heart of the south west
local enterprise partnership

Quarterly Business Bulletin
Winter 2021/22

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Executive Summary

David Ralph
HotSW LEP Chief Executive

Hello and welcome to our Winter Business Bulletin which offers a digest of intelligence from national and local partners specifically reflecting the Heart of the South West.

Every bulletin seems to bookend a period of significant change! I think I can summarise the current situation as a high degree of volatility and uncertainty in the short term, a more positive outlook starting to emerge against major headwinds with the persistence of underlying challenges but also opportunities.

With the sudden emergence and then fairly rapid subsidence of the Omicron variant, we are seeing a return to the conditions prevalent earlier in the autumn. Businesses and data are reporting that the headwinds of rising costs, severe labour & skills shortages and supply chain blockages are back with a vengeance. Vacancies are at a record high nationally and the local labour market is very much back to its pre-pandemic status as one of the tightest in the UK. All this means we are some way from the stable conditions businesses need to be able to plan and invest with confidence and sentiment is volatile as a result.

Despite these challenges, GDP is continuing to recover, albeit at a slower rate than earlier in 2021, and is now 1.5% below pre-pandemic levels, after falling around 19.6% at the start of the pandemic (Q2 2020). Businesses, especially in manufacturing but across other sectors, are reporting strong order books and I continue to be optimistic for the future.

Outside the specific, and often acute challenges now facing the economy and businesses, I have a deeper anxiety over the level of growth we can expect in the medium term; historically 2-2.5% growth per year was typical but we are currently looking at 1-1.5%. What might not appear a major difference fundamentally weakens the longer term prospects for increased prosperity for people in this area; not only are these gains more than exceeded by the current inflation rate, but over a longer period they result in people being worse off.

I can summarise the current situation as a high degree of volatility and uncertainty in the short term, a more positive outlook starting to emerge against major headwinds with the persistence of underlying challenges but also opportunities

More than ever, a tight labour market means medium and long-term growth must be driven by increased in productivity. This may sound a theoretical concept but fundamentally it means investment; investment in better skills, in supporting the creation of new products and services, in adopting new digital ways of working, in accessing new markets in the UK and overseas, and in nurturing the key growth sectors of the future. And across all these, investing to ensure that everyone has the has the opportunity to contribute to and benefit from that growth.

I have a deeper anxiety over the level of growth we can expect in the medium term

Of course we need to safeguard jobs, and we know the indebtedness of firms has increased and economic outlook is uncertain, but achieving good growth requires sustained, long term commitment. The LEP has set out a vision for the area in the Build Back Better plan and will be working hard to deliver this in the coming months, aiming to accelerate good growth to help pay for the ever-increasing challenges of health and social care, other good quality public services and, ultimately, to help raise prosperity of people of this area.

In that vein, the long-awaited Levelling-Up white paper has finally been published. Formally putting the long-standing issue of geographic inequality at the heart of Government thinking is to be welcomed and many of the specific policies such as the commitment to increase R&D investment outside the south east will help address this. But it's unclear if the scale of investment will really address these structural issues and this is absolutely a long term project. Much has been made of the relative success of Germany in integrating the former eastern half and raising productivity there from 60% to 85% of western Germany; this has taken thirty years of consistent and high levels of investment – around £70 billion a year over that period. The white paper is a positive step, but there is so much more to be done to make a difference to people's everyday lives.

More than ever, a tight labour market means medium and long-term growth must be driven by increased in productivity… fundamentally that means investment

Closing the productivity gap between the old east and west Germany has taken around £70 billion a year over 30 years

So I hope you enjoy perusing the insights in this Bulletin. Alongside it we have also published graphic summaries of the HotSW economy in our new suite of dashboards, available at

Economy dashboard - Heart of the south west LEP (heartofswlep.co.uk) and Clean Growth dashboard - Heart of the south west LEP (heartofswlep.co.uk)

The Bulletin wouldn't be possible without the support of all those in our partner organisations who help us bring these Bulletins together and a special thanks to these partners who represent over 25,000 businesses across our patch.

The National Picture

Summaries and Extracts from Key Reports

NB We have used the most recent data available at the time of the production of this Bulletin and thus, some reports refer to different 'quarters'.

ONS, GDP quarterly national accounts, UK: July to September 2021

ONS, GDP monthly estimate, UK: November 2021

GDP quarterly national accounts, UK - Office for National Statistics (ons.gov.uk)

GDP monthly estimate, UK - Office for National Statistics (ons.gov.uk)

UK GDP increased by 1.1% in Q3 2021, following the 5.5% growth reported in Q2 2021. The level of GDP in the UK is now 1.5% below where it was before the pandemic (Q4 2019).

Services output rose by 1.4% in Q3 2021, and is now just 0.6% below Q4 2019 pre-pandemic levels. This growth was primarily driven by output increases in accommodation and food services, and the arts, entertainment and recreation sector due to the relaxation of most public health restrictions in July 2021. In November 2021 alone, services output increased by 0.7%, largely driven by professional, scientific, and technical activities, which grew by 2.5% in the same month due to increases in architectural and engineering activities, and technical testing and analysis, as work was brough forward towards the end of the year.

Production output decreased by 0.1% in Q3, driven by electricity, gas, steam, and air conditioning supply, which fell by 7.3%. In November 2021 however, production output increased by 1%, following two consecutive months of output decreases. The largest contributor to production growth in November was manufacturing, which grew by 1.1% over the month.

Following four consecutive quarterly increases, construction output fell by 1% in Q3 2021, and is now 2.1% below pre-pandemic levels (Q4 2019). However, in November 2021, construction output increased 3.5%, the largest monthly rise in output growth since March 2021.

Household consumption increased 2.7% in Q3 2021, reflecting the easing of public health restrictions over the quarter. Household consumption is now 2.1% lower that its pre-pandemic level (Q4 2019).

Government consumption decreased by 0.5% in Q3 2021, with the consumption of health services having fallen by 1.6% over the same period.

The above figures for Q3 2021 were released by the ONS in December 2021. The figures for Q4 (October to December 2021) is due to be released by the ONS in February 2022. The monthly estimate figures for December 2021 is also due to be released in February 2022.

ONS, Labour Market Overview, UK: January 2022

ONS, Vacancies and jobs in the UK: January 2022

Labour market overview, UK - Office for National Statistics (ons.gov.uk)
Vacancies and jobs in the UK - Office for National Statistics (ons.gov.uk)

Estimates indicate that in December 2021, there were 29.5 million payrolled employees in the UK. This figure has increased by 184,000 from November 2021, and is up 409,000 from its pre-pandemic level (February 2020). From mid-2016 until 2019, annual growth in the number of employees remained between 1% to 1.5%, and therefore the recent increases in growth rates in late 2021 signifies a return to the trends seen before the pandemic.

The latest Labour Force Survey estimates for September to November showed that the employment rate had increased by an estimated 0.2 percentage points to 75.5%, whilst the unemployment rate had decreased by 0.4 percentage points to 4.2% on the quarter. The economic inactivity rate rose by 0.1 percentage points to 21.2% over the same period.

Job vacancies increased to a new record of 1,247,000 in October to December 2021, a rise of 462,000 from the pre-pandemic (Q1 2020) level. The rate of growth varied across industries, with the highest rates seen in mining and quarrying (21.4%) and accommodation and food service activities (17.2%), whilst real estate activities saw a contraction in growth by 10.9%.

Office for Budget Responsibility, Economic and fiscal outlook – October 2021

[Economic and fiscal outlook - October 2021 - Office for Budget Responsibility (obr.uk)]

The Office for Budget Responsibility's (OBR) October 2021 forecast, published in conjunction with the Government's Budget and Spending Review, provides some of the most up to date information available on the projected future impact of the pandemic on the UK economy.

Despite high numbers of coronavirus cases, the economy has reopened largely on schedule, and output has recovered faster than expected in the March forecast, primarily due to the successful vaccine rollout.

In October, the OBR expected that the economy will have grown by 6.5% in 2021, 2.4 percentage points faster than predicted in the March forecast.

Unemployment was projected to increase to 5.25% over the remainder of 2021, 1.25 percentage points lower than set out in the March forecast.

However, this predicted unemployment rate is still higher than the estimated rate reported by the ONS for September to November 2021, which was 4.1%.

These figures have contributed to the budget deficit almost halving to £183 billion in 2021-2022, £51 billion lower than in March.

In the UK, supply constraints have been noted in several markets, exacerbated by changing trading regimes following Brexit. These, alongside increased energy prices and labour shortages observed across many occupations, are expected to constrain output growth in the coming quarters.

CPI inflation is projected to reach 4.4% next year, although updated OBR predictions following the publication of the October forecast suggest inflation could peak closer to 5% over the year.

Bank of England, Monetary Policy Report – November 2021

[Monetary Policy Report - November 2021 | Bank of England]

The Bank of England's 'monetary policy report' published on the 4th of November 2021 outlined projections for the UK economy for the coming months.

The Bank estimated that UK GDP increased by 1.5% in Q3 2021, at a slower rate therefore than predicted previously in their August report. However, official figures released by the ONS for Q3 (see above) demonstrate that GDP actually increased by 1.1%. The Bank cited disruption in supply chains as having restricted activity over Q3, and that these supply issues are expected to constrain growth in the near term. UK GDP is projected however to return to pre-pandemic levels (Q4 2019) in the first quarter of 2022.

The number of jobs furloughed immediately before the end of the Coronavirus

Job Retention Scheme (September 2021) was estimated to have been over a million, a significantly higher number of jobs than predicted by the Bank in the August Report. Despite this, a corresponding increase in redundancies was not seen, although there is still considerable uncertainty as to how the unemployment rate will be affected in the coming months

CPI inflation, which was previously reported as 3.1% in September 2021, is expected to increase further in the near term. This is accounted for by the continued rise in consumer goods prices, and the expectation that energy prices would also increase. As a result, the Bank expected CPI inflation to reach 4.5% in November 2021 and remain around that level until the end of the first quarter of 2022, before likely rising to around 5% in April 2022.

Bank of England, Agents' Summary of Business Conditions – 2021 Q4

Agents' summary of business conditions - 2021 Q4 | Bank of England

The Bank of England's Agents' Summary of Business Conditions report summarises intelligence gathered by the Bank's agents between mid-October and late November 2021, and therefore was largely compiled before the emergence of the Omicron variant and subsequent Government measures implemented as part of the effort to control the spread of Covid-19.

Consumer demand: Retail sales had seen a steady growth over the reporting period, although the ranges available for some goods was limited by supply shortages. Across the hospitality sector, labour shortages led to restricted services, which constrained growth.

Manufacturing: Demand was high over the quarter, although output growth slowed due to shortages of labour and materials. The Bank's contacts within the sector reported that supply chain disruption was likely to persist into 2023, as bottlenecks are expected to unwind at different paces.

Construction: Construction output similarly slowed as shortages in materials and labour, and increases in costs, impacted activity. Due to these challenges, some contacts revealed there was caution around committing to new developments in the short term.

Investment: Investment intentions continued to recover, as companies sought to increase efficiency and relieve capacity constraints.

Corporate finance: Credit demand was reportedly weak over the quarter, reflecting a limited appetite among firms to take on more debt, and strong investor desire for issuance in debt and equity markets seen by large corporates.

Employment & pay: Employment intentions picked up and recruitment difficulties became more widespread and acute even beyond the end of the furlough scheme, which lead to further upward pressure on pay. Staff shortages were reported to be particularly strong in professional services, hospitality, logistics, distribution and warehousing, construction and engineering.
Many of the Bank's contacts expected upwards pressure on pay growth to continue into 2022, as the labour market is expected to remain tight and recent increases in consumer price inflation could encourage workers to demand larger pay settlements.

SWMAS, National Manufacturing Barometer Q2 2021/22

National Manufacturing Barometer Report (Q2 2021) | SWMAS

The Manufacturing Barometer for Q2 2021/22 surveyed small and medium-sized manufacturing businesses in the UK, covering July, August and September 2021.

For the first time in over a year, the percentage of respondents that reported having seen an increase in trade levels was higher than the percentage who reported seeing reduced trade.

- **60% of respondents reported that sales turnover had increased over the six months before the survey, and 64% expected to see turnover to increase over the next six months.**
- **38% of businesses had seen their profits rise over the previous six months, whilst 43% expected to see profits increase in the coming months. However, this figure has decreased over the last two quarters from 52% expecting to see increases in Q4 2020.**
- **45% of respondents reported that their staff numbers had increased over the past six months, and 50% expected numbers to increase over the next six months.**

Despite the positive predictions, manufacturing businesses were still experiencing significant supply chain challenges, with 64% of respondents seeing extended lead times, 62% reporting increased stockpiling of key products, 58% looking to purchase bulk quantities, and 51% increasing product prices as ways of protecting profits.

Businesses also reported recruitment struggles, with 73% of respondents facing difficulties recruiting skilled staff including managers and leaders. This is believed to have been caused by shortages of relevantly trained staff, increased salary expectations and shortage of available labour.

ICAEW, UK Business Confidence Monitor: National – Q4 2021

UK Business Confidence Monitor: National | ICAEW

The ICAEW's latest report utilised data gathered from the 19th of July to the 15th of October 2021. This showed that overall, business confidence for the next 12 months has weakened slightly compared with Q3, although it generally remains very high. Companies surveyed reported that they expected to see sales growing strongly over the next year, but less so than they believed during the previous quarter.

The small decline in the quarter likely reflects the challenges businesses have experienced, including rising costs, supply chain disruptions, and difficulties with skill availability.

Confidence levels varied between sectors, with IT & Communications, Transport & Storage, and Business Services companies the most confident about future business conditions. Meanwhile, Manufacturers, and Retailers & Wholesalers, expressed the least confidence. These differences reflect the variations in the extent to which these sectors are impacted by recent business challenges.

British Chambers of Commerce, Quarterly Economic Survey – Q4 2021

QES report Q4 2021.pdf (britishchambers.org.uk)

The British Chambers of Commerce's Quarterly Economic Survey for Q4 2021 utilised data gathered between 1st and 22nd November 2021. The report highlighted that economic recovery stalled in Q4, with businesses facing inflationary pressures that increasingly limited activity.

The Chamber reports that the record rise in price pressures suggests that a considerable inflationary surge is likely to be seen in the coming few months, with rising material costs, increasing energy prices, and the reversal of VAT reduction for hospitality expected to drive inflation above 6% by April 2022. Staff shortages and reluctance to spend amongst consumers due to the rise in numbers of the Omicron variant and the introduction of Plan B means that UK GDP could be seen to fall in the near term.

Key findings reported from the manufacturing sector included:

- **The percentage of manufacturers reporting increased domestic sales in Q4 2021 stood at +22%, a reduction from the +28% reported in Q3 2021.**
- **The percentage of firms reporting increased export sales in Q4 2021 stood at +9%, up from +7% in Q3 2021.**
- **The percentage of manufacturers reporting increased cash flow in Q4 stood at -1%, a reduction from the +7% reported in Q3 2021.**
- **The percentage of firms reporting increased investment in training in Q4 2021 stood at +18%, up from +17% in Q3 2021.**
- **Confidence that turnover will increase in the next 12 months stood at +50%, a slight decrease from the +52% reported in Q3.**

Key findings from the services sector included:

- **The percentage of firms reporting increased domestic sales stood at +26%, down from +31% in Q3 2021.**
- **The percentage of firms reporting increased export sales stood at 0% in Q4 2021, down from +6% in Q3.**
- **The percentage of firms reporting improved cash flow stood at +9% in Q4 2021, down from +12% reported in Q3 2021.**
- **The percentage of firms reporting increased investment in training stood at +18%, slightly down from +19% in Q3.**
- **Confidence that turnover will increase in the next 12 months has decreased slightly to +45% in Q4, from +52% in Q3.**

British Chambers of Commerce, Quarterly Recruitment Outlook – Q4 2021

Record High in Firms Reporting Difficulty Finding Staff - Quarterly Recruitment Outlook (britishchambers.org.uk)

The results from the BCC's latest Quarterly Recruitment Outlook survey for Q4 2021 shows that the proportion of businesses struggling to recruit staff has reached new record levels.

The proportion of firms attempting to recruit staff over Q4 was 64%, an increase from 61% in Q3. Alongside this, the proportion of firms reporting difficulties in filling positions reached a historical high at 79%, an increase from 77% reported in Q3.

The sectors most likely to report difficulties were the construction and hospitality sectors, at 83% each. By comparison, marketing and media firms were the least likely to report challenges at 70%, a proportion that is still historically very high for these sectors.

The Local Picture

ONS, Labour market in the regions of the UK: January 2022

[Labour market in the regions of the UK - Office for National Statistics]

The South West recorded the second highest employment rate in the UK at 78.8% over September-November 2021, compared to the national average of 75.5%. The South West also saw the employment rate increase by 1.1 percentage points since the previous quarter, the largest increase in the UK.

The unemployment rate in the South West in September-November 2021 was 3%, the second lowest rate in the UK. By comparison, the unemployment rate in the UK over the same period was 4.1%. The rate in the South West had dropped 0.5 percentage points since the previous quarter, only slightly more than the UK average, which had dropped by 0.4 percentage points. Similarly, the change in the unemployment rate in the South West since September to November 2020 was -1.1 percentage points, compared to -1.0 percentage points recorded for the UK as a whole.

The South West inactivity rate was 18.7% in September-November 2021, representing a 0.8 percentage point decrease from the last quarter, compared to the UK inactivity rate of 21.3%, representing a 0.2 percentage point increase from June to August 2021. The rate in the South West had fallen 0.7 percentage points since the same time the previous year, whilst the UK figure had increased by 0.3 percentage points over the year.

FSB, South West Quarterly Small Business Index – Q4 2021

The Federation of Small Businesses (FSB) noted in their latest quarterly Small Business Index a marked fall in levels of business confidence among SMEs in the South West. Confidence levels reportedly fell to -22% in Q4, from 9% in Q3, meaning that the South West has gone from being one of the most optimistic regions for SMEs in the summer of 2021, to sentiment being the second lowest in the UK in the fourth quarter. The fall in business confidence may be reflective of the uncertainty associated with the spread of the new Omicron variant.

In Q4 2021, the overall net balance for gross profit for small businesses in the South West was negative (net -10%). This represents a decline since Q2 2021 when the net average was 9%, and shows the South West to be one of the most negative regions in the UK over Q4 in terms of gross profit.

The outlook for future gross profit in the South West was also negative in Q4, with 45% of small businesses expecting to see a decrease in profits over the coming quarter, compared to 28% expecting an increase, leaving a net balance of -17% for predicted gross profit changes. This had fallen steeply since Q2 when the net balance was 19% in the region, and shows sentiment was much less optimistic in the South West than the UK average (-3%) at the end of 2021.

Employment within South West small businesses was net positive (1%) in Q4 2021, and 15% of business intending to increase staffing levels over the coming quarter. 65% of small businesses also reported that they had increased their average salary over the past 12 months, with 58% reporting an average increase of 2% or above. 72% of small businesses also expected to see salary increased over the coming year.

Investment intentions for small businesses in the South West were above the UK average in Q4 2021, with the net balance of firms expecting to see increases over the coming quarter standing at 19%.

The greatest perceived barriers to growth in the coming year in the South West were the general economic conditions in the UK, with 62% of businesses expecting this, followed by acquiring appropriately skilled staff (38% of businesses) and consumer demand (33% of businesses).

13% of small businesses in the South West also reported that they intended to downsize, sell, or close the business in the coming 12 months, representing a slight rise from Q3, when 11% reported an expectation to contract.

SWMAS, South West manufacturing Barometer – Q2 2021/22

Q2 2021 Manufacturing Barometer - South West Report_0.pdf (swmas.co.uk)

The latest South West Manufacturing Barometer for Q2 2021/22 reported data collected from SME manufacturing businesses between July and September 2021.

Turnover: 56% of respondents stated that their sales turnover had increased over the past six months, whilst 16% saw turnover decrease. 58% of manufacturers reported that they expected sales turnover to increase over the coming six months, a reduction from the previous quarter when 69% expected to see an increase. 16% expected to see turnover decrease in the next six months, an increase from the 7% recorded for the previous quarter.

Profits: Figures were less mixed for profits, with 35% of manufacturers reporting an increase in profits, and 30% reporting a decrease in profits over the previous six months. The proportion of manufactures expecting to see profits increase over the coming six months was the same as the proportion expecting to see a decrease: 36%.

Employment: 48% of respondents saw staff numbers increase over the past six months, and 50% expected to see staff numbers increase over the coming six months. By comparison, only 5% of respondents expected to see staff numbers decrease in the next six months.

Capital Investment: 46% of manufacturing businesses had increased their investment in new machinery or premises over the previous six months, compared to 9% who saw decreases in investment. 58% expected to increase investment in the coming six months, whilst 9% expected that investment would decrease in the coming six months.

Resources: When asked about their actions taken to overcome supply chain challenges, 67% of respondents reported that they extended lead times, 60% increased stockholding of key products, and 58% purchased bulk orders.

Recruitment: 52% of respondents had lost skilled staff, including managers and leaders over the previous 18 months, and only 15% of respondents had managed to replace all staff lost over that period – 10% lower than the national figure.

Significantly, 53% of manufacturing businesses reported that they were trading at increased levels compared to their pre-pandemic position, and the proportion of respondents reporting that they were trading at increased levels in Q2 2020/21 was the highest it had been since the Barometer began to be published in October 2020.

NatWest, South West Purchasing Managers' Index (PMI) – January 2022

NatWest | PMI survey: South West (natwestbusinesshub.com)

The latest PMI survey collected data from South West businesses during the second half of December 2021. The report noted that the Business Activity Index, which measures the monthly change in output of regional manufacturing and service sectors, fell from 54.6 in November 2021 to 52.3 in December. December also saw the softest rate of expansion for nine months, with growth in the South West lower than the UK average. A number of businesses linked this slowdown to the emergence of the Omicron variant and increased hesitancy to spend amongst clients.

Private sector firms in the South West experienced average input prices increasing for the nineteenth month running in December, at a rate higher than the national average. Higher cost burdens were often linked to increased transport, fuel, raw material, and staffing costs. Against the backdrop of rising costs, firms in the South West reportedly increased their selling prices towards the end of 2021.

Regional Chambers of Commerce: Somerset Chamber of Commerce perspective

As we move out of the latest COVID restrictions, businesses will want to know what the Government's longer-term contingency plans are to support firms should a new variant create a fresh wave of serious infections and require restrictions. Businesses reported confusion and loss of confidence at the onset of Plan B when no accompanying support was announced. Although a financial package was subsequently provided by the Treasury, being clear on what support will accompany which restrictions ahead of time will help maintain business confidence.

Feedback from members shows maintenance of testing capacity must be a priority for Government, as the supply must remain consistent to maintain consumer confidence and avoid unnecessary absences. Chambers are advocating that Government must also make positive interventions to power forward our economic recovery, by making strides on key issues such as growing our export base and levelling up local economies.

The British Chambers of Commerce (BCC) has set out a manifesto to recruit legions of new UK exporters as its research continues to show poor overseas trade growth. Exporters are uniquely facing a wide range of issues, from unprecedented inflationary pressures and global supply chain crises to a raft of new requirements flowing from the EU trade deal. The manifesto sets out a comprehensive list of steps to get more UK businesses, currently just 10%, involved in international trade. This compares to more than 60% of companies which are members of an Accredited Chamber of Commerce.

Feedback also points to more needing to be done to support UK companies that have had to battle with rocketing costs, disrupted supplies and increased paperwork for trading in Europe. If we all work together to take action then we can revitalise our exports growth and help power the UK's economic recovery.

ICAEW Business Confidence Monitor (BCM): South West – Q4 2021

South West | ICAEW

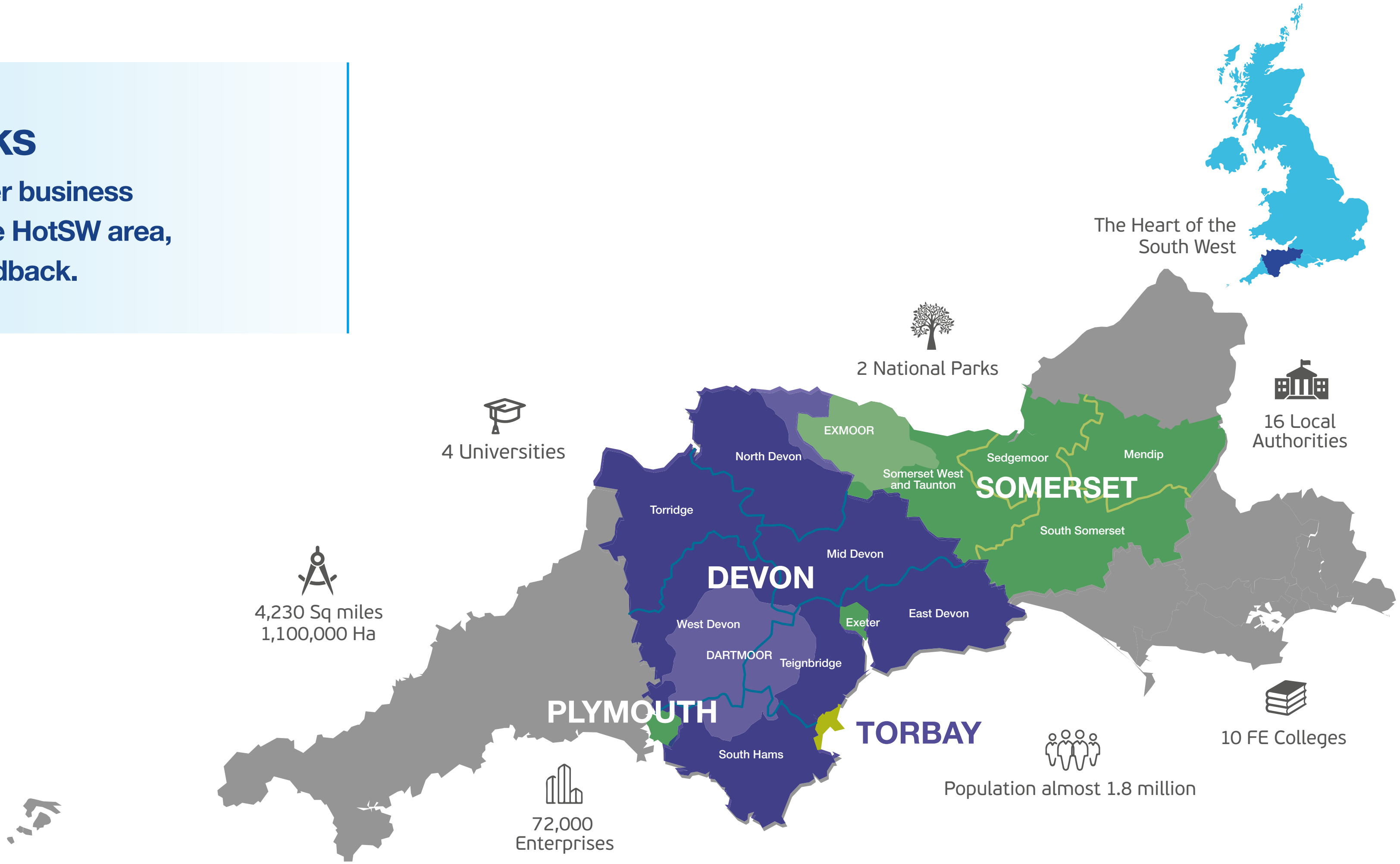
The latest ICAEW Business Confidence Monitor for Q4 2021 reported that overall, business sentiment in the South West remained positive over the quarter, underpinned by a strong sales outlook. Consumer demand pressures have also begun to ease, with 34% of businesses reporting it as a challenge in Q4 2021, compared to 49% over the same period last year.

Despite the Confidence Index remaining above historical averages, the Index has fallen slightly from its peak in Q3 2021, likely reflecting the cost pressures and labour market challenges businesses have faced recently. 36% of businesses cited challenges surrounding the availability of non-management skills, and 40% cited staff turnover as becoming an increasing issue over the past quarter. Whilst companies plan to increase the size of their workforces to meet surging demands for goods and services, these recruitment challenges may hinder growth in the short term.

The Heart of the South West

With thanks

again to the wider business community in the HotSW area, for providing feedback.



£37 BILLION ECONOMY
as big as Birmingham or Liverpool