LONDON CHAMBER of COMMERCE AND INDUSTRY

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CAPITAL 500

LONDON QUARTERLY ECONOMIC SURVEY

Q3

2018

ComRes

July - September 2018

LCCI COMMENTARY – THE BUSINESS VIEW

"The latest *Capital 500* economic survey results show a mixed picture. While many of our performance figures have gone up gone on last quarter, they remain low compared to pre-referendum levels. Meanwhile, concerns remain about the confidence and expectations of London's business community for the future.

"During the last quarter, more businesses reported a decline in their domestic sales than a rise, although the reverse was true for exports. Investment figures also showed some promising signals, with more businesses raising than dropping their planned training spend. Meanwhile, most rises in cost pressures were also brought to a halt.

"A positive deal with the EU will be vital to boost confidence levels in the capital. London businesses need certainty about the business environment post-Brexit, including in relation to the flexible migration system London needs. Beyond Brexit, there is more that must urgently be done to enhance the capital's performance, including further devolution of skills funding, a fundamental review of business rates and prioritising key infrastructure projects in the capital."

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 regular business survey.**

Since Q1 2016, the *Capital 500* has included trend graphs, which as of Q3 2018 track the quarterly results for the past five years.

METHODOLOGY

ComRes surveyed a total of 517 London business leaders between 14 August and 11 September 2018. All data were 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.comresglobal.com.

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 fewer than 10 employees and larger (small, medium and large) businesses with 10 or more employees.

Any data reproduced from this report should be fully referenced.

GUEST COMMENTARY – THE ECONOMIST'S VIEW

"Overall economic activity seems to have continued to recover in the summer months helped by good weather, and the expectations are that we may have seen growth of up to 0.5% in the third quarter. But the escalating trade disputes between the US and China and the wider impact of US protectionism are an increasing worry. The EU which remains the UK's main export destination is showing signs of slowing down as a result. Worryingly, while the UK in the last quarter saw a recovery in services and construction, manufacturing moved into recession despite the weakness of the pound. In fact, manufacturing output declined further in July.

"Just before the rather disappointing Salzburg meeting, the IMF, on a hopeful scenario that assumed a good trade agreement between the UK and the EU, was predicting growth of 1.5% for this year and next. However, it worried about the implications for the economy if no satisfactory deal is struck. The Bank of England also warned of the impact on the implications for sterling, inflation and house prices among others of such a scenario. With Brexit uncertainty having increased once again, one main area of worry whatever the deal will be business investment which in fact had shown tentative signs of recovery in Q2."

Vicky Pryce, Chief Economic Advisor and Board Member, Centre for Economics and Business Research (Cebr)

DOMESTIC DEMAND

Q3 2018 recorded an uptick in domestic demand figures, although figures remained in negative territory for the fifth consecutive quarter.

The domestic orders balance rose by 8 points, its joint second largest increase to date (to -2%). Meanwhile, more businesses recorded a decrease than an increase in sales (-2%) although this figure still represents an improvement on Q2 (-10%).

For both domestic orders and sales, the balance figure for larger businesses remained positive (+11% for each), while micro businesses reported negative figures (-4% for each). Similarly, inner London businesses reported a positive balance figure for both categories (+4% and +2%), while outer London businesses recorded negative figures (-8% and -7%).

EXPORT DEMAND

More businesses reported an increase than a decline in export demand in Q3 2018, while 35% of respondents said they had been exporting during the past 3 months (down 5 points on Q2 of this year).

Both of the export demand balance figures rose by 1 point, to +1% for orders and +2% for sales.

While for larger businesses the balance declined compared to last quarter (to +8% for orders and +9% for sales), the balance for micro businesses has risen by 7 and 2 points, to 0% and +2% respectively.

Domestic demand must ultimately be underpinned by a healthy and productive domestic economy. Better transport links have a vital role to play in releasing the capital's further economic potential. While LCCI was disappointed to hear that the opening of the Elizabeth Line has been delayed, there is no room for complacency and the government should commit to progressing further London Strategic Infrastructure Projects (LSIPs).

The Government should commit to progressing London Strategic Infrastructure Projects (LSIPs) including Crossrail 2, fixed river crossings in East London and a new runway at Gatwick after Heathrow.

LABOUR MARKET

During Q3 2018, the *Capital 500* employment balance remained consistent, increasing by one point. The figure has now been in negative territory for 9 consecutive quarters.

Capital 500 businesses were more optimistic about their future employment balance than in previous quarters, with, on balance, 7% of firms expecting their staff numbers to rise over the next three months (up 1 point on last quarter), the highest figure since Q2 2016.

Significant differences were recorded between larger and micro businesses. While the employment balance rose by 3 points for micro businesses, the figure remained in negative territory at -3%. The balance figure for larger businesses dropped by 15 points, but remained in positive territory at +7%.

RECRUITMENT AND TRAINING

In Q3 2018, the balance figure for companies looking to invest in training remained stable at +2%. While the balance for larger businesses dropped by 2 points to +12%, the figure for micro businesses was 0%.

The percentage of companies looking to recruit over the last three months stayed unchanged at 15% (12% for micro businesses, 43% for larger businesses). Of these, 70% recruited for full time and 32% for part time roles.

Of those trying to recruit, 55% encountered difficulties, down 5 points on last quarter. Skilled manual/technical roles (46%) and professional/managerial roles (41%) continued to be the hardest to fill for recruiting companies.

The skills system is not providing what London businesses need. Firms continue to face considerable recruitment and training challenges. Local government, with its firm democratic mandate and local knowledge is in many cases best placed to respond to the needs of both its local residents and business community. The devolution of the Adult Education Budget to the Mayor from 2019 is an important step, but it is only a small part of the system.

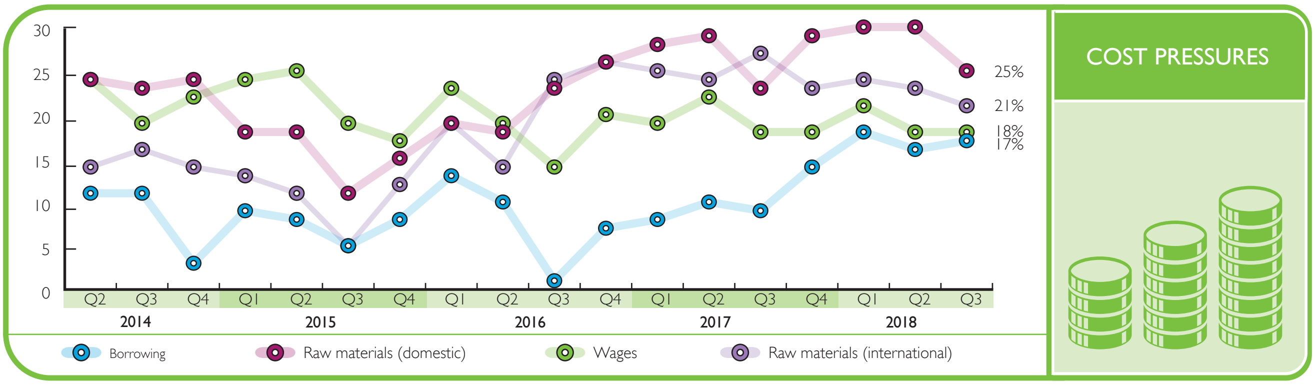
The government should move rapidly to progress devolution to London of 16-18 skills provision, vocational capital investments, careers information, advice and guidance, as well as the apprenticeship levy, starting with unspent levy funds.

BUSINESS COSTS AND PRICES

During Q3 2018, the balance figure for the cost of raw materials sourced internationally fell to its lowest point since Q2 2016 at +21%, while the figure for raw materials sourced domestically dipped by 5 points to +25%.

Meanwhile, the balances for the cost of energy and cost of fuel – not included in the graph – also declined by 8 points (to +32%) and 4 points (to +44%) respectively. In contrast, the balance for cost pressures to increase wages remained unchanged at +18%, while the figure for the cost of borrowing rose by 1 point to +17%.

The balance figure for the proportion of firms who expected to raise their prices over the next three months was +18%, down 5 points on Q2. The main cost factors putting pressure on firms to do so continued to be raw material prices (22%) and other overheads (29%).

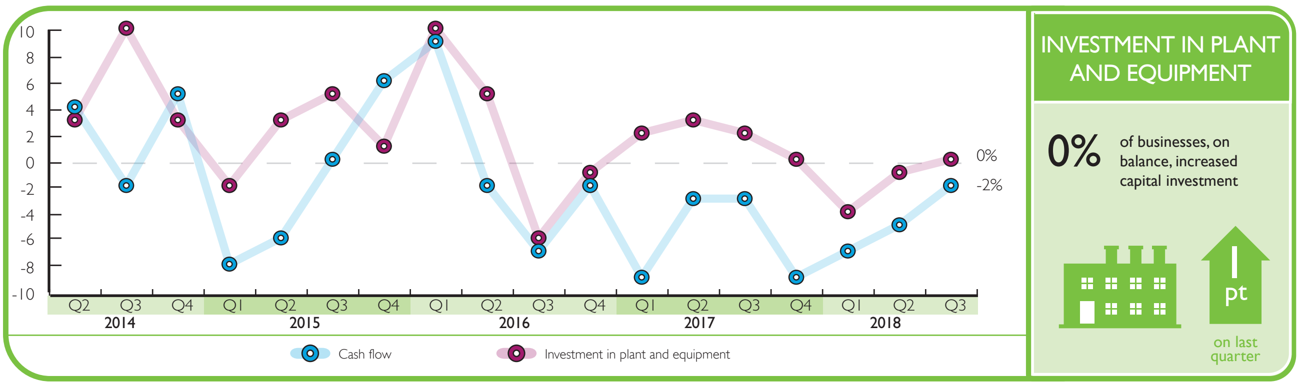


CASHFLOW AND INVESTMENT

A 1 point uptick was recorded in the capital investment figure in Q3 2018, lifting it out of negative territory (+2% for larger businesses, 0% for micro businesses).

The balance figure for cashflow on the other hand remained in negative territory at -2%, despite a 3 point increase on Q2. The figure has now been negative for ten consecutive quarters, with a significantly higher balance for larger businesses (+21%) than micro businesses (-5%).

The percentage of companies operating at full capacity is roughly level with Q2 at 37%, leaving 63% of businesses operating below that. However, this was more of an issue for micro businesses, of whom around two thirds 65% were operating below capacity, compared to 46% of larger businesses.



The cost of business space is one of the key challenges facing many London firms. With business rate rises forming a significant part of that, LCCI has long called for a fundamental review of the business rate system, which creates perverse incentives for firms' investment decisions and is increasingly disconnected from London's economic reality, especially in light of the rise of online shopping. Businesses must of course play their part in contributing to London's needs, including as rates are being devolved to the capital. However, it is essential that going forward they will not be treated as a 'cash cow'.

A fundamental review of the business rates system is needed to ensure the tax remains fit for purpose in today's digital age. Additionally, as business rates are devolved to London, businesses should be consulted on an appropriate mechanism to ensure future rates are fair and to decide on the allocation of funds.

BUSINESS CONFIDENCE

Q3 2018 saw each of the *Capital 500* business confidence indicators fall or remain stable.

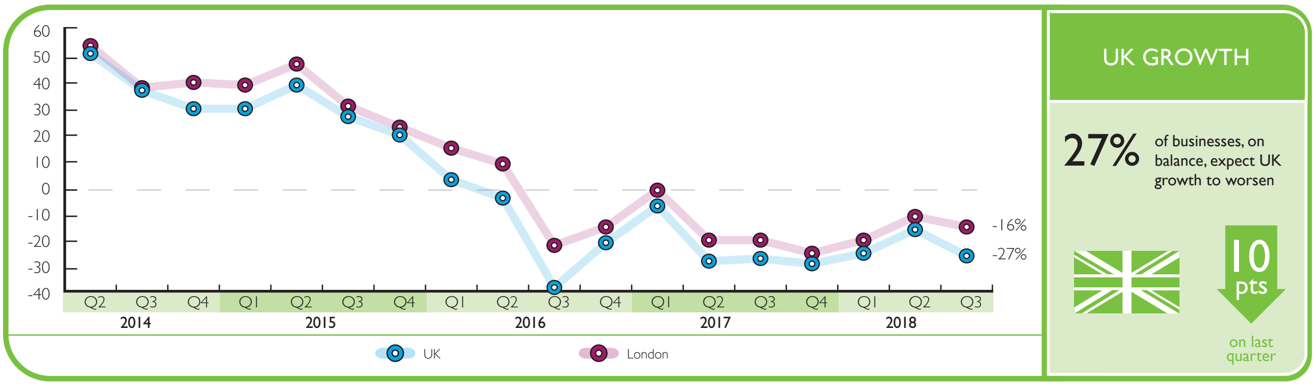
The *Capital 500* balance figure for overall company prospects dropped by 4 points back into negative territory as more businesses reported a decline than an improvement in their expectations. It has now been 10 quarters since the figure was in positive territory. Turnover expectations, on balance, also fell on last quarter (by 2 points to +7%), while the profitability expectations figure remained unchanged at +3%.

In terms of overall company prospects, the balance for larger businesses fell to its joint lowest recorded level to date at -3% (down 16 points from Q2), while the figure for micro businesses dropped to -5% (down 3 points). On that same measure, outer London businesses recorded a negative figure (-10%) whereas the balance for inner London businesses remained stable at 0%.

ECONOMIC OUTLOOK

Expectations for both the London and UK economy continued to fall and have now been negative for respectively nine and ten consecutive quarters. The balance figure for expectations of the UK economy fell by 10 points to -27%, while expectations for the London economy fell by 4 points to -16%, as more businesses expected economic prospects to worsen than improve.

On balance, inner London businesses remained more pessimistic about the London economy (-18%) than their outer London counterparts (-13%), while expectations for the UK economy were similar for inner (-27%) and outer London (-28%).



To boost confidence, London needs certainty about the business environment post-Brexit. Last month the Migration Advisory Committee (MAC) published a long-awaited report to provide an evidence base for the future migration system, but it failed to recognise the full value and benefit of migration to London. London Mayor Sadiq Khan previously said that if satisfactory migration proposals for London were not put forward, he would look at alternative options. Now is the time to act and prepare for such a scenario.

Given the capital's reliance on foreign labour, it is vital that London will get the flexible migration system it needs post-Brexit. The Mayor should bring London's civic and business leaders together to design practical proposals for future migration.

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