LONDON CHAMBER of COMMERCE AND INDUSTRY

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Q1 CAPITAL 500

London Quarterly Economic Survey

January – March **2021**

Savanta: ComRes

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LCCI COMMENTARY – THE BUSINESS VIEW

It will be of little surprise to followers of the Capital 500 that the latest results show London's businesses continue to see reduced demand. The fieldwork for the Q1 survey was conducted during the third national lockdown, imposed to combat the spread of Covid-19. Our survey – the most authoritative and robust survey of business conditions in the capital – suggests that for half of London businesses, Q1 was another quarter of decreased cashflow.

It is worth noting the improvement in business expectations for the year ahead. The Prime Minister outlined his roadmap for the removal of Covid-19 restrictions in late February, which has been accompanied by an impressive vaccination programme. However, there will need to be substantial leadership from political, business and community leaders in building back confidence amongst the UK public – which will hopefully drive a swift rebound for the UK economy.

Chancellor Rishi Sunak has committed to extending several business support measures through the summer, which LCCI was pleased to see. Nevertheless, the timescales remain tight and we urge the Chancellor to remain prepared to step in again should the economy not be able to bounce back as swiftly as hoped.

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.

Since Q2 2014 we have worked with leading polling company, Savanta ComRes, to expand the survey beyond LCCI membership to poll a panel of London businesses that are fully representative of the London economy by business size and broad industry sector. The LCCI QES is based on responses from over 500 London businesses – the Capital 500 – that makes it London's largest and most authoritative regular business survey.

METHODOLOGY

Savanta ComRes surveyed a total of 500 London business leaders between 4 February and 16 March 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 balance figures represent the percentage of firms that reported an increase minus the percentage that reported a decrease. The arrow figures represent the percentage point change in the balance on the previous quarter.

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.

VICKY PRYCE

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

GUEST COMMENTARY – THE ECONOMIST'S VIEW

London has been worst hit in many ways by the pandemic and has a lot to look forward to when things reopen. The PM's lockdown roadmap has been helpful in this context. But the exact impact on the economy remains unclear. In their statement that accompanied the Budget of 3 March, the Office for Budget Responsibility (OBR) made three major revisions to their November 2020 projections. First, 2021 growth was revised down from 5.5% to 4.0%, taking account of the new lockdown since Christmas and also the early trade problems with the EU following the end of the Brexit transition period. Second, they upped next year's growth to 7.3%, a good two points above most other forecasters' current predictions. And third, they significantly raised 2021/22's borrowing totals on the back of an additional £65 billion direct stimulus to the economy. As a result, borrowing of £355 billion this year is to be accompanied by a further £234 billion next year. By the end of the forecast period in 2025-26, the UK will still need to be borrowing £74 billion from the market.

The interest burden of funding that debt may well have gone up by then, although inflation so far seems to be muted, limiting the prospect of substantive interest rate increases ahead. However, the OBR figures suggest no debt repayment over the period with the debt-to-GDP ratio remaining well above 100%. The Budget did introduce a fiscal stimulus of around £50 billion by the end of the forecast period in tax increases and extra cash cuts for non-prioritised departments. The two-year postponement until 2023 of the corporation tax rate rise (from 19% to 25%) also gives a bit of a breathing space for firms, and is sweetened by the 130% super deduction for capital expenditure. A welcome development for SMEs is the reintroduction of the small profits tax after its abandonment in 2015 – and this will stay at 19%. Additionally, the freezing of income tax thresholds to 2026 does not come into effect for another year.

The reaction to the Budget has been positive overall though businesses would have liked to see more work on reforms to business rates if possible. Business and consumer confidence have improved, helped by the rapid vaccine roll-out. Business investment is forecast to grow by 16.6% next year if the OBR forecasts are to be believed.

Consumers are also sitting on forced savings of anywhere from between £100 to £250 billion, a substantial percentage of which the Bank of England hopes will be spent as soon as the economy opens.

Nevertheless, new concerns over vaccine nationalism since the Budget, the worsening outlook for foreign travel given the rising Covid cases in Europe and the controversy over possible vaccine passports to travel, work or be able to go about one's business after restrictions are due to be lifted are all clouding the horizon.

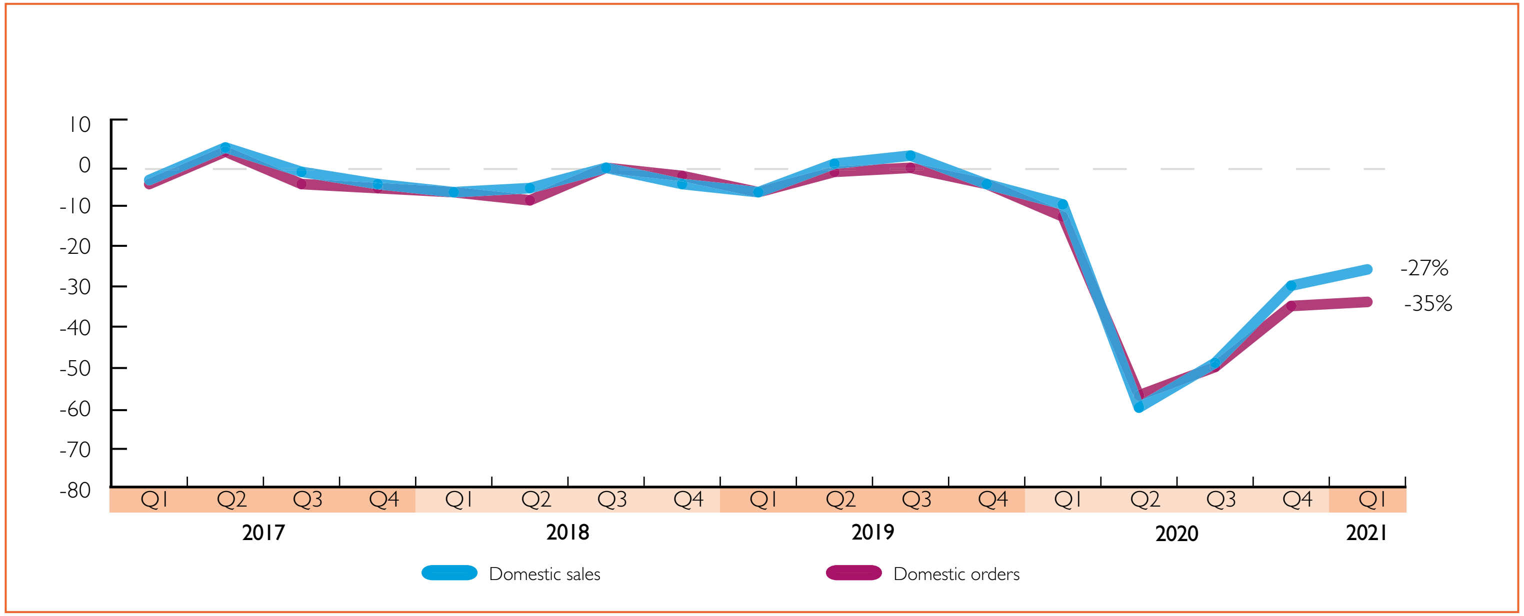
There is therefore renewed unease as to what will happen after furlough ends in September, when the stamp duty cut that has supported house prices, business rate holidays and the cut in VAT for hospitality and tourism are also gradually unwound and reversed.

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

DOMESTIC DEMAND

15% of London businesses reported an increase in domestic sales last quarter

10% of London businesses reported an increase in domestic orders last quarter



Domestic demand was little changed in Q1, which will come as no surprise given the national lockdown restrictions imposed in January. A marginally higher share of firms reported stronger domestic sales in the first three months of 2021 (15%, compared to 14% in Q4 2020). There was a smaller proportion of businesses noting a decrease in sales, with the net balance rising from -31% to -27%.

There was however a jump in the proportion of larger firms (10 employees or more) reporting an increase in sales in Q1, from 12% to 23%. The net balance climbed from -28% to -17%, a one-year high. For micro firms (0-9 employees), there was only a modest rise in the number of firms reporting higher sales (15%, versus 14% in Q4 2020) – the net balance for micro firms rose from -32% to -27%.

Both manufacturing and services saw little changes in domestic sales in Q1.

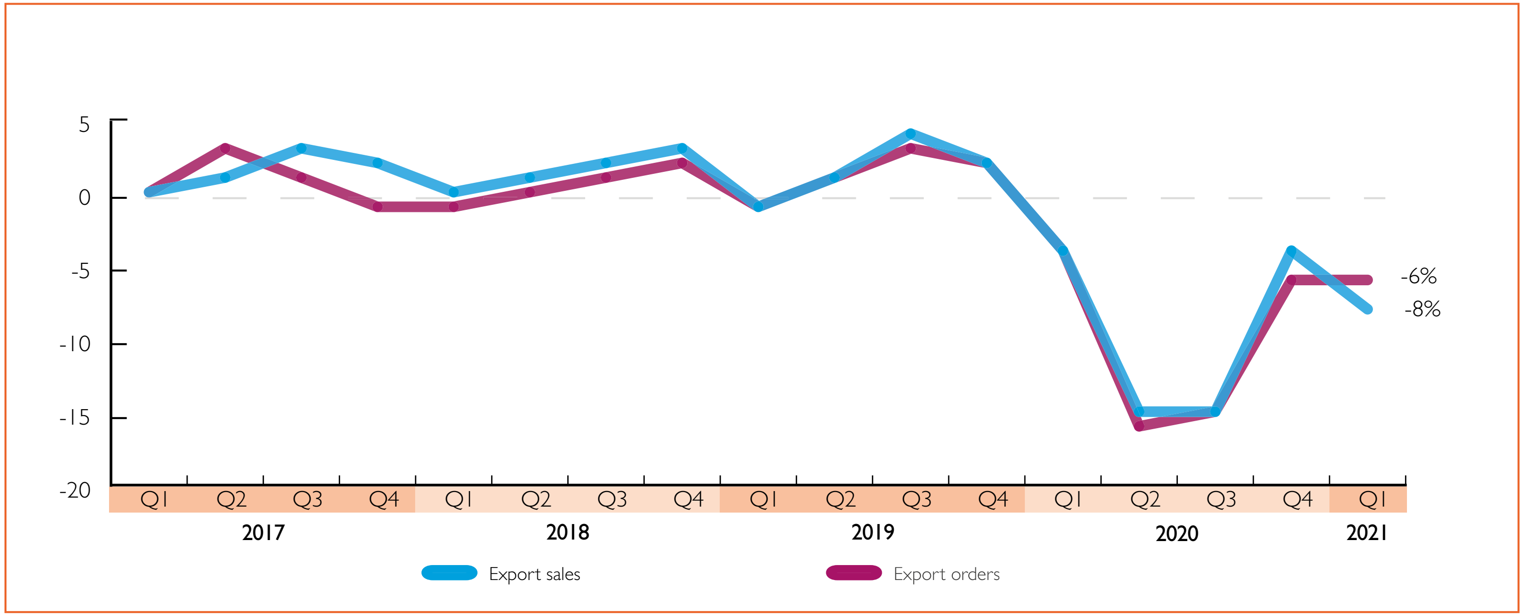
For domestic orders, 10% of firms reported an increase in the first three months of Q1 – unchanged from Q4 2020. The net balance for orders nudged up from -36% to -35%.

The share of micro firms noting an increase in orders was largely consistent between Q4 2020 and Q1 2021 (10% to 9%), and the net balance was unmoved at -38%. There were marginally more larger businesses who reported an increase in orders in Q1 (21%, versus 19% in Q4 2020). However, the net balance nudged down 1 percentage point to -14%.

7% 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



The Q1 2021 report for the Capital 500 is the first following the end of the transition period with the European Union. A new Trade and Cooperation Agreement was signed between the UK and EU in late December 2020.

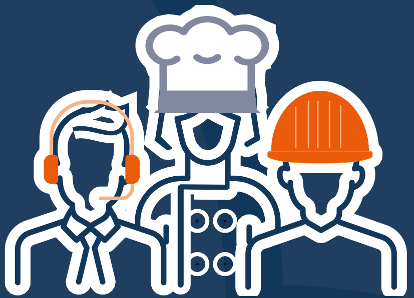
Initial reports from national statistics agencies show a drop in trade between the UK and EU member states in January. According to the UK's Office for National Statistics, exports of goods to the EU fell by 40.5% between December 2020 and January 2021, while imports were down 28.9%. It is worth noting this is just one month's figures, and there will be issues with the methodology. Of course, the ongoing Covid-19 pandemic will be impacting the data too.

Turning to the Capital 500, the share of firms who reported a decrease in export sales in Q1 was 15% - up from 11% in Q4 2020. The net balance for export sales declined 4 percentage points to -8%, following a sharp rise in Q4 2020 that may have been partly driven by stockpiling.

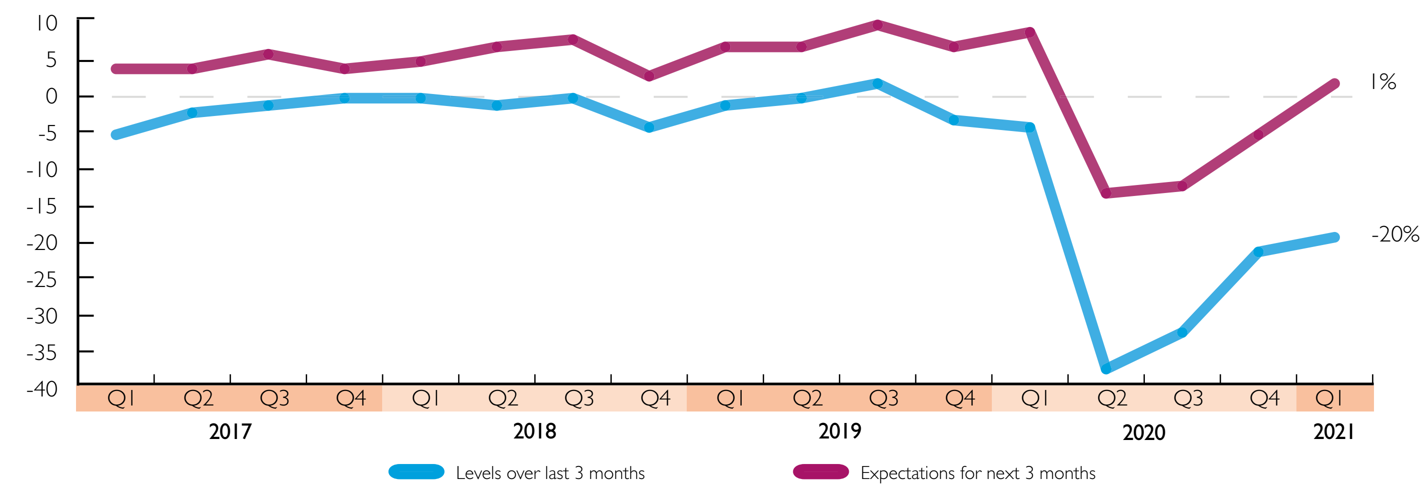
For export orders, the net balance was unchanged at -6% in Q1. There was a slightly bigger share of firms who said export orders had increased, matched by a greater proportion of firms noting a decrease.

The net balance for manufacturing export orders dipped from 5% to 2% in Q1 2021, while the services balance was unchanged at -8%.

LABOUR MARKET



8% of London businesses reported an increase in their workforce size last quarter



The Bank of England struck a slightly more optimistic tone at its most recent Monetary Policy Committee meeting, predicting that the peak of the rise in the UK's unemployment rate is likely to be lower than previously forecast. London's labour market has been one of the worst-affected in the country, with an unemployment rate of 7.0% in Q4 2020 – well above the UK rate (5.1%).

However, there are signs that the rate of decline in London's payroll employees is easing. Furthermore, expectations for the capital's labour market have continued to improve. In the Q1 2021 Capital 500, one in ten (11%) businesses anticipated their workforce size would increase in the next three months. This pushed the net balance for workforce size expectations back into positive territory (+1%).

This indicator has traditionally closely tracked London employment as defined by the ONS (workforce jobs). The proportion of firms who expected their workforce size to increase grew for both micro and larger businesses.

The latest Capital 500 showed 10% of businesses expected their workforce size to decrease, a marked improvement from the Q2 2020 survey (22%).

The employment balance edged up from -22% to -20% in Q1, with 8% of firms stating that their workforce size had grown over the previous three months. This was a slight improvement on Q4 2020 (7%).

11% of London businesses expected their workforce size to increase over the coming three months

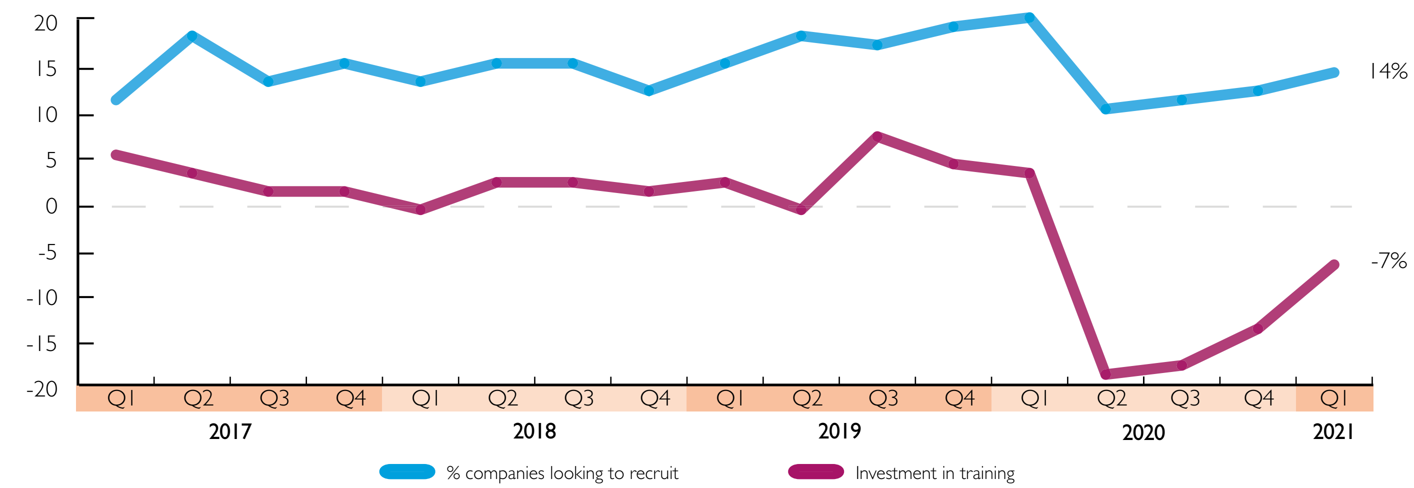
14%

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

15%

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

RECRUITMENT AND TRAINING



The proportion of London businesses looking to recruit has steadily risen since the Q2 2020 low, and climbed to 14% in Q1 2021. Of those who did look to recruit, three-fifths (59%) said that they experienced difficulties doing so.

Both micro and larger businesses were more active in hiring in Q1, with more than two-fifths (42%) of larger companies reporting that they had looked to recruit.

Recruitment picked up across sectors, with more businesses in manufacturing and services looking to hire in Q1.

Q1 also saw greater investment in training by businesses. More than one in ten (15%) firms said they had increased spending on training in the past three months, while the proportion who had lowered spending shrunk. This pushed the net balance up from -14% to -7%. This was the biggest rise in the net balance since Q3 2019.

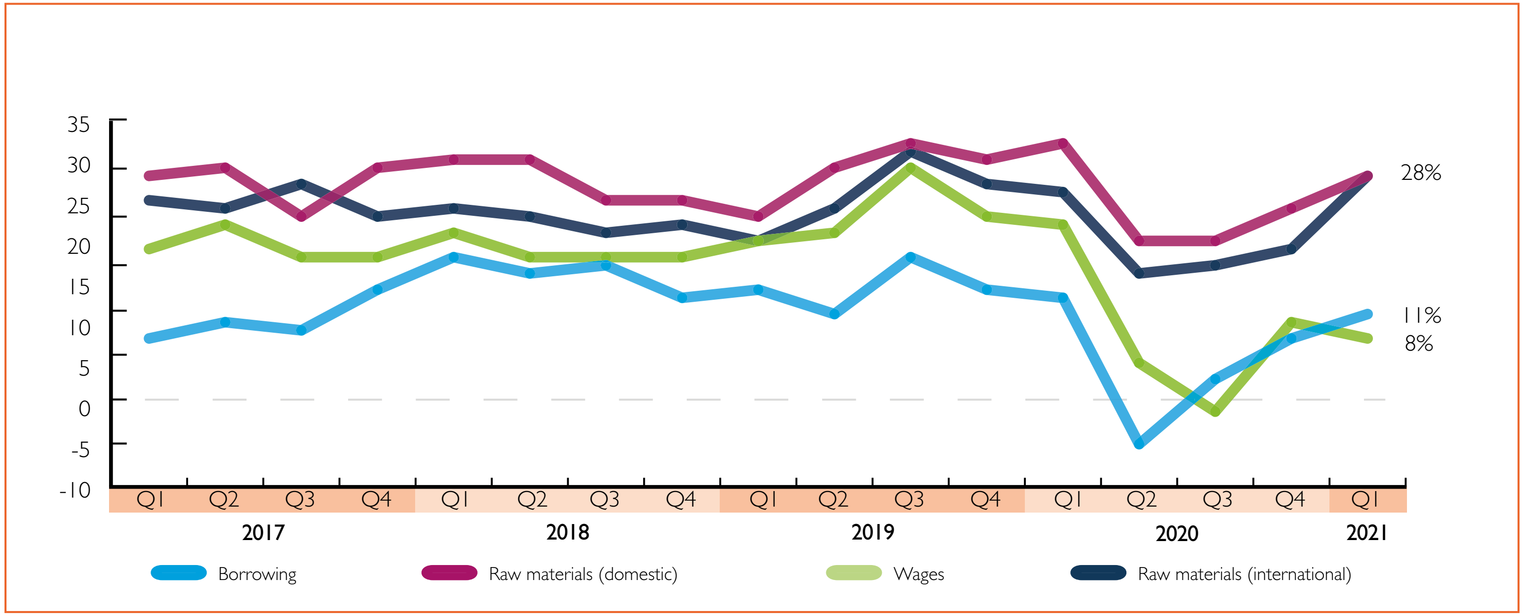
The increase was encouragingly not confined to larger firms either: 14% of micro firms said they had raised investment in training in Q1, again the strongest reading since Q3 2019.

The share of service sector firms who raised spending was 16% in Q1, up from 11% in Q4 2020. Within services, spending on training was much greater from businesses in the finance & insurance / business administration and support sectors.

30% of London businesses reported an increase in their fuel costs last quarter

38% of London businesses reported an increase in their energy costs last quarter

BUSINESS COSTS



In his Spring Budget, Chancellor Rishi Sunak offered businesses continued support in managing their costs through extensions of existing payment deferrals and holidays. Firms have turned to external finance throughout the pandemic in order to keep their businesses afloat.

However, the costs of borrowing are rising according to the Capital 500.

Nearly a quarter (23%) of London firms said their borrowing costs had increased over the previous three months, the highest share since the Capital 500 began in Q2 2014. The net balance for borrowing costs rose 3 percentage points to 11% in Q1.

Both micro and larger companies reported higher borrowing costs, and the Chancellor should be aware of the significant levels of external finance that businesses have taken on during the pandemic.

Utility costs continued to rise in Q1, particularly for raw materials sourced internationally: the balance climbed 9 points to 28%, the highest reading since Q3 2019. Domestic raw material prices were also higher. Pressure to raise wages subsided in Q1, and the net balance remains well down from the pre-pandemic levels.

Company expectations for costs of goods and services were little changed in Q1.

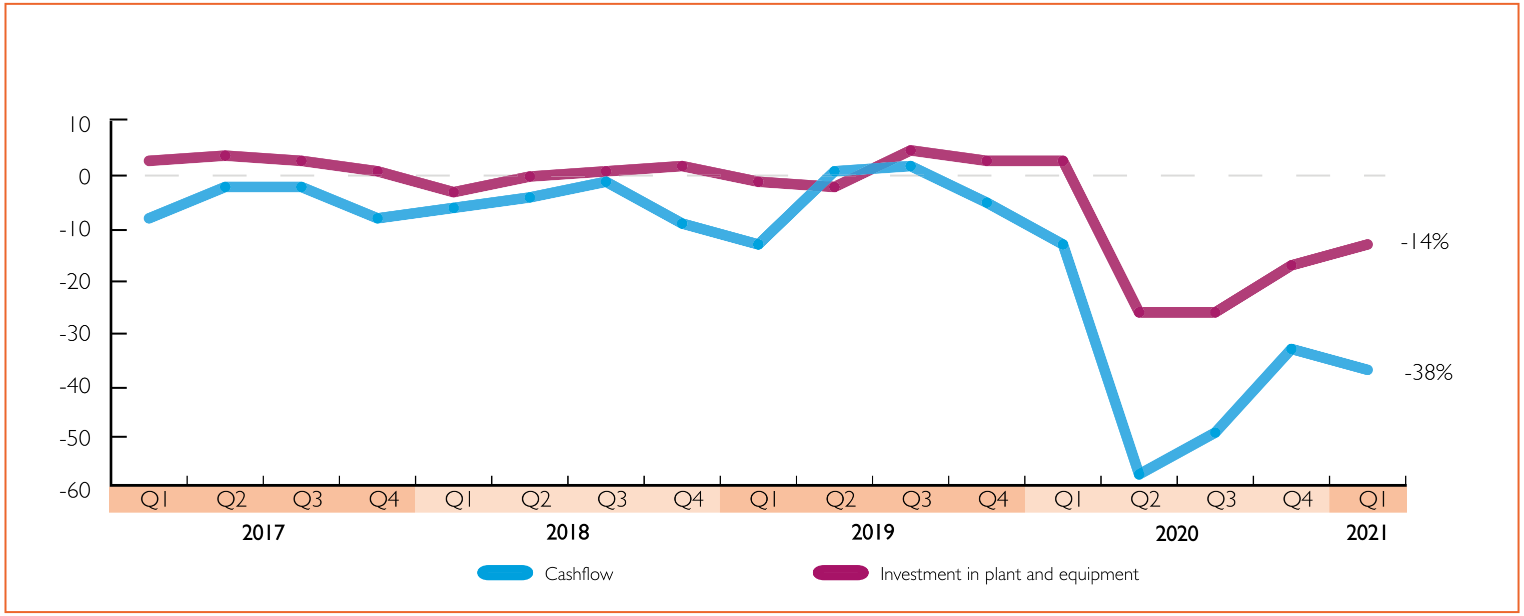
12%

of firms reported an increase in cashflow last quarter

10%

of firms reported an increase in investment in plant and equipment

CASHFLOW AND INVESTMENT



Of course, the news of a third national lockdown will have come as a huge disappointment to the legion of London businesses already under extreme financial pressure. Unsurprisingly, the proportion of businesses who reported a decrease in their cashflow was 50% in Q1, consistent with Q4 2020 (49%). The share of firms who said their cashflow increased also declined, (from 15% to 12%) pushing the net balance down 4 percentage points to -38%.

Greater shares of micro and larger businesses said their cashflow had decreased in Q1, although more large firms noted an increase.

Given that only 35% of companies stated that they were operating at full capacity, it is not surprising to see continued downward pressure on cashflow.

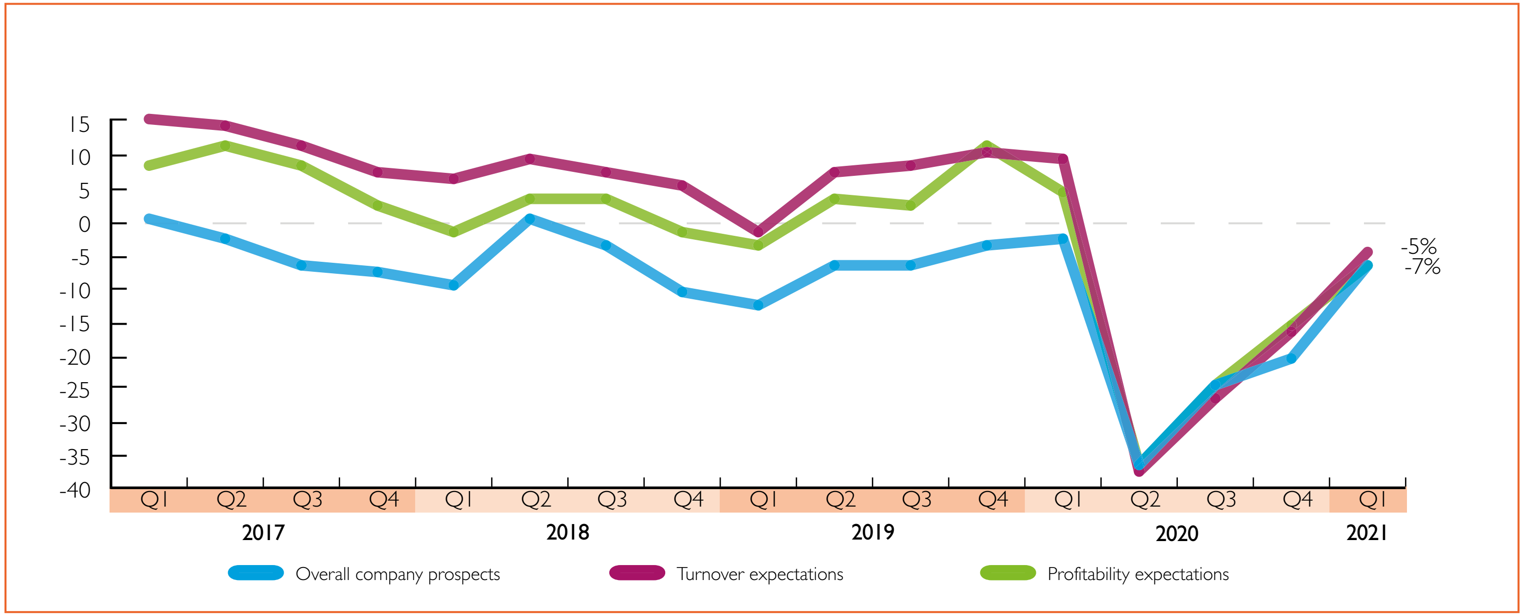
However, there was a modest increase in investment in plant and equipment in Q1, with 10% of firms saying they had raised spending. This is compared to 8% in Q4 2020. The net balance for capital investment rose from -18% to -14% as a result. A quarter (25%) of larger firms reported an increase in investment in plant and equipment, a sharp rise on the previous quarter (10% in Q4 2020).

Firms across manufacturing and services increased capital investment in Q1.

26% of London businesses expect their profitability to improve over the coming 12 months

29% of London businesses expect their turnover to improve over the coming 12 months

BUSINESS CONFIDENCE



Despite a national lockdown, business confidence continued to recover in Q1.

The net balance for turnover expectations for the coming year jumped 12 percentage points to -5% in Q1. Close to one in three (29%) businesses expect their turnover to improve over the next 12 months, which is a steady improvement from the Q2 2020 slump (20% expecting an increase).

As the economy reopens, turnover expectations should continue to recover. However, this will be predicated on a successful vaccination programme and control over any further outbreaks.

Profitability expectations have similarly improved, with 26% of businesses anticipating an increase over the coming 12 months. The net balance rose from -16% to -7% in Q1.

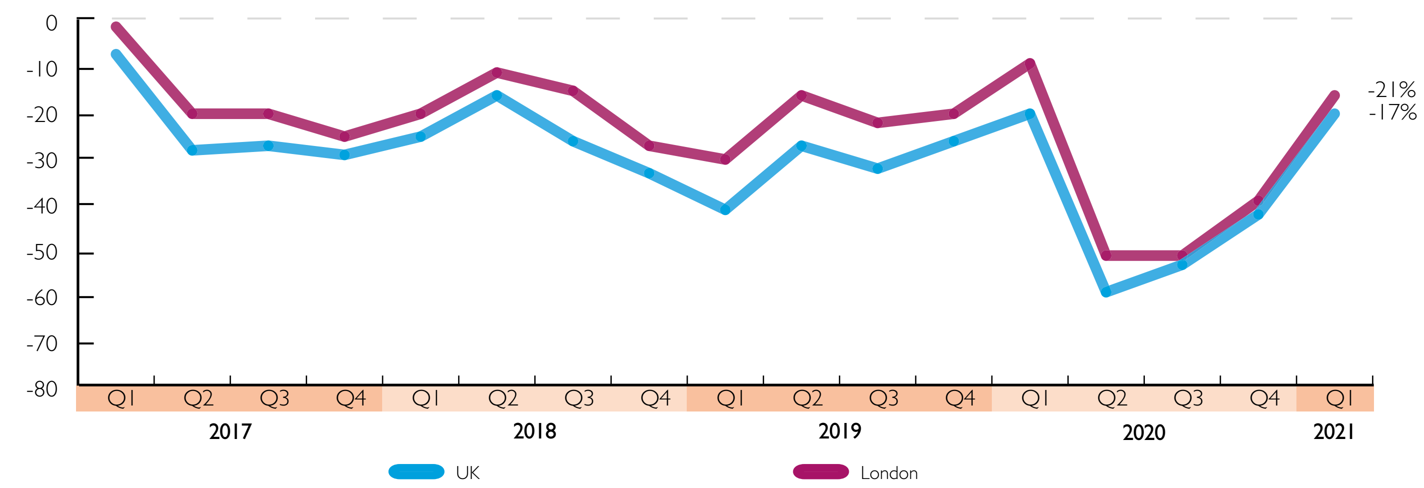
It is worth noting that around two-fifths of firms did not expect their turnover (37%) or profitability (41%) to change in the year ahead.

The net balance for overall company prospects rose from -21% to -7% in Q1, with gains for micro and larger firms.

ECONOMIC OUTLOOK

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

31% of London businesses expect the UK's economy to improve in the next 12 months



The economic outlooks for London and the UK both improved sharply in Q1. This will no doubt be driven by the ongoing success of the UK's vaccination programme, and the publication of the Prime Minister's roadmap out of lockdown. In addition, there was the signing of the landmark Trade and Cooperation Agreement between the UK and the EU.

The net balance for London's economic outlook in the next 12 months jumped from -40% to -16% in Q1: 29% of businesses now expect London's economy to improve, nearly double the share in Q2 2020 (15%). The proportion of firms who expect the capital's economy to worsen also shrunk in Q1, but was still high at 45%.

Both micro and larger businesses were more upbeat about London's economy, with the net balance for larger firms climbing back into positive territory.

Turning to the wider UK economic outlook, again there was a sharp rise in the net balance from -43% to -21%. Nearly one third (31%) of businesses expect the UK's economy to improve in the next 12 months, although more than half (52%) still anticipate a deterioration.

Whether this recovery in confidence can be maintained will depend on how quickly businesses can reopen, and the ability to avoid any significant Covid-19 restrictions in the coming months.