LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

Q1 2015

April 2015

ComRes

"The first *Capital 500* Quarterly Economic Survey of 2015 provides a timely check of business mood in the capital ahead of the widest-open General Election in decades. Declines across a number of indicators suggests that the uncertain political environment is having an impact on London business sentiment. In particular, there was a worrying deterioration in domestic demand and cashflow balances, while firms have continued to pull back on investment plans in capital and staff training. Hiring sufficiently skilled staff remains an issue for firms looking to recruit.

"Generally, London businesses continue to be positive about their own prospects, as well as the UK and London economies. To ensure that the economy remains on a steady footpath in the long-term, the next Government should look to reduce dependence on consumer spending as a driver of UK growth and redress current imbalances, such as encouraging more firms to explore global trade opportunities and creating conditions more conducive to stronger business investment"

Colin Stanbridge, LCCI Chief Executive

"The picture on the whole remains positive. The Office for Budget Responsibility (OBR) has upgraded its forecast for 2015 to 2.5% from 2.4%, in line with London business expectations. Lower oil prices, if properly translated into lower energy costs, should help not only in the UK but also internationally.

"However, concerns about growth and trade prospects remain. Recent injections of funds by the European Central Bank through Quantitative Easing should assist to reverse the trend to deflation in Europe but the Greek political and economic crisis still looms large. Financial markets have reacted positively to the prospect of interest rates staying lower for longer as inflation drops, but the strength of sterling against the euro may hinder export growth. Business investment in the UK as a whole has been negatively affected by drops in capital spending in the North Sea, as well as uncertainty over the outcome of the May 7 elections and the impact of a possible referendum for the UK's position in the EU".

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 503 London business leaders between 29 January and 16 February 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

-5%

↓ 7 POINTS

18% reported increased domestic sales

Domestic sales declined significantly during the first quarter of 2015. The balance figure for domestic sales **fell by seven points on the previous quarter to -5%**, as 18% of *Capital 500* businesses reported an increase and 23% reported a decrease. Similarly, the balance figure for domestic orders declined by five points to -4% (16% of firms reported an increase and 20% a decrease). **This is the first time *Capital 500* domestic demand balances have fallen into negative territory, possibly caused by uncertainty in the run up to the General Election in May**.

However, the decrease in domestic demand figures contrasts with recent data published on the UK manufacturing sector, which continued to strengthen at the start of 2015, driven by growth in output and new orders (Markit/CIPS: *Purchasing Manager's Index*, March 2015). The UK service sector has also continued to grow at a marked pace, supported by a sharp rise in new business volumes (Markit/CIPS: *UK Services PMI*, March 2015).

With the uncertain political climate having an impact on domestic returns for London businesses, **it is important that authorities maintain interest rates at a low level until at least the beginning of 2016 to minimise the risk of the recovery stalling**.

EXPORT DEMAND

EXPORT SALES

+2%

↓ 1 POINT

7% reported increased export sales

Export demand remained sluggish during the first quarter of 2015. The Q1 2015 balance figure for export sales fell by one point to +2%, with only 7% of *Capital 500* businesses reporting an increase and 5% reporting a decrease. The balance figure for export orders saw a similar decrease by two points to +1%, with 7% of London firms reporting an increase and 6% a decrease.

Recent trade data highlights the continued difficulties faced by firms in external markets. Export performance deteriorated for the fourth time in the past five months, reflecting a combination of subdued external market conditions and appreciation in the value of sterling (Markit/CIPS: *Purchasing Manager's Index*, March 2015). With the value of sterling recently hitting a seven-year high against the euro, an interest rate rise in 2015 would risk further compounding difficulties experienced by UK exporters in the eurozone market.

Official data shows that the UK trade deficit narrowed significantly in January 2015 from £2.1 billion to £0.6 billion. However, exports decreased by £1 billion, with fuel exports falling to their lowest level since March 2007 as a result of plummeting oil prices (ONS: *UK Trade January 2015*, March 2015).

Stagnating export demand is likely to persist into 2015 as the pound continues to strengthen. To help reduce dependence on domestic demand, the Government and the Monetary Policy Committee must do all they can to help rebalance the economy towards exports by keeping interest rates low until at least the new year, and by doing more to encourage businesses to explore trade opportunities with global markets.

While provisions in the Small Business, Enterprise and Employment Bill, which recently received Royal Assent, could help expand access to finance for existing and aspiring exporters, the Government must look to initiate more sweeping reform to export support services now, such as putting in place long-term support to develop a world-class, global business-to-business network to support all UK businesses.

LABOUR MARKET

EMPLOYMENT

-5%

↓ 5 POINTS

6% increased employment in the last three months

Capital 500 **firms reported an overall decline in employment levels during the first three months of 2015**. Despite the vast majority of London businesses (83%) reporting no change in employment levels during Q1 2015, **the overall balance figure for employment fell by five points compared with the previous quarter to -5%**, with only 6% of firms reporting an increase in employment levels and 11% reporting a decrease.

Employment expectations for the next three months remain broadly positive. While over four-fifths (82%) of *Capital 500* firms anticipate no change to their workforce size in the next quarter, 13% of London companies surveyed predict their workforce size will increase, compared to only 5% of firms that think their workforce size will contract, **leaving a balance figure of +8%**.

Positive employment expectations were echoed in recent UK jobs data, which shows employment levels continuing to rise while unemployment falls (ONS: *Labour Market Statistics*, February 2015).

RECRUITMENT AND TRAINING

INVESTMENT
TRAINING

-2%

↓ 5 POINTS

8% increased investment in training

There was a marginal decline in the number of London businesses looking to recruit during the first three months of 2015. **14% of London firms sought to recruit during Q1 2015, a two point decline on the previous quarter.** While the majority of jobs being advertised continued to be for full-time positions (69%), only 29% of *Capital 500* firms recruited for part-time workers, a 26 point fall from the previous quarter.

Difficulties in recruiting rose for the second successive quarter, with over half (54%) of *Capital 500* companies looking for new staff experiencing problems hiring at the beginning of 2015, a two point increase from Q4 2014. 51% of recruiting firms had difficulties hiring skilled manual or technical staff positions, a two point rise on the previous quarter. Professional or managerial job vacancies remained the second most difficult area to hire for, although less difficult than the previous quarter (32% of recruiting companies reported difficulties compared to 42% in Q4 2014). Firms also reported a significant increase in issues with hiring clerical workers, with a quarter (25%) experiencing difficulties compared to only 7% in the last three months of 2014.

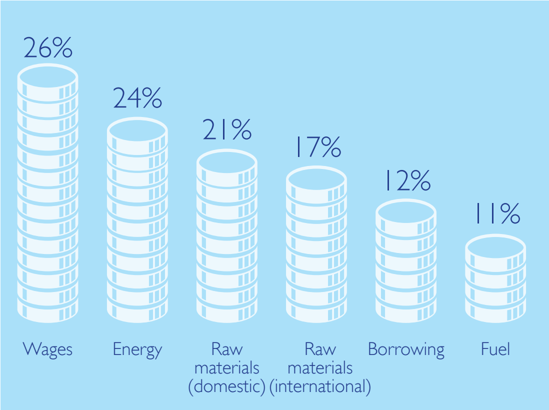
Despite persistent difficulties in recruiting workers, investment in training staff has continued on a downward trajectory. While the majority of firms (82%) kept training allocations the same, **the balance figure for investment in training saw a five point decline to -2% in Q1 2015**, with only 8% of *Capital 500* businesses planning to increase their training budgets and 10% planning a reduction. The balance figure for investment in training has now decreased by 11 points in total since reaching +9% in Q3 2014.

Encouraging businesses to employ apprentices would go some way to providing businesses with the skills they need to grow. The Chancellor used Budget 2015 to announce an Apprenticeship Voucher to give employers control of government funding for the training that apprentices need. The voucher will be implemented from 2017, after being developed and tested with employers. The Government must ensure that any reform to the apprenticeship funding model minimises the administrative burden on businesses, particularly SMEs, so as not to reduce the number of apprenticeships available.

The Government's recently announced Apprenticeship Voucher must achieve a correct balance between increased business purchasing power, and a funding system that is easy to understand and that minimises financial and administrative risk to business where possible.

BUSINESS COSTS

INCREASED COST PRESSURES



Pressure from employees to increase wages is now the main cost pressure facing *Capital 500* businesses. A quarter (26%) of London companies reported increased pressure to raise wages over the last three months, two points higher than the previous quarter. Real wages are expected to increase during 2015 for the first time since 2007, amid low inflation.

Less than a quarter (24%) of firms reported an increase in energy costs over the last three months as their biggest cost pressure, 11 points lower than in Q4 2014, as oil price falls begin to have an impact. Only 11% of businesses reported the cost of fuel as having an impact, a 14 point decline from Q4 2014, following several months of price cuts to petrol and diesel.

Competition remains London companies' main business concern, with 40% of *Capital 500* businesses more concerned about competition than they were three months ago. Exchange rates and corporate taxation were businesses' joint second highest concern, with 21% more worried about them in Q1 2015. Interest rates and inflation continue to decline as business concerns, with only 18% of firms more worried about interest rates in Q1 2015 (down four points from the previous quarter) and 19% more concerned about inflation (down three points). Decline in concerns over interest rates and inflation may be due to more positive signals from the Monetary Policy Committee that rates will stay at the same level as inflation remains low.

20% of *Capital 500* businesses were more concerned about business rates than they were three months ago in Q1 2015, a two point rise on the previous quarter. LCCI welcomed the launch of a "radical" review of the business rates system in England, with findings due in time for Budget 2016. However, **the next Government must ensure that the process is given full scope to bring about fundamental changes to the current business rates system, including fiscal devolution to the capital.**

CASHFLOW AND INVESTMENT

INVESTMENT
PLANT AND EQUIPMENT

-2%

↓ 5 POINTS

11% increased capital investment

The first quarter of 2015 saw a worrying slide in *Capital 500* businesses' cashflow balances. While over half (51%) of London firms saw no change in their cashflow position in the last three months, **the overall cashflow balance figure decreased by thirteen points from the previous quarter to -8%** (21% reported an increase and 29% a decrease). This is the lowest cashflow balance figure since the *Capital 500* survey began in Q2 2014, highlighting the fragile nature of the economic recovery and reinforcing the need to maintain low interest rates so businesses have the opportunity to stabilise growth.

Business investment plans have continued to deteriorate during Q1 2015. **The balance figure for investment in plant and equipment decreased by five points to -2% during the previous three months**, with only 11% of *Capital 500* businesses reporting an increase, compared to 13% reporting a decrease.

The decline in capital investment is reflected in recent Government figures, which shows that business investment in the UK decreased by an estimated £0.6 billion in Q4 2014 compared to the previous quarter, its steepest decline in years. To encourage businesses to invest with more certainty in the long-term, the Annual Investment Allowance should be fixed to a permanent level of £500,000. The Annual Investment Allowance has changed four times since 2008 and under current plans will return to £25,000 once the latest temporary extension ends at the end of 2015. A high, long-term investment allowance will help businesses invest with more confidence and support more balanced and sustainable growth.

> To boost business investment's contribution to UK growth and create a more balanced economy, the next Government should introduce a permanent Annual Investment Allowance of £500,000 which would encourage businesses to invest with more confidence.

BUSINESS CONFIDENCE

BUSINESS CONFIDENCE

+23%

↓ 2 POINTS

35% expect their company's prospects to improve over the next 12 months

There was a slight drop in confidence figures for the next 12 months during Q1 2015. **The balance figure for *Capital 500* businesses' overall performance expectation decreased by two points to +23%, with 35% expecting an improvement and only 12% a deterioration.** Over half (53%) anticipated their company's prospects to stay the same for 2015.

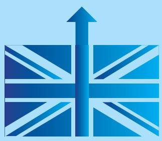
There were marginal declines in company performance indicators for the next 12 months but they remain in firmly positive territory. The balance figure for turnover expectations fell by six points to +19%, with 39% of *Capital 500* businesses anticipating increased turnover and 20% a decrease. The balance figure for profitability expectations fell by one point to +18% in Q1 (38% predicted an increase and 20% a decrease).

These confidence figures correlate with findings from other business surveys, with businesses approaching prospects for the year ahead with caution as uncertainty caused by the upcoming General Election and continued fragility in the eurozone and global markets weigh down on expectations (ICAEW & Grant Thornton: *UK Business Confidence Monitor Q1 2015*).

ECONOMIC OUTLOOK

UK GROWTH

+29%



NO CHANGE

43% expect UK growth to improve over the next 12 months

The start of 2015 saw *Capital 500* businesses remain optimistic about UK economic growth prospects over the next 12 months. 43% of London businesses expect the UK's economic growth rate to improve over the next 12 months and only 14% expect it to worsen **leaving a balance figure of +29%, the same level as the previous quarter**.

Prospects for economic growth in London over the next year remain at high levels. **The balance figure for London's prospects for growth over the next 12 months is +38%, broadly consistent with the previous quarter** (46% expected growth and only 8% anticipated a decline).

General optimism about UK and London growth prospects is reflected in the latest forecasts for the economy. The British Chambers of Commerce upgraded its UK GDP growth forecast for the next two years, from 2.6% to 2.7% in 2015, and 2.4% to 2.6% in 2016, with low inflation and interest rates driving domestic consumption. However, political uncertainty caused by the most wide open General Election for decades, continued fragility in the eurozone economy and weak global market conditions mean prospects for long-term growth are tinged with doubt. To reduce dependence on consumer demand and create sustainable growth conditions, the next Government must focus on rebalancing the economy through stronger business investment and greater emphasis on exporting.

With a seemingly close General Election race fuelling uncertainty about business prospects in the long-term, this and the next Government should look to offer more reassurances to firms. By revealing their economic plans, the main political parties can provide businesses with a greater degree of certainty which in turn will help firms plan their future activities and investments.

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