LONDON CHAMBER of COMMERCE AND INDUSTRY

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Q2

CAPITAL 500

London Quarterly Economic Survey

April – June **2022**

In partnership with

Savanta: ComRes

Sponsored by

haysmacintyre

JAMES WATKINS

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

LCCI COMMENTARY – THE BUSINESS VIEW

The economic climate for London's businesses, particularly our capital's micro companies, remains uncertain. On the one hand, there are encouraging signs of a recovery in London as the number of inbound tourists from overseas increases and office workers make more journeys in the week into the centre. The Platinum Jubilee weekend offered a chance for London to showcase its businesses to the world.

At the same time however, the latest Capital 500 shows domestic sales have plateaued, business confidence has slumped, and costs are rising sharply for London companies. Concerns over inflation, rising borrowing costs and a tight labour market are growing as well.

Measures undertaken by the Chancellor to support households are welcome and will hopefully alleviate the pressures on the most vulnerable in our society. Additional support is needed, however, to reduce the cost of business to help London and the UK thrive.

Businesses have had to weather uncertainty with concerns regarding stagflationary pressures, higher energy and food prices and worries with employing key workers. With the tragedy of the ongoing war in Ukraine combined with the slow recovery from the pandemic and fears of a trade war with the European Union, it is testament to the entrepreneurial drive of London businesses that the capital remains the place to do business. London Chamber of Commerce and Industry is committed to working with London businesses in the challenging times that lie ahead.

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 ComRes surveyed a total of 510 London business leaders between 4 May and 30 May 2022. All data were weighted to be representative of all London businesses by company size and broad industry sector. Savanta ComRes is a member of the British Polling Council and abides by its rules. Full data tables are available at www.comresglobal.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

Since the fieldwork for the latest London Quarterly Economic Survey was undertaken, the mood has turned increasingly negative and stock markets have reflected that unease in recent months. After more or less stagnant growth in advanced economies in the first quarter, global indicators suggest a further slowdown in activity in Q2. What now looks like a prolonged war in Ukraine has sent inflation upwards, resulting in sharper than anticipated interest rate increases and accentuating an already developing cost of living crisis.

New Covid lockdowns in China have contributed to this. However, the war has had a wider impact across the globe. Input costs are rising strongly on the back of energy price increases and continued supply shortages. Investment and growth have suffered. In the US, where GDP fell at an annualised rate of 1.4% in Q1, both manufacturing output and consumer confidence have been under pressure in Q2. In the UK GDP fell by 0.3% in April after a 0.2% decline in March. The drop was felt across all sectors, including manufacturing and construction, though the services decline was mainly due to a drop in health service spending: this reflected, amongst other things, a reduction in vaccine boosters and in Covid testing. Business surveys indicate increased pessimism, while consumer confidence has dropped to the lowest on record. In the EU, economic sentiment fell further in May, with the countries most reliant on Russian oil and gas worst affected.

Cost of living issues are rising up the agenda across the globe and growth forecasts have as a result been revised sharply downwards. Globally, the only upward revisions are for a handful of commodity producers. For the world economy as a whole, which did rebound from the Covid slump to grow by 5.7% in 2021, the World Bank in June reduced its 2022 GDP forecast to only 2.9% in compared to a January forecast of 4.1%.

In the UK the Bank of England raised interest rates again by 25 basis points in June, the fifth increase in as many meetings since December, bringing the rate to 1.25%. In its accompanying forecast it lowered its growth expectations, anticipating little increase in activity for the rest of the year and through most of 2023. Inflation was revised further upwards to now peak at 11% later in 2022. The country is facing a 'summer of discontent' as real wages are not keeping up with inflation, particularly in the public sector.

On the positive side, unemployment remains near record low levels at 3.8%, while pockets of big staff shortages remain across many sectors. At the same time, although retail is suffering, spending in other consumer services is rising, including hospitality. Tourism is rebounding too, but it has brought with it travel chaos as the industry – and the supporting infrastructure – were ill-prepared for the unleashing of the huge pent-up demand. This has been well-documented, and the UK is not the only country in Europe with problems in the sector that will be difficult to resolve in a hurry.

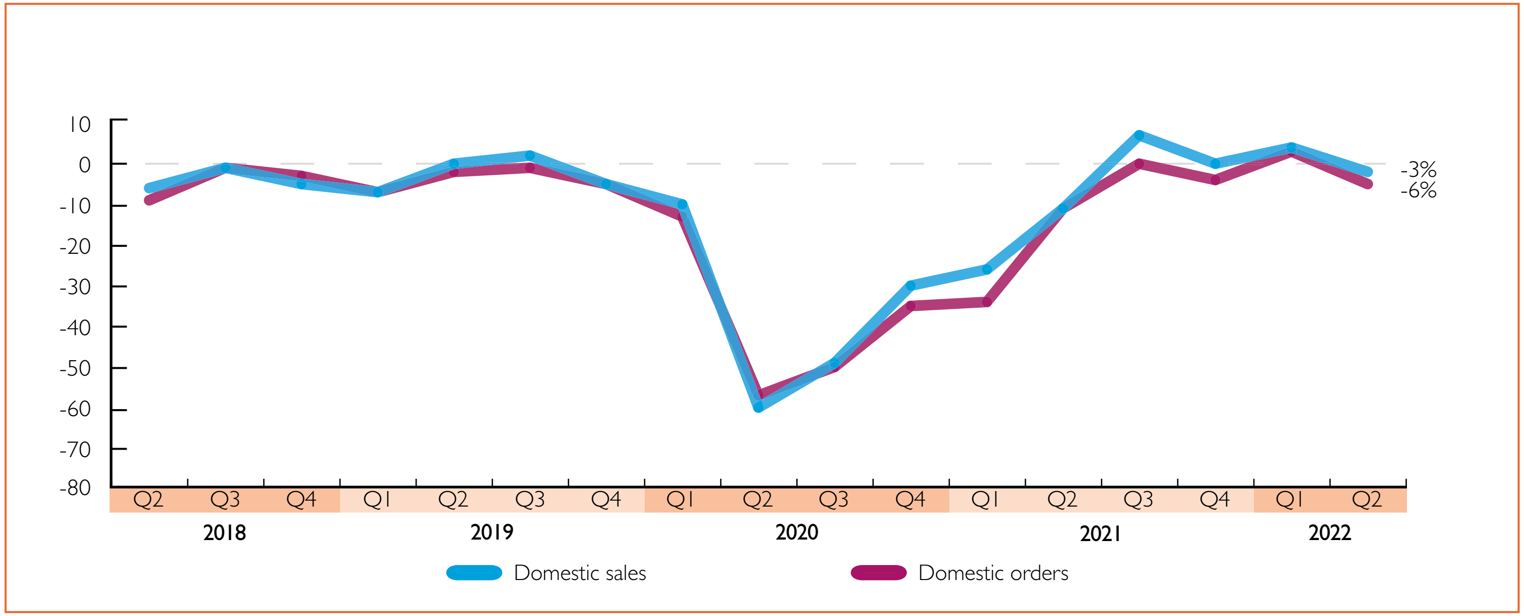
In the meantime, cost of living issues, centring mainly on energy, fuel and food are likely to dominate the remaining of the year. The Government is widely expected to intervene again, despite pressure on public finances, to provide further support to those most in need.

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

DOMESTIC DEMAND

22% of London businesses reported an **increase** in domestic sales last quarter

17% of London businesses reported an **increase** in domestic orders last quarter



London businesses saw weaker domestic demand in Q2 2022 according to the latest Quarterly Economic Survey. The net balance for domestic sales (the percentage of businesses who reported an increase minus the percentage who reported a decrease) fell back into negative territory, down 6 points to -3. A quarter (25%) of businesses said sales had fallen in Q2, up from 20% in Q1. There was also a small dip in the share of firms who said sales had risen (from 23% to 22%).

Micro businesses (0-9 employees) bore the brunt of this decline in domestic sales: the net balance fell from +3 to -5, with a quarter (26%) of micro firms reporting a drop in sales last quarter. By contrast, the sales net balance for larger companies (10 or more employees) rose from +9 to +11 in Q2, on the back of a bigger share of firms who said sales has risen over the previous three months.

Businesses in the West London Alliance and Local London geographies saw declines in the net balances for domestic sales in Q2, but firms based in the Central London Forward and South London Partnership areas reported a rise in the sales balance. Across London, sales demand jumped for manufacturers but fell for service sector businesses, particularly those based in professional services and the arts, entertainment and recreation industries.

Domestic orders fell in Q2 as well, with the net balance also turning negative (from +2 to -6). The proportion of firms who said orders had risen shrunk from 20% to 17%, while more businesses reported a decline in orders. The domestic orders net balances fell for both micro and larger companies in Q2, with one quarter of micro businesses saying orders had dropped over the prior three months. As with sales, domestic orders in Q2 improved for manufacturers but were weaker in service sectors, with the biggest fall seen in professional services.

EXPORT DEMAND

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

8% of London businesses reported an **increase** in export orders last quarter

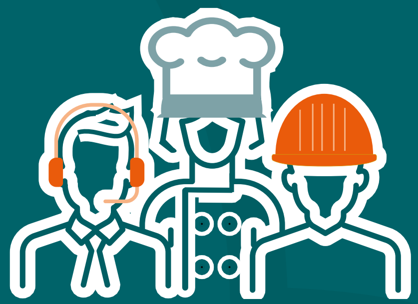
The latest London QES did not point to any sizeable changes in overseas demand in Q2.

Export sales were marginally stronger, with the net balance nudging up 1 point to -2. One in ten (10%) of London firms said export sales had risen in the previous three months, although there was a similar share who said sales had fallen (11%). Both micro and larger businesses saw a pick-up in export sales in Q2. For larger firms, the net balance climbed 10 points to +9, with 21% reporting a rise in sales over the previous three months.

Manufacturing export sales were somewhat weaker in Q2, while service sector firms reported a small uptick in sales demand.

For export orders, the net balance slipped from -1 to -3 last quarter, with a greater share of firms reporting a decline in orders compared to Q1. The export orders net balance for micro companies dipped 3 points to -4, as one in ten (11%) said orders had declined in Q2. By contrast, larger firms saw stronger export order demand, with the net balance climbing 9 points to +8.

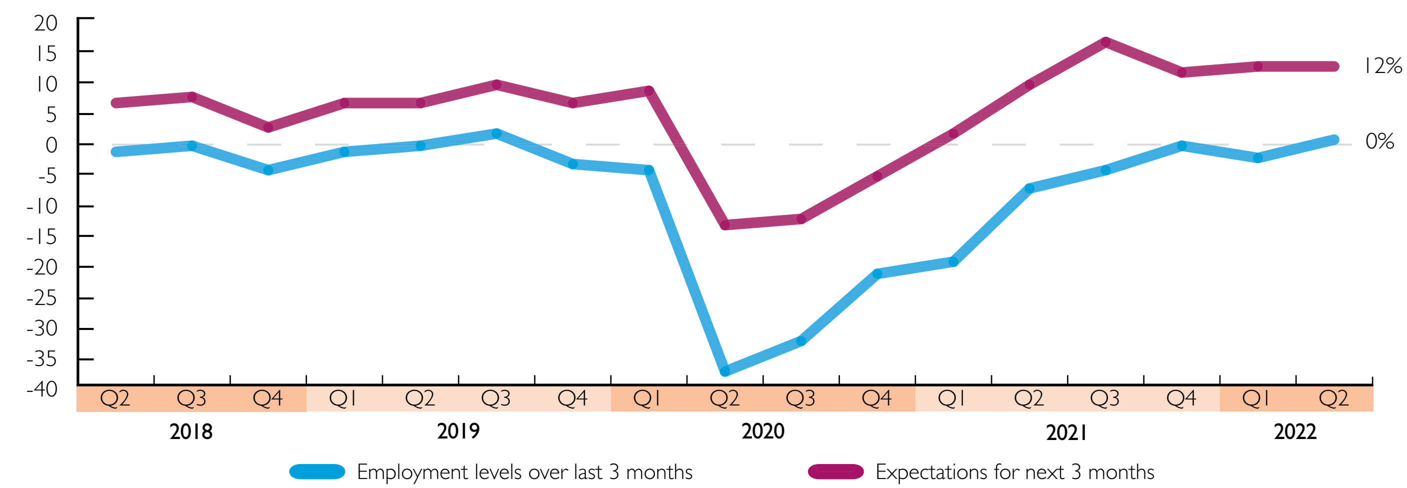
Service sector companies saw little change in export order demand in Q2 (net balance rose from -3 to -2). In manufacturing, the export orders balance dropped sharply on the back of a steep decline in demand in the agriculture, forestry, fishing and production industries.



11% of London businesses reported an **increase** in their workforce size last quarter

20% of London businesses expected their workforce size to **increase** over the coming three months

LABOUR MARKET



London businesses remain fairly optimistic about the labour market, despite the recent small uptick seen in the official unemployment rate produced by the Office for National Statistics.

In the Q2 2022 QES, the employment balance rose from -3 to 0, the first non-negative reading since Q3 2019. One in ten (11%) businesses said the size of their workforce had increased in Q2, up from 8% in Q1. The proportion who said employment levels had fallen was unchanged at 11%.

For micro businesses, the net balance for employment rose 2 points to -2, with more firms saying their workforce had grown in size. A greater share of larger companies also said workforce levels had risen in Q2 (30%, versus 25% in Q1), but there was also a rise in the share of large firms who saw a decrease in staffing levels (from 9% to 15%). The net balance slipped from +16 to +15.

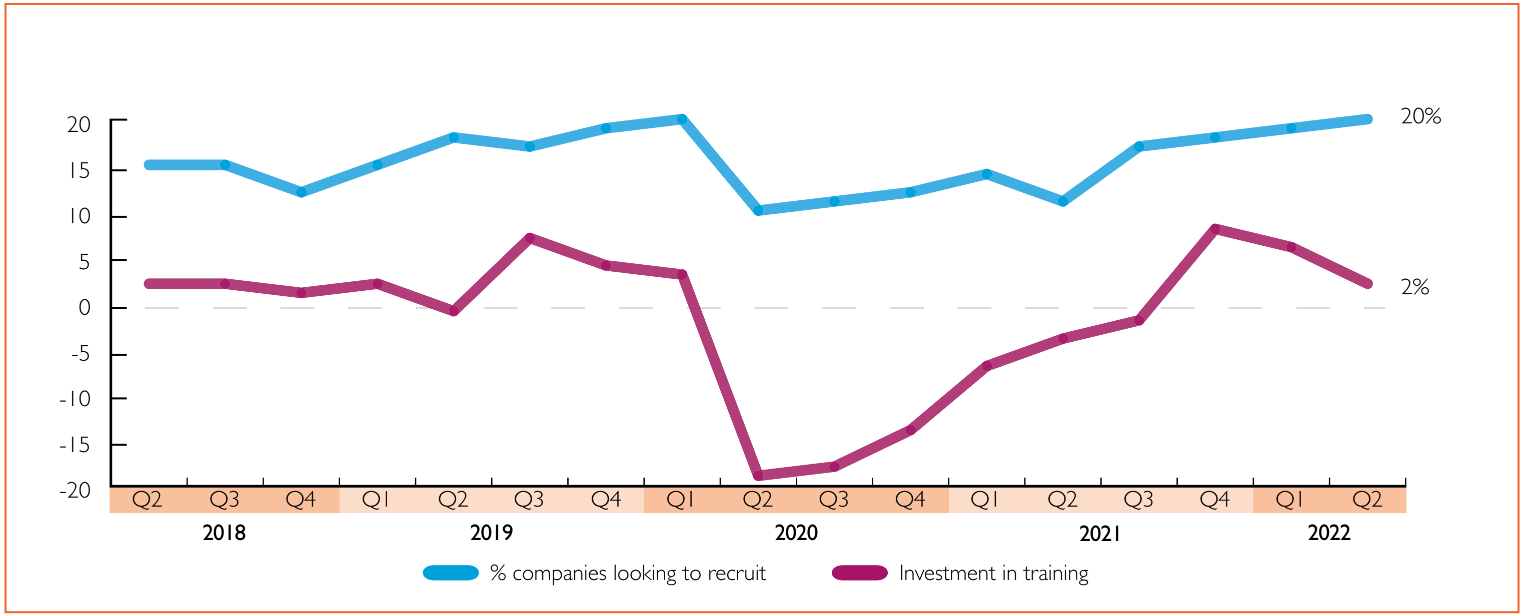
Manufacturers and service sector businesses alike saw an increase in the net balance last quarter, with the biggest increases seen in information and communication, and arts, entertainment and recreation.

Employment expectations for the coming three months have remained stable in the past two surveys, with the net balance unchanged at +12 in Q2. One-fifth (20%) of firms expect their workforce levels to increase, up from 16% in the Q1 QES. However, there was also a greater proportion of firms expecting a decrease (8%, up from 4% in Q1). This pattern was consistent for both micro and larger companies.

20% 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

RECRUITMENT AND TRAINING



Recruitment activity by London businesses returned to the pre-pandemic high in Q2 2022, with one in five (20%) firms saying they had sought to hire in the prior three months. This is nearly double the proportion who were recruiting one year ago (11% in Q2 2021).

There was no change in the proportion of micro businesses who were looking to recruit in Q2 (15%), but there was a rebound in hiring activity by larger companies (66%, up from 59% in Q1).

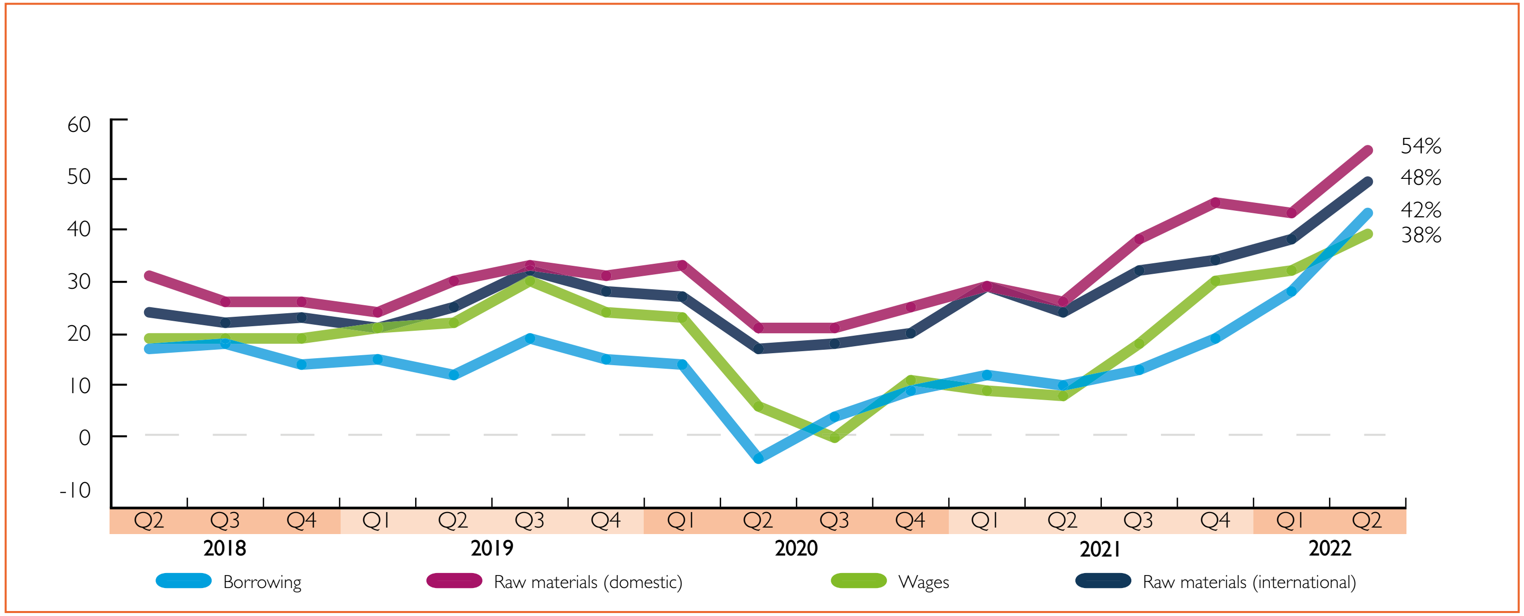
The uptick in hiring was driven by the manufacturing sector, with more than half (60%) of manufacturing firms saying they had sought to recruit – up sharply from Q1. By contrast, in the services industries recruitment efforts slowed in Q2 due to weaker hiring activity in the public sector and hospitality.

The vast majority (63%) of firms who are looking to hire are finding difficulties doing so. This was a slight dip compared to Q1 (64%), but remains elevated. Two fifths (61%) of micro businesses who tried to recruit had difficulties, rising to two-thirds (67%) of larger firms.

The net balance for training investment fell from +6 to +2 in Q2 2022, due to a greater share of firms who said they reduced spending (13%, up from 9% in Q1).

This was due to weaker training investment from micro businesses: the net balance fell from +4 to 0 last quarter. For larger companies, the net balance was a touch higher in Q2 (up 1 point to +29).

BUSINESS COSTS



75% of London businesses reported an **increase** in their fuel costs last quarter

77% of London businesses reported an **increase** in their energy costs last quarter

It will come as little surprise to see a further intensification of cost pressures for London businesses in the latest Quarterly Economic Survey. Three quarters (77%) said their energy costs had risen in Q2 compared to the previous three months (the energy price cap rise came into effect from April 2022), up from 69% in Q1. Close to nine in ten (89%) of manufacturers reported a rise in their energy costs in Q2, while 75% of service sector firms said costs had increased. In addition, 75% of all London businesses said that their fuel costs had risen in Q2, up sharply from 61% in the Q1 2022 QES.

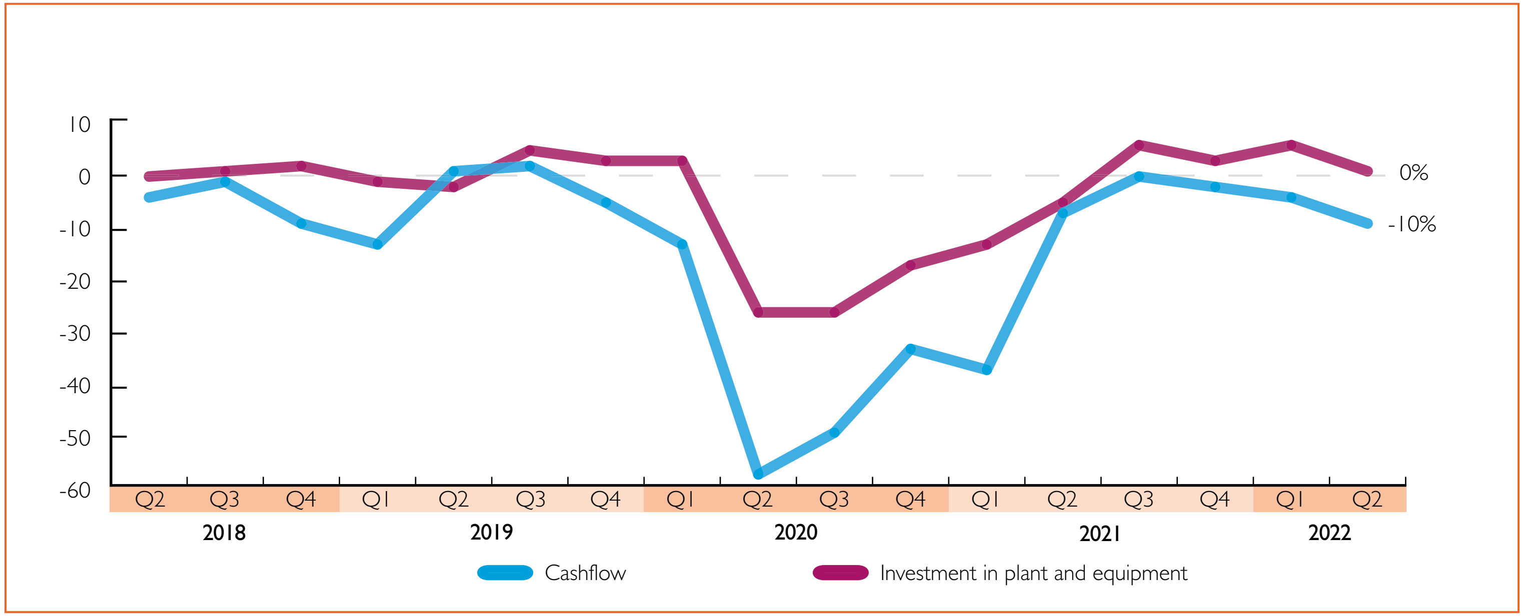
More than half (55%) of firms said that their domestic raw material costs increased last quarter, with these pressures being felt most acutely in the manufacturing industries: 93% of manufacturers said that the cost of raw materials sourced from the UK had risen. For service sector firms, the share was lower (52%), but still significant. When considering their overseas raw material costs, 49% of all London companies reported an increase in Q2 compared to Q1. Away from utilities, borrowing costs for companies continue to accelerate, with two-fifths (43%) of firms noting a rise in Q2: this was up from 31% in Q1. The proportion of micro firms who said borrowing costs had risen jumped from 29% in Q1 to 41% in Q2.

Two-fifths (40%) of London companies said pressure from employees to increase wages had grown in Q2, up from 35% in Q1. Only 2% of businesses said they felt there was less pressure to raise wages, pointing to the tight labour market and scrutiny on firms to offer higher salaries. Unsurprisingly, the sharp increase in utilities costs is the biggest factor that is pressuring firms to raise their prices (63% of all London firms). For larger companies (10+ employees), three-fifths (60%) also noted labour costs as an upward inflationary pressure. More than half (56%) of London firms expect the prices of their goods and / or services to rise in the coming three months, a new high for the QES: this rises to 69% of larger companies.

CASHFLOW AND INVESTMENT

21% of firms reported an **increase** in cashflow last quarter

13% of firms reported an **increase** in investment in plant and equipment



Cashflow for many London businesses remains an issue and has not shown significant signs of recovery. The net balance for cashflow fell from -5 to -10 in Q2, the third consecutive decline. The proportion of firms who said their cashflow had decreased grew from 27% in Q1 to 31%, while there were slightly fewer businesses who reported an increase in cashflow (21% in Q2, versus 22% in Q1).

This was driven entirely by micro businesses, for whom the cashflow net balance slipped 5 points to -11: nearly a third (31%) of micro companies said cashflow had dropped last quarter. By contrast, the net balance for larger firms climbed from 0 to +9.

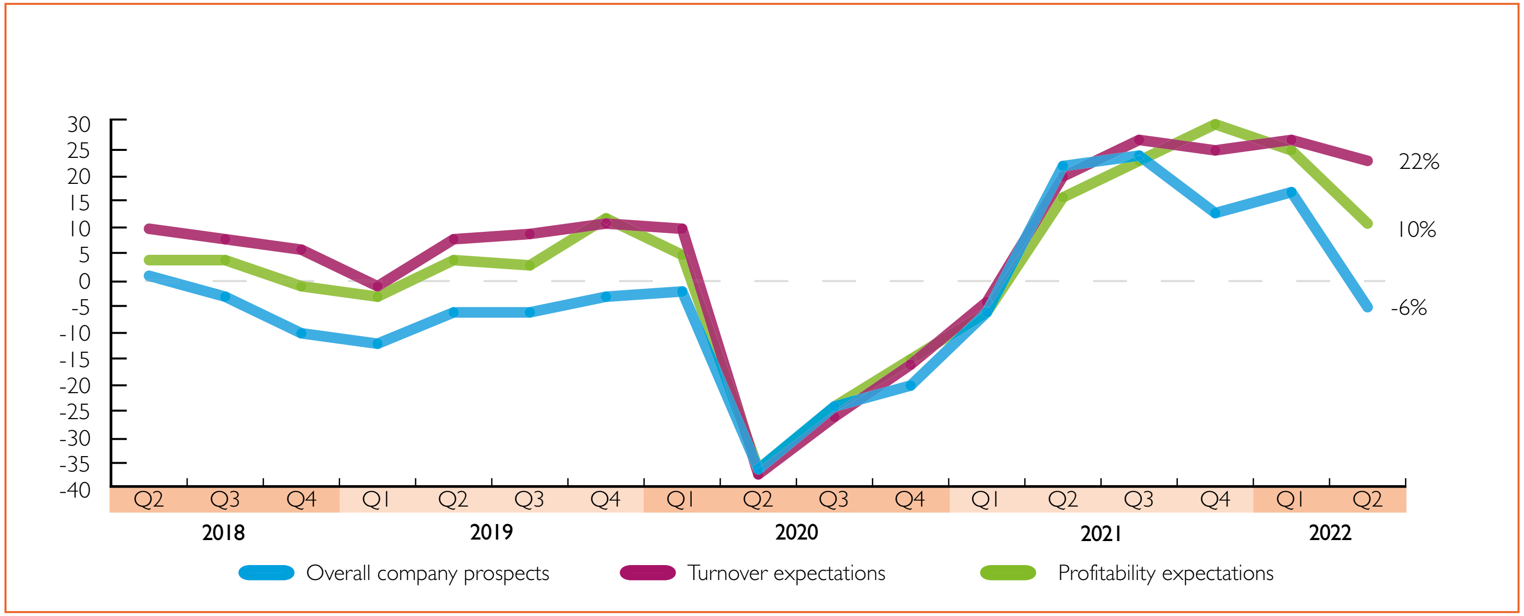
There was a small uptick in the number of companies who said they were operating at full capacity in Q2 (40%, up from 39% in Q1). Three-fifths (59%) of larger businesses said they were operating at full capacity last quarter, up from 53% in Q1.

Investment in plant and equipment by London businesses remains weak according to the London QES, with the net balance falling from +5 to 0 in Q2. Three-quarters (74%) of firms said their capital investment plans had not changed in the previous three months.

For micro companies, the net balance fell 7 points to -4 in Q2, with fewer firms saying they had raised investment in plant and equipment. Larger businesses reported an increase in capital investment last quarter: the net balance climbed from +12 to +17. Manufacturers and companies in the services sector both reported lower levels of investment in plant and equipment in Q2.

BUSINESS CONFIDENCE

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



42% of London businesses expect their turnover to **improve** over the coming 12 months

Business confidence deteriorated sharply in Q2, amid a worsening economic climate. The net balance for profitability expectations in the next 12 months fell 14 points to +10: just over one in three (36%) of firms expect their company's profitability to improve, down from 42% in Q1. In addition, the proportion who expect profitability to worsen over the coming year grew from 18% to 26%, the biggest in five quarters.

Both micro and larger businesses were less optimistic about their profitability. For micro firms, the net balance slipped from +23 to +9, while for larger companies there was a ten-point drop in the balance (to +20).

Turnover expectations were less affected: the net balance for all London firms declined from +26 to +22 in Q2. The share of firms who anticipate an improvement in their company's turnover over the next 12 months actually increased (from 41% to 42%), but there was also a rise in the proportion expecting a worsening (from 15% to 20%).

For micro businesses, the turnover expectations balance fell from +26 to +21, due to a rise in the number of firms anticipating a fall. The balance for larger businesses grew slightly in Q2 (from +30 to +32).

Against a backdrop of weak cashflow, intensifying cost pressures, and softer profitability expectations, the net balance for overall company prospects in the next 12 months fell back into negative territory in Q2 (from +16 to -6).

The company prospects net balance for micro businesses recorded a 25 point drop to -8 in Q2, while for larger firms the decline was less severe (from +11 to +4). Close to a third (31%) of micro businesses thought their company prospects would worsen in the next 12 months, up from 20% in Q1.

20%

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

19%

19% of London businesses expect the UK's economy to **improve** in the next 12 months

ECONOMIC OUTLOOK

The outlooks for the London and wider UK economies also deteriorated. Considering the economic outlook for London, the net balance slumped from 0 to -28 in Q2. Nearly half (48%) of London firms expect the capital's economy to worsen over the coming 12 months, up from 33% in Q1. Only one in five businesses thought London's economy would grow.

There were no discrepancies based on business geography, with all sub-regions seeing sharp declines in the net balance for the London economic outlook in Q2. For service sector businesses, the outlook for London's economy worsened as the net balance slid from -1 to -31. However, for manufacturing companies the decline was much smaller (from +11 to +8).

There was a similar, steep decline in the outlook for the wider UK economy: the net balance fell 32 points to -37, with more than half (56%) of firms expecting the UK economy to worsen over the coming 12 months.

As with the outlook for the capital, both micro and larger businesses were much more pessimistic for the wider UK economy. For micro companies, the net balance slid from -6 to -39, as close to three-fifths (57%) expect a worsening over the coming 12 months. The net balance for larger businesses declined 15 points to -20.

Inflation remained the main concern for businesses, with three-quarters (76%) of firms saying that the rise in prices was more a concern in Q2 than it had been three months prior. However, interest rates also becoming more of a concern for London firms: one-third (34%) cited greater unease about the cost of borrowing in Q2, the highest share recorded on the London Quarterly Economic Survey since Q2 2014.

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