heart of the south west
local enterprise partnership

HEART OF THE SOUTH WEST LOCAL ENTERPRISE PARTNERSHIP (HotSWLEP): LOCAL QUARTERLY BUSINESS BULLETIN SUMMARY, SUMMER 2019

With thanks to the wider business community in the HotSW area, for providing feedback about what are the important issues for you this quarter and your impressions on the local economy.
And particulalry to the following business groups who have kindly shared their data & thoughts in this Bulletin.

fsb Experts in Business

ICAEW SOUTH WEST

NFU

IoD Inspiring business South West

SWMAS (not correct version)

MANUFACTURING barometer

BCCSW British Chambers of Commerce SOUTH WEST

CBI LOGO to come

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EXECUTIVE SUMMARY

Summary (from David Ralph)
To draw out key conclusions & insights – to be drafted. Key points below

The Bulletin covers representatives from over 25,000 businesses across Heart of the SW

Nationally

- *Increasingly challenging global and domestic conditions leading to a reduction in business and consumer confidence and business investment. Some emerging evidence of late payment/cashflow issues emerging*
- *There is growth but the pace is slowing*
- *Some potential upside in sentiment amongst exporters even though overall export numbers have fallen*

Heart of the SW

- *Confidence particularly low; growth does remain albeit at lower levels. Sectorally, manufacturing is seeing more decline year-on-year*
- *Availability of the right skilled labour increasingly acute*
- *Business investment has remained steady but is forecast to decline in the coming months*
- *Higher staffing costs and inflation starting to add to pressures*
- *Significant downward move in beef and lamb prices coupled with rising input costs are threatening profits in the farming sector*

South West Business Confidence
Q2 2019 (April – June)

Overview:

Business confidence is consistently reported across a number of surveys to be deteriorating from a year ago, despite slight quarterly volatility linked to political developments related to Brexit; it is also shown to be at its lowest since the EU referendum. Q1 2019 has seen manufacturers stock-piling imported inputs and some of their own stock, and more generally the Article 50 extension in March and Parliament ruling out 'no-deal' Brexit temporarily boosted business confidence and output, before both falling again in Q2.

Global trade tensions are escalating, putting a strain on growth in exports, and costs are outpacing prices – despite inflation being at a 3-year low, and given a depreciation of the sterling –, which caused a restrain on recruitment and capital investment.

Pessimism is reported all across the board, as year-on-year confidence falls across all regions, and both across SMEs and larger companies. The South West region has amongst one of the lowest business confidence indices, with northern regions experiencing more positive readings.

UK Context:

ONS:

UK GDP contracted by 0.2% in Q2 2019, having grown by 0.5% in the first quarter of the year. This is weaker than market expectations and the latest Bank of England forecast, which were for a flat Quarter 2. The UK economy grew by 1.2% compared with the same quarter in the previous year, a slowing from 1.8% in Quarter 1 (Jan to Mar) 2019.

The path of GDP and some of its components has been particularly volatile through the year so far, largely reflecting changes in timing of activity related to the UK's original planned exit date from the EU in late-March. There is evidence that stockpiling was taking place in the first quarter of the year, which provided a boost to GDP, with the latest figures showing that these increased stock levels were partly run down in Q2 2019. Furthermore, it was also reported that a number of car manufacturers had brought forward their annual shutdowns to April as part of contingency planning.

In Q1 2019, the UK's employment rate was 76.1%, the highest estimate on record, while the unemployment rate fell to 3.8% – the lowest rate since Q4 1974. Despite such strong employment levels, average weekly earnings inc. bonuses increased by just 3.1% compared to a year earlier. On top of modest pay growth, households continued to rein in their borrowing in April, and the y-o-y growth rate of consumer credit is now 5 ppts below its peak of Nov 2016, with household borrowing in the midst of a cyclical downswing.

Bank of England:

Since May, global trade tensions have intensified and global activity has remained soft. This has led to a substantial decline in advanced economies' forward interest rates and a material loosening in financial conditions, including in the UK. An increase in the perceived likelihood of a no-deal Brexit has further lowered UK interest rates and led to a marked (4%) depreciation of the sterling exchange rate.

Evidence from companies suggests that uncertainty over the UK's future trading relationship with the EU has become more entrenched. Purchasing Manufacturers' Indices have fallen across a number of advanced economies over the past year. But the UK's composite output PMI is now at the bottom of a range of advanced economies, so the weakness is likely to also reflect an increase in Brexit-related uncertainties. One area of the economy where this effect may be apparent is in business services and finance, where output growth has slowed sharply. Evidence from the Bank's Agents suggests that a dampened appetite for investment in the UK has led to weaker demand for related professional services. The UK's financial account does show unusual weakness in foreign inflows of direct and portfolio investment in Q1. The labour market remains tight. Annual pay growth has been relatively strong. Consumer spending has remained resilient. CPI inflation (inc. households) was 2.0% in June and core CPI inflation was 1.8%.

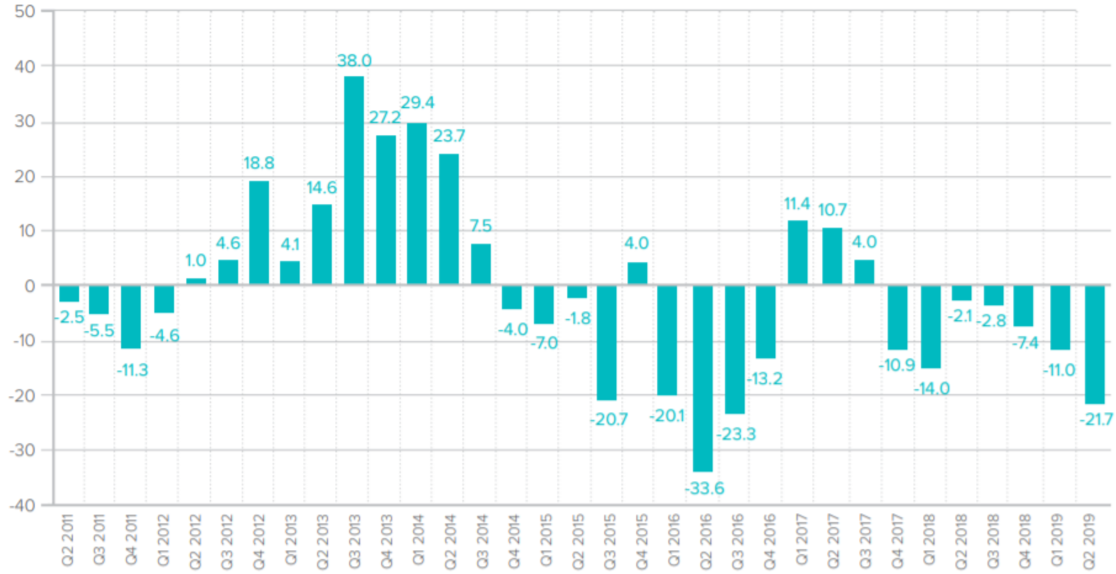
Federation of Small Businesses:

The UK economy experienced a notable uptick in economic growth in the first quarter of 2019. Indeed, while the latest quarterly data are superficially quite impressive, much of the reported increases in output were caused by businesses building up stockpiles of either imported inputs, for their production processes, or their own finished products. The UK has also felt the impact of a slowdown in growth around the world. Combined with uncertainty over Brexit, this has knocked the confidence of consumers and businesses alike. The combination has also had a profound impact on business investment, which fell every quarter in 2018, and is down by 1.4% when compared to the same period last year.

This lack of investment and consumer borrowing continues despite the Bank of England holding interest rates at just 0.5%. The annual rate of growth in the Consumer Prices Index (CPI) was 2.1% in April, up 0.2 percentage points from March, and now sits above the BoE target. Although some inflationary pressure is starting to build, it is likely to be tolerated by the BoE while the exact nature of the UK's future trading relationship with the EU is clarified. Businesses are likely holding back large capital investments for the same reason. As a consequence, UK productivity and growth are probably going to remain sluggish.

Business confidence among small firms fell back in Q2 2019 after a small rise in the previous quarter. The UK Small Business Index sits at -8.8, a decline of 3.8 points from the first quarter of 2019. Year-on-year, the index fell by 21.7 points, its largest annual drop since Q3 2016, when a fall of 23.2 was recorded in the wake of the EU referendum.

Figure three: Year-on-year change in the FSB Small Business Index.
Source: FSB - Verve 'Voice of Small Business' Panel Survey.



ICAEW:

Confidence is higher, on average, in Q3 than in Q2 2019, but there is a clear downward trend within the year.

Export growth has dipped, partly because of slower growth in the global economy. Companies expect that export growth will improve, despite the challenges created by Brexit. The number of companies running with spare capacity is now at 57%, and one in five businesses say that late payments are a growing challenge for their businesses. Regulations remain the fastest growing business issue, although less markedly than in recent quarters.

Costs are outpacing prices, and companies are therefore restricting employment growth to less than the increase in their sales volumes. New labour-saving technology is likely to be one factor making that possible. Profits are growing slowly, and with subdued confidence, investment is suffering. The increase in capital investment in the last year is the weakest since Q3 2011.

Negative business sentiment is now apparent in every business sector, with the sole exception of IT & Communication. Confidence is less negative among SMEs than among quoted companies, although the difference is not large. More striking is that a larger proportion (24%) of SMEs say that late payments are a growing challenge than is the case for quoted companies (13%).

British Chambers of Commerce Quarterly Economic Survey (QES):

"Over the last three months, the Brexit 'pressure valve' has loosened a little for some firms, but the overall picture is still one of an economy in stasis. (Dr Adam Marshall, Director General, BCC)

The Quarterly Economic Survey (QES) examines business sentiment on a range of forward looking indicators, including investment intentions, turnover confidence, and prices. In Q2 2019, these indicators point to the impact that relentless Brexit uncertainty, rising business costs and tougher global trading conditions are having on the UK economy, with continued weakness in the QES investment, cash flow, and domestic and export orders balances.

In Q2 2019, 10% more manufacturers reported growth in domestic sales than contractions – this is down from a balance of 15% in favour of growth in Q1. Services firms, on the other hand, were more likely to report growth in domestic sales in Q2 than in Q1, with a balance of 17% in favour of growth compared to 10% the previous quarter. The picture is similar in terms of export sales. Nevertheless, compared to the same time last year, both domestic sales and exports have continued to decline both for UK manufacturers, and for services firms.

"The continued weakness in the balance of firms reporting improved orders - both domestic and export - highlight the downward pressure firms face from the running down of excess stock, deteriorating global trading conditions and rising cost pressures." (Suren Thiru, Head of Economics, BCC)

The South West Picture:

ICAEW Business Confidence Index (BCI)

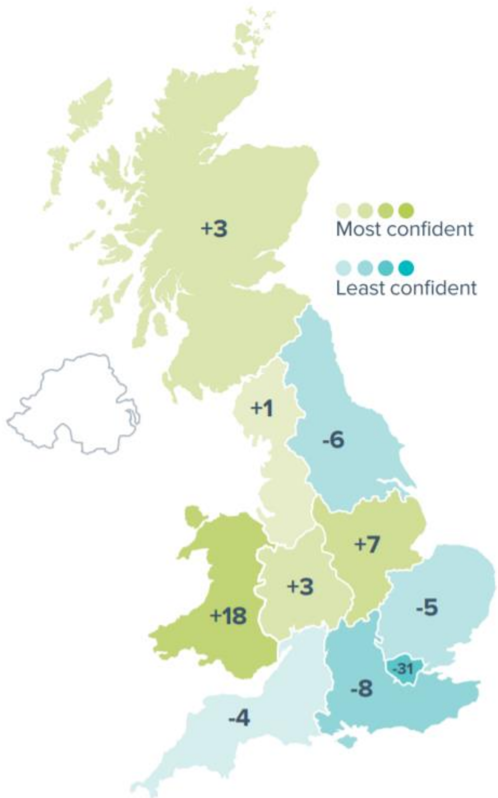
For the 4th consecutive quarter, the BCI in the South West is firmly negative, at -17.2. Businesses are facing a range of challenges, particularly in the labour market. The proportions of businesses citing the availability of non-management skills (27%) and staff turnover (23%) as a rising issue are both up from last year. This is likely to reflect tightness in the labour market. Indeed, the latest ONS Labour Force Survey data give an unemployment rate of just 2.4% in the three months to March 2019, the lowest across all UK regions.

Companies report more subdued domestic sales growth than a year ago. Domestic sales are rising by 2.7% in Q2 2019, compared to 4.5% a year earlier. Exports are faring a little better, increasing by 4.5% over the past year, compared to 2.9% a year ago. Given the sluggishness of domestic sales growth, businesses are struggling to achieve substantial increases in selling prices, with a rise of just 1.6% this year. This is notably slower than input price inflation (2.3%) and total wage growth (2.4%). Combined, all these factors are hindering profits, which are up by 3.3% year-on-year in Q2 2019, compared to 3.9% last year.

Despite these developments, the rate of investment growth remains broadly similar to a year ago. However, in the year ahead businesses look set to be markedly more restrained in their investment behaviour. Growth in R&D spending is expected to slow from 1.9% this year to just 0.4%. Companies also foresee a similar weakening in capital investment growth, from 2.2% this year to 0.8% in the coming 12 months. Businesses in the South West are also cautious about exports, which they expect to rise at the more modest rate of 3.3% in the year ahead. They are more bullish, however, in terms of domestic sales growth, projecting an increase of 4.9%. They expect this acceleration in domestic sales, if achieved, to help support a 5.1% rise in profits.

Federation of Small Businesses Small Business Index (SBI)

Pessimism across the board, as y-o-y confidence falls across all regions. Scottish small businesses recorded the largest q-o-q improvement in sentiment in Q2 2019. Increases were also recorded in the South West (+13.4 to an SBI of -4), the West Midlands (+8.8) and Wales (+4.4). Despite the large quarterly swing, all regions saw confidence fall compared to Q2 2018.



As the Article 50 deadline for the UK to leave the EU was extended, and Parliament indicated it was not willing to accept a no deal outcome on 29 March or 12 April that could have caused major disruption to business, it is possible that this inspired a major confidence boost among businesses. Nevertheless, the continuation of political uncertainty and slow economic growth are taking their toll across the board as confidence weakens in all parts of the UK.

IHS Markit Economics/ Natwest Purchasing Managers' Index (PMI)

Latest survey data indicated that business conditions remained relatively weak across the South West private sector in July. The NatWest PMI survey showed that business activity across the region fell at the steepest rate since October 2012. The sustained drop in output was widely linked to softer market conditions and muted customer demand. Total new business placed with South West private sector companies declined for the 5th month in a row. According to a number of monitored companies, Brexit-related uncertainty and delayed decision-making among clients had hampered sales. Furthermore, both manufacturers and service providers in the region noted lower order volumes.

A lack of new orders underpinned a further fall in outstanding business at South West private sector firms during July. Greater staffing costs and a weak sterling exchange rate were linked to a further marked increase in average input costs during July. This was despite the rate of inflation slipping to a near three-year low. Consequently, prices charged by private sector firms in the South West rose again. Subdued demand conditions and efforts to contain costs meanwhile led firms to reduce their headcounts for the first time since April.

SWMAS Manufacturing Barometer

Actual performance of manufacturing businesses in the last six months continues to underline the challenge Brexit and its associated uncertainty presents throughout the sector. Nearly a quarter of SME manufacturers experienced a reduction in sales and a third experienced a loss in profits. Moving towards a fifth of manufacturers reduced investment in machinery or premises, and nearly a fifth registered their active reduction in staff numbers.

Looking ahead to what the next six months holds shows gritty determination as just over half of the South West's SME manufacturers continue to anticipate an increase in sales, and the number forecasting recruitment of new staff recovers somewhat to 45% after last quarter's plummet.

Draw a trend line through the reported findings across sales, profits, investment and recruitment, and there is no doubt that the swing in performance continues to move downward. It is therefore unsurprising that nearly 20% Barometer respondents reference the need for certainty and nearly 15% define their immediate aspiration as 'survival'.

Where recruiting new skilled and motivated people into the business could be a strategy to enable growth, over 50% are finding this difficult (largely due to talent shortages, and attitude and salary expectations of the candidates) – just 2% say it is easier than this time last year. This suggests pragmatism and a shift in focus internally on what they already have and on three core areas vital to driving productivity: people, products and processes. Out of this, development of existing people and existing processes is getting the bulk of the attention, but there is also a desire to develop new products (a likely catalyst for new sales). This focus is reflected when you look at manufacturers' staffing strategies: nearly 70% say they will be deploying strategies to support the development of their existing people.

NFU 'State of the Farming Economy'

The UK farming industry's contribution (measured through Gross Value Added (GVA)) to the national economy fell in 2018 by 6% to £9.6bn. The last quarter has seen virtually all farm gate prices under pressure, with the exception of dairy, which remains broadly static. The HOTSW area has a large number of beef and sheep farmers and they have seen significant downward pressure on prices, with beef prices over 12% down since the start of the year and lamb prices were down by 12% in Q2. This has been compounded by price increases across the vast majority of inputs, which will for many eliminate any potential profit margin.

Total input costs have seen an overall increase of 5.0% in May 2019 compared with a year ago, according to the latest Defra's Agricultural Price Index. The annual increase is driven by price rises across the majority of inputs. The most significant of these were large increases in fertilisers (14%), electricity (12%), followed by fuels for heating and energy & lubricants both increasing 8% respectively.

The impact of Brexit remains a major issue hanging over the sector, both in terms of the manner of our exit and the future relationship with the UK Government through the Agricultural Bill. The immediate concerns are around our external tariffs and labour provision post October 31st, in the event of a No Deal Brexit.

Devon & Plymouth Chamber of Commerce Quarterly Economic Survey (QES)

Compared to the previous quarter, Q2 2019 has seen an improved outlook amongst Devon and Plymouth businesses. Domestic sales and exports have mostly either remained the same (cca. 41%) or increased (41%). Of those who exported (approx. 38% of respondents), 29% reported an increase in export sales over the period, 50% said they remained the same, and 21% reported a decrease; 43% reported an increase in the number of export orders.

Employment has remained broadly unchanged over the quarter, with only 31% reporting some increase in their workforce over the last 3 months, but 56% keeping it the same; 64% of respondents plan to put their recruitment on hold over the next 3 months. At the same time, 59% of respondents have said that they have attempted recruitment, and 64% of them have reported difficulties in recruiting.

Cash flows and capital investment appear to have deteriorated, however: 53% report that their cash flow remained the same, and nearly a third reported a decrease; 42% have held their investment in machinery and equipment unchanged, while a quarter have decreased their investment over the last quarter. Moreover, despite limited growth in employment, investment in workforce training has also broadly remained unchanged (67%).

Overall, business sentiment across Devon and Plymouth appears to be broadly in line with confidence nationally. Note, however, that this looks at changes between Q1 and Q2 2019 only, and information on the annual trend is not yet available.

CBI South West

A number of priorities have been raised by members across our region, with Brexit continuing to dominate concerns. It is clear that only a good deal with the EU protects jobs, communities and the economy in the South West. However, it is not only Brexit that concerns members in the South West. Our members have been clear that improving transport infrastructure is essential to ensure productivity rises, and the region receives its fair share of transport funding.

Top 3 issues for members in the South West: 1. Brexit; 2. Transport Infrastructure; 3. Ensuring the region has the right skills for the right jobs.

IoD South West

In the SW, the key local labour market challenges are: difficulties in attracting workers with the right skills/specific skills (66%), mismatch between education offerings and business needs (48%) and ageing demographics (34%). Top priorities for the Industrial Strategy are: improvements in existing infrastructure (53%), support for small businesses and start-ups (47%) and development of faster broadband infrastructure (43%). The South West is the region least confident in its ability to compete for trade, talent and investment from other regions/devolved administrations (compared to London and the South of England who are most confident).

The IoD's members in the South West remain optimistic about the future as we cope with the considerable raft of pressures globally, nationally and regionally. Yet, there are specific issues that continually feature in the priorities for our unique region – notably:

- Improvements to existing infrastructure, especially transport and broadband
- Competing (and with other regions) to attract the right skills into our enterprises
- Support for start-ups and SMEs – the engine of our future

These priorities are reinforced in the IoD's timely Policy Report of July 2019 – *Connected Economies, People and Places: A Blueprint for Local Growth in Post-Brexit Britain.* As the title suggests, this looks beyond Brexit and aims to give much more impetus to the 2017 Industrial Strategy by recognising the potential for Local action, each with a different, regional emphasis… the IoD sees that the LEPs are critically important and one of our report's 8 recommendations to central government gets to the point: *Develop LEPs/Growth Hubs to become regional anchors for business support…*

FEEDBACK FROM THE HotSW BUSINESS COMMUNITY – WHAT ARE YOUR TOP THREE ISSUES?

Each quarter the LEP ask the wider business community what the key issues faced are, with the intelligence is used to improve policy and decision making.

The top three issues have remained roughly the same for the last year or so, with the only change being a slight shift in the order of priority. This ranking is also reflected in a number of other surveys from across our area, with ***labour supply and the right skills being reported as the most pressing issues*** (and this is across all business sizes / sectors). And with many businesses saying that this is being compounded by BREXIT and particularly the uncertainty surrounding leaving the EU.

1. Workforce – people, including:

Restricted labour pool; Restricting growth potential (because of tight labour supply), attracting people to the area, demographic affect.

2. Brexit, including:

Uncertainty and final outcome; Labour pool (inc. availability of skills); Agricultural policy.

3. Workforce – skills & Training, including (very close 3rd to Brexit)

Finding / keeping people with the right skills; training - Apprenticeships, Higher level / HE, etc; Careers advice / schools; Digital.

4. Infrastructure - other, including:

Lack of public transport; Roads; Rail; Commercial development; Housing; Large projects.

5. Digital Infrastructure, including:

Digital connectivity; Broadband - access and speed; Mobile connectivity; Telecoms investment.

6. Jointly shared between:

Increasing cost / bureaucracy of doing business, including:

Increasing costs; Regulations inc. GDPR & Business rates.

And

Financing - for businesses:

Including access to finance and finance ready.

(The 20 organisations that provided feedback, together represent more than 25,000 businesses)

Overview of HotSW's Economy

GVA (2017)

Real (CVM, 2016 prices): 34.7bn (+0.6% v. UK +1.9% on 2016)

Nominal (CP): £35.3bn (+2.2% v. UK +3.7% on 2016)

Productivity

Nominal GVA per hour worked: £27.9 (82.9% of the UK average); +2.9% 2016 to 2017 v. UK +2.5%

Real GVA per FTE job: £44,084 (73% of the GB average); -1.2% 2016 to 2017 v. GB +1.2%

FTE Jobs

FTE Jobs: 721,378; +1.9% 2016 to 2017 v. GB +0.6%

Earnings

Gross median FT wages per week (workers): £498.3 (87.6% of the UK average); +2.0% 2017 to 2018 v. UK +3.5%

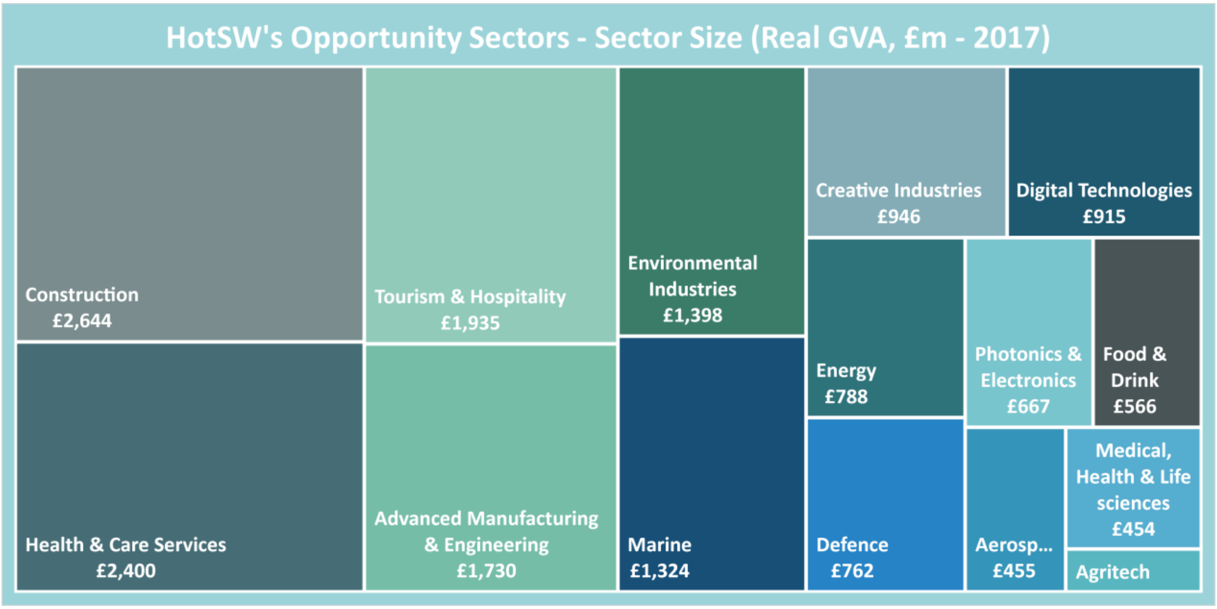
Inclusive Growth

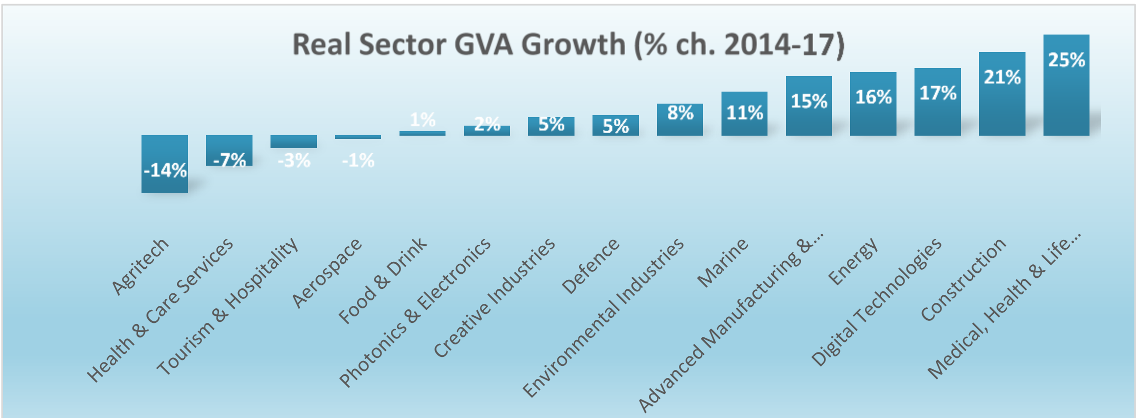
Earnings (bottom 25% of working residents)

Gross median FT wages per hour week (residents): £383.3 (93% of the UK average); +2.6% 2017 to 2018 v. UK +3.1%

Household Income

Gross Disposable Household Income (GDHI) at current basic prices per head: £18,071 p.a. (92.6% of the UK average); -0.08% 2016 to 2017 v. UK + 0.99%





IMPACT REPORT

To show impact of LEP investments – work in progress to be completed by end September

LINKS TO SURVEYS