so (71%), a new high for the Capital 500. There was an increase in micro and larger companies who had difficulties recruiting in Q4. Businesses said it was more difficult to recruit people into professional / managerial (65%), skilled manual/ technical (48%), and clerical (24%) roles.

There was a sizeable increase in reported training investment in the latest Capital 500, with the net balance reversing three consecutive declines to jump from -4 to 8. The proportion of firms who said they had increased spending on training in Q4 grew from 12% to 21%.

This uptick was seen across businesses of all sizes. For micro firms, the investment in training net balance climbed back into positive territory in Q4 (from -5 to 4), as 18% said spending had risen compared to Q3. The increase in the training investment balance for larger companies was even bigger (up 25 points to 40), a record high on the Capital 500.

BUSINESS COSTS

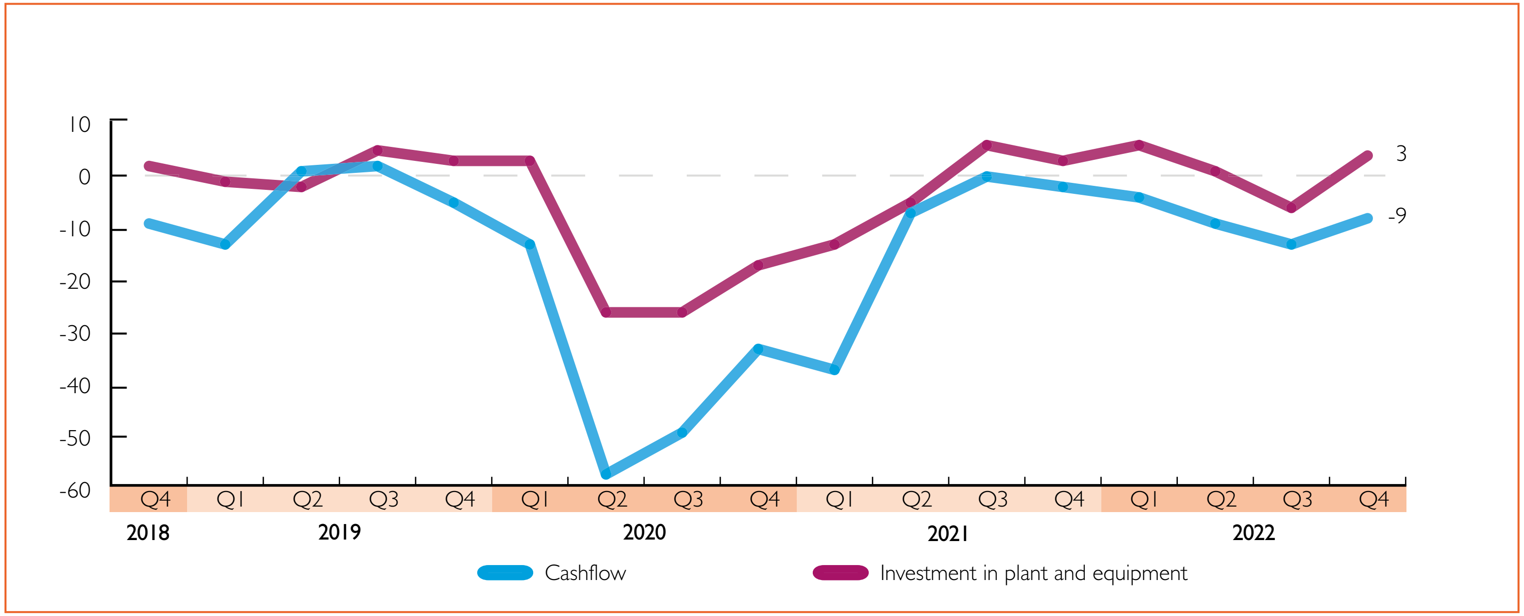
70% of London businesses reported an **increase** in their fuel costs last quarter

79% of London businesses reported an **increase** in their energy costs last quarter

London businesses continue to face intense cost pressures, with the tight labour market and cost of living crisis clearly having an impact. Pressure to raise wages from employees was reported to have increased in Q4 by 50% of companies, the highest reading since the Capital 500 began in 2014. Nearly half (47%) of micro firms said pressure to raise wages had grown last quarter, up from 37% in Q3. Four-fifths (79%) of businesses with 10 or more employees said there was more pressure to increase wages. Just under half (48%) of London firms say they are under pressure to raise their prices as a result of labour costs. The cost pressures continue to be felt elsewhere, with 79% of firms saying their energy costs had risen in Q4. There was a slight uptick in the share who said energy costs had fallen compared to Q3 (from 1% to 4%), but this remains a small proportion of firms. Seven in ten (70%) London businesses said their fuel costs had increased in Q4.

After easing in the Q3 2022 Capital 500, cost pressures from raw materials were reported to have grown again in Q4. For raw materials sourced domestically, 57% of businesses said there had been an increase in costs. There was a similar share of firms who said costs for raw materials sourced internationally had grown in Q4 (53%). Borrowing costs climbed further in Q4, with two in five (43%) of London firms noting an increase in the past three months. Inflation remains the number one concern for London businesses (74%), but 43% are also now more concerned about interest rates than they were in Q3. A similar share (39%) of companies noted that finance costs were putting pressure on them to raise prices. In addition to concerns over inflation and interest rates, there was a big jump in the proportion of firms who said they were more worried about corporate taxation (from 22% to 34%). As a result of rising costs, more than half (52%) of London firms expect to raise the prices of their goods and / or services in the next three months. Utilities (60%) and labour costs (48%) are the main upward driving forces on firms' prices, alongside fuel (40%) and finance costs (39%).

CASHFLOW AND INVESTMENT



The net balance for cashflow rose for the first time in five quarters, from -14 to -9 in Q4 2022, with 24% of companies noting an increase compared to Q3: this was up from 20% in the previous Capital 500. Part of this may be linked to a big rise in the proportion of firms who said they were operating at full capacity in Q4 (from 38% to 50%). To be clear, a third (33%) of firms still noted a decline in cashflow in the final three months of 2022. For micro companies, the cashflow net balance climbed 4 points to -11 in Q4, with 23% saying cashflow had risen compared to the previous quarter. Larger businesses saw an even bigger increase, with the net balance jumping back into positive territory (up 16 points to 13): four in ten (39%) larger firms said cashflow had improved in Q4, up sharply from Q3 (25%).

Mirroring the latest figures on domestic sales, the change in cashflow was driven by inner London companies: 27% said cashflow had increased in Q4, up from 21% in Q3, and there was a smaller proportion noting a decline in cashflow. The net balance jumped 13 points to -1. By contrast, four in ten (39%) outer London companies said that cashflow had worsened in Q4, up from 33% in Q3. The net balance fell from -13 to -17.

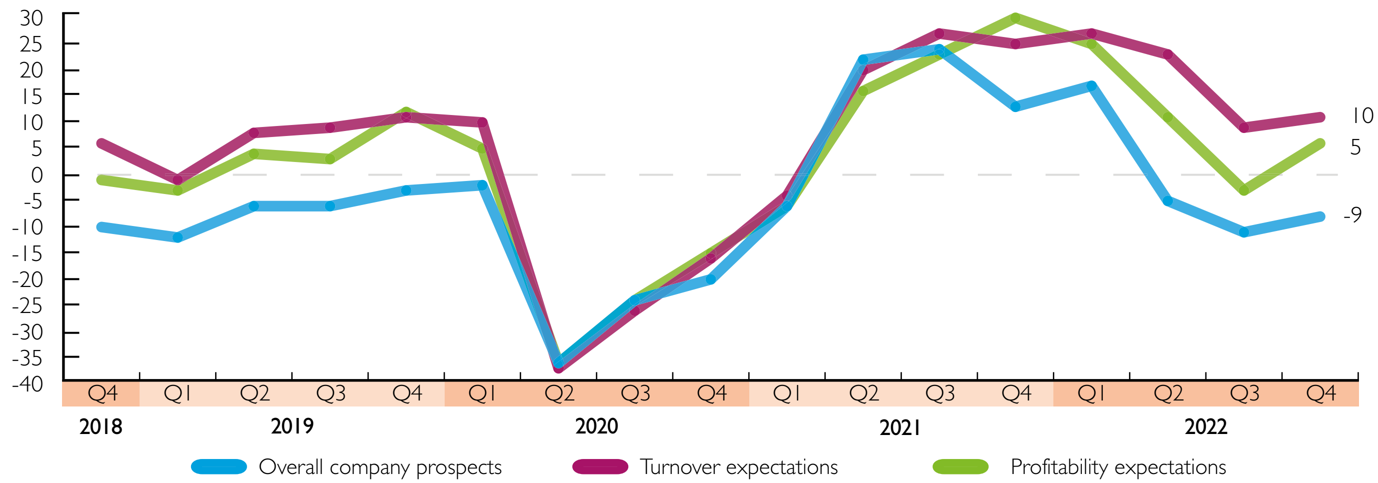
Investment in plant and equipment improved in the final three months of 2022, with the net balance climbing back into positive territory (from -7 to 3). One in seven (14%) London businesses said that they had increased plant and equipment investment in Q4, while 11% said there had been a decline. Businesses of all sizes raised investment spending on plant and equipment in Q4, with the net balance for micro firms rising from -9 to 2. For larger companies, the net balance improved from 5 to 13, as 25% reported higher plant and equipment investment last quarter.

24% of firms reported an **increase** in cashflow last quarter

14% of firms reported an **increase** in investment in plant and equipment

BUSINESS CONFIDENCE

28% of London businesses expect their profitability to **improve** over the coming 12 months



37% of London businesses expect their turnover to **improve** over the coming 12 months

Despite the external headwinds – such as the cost of doing business crisis, a looming recession, and the continued war in Ukraine – there was a small uptick in business confidence in Q4. After falling sharply in Q3, the net balance for turnover expectations nudged up from 8 to 10, with 37% anticipating an increase in turnover in the next 12 months. There was a small rise in the share of firms who expect turnover to worsen in 2023 (from 26% to 27%).

The net balance for micro firms' turnover expectations was relatively stable (8 in Q3, 7 in Q4), with the proportion who expect weaker turnover in the next 12 months growing slightly from 26% to 29%. For larger companies, the turnover expectations net balance jumped 16 points to 32: 47% are anticipating higher turnover in 2023, while only 15% are expecting a decline.

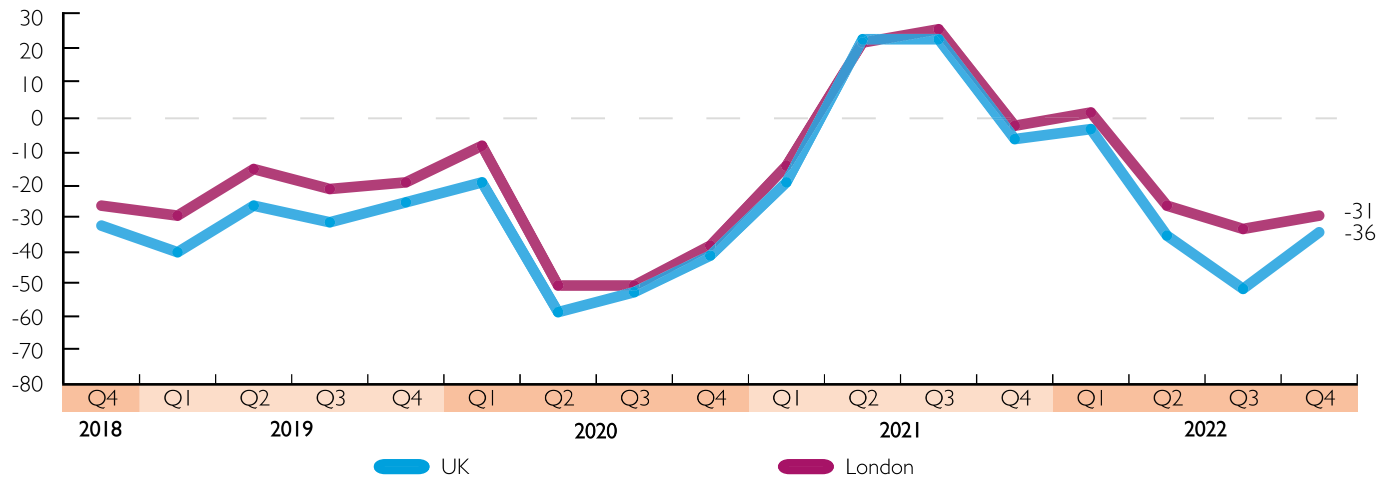
Profitability expectations turned positive again in Q4, as the net balance climbed 9 points to 5. Close to two-fifths (37%) of London businesses think their profitability will increase in the coming year, while a third (32%) expect profitability to worsen. As with turnover, both micro and larger businesses were more optimistic in Q4 about their profitability in the next 12 months. The net balance for larger companies' profitability expectations climbed from 8 to 20, with 43% thinking profitability will increase in 2023. More than a third (36%) of micro companies think profitability will improve next year, pushing the next balance back into positive territory (up from -5 to 3).

As a result, firms were slightly more upbeat on their own company prospects in Q4. The net balance nudged up from -12 to -9, with a quarter (25%) of businesses thinking their company's outlook will improve in the next 12 months. It is important to note that the fieldwork for this survey was conducted *before* the Chancellor's Autumn Statement on 19 November 2022, and before the recent rounds of industrial action were announced.

ECONOMIC OUTLOOK

21% of London businesses expect London's economy to **improve** in the next 12 months

22% of London businesses expect the UK's economy to **improve** in the next 12 months



Business confidence for the UK and London economy posted a small rebound in the final three months of 2022, although the outlooks for the coming year remain pessimistic. When considering the capital's economy, 21% of firms thought there would be an improvement in the coming year, pushing the net balance up from -35 to -31. Nevertheless, more than half (52%) of London firms still think the capital's economy will worsen in 2023.

A majority of both micro (52%) and larger (54%) think London's economy will decline over the next 12 months. Nearly three-in-five (57%) outer London businesses were pessimistic about the capital's economy, higher than their inner London counterparts (48%).

After falling to the lows seen during the pandemic, the business outlook for the wider UK economy picked up in Q4: the net balance climbed 17 points to -36, on the back of more companies thinking the UK economy would improve in the next 12 months (22% in Q4 versus 13% in Q3). However, three in five (58%) London businesses still think the UK's economy is going to worsen in 2023.

For micro companies, the outlook for the UK economy was slightly improved as the net balance rose from -54 to -36. Larger businesses reported a much smaller increase in the net balance (from -41 to -40). A similar share of micro and larger firms thought the UK's economy would worsen in the coming 12 months (58% and 62%, respectively).

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