

Summary of economic conditions

- The latest GDP revisions showed that the **UK economy grew by 0.3%** (up from 0.1%) in the last quarter of 2009. This upward revision is corroborated by the latest results of the South East Quarterly Business Survey (February 2010) which indicate that, **for a majority of businesses, overall performance has remained stable (47%) or improved (30%)**, while a fifth (22%) reported worsening performance in the last 3 months.
- In Q1 2010, **South East business confidence rose for the fourth consecutive quarter, reaching its highest level since 2004**, according to the latest ICAEW Business Confidence Monitor. 140 senior business professionals in the South East scored a Confidence Index of 24.3 in the first quarter of 2010, up from a low of -38.7 for the same period last year.
- The **performance of the manufacturing sector in the South East has improved considerably** in the first quarter of 2010, according to the latest EEF Business Trends Survey. Total output rose significantly, from a balance of 9% in Q4 2009 to 32% in Q1 2010, while the balance for new orders increased from 16% to 35%.
- After a relatively stable few months, **the performance of the South East labour market has deteriorated somewhat**, with a rise in unemployment of 12,000 in the 3 months to December (the largest of any region) and an increase of nearly 10,000 in the claimant count between December 2009 and January 2010. Redundancy notifications increased significantly, from 980 in January to 3,650 in February.
- The latest ICAEW Business Monitor shows that firms reported an **average cut in the number of employees of 2.7% over the last year – a record decline for the region**. Small businesses in the South East reported using notably more casual and seasonal staff than any other region.

Key challenges and hotspots

- Despite the improved business performance in the South East, **many companies continue to see a negative trend in terms of their profit margins and cash flow**. Two-fifths (44%) of firms reported that their customers delayed payments to them (up from 39% previously) and almost a third (28%) said they had to delay payments to their suppliers, according to the latest Quarterly Business Survey.
- Anecdotal evidence from businesses suggests that the **key challenges they face are overall economic uncertainty, including concern about impending public sector funding cuts**, while for some businesses bank charges, low profit margins and a scarcity of credit remain of concern.
- Business Link reports that enquiries relating to access to finance and the Enterprise Finance Guarantee scheme are increasing again after January. Meanwhile, there is a **growing trend for ‘necessity’ start-ups** (resulting from redundancy).
- Capital investment at UK level fell markedly in Q4 2009, but the Quarterly Business Survey for the South East shows that **recent investment levels in key business areas have been solid, particularly in marketing and sales, and in staff training**, and a clear majority of businesses expect to maintain their future levels of investment. These expectations are corroborated by the ICAEW Business Confidence Monitor which reports that firms in the South East expect to increase their level of capital investments by 2% over the coming year.

Business specific intelligence / information on key questions

- Anecdotal evidence suggests that the **extreme weather conditions experienced from early January onwards severely affected the retail and hospitality sector**, in contrast to an upbeat December. Footfall figures fell and sales growth was slower compared to the previous January.
- The latest FSB Annual Survey highlights that **over half of South East small businesses have introduced new or improved products or services in the last 12 months and the same proportion plan to do so over the next year**. The largest proportion of innovative firms is in Buckinghamshire (66%) while the smallest is in West Sussex (48%).
- The **number of 18-24 year olds claiming Jobseekers Allowance in the South East increased by more than 2,500 between December 2009 and January 2010, and by 11,900 in the year to January**. This is likely to be a significant undercount of the ‘true’ number of unemployed young people, since many are still being supported by their parents rather than claiming benefits. More positively, at a recent CBI South East Council meeting, half the members reported that they were planning to increase graduate recruitment.

Sectoral Overview

Manufacturing

According to the Institute of Chartered Accountants in England and Wales (ICAEW) UK Business Confidence Monitor, confidence in the Manufacturing & Engineering sector in Q1 2010 remains at Q4 2009 levels and just above the all-sector average. There are signs of hope for the sector, including the support of the relatively weak pound.

The most recent Engineering Employers Federation (EEF) Business Trends Survey for the South East, for Q1 2010, paints a generally positive picture for the region's manufacturers. Looking at the difference between the proportion of firms reporting improvement and the proportion reporting deterioration (the balance), the total volume of output and new orders both recorded a very positive balance, of 32% and 35% respectively in Q1 2010. This was significantly higher than the 9% balance for output and 16% for new orders in quarter 4 of 2009. The volume of new export orders has also shown significant improvement on the previous quarter, with a very positive balance of 35% for Q1 2010, compared to just 3% in the last quarter of 2009.

Anecdotal evidence from EEF members in February 2010 confirms that a number of manufacturing & engineering companies in the South East are exporting or expect to export in 2010 to non-EU markets (such as the BRIC countries – Brazil, Russia, India and China, as well as the Middle East and US) given the relative weak domestic demand. Some of them pointed to investment in cost-saving technologies and machinery as key competitive advantages to gain access to global markets. However, most firms, especially in the automotive industry, are investing in marketing and sales to ensure their position within the market remains strong, as reported by Hampshire Economic Partnership.

A number of EEF's South East members are agreed on the fact that tightening cash flow, lack of appropriate skills and increasing regulation (i.e. red tape) are factors acting as barriers to a sustained recovery. There is a mixed picture in terms of employment. Some manufacturers in the region reported downsizing of staff in 2009, while others said they were recruiting specialised staff. However the majority of EEF's members reported that they have been attempting to maintain staff numbers, although under more flexible working conditions. The EEF South East Business Trends survey confirms that staff numbers have remained flat between quarter 4 of 2009 and the first quarter of 2010.

Although overall margins on domestic sales and cash flow levels have fallen over the past quarter in the South East, encouragingly, there has been some improvement in capital expenditure plans, with the balance rising from -17% in quarter 4 of 2009 to -3% for quarter 1 2010. However, almost two fifths of respondents reported that their capital expenditure plans had remained the same.

Credit conditions in the manufacturing industry nationally appear to be beginning to stabilise. The majority of companies who sought finance in January and February had their needs met, with most companies reporting no change in the cost of credit in the past two months. However, with many manufacturers expecting their finance requirements to increase in the next two months, having placed relatively few demands on the banking system in recent months, the supply of credit could yet be placed under strain.

Business specific intelligence highlights the differing performance of sub-sectors within the manufacturing industry in the South East. In the chemicals and pharmaceuticals sector, for instance, firms are raising funds to invest in new technologies and research & development. **Oxford Nanopore** has raised £17m from investors to fund the commercial development of its DNA mapping technology. **Exosect**, the Hampshire-based agrochemicals company, has raised £2.2m from investors to fund the commercial development of its pest control products. **Vernalis** (of Winnersh, Berkshire) has raised £25m in a share placing to fund the expansion of its pharmaceuticals research business. In the engineering sector, conversely, some firms are still cutting labour costs. For instance, Farnborough based **BAe Systems** is to shed 230 of the 4,500 jobs at its submarine site in

Barrow-in-Furness, while **Siemens Flow Instruments**, based in Frimley, is to close its factory in Stonehouse, Gloucestershire, by the end of the year, with the loss of 116 jobs, in order to transfer production to France and China.

Construction / property

The Construction sector posted the largest gain in confidence in the first quarter of 2010, rising from 15.1 to 24 points, according to the UK ICAEW Business Confidence Index. Meanwhile, property sector confidence moved back in Q1 2010 but still remained above the low levels recorded in 2009. ICAEW's latest report indicates that recovery in the housing market has surpassed expectations, boosted by a gradual pick-up in lending. However, the fragility of the recovery is highlighted by the fact that although mortgage approvals in November 2009 reached their highest level since March 2008, they have since fallen to an eight month low in January 2010.

However, anecdotal evidence from Hampshire Economic Partnership suggests that the current high level of tendering opportunities in the construction industry could be explained by a rush to start projects before the election, and there is likely to be a lull in activity very shortly. Indeed, the impending election makes the future unclear and the feeling is that whichever party wins power there are likely to be significant cuts in spending, with knock-on effects on the construction sector.

Across Berkshire, the performance of the commercial property market in early 2010 appears mixed. Vacancy rates in Bracknell Forest stood at 9% on average in January 2010, compared with 12% in January 2009. In the Royal Borough of Windsor & Maidenhead, by contrast, the number of empty business premises has continued to rise in February 2010. Businesses specific intelligence suggests that Reading's recent bid for city status could bring substantial benefits in terms of job creation, new inward investment and property market value. For instance, **Wilkinson** has already signed to take 25,000 sq ft of first floor space at Broad Street Mall, Reading, with a store opening date set for early November 2010. Elsewhere, plans have been unveiled to build a £60m event venue at the **Bluewater Shopping Centre**, which could create hundreds of jobs. Work to construct the centre, which will host retail and leisure exhibitions and shows, is expected to start in spring 2010.

Retail

According to the latest UK ICAEW report, confidence in the retail & wholesale sector grew for the fourth consecutive quarter in February 2010 and now stands slightly above the composite index for the UK. However, the same report also cautions that consumer spending in 2010 is likely to come under strain due to weak earnings growth, further rises in precautionary saving and debt repayment.

The latest CBI Distributive Trades Survey shows that retail sales nationally saw the fastest growth since May 2007 in the year to February 2010 – exceeding expectations of broadly flat sales. Orders also rose on a year ago. While price inflation accelerated on the past three quarters, the deterioration in other retail conditions continued to ease: the fall in employment slowed for the second quarter running, and investment intentions for the coming year have stabilized for the first time since August 2007. Overall, retail sentiment for the next quarter is broadly unchanged, and further sales growth is predicted in March. Wholesalers saw a modest increase in sales volumes in February, but sales continued to fall sharply among motor traders.

While Christmas provided a considerable boost to many retail & hospitality businesses in the South East (particularly SMEs in Surrey), the extreme weather conditions experienced from early January severely affected the sector in contrast with an upbeat December. The latest Berkshire Economic Commentary (February 2010) reports that the High Street has suffered a very difficult start to the year with the slowest January sales growth for 15 years. The value of goods sold grew by just 1.2% in January compared with the previous year as bad weather kept shoppers away. January car park figures were hit very hard by the severe weather as well. In Windsor & Maidenhead, car parking usage in January 2010 was 8% lower than the same time last year due to the snow, while car park revenue also dropped over the same period of time. In Reading, footfall and car parking figures

were, on average, 12% lower in January 2010 than January 2009. However, retail sales in the month were only 0.1% lower.

In recent positive news for the retail sector in the South East, **TK Maxx** has opened a new store in Windsor, employing 50 people, while the company is also set to create 35 jobs at a new HomeSense homewares store due to open at the Forbury Retail Park in Reading in April. Elsewhere, **Aldi** has been given the go-ahead to build a new store on BAe Systems' land at Northwood on the Isle of Wight, and Witney-based **Past Times** is planning to expand its chain of 120 gift shops with about 25 new outlets this year.

Transport

The transport and storage sector showed one of the strongest gains in business confidence as the relevant UK ICAEW Index increased from 13 to 27 points between Q4 2009 and Q1 2010. This is corroborated by business specific intelligence relating to new initiatives in the South East transport sector. For instance, **Medway Council** has approved plans for the development of a new £6m bus station in Chatham by April 2011. Similarly, **City Link**, based in Blackwater, Surrey is investing £2.5m in a new 870,000 sq ft parcels distribution centre in Warrington (Cheshire), and this will be followed by a similar site in Peterborough and a multi-million pound investment in its branch network.

Anecdotal evidence from Hampshire Economic Partnership suggests that some companies in the transport and logistics sector are attempting to extend their networking abroad. However, some SMEs in Hampshire have found their bids for contracts significantly undercut by larger firms, who are prepared to cut their prices in order to win business. As a result, SMEs would welcome more opportunities to bid for public sector contracts.

Business Services & Finance

Despite a slight decline in the UK ICAEW Index, business confidence in the banking, finance & insurance sector remains strong in Q1 2010 as most banks return to profitability under low interest rates and quantitative easing monetary policies. Additionally, anecdotal evidence from the latest Berkshire Economic Commentary indicates that lenders have raised the cost of borrowing through increased facility fees and tightened other lending criteria, which, while helping to boost banks' profitability, has had a knock-on effect on finance for development.

Anecdotal evidence from the industry suggests that there is a 'good appetite' for commercial mortgages in the South East but the loan to value ratio is not totally realistic yet as property prices are still depressed. The timescale for commercial mortgages has fallen substantially from 25 years to 15, 12 or 10 years during the economic downturn. Moreover, they argue that there is still a reduced appetite for lending to industries dependent on discretionary spending such as pubs, clubs and restaurants. More generally, banks may not be willing to fund restocking as the upturn begins, so further insolvencies are very likely.

In spite of some improvement in profitability, business specific intelligence indicates that some businesses are still downsizing or restructuring their staff. For instance, **Skandia** is to shed a further 150 of the 1,900 jobs at its pensions and investment office in Southampton. Likewise, **Alliance & Leicester** is to close its financial call centre in Ashford in June, with the loss of up to 128 jobs, in order to transfer the work to Merseyside and Leicestershire.

Tourism / hospitality

The latest Tourism South East Intelligence Update (March 2010) points out that despite tough challenges for some parts of the industry, the overall level of confidence amongst the region's tourism businesses for performance in 2010 is higher than a number of other key industries such as construction and transport. Tourism South East's latest 'How's Business Monitor' shows that, on average, 42% of all businesses surveyed experienced better performance for the whole of 2009

compared with 2008, which is up from 39% last year. Indeed, the latest figures released by VisitEngland (from the UK Tourism Survey) shows that there were just over 15.5 million trips made by UK residents to the South East during the first ten months of 2009, an increase of 13.8% compared with the same ten months in 2008. The number of bednights (up 12.0%) and visitor spending (up 12.1%) also saw increases over this period.

Local visitor attractions in the South East were adversely affected by the severe weather in January, and more generally hotels are finding that they need to work hard to offer good value for money and flexibility in a more competitive market, particularly for weddings and events.

Looking ahead, the latest research suggests that 75% of Britons plan to take a break in the UK this year and many of these trip takers will chose self catering and camping or caravanning holidays. Across the South East, bookings for Camping and Caravan Club sites are already 14% up on this time last year. Business specific intelligence indicates that **Norton Grange Coastal Village** is creating up to 100 new jobs, following the refurbishment of its hotel in Yarmouth on the Isle of Wight. Elsewhere, **Macdonald Hotels and Resorts** is to open a new 120-bedroom hotel in the former Caley's department store in Windsor in summer 2010.

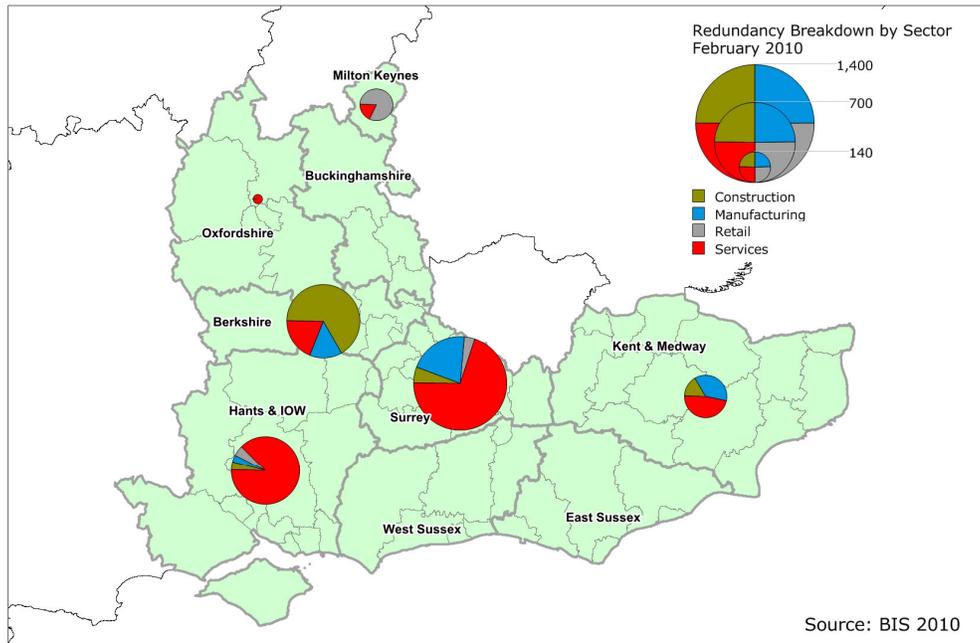
By contrast, in the hospitality sector fierce price competition, mainly in the restaurant and licensed pubs and bars industry, is heavily increasing the burden of labour costs and hence leading to deteriorating working conditions. Anecdotal evidence from the latest Berkshire Economic Commentary suggests that it is not uncommon for management teams to be working in excess of 60 hours a week to cover front line bar staff/waiting staff simply to reduce labour costs. As a consequence, staff paid by the hour are being laid off or having their hours drastically cut. Meanwhile, the widespread 'Two for One' type offers at lunchtimes in restaurants are increasingly putting adverse pressure on operating margins.

Redundancy Notifications: According to HR1 data there was a significant increase in the number of redundancy notifications between January and February 2010, from 980 to 3,650. This is the largest monthly increase since September 2009.

The majority of redundancy notifications (57%) in February were in the service sector (excluding retail) – continuing a trend seen in the latter half of 2009. Similarly to last month, redundancies in the construction sector accounted for about one fifth of all notifications. The share of redundancies in the retail sector was up slightly on last month, at 8%.

Surrey saw the largest number of redundancy notifications of any county in February (1,350, or 37%), including several large redundancies in the service sector. Berkshire and Hampshire and the Isle of Wight each accounted for around one quarter of all large notifications this month, the majority of which were in the service sector. Meanwhile, there were no large redundancies recorded in Sussex or Buckinghamshire this month, and very few in Oxfordshire.

**Redundancy notifications by sub-region, volume and sector
February 2010 (Source: HR1 data via BERR / Job Centre Plus)**



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