Regional Intelligence Snapshot for the South East

September 2009

Summary of economic conditions

- According to the latest Purchasing Managers Index (PMI) Survey, **business activity in the South East increased** in August, for the second month in a row. The rate of increase was the fastest since February 2008, but below the UK average. There was also **further growth in new orders,** but the rate of growth was slower than in July, and below the national average. Growth in incoming business was commonly linked to improving export demand, the results of marketing campaigns and new product launches.
- The EEF South East Business Trends report for Q3 shows **further improvement in business conditions for manufacturing & engineering companies.** Although the level of output, new orders and employment fell again in Q3, the pace of decline has now eased to a great deal. Levels of cashflow showed a significant improvement during the third quarter of 2009: the balance increased to 12% from -15% in Q2.
- Employment continues to fall in the South East, with the number of people in work dropping by 23,000 in the 3 months to July. According to the PMI Survey, **employment in the region fell for the fourteenth successive month in August**, but the pace of decline eased further. The fall in employment was the slowest since September 2008 and slower than the UK average.
- Unemployment continues to rise, with ILO unemployment up by 20,000 in the 3 months to July, while the claimant count increased by 3,070 between July and August. After falling during the summer months, **redundancy notifications increased in September,** to 2,350 (compared to 1,300 in August).

Key challenges and hotspots

- **Access to finance continues to be challenging**. However, according to the Institute of Chartered Accountants in England and Wales (ICAEW), credit appears to be more difficult to access for some sectors (such as construction and property) and less so for other sectors (such as retail).
- There is some anecdotal evidence that venture capitalists are starting to become active again, but feedback suggests that **banks are still reticent to lend, stifling companies' attempts to grow and develop into new markets**. There are inconsistencies in lending practices between different banks but also within the same banks, depending on the decision of regional managers.
- Continued cost cutting activities are unsustainable and could impede business growth in the longer term.

Business specific intelligence / information on key questions

- **Increasing raw material costs, particularly for steel, is becoming a major concern** as many manufacturers are dealing with suppliers who have been actively de-stocking as a strategy for surviving the downturn and now materials are either not readily available or at much higher price, particularly if being imported form the eurozone.
- **There are some tentative signs of improved business confidence.** Largely anecdotal evidence from businesses and business representative organisations supports a general feeling that the recession appears to be ending but most businesses do not yet anticipate this to translate into better economic conditions. **Firms are concerned about higher inflation in the medium term**, as well as the pending rise in VAT and the end of the car scrappage scheme.
- **Awareness of Government schemes to support business is reportedly low** and there is a need for improved understanding of lending conditions and terms.
- **Unemployment amongst 18-24 year olds in the South East has been rising over the past year**, at a faster rate than in the UK, but slower than the rate of increase in total JSA claimants.
- Survey evidence indicates **cautious investment intentions**. Capital investment and investment in training is set to fall, while firms expect to invest more only in marketing and sales avtivities, and in some cases product and process development.

Sectoral Overview

Manufacturing

In the South East, output, new orders, numbers employed, profit margins and investment were all higher in quarter 3 of 2009 than in quarter 2, according to the Engineering Employers' Federation's (EEF) latest Business Trends Survey. However, there are still more firms reporting declines in these indicators than reporting increases – what is happening is that the rate of decline is slowing down. The exceptions to this picture are prices charged to customers, which were significantly lower in quarter 3 than in quarter 2, and cashflow, which was significantly higher than in the previous quarter. Planning production is proving very challenging currently, as demand is very volatile due to de-stocking being followed by sudden restocking. Raw material costs have also been affected by de-stocking. Many suppliers ran down their inventories as a means of surviving the recession, with the result that materials are now either not readily available or only available at a significantly higher price (especially if imported from Europe).

At national level, EEF reports that manufacturers seem to have overcome the worst. In quarter 3 of 2009 the balance of firms reporting an increase in output and new orders against those reporting a decline was the highest since quarter 4 of 2008. With early signs of recovery in European economies, the exports balance improved in quarter 3 of 2009. There are still more firms cutting jobs than recruiting, but the pace of job shedding is slowing. Capacity concerns in some parts of the manufacturing sector mean that further major job cuts are largely on hold for now. In the South East, **BAe Systems** has announced it is to shed 111 jobs at its Farnborough base, following the closure of its Woodford aerospace factory near Manchester in 2012. Meanwhile, **HBC Engineering Solutions** is to shed up to 60 of the 108 jobs at its plastic injection moulding operation on the Isle of Sheppey, Kent.

There have been few signs of improvement in manufacturers' investment intentions in quarter 3 of 2009, despite cashflow picking up. Investment is usually slow to recover after a recession, but further delays in investment could raise concerns about the longer term productive capacity of the manufacturing sector. Nevertheless, manufacturers are less pessimistic about the outlook for the sector than they were in quarter 2 of 2009. Forward-looking output and orders balances in quarter 3 were at their highest level for over a year: 28% of firms expect to see an increase in new orders in the next 3 months, compared to 18% of those surveyed in quarter 2.

Motor trade

A number of firms report strong sales in September, as the scrappage scheme continues to sustain demand, particularly for smaller cars. Luxury cars for the super-rich have reportedly not been significantly affected by the recession. **Rolls Royce**, for example, reports that orders for its new model 'Ghost' are good. However, major de-stocking by motor manufacturers means that the supply of cars is still relatively small, which could prove problematic if demand continues to pick up. Nevertheless, all the major car plants in the UK are now back in production, and at some plants output is starting to show the first signs of an upturn. BMW is to produce two new Mini models at its car factory in Oxford, which could create an estimated 1,000 jobs. Demand is expected to flatten or reduce in the new year with the re-introduction of a higher rate of VAT. Demand for fleet vehicles is still suppressed. Meanwhile, some dealers have reported a steady demand for hire cars from occasional users who have decided that rental is better value than car ownership with low usage.

Construction / property

Output in the UK construction sector shrank for the 18th consecutive month in August; however, the rate of contraction was the slowest for 18 months. A key factor affecting the speed of recovery in this sector will be lack of capacity (as well as access to finance). Falling demand and consequent loss of skilled staff could mean that once the upturn comes many firms may not have sufficient capacity to respond. Sharp price inflation could also occur once demand picks up. Currently, fierce competition for new work is causing a squeeze on profit margins as firms cut prices to attract business, which is not sustainable. At the same time, there is concern that future Government spending cuts could affect public sector building projects. Business specific intelligence suggests mixed news in the sector this month. **RJ Barwick** has gone into administration with the loss of 110 jobs at its Dover-based construction business, while **Vinci** is to close its Crispin & Borst construction offices in Swanley, Kent, and the Thames Valley, as well as its Norwest Holst office in Winchester, Hampshire. On the positive side, **Swale Borough Council** has approved plans for the £20m expansion of Kent Science Park at Sittingbourne, which could lead to the creation of up to 500 jobs, and **Kilmartin** has unveiled proposals for the £325m transformation of Southampton's waterfront, including new shops, hotels and offices.

In the commercial property sector, it is proving difficult to secure tenants for both new and existing buildings. The risk of incurring empty property rates is also stifling much speculative property development. Smaller, flexible units are more popular with tenants, but less preferable for landlords due to the high potential churn of tenants and risk of incurring empty property rates. In the residential sector, there is still strong demand for quality houses, with estate agents competing to add these to their books. In the rental market, yields are still down, particularly for flats, due to an over-supply of buy to let properties.

Retail

Footfall is generally up on the year, but spending per head tends to be lower and sales volumes generally remain below average for the time of year (although total retail sales in Brighton are still holding up well, with a year-on-year increase in sales in August, while at UK level sales were down on the year). Heavy discounting is still common, especially in larger stores keen to clear seasonal stock. Food is largely sustaining the overall retail sales figures, with significant growth in sales of cheaper, value own brand goods in the major grocery chains. While jewellery sales are reportedly doing well, there is a mixed picture in fashion retail, with many less up to date brands struggling. While some retailers have gone into administration, enquiries for new leases are holding up quite well – particularly for seasonal space pre-Christmas. Some smaller landlords are reportedly starting to offer deals to attract tenants in time for Christmas. Online retailers are still tending to perform better than high street stores, as people compare prices and look for good deals on household goods online.

Despite relatively gloomy news on the high street, a number of retailers in the South East have positive news to report. **Menkind,** with head office in Dorking, Surrey, is planning to open a further 12 gifts and accessories stores by the end of October, while **Waitrose**, with head office in Bracknell, Berkshire, is planning to open up to 300 small convenience stores across the country, while a further nine outlets will open at Welcome Break service stations. A number of new stores will be opening in the region, including **Peacocks** in Dover, with the creation of 13 jobs, **Poundland** in Redhill, Surrey and **Dunhelm Mill** in Broadstairs, Kent.

Hospitality / tourism

Several parts of the region, such as Brighton and Hove and Hampshire, have seen little or no decline in visitor numbers year-on-year, with a particular increase in visitors from the EU given the favourable exchange rate, as well as more UK-based visitors. A Business Link survey in Surrey found that conference facilities and hotels in the county had a very poor August but saw an upturn in September, with an increase in bookings for the last quarter of 2009. However, the lack of long-term bookings for 2010 is a particular concern for wedding and conference venues. Hotels relying on corporate business are also reporting poor occupancy. Longer-term prospects are more promising, however, with several new hotel and leisure developments being announced in the region this month. **Xscape** has won approval to build a £40m hotel, casino and shopping centre at its site in Milton Keynes, with the creation of 200 jobs. Meanwhile, **Riviera Park Group** has unveiled proposals to build a £25m multi-storey holiday complex at Shanklin on the Isle of Wight. In the catering sector, 'gastropubs' are reportedly seeing an increase in bookings, especially at weekends when the weather has been good. More traditional pubs, by contrast, are faring less well, with a number of closures across the region.

Agriculture

Soft fruit producers in parts of the region reported a good season, with a good volume and quality of produce and no difficulties with recruiting pickers. However, profits for arable farmers are suffering because of a sharp drop in grain prices coupled with unusually high input prices. Volatility in global food markets makes farmers particularly vulnerable. The message last year that the world needed more food, coupled with the high prices achieved for grain in 2008, prompted an increase in production, which has now led to a significant over-supply of grain on the world market, and hence a reduction in prices.

Creative industries
There has reportedly been an increase in incentives for television production companies to take their business to northern England or Scotland, with companies that do remain in the south looking for discounts on studio space to offset the incentives they are offered to produce programmes elsewhere. On the positive side, there has been increased demand for studio space for events and activities, presenting studios with a good opportunity to diversify into this area.

Voluntary and community sector
A recent survey by Surrey Community Action of voluntary and community groups in Surrey found that the recession has had a negative impact on 70% of organizations. The main concern is loss of funding (from local authorities, the public and grant making trusts who are suffering because of the low interest rate). Staffing levels have been largely unaffected, with some organizations taking on more staff to cope with demand, and volunteer numbers generally being maintained (perhaps because people out of work wish to keep themselves occupied and learn new skills until they find paid work). More than half of voluntary groups in the county have clients with more complex needs than before – including issues relating to the recession, such as debt, unemployment and business failure. More than 40% of organisations are entering partnerships with others in the voluntary sector to help meet clients' demands.

Redundancy Notifications: According to HR1 data, the level of redundancy notifications increased in September, compared to a month on month decrease witnessed over the period June to August. There were some 1,300 redundancy notifications in the South East in August against 2,300 in September 2009.[1]

The service sector continues to account for the greatest proportion of redundancies, totalling three quarters of all notifications in September. For the first time in 2009, there were no large redundancy notifications recorded in the construction sector. One quarter of all redundancy notifications were in the manufacturing sector - a similar proportion to previous months.

For the second month running, there were no redundancy notifications in East or West Sussex. However, all other sub-regions, with the exception of Surrey and Oxfordshire, saw an increase in the number of notifications. Hampshire and the Isle of Wight have seen a marked increase in the number of redundancies in the service sector compared to the previous two months; the sub-region accounted for 30% of all notifications in this sector in September. Berkshire continues to be affected by job losses in the service sector, with approximately 20% of all redundancies in this sector being in Berkshire.

A drop in the number of notifications in the construction sector coincides with a drop in the number of redundancies attributed to the completion of contracts, perhaps indicating a reduction in the number of large scale construction projects. Lower demand continues to be the predominant reason given for redundancies stated, with over 30% of all notifications.

[1] 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.

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