LONDON CHAMBER of COMMERCE AND INDUSTRY

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Q3

CAPITAL 500

London Quarterly Economic Survey

July – September **2022**

In partnership with

Savanta: ComRes

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JAMES WATKINS

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

LCCI COMMENTARY – THE BUSINESS VIEW

The latest results from our Quarterly Economic Survey suggest a fraught economic environment for London businesses. Domestic demand has turned lower again, following the recent slide in retail sales seen across the country. Turnover and profitability expectations for the year ahead have deteriorated further in Q3, with cashflow becoming an issue for more and more firms.

Raw material costs are still rising for more than half of London firms. Borrowing costs are climbing, with the latest increase in interest rates from the Bank of England set to put further pressure on debt repayments. Labour costs continue to grow, while energy and fuel bills remain elevated. In this aspect, the support announced by the Government on energy is welcome, although we caution policymakers to avoid a cliff-edge in six months' time. Work must start now on giving firms a clear idea of what support will be available come March 2023.

In addition, the Chancellor's decision to scrap the rise in National Insurance Contributions and the planned increase in corporation tax are welcome news for businesses. These measures, alongside the changes to investment allowances, will hopefully support greater business investment in both the short- and medium-term.

This is a difficult time for the capital's businesses but London firms' ability to bounce back from adversity has been demonstrated time and again. Nonetheless, LCCI is urging Ministers to put in place long term measures so that firms, and the jobs that depend upon them, do not suffer from factors which are beyond the control of business.

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 ComRes surveyed a total of 501 London business leaders between 4 August and 1 September 2022. All data were weighted to be representative of all London businesses by company size and broad industry sector. Savanta ComRes is a member of the British Polling Council and abides by its rules. Full data tables are available at **www.comresglobal.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

The latest QES coincides with a real shock to the markets from the sharp cut in taxes announced by the new Chancellor on 23 September 2022, the largest since 1972. It comes on top of a deterioration in world economic conditions, with the Global PMI flattening for a few months now and increases in global interest rates, including in the UK where the Bank of England raised rates by 50 basis points on 22 September. The World Bank has suggested that a sharp and synchronised increase in interest rates, which it thought would be necessary to tackle global inflation, would likely dip the world economy into recession. Yet the Bank of England was criticised after the recent rate increase for not undertaking a more aggressive hike, given that both the US Federal Reserve and the European Central Bank had lifted their own rates by 75 basis points.

In defence of the BoE, one assumes that it took account of the massive energy price freeze for households and businesses starting in the autumn, which once implemented could well reduce the expected inflation rate by as much as 4%. Nevertheless, the developments of the days that followed caught many by surprise. As the dollar surged on hawkish statements from the Fed and the full impact of the tax cuts in the UK was realised, sterling was hit as inflation expectations were once again adjusted upwards. Although the Bank has resisted intervening to raise rates as an emergency measure, it has said it would adjust policy if necessary at its next scheduled meeting on 3 November. Shortly after, HM Treasury has said it will publish a medium-term fiscal plan, backed up one assumes by the scheduled Office for Budget Responsibility forecast. However, in the meantime yields on government bonds have shot up, with the 10-year gilt yield up to over 4% (at the time of writing) – compared to less than 1% a year ago.

Uncertainty has therefore increased. The signs of a substantial slowdown in the economy were already appearing, with the BoE suggesting that the UK was likely already in recession. Worryingly, the services PMI fell in September for the first time since February 2021 and manufacturing output has been in decline for a number of months now. Consumer confidence dropped sharply in the summer as did business confidence. In addition, the OECD in September forecast that the UK will see a drop in GDP in 2023, alongside Germany and Italy which are suffering from energy supply disruptions.

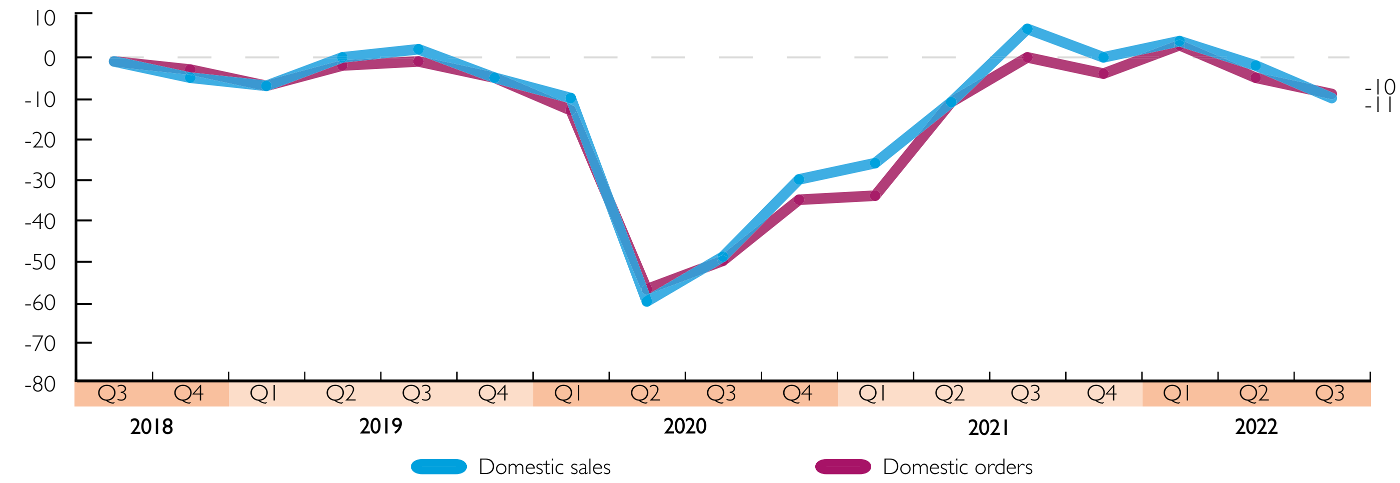
On the positive side, oil prices and European and UK gas prices have fallen back recently, global food prices are in decline and freight rates and supply chain issues have been easing. In the UK, the energy freeze has been welcomed by business though there are worries about whether it will be extended and in what form beyond March 2023. A number of measures announced in the mini budget, including the reintroduction of duty-free shopping in places like London, new industrial zones, an extra £500 million in funding for investment in technology, renewed promises of planning reforms, and measures to deregulate parts of the City, will probably be welcomed by businesses. One hopes though that this positivity does not get drowned out by the noise about what looks like an unfunded series of tax cuts – with more possibly to come.

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

DOMESTIC DEMAND

18% of London businesses reported an **increase** in domestic sales last quarter

18% of London businesses reported an **increase** in domestic orders last quarter



London businesses reported a drop in domestic demand for the second consecutive quarter in Q3 2022, according to the latest Quarterly Economic Survey. The net balance for domestic sales fell from -3 to -11 in Q3, with the share of firms reporting an increase in sales shrinking from 22% to 18%. More businesses also indicated sales had fallen when compared to the previous three months (29%, up from 25% in Q2).

This drop in domestic demand was felt most keenly by London's smallest firms. For micro businesses (0-9 employees), the net balance fell 8 points to -13, with close to a third (30%) saying that sales had fallen in the past three months. The drop in the domestic sales balance for larger firms (10+ employees) was less severe (from 11 to 7).

Businesses across London saw weaker sales in Q3, while on an industry basis the biggest declines were seen in the motor trades, wholesale, retail, transport and storage, and accommodation and food services sectors. Firms in the arts, entertainment and recreation services sectors also saw a sharp drop in demand over the summer. This was offset by increased sales in information and communication, finance and business support, and the public sector.

The drop in domestic orders was not as pronounced, with the net balance slipping 4 points to -10 in Q3 2022. The proportion of businesses who saw a rise in orders grew slightly, but this was offset by a greater share of firms reporting a decline (28%, up from 23% in Q2). Orders fell for micro companies (the net balance dipped from -8 to -12), but rose for larger companies (balance climbed from 7 to 11).

As with sales, domestic orders were down sharply in the retail, motor trades and accommodation sectors, while manufacturing firms also reported a sharp fall in Q3.

4%

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

6%

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

EXPORT DEMAND

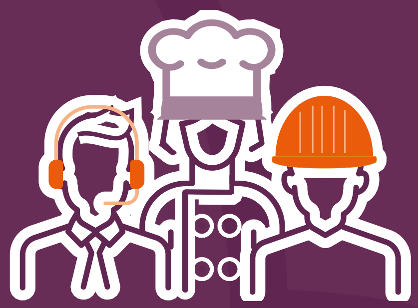
Export sales fell to their lowest level in 18 months in Q3 2022, with just 4% of London businesses reporting an increase in sales over the past quarter. The net balance for export sales slipped from -2 to -8 in Q3. One in ten (12%) firms said sales had fallen in Q3, unchanged from the previous quarter.

This decline was due almost entirely to micro businesses: only 3% said export sales had risen last quarter, down from 9% in Q2. The net balance fell 6 points to -9, a two-year low. For larger companies, there was only a small decline in the export sales net balance in Q3 (down 1 point to 8), with a fifth (21%) reporting an increase in sales.

On a sectoral basis, motor and retail trade saw the steepest fall in sales, which was offset partially by higher manufacturing export sales. There was also a split based on geography: firms in inner London reported a sharp drop in sales, while outer London businesses saw sales increase in Q3.

Demand for export orders also slipped in Q3, with the net balance declining for a second consecutive quarter (from -3 to -5). Orders for micro businesses were slightly lower: the balance nudged down from -4 to -5, with fewer firms saying orders had risen. There was an increase in the proportion who had seen no change in orders. For larger companies, the export orders balance dipped 2 points to 6 in Q3.

As with sales, the decline in export orders was concentrated in the service sector, predominantly in public administration, health and defence, and professional, scientific and technical services. Manufacturing export orders climbed in Q3.



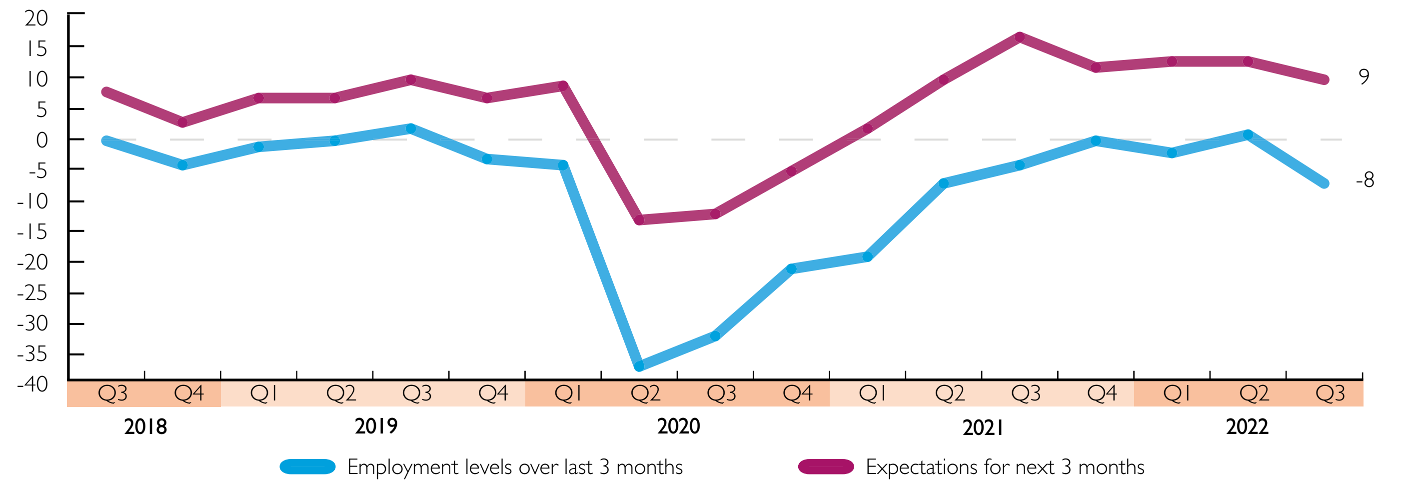
7%

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

LABOUR MARKET



The latest figures from the Office for National Statistics showed a decline in London's unemployment rate to 4.2% in the three months to July 2022, the lowest since January 2019. However, there has been a rise in the number of Londoners who are 'economically inactive' that has accompanied this decline in unemployment. The number in employment also fell back in the three months to July 2022.

London businesses also indicated employment levels had fallen back in Q3 2022, with the net balance dropping back into negative territory (from 0 to -8, an 18-month low). The proportion of firms who reported an increase in employment levels in Q3 shrunk, while more businesses said they had seen workforce levels decrease.

The drop in employment was due nearly entirely to micro companies (0-9 employees), as the net balance fell 9 points to -11. Only 5% of micro firms saw employment levels rise in Q3, and there was a greater share who reported a decrease in their workforce size. The employment net balance for larger companies (10+ employees) nudged down from 15 to 14, suggesting little change in employment levels in Q3.

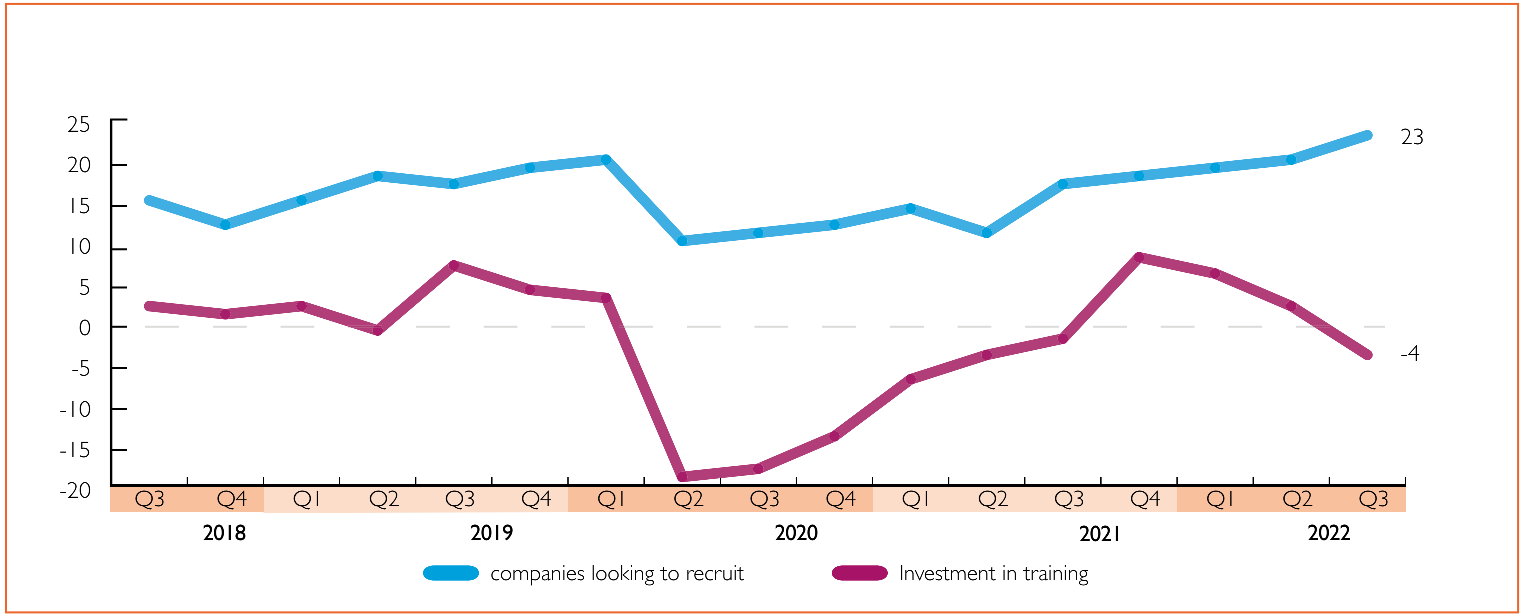
Almost every sector reported a decline in the employment balance in Q3, with the biggest drops seen in hospitality, information and communication, finance and insurance / business administration and support, and manufacturing.

Somewhat more encouragingly, employment expectations are still holding up: the net balance for expected workforce levels in the next three months dipped from 12 to 9 in Q3. There was a smaller share of businesses expecting their workforce to increase in size, but no change in the share anticipating a decrease. Indeed, 43% of larger businesses think their employment levels will rise in Q4, up from 39%.

RECRUITMENT AND TRAINING

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

12% of London businesses reported an **increase** in investment in training last quarter



Recruitment activity strengthened again in Q3 2022, with close to a quarter (23%) of London businesses saying they had sought to hire last quarter: this was the highest reading recorded on the Capital 500 since the survey began in 2014. This rise was due to micro companies, with 19% looking to recruit in Q3 (up from 15% in Q2). By contrast, the proportion of larger firms who had looked to recruit shrunk slightly from 66% to 63%.

Hiring in the service sector picked up, and the biggest increases were seen in information and communication, and public administration, health and education. Recruitment efforts in construction also stepped up in Q3, but eased in manufacturing. More than a quarter (29%) of inner London companies had tried to recruit last quarter, up from 18% in Q2. In the outer London boroughs, fewer businesses had sought to hire in Q3 (16%, down from 22% in Q2).

However, recruitment remains an issue for the majority of firms looking to hire: 70% of all London businesses who had tried to recruit experienced difficulties doing so, a record high for the Capital 500.

Training investment was pared back further in Q3: the net balance fell from 2 to -4, the first negative reading in a year and a third consecutive drop. Fewer businesses reported an increase in training investment last quarter, while there was a bigger proportion who indicated a decline.

Micro and larger companies both saw lower levels of investment in training in Q3. For larger firms, the balance dropped from 29 to 15, with twice as many firms saying investment in training had fallen. The fall in the training investment balance for micro firms was less pronounced (from 0 to -5).

BUSINESS COSTS

69% of London businesses reported an **increase** in their fuel costs last quarter

74% of London businesses reported an **increase** in their energy costs last quarter

The cost pressures on London businesses remain severe, with the vast majority still seeing increases in their energy and fuel prices. Three-quarters (74%) of firms said energy costs rose in Q3, down slightly from 77% in Q2 but still the second-highest reading since the Capital 500 began in 2014. Only 1% of companies said energy costs had fallen in Q3. Fuel costs rose for two-thirds (69%) of London firms last quarter, while a third (30%) said they had stayed the same and only 2% reported a decline. Energy cost pressures are being felt by most businesses across all sectors, with construction and manufacturing some of the worst-affected in Q3.

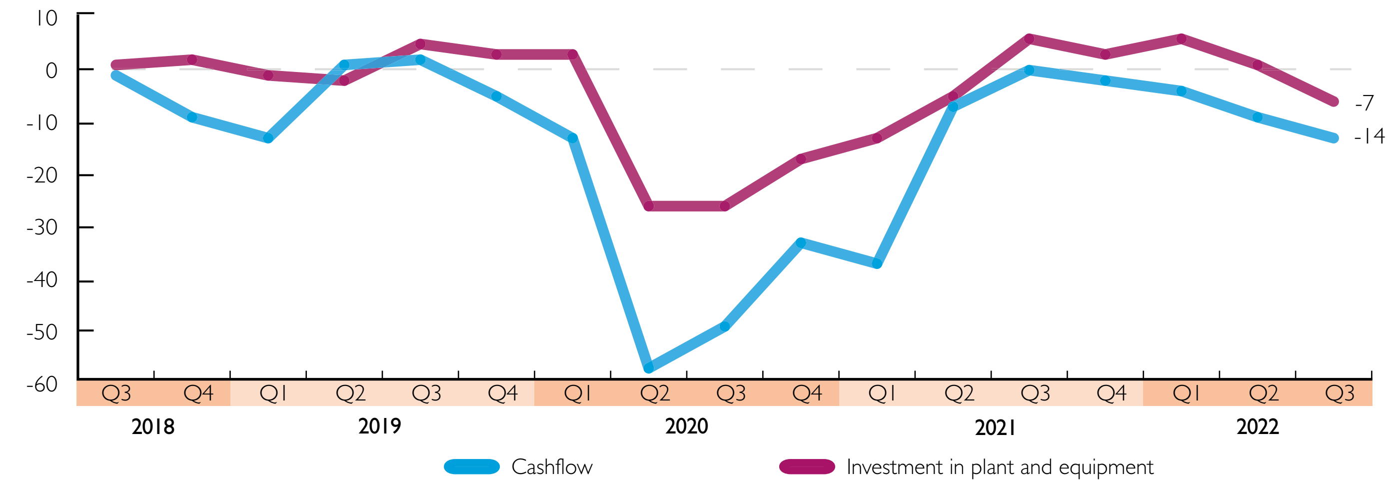
There is no let-up in raw material cost pressures either, with 54% of firms saying domestic raw material outlays rose in Q3 and only 1% seeing a decrease. Again, manufacturers (85% reported a rise in raw materials sourced domestically) and constructors (73%) were two of the worst-affected industries. A smaller share of all firms said costs for raw materials from abroad had risen in Q3 (43%, down from 49% in Q2).

Borrowing costs remain elevated, with 39% reporting an increase in Q3. The rise in borrowing costs is of great concern considering the additional debt that businesses took on to manage through the worst of the pandemic. The tight labour market and cost of living crisis may be putting more pressure on employers to raise wages, with 41% noting an increase in Q3. Close to three-quarters (72%) of firms who are trying to recruit said pressure from employees to raise wages had increased in Q3, compared to 32% of companies who did not try to recruit in Q3. There was a slight decline in the share of firms who expect the prices of their goods and / or services to rise in the coming three months (from 56% in Q2 to 48% in Q3). The main upward pressures on prices are utilities, but rising labour costs and raw materials also forcing firms to consider price increases.

20% of firms reported an **increase** in cashflow last quarter

10% of firms reported an **increase** in investment in plant and equipment

CASHFLOW AND INVESTMENT



With domestic and export demand dropping back, it will be of little surprise to see cashflow for London businesses worsening further in Q3. The net balance for cashflow fell 4 points to -14, with a third (34%) of companies seeing their cashflow worsen over the previous three months. The share reporting an increase nudged down (from 21% to 20%).

For micro businesses, the cashflow balance declined from -11 to -15 last quarter, and the share of firms who indicated a decline grew from 31% in Q2 to 35% in Q3. Larger companies also saw weaker cashflow, with the net balance turning negative for the first time in 18 months (down from 9 to -3 in Q3).

Businesses in outer London fared worse in Q3, as the net balance dropped 10 points to -13. By contrast, the cashflow balance for inner London firms nudged up from -15 to -14. That said, at least a third of businesses in both inner and outer London reported a fall in cashflow in Q3. Most sectors saw a decline in the cashflow balance last quarter, with the motor trades, wholesale, retail, transport and storage, and accommodation and food services sectors, and hospitality, faring worst.

Investment in plant and equipment fell again in Q3 2022: the net balance fell back into negative territory (from 0 to -7), on the back of a greater share of firms who said investment had declined in the previous three months.

Capital investment by larger companies saw a sharp drop, as the net balance fell 12 points to 5 in Q3: the proportion of larger firms who said investment in plant and equipment fell in Q3 doubled from 8% to 17%. For micro businesses, the net balance slipped from -3 to -9, the lowest level in 18 months.

BUSINESS CONFIDENCE

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

Business confidence has rolled over, with profitability and turnover expectations both weakening in Q3. For turnover expectations, the net balance dropped from 22 to 8, the lowest since Q1 2021. A quarter (26%) of firms expect turnover to worsen in the coming 12 months, up from 20% in Q2. Considering the drop-off in domestic and export demand, and fears of a looming recession in the UK, it will be of little surprise to see London businesses' turnover expectations fall back too.

The net balance for turnover expectations for micro businesses fell 13 points to 8 in Q3, with 26% of companies expecting a worsening over the next 12 months. The share of larger companies who thought turnover would fall in the next 12 months doubled from 12% to 23% in Q3, pushing the net balance down from 32 to 16. As seen in other metrics of the latest Capital 500, hospitality and the motor trades, wholesale, retail, transport and storage, and accommodation and food services sectors were worst affected.

34% of London businesses expect their turnover to **improve** over the coming 12 months

Profitability expectations deteriorated sharply for a second consecutive quarter, with the net balance turning negative again in Q3 (down from 10 to -4). A third (32%) of companies now think their profitability will worsen over the coming 12 months, up from 26% in Q2. Both micro and larger firms saw declines in their profitability balances: for micro businesses, the balance dropped from 9 to -5, the first negative reading in six quarters. The balance for larger companies slipped from 20 to 8.

The balance for overall company prospects fell further into negative territory as a result, down 6 points to -12. This increased pessimism was felt most acutely by outer London firms, with the net balance for company prospects falling from -4 to -16. By contrast, for inner London firms, the balance nudged up from -9 to -8.

ECONOMIC OUTLOOK

16% of London businesses expect London's economy to **improve** in the next 12 months

13% of London businesses expect the UK's economy to **improve** in the next 12 months

With concerns over a recession, the rising costs of living and doing business, and the war in Ukraine, the economic outlook for the UK economy returned to the record lows seen during the height of the pandemic. The balance for London businesses' outlook for the UK fell 16 points to -53 in Q3 2022, with two-thirds (66%) of companies expecting a worsening in the national economy over the next 12 months. Only 13% of firms think the UK's economy will grow in the next year, down from 19% in Q2.

Both micro and larger businesses were more pessimistic about the UK's economy in Q3. For micro firms, the net balance fell 15 points to -54, with 67% expecting a worsening in the UK economy over the coming year. Larger companies saw an even bigger drop (from -20 to -41): only 14% think UK GDP will grow in the next 12 months.

As with views on the UK economy, the outlook for London's economy also deteriorated in Q3, although the drop in the net balance was not as severe (down 7 points to -35). Half (51%) of firms think London's economy will worsen in the coming year, up slightly from 48% in Q2. The share who think the capital's economy will improve shrunk from 20% to 16%.

The net balance for larger businesses' outlook for London dropped 11 points to -27, with two-fifths (43%) expecting a deterioration in the economy. For micro firms, the balance slipped from -29 to -36.

There was a geographical split when considering the outlook for the capital's economy. In outer London, the net balance fell 14 points to -36, with more businesses expecting the economy to worsen in Q3. By contrast, there was no change in the outlook amongst inner London companies.

Q3

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