LONDON CHAMBER of COMMERCE AND INDUSTRY

CONNECT. INFLUENCE. SUPPORT.

Q4 CAPITAL 500

London Quarterly Economic Survey

October – December **2021**

In partnership with

Savanta: ComRes

Sponsored by

haysmacintyre

RICHARD BURGE

Chief Executive, London Chamber of Commerce and Industry

LCCI COMMENTARY – THE BUSINESS VIEW

Our latest Capital 500 survey suggests the Omicron variant had an immediate impact on London businesses, with a drop in domestic demand felt by large and small firms alike. Even sharper was the hit to business outlooks for the local and national economies, following a period of growing optimism.

This may prove temporary. The UK's vaccination programme looks to have put the country in a robust position, while there are encouraging early signs that the Omicron variant may induce a milder illness. However, there is no room for complacency. The transmissibility of the new variant will put the health system under pressure, and businesses are feeling the effects of employees forced to self-isolate, which is impacting their ability to operate to their full potential.

At the same time as dealing with reduced demand and staff shortages, firms are facing soaring cost pressures. Utility bills continue to rise quickly, while the majority of London businesses are concerned about inflation. Supply chain issues continue to persist, which may be exacerbated further by the new import rules introduced at the start of 2022.

London businesses – indeed, firms across the country – have proven their willingness and ability to adapt to rapidly changing events. They will be tested again in the coming months, and the Government should stand ready to provide additional support where possible.

Richard Burge, Chief Executive, 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 503 London business leaders between 28 October and 11 December 2021. 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

Since the Q4 2021 Capital 500 survey was conducted, the UK has seen new restrictions introduced as the Omicron variant became dominant – not only in the UK. but in Europe and much of the rest of the world. In many ways this could not have come at a worse time as UK profitability and activity levels were recovering in the autumn. Retail spending was turning positive after falling in the summer, and the PMIs were once again strengthening.

However, higher inflation, mainly due to a sharp rise in energy costs but also reflecting worsening staff shortages and supply chain issues, has been pushing up input costs. As a result, manufacturing output prices in November 2021 were up 9.1% year-on-year, the fastest since September 2008. New 'on-and-off' border restrictions have created uncertainties for the travel and airline sectors. This has depressed business confidence, already negatively affected by the hike in National Insurance contributions for employers and employees alike from April 2022.

In addition, though isolation periods are now being relaxed, the rapid spread of the virus has intensified staff shortages. Train operators, airlines, and increasingly supermarkets are beginning to feel the strain, resulting in the cancellation of routes and shop closures being threatened. We also saw the first rise in interest rates in the UK since 2018 and there could be more.

2022 could well therefore see a real squeeze in disposable incomes as energy and other prices dent household budgets and spending. December may prove to have seen negative growth in GDP, which will remain below pre-pandemic levels for a few more months. UK economists now think growth of 4-5% in 2022 is the most likely scenario for the UK, compared to expectations of 6% made just a few months ago, with inflation peaking at over 6% in the spring.

Even before the extent of the Omicron variant's transmissibility was realised, the OECD in December was expecting global GDP to rise by just 4.3% in 2022, and that may well be revised down again. Much will depend on the vaccine rollout across both the developed and developing world, and the impact on world trade. However, what the latest surge in cases suggests is that reducing fiscal and monetary support as fast as had been planned may prove difficult. In the UK there is the additional concern over the post-Brexit impact on SMEs, particularly around the extra import checks on goods from the EU introduced on 1 January.

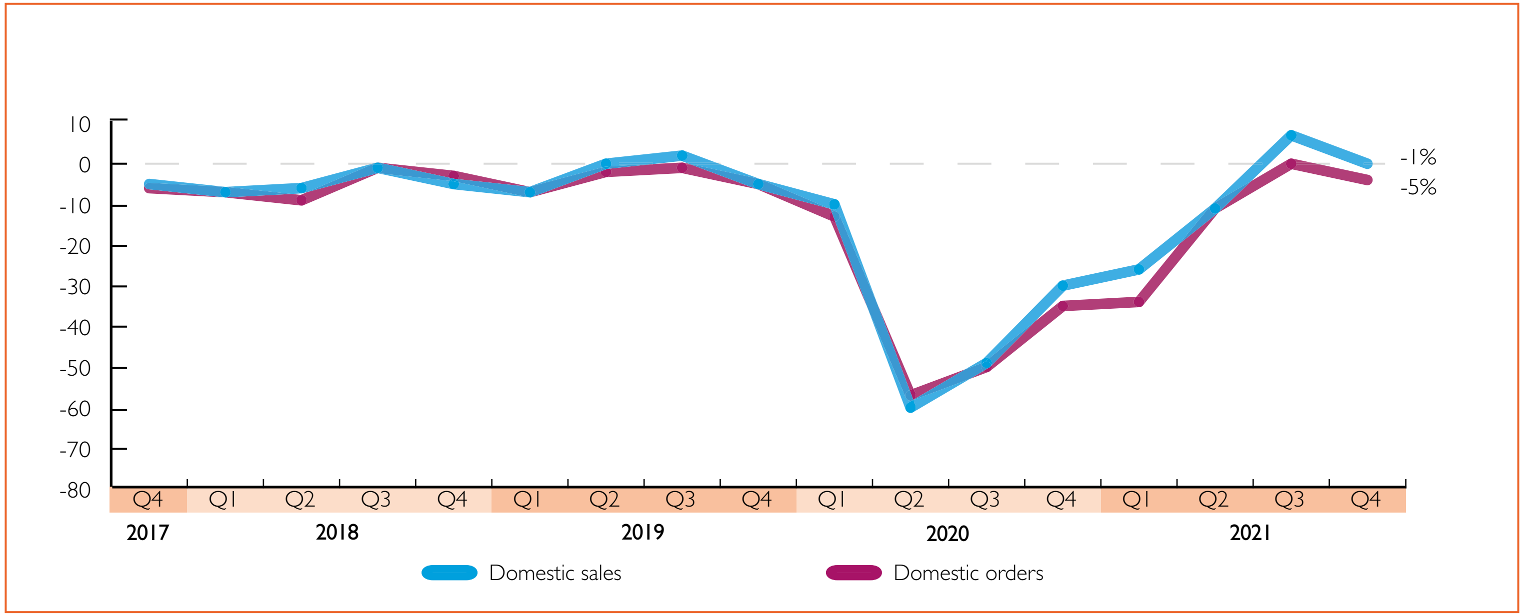
On the positive side, early signs suggest Omicron may be proving to be a milder variant than originally expected. The slowdown in growth in the meantime may take some of the inflationary pressures away, limiting the need to tighten monetary as much as expected. Nevertheless, a renewed spike in activity later in the year could bring about a renewed inflation flurry. Frankly, it is too early to tell.

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

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

19% of London businesses reported an **increase** in domestic orders last quarter

DOMESTIC DEMAND



After turning positive for the first time in two years in Q3 2021, the domestic sales balance has fallen back into negative territory in the latest Capital 500 for Q4 2021. The net balance – the percentage of firms noting an increase minus the percentage noting a decrease – fell from 6% to -1%, after rising for six consecutive quarters. The share of firms who said domestic sales increased in Q4 2021 shrank slightly from 26% to 24%, while 25% of companies reported a decline in sales – up from 20% in Q3 2021.

For micro firms, the net balance dipped 6 percentage points to -4%, while the drop in the balance for larger businesses was even bigger (from 39% to 26%).

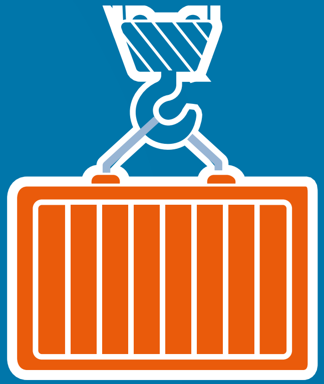
After showing stronger signs of growth in Q3, the domestic sales balance for inner London companies fell 12 points to 4% in Q4: 28% of inner London firms said sales had increased, down from 33% in Q3, while a quarter (24%) reported a drop last quarter, (versus 17% in Q3). By contrast, the net balance for outer London firms nudged higher (-8% to -6%), with more firms noting an increase in sales.

Manufacturing saw a steep drop in the net balance for domestic sales (from 20% to -25%), while the balance for services nudged down from 4% to 2%.

Turning to domestic orders, the net balance also fell from -1% to -5%. There was a slight dip in the share of firms reporting an increase in orders (from 21% to 19%), while the proportion that said sales had dropped grew slightly (from 22% to 24%).

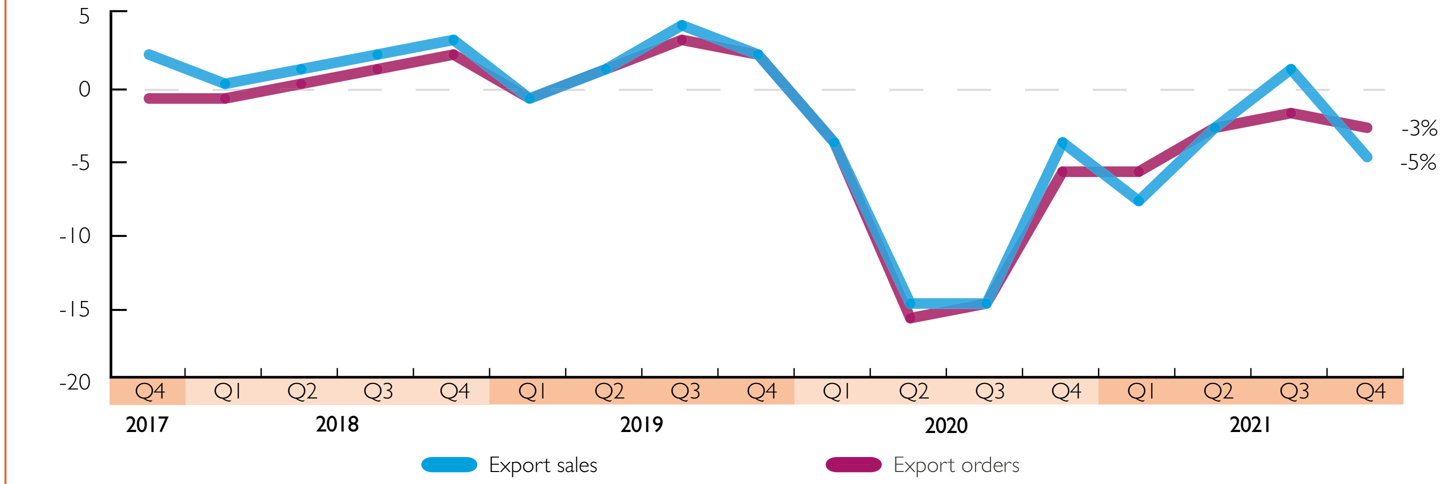
Similar to sales, both micro and larger firms saw weaker growth in domestic orders in Q4.

EXPORT DEMAND



6% of London businesses reported an **increase** in export sales last quarter

6% of London businesses reported an **increase** in export orders last quarter



As with domestic demand, growth in export sales slowed in the final quarter of 2021. The net balance for sales fell from 1% to -5% in Q4: 6% of firms said sales had increased over the previous three months, down from 10% in the Q3 2021 Capital 500. The proportion of companies reporting a drop in export sales was broadly unchanged (11% in Q4, up from 9% in Q3).

Micro companies saw a bigger decline in export sales, with the net balance down 7 points to -7% in Q4 2021. For larger firms, the drop in the net balance was smaller (-2 percentage points to 11%).

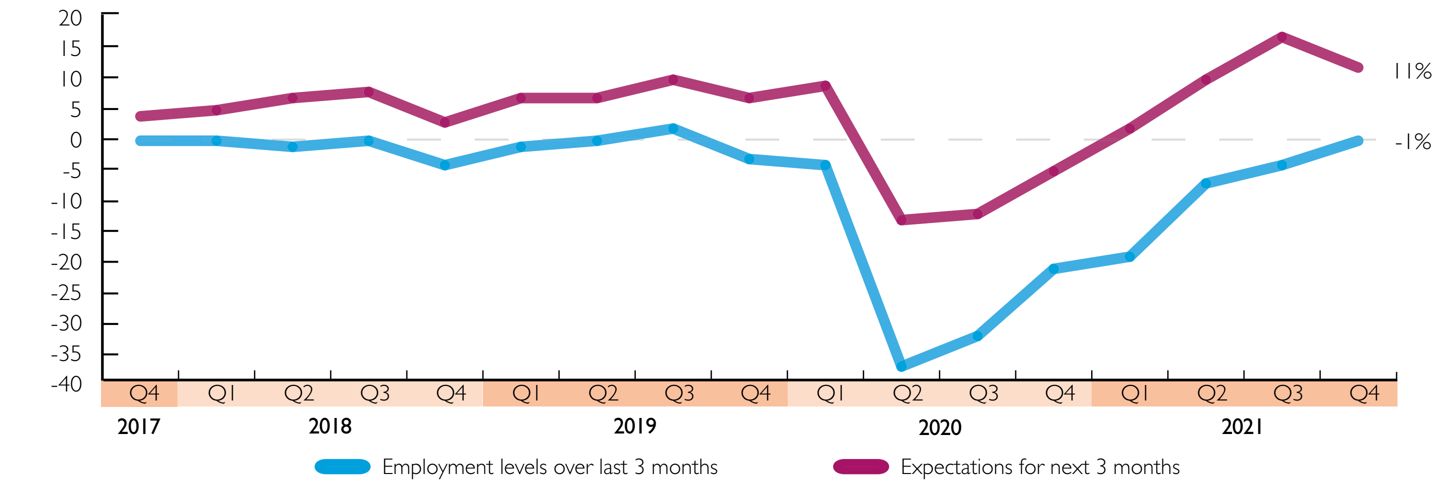
On a sectoral basis, export sales for services companies were down in Q4: the net balance declined 7 percentage points to -5%. However for manufacturers, the net balance for sales climbed into positive territory (from -3% to 1%).

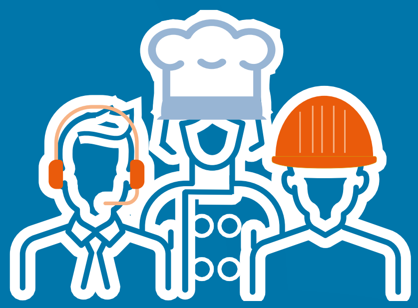
For export orders, demand also softened in Q4 albeit at a slower pace than in sales. The net balance for export orders edged down from -2% to -3%, with 6% of firms reporting an increase in orders.

The export orders balance for micro companies was unchanged at -4%, although the balance for larger firms dropped from 17% to 8%.

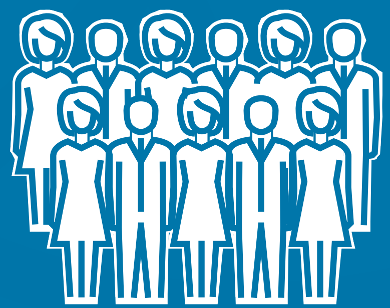
Manufacturers saw a rebound in demand for export orders in Q4, with the net balance rising from -8% to 0%. For service sector firms, the net balance was down slightly (from -1% to -2%).

LABOUR MARKET





13% 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

According to data from the Office for National Statistics, fears of a rise in unemployment following the closure of the furlough scheme in September 2021 have not yet been realised. The number of payroll employees in London rose in October and November, while the unemployment rate has fallen to 5.4% (three months to October 2021).

The employment balance for the Capital 500 also rose again in Q4 2021, from -5% to -1%. The proportion of firms who said their workforce levels had increased over the previous three months grew from 11% to 13%, while there was a small dip in the share who said their workforce had shrunk (from 16% to 14%). This was driven entirely by micro companies: the net balance rose from -8% to -3%, while for larger businesses there was a drop in the balance from 19% to 11%.

However, attention will now turn to the implications for the labour market in the wake of newly introduced restrictions, implemented to stem the wave of infections as a result of the Omicron variant. The fieldwork for the Q4 2021 Capital 500 was conducted from 28 October to 11 December 2021, and captured firms' responses as these new restrictions were introduced.

The net balance for employment expectations dipped slightly in Q4 2021 from 16% to 11%, ending a run of five consecutive improvements. A smaller share of firms said they expected their workforce to increase in size over the coming three months (17% in Q4, versus 20% in Q3), while there was a slightly bigger proportion expecting a decrease in headcount (up by 2 percentage points to 6% from 4%). Firms of all sizes were less optimistic about their workforce size in the coming three months. Most sectors saw the net balance for employment expectations fall in Q4, although arts, entertainment & recreation services and the broad 'motor trades, wholesale, retail, transport & storage, accommodation & food services sectors both expected an increase in headcount.

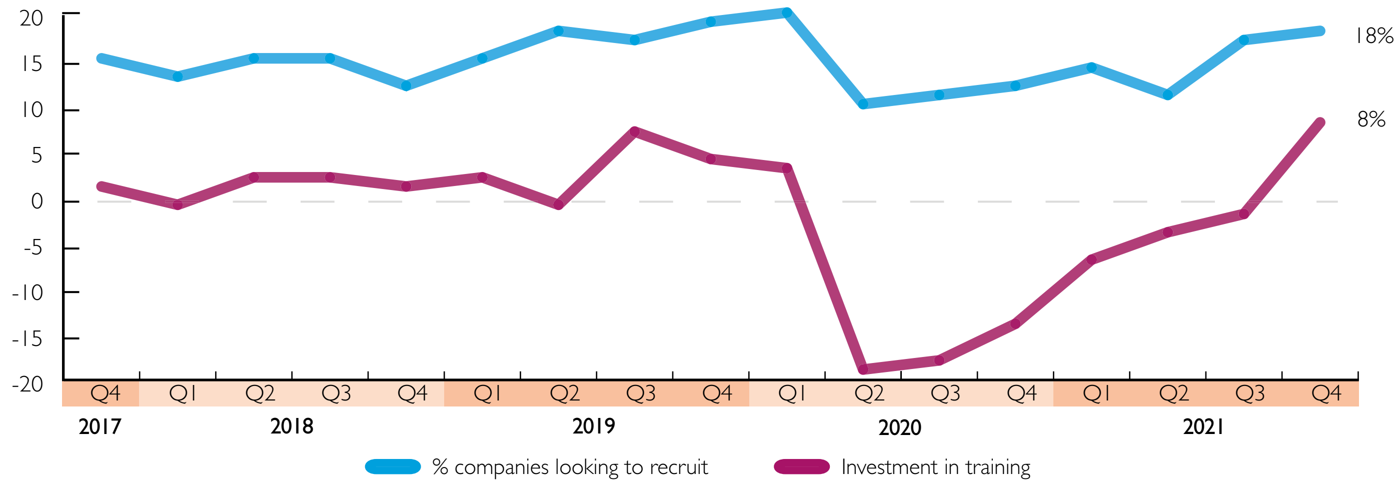
RECRUITMENT AND TRAINING

18%

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

17%

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



There was a slight increase in the share of firms who had sought to recruit in the previous three months, from 17% to 18%. This was driven by larger businesses, who were much more active in Q4 2021 in terms of hiring (69% said they had looked to recruit, up from 55% in Q3). There was no change in the share of micro firms who were looking to hire (13%). Firms in inner London were more actively recruiting in Q4, while companies in outer London reported a drop in recruitment.

Of those London businesses who did look to recruit, 59% said they had experienced difficulties doing so – this was down slightly from 66% in Q3.

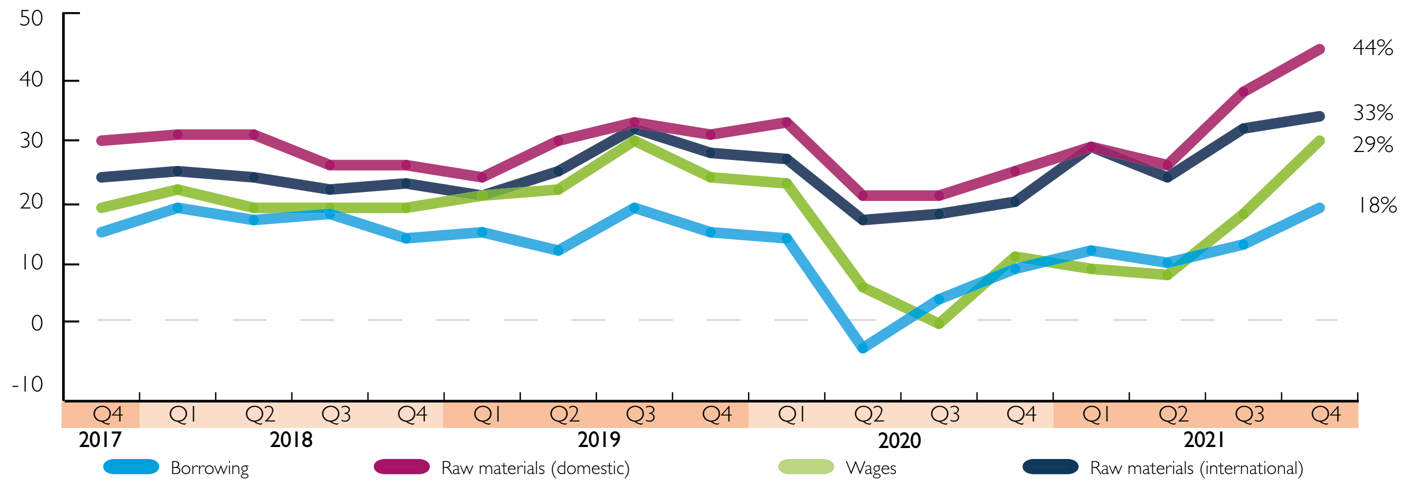
Business investment in training grew at a quicker pace in Q4 2021, with the net balance climbing ten percentage points to 8%. Nearly one-fifth (17%) of firms said they had raised spending on training over the previous three months, while the proportion who said investment had declined shrank from 14% to 9%.

The net balance for training investment by micro companies jumped eleven points to 6%, with 15% stating that investment had increased – up from 10% in Q3. Larger companies also reported stronger investment in training, with the net balance rising from 24% to 29%. On the Capital 500, spending by larger firms typically outpaces their micro counterparts.

64% of London businesses reported an **increase** in their fuel costs last quarter

64% of London businesses reported an **increase** in their energy costs last quarter

BUSINESS COSTS



In the final quarter of 2021, London businesses were reporting a further ramp-up in cost pressures. Utility costs continued to rise sharply for London firms, with close to two-thirds (64%) saying their fuel and energy costs increased in Q4 2021 – for both measures, this is the highest reading since the Capital 500 began in 2014. In Q4 2020, 30% of firms said their energy costs had risen over the previous three months.

Raw material costs, both domestic and international, are still climbing too: the net balance for domestic raw material costs rose to 44% in Q4 2021. Nearly half (45%) of London businesses said their domestic raw material costs had risen over the previous three months, rising to 83% for manufacturers. The net balance for international raw materials edged up from 31% to 33%, with 35% of firms saying costs had increased over the previous three months.

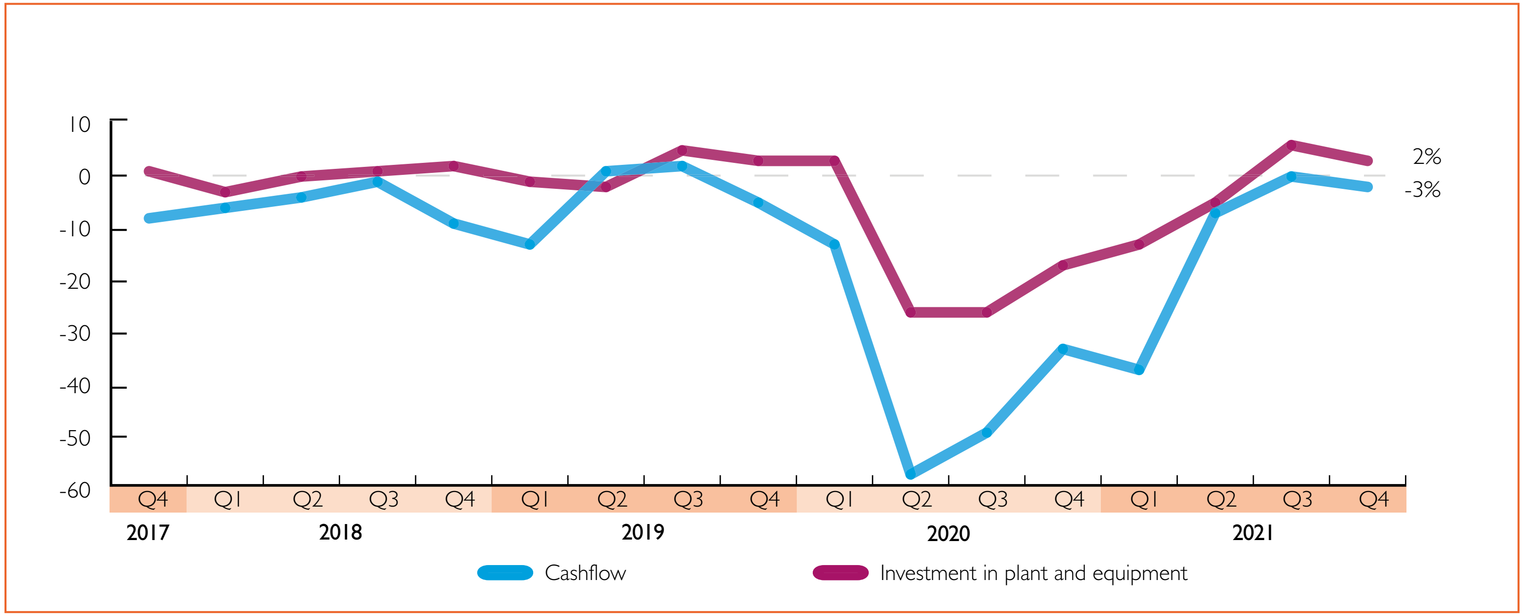
However, business cost pressures are not limited to their utilities. Pressure to increase wages has been building quickly in the second half of 2021, with the net balance up 12 points to 29% in Q4. The proportion of firms who said pressure to raise wages had increased in the previous three months rose from 20% to 30% in Q4. Both micro and larger companies reported intensifying pressure to raise wage offerings. Borrowing costs are climbing as well, with the net balance up six points to 18% in Q4 2021: 21% of firms said their cost of borrowing had grown, up slightly from 19% in Q3.

Three in five (61%) London businesses said they were more worried about inflation in Q4, compared to the three months prior. More than two-fifths (45%) of firms said they expected the prices of their goods and / or services to rise in the coming three months.

CASHFLOW AND INVESTMENT

25%

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



13%

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

Cashflow was little changed for London firms in Q4 2021, with the net balance nudging down from -1% to -3%. The proportion of companies who said cashflow had increased was slightly smaller (25%, versus 26% in Q3), while there was a minor rise in the share who said cashflow had fallen (28%, compared to 27% in Q3).

For micro companies, the cashflow balance edged down from -4% to -5% in Q4 2021. The net balance for larger businesses fell five points to 17%: more larger firms said their cashflow had increased compared to Q3, but this was outpaced by a bigger rise in the share who said their cashflow had declined.

There was no change in the percentage of firms who said they were operating at full capacity (43%), although there was a small divergence based on geography: compared to Q3, fewer companies in inner London said they were operating at full capacity in Q4, but more firms in outer London said they were able to operate fully.

Investment in plant and machinery remains weak, with the net balance falling back slightly from 5% to 2% in Q4 2021. This was driven mainly by a smaller share of firms who said investment had increased (13% in Q4, compared to 18% in Q3). The net balances for capital investment for both micro and larger businesses fell last quarter.

Manufacturers reported stronger investment in plant and machinery, with the balance rising eleven points to 15%. For services, the net balance declined from 4% to 0%.

46% of London businesses expect their profitability to **improve** over the coming 12 months

41% of London businesses expect their turnover to **improve** over the coming 12 months

BUSINESS CONFIDENCE

It would certainly appear that the threat of the new Omicron variant hit business confidence, based on the latest Capital 500. The net balance for overall company prospects (over the coming year) fell from 23% to 12% in Q4 2021, with 31% of companies expecting their prospects to improve – this was down from 39% in Q3. It is worth noting that the share of firms expecting a worsening in their prospects rose, but not at a rapid pace (from 16% to 19%). Indeed, half (50%) of London businesses expected their company prospects to remain the same.

Both micro and larger companies were less optimistic for their own prospects over the coming year, and businesses in inner and outer London saw a decline in their net balances.

However, the decline in the company prospects balance was not mirrored by turnover or profitability expectations. Turnover expectations from all London businesses were only slightly weaker in Q4, with the net balance edging down from 26% to 24%. There was no change in the share of firms who thought their turnover would increase (41%), while the share who felt turnover would worsen was marginally bigger (17% in Q4 2021, compared to 15% in Q3). Furthermore, this drop was due to more pessimism in larger companies: for micro firms, the net balance for turnover expectations rose from 23% to 24%.

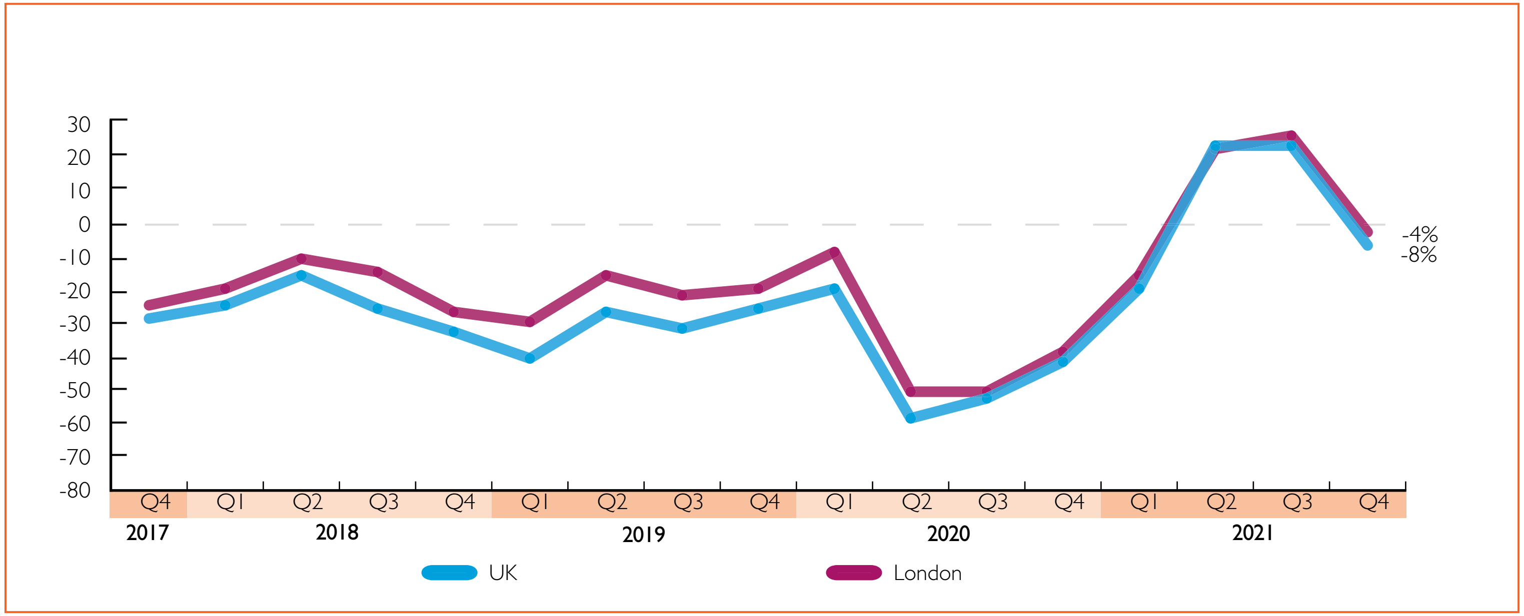
Profitability expectations improved too for London businesses, with the balance climbing seven points to 29% in Q4 2021: close to half (46%) of London business leaders felt their profitability would improve in the coming 12 months, up from 39% in Q3.

The divergence between overall company prospects and turnover / profitability expectations is not usually seen in the Capital 500.

ECONOMIC OUTLOOK

29% of London businesses expect London's economy to **improve** in the next 12 months

30% of London businesses expect the UK's economy to **improve** in the next 12 months



What is clear though is that London businesses fear a worsening for the economy. The net balance for the UK's economic outlook dropped 30 points back into negative territory in Q4 2021, at -8%. Nearly two-fifths (38%) of firms said they expected the UK's economy to worsen in the coming 12 months, up from 22% in the Q3 2021 Capital 500. The share who felt the economy would improve also shrank from 44% to 30%.

Micro and larger firms alike were more sanguine about the UK's economic prospects, with the net balances falling sharply for both. There was also no discrepancy based on geography: inner and outer London firms both reported a more downbeat assessment for the economy.

This assessment extends to the local London economy, with the net balance for the capital's economic outlook falling from 25% to -4% in Q4 2021. A third (33%) of firms said London's economy would deteriorate over the next 12 months, up from 21% in Q3, while there was a smaller share who expected an improvement.

The net balance for micro companies' view on London's economy fell from 24% to -3%, and for larger firms the decline was even bigger (-39 percentage points to -3%). Firms in both inner and outer London turned pessimistic in their outlooks for the capital.

Both manufacturers and service sector companies were significantly more downbeat in their assessments of London's economy over the coming 12 months, particularly in the hospitality and tourism-related sectors.

Nadine Tewfik-Saad
Head of Policy and Research
ntewfik-saad@londonchamber.co.uk

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