Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q2 2014 Economic Review

How's business in Herefordshire & Worcestershire?

SUMMARY

"The Quarterly Economic Survey for Q2 2014 shows that recovery is continuing to move in the right direction, although the pace is slow. Most key balances show falls when compared with the unusually strong Q1 figures but both manufacturing and services balances are stronger than their long-term averages. Locally, the trends remain positive and show progress".

Herefordshire & Worcestershire Chamber of Commerce

GENERAL NATIONAL OVERVIEW

The national domestic balances recorded small divergent movements in Q2. All the domestic balances remain at historically high levels. One manufacturing balance is at an all-time high. Two domestic balances fell back in Q2, one in manufacturing and one in services. The manufacturing sector's net balance for domestic sales rose from +38% in Q1 to +42% in Q2, a new all-time high for the QES. The net balance for manufacturers' domestic orders fell from +42% in Q1 to +41% in Q2, just below the all-time high recorded in Q1. The service sector's balance for domestic sales was +35% in Q2, the same as in Q1, and at a historically high level. The balance for service domestic orders fell from +33% in Q1 to +30% in Q2, still a high level.

The national export balances fell in both sectors in Q2. But all the export balances remain positive and are relatively strong. All are still higher than their average 2007 pre-recession levels for both manufacturing and services. The manufacturing balance for export sales dropped from 40% in Q1 to +30% in Q2, the worst level since Q2 2013. The manufacturing balance for export orders fell from 35% in Q1 to +31% in Q2, still a high level by historical standards. The service balance for export sales dropped by nine points in Q2, to +29%, the worst level since Q4 2012. The service export orders balance fell by seven points in Q2, to +30%, the worst level since Q3 2013.

The national employment balances recorded mixed movements in Q2. The backward-looking employment balance fell for manufacturing and rose for services. The forward-looking employment expectations balances fell for both sectors. The manufacturing employment balance fell one point, to +30%, the lowest since Q2 2013, but still a high level by historical standards. The manufacturing employment expectations balance dropped nine points, to +31%, also a high level. The service employment balance rose three points, to +19%. The service employment expectations balance fell three points, to +26%, still a relatively high level.

All the national investment balances recorded falls in both sectors in Q2. However, all the investment balances remain above their long-term historical averages. The balance of manufacturing firms that have revised upwards their plans to invest in plant & machinery fell eight points, to +29%, the worst level since Q3 2013 but still relatively high. Manufacturing intentions to invest in training fell three points, to +30%. The balance of service firms that have revised upwards their plans to invest in plant & machinery fell two points, to +21%, the worse since Q3 2013 but still a relatively high level. Service sector intentions to invest in training remains high by historical levels but fell two points, to +28% this quarter.

The balance of manufacturing firms operating at full capacity rose two points in Q2, to +46%, a joint all-time high for the survey. The balance of service firms operating at full capacity fell two points, to +44%, but this is still high level.

The Q2 cashflow balances improved for both sectors. The manufacturing cashflow balance rose four points, to +17%, the best level since Q3 2013, and a historically strong level. Services cashflow rose two points, to +17%, the best since Q4 2006 and a very strong level by historical standards.

Intentions to raise prices eased in Q2 in both sectors. The balance of manufacturing firms reporting pressure to raise prices fell seven points, to +17%, the lowest level since Q2 2013. The balance of service firms expecting to raise prices dropped 10 points, to +19%, also the lowest level since Q2 2013.

OVERVIEW LOCAL LEVEL

The national Q2 results are positive overall and show continued growth. However, for both manufacturing and services, most key balances fell in Q2 following the unusually strong Q1 figures, but are still stronger than their long-term averages.

Locally, trends are still showing positive signs from the domestic market. Domestic sales and orders have showed an overall improvement and have increased for both services and manufacturing firms.

Overseas sales and orders have shown an improvement compared with Q1. Although the national export figures fell, locally they are very positive.

There has been an increase in workforce over the last 3 months although over the next 3 months relating to workforce the percentage increase is lower than Q1 but for remaining the same the percentage has increased. Full-time positions have increased. Firms that had difficulties in recruiting has doubled since Q1 showing an issue with recruitment and skills.

There has been a slight decrease in investments in plant and machinery.

Overall, turnover and profitability locally have improved compared with Q1.

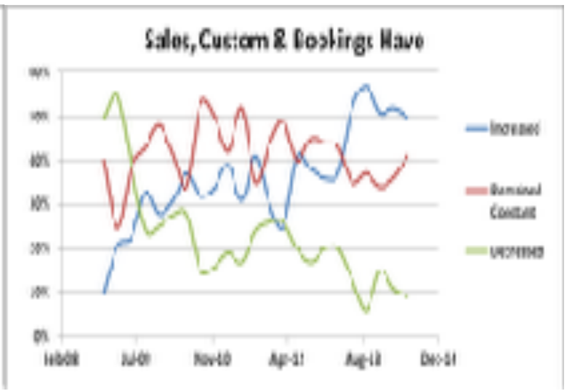
Pressure to raise prices has increased slightly compared to Q1. The main causes of price increases were other overheads and raw material prices.

Concerns locally are competition, corporation tax and business rates. These have been the same concerns over many quarters.

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

The domestic sales balance is 41%, which is the same as Q1. All the domestic balances remain at historically high levels in both sectors. Increased sales were reported by 50% of local businesses, just 2% lower than the previous quarter. 41% reported their sales figures have remained constant.



47% of local manufacturing saw an increase in sales (down 14% from Q1). Figures for the local service sector show an increase of 52% (up 4% on Q1), a decrease of 8%, with 39% remaining constant.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 45% increase for orders and advance bookings in the domestic market (down just 1% on Q1). The balance is at 33% (Q1 the balance was 37%).

47% of local manufacturing saw an increase in orders, 6% lower than Quarter 1.

The local service sector figures show 42% reporting an increase in orders, 2% lower than Q1, 43% with orders remaining constant and 11% with decreasing orders over the last three months (2% higher Q1).

EXPORT SALES

SALES, CUSTOM AND BOOKINGS

The overseas figures are much higher this quarter. 43% saw export sales increase, which is 26% higher than the last quarter. Just 12% of companies saw a decrease in their overseas sales, custom and bookings.

Local manufacturers reported 36% increased sales, 8% decreased sales and 34% experienced constant overseas sales. Local service sector sales figures were lower at 12% increased sales, 5% decrease but with 16% remaining constant.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

The balance for overseas orders has increased to 24%, 12% higher than Q1. There has been an increase in orders from 16% in Q1 to 37% in Q2.

OVERVIEW - EMPLOYMENT

Changes to Workforce

The workforce change balance has increased to 24% (4% higher than Q1). There was a 27% increase in workforce in Q1, but in Q2 there are 4% points difference at 31% at Q2. Outlook regarding employment is still remaining positive. 32% of companies responding reported plans to increase their workforce over the next three months (previous quarter was 35%), with just 6% with plans to decrease the workforce.

ATTEMPTS TO RECRUIT

79% have attempted to recruit full-time staff, an increase of 5% on the last quarter. Employing permanent positions has decreased by 5% on the previous quarter. There is an 6% decrease on last quarter for filling temporary positions. Taking a closer look at the local level we see that 60% of local manufacturers have attempted to recruit in the last quarter which is up 4% on last quarter and 51% in the service sector, which is up 7% on Q1.

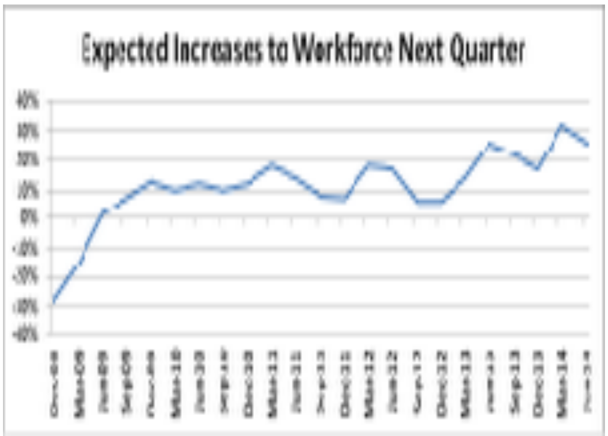
The recruitment of permanent staff has decreased slightly to 35%. Part-time recruitment has decreased 1%. Full-time staff recruitment is higher at 79%, which is an increase on the last quarter.

27% of local manufacturers have seen an increase in their workforce. Turning to the local service sector, 33% increased their labour force.

RECRUITMENT DIFFICULTIES

Recruitment difficulties have increased by 31% on the previous quarter. 55% of businesses experienced difficulties recruiting. 39% of local manufacturers (an increase of 8%) and 26% of local services (an increase of 4%) have reported recruitment problems.

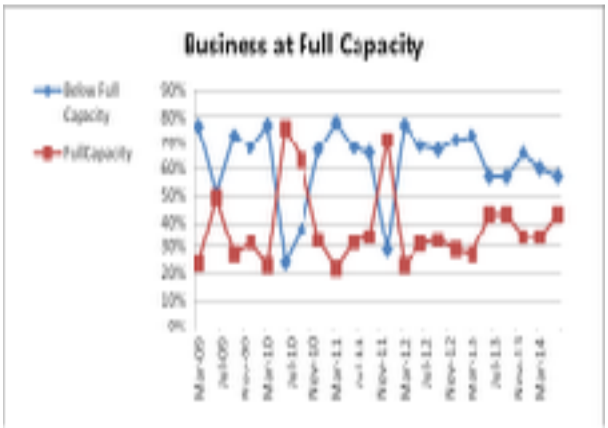
The key difficulty for manufacturer and service sector businesses alike was finding skilled manual/technical staff and also professional/managerial staff. This follows a similar pattern to the last few quarter's.



EXPECTATIONS TO RECRUIT NEXT QUARTER

The balance for changes to workforce is 26% which is a 6% decrease from the previous quarter.

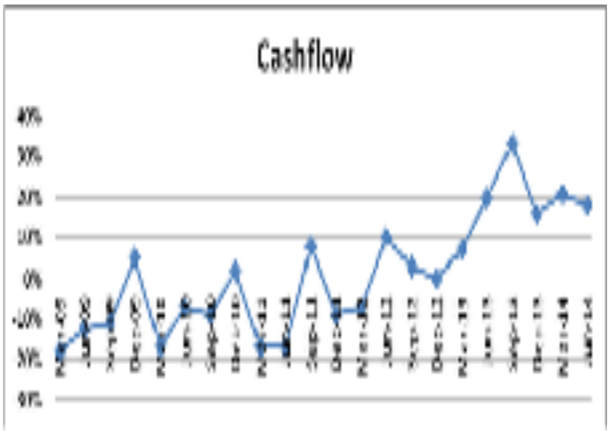
There were high percentages for the local manufacturing and service businesses reporting that they expect their workforces to remain on the same level. 61% of local service and local manufacturing sector businesses believe they will maintain their current staff levels.



CAPAPCITY CONSOLIDATION, CASHFLOW & INVESTMENT

Capacity

The full capacity balance has increased from the last quarter to 43%. 57% of local businesses reported to be operating below full capacity. Turning to local manufacturers, 37% stated over the last period they operated at full capacity and 53% reported to be operating below full capacity. Figures in the service sector show that 51% are operating below full capacity and 41% operating at full capacity.



CASHFLOW

Regarding the cashflow balance this has decreased to 18%, 3% lower than Q1.

31% reported an improved cashflow experience, slightly lower than Q1 and 56% stated their cashflow remained the same which is up 10% from the previous quarter. 31% reported improved cashflow figures in the service sector and 24% reported improved cashflow in the manufacturing sector.

INVESTMENT

Overall the investment balance is -33%. Investment in plant machinery and equipment is down slightly to 23%. Investment in training is down just 1% from the last quarter.

58% of local manufacturer's have seen investment in plant machinery and equipment remain the same. 63% of local services have seen investment in training remain the same.

EXTERNAL FACTORS

PRICE PRESSURES

The balance figure for pressure on businesses to raise prices has increased by 2% to 21%. 24% of companies surveyed experienced pressures to raise their prices, which is an increase of 3%.

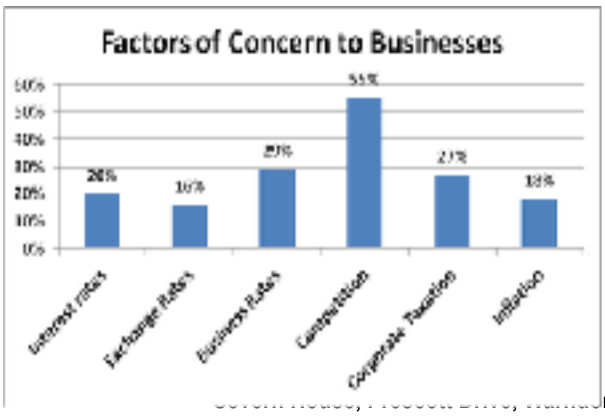
3% reported they expect prices to decrease over the next quarter. 73% anticipate their price levels to remain unaffected. 22% of local services and 20% of local manufacturing firms expect prices to rise .

Overall, raw materials and other overheads were mentioned as main contributors to price increases. This is similar to the previous five quarters now. Local manufacturing and service sectors mention that raw materials and other overheads were too the main contributors to price raises.

BUSINESS CONFIDENCE

Both the turnover and profitability balance have improved. Turnover confidence increased 7% from Q1 (from 70% to 77%). Confidence regarding profitability also increased by 2%.

67% of local manufacturers are expecting an increase in turnover, just 2% lower than Q1 and 61% believe profitability will improve, just 3% lower than Q1. Confidence figures for the local service sector remain the same for turnover as 70% believe they will see an improvement of turnover (the same as Q1) but expectations of profitability has decreased as just 38% expect profitability to increase (a decrease of 27% on Q1) .



FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are competition, business rates and corporation tax (55% and 29% and 27%).

Competition and corporation tax have been

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major concerns for companies over many quarters now.

Summary 2nd Quarter 2014

The Q2 2014 QES results are positive overall and point to continued growth. However, for both manufacturing and services, most key balances fell in Q2 following the unusually strong Q1 figures. It is important to put the results into perspective. For both manufacturing and services, all the key Q2 balances are stronger than their long-term averages. In manufacturing, three balances were at their all-time highs in Q2; domestic sales, profitability confidence and capacity utilisation; compared with six manufacturing balances at their all-time highs in Q1. In services, there were no balances at their all-time highs in Q2, compared with two all-time highs in Q1. Lower export and investment balances, for both manufacturing and services, are unwelcome. Even so, all the Q2 export balances, and most investment balances, are still above their average 2007 pre-recession levels. In both manufacturing and services, cashflow balances improved, intentions to raise prices eased, and wage pressures weakened.

Commenting on the results, John Longworth, Director General of the BCC, said:

“These are strong results that show the recovery is moving forward. Our members continue to do themselves proud by showing dedication, confidence and resilience. While we never like to report even modest declines in our investment and export balances, these are unsurprising, as the economy jolted forward last quarter and has now settled into a period of more stable growth. But we must still aim higher – great, long-term sustainable growth must be our ambition, and we should not settle for second best.

“Repairing our broken business finance system, which constrains access to credit for businesses with the potential to grow, must be a top priority. This will help to provide the building blocks for companies who can then look to take on additional staff, invest and grow.

“These results reinforce the case against the Bank of England making any hasty decisions on raising interest rates in the very short-term. By driving up the cost of credit for fast-growing firms, many of whom do not sit on the same healthy cash piles as their more established counterparts, early rate rises may mean more limited growth ambitions among the very firms we are counting on to drive the recovery. We must nurture the business confidence we are seeing at present by giving firms the security of working in a low interest rate environment for the foreseeable future – with eventual rises both moderate and predictable.

“As we enter a period of heightened political uncertainty, it is even more important to maintain a healthy and sustainable economic recovery. At this crucial stage of the economic cycle, the UK cannot afford populist decision-making that undermines strategic long-term decisions as this could jeopardise our national success in the years to come.”

David Kern, Chief Economist at the BCC, said:

“Although most key balances for Q2 are lower than the very strong figures seen in the first quarter, they remain high by historical standards. In our recent economic forecast, we predicted that quarterly GDP growth for Q2 would be 0.8%, with full-year growth of 3.1%. However, these results mean that risks of a downgrade have increased.

“The Q2 falls in all the export and investment balances act as a timely warning that although growth is stable, challenges facing our economic recovery still remain. Rises in sterling are making UK exports more expensive. Uncertainties around early interest rate increases are adding to the difficulties, and our excessively large current account deficit poses potential risks. UK growth cannot permanently rely on rising consumer spending, which is driven by a buoyant housing market, and on excessive household debt. Unless investment and net exports make bigger contributions to growth, the recovery could stall.

“Both the government and the MPC must make every effort to stimulate enterprise and wealth creation. On its part, the MPC must restore clarity to its forward guidance and reassure business that from next year they will face only gradual rather than sudden change. With inflation well below target and earnings still rising by less than one per cent per year, the risks to the recovery from raising rates prematurely are much greater than the risks of waiting a little longer.”