

## Summary of economic conditions

- According to the latest Purchasing Managers Index (PMI) Survey, **business activity in the South East fell for the twelfth consecutive month in June**. The rate of contraction was the sharpest since March 2009. In contrast, in the UK as a whole business activity increased at the fastest rate since March 2008. The **rate of decline in new orders in June was the fastest for three months** in the South East and sharper than the UK average, with the region's manufacturing sector recording steeper falls than the service sector.
- The latest (largely anecdotal) evidence from businesses and business representative organisations shows that there has been **little improvement in business conditions in the region in July**. Output, new orders, profit margins, cashflow and investment are all mostly flat or lower. However, there is still a mixed picture, with some businesses seeing an improvement in performance. A quarter of businesses surveyed in Surrey in July had seen an increase in turnover in the last 3 months, with almost half predicting an increase over the next 3 months.
- **Employment continues to fall in the South East**, though not to the same extent as in neighbouring regions in the Greater South East. The **claimant count measure of unemployment rose slightly in June**, by 1,500. Although businesses are still trying to avoid large-scale redundancies by implementing pay and recruitment freezes, anecdotal evidence from some representative organisations suggests that **businesses are still considering further tranches of redundancies** in order to survive the next 12 months.
- Businesses are adopting other **proactive approaches to surviving the recession**, including investing more in marketing, diversifying their products and services and improving cashflow management. There has been a **marked increase in start-up enquiries to Business Link** in some parts of the region. Enquiries were up by 70% in Milton Keynes between Quarter 1 and 2 of 2009, although a shortage of suitable start-up premises could prove a problem.

## Key challenges and hotspots

- **Late payment has reportedly worsened over the last two months**, with evidence of payment terms being stretched to 70 days in some sectors. In some cases, problems are exacerbated by poor credit control procedures, where companies haven't adapted to the changed circumstances of the recession.
- Anecdotal evidence suggests that **access to finance is still difficult, with few firms reporting that borrowing from banks is becoming easier**. Many businesses are avoiding seeking credit altogether, but of those who have approached banks, many report them applying stringent conditions or increasing their charges. However, there is anecdotal evidence of some smaller banks offering good business deals.

## Business specific intelligence / information on key questions

- Anecdotally, **consumer confidence is starting to return in some parts of the region**, with some pick-up in the housing market, and evidence that customers who traded down to 'budget' items are returning to their usual purchasing habits. There is **some evidence of re-stocking**, with the FSB reporting that wholesalers are asking retailers to order by the end of July for Christmas.
- The **number and value of exports are down on last year in some parts of the region**. So far the weak pound has made relatively little difference, as demand is depressed across the EU market, which accounts for two thirds of South East exports. However, **sterling appears to have helped boost levels of inward investment in the region**. Enquiries from northern Europe are most buoyant, although there is evidence of increasing interest from the US.

## Sectoral Overview

**Manufacturing:** Manufacturers continue to face difficult trading conditions, with output still depressed in the second quarter of 2009 and the squeeze on margins continuing as price cutting picks up. Activity in the Eurozone, the South East's main export market, remains weak. Employment and investment plans continue to be cut back. Almost half of EEF members in the South East reported contraction of employment in the quarter ending in June. **Air Products**, with its European head office in Walton, Surrey, has entered into consultation with a view to cutting 400 jobs from its workforce of 12,000. Meanwhile, **New Hythe Paper Mill** in Larkfield, Kent has closed with the loss of 130 jobs.

Given the slackening in the labour market, wage growth slowed in the three months to June at national level, and more than two thirds of pay settlements were pay freezes. Extended payment terms and access to credit continue to affect manufacturers in the South East. According to a Business Link survey in June, more than half of manufacturing firms are seeing more customers paying late, while more than one quarter of firms who sought new finance have experienced difficulties in accessing it. There is also evidence of credit insurance being withdrawn or reduced for some firms.

However, there are signs that the effects of the recession may be bottoming out, as destocking nears an end, with the rate of decline in output and new orders improving in some sub-sectors. The Manufacturing Advisory Service reports that the flat cashflow balance in the South East, coupled with a more stable outlook for orders, helped prevent further deterioration in firms' investment intentions in the second quarter of 2009. For the first time in six months, the output balances in basic metals and motor vehicles improved, reflecting the fact that most of the significant production cuts by the automotive industry had already been carried out in the previous two quarters. The timing of a return to growth remains uncertain, although EEF is forecasting an improvement in trading conditions in the first half of 2010. Almost all sectors within the manufacturing industry are less pessimistic about output and orders from both domestic and overseas customers over the next three months. A balance of 13% of companies expects further output cuts next quarter compared with 41% in the first quarter of 2009.

There is still a very mixed picture across the South East, with a number of companies reporting strong trading, with output up and a continuing flow of new orders, while others have seen significant falls in sales and consequent redundancies or reductions in working hours. EEF reports that its members are finding it harder to recruit specialist skilled employees, and the high cost of living in the South East acts as a barrier to attracting skilled people. Companies continue to seek alternatives to redundancies, such as short-time working, to try to retain the skills they are likely to need once the upturn comes.

**Automotive:** Car sales are on the increase, although the greatest demand is for small, relatively cheap cars. The scrappage scheme is reportedly having an effect (at the very least generating increased footfall in car dealerships). Commercial and fleet sales are still flat, however. The Kent Economic Board reports that car manufacturers are telling dealers that they are budgeting for a slight increase in sales next year. The latest business specific intelligence shows that **McLaren Group** has put forward proposals to expand its Woking site with a £500 million investment – potentially creating 500 jobs over the next 2-3 years. Meanwhile **Stagetruck**, the trucking firm with 60 vehicles and 80 staff, is to seek planning permission for a new headquarters at Micheldever near Winchester.

**Construction / property:** Construction firms in several parts of the region report needing to secure further work in late 2009 / early 2010 to avoid losing key employees. **Brett Group**, the Canterbury-based landscaping supplies company owning depots across Kent and Sussex, is seeking to reduce labour costs by £2 million and has asked 700 workers to take a pay cut to prevent them from losing their jobs. More housebuilders are looking to work with the social housing sector, where demand is rising. There is also significant interest from construction firms in opportunities for retro-fitting existing housing stock to help meet low carbon targets. As evidence of a pick-up in public sector development projects, **Wycombe District Council** has unveiled plans for a new business park, coach station and hotel, with work due to start in 2012.

In the commercial property sector, limited access to finance is reportedly constraining recovery. However, there is evidence from a property developers' group in Surrey that land buying is now at a level not seen since the last property boom. Many developers are not intending to build in the short-term, but are taking advantage of the fact that some people have had to dispose of their assets quickly. Estate agents are reporting high demand for quality properties, although supply is short as many people are delaying putting their houses up for sale.

**Retail:** Larger centres are generally performing better than smaller ones, with retail sales in Brighton in June up almost 2% on the year, against 1.4% nationally. Reading and Slough have seen year on year reductions in footfall, though. In Kent, many retailers are reportedly feeling increasingly negative. Some are asking employees to work for reduced pay. **Allied Carpets**, with a head office in Orpington, Kent, has gone into administration. 400 of the 1,500 jobs have been secured with the sale of 51 stores and its insurance inspection business. Amongst the positive news stories, **Morrisons** is creating 1,000 warehouse and driving jobs at a new distribution centre due to open in Sittingbourne, Kent in autumn 2009, while **Sainsbury's** in Pepper Hill, Gravesham, is looking to expand and create 300 jobs.

Discretionary spend is still falling, with customers continuing to look for good deals. Independent stores are finding that they cannot compete with heavy discounting by large chains (in some instances sale prices are cheaper than wholesale cost price). Many retail businesses are now choosing a controlled exit from business in preference to bankruptcy, with many opting not to renew their leases rather than closing through liquidation. As a result there has been an increase in the number of void retail units. Business rates remain high, partly because the rateable values calculated by the Valuation Office Agency often do not reflect the number of void units and falling rents.

**Consultancy:** The private sector client base has virtually disappeared (as consultancy is seen as non-essential spend) and competition for public sector contracts has become very fierce, with even large, well known firms bidding for relatively low value contracts. There are concerns that further budget tightening in the public sector could lead to even more intense competition for work.

**Legal:** The picture is mixed in this sector. There has been some increase in conveyancing work for private property as house sales increase. However, corporate work is still slow or on hold due to the fact that clients are having difficulty accessing credit on reasonable repayment terms. Employment tribunal cases are increasing, as is usual in difficult economic times.

**Tourism / Hospitality:** Increased demand from both the UK and Europe means that the industry in some parts of the region is relatively buoyant: visits are up by a third on the year in Kent, and visitor numbers were steady in Brighton and Hove in June compared to June 2008. However, major fixed events (such as Ascot and the Henley Regatta) did not sell as many tickets as in previous years.

Camping and self-catering bookings are significantly up on 2008, but bookings for B&Bs and hotels are less strong. Many visitors are opting for very short breaks in hotels (1 or 2 nights). The corporate hospitality market is still suffering, with limited prospects of recovery before 2010. However, the construction of several new hotels in the region was announced this month. **Travelodge** has invested £70 million in the acquisition of 12 sites for budget hotels across the country, including in Camberley, Chesham, Chichester and Maidenhead. In Southampton, **Development Securities** have submitted plans to build a £35 million six-storey hotel and seven-storey office block in the city centre, with the creation of up to 350 jobs. The restaurant sector is faring better than in Q1 2009, though smaller restaurants are doing less well than chains, and many restaurants are having to offer discount deals. Pub sales are still falling significantly – due to a combination of the recession, drink duty and heavy discounting by supermarkets. Lead times for wedding venue bookings have shortened considerably, with couples being more cost conscious and trying to negotiate discounts.

**Agriculture / rural:** The key challenges for the sector are keeping costs down and trying to improve margins at a time when prices are static. Some investment plans have been put on hold, but some may be implemented as output begins to rise. Many farmers are looking into diversification opportunities, recognizing the need to introduce new products in order to survive.

**Creative industries:** Some graphic design/advertising companies are reporting difficulties turning work around due to staff reductions amongst suppliers (such as printers). This could inhibit their ability to meet client demand in what is an increasingly competitive market. Some media companies in Kent are reporting brisk business at the moment, but there are concerns that the South East may be missing out on some major film projects which are being attracted to other parts of the country.

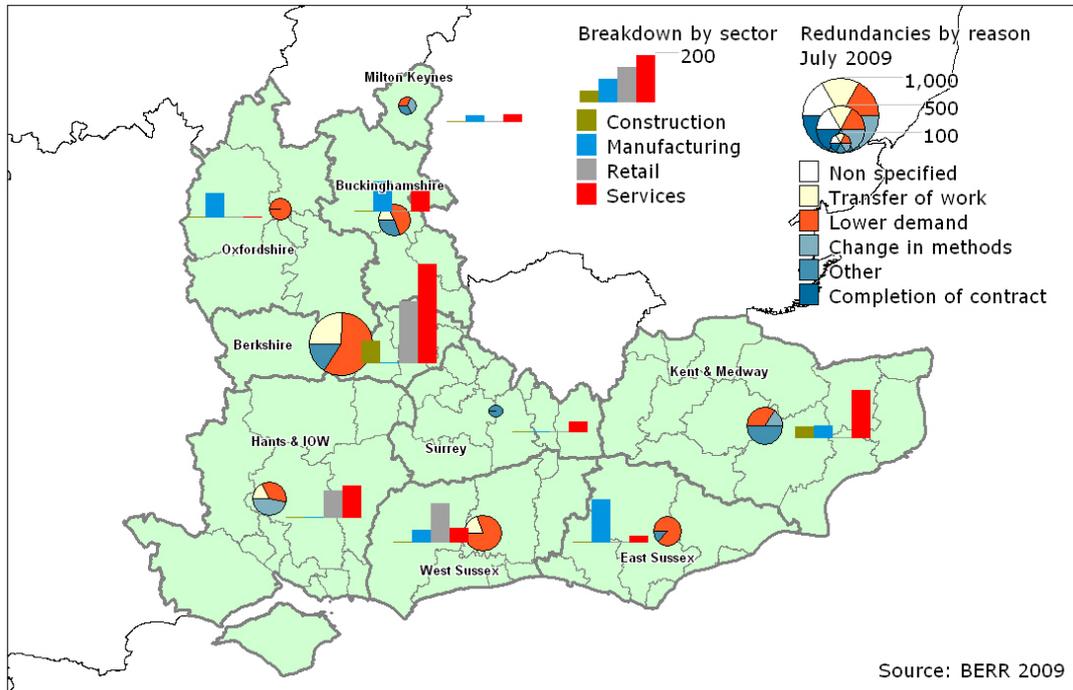
The computer games industry was fairly resilient during the last recession, as its main market was 'dedicated' gamers who would continue to buy games, even if this meant cutting back on other items of expenditure. Since the last downturn, there has been significant growth in the 'social games' market (including singing, dancing and keep fit games). It is not known whether demand from these types of gamers will hold up in a recession, and as a result publishers are adopting a very cautious approach to signing contracts with developers for new games.

**Redundancy Notifications:** According to HR1 data, the level of redundancy notifications decreased in July. There were some 2,200 redundancy notifications in the South East in July against 3,500 in June 2009.

Although the service sector (excluding retail) continues to be hit, the proportion of redundancies attributed to this sector has dropped to 45% in July, compared to 70% in June 2009. In July there was a marked increase in the number of redundancies in the retail sector, with nearly 500 notifications - more than double the number reported in June. The retail sector accounted for approximately a quarter of all notifications in June, as did manufacturing. The number of notifications in the construction sector fell by a third in July compared to June 2009.

Berkshire accounted for approximately one third of all notifications in July. Berkshire continues to be dominated by redundancies in the retail and service sectors, with over 40% of all the notifications being in this sector. The number of redundancies in Buckinghamshire and East Sussex saw a ten fold increase in July on the number reported the previous month (though from a small base) with the majority of redundancies in these counties being in the manufacturing and service sectors. Hampshire and the Isle of Wight reported significantly fewer redundancies in July than in June 2009, while the number of notifications in Surrey also fell compared to the previous month.

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



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