LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

Q3 2015

October 2015

ComRes

"Our latest *Capital 500* Quarterly Economic Survey results provide both signs of encouragement but also a level of concern about the London business environment. Positive gains were made across several indicators, with stronger cashflow balances, continued appetite to invest in plant and equipment, and easing of business cost pressures all welcome developments.

"Yet, while London businesses remain generally upbeat about their own prospects and those of the wider UK and London economies, there were worrying declines in business confidence levels compared to previous quarters. With growing uncertainty over the health of the global economy potentially affecting business sentiment in the short to medium term, decisive UK Government action on key long-term infrastructure projects like Heathrow as well as committing adequate capital for infrastructure investment at the forthcoming Spending Review, would provide some reassurance to London businesses about the path that lays ahead."

Colin Stanbridge, LCCI Chief Executive

"The UK is not immune from the weakening trend in world growth as emerging markets, particularly China but also others such as Brazil and Russia, are slowing down or already in recession. The US has been downgrading growth expectations for next year and the European Central Bank has reduced its own forecast for the Eurozone in 2016. This is bound to affect business and investors' confidence.

"On the positive front, interest rates are likely to remain at record low levels for longer and falling commodity prices will keep business costs and inflation low. In addition, the increase in real earnings finally being seen in the UK coupled with near-record employment levels will keep domestic demand buoyant despite cuts in government spending. Productivity is also slowly picking up. There are helpful signs too that lending conditions for SMEs are improving, though wage rises and skill shortages are becoming an issue in many parts of the UK."

Vicky Pryce, Chief Economic Adviser, CEBR

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 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.**

Capital 500 QES results are not directly comparable to QES results published between Q1 2008 and Q1 2014, as only LCCI members were polled during this period.

METHODOLOGY

ComRes surveyed a total of 514 London business leaders between 18 August and 7 September 2015.
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.

Balance figures referred to throughout this report are determined by subtracting the percentage of companies reporting decreases from the percentage of companies reporting increases.

Any data reproduced from the report should be fully referenced.

DOMESTIC DEMAND

DOMESTIC SALES

NO CHANGE

20% reported increased domestic sales

Domestic sales remained in positive territory in Q3 2015, but overall performance has been disappointing considering the strong gains registered in the previous quarter. **The balance figure for domestic sales was +3%, the same level as Q2 2015,** with 20% of *Capital 500* firms reporting an increase in sales and 17% reporting a decrease. Similarly, there was no change to the balance figure for domestic orders, remaining just in negative territory at -1% (17% reported an increase and 18% a decrease). Limited movement in domestic demand figures is reflected in recent UK Purchasing Managers' Index survey data. The UK manufacturing sector remains near stagnant with marginal growth (Markit/CIPS: *UK Manufacturing PMI,* August 2015). Growth in the UK service sector has moderated but remains strong overall (Markit/CIPS: *UK Services PMI,* August 2015).

Recent uncertainty over the strength of China's economy, as well as continued weakness in the Eurozone, reinforces the case for interest rates to be kept at a low level well into 2016. This will help to support business growth in the short to medium term.

EXPORT DEMAND

EXPORT SALES

↑ 1 POINT

8% reported increased export sales

Export performance improved marginally in the third quarter of 2015. The balance figure for export sales was +3%, a one point increase from the previous quarter, with 8% of *Capital 500* firms reporting an increase in export sales and only 5% a decrease. Similarly, there was a single point increase in the balance figure for export orders to +2% (7% reported an increase and 5% a decrease).

Recent trade data shows a widening in the UK trade deficit, although monthly trade figures remain volatile. The UK's deficit in goods and services rose to £3.4 billion in July, a £2.6 billion increase since June 2015 (ONS: *UK Trade July 2015,* September 2015). Following the pound's sharp rise against the euro during the summer months reaching a peak in July, the value of sterling has since declined, providing some respite for exporters.

The Chancellor's recent productivity plan included welcome measures to widen the powers of UK Export Finance, as well as a commitment to review the finance challenges facing SMEs that export or are looking to export. Export performance has remained sluggish since the first *Capital 500* survey over one year ago, demonstrating that stronger efforts to boost export performance are required. The Government must ensure recommendations following the review of SME export financing are swiftly implemented so that export support services can be directed to better meet the needs of London firms aspiring to trade abroad. Keeping interest rates at a low level until further into 2016 will also help prevent further appreciation of sterling.

The Government's intention to review the financing challenges for SMEs that export, or aspire to export, is welcome but any review recommendations must be followed through quickly to enable support to be better directed to potential exporters.

LABOUR MARKET

EMPLOYMENT

0%

↑ 4 POINTS

8% increased employment in the last three months

The balance figure for employment levels has improved over the last three months. While 84% of *Capital 500* businesses reported no change in employment levels during Q3 2015 (3% more than in Q2 2015), 8% of firms saw an increase in employment levels compared to 8% that saw a decrease, leaving a neutral balance figure of 0%. This is four points above the previous quarter's figures.

Capital 500 businesses remain generally optimistic about their employment prospects for the next three months. 12% of *Capital 500* firms predict their workforce will increase in size, compared to 2% that anticipate a decrease, **leaving a balance figure of +10%, a two point decrease on the previous quarter.**

Improvements in *Capital 500* businesses' employment levels and continued optimism in employment intentions are reflected in recent London jobs data, which show a slight increase in the employment PMI in July 2015 (GLA Economics: *London's Economy Today*, August 2015).

RECRUITMENT AND TRAINING

INVESTMENT
TRAINING

+3%

↓ 3 POINTS

9% increased investment in training

There was a decline in the number of London businesses looking to recruit in the last three months. 15% of *Capital 500* firms looked to hire new staff during the last three months, **a five point decline from the previous quarter.** Worsening global market conditions following persistent concerns over the Chinese economy during the summer months may have contributed to the decline in recruitment during Q3 2015. The majority of jobs advertised were for full-time positions (65%), while 31% of roles were for part-time positions (down seven points on the previous quarter).

Recruitment continues to be a challenging issue for *Capital 500* firms. **Half (49%) of London firms looking for new staff in the last three months encountered difficulties finding suitable workers, although this represents an eight point decrease on the previous quarter.** Skilled manual or technical staff continue to be the positions where most issues were experienced, with 43% of London companies which had difficulties recruiting struggling to fill those vacancies (down 15 points from the previous quarter). Over a third (37%) of recruiting firms experienced difficulties hiring professional or managerial staff, a four point increase from Q2 2015.

There was a minor decrease in *Capital 500* businesses' investment in training following strong gains the previous quarter. **The balance figure for investment in training fell by three points to +3% in Q3 2015,** with 9% of companies planning to increase their training budgets and only 6% planning a reduction.

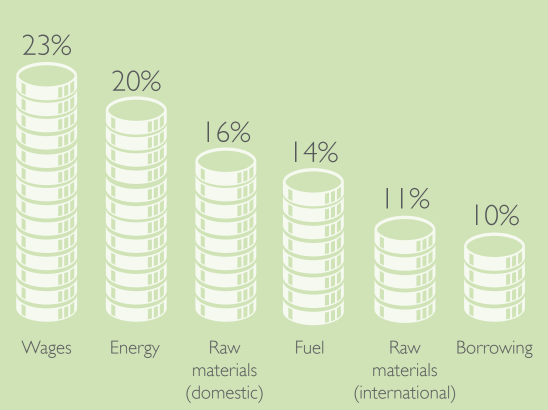
Skills shortages remain an ongoing challenge for London firms looking to grow. While the Government's intention to tackle skills shortages in the long term through the creation of more apprentices is positive, more detail is required on how a proposed Apprenticeship Levy would help meet its target of three million apprenticeships by 2020.

In the short term, London firms are dependent on migrant workers to plug the skills gap. The Government has asked the Migration Advisory Committee (MAC) to review the Tier 2 visa system, with a view to making recommendations to significantly reduce the number of economic migrants hired from outside the EEA in the UK. London businesses are already experiencing difficulties hiring sufficiently skilled staff and further restrictions on their ability to recruit from outside the EEA risk exacerbating skills shortages clearly present in the capital.

The Government must not impose further restrictions on firms looking to recruit from outside the EEA through changes to the Tier 2 visa system. Any changes limiting the number of skilled workers hired through the Tier 2 system risk harming the growth prospects of London firms already struggling to find skilled workers.

BUSINESS COSTS

INCREASED COST PRESSURES



Pressure to increase wages was the main cost pressure faced by London businesses over the last three months. 23% of *Capital 500* firms said they faced greater pressure from employees to increase wages during Q3 2015, although this represents a four point decline from the previous quarter. The price of energy was the second highest cost pressure faced by firms, having been the main one the previous quarter. 20% of London companies faced higher energy costs, down nine points from the second quarter of 2015.

There was a large reduction in the number of London firms experiencing higher fuel costs, with 14% listing fuel prices as their main cost pressure, seven points lower than Q2 2015. A steady decrease in the price of fuel, particularly diesel, may have contributed to this decline.

Competition remains the most common concern for London businesses, with a third (34%) saying it is a greater concern to their business than three months ago, despite this figure being seven points lower than in Q2 2015. A quarter (24%) of *Capital 500* firms were more concerned about interest rates than they had been three months ago – the same as the previous quarter's results. Inflation continues to decline as a business concern with only 13% of London firms more concerned about inflation now than in the last three months (a four point decline). This follows the CPI measure of inflation falling back to 0% in August 2015.

CASHFLOW AND INVESTMENT

INVESTMENT
PLANT AND EQUIPMENT

+5%

↑ 2 POINTS

12% increased capital investment

Cashflow balances for *Capital 500* firms continued to improve in the third quarter of 2015. While 60% of London firms reported no change in their cashflow position, **the overall cashflow balance figure increased by six points to a neutral position of 0% over the last three months** (20% of companies reported an increase and 20% a decrease).

Improvement in companies' cashflow balances were echoed in business investment plans, which experienced a marginal increase in Q3 2015. **The balance figure for investment in plant and equipment increased by two points to +5% during the third quarter of 2015,** with 12% of *Capital 500* businesses reporting an increase in capital investment plans and only 7% reporting a decrease. Healthier balance sheets and continued low oil prices may have provided businesses with more room to invest in capital.

The stronger business investment figures are reflected in recent Government data, which shows that business investment in the UK increased by an estimated £1.4 billion to £47.8 billion, building on improvements seen in Q1 2015 (ONS: Business Investment, Q2 2015 Provisional Results, August 2015).

LCCI was pleased to see measures in the Chancellor's Budget to permanently fix the Annual Investment Allowance to £200,000, an issue we have long lobbied on. The Government must now demonstrate its commitment to investing in the UK's infrastructure and move swiftly on the Airports Commission's recommendation for expansion at Heathrow. Decisive action to increase the UK's aviation capacity will provide greater certainty for London businesses to invest in the long term, as well as boosting overall productivity.

A clear decision on increasing aviation capacity would enable businesses to invest with more certainty. By enacting the recommendations of the Airports Commission final report the Government would demonstrate a practical 'future-proofing' of the London and wider UK economy.

BUSINESS CONFIDENCE

BUSINESS CONFIDENCE

+24%

↓ 7 POINTS

33% expect their company's prospects to improve over the next 12 months

There was a notable decline in *Capital 500* businesses' confidence over the last three months, but overall figures remain healthy. **The balance figure for London firms' overall performance expectations for the next 12 months decreased by seven points to +24%,** with 33% expecting an improvement (a seven point reduction from Q2 2015) and only 9% anticipating a decline.

Similar declines were registered in company performance indicators for the next 12 months. **The balance figure for turnover expectations decreased by four points to +25% in Q3 2015,** with 39% of *Capital 500* firms forecasting increased turnover and 14% predicting a decrease. The balance figure for profitability expectations decreased by six points to +18% (33% anticipating an increase and 15% a decrease).

Overall business confidence among London businesses is reflected in other business surveys, although recent turmoil in external markets and continued skills shortages may have an impact on confidence levels (ICAEW/Grant Thornton: *UK Business Confidence Monitor Q3 2015*).

ECONOMIC OUTLOOK

UK GROWTH

+26%

↓ 12 POINTS

41% expect UK growth to improve over the next 12 months

There was a significant drop in *Capital 500* firms' expectations for the UK's economic growth during Q3 2015. 41% of London businesses expect UK economic growth to improve over the next year while 15% expect it to contract, **leaving an overall balance figure of +26%, a 12 point decline on the previous quarter's results.**

A similarly large contraction can be seen in *Capital 500* firms' confidence in London's future growth prospects. **The balance figure for London's economic growth prospects over the next 12 months is +30%, a 16 point decline from Q2 2015** (40% expect growth and 10% predicted a decline). This is the lowest recorded figure since the *Capital 500* survey began over a year ago.

While a post-Election bounce may have caused confidence figures in the previous quarter to be higher than expected, the large declines in optimism for the UK and London economies are concerning. The Office for Budget Responsibility recently revised down its GDP growth for the UK in 2015 to 2.4%, reflecting slower growth earlier in the year. Financial turmoil in Asian markets over recent months and continued uncertainty over when a referendum over the UK's future membership with the EU might take place threaten to further hamper the UK's growth prospects.

As the Government looks increasingly at the role that devolution could play in boosting growth and productivity across the country's cities and regions, London should not be overlooked. Greater fiscal powers would provide London businesses with much greater confidence that some of the capital's critical infrastructure needs can be addressed without the need for protracted and uncertain future negotiations with central Government (or Whitehall) over funding.

London should not be excluded from moves towards wider devolution in England. The Government should look to pilot devolving some fiscal elements, such as property taxes, in all or part of the capital over the course of this Spending Round period, providing greater certainty to London businesses over the capital's growth prospects.

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