# Regional Intelligence Snapshot for the South East

November 2009

## Summary of economic conditions

- According to the Purchasing Managers' Index, both business activity and incoming new orders in the South East rose for the fourth consecutive month in October, and **the rate of growth accelerated at its fastest for 2 years.**
- Across the region, there are reports that businesses have started to see **stabilisation or improvement in the volume of domestic and overseas orders, staff numbers, costs and cashflow**. In Surrey, domestic orders have remained stable or increased for 57% of surveyed businesses in the past three months. However, profit margins continue to be squeezed as sales fall and customers continue to demand lower prices. 42% of businesses in Surrey have seen a reduction in turnover in the past 3 months.
- Anecdotal evidence suggests that **export orders are picking up, particularly in the manufacturing sector, while demand in some local markets remains subdued**. Survey evidence from the South East FSB October Snap Poll shows that over the previous two months, trade improved for 26% of companies, up from 23% in August.
- **Growing numbers of companies in the South East are now more optimistic about the business climate looking ahead**: According to interim results from the RDA Business Survey for November, 32% of companies expect the business climate to improve in the next 12 months, up from 23% in June. While 22% of firms in the South East still expect the business climate to get worse in the next 12 months, this is significantly lower than in June (33%). Overall, **South East businesses are more optimistic than the national average.**
- **There are some tentative signs of stabilisation in the labour market,** with a relatively small fall in employment in the three months to September (by 3,000), while unemployment increased by 4,000. The claimant count fell slightly (by 345) to 154,900 in October. There were over 42,000 vacancies notified to Jobcentre Plus in October 2009, averaging 4 claimants per vacancy.
- **House prices in the South East are picking up**. According to the RICS housing market survey, the proportion of surveyors reporting higher house prices outnumbered those reporting lower prices, for the fifth consecutive month. In October 56% reported an increase in house prices while only 5% reported a fall.

## Key challenges and hotspots

- **The cost of finance is still difficult for many small businesses**. According to the latest South East FSB Snap Poll, 28% of companies reported an increase in the cost of existing finance in October (up from 22% in June). 25% report higher costs for new finance (up from 22% in June). There are reports that the banks continue to be risk averse. Problems in accessing finance are having an impact on SME performance, with small businesses more likely to have seen worsening performance in the past 3 months. This also has a knock-on effect on large companies through their supply chains.
- Anecdotal evidence suggests that **more businesses are currently being affected by skills shortages compared to last month.** This could be a result of significant reductions in headcount earlier in the recession which mean that some firms are now facing difficulties meeting the demands of renewed growth. However, recruitment remains subdued in many sectors. According to the October PMI, **employment has fallen for the 16th consecutive month**. The South East FSB survey shows that only 10% of companies expect to create a new post in the next 6 months.

## Business specific intelligence / information on key questions

- **Investment intentions remain relatively low, with investment most likely to be geared towards marketing and sales activities**. 28% of firms in the latest RDA Business Survey expect to increase investment in this area in the next 12 months. Only a small proportion of companies plan to invest in training and retraining (17%), product and process development (14%), or plant and machinery (10%). This is corroborated by results from the latest FSB Snap Poll for the South East. Whilst half of the surveyed companies do not plan to expand their business in the next 6 months, the majority of those who do plan to invest will focus on marketing and new products or services. **Innovation is being used more widely now to assist the recovery.**
- **The financial services and manufacturing sectors are most optimistic about future prospects,** with a quarter of companies nationally expecting the business climate to improve in the next 12 months. Companies in the hotels & catering and construction sectors are the least optimistic – at national level only 15% and 18% respectively expect a better business climate in the next 12 months.

# Sectoral Overview

**Manufacturing**

According to the Office for National Statistics, output in the production industries as a whole fell by 0.7% in the third quarter of 2009 compared with a decrease of 0.5% in the second quarter of 2009. GDP in the manufacturing sector dropped slightly, by 0.2%, compared to much larger falls of around 5% in previous quarters (2008:Q4 & 2009:Q1). Indeed, the Chartered Institute of Purchasing & Supply indicates that Britain's struggling manufacturing sector, particularly in the South East, may finally have begun emerging from recession with companies reporting increasingly high levels of business activity. The Markit UK Purchasing Manager's Index (PMI) for the manufacturing sector rose to 53.7 in October from 49.9 in September - the first reading above 50 since the recession began.[1] The latest Snapshot Business Survey for the South East (October 2009) corroborates those figures by highlighting that the worsening business performance has eased in the past 3 months. The proportion of respondents stating that their business performance had got worse fell to 21% in autumn 2009, compared to 54% in spring this year.

The latest EEF South East Business Trends report shows further improvement in business conditions for manufacturing and engineering companies in the South East in quarter 4 2009. Volumes of output and new orders increased significantly, with the net balance (difference between the proportion of companies reporting an increase and those reporting a decline) increasing to 9% for output (from -19% in Q3) and 16% for new orders (from -24% in Q3). The pace of employment decline has now eased, although levels of cashflow have worsened in quarter 4.

The depreciation of sterling along with the early recovery of major economies within the Eurozone have helped to give a boost to manufacturing. According to the Snapshot Business Survey the number of respondents reporting a higher level of export orders in the South East increased slightly between March and October this year. The downside is that the cost of imports is rising, especially raw materials such as metals and fuel. The Markit PMI indicates that the average input cost faced by firms operating in the South East private sector rose by 6.8% in October.

Anecdotal evidence suggests that banks are still reluctant to lend money to some manufacturing firms. The results of the latest Snapshot Business survey for the South East (October 2009) show that businesses in the manufacturing & construction sector have been increasingly seeking additional finance in the past 3 months, while in other sectors demand for credit has been static or declining.

According to the latest research from EEF, however, investment in innovation is helping Britain's manufacturers prepare for recovery. They are taking innovation out of the lab and into the heart of their businesses. In the South East, a number of R&D facilities in Surrey are being re-positioned as profit centres, tasked with selling services to external clients, as part of cost management activities. In Hampshire, the expectations are that businesses will use the introduction of new products as well as pricing and repositioning in order to boost their competitiveness in the current climate. There has also been a boost to innovation activity in Berkshire, where **Microchip Technology** has opened its European headquarters in Winnersh Triangle as part of a £100 million development scheme at the business park.

Within the manufacturing sector, aerospace and defence is holding up reasonably well for the moment, although tough conditions are expected in the region in 2010, before a recovery takes place in 2011. Some companies have seen an increase in turnover, although there are concerns about the rising costs of some raw materials and energy, as well as potential cuts in defence spending. Some companies are continuing to shed jobs and relying on sub-contracted labour instead.

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[1] Although it is worth mentioning that in recent months the PMIs have tended to be more optimistic than official statistics.

Elsewhere, as part of a cost reduction policy, the pharmaceutical giant **Pfizer** is planning to close its vaccine and bio-therapeutics research departments at Sandwich, Kent, and downsize the R&D staff at the Bath Road factory in Berkshire. Overall, the job losses will hit around 100 scientists and high-skilled employees.

**Construction / property**

At national level, GDP in the construction sector fell by 1.1% in 2009 Q3 compared with a decrease of 0.8% in the previous quarter. The sector recorded a fall of 13% between 2008 Q3 and 2009 Q3, which is the largest annual fall in GDP since the economic recession began.

Nevertheless, there are signs of recovery in the housing market. The latest RICS House Price Survey headline balance rose to 34% in October 2009, the highest balance since December 2006. The sales to stocks ratio, generally a good guide to future prices, rose for the 10th consecutive month to 29.7%, up from 29% in September.

At regional level the construction sector is still suffering from a lack of confidence in the market and uncertainty about the timing and scale of any cuts in Government spending on infrastructure projects. Hampshire Economic Partnership reports that property development is being severely hampered by the inability to secure funding for speculative schemes. This has a knock-on effect within the construction sector. More generally, banks reportedly remain risk-averse, in particular when lending to construction firms, though anecdotal evidence suggests the banks are less cautious than previously. Stiff competition for new work continues to squeeze profit margins as companies pare their prices down. There is continuing evidence of some construction companies reducing the size of their workforce. For instance, **AECOM** is to shed a further 350 jobs at its project management and engineering operations in the UK (Surrey, Kent) and Europe.

**Retail and hospitality**

According to the latest UK figures from the Office for National Statistics for the third quarter of 2009, output in the distribution, hotels and restaurants sector fell by 1% compared with a decrease of 0.4% in the previous quarter, with wholesaling and motor trades making the largest contribution to the GDP decrease at national level. However, there have been signs of some improvement in trading conditions in the sector more recently. The British Retail Consortium reports that total retail sales rose by 5.9% year-on-year in October - a good sign of consumer confidence ahead of the Christmas sales season. In Brighton, the Economic Partnership reports that retail sales were up 3.6% on the year to October. Moreover, the EEF Weekly Intelligence Briefing points out that the Government's scrappage scheme continues to boost demand in the UK motor trade, as new vehicle registrations rose by 13.6% from September to October this year. This positive tendency is likely to continue until the end of the holiday period as new car buyers are likely to bring forward their spending before the coming VAT rise next year.

The hotel and leisure sector in Berkshire has been particularly affected by the downturn in recent months, with fewer corporate bookings than previous years, although most visitor attractions and shopping centres are seeing increased footfall. For instance, Reading has seen, on average, a 3% increase in footfall and also a 3% average rise in car parking numbers while Windsor and Maidenhead has seen, on average, a 1% rise in car parking numbers. Town centre vacancy rates are below the national average in Berkshire and Milton Keynes. Elsewhere, **Travelodge** is to invest £47 million opening a further ten budget hotels, with the creation of 250 jobs, including sites in High Wycombe and Newbury among other locations across the UK.

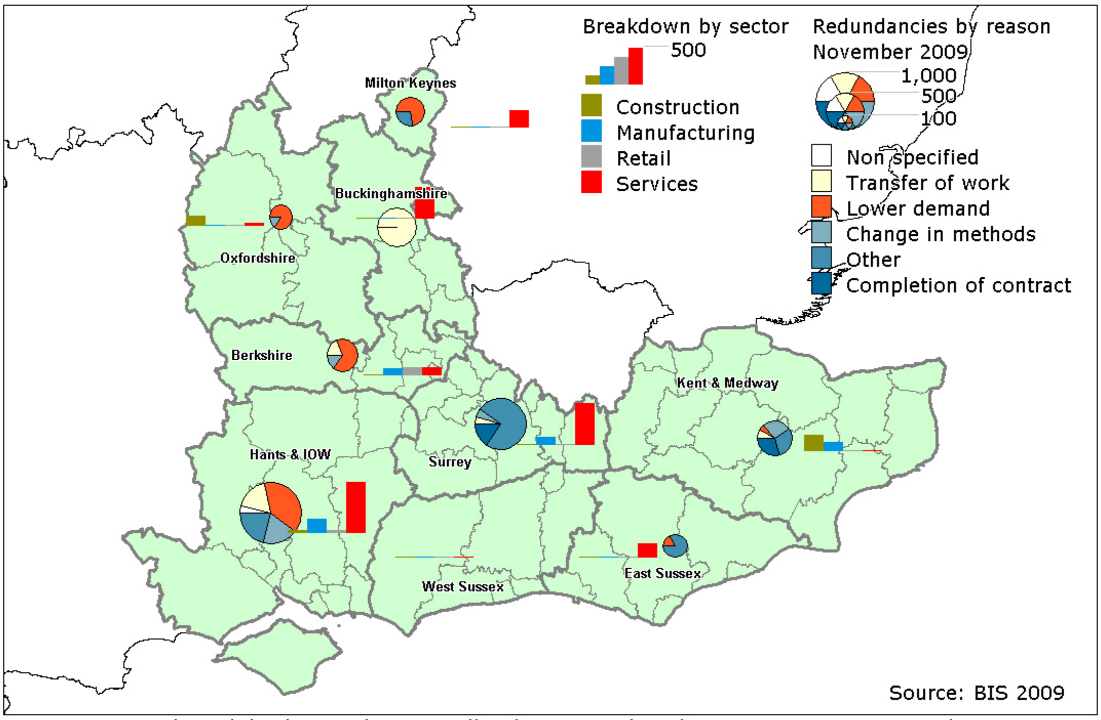
The sharp economic downturn has drastically affected the market shares in the retail sector as some companies have been better placed to face the liquidity squeeze than others. For instance, on the one hand, the company that owns **Threshers** and **Wine Rack** collapsed into administration in October, putting 6,500 jobs at risk in the UK, including more than 80 staff at these stores in Surrey who are likely to lose their jobs before Christmas. On the other hand, **Sainsbury's** is seeing the economic recovery as an opportunity to gain market share. It has recently announced plans to build a 64,000 sq ft store on the Medway City Estate at Strood, Kent, which would create up to 500 new jobs in the region if Sainsbury's gets the go-ahead to build the supermarket.

**Legal**
This sector continues to feel the effects of the recession, with loss of business in the City having a knock-on impact in the South East. Parts of the legal profession dealing with disputes or debt are reportedly busy, but overall performance is unpredictable with uncertainty about the timing of any recovery. Anecdotal evidence suggests that access to finance remains difficult for some firms.

**Rural**
In Hampshire the agricultural sector has reportedly been hardest hit by squeezed profit margins and a lack of investment opportunities. Obtaining sufficient capital for business expansion remains a key challenge. Input costs (particularly energy and fertiliser) have increased. Pay increases in the sector have been marginal. In Kent, agriculture is reportedly performing better than many other sectors, with livestock farming doing reasonably well.

**Redundancy Notifications:** According to HR1 data, the level of redundancy notifications increased marginally in November. There were approximately 2,000 redundancy notifications in the South East in October (full month) against approximately 2,400 in November 2009.[2]

**Redundancy notifications by sub-region, volume, reason and sector November 2009 (Source: HR1 data via BERR / Job Centre Plus)**






The service sector continues to account for the greater proportion of redundancies, totalling 70% of all notifications in November (an increase from 60% in October). The service sector accounts for around 70% of employment in the South East, so in effect the proportion of redundancy notifications in the service sector, though increasing, is now in balance with the share of total employment in this sector. Notifications in the manufacturing and service sectors saw an increase in November, with the construction and retail sectors reporting a decrease.

[2] Note that this data only captures redundancies of more than 20 employees; some of the job losses are not scheduled to take place until later in 2009; and in some cases the redundancies are happening in another region but are registered in the South East because it is home to the company's headquarters.

For the first time in three months East Sussex recorded some large redundancy notifications – approximately 150, all of which were in the service sector. The number of notifications in Berkshire fell significantly in November compared to the previous two months. In November Berkshire accounted for 10% of all large notifications compared to approximately one third in October and almost half in September. Hampshire and the Isle of Wight reported a significant increase, from 5% of all redundancies reported in October to almost 30% in November.