Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q4 2015 Economic Review

SUMMARY

"While we must not forget the strengths of the UK economy – our recovery is still fragile. Given uncertainties in the global arena right now, it is important to avoid unnecessary risks and I hope the Monetary Policy Committee will continue to keep interest rates low."

Mike Ashton, Chief Executive, Herefordshire & Worcestershire Chamber of Commerce

GENERAL NATIONAL OVERVIEW

The 4th Quarter shows that most key manufacturing and services balances were weaker this quarter, but manufacturing firms fared far worse. This has led Britain's two-tier growth trend to become further entrenched.

Most key balances for the services sector dipped slightly again on the previous quarter, with domestic sales continuing to be the main contributor to overall growth. The sector however continues to remain resilient in the face of global headwinds.

However the manufacturing sector continues to struggle. Domestic and export sales and order balances have now fallen well below their pre-recession levels in 2007, suggesting that the sector is close to stagnation. Firms are looking to increase prices markedly in the next 12 months, but are also thinking about investing more in plant and machinery, suggesting that the sector is keen to make the most of low inflation and low interest rates to improve productivity.

The domestic balances fell in Q4 2015 for both manufacturing and services. In the manufacturing sector, the domestic balances dropped further below their prerecession levels in 2007. The balance of manufacturing firms reporting improved domestic sales was +13% in Q4 2015, down from +20% in Q3 2015, and is now at the lowest level since Q1 2013. The balance for manufacturers' domestic orders was +10% in Q4, down from +18% in Q3, and is at the lowest level since Q4 2012. The service sector's balance for domestic sales fell from +36% in Q3 2015 to +32% in Q4 2015, the lowest level since Q3 2013. The service balance for domestic orders was +23% in Q4, down from +29% in Q3, the lowest level since Q2 2013.

Nationally, domestic manufacturing balances are static in Q3. The balance of manufacturers reporting improved domestic sales was +20% and for orders +18%. Service sector's balance for domestic sales rose from +31% in Q2 to +36% in Q3. The services balance for domestic orders stood +29% in Q3 unchanged from Q2.

The national export balances weakened in Q4 2015 for both manufacturing and services. The balance of manufacturers reporting improved export sales fell by nine points in Q4 2015, to

+1%, the lowest level since Q3 2009. The manufacturing sector balance for export orders also fell to +1%. The service sector balance for export sales fell by three points in Q4 2015 to +15%, the lowest level since Q4 2011. The service balance for export orders fell by seven points in Q4 to +9%, also the lowest level since Q4 2011. The national export balances weakened in Q3 2015 for both the manufacturing and services sectors. In the manufacturing sector, the balance of firms reporting improvements in export sales is not only below its prerecession level in 2007, but is also below its long-term historical average. The manufacturing balance for export sales fell to +10%, the lowest level since Q3 2009. The balance of service sector firms who reported improved export sales fell by one point in Q3 2015 to +18%, the lowest level since Q1 2012. For service sector export orders, the balance fell by four points in Q3, to +16%, the lowest level since Q3 2012.

The national employment balances weakened in Q4 2015 for both manufacturing and services. In the manufacturing sector, the balance of firms reporting an increase in their labour force over the last three months fell to +20%. The balance of manufacturers expecting their labour force to expand in the next three months fell five points to +17%, the lowest level since Q1 2013. In the service sector, the backward-looking employment balance fell one point in Q4 2015, to +23%. The forward-looking service employment expectations balance fell by three points in Q4 to +21%, the lowest level since Q1 2013.

The balance of manufacturing firms that have revised upwards their plans to invest in plant & machinery rose by six points in Q4 2015 to +24%. The balance of manufacturers that have revised upwards their plans to invest in training rose by three points in Q4 to +23%. The balance of service firms that have revised upwards their plans to invest in plant & machinery rose three points in Q4 2015 to +20%. The balance of service firms that have revised upwards their plans to invest in training fell by one point in Q4 to +26%.

The national manufacturing confidence balances, after falling in Q3, were broadly stable in Q4 2015, recording very small divergent movements. The balance of manufacturing firms confident that turnover will improve in the next 12 months fell from +43% in Q3 to +42% in Q4, the lowest level since Q4 2012. The balance of manufacturing firms confident that profitability will improve in the next 12 months rose from +32% in Q3 to +33% in Q4. The balance of service sector firms expecting turnover to improve in the next 12 months fell markedly from +54% in Q3 to +45% in Q3, the lowest level since Q1 2013. The balance of service sector firms expecting profitability to improve in the next 12 months fell from +42% in Q3 to +41% in Q4.

Capacity utilisation in Q4 2015 rose in the manufacturing sector and was unchanged in the service sector. The percentage of manufacturing firms operating at full capacity increased by five points in Q4 to 41%, joint highest level since Q4 2014. The percentage of service firms operating at full capacity was unchanged in Q4 at +48%, an all-time high for our survey.

The balance of firms reporting improvements in cashflow recorded divergent movements in Q4 2015, rising for manufacturing and falling for services. The balance of manufacturers reporting improved cashflow rose from +9% in Q3 to +12% in Q4, still slightly lower than its average 2007 pre recession level. The balance of service sector firms reporting improved cashflow fell two point in Q4, to +14%, the same as the average 2007 level.

Intentions to increase prices rose markedly in the manufacturing sector and fell slightly for service firms. The balance of manufacturing firms reporting an intention to raise prices rose by eleven points in Q4 2015 to +19. The balance of service firms expecting to raise prices fell two points in Q4 to +21%. Both manufacturing and service firms report sharply increased pressures for higher pay settlements.

OVERVIEW LOCAL LEVEL

The local figures are more positive than the National outlook, showing slight increases in many of the key areas, although in the area of employment the figures are lower which is similar to the National pattern.

The local Q4 results for the manufacturing and service sector results show a slight increase in domestic sales and order balances. Nationally, balances were lower.

The national employment balances weakened in Q4 for both manufacturing and services. Locally, the balance of firms which grew their workforce in the previous three months has decreased and the balance of firms anticipating growth over the next three months has weakened, similar to the national anticipation. Skilled/manual and Professional/managerial positions are the most difficult positions to fill locally, which seems to be a consistent pattern over many quarters now.

Both the manufacturing and the services sector expect no change in investment for plant/ machinery/equipment/buildings or for training.

Locally, businesses believe that turnover and profitability will improve. This is for both the manufacturing and the services sector although slightly lower percentages than the last quarter.

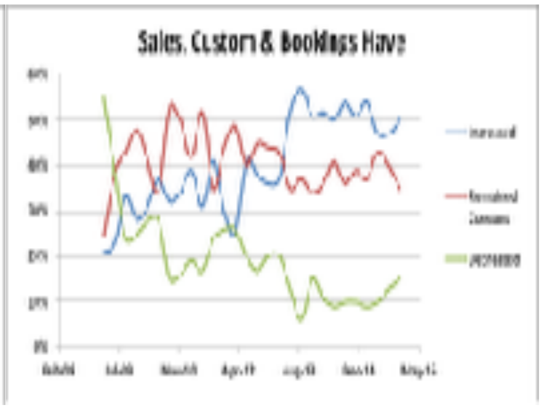
The main causes of price increase were again raw material prices, other overheads and pay settlements.

Concerns locally are competition, exchange rates and corporation taxation. Last quarter main concerns were competition, exchange rates and business rates.

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

Locally, the domestic sales balance was 35%, up 1% on the last quarter. There was an increase in domestic sales at 50% (an increase of 3% on the last quarter).

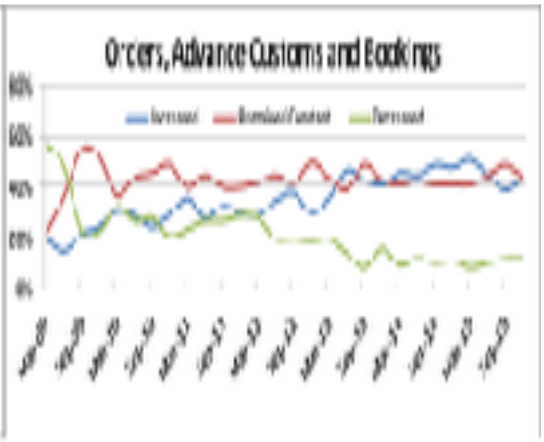


ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 44% increase for orders and advance bookings in the domestic market (which is up 5% Q3). The balance is at 32% (Q3 the balance was 27%).

44% of local manufacturing saw an increase in orders. Nationally, both manufacturing and sales domestic orders are down.

The local service sector figures show 44% reporting an increase in orders, 7% higher than Q3, 47% with orders remaining constant and 9% with decreasing orders over the last three months. Nationally, the balance for service domestic orders has fallen.



EXPORT SALES

SALES, CUSTOM AND BOOKINGS

The export sales balance is at 32% in Quarter 4, up from Quarter 3.

43% saw export sales increase, which is 4% higher than the last quarter. Only 14% of companies saw a decrease in their overseas sales, custom and bookings, up just 2% on last quarter.

Local manufacturers reported 42% increased sales, 21% decreased sales and 37% experienced constant overseas sales. Local service sector sales figures were lower at 43% increased sales, 10% decrease but with 47% remaining constant.

Nationally and locally export balances weakened.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

The balance for overseas orders has increased 12% to 32% in Q4 2015. There has been an 8% increase in the number of orders from Q3 to Q4.

OVERVIEW - EMPLOYMENT

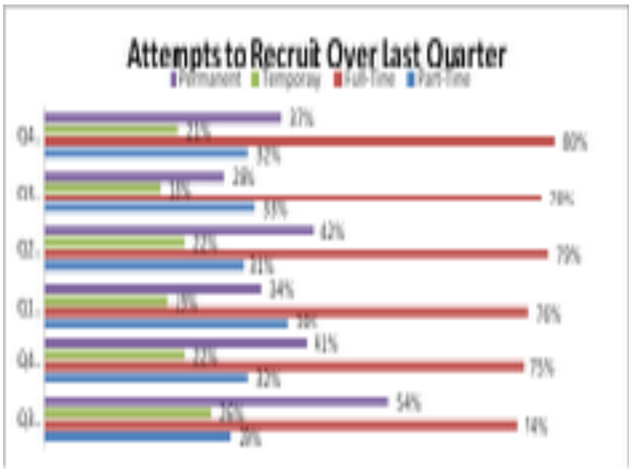
Changes to Workforce

The workforce change balance has decreased 8% to 15%. There was a 25% increase in workforce in Q4, just 5% lower than Q3.

24% of companies responding reported

plans to increase their workforce over the next three months (previous quarter was 27%), with just 8% with plans to decrease the workforce, the same as last quarter.

ATTEMPTS TO RECRUIT



80% of companies who responded have attempted to recruit full-time staff, an increase of 2% on the last quarter. Employing permanent positions has increased 9% on the previous quarter to 37%. There is a 3% increase on last quarter for filling temporary positions. Taking a closer look at the local level we see that 62% of local manufacturers have attempted to recruit in the last quarter which is 3% higher than the last quarter and 44% in the service sector, which is down 2% on Q3. Nationally, the employment and recruitment balances are lower.

32% of local manufacturers have seen an increase in their workforce, which is just a 2% decrease on Q3. Turning to the local service sector, 21% increased their labour force, which is a 6% decrease on last quarter.

RECRUITMENT DIFFICULTIES

Recruitment difficulties were experienced by 55% of businesses, up 1% from Q3.

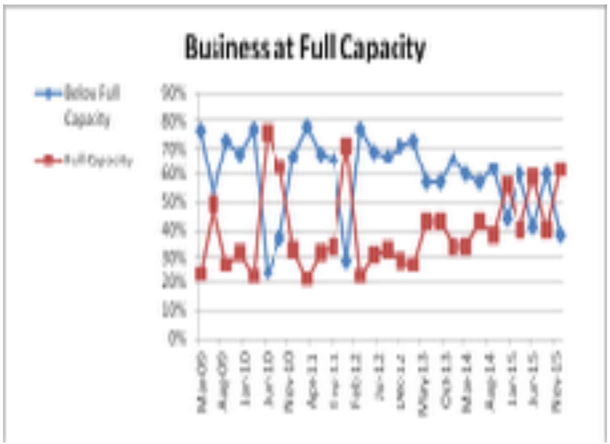
57% of local manufacturers and 54% of local services have reported recruitment problems.

The key difficulty for the manufacturer and service sector businesses alike was finding skilled manual/technical staff and also professional/managerial staff. This follows a similar pattern to the last few quarters.

EXPECTATIONS TO RECRUIT NEXT QUARTER

The balance for companies expecting to recruit is 16% in Q4, down 3% from the last quarter.

There is a high percentage from both the local manufacturing and service sector report that they expect their workforce to remain constant over the next 3 months.



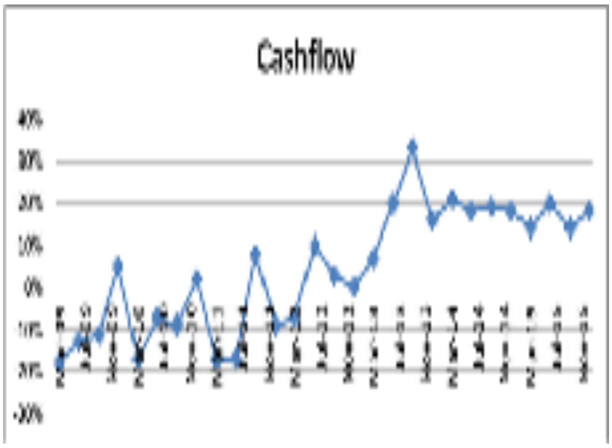
CAPACITY CONSOLIDATION, CASHFLOW & INVESTMENT

Capacity

62% of local businesses reported to be operating at full capacity (up 22% from the last quarter). 38% of local businesses are below full capacity (22% lower than the last quarter).

Turning to local manufacturers, 40% stated over the last period they operated at full capacity and 60% reported to be operating below full capacity. Figures in the service sector show that 38% are operating below full capacity and 62% operating at full capacity.

CASHFLOW



Regarding the cashflow balance this has increased 14% to 18%.

35% reported an improved cashflow experience, 2% higher than Q3. 48% stated their cashflow remained the same which is the same figure as the last quarter. 17% reported a worsening cashflow (2% lower than last quarter).

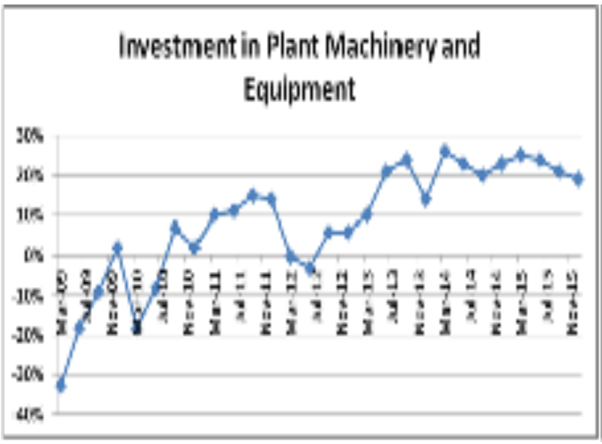
36% reported improved cashflow figures in the service sector and 34% reported improved cashflow in the manufacturing sector. Nationally, the balance of manufacturers reporting improved cashflow rose from +9% to +12% in

Quarter 4. The balance of service sector firms reporting improved cashflow fell two points in Quarter 4.

INVESTMENT

Overall the investment balance is -34%. Investment in plant machinery and equipment is down 2% to 19%. Investment in training is the same as last quarter at 21%.

57% of local manufacturer's have seen investment in plant machinery and equipment remains the same, slightly lower than last quarter. 68% of local services have seen investment in training remain the same, down just 1% on last quarter.



EXTERNAL FACTORS

PRICE PRESSURES

The balance figure for pressure on businesses to raise prices has increased 3% to 17%. 23% of companies surveyed experienced pressures to raise their prices, 2% lower than the last quarter.

6% reported they expect prices to decrease over the next quarter. 71% anticipate their price levels to remain unaffected, down just 1% on the last quarter. 23% of local services

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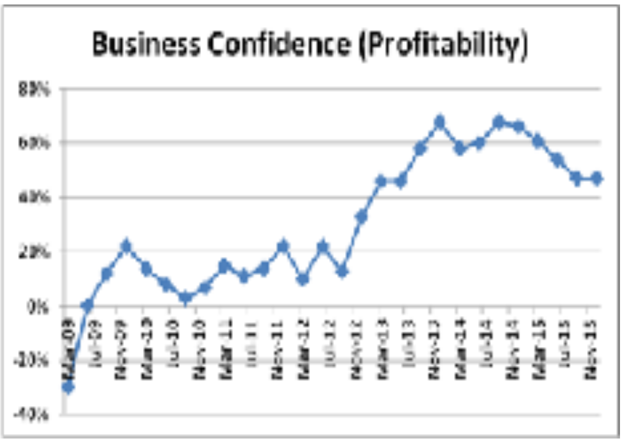
and also 23% of local manufacturing firms expect prices to rise.

Overall, other overheads, pay settlements and raw materials were mentioned as main contributors to price increases which are the same as the last few quarters'. Factors of concern to businesses were competition, exchange rates and corporation tax.

BUSINESS CONFIDENCE

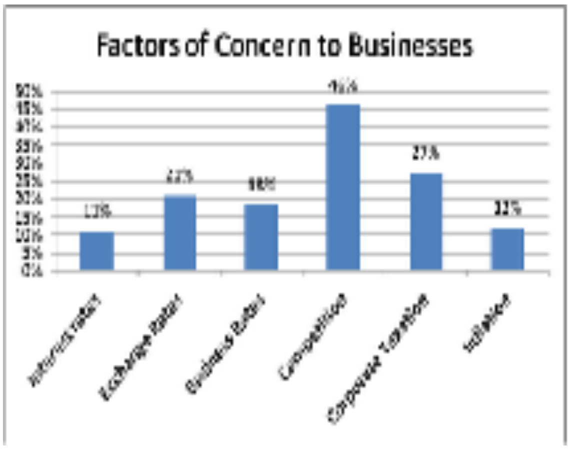
The turnover balance has decreased 1% to 57%. The profitability balance has remained the same as last quarter at 47%.



61% of local manufacturers are expecting an increase in turnover, the same as the last quarter and 49% believe profitability will improve, 10% lower than Q3. Confidence figures for the local service sector show that 67% expect turnover to improve. (10% higher than Q3) and expectations of profitability show that 60% expect profitability to increase (this is 5% higher than Q3).

FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are competition, corporation tax, exchange rates (46%, 27% and 21%).



Locally, the manufacturing sector has also included interest rates as a main concern.

Summary 4th Quarter 2015

Although the key national balances remained positive in Q4 2015, pointing to continued growth, they confirm that the UK economy is facing challenges. In both the manufacturing and services sectors, most key balances were weaker in Q4 2015 than in Q3, with the manufacturing results suffering to a greater degree. The domestic and export manufacturing balances for both sales and orders are now well below their pre-recession levels in 2007. The sharp decline in the Q4 export manufacturing balances, to levels approaching stagnation, is particularly disturbing. However, there were some positive results in the Q4 survey, as the balances for investment in plant & machinery rose for both the manufacturing and services sectors. Capacity utilisation was high in both sectors, in spite of the falls in the domestic and export balances. The need to build new capacity, as labour costs increase, may explain the increase in Q4 investment balances at a time of slowing demand. Intentions to increase prices rose markedly in manufacturing and fell slightly in services. Both manufacturing and service firms also report sharply increased pressures for higher pay settlements.

John Longworth, Director General of the British Chambers of Commerce, said:

“While these latest figures demonstrate growth, it is clear that there are warning signs of potential trouble ahead. The declines across the board should send a message to government that UK firms are in desperate need of a favorable business environment, not more administrative burdens.

“It is not enough to rely upon consumer spending and the housing market to grow the economy, nor to rely purely on services to drive export growth. We need a rebalanced economy if we are to continue punching above our weight on the global stage. The quality and variety of our goods and services is what gives Brand Britain its strength overseas.

“The vast windfall from the OBR in the Autumn Statement led to revised forecasts based on improving tax receipts. However businesses can’t focus on growing amid a storm of red tape and tax compliance burdens. In addition, government policy has created overwhelming pressure to increase pay settlements, despite downward pressure on wages created by continued migration to the UK. Businesses are finding themselves chafed and stagnating.

“The real concern is that this period of two-tier growth becomes the norm rather than a blip. This requires the government to make 2016 a year of action, on infrastructure, skills, and access to non-equity finance for firms. Otherwise the UK economy could suffer negative consequences in the face of increasing global uncertainty.”

David Kern, Chief Economist at the British Chambers of Commerce, said:

“Coming after relatively weak figures in our Q3 survey, the falling balances in Q4 highlight the risk that the pace of growth may slow further. The results also underscore the serious obstacles that the UK will face when trying to rebalance the economy towards net exports. While worsening global circumstances are the main impediment, we are not doing enough closer to home to encourage businesses to trade overseas.

“The sharp decline in export manufacturing balances, to levels approaching stagnation, is particularly disturbing. Slowing growth in international markets is causing these firms to become pessimistic about their short-term prospects.

“Though our vibrant and resilient services sector will remain the main UK growth driver, the Q4 results indicate that it is also losing some of its momentum. But the challenges facing manufacturing are much more serious.

“While we must not forget the strengths of the UK economy - with higher growth than in most G7 economies and with a dynamic and flexible labour market - the recovery is still fragile. Given the global uncertainties, it is important to avoid unnecessary risks. Though wage pressures are rising, inflation is likely to remain below target over the next 18 months, and the MPC should keep interest rates at their current low levels for the time being.”