Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q2 2015 Economic Review

SUMMARY

"In Quarter 2 2015 QES results, there are signs of continued economic growth but this is driven mostly by the service sector. The manufacturing sector shows decline in most key areas nationally and highlights obstacles facing the sector. Locally, the manufacturing sector results are static and many key areas remain constant. The service sector follows the same pattern as national results with an increase in most key areas and positive figures."

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

GENERAL NATIONAL OVERVIEW

The national domestic manufacturing balances weakened in Q2 2015. In services, the national domestic balances recorded small divergent movements, but the overall position was broadly static. In manufacturing, the domestic balances are now below their pre-recession levels in 2007. The manufacturing sector's balance for domestic sales fell from +30% in Q1 2015 to +20% in Q2 2015, the lowest level since Q2 2013. The net balance for manufacturers' domestic orders fell from +27% in Q1 to +18% in Q2, also the lowest level since Q2 2013. The service sector's balance for domestic sales fell from +34% in Q1 2015 to +31% in Q2 2015, the lowest level since Q2 2013, but still slightly higher than in 2007. The net balance for service sector domestic orders rose marginally, from +28% in Q1 to +29% in Q2.

The national export manufacturing balances weakened in Q2 2015. For services, the national export balances recorded small divergent movements, but the overall position was broadly static. In the manufacturing sector, the export balances are now below their pre-recession levels in 2007. The balance for manufacturing export sales fell five points in Q2 2015 to +14% and the balance for export orders fell to +15%. These are the lowest levels since Q4 2012. The net balance for service sector export sales fell by two points in Q2 2015 to +19%, the lowest equal level since Q1 2012. The service balance for export orders rose by three points in Q2, to +20%.

The national employment balances recorded divergent movements in Q2 2015, falling in the manufacturing sector and rising slightly in the service sector, although both sectors are still above their average 2007 pre-recession levels. The balance of manufacturers which took on staff in the previous three months (the backward-looking balance) fell 12 points in Q2 2015 to +20%, the lowest level since Q2 2013. The balance of manufacturers which expect to expand their workforce (the forward-looking balance) fell five points in Q2 to +27%, also lowest level since Q2 2013. The backward-looking employment balance for the service sector rose two points in Q2 2015 to +22%. The forward-looking service employment expectations balance rose four points to +30%.

The national investment balances recorded divergent movements in Q2 2015, falling for manufacturers and rising slightly in service sector. The balance of manufacturing firms that have revised their plans to invest in plant & machinery upwards fell eleven points in Q2 2015 to +21%, the lowest level since Q3 2013. The balance of manufacturing firms that have revised their plans to invest in training upwards fell seven points to +26%, the lowest level since Q2 2013. The balance of service firms that have revised their plans to invest in plant & machinery upwards rose one point to +20%. The balance of service firms that have revised their plans to invest in training upwards rose three points to +27%, the highest level since Q2 2014.

The national balances for business confidence also saw divergence between the two sectors. The balance of manufacturing firms which believe turnover will improve in the next 12 months fell from +55% in Q1 to +51% in Q2, the lowest equal level since Q1 2013. The balance of manufacturers who believe profitability will improve in the next 12 months fell from +47% in Q1 to +45% in Q2, the lowest equal level since Q2 2013. The balance of service sector firms which believe turnover will improve in the next 12 months rose from to +50% in Q1 to +55% in Q2. The balance of service sector firms which believe profitability will improve in the next 12 months rose from +41% in Q1 to +45% in Q2.

Capacity utilisation fell slightly in the manufacturing sector and rose slightly in services. The percentage of manufacturing firms operating at full capacity fell to 34%, the lowest level since Q1 2013. The percentage of service firms operating at full capacity rose to 46%.

The balance of firms reporting improvements in cashflow remained unchanged for manufacturers but rose for the service sector. The manufacturing cashflow balance was static in Q2 at +11%, the joint lowest level since Q2 2013, and slightly lower than its average 2007 pre-recession level. The service sector cashflow balance rose five points in Q2 to +17%, slightly higher than in 2007.

Intentions to raise prices have increased markedly in the manufacturing factor but are down slightly for service sector firms. The balance of manufacturing firms who reported that they intend to raise prices increased by twelve points in Q2 2015 to +23%, the highest level since Q1 2014. The balance of service firms expecting to raise prices fell three points in Q2 to +20%, the lowest level since Q2 2014.

OVERVIEW LOCAL LEVEL

The local Q2 combined manufacturing and service sector results show a decrease in the domestic sales and orders balances which is the trend nationally but mostly driven by the decline in key balances for the manufacturing sector. Locally, the manufacturing sector results show that sales and orders have remained constant and the service sector results are more promising showing increases in sales and orders.

The national employment balances fell for both manufacturing and services. A higher percentage locally expect there to be no change in their workforce, which is a similar pattern to last quarter. Skilled/manual and Professional/managerial positions are the most difficult positions to fill locally.

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.

The main causes of price increase were raw material prices and other overheads. These are the same causes as Q1 2015.

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

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

The domestic sales balance is 37%, a decrease of 8%. Nationally, domestic manufacturing balances weakened in Q2 and services showed a small movement but broadly static. Locally, domestic manufacturing figures remained stable but reported lower increases than Q1. The local service sector shows an increase of 47%, just 7% down on Q1.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 45% increase for orders and advance bookings in the domestic market (which is down 6% from Q1). The balance is at 35% (Q1 the balance was 43%).

42% of local manufacturing saw an increase in orders, 6% lower than last quarter. Nationally, manufacturing domestic orders decreased further.

The local service sector figures show 43% reporting an increase in orders, 7% lower than Q1, 33% with orders remaining constant and 19% with decreasing orders over the last three months. Nationally, service domestic orders rose slightly.

EXPORT SALES

SALES, CUSTOM AND BOOKINGS

43% saw export sales increase, which is 6% lower than the last quarter. Only 10% of companies saw a decrease in their overseas sales, custom and bookings, down 4% on last quarter.

Local manufacturers reported 28% increased sales, down 7% from Q1, 11% decreased sales and 35% experienced constant overseas sales which is 4% higher than Q1. Local service sector sales figures were lower at 24% increased sales, 11% decrease but with 19% remaining constant.

Nationally and locally export sales weakened.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

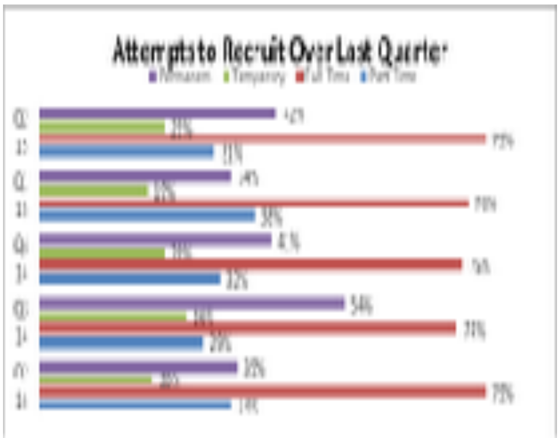
The balance for overseas orders has decreased 5% to 37% in Q2 2015. There has been an increase in orders from 47% in Q1 to 45% in Q2.

OVERVIEW - EMPLOYMENT

Changes to Workforce

The workforce change balance has decreased to 23%, 4% lower than Q1. There was a 33% increase in workforce in Q2, just 1% lower than Q1.

34% of companies responding reported plans to increase their workforce over the next three months (previous quarter was 34%), with just 8% with plans to decrease the workforce, 5% lower than Q1.



ATTEMPTS TO RECRUIT

79% have attempted to recruit full-time staff, an increase of 3% on the last quarter. Employing permanent positions has increased 8% on the previous quarter. There is 3% increase on last quarter for filling temporary positions. Taking a closer look at the local level we see that 61% of local manufacturers have attempted to recruit in the last quarter which is 1% higher than the last quarter and 49% in the service sector, which is up 2% on Q1.

38% of local manufacturers have seen an increase in their workforce, which is a 4% decrease on Q1. Turning to the local service sector, 29% increased their labour force, which is a 3% decrease on last quarter.

RECRUITMENT DIFFICULTIES

Recruitment difficulties were experienced by 56% of businesses, up 3% from Q1.

39% of local manufacturers (the same as last quarter) and 27% 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.

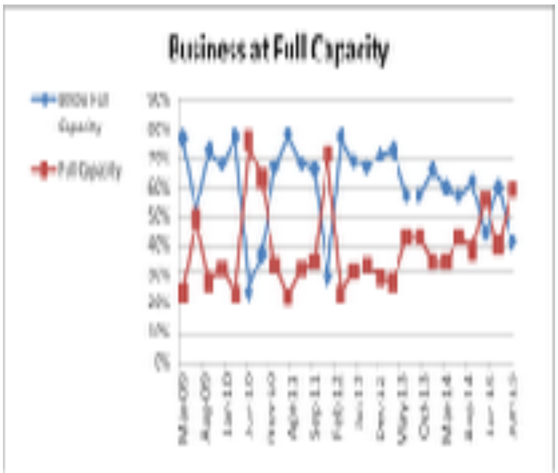
This follows a similar pattern to the last few quarters.

EXPECTATIONS TO RECRUIT NEXT QUARTER

The balance for changes to workforce is 32%, a 2% increase on last quarter.

A high percentage from the local manufacturing sector report that they expect their workforce to decrease over the next 3 months. In the local service sector businesses believe they will maintain their current staff levels. This follows a similar pattern to last quarter.

CAPACITY CONSOLIDATION, CASHFLOW & INVESTMENT

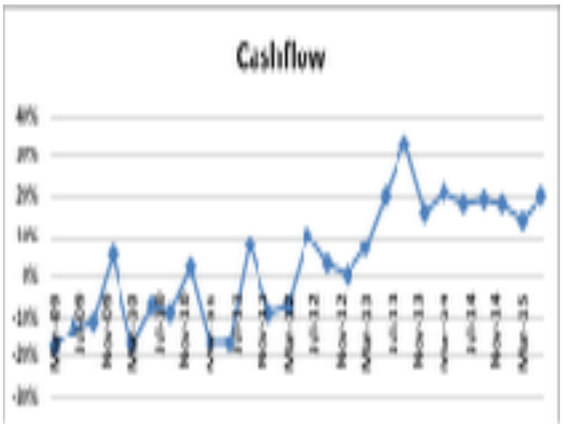


Capacity

The full capacity balance has increased to 59% (up 19% from the last quarter).

41% of local businesses reported to be operating below full capacity, a decrease of 19%. Turning to local manufacturers, 51% stated over the last period they operated at full capacity and 45% reported to be operating below full capacity. Figures in the service sector show that 37% are operating below full capacity and 56% operating at full capacity.

CASHFLOW



Regarding the cashflow balance this has increased 6% to 20%. 33% reported an improved cashflow experience, a 1% increase on Q1. 54% stated their cashflow remained the same which is up 4% from the previous quarter.

34% reported improved cashflow figures in the service sector and 26% reported improved cashflow in the manufacturing sector. Nationally, the manufacturing cashflow balance was static and the service sector cashflow balance rose.

INVESTMENT

Overall the investment balance is -30%. Investment in plant machinery and equipment is down 1% to 24%. Investment in training is up at 29%, the same as last quarter.

61% of local manufacturer's have seen investment in plant machinery and equipment remains the same. 68% of local services have seen investment in training remain the same.

EXTERNAL FACTORS

PRICE PRESSURES

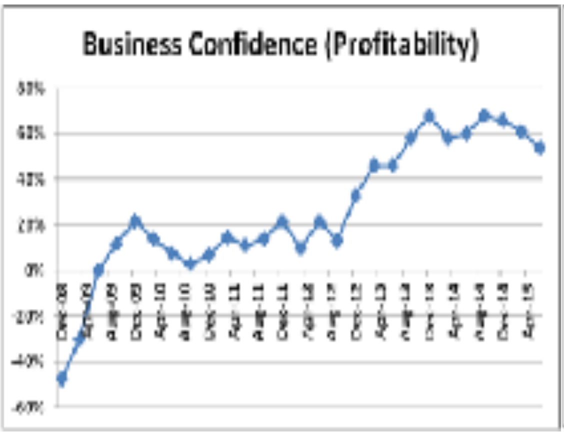
The balance figure for pressure on businesses to raise prices has decreased by 2% to 15%. 19% of companies surveyed experienced pressures to raise their prices, which is slightly lower than the last quarter.

4% reported they expect prices to decrease over the next quarter. 77% anticipate their price levels to remain unaffected, up 8% which is similar to the last quarter. 22% of local services and 18% of local manufacturing firms expect prices to rise.

Overall, raw materials and other overheads were mentioned as main contributors to price increases which are the same as last quarter. Factors of concern to businesses were competition, exchange rates and business rates which were similar to last quarter.

BUSINESS CONFIDENCE

The turnover balance has decreased 6% to 67%. The profitability balance has decreased 7% to 54%.



70% of local manufacturers are expecting an increase in turnover, 3% lower than Q1 and 57% believe profitability will improve, 11% lower than Q1. Confidence figures for the local service sector show that 67% expect turnover to improve. (10% lower than Q1) and expectations of profitability show that 60% expect profitability to increase (this is 2% lower than Q1).

FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are competition, exchange rates and business rates (49%, 32% and 25%).

Locally, the manufacturing and service sector also state that competition is their main factor of concern. The manufacturing sector also states that exchange rates are a main concern.

Summary 2nd Quarter 2015

The Q2 2015 QES results signal continued UK economic growth, but with sharp differences between manufacturing and services. In the service sector, the results, though mixed, are positive overall. Most key national service sector balances recorded small increases and most are higher than their average 2007 pre-recession levels. However, in the manufacturing sector, virtually all the key national balances

recorded declines in Q2 and most are now lower than their average 2007 pre-recession levels. In the service sector, the overall position of the domestic and export balances remained broadly static, with the balances for employment, investment, confidence and cashflow all rising slightly. Intentions to raise prices have risen markedly for manufacturers but are down for service sector firms. The Q2 results still point to continued economic growth, but with many headwinds, notably within the manufacturing sector.

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.”