'CAPITAL 500'

LONDON QUARTERLY ECONOMIC SURVEY

Q3 2014

OCTOBER 2014

ComRes

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COMMERCE AND INDUSTRY

This is the second consecutive quarter in which we have run the *Capital 500* Quarterly Economic Survey – London's biggest and most authoritative business survey – in partnership with ComRes. It provides an accurate assessment of business performance and confidence, allowing us to monitor the mood of business leaders in the capital as we inch closer to next year's General Election.

The results for the third quarter of 2014 results reveal a slight cooling in some indicators, although overall prospects remain positive. Businesses continue to be confident about their own performance and London's economic prospects. Particularly reassuring is news that businesses are investing more in capital equipment and staff development, perhaps as a result of continued difficulties in recruiting sufficiently skilled staff.

However, significant vulnerabilities remain. While exporting activity has improved, a significant number of London firms are still not trading overseas. More concerning is the fall in domestic sales, which may perhaps be linked to the degree of uncertainty about the United Kingdom's future status in the run-up to the Scottish Referendum. With the Union now assured, Government should move to give business more detail on its promised new devolutionary arrangements for Scotland and England. Part of that must focus on delivering greater control of finances to London to enable our capital to maximise its growth potential.

Colin Stanbridge, LCCI Chief Executive

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 516 London business leaders between 26 August and 22 September 2014.

All sectors of the London economy were represented including production (4%); property and construction (12%); motor trades (5%); retail and wholesale (6%); transport and storage (8%); information and communication (5%); finance and insurance (13%); professional, scientific and technical (8%); business services (23%); education (2%); health (4%); and arts, entertainment, recreation and other services (8%). All data has been weighted to be representative of all London businesses by company size and broad industry 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

+1%

↓ 11 POINTS

19% reported increased domestic sales

Domestic demand has been disappointing in Q3 2014. The balance figure for domestic sales fell by 11 points to +1%, as 19% of *Capital 500* businesses reported an increase and 18% reported a decrease. Domestic orders also declined by six points to +3% (20% of firms reported an increase and 17% a decrease).

The results are consistent with recent indications that the upturn in the UK manufacturing sector has decelerated, following a slowdown in the growth of output and new orders (Markit/CIPS: *Purchasing Manager's Index*, August 2014). Low inflation and recent stagnation in wage growth are also factors contributing to subdued domestic performance.

This drop in demand may be due to the fact that this *Capital 500* survey was carried out in the run up to the Scottish Referendum, which led to significant uncertainty over the future of the Union. Post plebiscite, the Government should focus on swiftly disseminating details of proposed reforms in order to avoid further disruption. Any new devolution deal for Scotland will trigger expectations of greater control of locally raised finances to London to enable the capital to fulfil its growth potential.

With the future of the United Kingdom assured, the Government should prioritise devolution proposals and provide a clear timeframe to minimise further uncertainty. As part of such deliberations, LCCI is supportive of proposals for fiscal devolution of the suite of property taxes to London government, as recommended by the London Finance Commission.

EXPORT DEMAND

EXPORT SALES

+5%

↑ 4 POINTS

13% reported increased export sales

There was an encouraging increase in export demand. Following a disappointing +1% balance last quarter, the Q3 2014 balance figure for export sales rose by four points to +5%, with 13% of *Capital 500* businesses reporting an increase and 8% reporting a decrease. The balance figure for export orders saw an even more encouraging increase by eight points to +7%, with 13% of London firms reporting an increase and 6% a decrease. The decline in the value of the pound in the run up to the Scottish Referendum could explain the positive export balance figures, but this is likely to have provided only a short-term boost.

The rise in export figures correlates with the latest trade data. Exports increased by £0.5 billion between June and July 2014, largely due to the strength of fuel and chemical exports. Exports to countries outside the EU accounted for roughly 95% of the total increase. Despite the growth in exports, the trade deficit has widened by £0.8 billion, owing to a rise in imports (ONS: *UK Trade July 2014*, September 2014).

However, **53% of *Capital 500* businesses indicated that they do not export.** Although not directly comparable, this is only a 1% improvement on the 54% of LCCI members that did not export when we published our *Exporting Britain* report in October 2013. This lack of progress is disappointing and demonstrates there is still much to be done to encourage firms to fulfil their potential to trade abroad.

Provisions in the Small Business, Enterprise and Employment Bill, which recently had a second reading in Parliament, could help expand access to finance for existing and aspiring exporters. However, more radical actions, such as reform of export support services and simplified visa access for foreign business people wanting to trade with the UK, will help boost exports.

LABOUR MARKET

EMPLOYMENT

-2%

↓ 6 POINTS

10% reduced employment in the last three months

Although 83% of *Capital 500* businesses reported no change in Q3 2014 employment levels, 10% reported a decrease in employment over the previous three months and only 8% reported an increase, leaving a **balance figure -2%. This represents a six point decline on the previous quarter**. Weakening in employment prospects, combined with low productivity of UK workers and wage growth lagging behind inflation, reinforces the need to keep interest rates at a low level to maintain stability.

The decline in the employment balance figure for London business is particularly disappointing, following the UK jobs figures for May to July 2014, which revealed a continued rise of the total number of people in employment (ONS: *Regional Labour Market Statistics*, September 2014).

Nevertheless, the capital's businesses remained broadly optimistic about employment levels for the next three months. **76% of London firms anticipated no change to their workforce**, with only 7% expecting a decline, compared to 17% predicting an increase. This leaves a balance figure of +10%, the same level as the previous quarter.

Weak employment prospects, low productivity of UK workers and lagging wage growth, reinforce the need to keep interest rates low for as long as possible in order to maintain stability. Active promotion of work experience and improved, quality careers advice in schools will help the next generation of workers develop the core skills necessary for employment.

RECRUITMENT AND TRAINING

INVESTMENT TRAINING

+9%

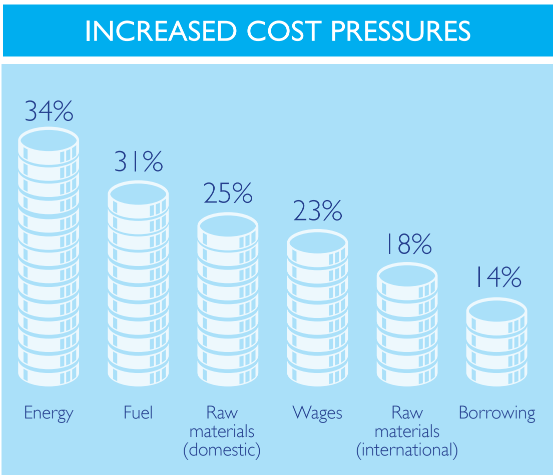
↑ 5 POINTS

15% increased investment in training

Over the last three months 23% of London's companies sought to recruit, a seven point increase from the previous quarter, with the vast majority of jobs advertised being full-time positions (69%). This is welcome news and demonstrates London companies' confidence to increase staff capacity. **However, 45% of *Capital 500* businesses continued to experienced difficulties in recruiting sufficiently qualified staff for vacancies, only a three point decrease on the last quarter**. The positions where the most difficulties were experienced were skilled manual or technical staff, for which 51% of London companies (up from 41% the previous quarter) struggled to recruit, and professional or managerial jobs (for which 48% of companies reported difficulties).

Given these recruitment difficulties, it is perhaps not surprising that London businesses are looking to fill those skills gaps by increasing investment in training. **The balance figure for investment in training saw a five point rise to +9% in Q3 2014**, with 15% of *Capital 500* businesses planning to increase their training budgets and only 6% planning a reduction. Labour productivity in the UK is notably weak, so indications that London firms are investing more in training staff is particularly encouraging, as it should allow existing employees to develop the professional and managerial skills increasingly needed by firms.

BUSINESS COSTS



The price of energy remains the biggest cost pressure on the *Capital 500* businesses, with 34% reporting an increase in the cost of energy over the last three months. This represents a 13 percentage point decline on last quarter, which is an indication that the growing market share of small independent energy suppliers outside of the 'Big Six' energy firms may be having an impact on lowering costs.

The second highest increase has been in the cost of fuel (31%). A quarter (25%) of London businesses saw an increase in raw materials sourced domestically, and 23% faced pressure to raise wage levels. Only 14% of business leaders reported an increase in the cost of borrowing.

Asked about what had grown as a concern over the last three months, 39% of *Capital 500* businesses selected competition. Interest rates were businesses' second highest concern, with nearly a third (32%) more worried about them in Q3 2014 compared to 29% in the last quarter. Just over a quarter of firms (26%) were concerned about inflation.

There are now stronger indications that the Bank of England may increase interest rates by early 2015. Any future interest rate rises should be gradual in order to minimise the impact on businesses' costs and profits, particularly given the high value of sterling and slow pace of exports.

CASHFLOW AND INVESTMENT

While over half (54%) of *Capital 500* businesses reported no change in their cashflow position in the last three months, **cashflow balance has declined by six points from the previous quarter to -2%** (22% reported an increase and 24% a decrease). The decline in cashflow balance reinforces the case for maintaining low interest rates, in order to provide businesses with a period of stable growth and to strengthen the overall economic recovery.

However, the decline in cashflow balance does not seem to have had an impact on businesses' investment plans, which have grown considerably since last quarter. **The Q3 2014 balance figure for investment plans in plant and equipment increased by seven points to +10%**, with 15% of *Capital 500* businesses reporting an increase, compared to only 5% reporting an increase.

With figures last quarter showing business investment at its highest level since Q3 2008 and making a strong contribution to UK economic growth (ONS: *Business Investment, Q1 2014 Revised Results*, June 2014), we expect to see those grow even further in the Q2 update.

The increasing investment balance demonstrates that businesses are finally beginning to feel confident enough to invest, following a long period of caution in the early days of the recovery. Introducing a long-term Annual Investment Allowance level, rather than short-term incentives, will give firms further certainty to invest with confidence.

BUSINESS CONFIDENCE

BUSINESS CONFIDENCE

+27%

↓ 5 POINTS

37% expect their company's prospects to improve over the next 12 months

Confidence figures for the next 12 months saw a slight drop in Q3 2014. **The balance figure for *Capital 500* businesses' expectation for their overall performance over the next 12 months decreased by five points to +27%, with 37% expecting an improvement and only 10% a deterioration.**

Looking at indicators of companies' performance, the balance figure for turnover expectations was seven percentage points lower than the previous quarter at +25%, as 41% of *Capital 500* businesses anticipated increased turnover in the year ahead and 16% a decrease. The balance of profitability expectations was +23%, three points down on Q2 (41% anticipated an increase and 18% a decrease). Uncertainty over Scotland and the UK's relationship with the EU, as well as doubts over future interest rate rises, may all partly explain the marginal decline in balance figures.

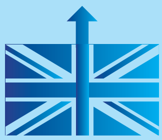
These figures correlate with findings from other business surveys, which reported a dip in confidence levels over the next 12 months in comparison to the previous quarter (ICAEW & Grant Thornton: *UK Business Confidence Monitor Q3 2014*).

Despite a slight cooling of business confidence, the business performance indicators remain in strongly positive balances (in high 20s), which indicates that London businesses are generally buoyant about their own prospects as the economy continues to strengthen.

ECONOMIC OUTLOOK

UK GROWTH

+36%



↓ 14 POINTS

48% expect UK growth to improve over the next 12 months

In Q3 2014, *Capital 500* businesses have been less confident in the UK's economic outlook than they were in the previous quarter. Almost half (48%) of *Capital 500* businesses expect the UK's economic growth to improve over the next 12 months, while 12% believe it will worsen, **giving a balance figure of +36%. This is 14 points lower than the balance figure from the last quarter**.

Confidence in London's economic prospects follows a similar pattern to *Capital 500's* expectations for the UK economy. **The balance figure for London's prospects for growth over the next 12 months was +37%, a 16 point decline on the previous quarter** (47% expected growth and 10% decline).

Although confidence in UK and London growth prospects have moderated, businesses remain firmly positive about the overall economic outlook, as highlighted by the high balance figures. This is reflected in strong UK GDP figures, which grew by 0.8% in Q2 2014, the second consecutive quarter-on-quarter increase of 0.8%.

Following a period of instability caused by uncertainty over the future of Scotland, the London (and wider UK) economy are primed for a period of consistent growth. However, to capitalise on this opportunity for expansion, businesses require assurances over future interest rate rises and further incentives to invest in staff development, so that the process of economic recovery can continue into and beyond 2015.

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