LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

QI

2018

January – March 2018

ComRes

LCCI COMMENTARY – THE BUSINESS VIEW

"The first *Capital 500* survey of 2018, undertaken before the recent announcement that the UK and EU have reached an agreement on a transition period, suggests a challenging quarter for London firms. The business confidence indicators continued to decline, and economic outlook figures have been in negative territory now for over a year. Some business performance indicators also took a hit, including those for domestic demand and planned investment in equipment and training.

"Notwithstanding any impact that the transition agreement might have had on business sentiment, there are things that can be done to turn these figures around and give a boost to confidence in the capital's economy. Additional fixed road crossings across the Thames in East London could unlock new growth potential, and the soon-to-be devolved Adult Education Budget could help address businesses' skills needs. The London Plan, currently under review, can also play a role, not least by helping bring down business costs by addressing current pressures on business space.

"Finally, with the UK and EU agreeing a post-Brexit transition period, it is vital that period is based on businesses' needs. LCCI believes three to five years would be a reasonable period for transition and would allow SMEs – in particular – time to adequately prepare for any changes to the business environment."

Colin Stanbridge, Chief Executive, LCCI

ABOUT '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 partnered with leading polling company, 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.**

Since Q1 2016, *Capital 500* has included trend graphs that track the quarterly results for the past two years.

METHODOLOGY

ComRes surveyed a total of 561 London business leaders between 15 February and 15 March 2018. All data has been weighted to be representative of all London businesses by company size and broad industry sector.

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.

GUEST COMMENTARY – THE ECONOMIST'S VIEW

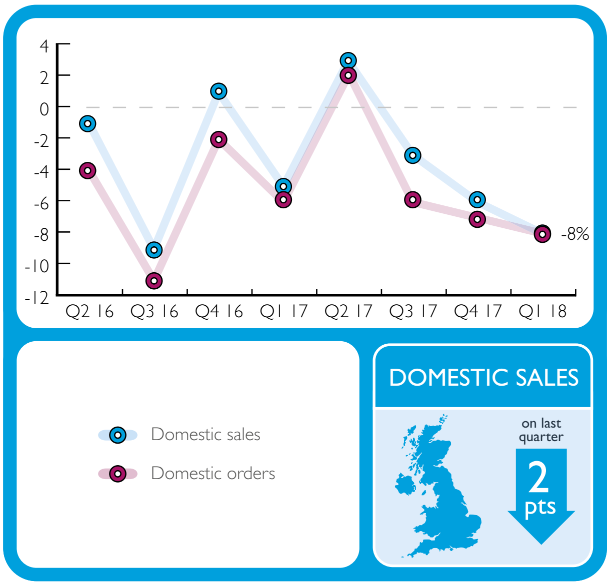
"The LCCI survey results come at a time when a number of other indicators also point to the hoped for improvement in sentiment not having yet come through. Although financial services volumes have kept up reasonably well, the latest CBI/PwC monitor suggests that optimism has fallen now for nine consecutive quarters which is the worst since the financial crisis.

"Despite some improvement in manufacturing there are serious worries in some service sectors such as retail and the hospitality industries, as the consumer is becoming increasingly cautious while construction also remains under the spotlight. Imported inflation has slowed down but skills shortages and increases in the minimum wage are becoming an issue as are concerns about the future path of interest rates.

"Upward revisions to growth for 2018 by the OBR and the Bank of England have been minimal and way below trend – and below those of our main competitors. While Brexit uncertainty remains, the picture is unlikely to change rapidly but it remains to be seen whether there will be changes now that a transition deal has been agreed."

Vicky Pryce, Centre for Economics and Business Research (Cebr)

DOMESTIC DEMAND



During Q1 2018, domestic demand figures declined for the third consecutive quarter and remained negative overall, as more businesses reported a drop than a rise in their domestic sales and orders.

Both domestic sales and domestic orders fell to their second lowest recorded level at -8%, somewhat higher than in Q3 2016 – the first *Capital 500* poll after the EU referendum.

For micro businesses the domestic sales balance even declined to its joint lowest recorded level at -10% on balance, down 2 points on Q4 2017. The figure for larger businesses stayed positive at +15% but did drop by 4 points on last quarter.

EXPORT DEMAND

In Q1 2018, the *Capital 500* export demand figures reached their joint lowest recorded level.

The balance figure for export orders stayed put at -1%, with fewer businesses reporting an increase in their export sales than a fall. For export sales, there were as many businesses reporting a drop as a rise, resulting in a balance of 0, down 2 points on Q4.

On both measures, larger businesses continued to outperform micro businesses, consistent with last quarter. Micro businesses reported a balance figure of -2% for their sales and -3% for their orders, while larger businesses listed a balance of +12 for both.

Domestic demand must ultimately be underpinned by a healthy and productive domestic economy. To boost the capital's productivity, targeted investment in London's infrastructure is required to increase efficiencies and unlock opportunities. Nearly half of London's population lives east of Tower Bridge, yet they are served by only two fixed river crossings. It is an area with a huge amount of potential that is being held back by significant gaps in infrastructure.

Mayor Khan's plan for one new East London road crossing at Silvertown is not enough. Proposals for fixed river crossings at Gallions Reach and at Belvedere – which include a public transport element – should be revisited to maximise growth potential in East London.

LABOUR MARKET

The *Capital 500* employment balance remained in negative territory for the seventh consecutive quarter – a series that began with the first survey after the EU referendum in June 2016.

The balance figure for businesses' employment levels over the last three months remained unchanged from Q4 2017 at -1%. Meanwhile, businesses' expectations for the next three months stayed positive, with on balance 4% of *Capital 500* companies expecting their employment levels to rise – up 1 point on Q4.

While the gap between micro businesses and larger businesses declined (the figure for micro businesses remained at -1% while the balance figure for larger businesses fell by 4 points), micro businesses continued to report a negative employment balance for the last three months (-1%), whereas larger businesses continued to report a positive balance (+6%).

RECRUITMENT AND TRAINING

The balance figure of companies looking to invest in training reached its second lowest recorded *Capital 500* level, as on balance 1% of respondents reduced their planned investment, down 2 points on Q4.

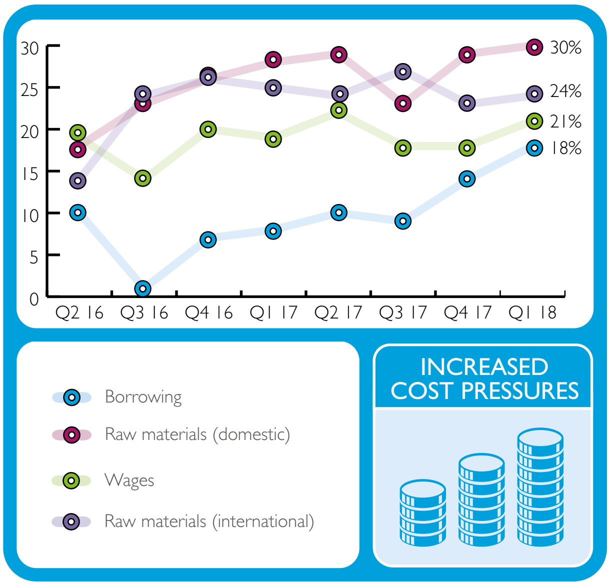
The percentage of companies looking to recruit also reached its second lowest recorded level at 13% (from 15% last quarter); of these, 65% recruited for full-time and 40% for part-time positions.

Of companies trying to hire new staff, half (51%) encountered difficulties, which is less than in the previous two quarters (57% and 60% respectively). Skilled manual/technical positions continued to be the hardest to fill for recruiting companies (63%), followed by professional/ managerial positions (40%).

A diverse, skilled workforce is essential for a competitive business environment. Further devolution to London of responsibility for skills provision, including the administration of the Apprenticeship Levy, will ensure the Mayor of London, Greater London Authority and businesses are better equipped to meet the needs of London's economy, now and into the future. Additionally, it will be vital that the newly devolved Adult Education Budget is tailored to ensure it helps address the needs of the capital's businesses.

The Mayor must continue to work with London businesses to ensure they are consulted on skills provisions for Londoners. This includes seeking business input to help tailor the administration of the Adult Education Budget when it is devolved to London from 2019/20.

BUSINESS COSTS



During Q1 2018, most analysed business costs did not rise significantly compared to last quarter.

Despite only incremental changes, the balance figures for the cost of borrowing (+18%) and the cost of raw materials sourced domestically (+30%) reached their highest recorded *Capital 500* level, while the balance of the cost of raw materials sourced internationally (+24%) stayed lower than for domestic materials (+30%).

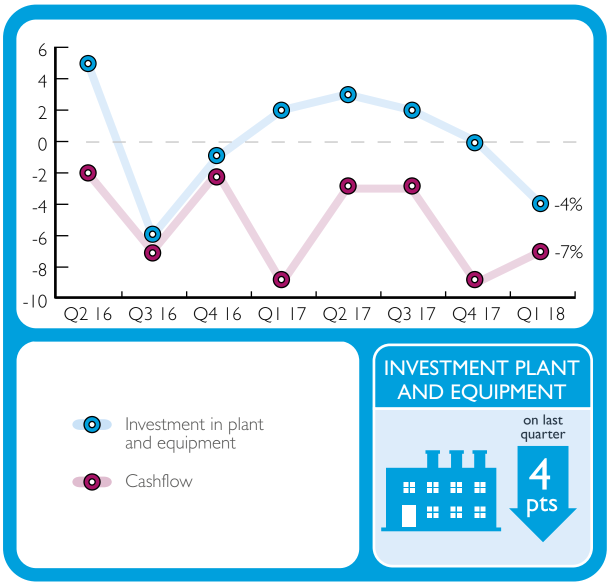
The figures for the cost of energy and the cost of fuel (not included in the graph) continued to be the highest of all analysed costs at respectively +39% (up 8 points) and +40% (up 2 points) – at their second and third highest recorded *Capital 500* levels. The cost pressure of employees to increase wages rose by 3 points to +21%.

CASHFLOW AND INVESTMENT

While the cashflow figure has now been in negative territory for eight consecutive quarters, capital investment turned negative for the first time since Q4 2016.

The capital investment balance dropped by 4 points to -4%, as fewer businesses increased than decreased their planned investment in plant and equipment. The cashflow balance rose by 2 points on last quarter but stayed negative at -7%.

While for larger businesses the capital investment figure remained positive at +15%, the balance for micro businesses continued to drop to -6%. Similarly, the cashflow balance stayed higher for larger businesses (+12%), than for micro businesses (-10%).



Businesses are faced with an increasingly competitive operating environment and, particularly in London, rising costs. A growing concern of businesses has been the impact of permitted development rights (PDRs) for office to residential conversions. PDRs have had a demonstrable effect on the volume of office premises within the capital, and consequently the cost of business space. There is a careful balancing act to be struck to ensure that London's housing supply issues are addressed, whilst giving London firms the space to grow, expand and create jobs. It is essential that areas of strategic importance including the Central Activities Zone (CAZ) are protected.

Through the review of the London Plan, the Mayor of London should seek to secure permanent exemption beyond 2019 for Tech City and the Central Activities Zone from permitted development rights to protect vital work space.

BUSINESS CONFIDENCE

All *Capital 500* business confidence indicators have now reached their lowest recorded level since Q3 2016, with two out of three balance figures in negative territory.

The balance figure for overall company prospects dropped for the fourth consecutive quarter to -10%, as more businesses expected their performance to worsen than improve. Meanwhile the balance for profitability expectations (-2%) turned negative for the first time since the start of the *Capital 500,* down 4 points on last quarter. Turnover expectations stayed positive at +6%.

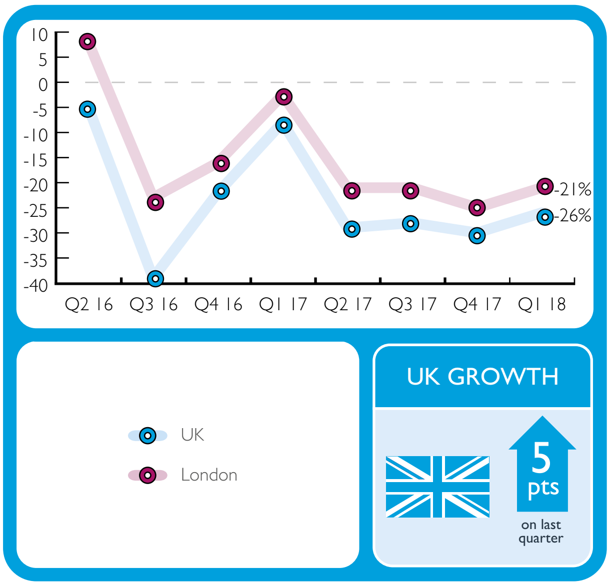
While micro businesses, on balance, remained pessimistic about their company's prospects (-11%, down 2 points on Q4), larger businesses turned optimistic again (+4%), following a negative figure in the previous quarter (-3%). Inner London businesses continued to be more pessimistic (-13%) than their Outer London counterparts (-7%).

ECONOMIC OUTLOOK

During Q1 2018, expectations for both the London economy and the UK economy rose compared to last quarter, while the overall figures continued to be negative on balance.

The balance for expectations of the London economy rose by 5 points to -21%, while expectations of the UK economy went up by 4 points to -26%. Negative figures have now been reported for 7 and 8 consecutive quarters respectively.

On balance, Inner London businesses continued to be much more pessimistic about the UK economy (-36%) than Outer London businesses (-16%). Similarly, larger businesses continued to be less negative about the UK economic growth (-6%) than micro businesses (-28%).



LCCI has long called for a post-Brexit transition period that avoids additional barriers to trade. However, with the UK and EU now agreeing a transition period proposed to end on 31st December 2020, there is real concern that this will not allow enough time for the bulk of firms to prepare for a new trading environment. More time is needed to allow SMEs in particular to plan for any potential changes.

The proposed transition period of 21 months – or just over 90 weeks – may not give many SMEs the time needed to adequately model the impact of potential new tariffs, assess potential non-tariff barriers, identify, recruit and induct any new staff required to process the changes, and order and install new plant, machinery or software.

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