

Summary of economic conditions

- According to the latest Purchasing Managers Index survey, **Business activity and incoming new business in the South East increased for the 11th consecutive month**, and was relatively strong compared to the rest of the UK. However, the pace of increase in order books was the slowest since September 2009.
- **Business confidence in the South East has risen for the fifth consecutive quarter**, and is the second highest nationally, according to the latest ICAEW Business Confidence Monitor (BCM) for Q2. South East businesses are more **positive about the outlook for turnover growth** than at any time since Q1 2008, with turnover expected to grow by 6.4% in the next 12 months - higher than in any other UK region. This is corroborated by anecdotal evidence from business representative organisations, reporting that companies in the South East continue to feel confident as the economy emerges from the recession.
- **Employment rose for the second month in a row** in May, although at a slightly slower pace than in April, according to the latest South East PMI. Businesses expect to **increase the number of employees by 1.3%** in the next twelve months, compared to a decline of 0.8% in the previous 12 months, with salaries expected to grow by 1.1%, according to the ICAEW's South East Business Confidence Monitor.
- The claimant to vacancy rate has remained stable for the last three months, at 4 claimants per vacancy. There were 152,000 Job Seekers Allowance claimants in April, 4,400 less than in March, and there were 1,236 more vacancies than in March. Redundancies dropped from 3,100 in April to 1,540 in May.
- The latest RICS Housing Market Survey (April) shows a positive net balance of surveyors reporting **rising house prices in the South East for the tenth consecutive month**, well ahead of any other UK region (apart from London). However, the seasonally adjusted balance is the lowest since it started to increase in July 2009.

Key challenges and hotspots

- The proportion of firms reporting **access to capital** as a greater challenge to the performance of their organisation declined to its lowest level since the collapse of Lehman Brothers, according to ICAEW BCM Q2. This is corroborated by evidence from Surrey Economic Partnership, reporting that **many SMEs are finding it easier to raise finance from banks**. However, this is not consistent across the board, probably because banks are looking very closely at borrowing requests based on the last 12 months' trading performance.
- According to anecdotal evidence from businesses and business representative organisations, **caution and uncertainty are reported from many businesses 'waiting and watching' to see what impact public sector spending cuts have** on supply chains and capital programmes for which the business community contract.
- Businesses which depend upon 'discretionary' expenditure by their customers are still struggling, suggesting that customers are only buying what is absolutely necessary, according to Surrey Economic Partnership.
- **Capital investment plans remain relatively cautious, but are now positive** at 1.6% of businesses in the South East planning investment in the next 12 months, according to the ICAEW. This compares to a negative -4% in the last 12 months.

Business specific intelligence / information on key questions

- **Consolidation is a key trend for many businesses in retail, construction and the third sector**, and there have been notably fewer retailers falling into administration in the last quarter, according to Kent Economic Board. However, evidence from Berkshire suggests that there are few signs of continued improvements in the retail sector. There have been further shop closures and when they are filled it is with poor quality temporary retail which does not attract footfall.
- A large number of enquiries from businesses are centred on how to increase sales opportunities, networking, and marketing, according to Business Link Surrey. There has also been a steady **growth in interest in 2012 sub-contracting opportunities**, according to Surrey Economic Partnership.
- **Currency fluctuations and the weak pound**, coupled with **rising raw material costs** 'eating into profitability' makes it **difficult for exporting companies** to have confidence in maintaining profit margins, according to Kent Economic Board. For example, the rise in paper prices (30% in the year to date) has negatively affected the packaging as well as the graphic design industries in the South East, particularly in Kent.

Sectoral Overview

Manufacturing

Business Confidence in the UK manufacturing & engineering sector has risen this quarter to stand 61.6 points higher than at this time last year. According to the Institute of Chartered Accountants in England and Wales (ICAEW), 30.1% of survey respondents reported in Q2 2010 that they are more confident about the economic prospects in the sector for the next 12 months, compared to 26.8% in Q1 2010. In addition to the continued depreciation of sterling (since mid-2007), recent re-stocking of inventories is said to have further bolstered demand in the manufacturing industry.

However, the picture appears to vary across the South East. Anecdotal evidence from Kent Economic Board highlights three main drivers of market fluctuations and business uncertainties. Firstly, traditional stable patterns of demand have not been re-established yet as the tail-end effects of de-stocking and a lack of long-term market confidence are still generating volatile trading conditions. Secondly, the weak pound and sharp currency fluctuations are posing difficulties for those exporting to quote with any confidence of maintaining profit margins – particularly in a “90 day valid quote” environment which is the industry norm for many businesses. Thirdly, fluctuating and rising raw material costs coupled with the weak pound are said to be undermining business profitability. Paper prices have risen 30% in the year to date, due to low production in Chile and rising demand from China, and this has negatively affected the packaging as well as the graphic design industries in Kent and elsewhere. Business specific intelligence indicates that, for instance, **Weston Business Forms** has gone into administration through Portland Business & Financial Solutions, with the loss of 31 jobs at its Southampton-based printing business.

Conversely, in Oxfordshire and Surrey the manufacturing sector appears to be performing better, at least in the automotive industry. Business specific intelligence indicates that **BMW** (based in Oxford) has reported first quarter pre-tax profits in its core automotive division three times higher than the previous quarter. The £250m figure for the first three months of 2010 was higher than stock markets had anticipated and followed a loss of £215m in the first quarter of 2009. Sales of Cowley built minis increased by 13.6% on last year, to 49,526 in the first three months of 2010. At the same time, ‘buoyant’ sales of **Caterham**’s lightweight two-seater cars from Surrey, means the firm will be boosting capacity at its production plant by a quarter, as well as increasing production staff by 20%. The firm has seen consistently strong UK sales boosted by a rapid rise in overseas demand over the past 12 months.

Construction / property

Following signs of improvement in Q1 2010, confidence in the construction sector nationally has dipped this quarter from 24% to 14.1% of respondents, as indicated in the most recent UK ICAEW Business Confidence Monitor. This comes as official data suggest the sector may slip back into recession – a second successive quarter of decline in construction sector output was recorded in the last quarter. Businesses in the sector are being hit by the still patchy lending recovery and the prospect of lower orders from the public sector, as cuts loom large in the next few months. Similarly, confidence in the housing market stuttered from 25% of respondents in Q1 2010 to 19% in Q2 2010, with mortgage approvals falling back. At the same time, though, commercial property has shown signs of recovery.

Anecdotal evidence from Kent Economic Board suggests that the construction sector is concerned about the cuts in public spending that might impact on large capital projects and therefore affect civil engineering and public works contracts. The uncertainty due to the election has delayed decisions in the short term – but clearly fixed organisational costs continue so there is pressure on the bottom line.

Many construction companies are finding it increasingly difficult to find the talent, experience and skills they need in the current labour market – so there is a desire to retain staff but concerns about what might be affordable in fragile market conditions.

However, the recession has resulted in consolidation in the construction sector and those that have survived (mainly large firms) are likely to thrive during the recovery. For instance, **Denne Construction Ltd** achieved some £75 million of orders last year, which culminated in 2009/2010 being a record year. The company had recently picked up five contracts from other contractors whose businesses had failed. Likewise, **Skanska** remains optimistic and is committed to opening a local office in Maidstone this summer and has been active in supporting and championing the use of Apprenticeships.

Retail & wholesale

According to the latest ICAEW Business Confidence Monitor, the retail & wholesale sector in the UK saw a drop in confidence from 27.6 in Q1 2010 to 20.8 points in Q2 2010. The VAT hike and imported inflation from rebounding oil prices, combined with further sterling depreciation, contributed to the annual rate of inflation reaching 3.4% in March. With average earnings growth still relatively weak, real disposable incomes have been squeezed.

This is corroborated by the latest results from the CBI – Distributive Trades Survey which indicates that, after three consecutive months of growth, retail sales volumes declined in the year to May, despite expectations of another increase. Retailers plan to authorise less capital expenditure over the coming year, after a stabilisation in investment intentions in the previous survey. However, wholesalers saw further growth in sales volumes in May, while motor traders also saw an increase after four months of declining sales.

In the South East, the picture differs between counties and sub-sectors. On the one hand, Kent Economic Board reports that discretionary spend is cautious with fashion retail reporting low sales, and sales of gift products falling, though home-wares & electrical goods seem to be holding up, and health & beauty products are doing well. It is also reported that there have been notably fewer retailers falling into administration in the last quarter. Yet, it is noted that vacant shops have become a feature of many high streets – partly a consequence of the trend amongst large retailers to consolidate, thus shedding sites and focusing their operations in prime locations. As an example, **John Lewis** is to open two new At Home stores in Swindon and Tunbridge Wells this year, with the creation of 350 jobs. Likewise, **Poundland** has opened a shop in the former Woolworth's store in St George's Street, Canterbury, creating 30 jobs.

On the other hand, the Berkshire Economic Strategy Board reports that, in the first half of April 2010, footfall figures for Newbury were 10% higher than during the same period a year ago. Similarly, Maidenhead had, on average, a vacancy rate of 9.7% in April 2010, compared with 12.5% in April 2009. In Windsor, the empty ex Woolworths store has now been let to **Boots** who will create a new flagship unit, therefore requiring additional staff.

Consumer services & hospitality

The latest results from the CBI Service Sector Survey (May 2010) for consumer services in the UK show that business volumes fell, but are expected to post marginal growth next quarter. Moreover, the inflation in selling prices was lower than had been expected and offset by faster growth in costs. This led profitability to fall unexpectedly strongly, at its fastest rate since last August. In the light of the current situation firms delivering consumer services expect to make cuts to their capital expenditure on IT and vehicles, plant and machinery in the coming year.

Sub-sectoral information from CBI suggests that hotels, bars and restaurants experienced a surprise fall in business volumes. As a result of this, and the fact that costs per employee have grown faster than selling prices, the sector saw a decline in its profitability.

There is a mixed picture in the South East, however. On the one side, Surrey Economic Partnership reports that businesses in the hospitality industry continued to see an increase in bookings last

month. However, business specific intelligence indicates that **Kent International Hotel** in Ramsgate, for example, is due to close in June, with the loss of more than 20 jobs.

The leisure and personal care services sub-sector saw business volumes fall moderately, at national level, though slightly faster than the quarter before. Selling prices were stable, having shown little change in the past three quarters, while costs per employee grew a little. The trend in profitability was lower again, increasing at the slowest rate since profits last grew in May 2008. However, the picture for this sub-sector appears to be different in the South East. Business specific intelligence indicates that **Cavendish** has been appointed by a group of doctors to raise £80m from investors to fund the development of a new hospital in Kent, under the name of the Kent Institute of Medicine & Surgery. Meanwhile, **Home Instead** is planning to create about 30 jobs at its new homecare franchise in Fareham.

Transport & communications

Further evidence of economic recovery has arrived in the first increases in value and volume of business for the UK transport of goods & post industry since May 2007, as indicated by the latest CBI – Service Sector Survey. Unfortunately, a surprisingly strong jump in total costs in the past three months, allied with continuing deflation in prices charged, prevented this from lifting profits, which fell further.

There is a mixed picture along the South East coastal area. Business specific intelligence shows that **G Lashly**, the Hampshire-based haulage firm with 14 staff, has gone into voluntary liquidation through Portland Business. Similarly, on the other side of the South East coast, **P&O Ferries** have scrapped a new service to Zeebrugge, less than a month after launch. The 78 crew members will be redeployed throughout the P&O fleet. The service from Dover to Zeebrugge has been withdrawn due to a lack of current demand from customers. However, at the same time, **LD Lines** is set to create around 100 jobs with the introduction of a second ship sailing between Boulogne and Dover.

According to the most recent UK ICAEW report, non-transport infrastructure problems have become substantially more of an issue for businesses in the South East over the last six months. The proportion of firms reporting non-transport infrastructure problems as a greater challenge than a year ago rose to one in six (16%) in Q1 2010, up from just 4% six months earlier. In Hampshire, the Local Economic Partnership suggests that the lack of a good broadband service is still hindering thousands of businesses across the county. It should be noted that this is not only in rural areas but in some key urban locations as well.

Business Services

According to the most recent CBI – Service Sector Survey, UK firms in the management & legal services sector were more optimistic than they were three months ago, despite a modest fall in business volumes. Selling prices fell at a slower rate, costs per employee rose gently, and the trend in profitability was low. Firms anticipate an end to recent deflation and light growth in business next quarter to offset faster costs and deliver a small rise in profits.

This trend is corroborated by evidence from Berkshire which indicates that, for example, **Ceridian**, the HR and payroll firm is to expand its office at Green Park, Reading, from 6,000 sq ft to 13,000 sq ft.

Agriculture / Rural

The agricultural sector in the South East is still facing tough conditions. In addition to the continued fall in output, the sector is now struggling to find the appropriate skills in the labour market. Anecdotal evidence from the Kent Economic Board suggests that one firm commenced the first harvest of the year with only two local people applying for picking / harvesting jobs. This highlights how dependent the operation is on the 500 Eastern European workers who have returned again to work this year. Moreover, business specific intelligence from Kent indicates that **Farms Ltd** has been flooded with applicants with inappropriate skills as colleges are turning out large numbers of individuals with management skills in agriculture & horticulture and not enough with technical skills (such as high level mechanical operational trades, husbandry, etc.)

Voluntary sector

A recent survey of voluntary and community sector organisations undertaken by RAISE (the umbrella group for the voluntary sector in the South East) in April 2010 showed that the majority of voluntary organisations see their key challenge for the next quarter as securing funding to sustain core services, particularly in the context of rising numbers of service users. Nevertheless, there has been a significant increase since January in the proportion of respondents who feel confident in their ability to meet increases in demand for their services now and in the coming year (up from 19% to 34%).

Other challenges identified by voluntary organisations include diversifying income sources and the need to identify gaps in service delivery and develop appropriate partnerships to respond to these opportunities. Overall the sector is slightly less optimistic compared to the last quarter, with less than two fifths of respondents believing that the current economic climate has created opportunities for their organisation.

Redundancy notifications

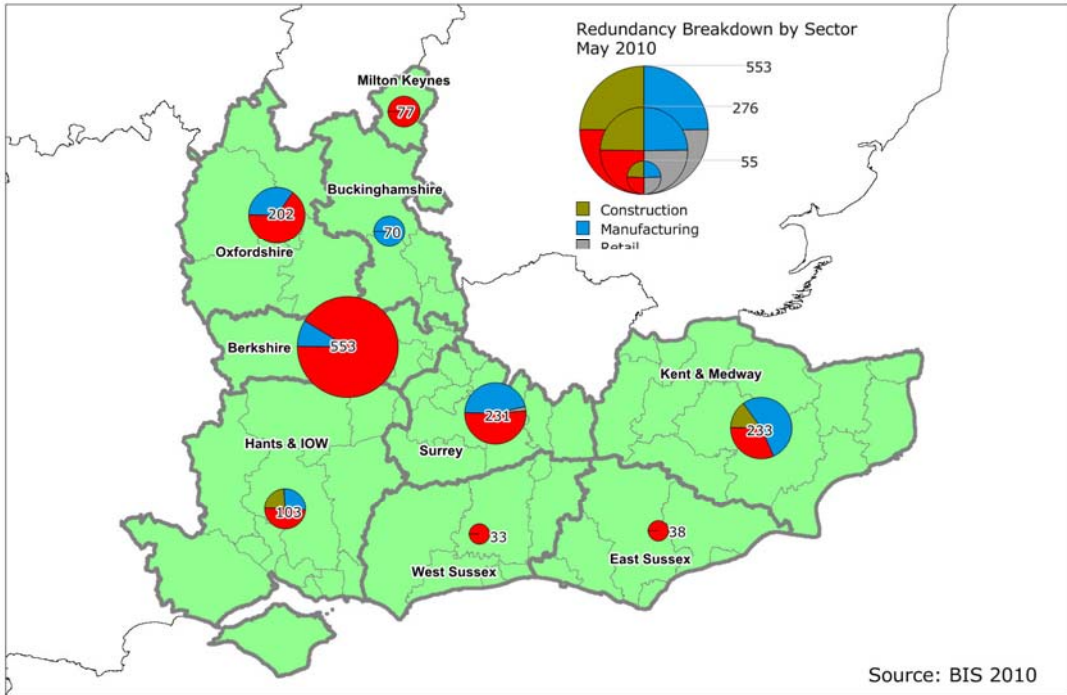
According to HR1 data, verified and checked using intelligence from SEEDA's Continuing Employment Support Service¹, there was a notable fall in the number of redundancies in May – from 3,110 in April to 1,540 in May. This is lower than the trend seen in the second half of 2009, when total redundancies averaged about 2,000 per month.

The majority of redundancies (67%) were in the service sector this month. This is greater than that sector's share of total employment in the South East (60%). Public sector job losses continue to make up a substantial proportion of redundancies in the service sector (two thirds). The share of redundancies in the manufacturing sector was slightly higher than last month (and indeed the trend seen for most of the past year), at 29%. This is still substantially higher than the sector's share of employment in the region (8%). The proportion of redundancies in the construction and retail sectors was substantially smaller than in recent months, at 4% and 0.3% respectively.

By far the largest number of redundancies this month (36% of the South East total) were recorded in Berkshire – the vast majority of which were in the service sector. Surrey and Kent & Medway each accounted for around 15% of all redundancies, with significant numbers of job losses in manufacturing in these areas. Once again there were few large redundancies recorded in Sussex, but a surprisingly low number in Hampshire and the Isle of Wight compared to recent months.

¹ Brokers from SEEDA's Continuing Employment Support Service exclude any notifications which relate to redundancies outside the South East or are simply renewals of contract rather than job losses. This helps to provide a more accurate picture of total large redundancies. The data 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
 May 2010 (Source: HR1 data via BIS / Job Centre Plus – verified by South East Continuing
 Employment Support Service)**



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