LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

Q1

2016

ComRes

January – March 2016

LCCI COMMENTARY – THE BUSINESS VIEW

"Our revamped Quarterly Economic Survey – *Capital 500* – is now two years old, with eight quarters of data allowing us to track the longer-term trends. All business performance indicators have been on a broadly upward trajectory for the past year, with export demand, recruitment, cashflow and investment reaching their highest recorded levels.

"However, exactly the reverse is true for business expectations for the year ahead. While London businesses' UK economic growth expectations have been in decline for the last three quarters, the first three months of 2016 saw the balance drop to its lowest recorded level and perilously close to a negative. The state of the global economy and the outcome of the London Mayoral election, as well as the forthcoming EU referendum, are among the factors contributing to overall uncertainty.

"The Government must act now to minimise economic uncertainty and support those that may be falling behind. Investment in the suburban transport network would boost the Outer London area, while micro businesses would benefit from practical support to increase their online presence and recruit employees from outside the EEA to fill urgent skills gaps."

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 business survey.**

From this quarter, *Capital 500* includes trend graphs that track the quarterly results for the past two years.

METHODOLOGY

ComRes surveyed a total of 506 London business leaders between 1 and 22 February 2016. 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.comres.co.uk.

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 less than ten employees (including sole traders), and larger (small, medium and large) businesses with ten or more employees.

Any data reproduced from the report should be fully referenced.

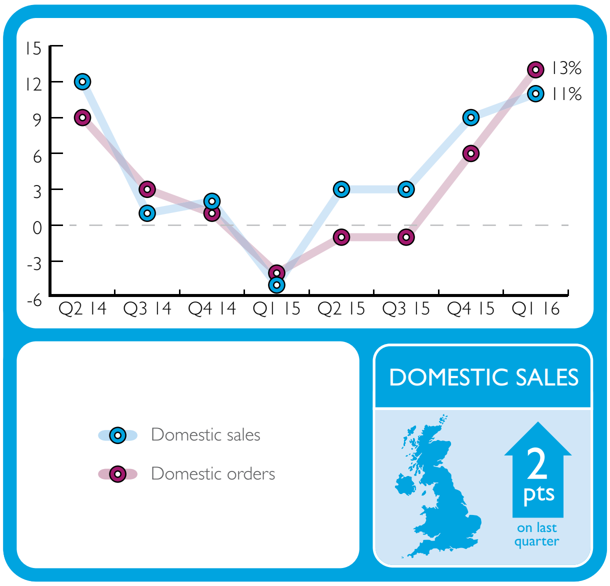
GUEST COMMENTARY – THE ECONOMIST'S VIEW

"Since the last survey, the world economic environment has worsened and forecasts for the world and the UK economy have been consistently revised downwards. The Office for Budget Responsibility's revised forecast accompanying the March 16 Budget was particularly downbeat, especially for this year, and there was a worrying revision of productivity for the economy as a whole.

"For the Chancellor to achieve his forecast budget surplus by 2019/20 in this worsening environment, he will need more tax cuts or a further tax hike than what we have seen already, but what the economy needs is an extra push to encourage investment and innovation. Much clearly depends on the sentiment around the referendum on June 23 and beyond, but other things can also help redress the worrying productivity trend. The further reductions in the main rate of corporation tax, reductions in capital gains tax and more than doubling of small business rate relief are welcome in this respect, as is the bringing forward of capital spending on infrastructure in London and the North, but more will be needed."

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

DOMESTIC DEMAND



Domestic demand continued to improve during Q1 2016. On balance, 11% of London businesses reported increased sales, up 2 points on last quarter. The domestic order balance figure rose by 7 points to +13%, the highest recorded *Capital 500* level.

There has been a significant turnaround in domestic demand, which declined consistently over the course of 2014 and Q1 2015. Q2 2015 saw a reversal of this trend, and the increase has continued steadily since. This is likely to be as a result of job creation and real wages improvement, impacting on households' disposable income and spending, as well as low interest rates and energy costs.

Larger companies reported a stronger domestic sales balance (+26%) than micro businesses (+10%), which is concerning as smaller companies tend to depend on the domestic market, rather than exports. Businesses based in Inner London also fared better (+20%) than those in Outer London (+1%).

EXPORT DEMAND

Export demand also remained on an upward trajectory, with both sales and orders balance figures reaching their highest recorded levels. The balance figure for export sales increased by 6 points to +10%, and the balance figure for export orders increased by 6 points to +9%. This is in marked contrast to a widening trade deficit at the national level in Q1 2016, as reported by the ONS.

Having started from a low point of +1% for export sales and -1% for orders in Q2 2014, export demand has shown strong growth since Q2 2015, which can be attributed, at least in part, to a weaker Sterling in recent months.

Larger businesses reported higher export sales (+17%) than micro businesses (+9%). While businesses based in Inner London, on balance, increased export sales (+19%), those based in Outer London saw a net decrease (-1%).

Although both domestic and export demand figures are pointing in the right direction, micro businesses still find it comparatively harder to attract new customers and access export markets. LCCI research has shown that sole traders and other small businesses are less likely to take advantage of digital technologies, with two in five London businesses of this size having no website, compared to only 8% of larger businesses.[1] Yet, digital platforms provide unparalleled opportunities to connect with potential new customers in Britain and overseas.

The new Mayor of London should establish a business panel focused on raising awareness of the benefits of developing an online presence – and the new UKTI e-Exporting programme – among offline sole traders and small businesses. The panel should encourage engagement with the London Digital Security Centre to ensure that businesses trading ideas, products and services online do so safely.

1 LCCI (2015): *Capital Connected: Helping London businesses grow online*, at www.londonchamber.co.uk/research/CapitalConnected

LABOUR MARKET

Q1 2016 saw the highest recorded *Capital 500* employment balance figures. They have now been on an upward trajectory for four consecutive quarters, as the balance figure for employment levels rose to +9%, a 6 point increase on last quarter.

Expectations for the next quarter were equally high, as 14% of businesses, on balance, expected their workforce to increase. Last quarter's initial expectations for Q1 2016 were the lowest since of the start of *Capital 500,* but the downward trend has now been reversed, which is in line with a strong increase in London businesses' actual employment levels over that last year.

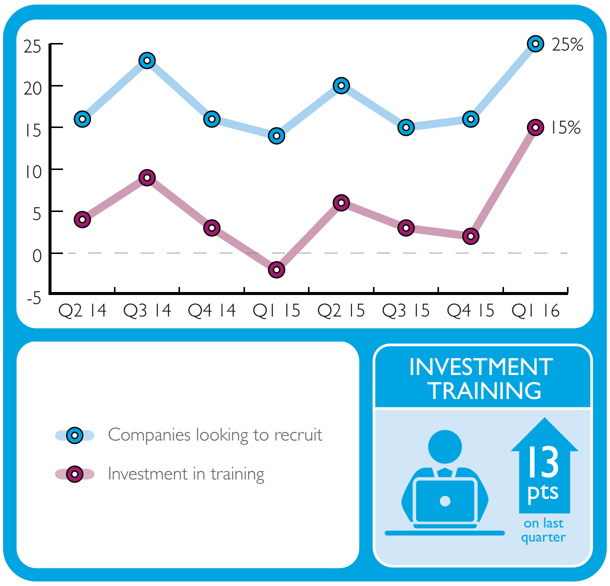
The balance figure for employment levels for this quarter was lower for micro businesses (+8%) than for larger firms (+15%). The latter were also more likely to expect their workforce to increase next quarter (+23%) than micro businesses (+13%).

RECRUITMENT AND TRAINING

A record number of *Capital 500* companies were investing in training and looking to recruit in the past three months. Plans for investment in training improved dramatically, with 15% of companies, on balance, increasing investment plans, a 13 point rise on last quarter.

Usually if the skills requirements cannot be addressed by training the existing workforce, businesses would seek to take on new workers. A total of 25% (22% of micro businesses and 51% of larger businesses) were looking for new staff. An overwhelming majority of recruitment was for full-time positions (87%), up 33 points on last quarter.

However, 58% of those looking to recruit encountered difficulties finding sufficiently skilled candidates, with micro businesses more likely to encounter challenges than larger companies. Professional/managerial and skilled manual/technical positions continue to be the ones where recruiting *Capital 500* companies experience the most difficulties.

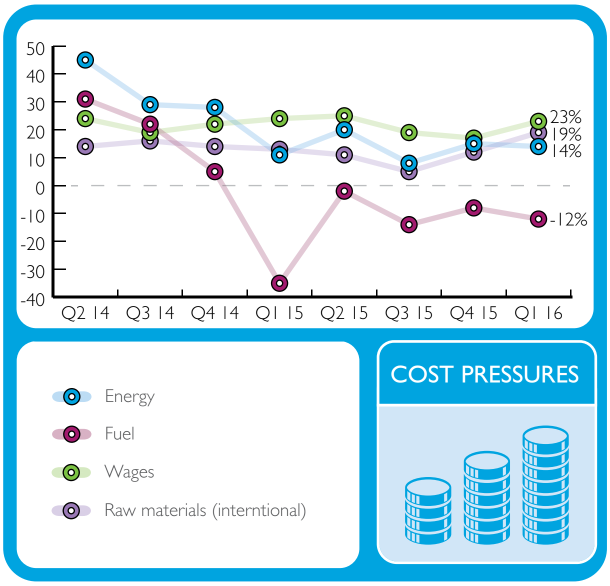


Many companies may look to overseas candidates to plug any urgent skills gaps. However, LCCI research has shown that smaller businesses find it more difficult and more costly to navigate the immigration system in order to recruit workers from outside the EEA.[2]

The Government should work with the new Mayor of London and his Business Advisory Council (LBAC) to establish a third-party sponsorship route ("London Visa") for established sector-specific organisations to support non-EEA worker visas on behalf of recognised small businesses.

2 LCCI (2015): *Worlds Apart: Making the immigration system work for London businesses*, at www.londonchamber.co.uk/DocImages/13696.pdf

BUSINESS COSTS



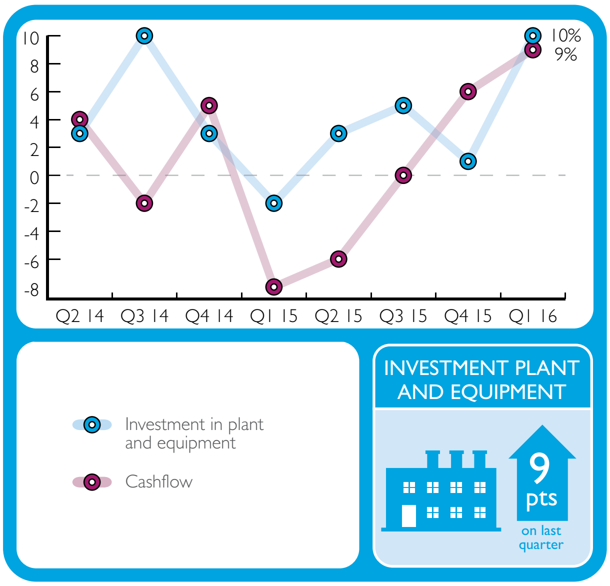
The balance figures for all analysed business costs, except for energy and fuel, increased compared to the last quarter. Having been relatively stable over the long term, the cost of international raw materials saw the biggest change: 19% of London businesses, on balance, reported increases, up 7 points on last quarter. This was closely followed by the pressure to increase wages, up 6 points on last quarter to +23%. The balance figure for borrowing costs increased by 5 points to +13%, while the cost of raw materials sourced domestically went up by 4 points to +19%.

The balance figures for energy and fuel costs have seen the largest long-term fluctuations. On balance, 45% of *Capital 500* companies reported increased energy costs in Q2 2014, dipping to a low of +8% in Q3 2015. Starting from a high point of +31% in Q2 2014, the balance figure for cost of fuel dropped dramatically to -35% in Q1 2015. Since then, the proportion of businesses reporting decreases has continued to outnumber those seeing increases, broadly reflecting continuing drops in wholesale energy prices in 2014-15.

CASHFLOW AND INVESTMENT

Capital 500 **companies' cashflow position has continued on an upward trajectory since Q1 2015,** with 9% on balance reporting an increase. Following a decline in capital investment last quarter, in Q1 2016 investment levels caught up with improved cashflow, rising by 9 points to a balance of +10%.

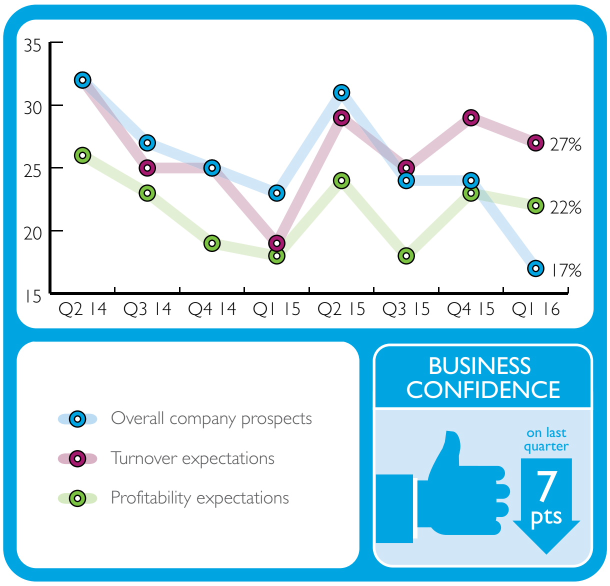
There were significant differences by business size. While micro businesses reported a worse cashflow balance (+8%) than larger companies (+20%), the balance for capital investment was only slightly lower for micro businesses (+10%) compared to larger ones (+14%). Businesses based in Inner London had better balances in both cashflow (+16%) and investment (+18%) than those in Outer London (0% and +1% respectively).



Despite the improved capital investment balance, more needs to be done to incentivise businesses to invest, particularly in Outer London, where the transport network is under increasing pressure. Infrastructure improvement projects have the potential to vastly improve business confidence and investment levels as a result. The £80 million funding commitment to bring Crossrail 2 forward and the £5 million Outer London Infrastructure Fund announced in the Chancellor's Budget are welcome in this regard.

The new Mayor of London should ensure that the transfer of responsibility for the management of London-bound rail services to Transport for London is rolled out as soon as possible and delivers real improvements in frequency and reliability.

BUSINESS CONFIDENCE



In contrast to the improvements seen in all indicators of London businesses' performance over the last quarter, expectations for the next 12 months are in marked decline. Expectations for company turnover and profitability have declined marginally from Q4 2015. On balance, 22% of businesses expected their profitability to increase over the next 12 months and 27% felt the same about their turnover. This is well above the long-term low in Q1 2015, when only 18% on balance expected profitability to increase and 19% expected an improved turnover.

However, **after stabilising the previous quarter, business confidence levels dipped by 7 points,** as only 17% of companies, on balance, expected their firm's performance to improve over the next 12 months – an all-time *Capital 500* low, compared to a high of 32% in Q2 2014. Larger businesses were more optimistic about their prospects (+27%) than micro businesses (+15%); companies based in Outer London were much more pessimistic about their prospects (+12%) than those in Inner London (+21%).

ECONOMIC OUTLOOK

The most significant decline can be seen in London businesses' economic growth expectations. Already at their lowest recorded level over the last two years, expectations for both the UK and London economy continued to decline.

Having started the reporting period at +50% for the UK and +53% for London in Q2 2014, this quarter only 2% of *Capital 500* businesses, on balance, expected the UK economy to improve, and 14% expected London's economy to improve. While it is encouraging that expectations for London's economic growth have consistently surpassed the national outlook, having historically been in strongly positive territory, the balance for UK growth expectations is now alarmingly close to negative. The smaller the company, the more prevalent the pessimism about the UK's growth prospects, with balances of +20% for larger companies, and 0% for micro businesses. Businesses in inner London were more optimistic about UK growth (+6%) than those in outer London (-2%).

There are many factors that may have contributed to this decline in business confidence and economic outlook. Volatile financial markets, low commodity prices, weakening Chinese exports, continuing Eurozone instability and uncertainty about the outcome of the Mayoral election all play a role. The survey fieldwork period (1-22 February) took place in the midst of negotiations on the terms of the UK's membership of the EU, with a June referendum date expected, which may have added to overall perceptions of uncertainty.

At the Referendum, LCCI will not be campaigning either to Remain or to Leave. We urge both the Remain and Leave campaigns to present clear information about each of their desired outcomes to assist London businesses to make an informed choice on 23 June.

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