

Summary of economic conditions

- According to the latest South East Purchasing Managers Index (PMI), **business activity in February grew at its fastest rate since September 2007. New orders continued to increase** at a marked rate, above the UK average. The increase has been attributed to gains in new orders, particularly in manufacturing exports.
- Businesses in the South East are optimistic about the coming months: **almost half (45%) expect the business climate to improve in the next 3 months**, and only 10% anticipate worsening conditions, according to the latest South East Business Snapshot Survey, conducted in January/February.
- **Labour market performance is mixed in the South East**: there has been a fall in the number of redundancies, from 3,650 in February to 1,885 in March, while the claimant count in February was 1,160 lower than in January 2010, and the unemployment rate fell by 0.1 percentage points over the previous three months. However, **employment fell by 10,000** and the **number of economically inactive people increased by 20,000** during the three months to January.
- **17% of companies plan to increase their staffing levels** in the short-term (next 3 months), while 6% expect a reduction, according to our Business Snapshot Survey. Large firms are more likely to take on new staff, but companies in the construction and transport & communications sectors are significantly less likely to do so. **Flexible responses to staffing are still evident**, with 43% of companies surveyed for Surrey's Business Barometer expecting to freeze pay and 15% planning to implement a reduced working week.
- The latest RICS Housing Market Survey (February) shows a positive net balance of **surveyors reporting rising house prices in the South East for the eighth consecutive month**, the net balance being significantly higher than nationally (37% compared to 17%).

Key challenges and hotspots

- **Cash flow and access to finance issues have eased for businesses in some parts of the region but remain tough in others.** Levels of cash flow remain challenging for manufacturers. According to EEF's South East Business Trends Q1 2010, a larger proportion of firms expect cash flow to worsen in the next three months than expect it to improve.
- According to the latest Business Snapshot Survey, **nearly two thirds of companies in the South East are still operating below full capacity**, which has two main effects. In the short term, **spare capacity pushes inflation below target** by year-end. In the longer term, however, **unused capacity acts as a drag on business investments and recruitment.** Indeed, just one third of SE companies expect to increase investment in the next 3 months. This is mainly driven by investment in marketing and sales, while capital investment remains at low levels, particularly in the manufacturing sector.
- Despite some **uncertainty over the outcome of the general election** and the extent of subsequent spending cuts, some businesses are positioning themselves to take advantage of the upturn by seeking or taking new office space, according to anecdotal evidence. Business Link's latest South East Business Monitor (conducted in February) shows that overall, **73% of SMEs in the South East feel well placed to take advantage when the economy recovers.**

Business specific intelligence / information on key questions

- More than **half of exporting companies in the South East expect export orders to increase** in the next 3 months, according to our latest Business Snapshot Survey. Exporting companies are also more inclined to expect their turnover to increase in the next 12 months (55%) compared to non-exporting companies (49%), according to the latest Business Link Monitor.
- **The recession has encouraged companies to innovate.** According to the latest FSB Snap Poll (Feb/March), 34% of businesses in the South East say that the **introduction of new or significantly improved products/ services was very important to help them weather the recession** (40% nationally). Furthermore, one third expect to introduce new or improved products/services in the next 12 months (in line with the national average). Maintaining competitiveness within existing markets is the main driver of this innovation.
- However, **better access to finance would improve the ability to innovate** in the next 12 months for a third of South East businesses, and **greater tax incentives** would improve innovation ability for 44% of South East companies, according to the FSB Snap Poll.

Sectoral Overview

Manufacturing

In February the South East Purchasing Managers Index (PMI) Business Activity Index went up sharply to 59.7 points (up from 55.3 in January) signalling a noticeable expansion of private sector output in the South East for eight consecutive months. The increase has been primarily attributed to gains of manufacturing firms, particularly in export markets.

The main reason behind the rapid expansion of manufacturing exports has been the continued depreciation of sterling (25% down) since mid-2007, as well as the recent recovery of demand in the UK's main export markets. The latest UKTI monthly economic brief suggests that firms (high-tech manufacturers especially) have kept export prices stable in foreign currency terms, enjoying higher sterling profits rather than increasing export volumes. This is consistent with reported growth in (nominal) output along with a stagnation in employment, which generates a jobless growth scenario in the short-term – perhaps not surprising given that a large majority of firms are currently operating below full capacity. In fact, the latest EEF Business Trends survey indicates that the percentage balance of responses¹ on employment has remained the same for quarter 1 2010 (-3%) as for quarter 4 2009.

According to the latest Business Snapshot Survey (February/March 2010), 69% of manufacturing firms in the SE reported that they have been working below operating capacity over the past three months. This means that manufacturing companies are unlikely to proceed with business investment given the existing high-levels of spare capacity and labour. Indeed, investment cuts have been particularly savage during the recession and few sub-sectors have bucked the downward trend. According to the EEF Business Trends survey, this looks set to remain the case over the next 12 months, with only a minority of sub-sectors planning to upwardly revise their investment plans (e.g. Electronics, Chemicals, Rubber & plastics, and non-metallic minerals). Additionally, inflationary pressures stemming from rising input costs (i.e. commodities, fuel, etc.) are adding further uncertainty to business investment plans within the manufacturing sector. Evidence from businesses in Kent suggests that most manufacturers are judging that their markets are not yet strong enough to pass on increased input costs to customers.

In more positive news, the latest Business Link South East Business Monitor (February 2010) suggests that over half of high, medium and low tech manufacturing SMEs (58%, 52% and 50% respectively) have recently undertaken at least 3 innovative activities; however this level of innovation is more prevalent amongst high tech manufacturers. There are a number of recent examples of investments in innovation by large manufacturing firms in the South East. In the advanced engineering & marine sector, for instance, the Government has agreed to back Ford's proposed £1.5 billion investment over five years for development of a new generation of environmentally friendly engines and vehicle technologies in the UK. **Ford's** plans will safeguard around 2,800 skilled research engineering jobs in the UK as well as underpinning the next generation Transit, a version of which is to be built in the Swaythling plant in Southampton, where 500 people are employed. Within the same automotive sector, the Formula 1 team **McLaren** formally launched its road car division on Thursday 18th March, after five years of preparation. The new division will bring together F1 technology with efficient manufacturing. McLaren is already the biggest employer in Woking and the construction of its £40m car factory will create at least 300 more jobs in the town. In the pharmaceutical sector, **Archimedes Pharma** has secured a £65 million equity investment to fund the expansion of its Reading-based pharmaceuticals business, including the global launch of a pain relief spray.

¹ The difference between the number of firms reporting an increase and the number reporting a reduction (in staff numbers, in this case).

Construction / property

Overall performance and confidence in the construction sector are highly volatile, not only over time but also between businesses – something which is exacerbated by the current economic uncertainty. This helps to explain why different surveys may show contrasting results. Compared to the optimism prevailing in previous surveys, the latest South East Business Snapshot Survey (BSS) shows that a large proportion of firms (65%) in the construction sector reported that their business performance had remained stable over the past 3 months. Only 23 % of respondents reported improving performance for the same period of time. Likewise, a larger proportion of construction businesses (73%) reported no change in the number of staff over a longer period of time (past 12 months), according to the latest Business Link South East Business Monitor.

Looking forward, some 42% of construction firms in the South East expect to increase their turnover in the next 12 months, while only one in six businesses (15%) expect to recruit more staff over the next year. This disparity is most likely to be associated with the fact that a significant proportion of firms are still operating below full capacity, so they do not need to take on additional staff to cope with their workload. As a result of reduced employment opportunities, there are anecdotal reports from Kent that skilled labourers are now prepared to work at significantly reduced rates.

Business specific intelligence indicates, for instance, that **Frankis Solutions** has secured a £2m investment from Octopus Ventures to fund the expansion of its Kent-based land restoration business, which will enable the company to increase its future site turnover. On the negative side, **Land Registry** has announced plans to shed a further 800 jobs, and has confirmed that offices in Stevenage and Tunbridge Wells will close in June 2011.

The picture in the property market is not particularly encouraging either, with demand for commercial floorspace remaining subdued. The economic partnership in Brighton & Hove, for instance, highlights the fact that the take-up by occupiers of office space for the calendar year 2009 stood at 40,000 sq ft, which represents only one third of the normal average annual take-up of 120,000 sq ft. Similarly, Berkshire Observatory reports that retail units in Reading had, on average, a vacancy rate of 6% in February 2010, compared with 2% in February 2009. New property developments are being stalled as lenders are reportedly now seeking much higher levels of security for loans.

Retail & wholesale

According to the latest South East Business Snapshot, companies in the retail & wholesale sector have seen some notable improvement in overall business performance over the last 3 months: a net balance of 19% report improved business performance, compared to an average of 8% across all sectors. Correspondingly, confidence in this sector is also greater than the South East average. A net balance of 38% of companies in this sector expect the business climate to improve in the next 3 months, compared to 35% across all sectors.

The latest CBI Distributive Trades Survey shows that retail sales nationally rose and orders grew again in March, but at a lower pace than in February. Expectations for April are similarly positive. However, the wholesale sector saw a fall in both sales and orders in March. Sales volumes are expected to be broadly flat in April, and orders are expected to fall slightly.

The latest Berkshire Economic Commentary reports a very mixed picture across the county for the first half of March 2010. Footfall figures for Newbury were 10% higher than during the same period a year ago, while footfall figures in Reading were on average 8% lower in February 2010 than February 2009.

In recent positive news for the retail & wholesale sector in the South East, **Mars** has started work on the development of a new £5.2m confectionery research centre in Slough. **The Range** is to create 150 jobs at a new homewares superstore due to open in **Worthing** in April. **Modelzone** is planning to expand its chain of 32 hobby stores to 43 this year, and **Tile Depot** is planning to expand its chain of 14 tile stores to 30 over the next two years. **TK Maxx** is to create 35 jobs at a new

Regional Intelligence Snapshot for the South East (cont'd)

HomeSense homeware store due to open at the Forbury Retail Park in April (Berkshire). Meanwhile **Wilkinson** is to create about 100 jobs at a new discount home and gardens store due to open in Reading in November.

However, **Game** is to close 43 of its 683 computer games stores over the next six months, including all of its 25 Debenhams concessions, with the loss of 247 jobs, and **Palmer & Harvey** is to shed up to 85 jobs at its Hove-based wholesaling business.

Business services & Finance

According to our latest Business Snapshot, in recent months, companies in the business & financial services sector have recorded a better performance than on average in the South East: 34% report that their overall business performance has improved in the last three months (30% regionally), while 18% report worsening conditions (22% regionally). Half (49%) of companies in the business & financial services sector are optimistic about the short-term outlook (business climate) - higher than the all-sector average (45%). Furthermore, companies in the business & financial services industry are more likely to plan increased investment in the next 3 months (40%) than the average regionally (34%).

This is corroborated by the latest Business Link Monitor: in the medium term (next 12 months) 57% of companies in the business & financial services sector expect higher turnover (51% regionally) and a quarter (25%) expect to increase staffing levels (21% regionally). **Hastings Direct**, for example, is considering plans to launch a chain of dozens of insurance branches across the country, depending on the success of three outlets in Sussex.

The latest CBI Financial Services Survey (March) shows that at UK level profitability in financial services rose for the third consecutive quarter, and expectations for the coming three months are the most positive since March 1999.

Tourism / hospitality

As the second largest tourism region after London, it is no surprise that the tourism industry in the South East makes a significant contribution to the economy. Visitors spent approximately £12 billion in the South East in 2009 which supported over 300,000 jobs, according to the latest Intelligence Update from Tourism South East.

The most recent performance data gathered by Tourism South East shows a healthy start for Q1 2010: on average, hotel occupancy is up 3.6%, the Camping & Caravanning Club and holiday park operators report increases in advance bookings for sites in the region and many of our visitor attractions are looking forward to a strong Easter.

Latest figures provided by the National Trust show that its properties in the South East enjoyed a boost in admissions between March 2009 and February 2010. Properties in Kent, Surrey and Sussex saw admissions increase by 14.9% to almost 3 million; properties in Berkshire, Buckinghamshire, Hampshire, Isle of Wight and Oxfordshire saw an increase of 17.5% to almost 1.5 million visitors during the same period.

However, according to our latest Business Snapshot, companies in the hotels and restaurant sector were significantly more inclined to report worsening business performance over the last 3 months (58%) than on average regionally (22%). On the other hand, this sector is very optimistic about the next 3 months ahead, perhaps reflecting the recent improvements in hotel occupancy and advanced bookings for holidays. 63% of businesses in the hotels and restaurants sector expect the business climate to improve, compared to 45% on average for all sectors in the region.

On the positive side, the latest figures from BAA show that **Southampton International Airport** reported the strongest growth of all its six airports during February, with traffic rising 5.9% compared to the same period in 2009, to 114,900. Latest figures from **Gatwick Airport** show that a total of

2.05 million passengers travelled through the airport during February 2010, with a gain in the domestic market of 4.7% compared with February 2009. However, the new owner of Gatwick Airport, Global Infrastructure Partners (GIP), has told 120 staff working in its planning and commercial departments to reapply for their jobs as part of a major overhaul of its management structure as it looks to compete with Heathrow and Stansted.

Macdonald Hotels & Resorts has unveiled plans to open a 120-bedroom hotel in Windsor. The hotel is due to open in August, and is expected to have meeting space for up to 270 delegates and first class facilities for business travellers. Meanwhile, **Southampton City Council** and developer **Hammerson** have signed a development agreement to push forward plans for the £150m Watermark WestQuay scheme. Proposals for the scheme include a 3,500sq m (37,674sq ft) park and public plaza, a 150-bedroom hotel, restaurants and cafés and up to 24,000sq m (258,334sq ft) of retail space and a residential development.

However, **Portsmouth Football Club** has gone into administration through UHY Hacker Young, casting doubt on the future of up to 600 jobs. Elsewhere, after three challenging years, the **Beaverbrook Foundation**, owner of **Cherkley Court and Gardens**, has reluctantly decided that the gardens will not be open to the public in 2010. The decision follows two consecutive wet summers and the general economic conditions.

Agriculture / Rural

Members of the Kent Economic Board report that currently the market for fruit is strong, but arable farmers are suffering as input prices exceed yield prices. Input prices per ton of grain now average £120, but yield is only £90 per ton. Delays in the planning system are proving frustrating for some farmers, with some reportedly receiving offers from the South African government, which is keen to attract experienced farmers and horticulturalists to develop this important sector of the country's economy. Unlike commercial property values, agricultural land values have risen recently. As a consequence, banks seem to be more willing to lend to farmers, but increasingly not for diversification.

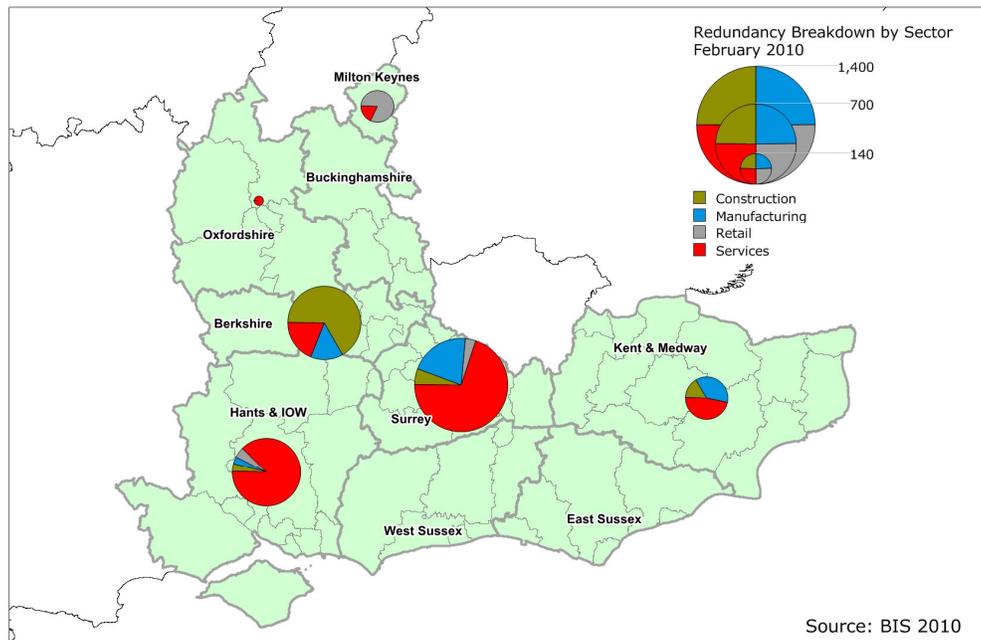
Redundancy Notifications

According to HR1 data there was a notable fall in the number of redundancy notifications in the South East between February and March, from 3,650 to 1,885.² February's figure was unusually high, though, so the figure for March represents a return to the trend seen in the latter part of 2009.

The vast majority of redundancy notifications (78%) in March were in the service sector (excluding retail) – continuing a trend seen since the latter half of 2009. This figure is slightly higher than the sector's share of employment in the South East (around 60%). The share of redundancies in the manufacturing sector has dropped to its lowest level for 18 months (9%) though it remains slightly higher than this sector's share of employment in the region (8%). The figure is significantly lower than in the spring and summer of 2009, when manufacturing accounted for the majority of large redundancy notifications. In contrast to last month, a relatively small proportion of redundancies were announced in the construction sector (9%), while the share of redundancies in the retail sector was also small (5%).

² To some extent this reduction could reflect the fact that from March the HR1 data has been verified by brokers from SEEDA's Continuing Employment Support Service, who have excluded any notifications which relate to redundancies outside the South East or are simply renewals of contract rather than job losses. This should provide a more accurate picture of total large redundancies for future monthly Snapshots. The data now also includes some smaller redundancies, picked up by the brokers, which fall below the threshold of 20 job losses required for a company to submit an HR1 form.

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



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