

CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

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Q2 2015



“London businesses are demonstrating levels of optimism not seen since we ran our first *Capital 500* Quarterly Economic Survey one year ago. Strong gains can be seen across a number of indicators, with business confidence, investment in staff and capital, and domestic demand figures at their highest level for several quarters. The decisive outcome of the General Election certainly seems to have provided London businesses with more certainty over their immediate future.

Despite renewed London business confidence, firms continue to experience cashflow difficulties, while recruiting sufficiently skilled workers remains a long-term challenge. Now that the new Government is firmly in place, it should look to capitalise on the positive momentum generated by giving the capital more freedom to invest in its own infrastructure needs, helping to engrain sustained growth across the London and UK economies”.

Colin Stanbridge, LCCI Chief Executive

“Renewed optimism in the *Capital 500* Quarterly Economic Survey since the election is echoed in other UK-wide surveys. However, some national indicators suggest a weaker path ahead, with service sector performance somewhat disappointing. The Bank of England has revised downwards its forecasts for 2015/6 with export markets likely to be constrained by the fall-out from the Greek crisis in the eurozone, relatively weak demand elsewhere, and by a stronger pound.

Concerns for businesses centre around the timing of any interest rise, the forthcoming EU referendum that may lead to the loss of major export markets, efforts to restrict the movement of people from within Europe which businesses would mostly want to preserve, and the likely impact on the pound which has benefited from a weaker eurozone”.



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 510 London business leaders between 7 and 20 May 2015.

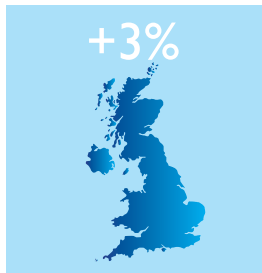
All data has been weighted to be representative of all London businesses by company size and sector:

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



↑ 8 POINTS

21% reported increased domestic sales

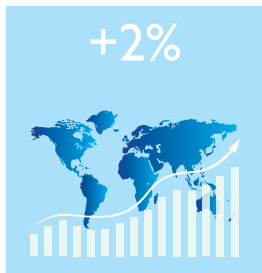
Domestic demand rebounded positively in Q2 2015, following a significant decline at the beginning of the year. **The balance figure for domestic sales rose by eight points to +3%**, with 21% of *Capital 500* firms reporting an increase in sales and 18% reporting a decrease. While there was also a slight pick up in domestic orders, the balance figure remained in negative territory at -1% (18% reported an increase and 19% a decrease).

Renewed buoyancy in domestic demand figures is reflected in recent data on the UK manufacturing sector, which saw further expansion of output and new orders in May 2015 (Markit/CIPS: *UK Manufacturing PMI*, June 2015). Similarly, the UK service sector has continued to expand, with firms reporting lower business uncertainty following the outcome of the General Election (Markit/CIPS: *UK Services PMI*, June 2015).

Following a period of political uncertainty in the UK, these positive domestic sales figures are a welcome sign that the economy is regaining momentum post-General Election.

EXPORT DEMAND

EXPORT SALES



NO CHANGE

8% reported increased export sales

Export demand continued to underwhelm in the second quarter of 2015. The balance figure for export sales was +2%, the same level as the previous quarter, with 8% of *Capital 500* businesses reporting an increase in sales and 6% a decrease. Similarly, the balance figure for export orders remained the same at +1% (7% reported an increase and 6% a decrease).

Recent trade data shows a marked improvement in the UK trade deficit. The UK's deficit in goods and services narrowed from £3.1 billion to £1.2 billion in April (ONS: *UK Trade April 2015*, June 2015). However, monthly trade figures are notoriously volatile, while the positive reaction of currency markets to the formation of a majority Conservative Government has seen the pound record its sharpest rise against the euro since 2009, exacerbating difficulties experienced by UK exporters in the eurozone market.

The Conservative Government has been quick to offer more support to potential exporters, having recently announced a First Time Exporters initiative which provides a new package of training and direct support to businesses looking to explore overseas markets. **However, stronger action is needed to encourage more companies to trade abroad.**

London businesses looking to export are disadvantaged by the high rate of Air Passenger Duty (Band B) on long-haul flights, which are more than double the rate of Germany. The Treasury intends to review the impact of devolution of APD to English regions and varying APD within England, yet in order to provide the support that businesses needed, the Treasury should consider including economic modelling on the impact of a lower rate of long-haul APD. This could provide a more valuable boost to London businesses looking to export to emerging overseas markets.

The Government's intention to review Air Passenger Duty (APD) is welcome, but does not go far enough to meet the needs of businesses deterred by the cost of travelling overseas. The Treasury's APD discussion paper should include a review of the impact of a lower long-haul rate of APD.

LABOUR MARKET

EMPLOYMENT

-4%



↑ 1 POINT

8% increased employment in the last three months

Employment levels remained negative in Q2 2015, consistent with figures from the first three months of 2015. While 81% of *Capital 500* businesses reported no change in employment levels over the last three months, only 8% of firms saw an increase in employment levels compared to 12% that saw a decrease, leaving a balance figure of -4%, a one point rise on the previous quarter.

London firms are more optimistic about their employment prospects for the next three months. 15% of *Capital 500* surveyed predict their workforce size will increase, compared to 3% that anticipate a decrease, leaving a balance figure of +12%, a four point rise on the previous quarter. Businesses in the Finance & Insurance/business administration sectors, as well as Information & Communication firms were the ones with the strongest intention to recruit over the next three months.

Optimism concerning *Capital 500* businesses' employment intentions is reflected in recent London jobs data, which shows that the employment rate in the capital is at near-record levels, with further rises in employment forecast for the year ahead (GLA Economics: *London's Economic Outlook Spring 2015*, May 2015).

RECRUITMENT AND TRAINING

INVESTMENT TRAINING

+6%



↑ 8 POINTS

12% increased investment in training

There was a strong increase in the number of London businesses looking to recruit in Q2 2015. 20% of *Capital 500* firms looked to hire new staff during the last three months, a six point rise from the previous quarter. Uncertainty surrounding the outcome of the General Election may have contributed to the low level of recruitment seen in Q1 2015; the number of London firms looking to recruit is now close to its *Capital 500* peak of 23% in Q3 2014. The majority of jobs advertised were for full-time positions (62%), while the number of part-time roles posted increased by nine points to 38%.

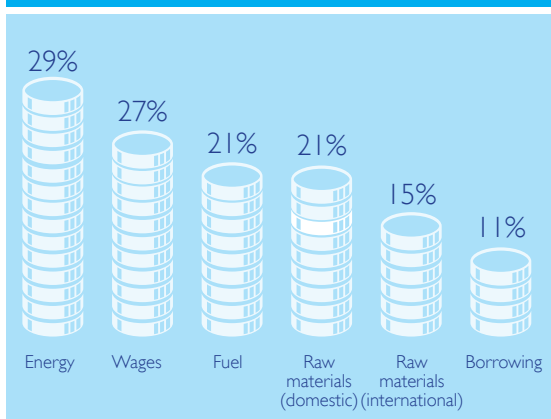
Capital 500 businesses continued to experience difficulties during the recruitment process. 57% of London firms looking for new staff in Q2 2015 encountered difficulties finding suitably skilled workers, a three point increase on the previous quarter. Skilled manual or technical staff were the positions where most difficulties were experienced, with 58% of London companies which had difficulties in recruiting struggling to fill those vacancies (up from 51% the previous quarter). 33% of recruiting firms which experienced difficulties hiring did so for professional or managerial staff (up one point from Q1 2015).

There has been a sharp increase in *Capital 500* businesses' investment in training. The balance figure for investment in training saw an eight point rise to +6% in Q2 2015, with 12% of companies planning to increase their training budgets and only 6% planning a reduction. This is perhaps not surprising given the recruitment difficulties experienced by London firms and shows that the perception that businesses are not addressing skills shortages in their sectors may be misplaced. The Queen's Speech announced a consultation on funding apprenticeships for British and EU workers by imposing a new visa levy on businesses hiring workers from outside the EU/EEA. In this context, the Government's intention to make it harder for businesses to recruit from outside the EU by imposing a visa levy would damage London businesses who are clearly struggling to recruit domestically.

The Government should not impose a visa levy on London businesses hiring workers from outside the EU. The Government should rather assist London businesses who need to recruit from outside the EU to do so more easily by simplifying the Immigration Rules

BUSINESS COSTS

INCREASED COST PRESSURES



The price of energy has overtaken wages as the main cost pressure facing London businesses. Almost a third (29%) of *Capital 500* firms said energy costs had increased over the last three months, up five points from the previous quarter. 27% of London companies faced greater pressure from employees to increase wages, broadly consistent with the previous quarter.

There was a notable increase in the number of London firms experiencing higher fuel costs, with 21% stating fuel prices as their main cost pressure, a ten point increase from Q1 2015. This follows a steady increase of petrol and diesel prices over the last quarter.

Competition remains the top concern for London businesses, with 41% naming it as their main business

concern over the last three months. Almost a quarter (24%) of *Capital 500* firms are now more concerned about interest rates than they were three months ago, a six point rise from Q1 2015. Only 17% of London businesses were more concerned about inflation, the lowest recorded figure since the *Capital 500* survey began, after the CPI measure of inflation hit a record low level of -0.1% in April 2015.

CASHFLOW AND INVESTMENT

INVESTMENT PLANT AND EQUIPMENT

+3%



↑ 5 POINTS

11% increased capital investment

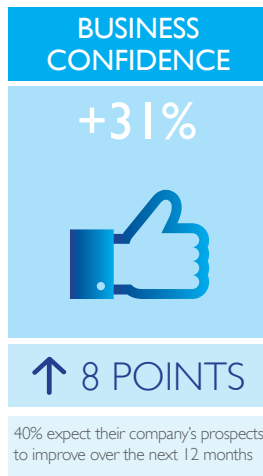
Following a significant slide in the first three months of 2015, *Capital 500* businesses' cashflow balances improved marginally in Q2 2015, although remained in negative territory. While 56% of London firms reported no change in their cashflow position, **the overall cashflow balance figure increased by two points to -6% over the last three months**, with 19% of companies reporting an increase and 25% reporting a decrease.

Despite continued cashflow worries, business investment plans experienced an uplift in Q2 2015. **The balance figure for investment in plant and equipment increased by five points to +3% during the second quarter of 2015**, with 11% of *Capital 500* businesses reporting an increase in capital investment plans, compared to only 8% reporting a decrease. Renewed business confidence to invest may be due to a more certain political environment, as well as continued low oil prices.

The upturn in business investment figures is reflected in recent Government data, which shows that business investment in the UK increased by an estimated £0.8 billion to £45.7 billion, its highest level in nearly a decade (ONS: *Business Investment, Q1 2015 Provisional Results*, May 2015). However, with a referendum on the UK's membership with the EU now confirmed by the end of 2017, and the prospect of a Greek eurozone exit a growing threat, business investment in the UK may experience renewed instability. In order to provide companies with more confidence to invest long-term, the Government should fix the Annual Investment Allowance on plant and machinery to a permanent level of £500,000; under current arrangements, the Annual Investment Allowance will return to £25,000 on 1 January 2016.

With London businesses showing renewed confidence to invest, the Government should look to capitalise on the momentum generated after the General Election and fix the Annual Investment Allowance to £500,000.

BUSINESS CONFIDENCE



Capital 500 businesses are the most confident they have been about their future prospects since Q2 2014. The balance figure for London firms' overall performance expectations for the next 12 months increased by eight points to +31%, with 40% expecting an improvement and only 9% anticipating a decline. Increased business confidence is particularly pronounced in the manufacturing and construction sectors, which report balance figures of +51% and +47% respectively.

Similarly, company performance indicators for the next 12 months were at near record high levels. **The balance figure for turnover expectations increased by 10 points to +29% in Q2 2015**, with 42% of *Capital 500* firms anticipating increased turnover and only 13% predicting a decrease. The balance figure for profitability expectations rose by six points to +24% (39% anticipating an increase and 15% a decrease).

High business confidence among London businesses is reflected in findings of other business surveys taken since the General Election, which indicate that company confidence is at its highest level since September 2014 (Lloyds Bank: *Business Barometer*, June 2015).

ECONOMIC OUTLOOK



There was a surge in optimism over the UK's economic growth prospects in Q2 2015. Overall outlook for the UK economy is remarkably positive, with 49% of *Capital 500* businesses expecting the UK's economic growth to improve over the next year while only 11% expect it to contract, **leaving an overall balance figure of +38%, a nine point improvement on the previous quarter's results.**

Capital 500 firms were even more positive about London's future growth prospects. **The balance figure for London's economic growth prospects over the next 12 months is +46%** (53% expected growth and only 7% predicted a decline).

Economic growth in London continues to outstrip growth in the UK as a whole, which may explain why London firms are marginally more confident about the capital's economic prospects (GLA: *London's Economic Outlook: Spring 2015*, May 2015). Despite a more certain political environment, the Bank of England recently cut its forecast for GDP growth in 2015 from 2.9% to 2.5% following weaker than anticipated growth during the first three months of the year. With a question mark hanging over the UK's future relationship with the EU, and persistent doubts over the Greece economy threatening to cause further financial turmoil across the eurozone, the UK's long-term growth prospects remain uncertain. To support London's ability to stimulate growth across the wider UK economy, the Government should provide the capital with greater freedom to invest in its own infrastructure.

While confidence in the UK and London economies remains overwhelmingly positive, uncertainty over the UK's membership within the EU and continued eurozone turmoil may dampen medium-term growth prospects. In order for London to remain the primary driver of the UK economy and address its own challenges of a burgeoning population, the Government should provide London with greater control of revenue raised in the capital so that it can deliver the infrastructure it needs.

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