LONDON CHAMBER of COMMERCE AND INDUSTRY

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QI CAPITAL 500

London Quarterly Economic Survey

January – March **2023**

In partnership with

Savanta:

Sponsored by

haysmacintyre

JAMES WATKINS

Head of Policy and Public Impact, London Chamber of Commerce and Industry

LCCI COMMENTARY – THE BUSINESS VIEW

London businesses continue to show their resilience in the face of severe economic conditions. Domestic demand has plateaued for several quarters, with around one third of firms saying sales weakened in the first three months of 2023. Demand for goods and services from overseas has also trended sideways and has not shown any material signs of growth since 2020, while cashflow fell back in Q1.

Cost pressures on businesses remain elevated, although there were signs of a slight easing in Q1 2023: nevertheless, the majority of London companies are still seeing increases in energy prices. The tight labour market continues to put upward pressure on wages. Half of London business leaders surveyed thought their prices would increase in the coming three months, with the main upward pressure coming from utilities and labour.

Concerning still is the steady increase in the number of firms who are seeing their borrowing costs rise. With the Bank of England raising rates, this is perhaps to be expected. However, with businesses now facing higher corporation tax from April 2023, and few concrete signs of wage pressures abating, we expressed our concerns to the Government that further energy support for SMEs was not announced in the Budget, as the outgoing scheme was wound down and its pared-back successor was put in place.

Nonetheless, our survey also shows businesses were more optimistic both about their own company's prospects, and the wider economic outlook. It is this optimism that typifies London's businesses, to stay positive in the face of difficult headwinds, which the Government should look to foster and support.

James Watkins, Head of Policy and Public Impact, London Chamber of Commerce and Industry

ABOUT THE '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.

Savanta surveyed a total of 529 London business leaders between 2 February and 9 March 2023. All data were weighted to be representative of all London businesses by company size and broad industry sector. Savanta is a member of the British Polling Council and abides by its rules. Full data tables are available at **www.savanta.com**.

The net balance figures represent the percentage of firms that reported an increase minus the percentage that reported a decrease. Two categories are used for business size segmentation: micro businesses with fewer than 10 employees (including sole traders), and larger (small, medium and large) businesses with 10 or more employees. Any data reproduced from the report should be fully referenced.

ABOUT HAYSMACINTYRE

haysmacintyre is an award-winning firm of chartered accountants and tax advisors, providing specialist advice to entrepreneurs, fast-growing and owner-managed businesses, and not for profit organisations across the UK and internationally.

VICKY PRYCE

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

GUEST COMMENTARY – THE ECONOMIST'S VIEW

Perhaps optimism is beginning to venture out from behind the clouds. Europe is proving more resilient, confounding earlier predictions. Activity is also picking up in the UK with a recovery in services in particular in the last couple of months. There has been an improvement in business confidence across the country, not just in London, as seen in the most recent monthly CBI trends survey and also the latest Lloyds business barometer. Consumer confidence is improving too.

A caveat – the surveys reflect on balance views before the worries about banks emerged, both in the US and in Europe. We saw the collapse of some regional and specialised banks in the US, with extra support needed for others to prevent a bank run including a tacit acknowledgement that deposits would be guaranteed even if uninsured. Contagion threatened, and bank shares sank internationally culminating in Europe with the acquisition of Credit Swiss by another Swiss bank, UBS, and the purchase of the UK subsidiary of the collapsed Silicon Valley Bank by HSBC for £1.

With markets semi-pacified and with assurances that the banking system is secure following the stricter regime since the financial crisis, central banks in most parts of the world then raised rates again in late March. In the Eurozone the ECB lifted rates by 50 basis points. In the US and the UK rates rose by 25 basis points against expectations of a possible pause to allow for the full implications to be examined. This was despite the fact that for many the banking malaise owed a lot to the recent very steep rise in rates.

This will hurt – many businesses are struggling to survive and the increase in shop prices we have seen is perhaps a reflection of firms trying to cover for earlier cost increases, even though international inflation is slowing. The substantial reduction in energy price support, except for those sectors deemed to be energy intensive, leaves many firms, including the hospitality sector, exposed. Jeremy Hunt in his Spring Budget also confirmed the planned increase in corporation tax from 19% to 25% from April would go ahead, though companies with profits below £250,000 will be paying less. The number of business insolvencies is increasing while real household disposable incomes are falling at the fastest rate since records began. Millions of workers are being sucked into paying 'stealth' taxes for the first time or brought into the higher income tax bracket even though wage rises remain below inflation.

So where do we go from here? Yes, the economy is performing better than anticipated, though still forecast to decline by 0.2% in 2023. Business investment has been picking up and according to the OBR it will be further helped by the new 100% capital allowance regime for the next 3 years that follows the end of the 130% 'super deduction' measure. Demand for labour remains high, and falling prices for oil and gas, and a lessening of supply problems, are welcome. But for most businesses energy and other costs are still much higher than a year ago. For households, real incomes continue to be squeezed. And if the latest Bank of England forecast is to be believed, UK GDP will remain below pre-pandemic levels until well into 2027-28 while all our G7 competitors are already above it. Not a good position to be in.

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

DOMESTIC DEMAND

21% of London businesses reported an **increase** in domestic sales last quarter

15% of London businesses reported an **increase** in domestic orders last quarter

For London businesses, there were no significant changes in domestic demand across the first three months of 2023. The domestic sales net balance (the percentage of businesses noting an increase minus the percentage noting a decrease) nudged down from -9 to -11 in Q1 2023. The proportion of firms who said that sales rose in Q1 was marginally lower (21%, versus 22% in Q4 2022). Roughly a third (32%) of companies said sales had fallen in Q1 compared to the three months prior.

The sales balance for micro businesses (0-9 employees) edged down from -12 to -13. However, for larger firms (those with 10 or more employees), the drop in sales was more pronounced (net balance fell from +21 to +14). Just under a quarter (23%) of larger businesses said sales had decreased in Q1 2023, up from 18% in Q4 2022. SMEs (companies with 10-249 employees) saw weaker domestic sales in Q1 (balance decreased from +20 in Q4 to +10 in Q1), but large businesses (250+ employees) noted an increase (balance increase from +49 in Q4 to +57 in Q1).

Looking at domestic sales by sector, the net balance for service sector businesses was unchanged at -12 in Q1 2023. For manufacturing firms, the sales balance slumped 26 points to -4. After rising sharply in Q4 2022, the domestic sales balance for inner London companies slipped from -2 to -5 in the first three months of 2023.

As with sales, domestic orders were largely flat in Q1 2023: the net balance fell 1 point to -17, a two-year low. A third (32%) of London businesses reported a decline in orders in Q1, unchanged from the previous quarter. Around one in seven (15%) companies noted an increase in orders.

Large businesses (10 or more employees) saw a sharp drop in domestic orders, with the net balance falling 17 points to +1. For micro companies, the orders net balance was unchanged (-19).

EXPORT DEMAND

10% of London businesses reported an **increase** in export sales last quarter

10% of London businesses reported an **increase** in export orders last quarter

Growth in exports was flat across the first three months of 2023, with the export sales balance falling 2 points to -4. The proportion of firms who said export sales had risen in Q1 grew slightly from 9% to 10%, but there was also a bigger share who saw sales decline (14%, up from 11% in Q4 2022).

For micro businesses, the export sales balance declined from -3 to -6, with 14% saying that sales had fallen and 8% reporting an increase in Q1. Larger companies largely reported a continuation of the picture seen in Q4, with the net balance down just 1 point to +16: 26% of larger firms said sales rose in Q1 2023, up from 22% in Q4.

Export sales for manufacturers were much weaker in Q1, with the net balance sliding 10 points to -8. For service sector firms, the export sales balance dipped 1 point to -3.

London businesses also saw no change in demand for export orders last quarter, with the net balance unchanged at -3.

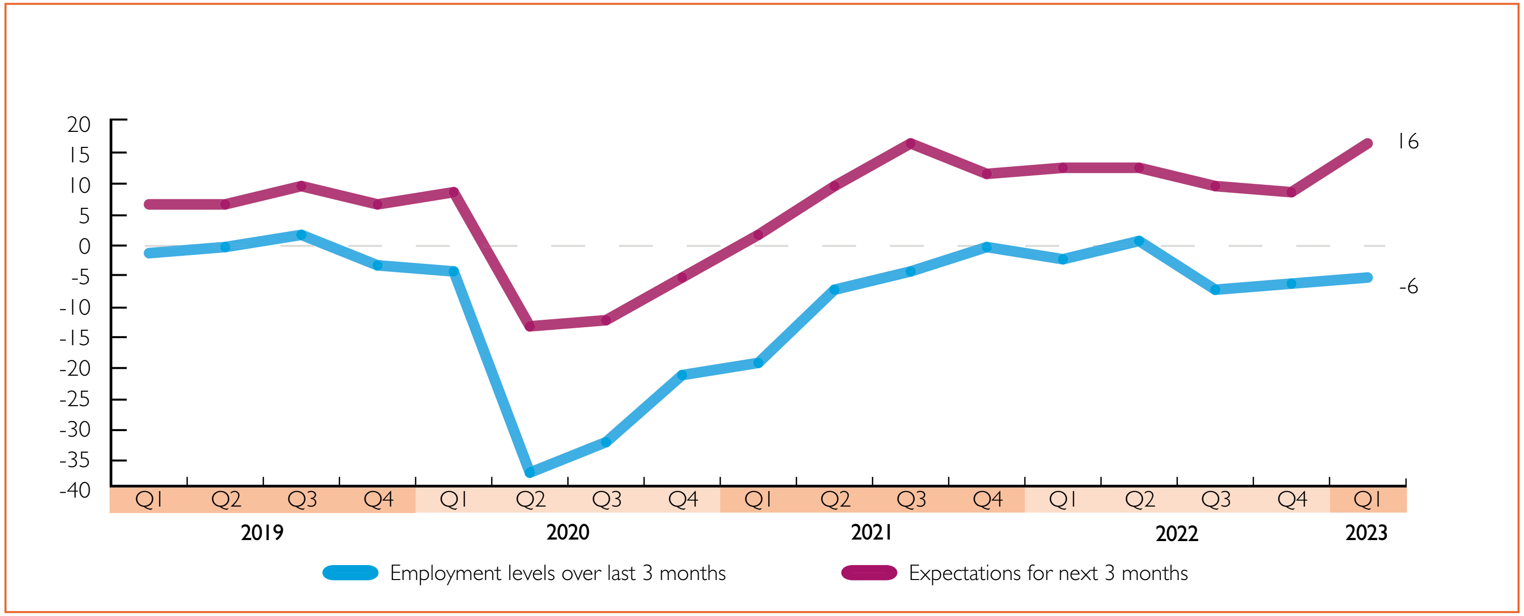
One in ten (10%) companies reported an increase in orders in Q1, offset by 13% who said orders had decreased.

Micro firms reported flat export order growth in Q1 (net balance unchanged at -5). For larger businesses, the export orders balance climbed 4 points to +15. On a sectoral basis, export demand was slightly weaker in services and flat for manufacturing.

LABOUR MARKET

13% of London businesses reported an **increase** in their workforce size last quarter

22% of London businesses expected their workforce size to **increase** over the coming three months



According to their latest Monetary Policy Committee report, the Bank of England has turned more optimistic on the UK labour market in the short-term, with unemployment due to remain at the current low levels. London businesses were also more positive on workforce levels in the Q1 2023 Capital 500, with more than a fifth (22%) now expecting an increase in the coming three months. Only 6% of firms thought their workforce levels would reduce in the next three months, pushing the net balance up 8 points to +16, a joint record high.

Half (50%) of larger companies thought their workforce size would grow over the coming three months, the highest share since the Capital 500 began, while 13% expect a decline in their workforce. For micro firms, around one in five (19%) anticipate an increase in their employment levels in the next three months, up from 14% in Q4 2022.

Both manufacturers and service sector businesses were more optimistic about the size of their workforce in the Q1 2023 Capital 500, particularly in the hospitality sector, and professional and businesses services.

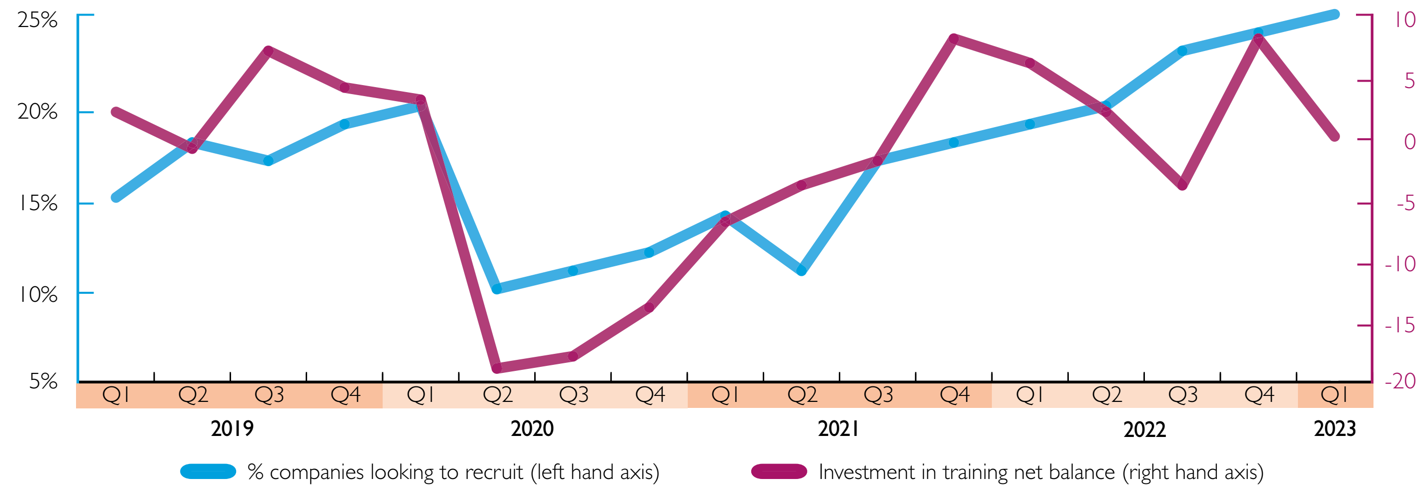
The net balance for current employment levels edged up from -7 to -6 in Q1 2023, with 13% of companies saying their workforce had increased in size compared to Q4 2022. This was partially offset by a slightly bigger share of firms who said employment levels had fallen in Q1 (19%, up from 17% in Q4 2022).

For London's micro businesses, the employment balance nudged up 1 point to -8 in Q1, with around a tenth (11%) reporting an increase in workforce levels. By contrast, the employment balance for larger firms fell 13 points to +6, owing to a smaller share of companies who said their workforce had grown and a bigger proportion reporting a decline in headcount.

RECRUITMENT AND TRAINING

25% of London businesses reported that they had looked to recruit in the last quarter

15% of London businesses reported an **increase** in investment in training last quarter



There was another increase in reported recruitment efforts in Q1 by London businesses. A quarter (25%) of companies said they tried to recruit in Q1 2023, a fresh record for the Capital 500. The increase was driven by micro companies, with 21% looking to hire in the first three months of the year. Fewer larger businesses were actively trying to recruit in Q1, with the share falling from 72% to 61%.

Service sector businesses saw an increase in reported recruitment efforts (from 21% to Q4 2022 to 23% in Q1 2023), particularly in the finance, insurance and business support industries, and professional, scientific and technical services. There was a slight drop in the share of manufacturing firms who tried to hire in Q1 (from 46% to 43%).

However, the vast majority of businesses who are trying to recruit continue to have difficulties doing so. A record 73% of firms reported issues in recruiting in Q1, with three-quarters (76%) of micro companies (who tried to recruit) saying they encountered issues. The industries where difficulties were being felt most acutely were professional, scientific and technical services, and the finance, insurance and business support sectors.

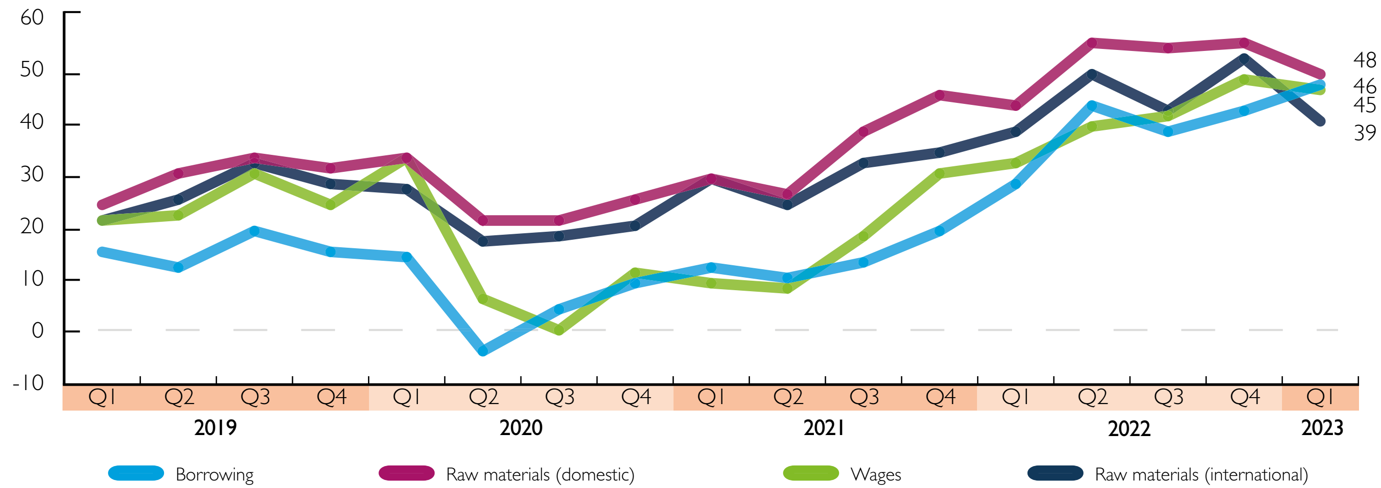
After jumping sharply in Q4 2022, companies' investment in training was pared back in Q1 2023, with the net balance falling 8 points to 0. The proportion of firms who increased their investment in training shrunk from 21% to 15%, while there was a slight rise in the share who reported a decline in training spending (from 13% in Q4 2022 to 15% in Q1 2023).

For micro firms, the training investment balance slipped back into negative territory in Q1 (from +4 to -2). The net balance for larger firms dropped sharply, down 18 points to +22.

60% of London businesses reported an **increase** in their fuel costs last quarter

74% of London businesses reported an **increase** in their energy costs last quarter

BUSINESS COSTS



There were some signs of a slight easing in cost pressures for London businesses in the latest Capital 500, although all of the measures remain close to record highs. Three quarters (74%) of firms said their energy costs had increased in Q1 2023, down slightly from 79% in Q4 2022. However, only 1% of businesses reported a decline in energy costs. Turning to fuel costs, three-fifths (60%) of companies reported an increase in Q1 2023, down from 70% in Q4 2022.

Around half (49%) of firms said their domestic raw material costs had risen in the first three months of 2023, down from 57% in Q4 2022. For raw materials sourced internationally, two in five (41%) businesses reported an increase in costs in Q1, compared to 53% in the previous quarter. However, in both cases, most firms saw no change in their costs for raw materials, highlighting that pressures remain elevated.

In the context of a tight labour market, 47% of London businesses said pressure to increase wages had grown in Q1 2023.

This was down slightly from Q4 2022 (50%), but was still the second-highest share recorded on the Capital 500. Only 2% saw wage pressures ease in Q1.

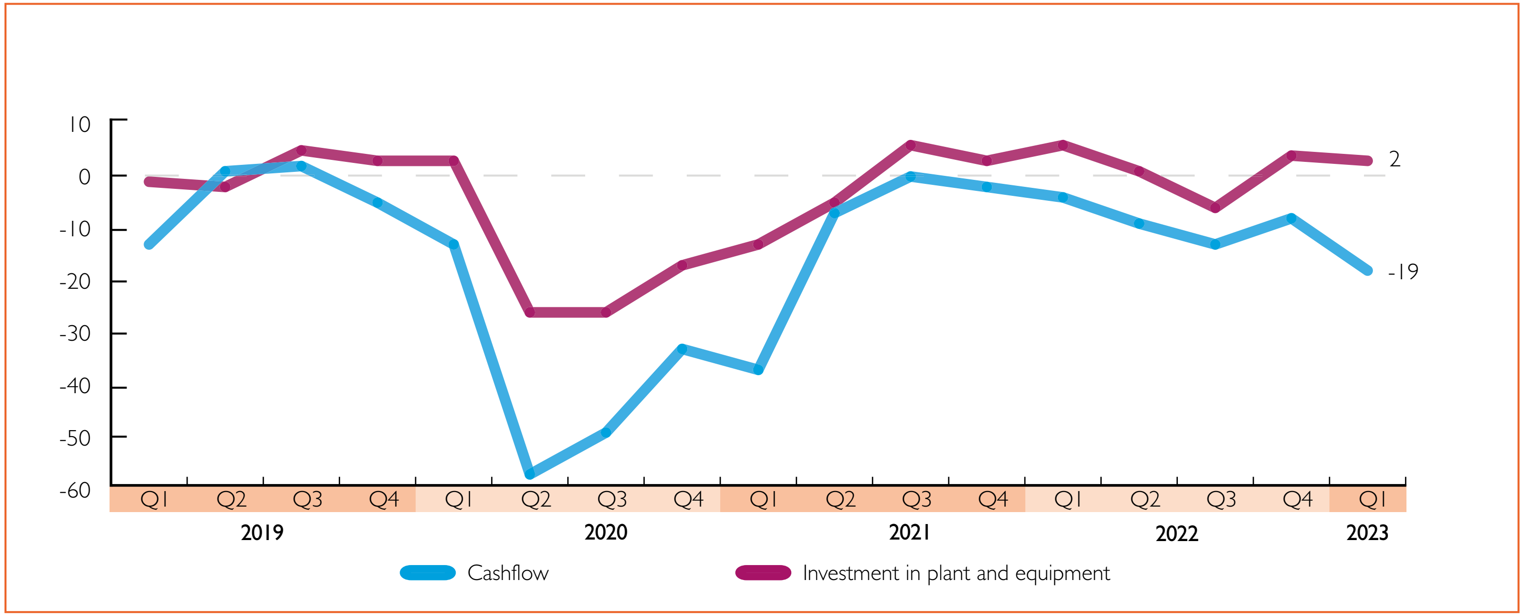
The Bank of England's decision to raise interest rates could put further pressure on firms at a time when borrowing costs are already elevated. Just under half (48%) of London firms said their borrowing costs had increased in Q1 2023, ahead of the most recent Bank of England MPC meeting, with 2% noting a decline.

In Q1 2023, half (50%) of London businesses expected the prices of their goods and / or services to rise over the next three months, down slightly from 52% in the Q4 2022 Capital 500. Utilities remain the principal upward pressure on firms' prices, followed by labour costs and costs related to financing.

CASHFLOW AND INVESTMENT

19% of firms reported an **increase** in cashflow last quarter

17% of firms reported an **increase** in investment in plant and equipment



After a small improvement in the previous Capital 500, the cashflow balance fell 10 points to -19 in Q1 2023, a two-year low for the survey. Close to two-fifths (38%) of London businesses said their cashflow had worsened in Q1 compared to Q4 2022, while only 19% noted an increase. Fewer firms were operating at full capacity in Q1 (42%, down from 50% in Q4 2022).

For micro businesses, the cashflow balance declined from -11 to -23 in Q1: 40% of micro firms said cashflow deteriorated in the prior three months, the highest proportion since Q1 2021. The proportion who saw cashflow increase in Q1 shrank from 23% to 17%. By contrast, cashflow for larger companies was stable in Q1, with the net balance unchanged at +13.

On a geographical basis, close to half (46%) of businesses in outer London reported a decline in cashflow last quarter, up from 39% in Q4 2022: the net balance fell 16 points to -33. Inner London companies also saw a drop in cashflow in Q1, with the net balance sliding from -1 to -8. Cashflow declined for most sectors in Q1, with arts, entertainment and recreation, motor and retail trade, and construction some of the worst affected.

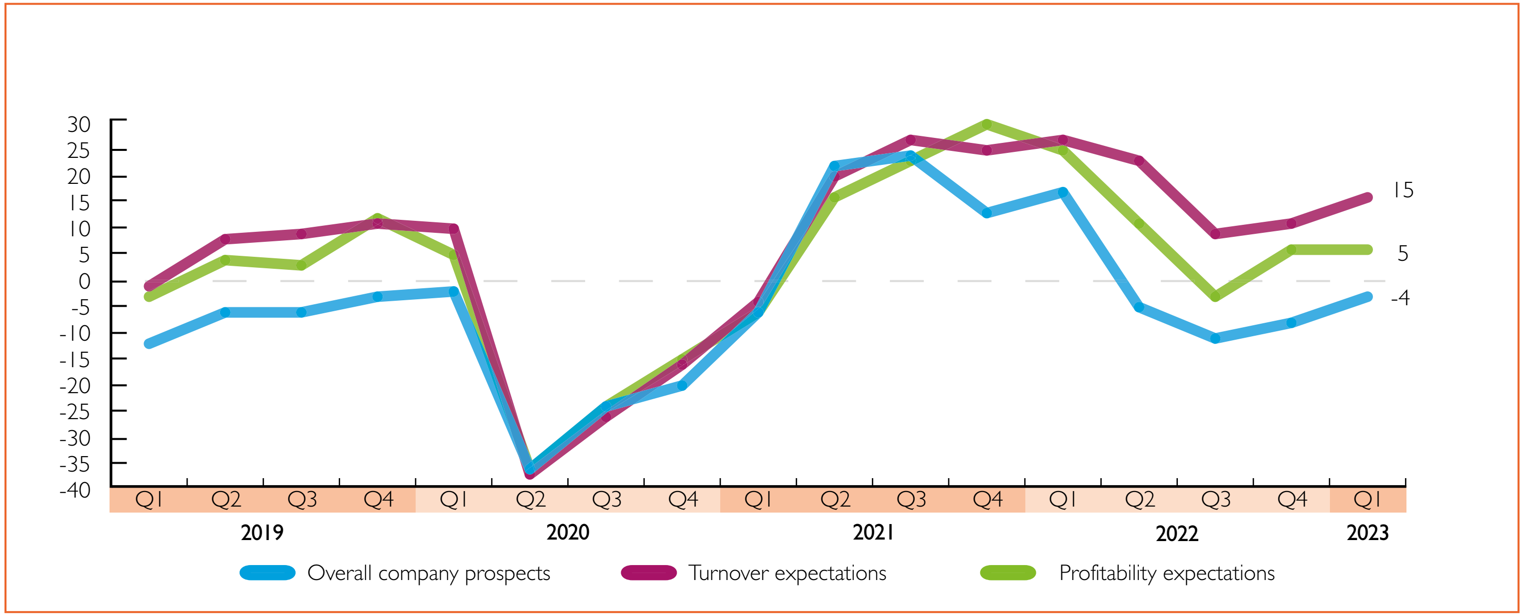
Investment in plant and equipment was broadly unchanged in Q1 2023, as 17% of firms raised spending in the first three months of 2023 – this was up from 14% in Q4 2022. This was offset by a bigger share of businesses who decreased capital investment, keeping the net balance roughly level at +3, compared to +2 in Q4 2022..

Larger businesses reported a sharper decline in investment in plant and equipment last quarter, with the net balance falling from +13 to +3. For micro businesses, the capital investment balance edged down 1 point to +1 in Q1: around one in seven (16%) micro firms raised spending on plant and equipment in Q1, up from 13% in Q4 2022.

BUSINESS CONFIDENCE

36% of London businesses expect their profitability to **improve** over the coming 12 months

39% of London businesses expect their turnover to **improve** over the coming 12 months



London business leaders continue to remain optimistic about their firm's future finances despite the deterioration in cashflow, and weak domestic and export demand. The net balance for turnover expectations in the next 12 months climbed 5 points to +15, with 39% of firms anticipating an increase in turnover.

This improvement in turnover expectations was due to micro firms: the net balance climbed from +7 to +13 in Q1. By contrast, the turnover balance for larger companies slipped from +32 to +30, although nearly half (45%) still expect an increase in turnover over the next 12 months.

Profitability expectations were stable in Q1 2023, as the net balance was unchanged at +5. More than a third (36%) of firms expect profitability to increase in the coming 12 months, compared to 31% who anticipate a decline.

Unlike turnover, it was larger firms who were more optimistic about profitability in Q1: the net balance climbed 12 points to +32, with more than half (53%) who said they think profitability will rise in the next 12 months. For micro firms, the net balance nudged down 1 point to +2.

As a result, the overall company prospects balance rose again in Q1 from -9 to -4, with a quarter (27%) expecting an improvement in their firm's outlook over the coming year. The chief concern for London business leaders remains inflation, with 73% saying it was more of a concern than in Q4 2022. Firms were less concerned about interest rates (38%) in the latest Capital 500, although it is worth noting that the fieldwork was conducted prior to the Bank of England's recent hike in Bank Rate.

ECONOMIC OUTLOOK

25% of London businesses expect London's economy to **improve** in the next 12 months

25% of London businesses expect the UK's economy to **improve** in the next 12 months

There was also an improvement in the outlooks for the London and UK economies in Q1, although overall sentiment remains pessimistic. A quarter (25%) of London firms expect the capital's economy to improve over the next 12 months, up from 21% in the Q4 2022 Capital 500. The proportion who thought London's economy would worsen shrunk from 52% to 43%, pushing the net balance up from -31 to -18 in Q1.

Both micro and larger businesses alike were more optimistic about London's economy in Q1 2023 than in previous quarters. The net balance for micro firms climbed 12 points to -20, the highest reading for a year. For larger companies, the outlook for the capital's economy improved from -30 to -1.

When asked about their outlook for the wider UK economy, firms were also slightly more positive. The net balance climbed from -36 to -29, with a quarter (25%) of companies expecting the UK economy to improve over the coming 12 months. There was a small drop in the share of firms who expect the UK economy to worsen: nevertheless, more than half (54%) of London business leaders still think the UK economy is set to deteriorate over the next 12 months.

The net balance for larger businesses' UK economic outlook jumped 29 points to -11 in Q1, with one in three (34%) expecting the UK economy to improve in the coming year. This was a much bigger increase than seen with micro companies: the net balance rose only 5 points to -31.

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