

Summary of economic conditions

- The latest Purchasing Managers Index survey shows that **growth of private sector business activity in the South East continued in June, although the rate of output expansion slowed to a five-month low**. The moderation in growth mainly stemmed from the slowest increase in new business since last September.
- **Labour market performance is mixed in the South East**: claimant count unemployment in June fell to 134,100 (down from 142,400 in May), at the same time the number of vacancies notified to JobCentre Plus dropped by 7,800, to 40,533. This pushed up **the claimant count to vacancy rate from 2.9 in May to 3.3 in June. However, the number of vacancies is still higher than in previous months**.
- The decline in unemployment could be partially explained by the decreasing number of economically active people, which dropped by 24,000 in the three month to May, as people may be moving from economic activity (i.e. unemployment) to inactivity.
- The total number of redundancy notifications (of 20 or more staff) in the South East reached 2,745, in July, compared to 2,067 in June. **Public sector job losses accounted for 40% of total redundancies reported**.
- The most recent RICS Housing Market Survey results for June show that **house prices rose in the South East for the twelfth consecutive month, although the proportion of surveyors reporting price increases fell to its lowest level since August 2009**. The seasonally adjusted net balance of surveyors reporting price rises was 17% in June, down from 37% in May.
- **Data from BankSearch suggest that the number of business start-ups in the South East grew in June**, with real estate, renting, computer & other business services accounting for nearly half of new starts. On average, 6,800 new businesses started up in June 2010, 5.4% more than the previous month. Surrey, Hampshire and Kent accounted for 44% the total number of new business start-ups in June.

Key challenges and hotspots

- According to the latest PMI survey, **input price inflation eased further from April's recent peak, but is nevertheless strong in the context of historical survey data**. Manufacturers again face a steeper rate of cost inflation than service sector counterparts, stemming from metals, oil-based and staff wages. Increasing output prices indicate that some of these increased costs have been passed on to consumers.
- **Some areas are facing a skills mismatch, with both high numbers of vacancies and high numbers of Job Seeker Allowance (JSA) claimants**. For example, there were 3,970 live unfilled vacancies available across all of **Berkshire** in June 2010, despite nearly 14,000 claimants.
- **The hotspot for total redundancy notifications in Q2 2010 was in Kent & Medway (23%)**, followed by Berkshire (16%) and Oxfordshire (15%). This can mainly be attributed to job losses in the public sector.
- **Tourism South East indicates that confidence is coming back to the hotel sector**-performance data for May reveals positive results in Average Room Occupancy, Average Daily Rate, and Revenue Per Available Room. However, the prospects of public sector travel and meetings cuts in the UK could further slow any rebound.
- The latest FSB Survey (June 2010) shows that **the South East has the largest proportion of businesses (64%) expecting to operate below capacity over the next three months**, compared to any other UK region. Business spare capacity may be due to the region's historic dependence on the service sector.

Business specific intelligence / information on key questions

- There is some encouraging news from the latest British Chambers of Commerce (BCC) Quarterly Survey for Surrey (June), where **54% of respondents said they expected turnover to increase** (up 2% compared with Q2 2010) and **43% expect their profits to improve**. However, 70% are still operating below full capacity.
- The BCC survey also indicates that **finding and retaining new customers is still the biggest concern for 39% of Surrey businesses**. Concerns also exist regarding competition and its impact on profitability (30% of respondents), interest rates (22%), inflation (16%), and corporation tax (10%).
- Anecdotal evidence suggests that **retailers in Kent have concerns regarding low levels of consumer confidence**, and have started reducing the number of branches, focusing on newer high-quality centres.
- However, there are **some signs of optimism in the Kent construction sector as projects previously on the back-burner are beginning to be brought forward**. Those construction firms that have weathered the recession are more likely to be embracing innovation and sustainable construction methods.

Sectoral Overview

Manufacturing

According to the latest statistics from the ONS, manufacturing output in the UK continued to grow in the second quarter of the year. It showed a quarterly growth of 1.6%, up from 1.4% in the previous quarter.

In line with the official data, the most recent CBI – Industrial Trends Survey (July 2010) show that activity within the manufacturing sector picked up strongly in the last quarter (from 12% to 18% of positive responses) as a strong rise in orders and a turn in the stock cycle saw output growth surge to the strongest rate since April 1995. Although the outlook for the quarter ahead is still positive, it is somewhat less upbeat with firms expecting the pace of growth to slow (from 20% to 5% of positive responses) in line with a more moderate increase in orders. The Survey's results also indicate that manufacturing firms continue to be less worried about access to credit, but political and economic conditions abroad are now slightly more of a concern. Following the boost in production, there are signs that capacity use is slowly returning to normal (60% of firms working below capacity though) and more firms plan to expand capacity in the year ahead. Although costs rose sharply again they are not expected to grow as strongly next quarter. Meanwhile, domestic prices rose for the first time since October 2008, however the increase fell short of forecasts and price expectations have now moderated.

Manufacturing performance is rather mixed across different sub-sectors, as reported by the latest CBI – Industrial Trends Survey. Optimism about the business situation facing the UK mechanical engineering industry fell, for though output and total new orders advanced fairly smartly, they are expected to fall next quarter by a faster rate. Such gloomy sentiments are clearly reflected in the South East as well. Business specific intelligence indicates that, for example, **Qinetiq** is to shed 230 jobs at its defence technology plant in Malvern and a further 130 jobs in Farnborough. Equally, **BaE Systems** is to close a factory in Leicester by autumn 2011, with the loss of almost 300 jobs, having failed to win a Ministry of Defence armoured vehicle contract.

Electronic & electrical engineering firms in the UK were more optimistic about the business situation facing their sector than they were three months ago, after a quarter of robust growth in production and employment. However, the picture in the south East seems to be quite the opposite. Business specific intelligence shows that **Hewlett Packard** has unveiled plans to shed 934 jobs, affecting sites in Bracknell, Bristol, Erskine, Hook, London, Milton Keynes and Warrington.

Optimism about the business situation facing the UK motor vehicles & other transport equipment sector advanced a little further. Firms are also planning to spend more on plant and equipment in the coming year than they did in the past twelve months. For instance, business specific intelligence indicates that **Rolls-Royce** is seeing a record surge in production. There are currently an average of 15 models being finished every day at the firm's plant in Goodwood, Chichester – up from an average of four to five cars per day in 2009. However, some other firms in the South East are still facing after-effects of recession and hence minimizing costs. For example, **Ricardo** has shed 64 jobs at its automotive engineering site in Shoreham and a further 28 in Leamington Spa.

Optimism about business conditions facing the food, drinks & tobacco industry increased, and there was a fourth successive and much stronger rate of growth in total new orders across the UK. However, there is a mixed picture in the South East as business specific intelligence suggests contrasting trends. On one hand, **Kraft** is expected to shed 120 of the 165 jobs at the Cadbury's administrative office in Uxbridge. Meanwhile, on the other hand, **GVS Assist** is setting up a 22,000 sq ft operations centre for its drinks machines business at the Methley Road Industrial Estate near Castleford.

The paper, printing & recorded media sector in the UK is still having to cope with faster growth in unit costs than in the prices it receives, with a very high rate of cost growth at least being met this

quarter with the first selling price inflation since April 2008. Such challenge is also mirrored in the South East where business specific intelligence from Kent shows **Wire Belt Co Ltd** reporting an increase in order book with exports up 60%, largely to Malaysia and Indonesia. Additionally, they are soon to open a representative office in Dubai and hopeful that this will increase further exports

Tourism (hospitality & travel)

Hospitality performance data for May 2010 gathered from over 300 hotels across the South East region reveal positive results in three key performance measures. According to the latest Intelligence Update (July 2010) from Tourism South East, average room occupancy, average daily rate (ADR), and revenue per available room (RevPAR) are all up, bringing confidence back to the hotel sector. In May 2010, the region's hotel occupancy rose 5 percentage points to 74.1%, ADR ended the month up by £3.3 and RevPAR increased on average by £6.2 to £57.

This positive trend in the hospitality sector is also mirrored through the investment plans of some South East districts. For example, a £65m regeneration of **Aldershot town centre** has been given the go-ahead in principle after a unanimous vote by councillors. The WestGate scheme includes a cinema complex, restaurants, a 91-bed hotel, a supermarket and a 522-space car park. Similarly, the **Worthing Borough Council** is to consider revised plans from Hanson Capital Management for the £150m redevelopment of Teville Gate, including a 100-bed hotel, a cinema, 260 flats and the creation of 1,000 jobs.

However, the hospitality sector continues to be hampered by skill deficits, according to the State of the Nation 2010 by People 1st. The report says that around 26% of businesses within hospitality employ staff they view as not fully proficient in their jobs – equivalent to 180,000 people. This compares with 19 per cent, or 140,000 people working within the sector, two years ago. The report concludes that customer service skills remain the most common skills gap across the sector.

The picture is very similar within the travel sector. In the first quarter of 2010 overall trip numbers were up 4% in the UK compared to January-March 2009, while trips in England were up 2% in the same period. Regional results for the South East are even more positive. The overall number of trips in the region increased by 17% compared to January-March 2009, while the number of nights and spend also increased by 8% and 10% respectively.

Those positive results are more surprising if we consider the damaging effects of the volcanic ashes to the transport industry. The latest results from the International Passenger Survey for the month of April, the month that Iceland's Eyjafjallajökull volcano started erupting, reveal that the number of overseas residents visiting the UK was 11% lower compared with April 2009.

Looking forward, the latest Intelligence Update from Tourism South East reports that we will see a significant growth in overseas trips in the coming years from the fast-growing BRIC nations (Brazil, Russia, India and China) as wealthy households from these countries start to spend their cash on overseas travel.

Domestic flights are also expected to show a better performance from the South East. For instance, business specific intelligence indicates that the **Kent airport** of Manston is to gain a second domestic service by Flybe. The airline is to serve Manchester six days a week in addition to an Edinburgh service. Flights will operate every day except Saturdays.

Financial Services

According to the latest CBI – Financial Services Survey (June 2010), UK business profitability rose for a fourth successive quarter (up to 20% on balance) supported by widening spreads, a considerable reduction in costs and a modest rise in business volumes. However, the rising trend in profitability seen over the past year is expected to level off next quarter (down to 3% on balance) in spite of very positive expectations for business volumes, growth in income values and further cost reductions. Besides, there was a further rise in training expenditure (up to 15% on balance) and expectations surrounding headcount are positive for the first time since December 2007. However,

investment intentions remain generally weak, although the cost of finance has eased back as a concern. Looking forward, competition is now widely regarded as a limit on business expansion for the year ahead.

The picture is rather mixed across different sub-sectors, as reported by the latest CBI – Financial Services Survey.

Business volumes were broadly flat for UK building societies and overall profitability just increased slightly in the quarter to June 2010. Meanwhile profitability in the banking sector rose for the third consecutive quarter, supported by strong growth in fee/commission income, falling costs and a sharp widening of spreads. This could explain why some building societies in the region are banking their operations. For instance, **Kent Reliance** is negotiating a £50m investment from US private equity firm JC Flowers, in order to create a new bank-style operation that could double in size over the next five years.

In the UK general insurance sector, profitability fell for a third quarter running, with another sharp contraction expected in the next quarter. However, South East companies seem to be more optimistic about their future as it is corroborated by business specific intelligence. **Fortis**, for example, is recruiting a further 100 staff for a new insurance sales and customer service office opening at Turnpike House in Chandler's Ford, Hampshire. Likewise, **Hastings Direct** is planning to create more than 100 new jobs at its Bexhill-based insurance business by the end of the year.

Retail & motor trade

According to the most recent CBI – Distributive Trade Survey (July 2010), retail sales volumes in the UK rose strongly in the year to July, with 33% of positive responses on balance which significantly exceeded expectations. Orders placed upon suppliers also increased and is expected to grow again next month.

The sub-sectoral results from the CBI survey show that grocers, footwear & leather, durable household goods, department stores and chemists all saw large increases in their volumes across the UK. This is corroborated through many examples provided by business specific intelligence from the South East.

In the durable household goods industry, **Best Buy** has announced plans to open new electrical stores in Derby this autumn and in Nottingham in summer 2011. Similarly, a **Panasonic Store** will open in Southampton High Street during June. The store's owner also runs a chain of electrical stores on the south coast.

In the supermarket industry, **The Co-operative** has decided to invest £180,000 converting the existing Somerfield on Fairview Road in Norbury, Surrey. All 35 jobs are due to be saved under the plans, which will feature a new-look store due to open on July 8th.

The UK clothing sector also saw an acceleration in sales growth. Business specific intelligence from the South East indicates that **Joules**, the fashion chain, has opened a new store in Lymington, Hampshire. Looking forward, **A Suit That Fits** is planning to open new stores in Cambridge, Leeds, Manchester and Reading to add to its existing sites in London, Bristol and Birmingham. Likewise, **Gant** is to open a new fashion store in Guildford in August, but its Bond Street store in London will close in September.

Despite the buoyant short-term trend in the sector, some retailers are still cautious about trading conditions. Anecdotal evidence from the Kent Economic Board suggests that local retailers are concerned about the impact of tax rises, public sector pay freezes and job cuts on the still prevailing low levels of consumer confidence. Indeed, there is continued evidence of retailers reducing the numbers of branches in portfolio – focussing on newer high quality centres – and thus leaving small town centres marginalised.

The CBI survey's results also suggested that motor trade sales volumes in the UK fell once again in the year to July, but the rate of decline decelerated, despite expectations of another sharp fall. Sales are set to contract again next month. Sales were reported to be below average for the time of year, and are anticipated to stay below seasonal norms in August. However, the picture seems to be quite different across the South East. Business specific intelligence from Oxfordshire indicates that **Mini** sales in the UK are surging ahead. Statistics from the Society of Motor Manufacturers and Traders show 4,925 of the Cowley-built cars were sold during June, 5.6 % more than in the same month last year. During the year to date, 22,266 cars have been sold compared to 17,422 for the same period in 2009, a rise of 27.8 %. In the export markets, anecdotal evidence from Kent suggests that increasing sales to the Chinese market has been supporting **Landrover & Jaguar** in recent months.

Construction

The latest figures from the Office of National Statistics showed that construction recorded the largest growth across the UK sectors. Between the first and the second quarter of 2010, the construction output increased by 6.6% (up from -1.6% in the previous quarter) and made a substantial contribution (0.4 percentage points) to the 1.1% UK GDP growth. Anecdotal evidence suggest that the fastest growth since 1963 has been in part because bad weather at the start of the year meant builders were catching up on work that should have taken place then.

The recovery is also mirrored across the South East, particularly in the coastal counties.

Anecdotal evidence from the Kent Economic Board suggests signs of optimism in the construction sector as back-burnered projects are beginning to be brought forward. Besides, those construction companies that have weathered the recession are more likely to be embracing innovation and sustainable construction methods. However, there are still a few concerns about the impact of the reduction in house building on the economy in terms of pent-up demand, and development of supply of accommodation for older people.

Business specific intelligence from Surrey and East Sussex shows further signs of improvement. For example, Spelthorne Borough Council is to consider new plans from **Invista Real Estate** to develop a 111,500 sq ft six-storey office building at the former British Gas site in Staines. Similarly, **Adenstar**, a building firm based in Portslade, is looking to double in size after signing a deal worth £7 million with BA to improve facilities at Heathrow in preparation of the delivery of new aircraft. The company had suffered badly from the economic downturn and laid off more than 80% of its staff.

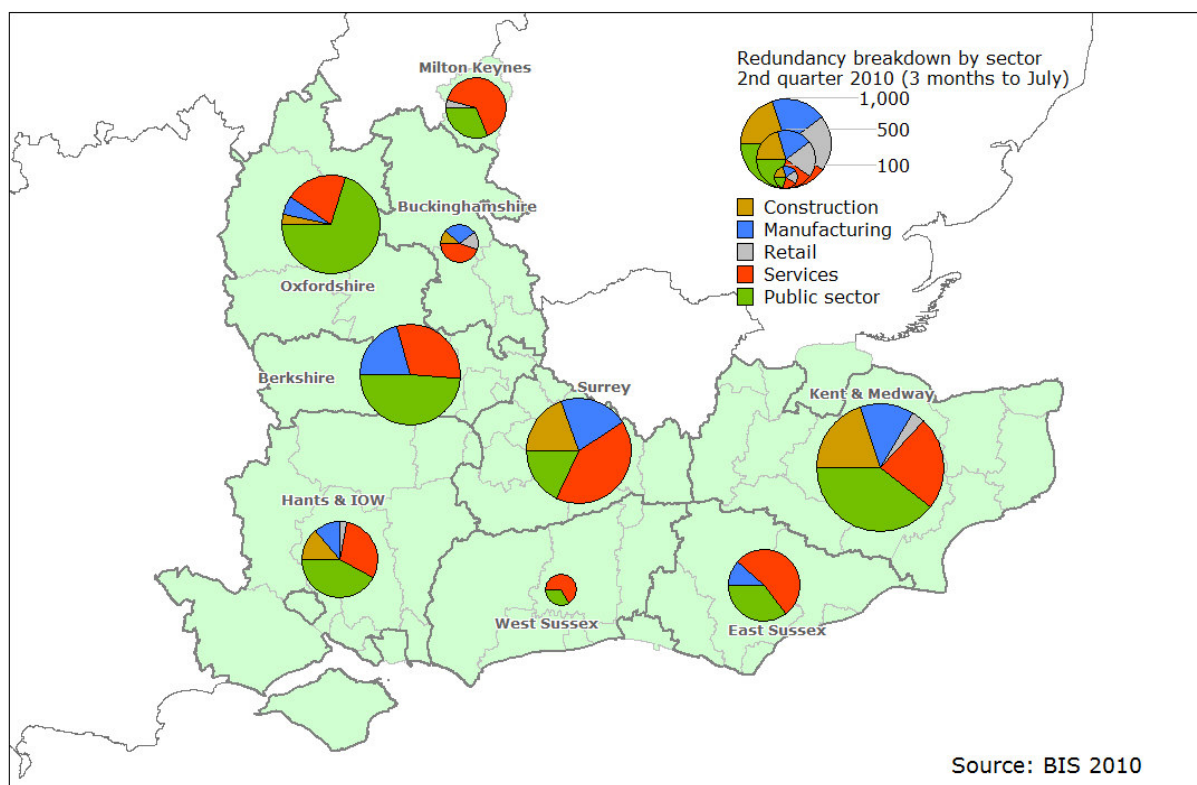
Redundancy notifications¹

Intelligence from CESS brokers shows that of the total number of redundancy notifications submitted to BIS via HR1 forms in the three months to July, the number of genuine redundancies relating to employees in the South East was 7,724. This is lower than the trend seen in the first quarter of the year, when redundancies reached 9,276 employees.

The vast majority of redundancies (74%) were in the service sector (including public sector) this quarter. This is greater than that sector's share of total employment in the South East (60%). The share of redundancies in the manufacturing sector in the 2nd quarter of 2010, at 14%, is higher than the sector's share of employment in the region (8%). The proportion of redundancies in the construction sectors is 10%, similar to its share of employment of 9%. Redundancies in the retail sector accounted for less than 2%. Public sector job losses made the largest contribution to redundancies, accounting for 40% of total redundancies, and for 54% of service sector redundancies. Nearly half the public sector redundancy notifications were recorded in the northwest of the region (Oxfordshire and Berkshire). The total number of public sector redundancies in the three months to July has been 3,084.

By far the largest number of total redundancies this quarter was recorded in Kent & Medway (23% of the South East total) – the vast majority of which were in the public sector. Surrey accounted for 17% of the regions' redundancies, mostly in private services sector. Berkshire and Oxfordshire each accounted for around 15% of all redundancies, with further notifications in services, mostly in the public sector.

Redundancy notifications by sub-region, volume and sector, 2nd Quarter 2010 (Source: HR1 data via BIS / Job Centre Plus – verified by South East Continuing Employment Support Service)



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¹Please note: '2nd quarter' data refers to a three-month period from 20/04/2010 to 19/07/2010 (latest data available). This is not directly comparable to the monthly period used in the previous report.