Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q3 2014 Economic Review

SUMMARY

"The Quarterly Economic Survey for Q3 2014 shows that economic growth is continuing, but at a slower pace than Q1 & Q2. Within manufacturing the domestic and export balances are lower than Q2, both nationally and locally. The services sector are showing continued strength although there has been a decline in the export balance from Q2 to Q3, both nationally and locally". However, local results show that our economy is growing above the national averages. In terms of domestic and export sales, we are above the national average. Coupled with higher than the national average results in recruiting full-time staff and investment in training, it shows that locally the economy continues to develop."

Herefordshire & Worcestershire Chamber of Commerce

GENERAL NATIONAL OVERVIEW

The Q3 2014 results point to continued UK economic growth, but the pace of expansion is easing. The signs of slowdown are particularly noticeable in manufacturing, where all the key domestic and export balances recorded marked declines in Q3. Services remain more resilient than manufacturing. But there were disappointing declines in the service export balances between Q2 and Q3 2014. The Q3 results are still positive overall for employment, cashflow and confidence. But increased signs of slower growth and weaker export balances are concerning, and require a forceful policy response. UK growth cannot rely permanently on consumer spending, and on unsustainable current account and budget deficits. Unless investment and net exports make bigger contributions to growth, the recovery will stall. Both the MPC and the Government must make every effort to remove obstacles to sustainable growth. With inflation well below target, and with 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.

The domestic manufacturing balances fell markedly in Q3 2014. In the case of services, one balance declined marginally and the other was unchanged. The domestic manufacturing balances are now lower than their average 2007 pre-recession levels. But the Q3 domestic service balances are higher than their 2007 levels, and most are relatively high by historical standards. The manufacturing sector's balance for domestic sales declined from +42% in Q2 to +23% in Q3, the lowest level since Q2 2013. The balance for manufacturers' domestic orders fell from +41% in Q2 to +24% in Q3, also the lowest level since Q2 2013. The service sector's balance for domestic sales was +35% in Q3, the same as in Q1 and Q2 2014, and a historically high level. The net balance for service domestic orders fell marginally, from +30% in Q2 to +29% in Q3, the lowest level since Q3 2013, but still a historically high level.

All the national export balances recorded fell for both sectors in Q3 2014. But, while the manufacturing export balances are now lower than their average 2007 pre-recession levels, the Q3 service export balances are still slightly higher. The net manufacturing balance for export sales dropped from +30% in Q2 to +16% in Q3, the worst level since Q4 2012. The net manufacturing balance for export orders plunged from +31% in Q2 to +14% in Q3, also the worst level since Q4 2012. The service balance for export deliveries dropped by eight points in Q3, to +21%, the worst level since Q3 2012. The service export orders balance fell by 12 points in Q3, to +18%, the worst level since Q4 2012.

The national balances for employment and future hiring intentions rose in Q3, for both manufacturing and services, and all are still higher than their 2007 pre-recession levels. The backward-looking manufacturing employment balance rose two points, to +32%, the highest since Q4 2013. The forward-looking manufacturing employment expectations balance rose three points, to +34%, an historically high level. The backward-looking service employment balance rose nine points, to +28%, near to an all-time high. The service employment expectations balance rose four points, to +30%, the highest since Q2 2007.

In manufacturing, one investment balance stayed unchanged, and one rose slightly. In services, both investment balances fell slightly in Q3. The balance of manufacturing firms that have revised upwards their plans to invest in plant & machinery remained unchanged in Q3, at +29%, still a relatively high level. The balance of manufacturing firms that have revised upwards their plans to invest in training rose two points, to +32%, a very high level. The balance of service firms that have revised their plans to invest in plant & machinery upwards fell one point, to +20%, the lowest level since Q3 2013 but still relatively high. The balance of service sector firms that have revised upwards their plans to invest in training fell two points, to +26%, the lowest level since Q3 2013.

The confidence balances remain relatively strong, and are still higher than their average 2007 pre-recession levels for both manufacturing and services. Confidence manufacturing turnover will improve in the next 12 months fell from +63% in Q2 to +60% in Q3, the lowest since Q2 2013 but still a relatively strong level. Confidence manufacturing profitability will improve in the next 12 months rose from +51% in Q2 2014 to +54% in Q3 2014, an all-time high for our survey. The service sector turnover confidence balance remained unchanged in Q3, at +56%, still a relatively strong level. Confidence service sector profitability will improve in the next 12 months fell marginally, from +46% in Q2 to +45% in Q3, the lowest level since Q4 2013.

The percentage of manufacturing firms operating at full capacity fell by six points in Q3, to +40%, the lowest level since Q2 2013. The percentage of service firms operating at full capacity rose two points in Q3, to +46%, a very high level historically.

The Q3 cashflow balances improved for both sectors. The manufacturing cashflow balance stayed unchanged in Q3, at +17%, the best level since Q3 2013, and a historically high figure. Services cashflow rose five points, to +22%, a new all-time high for our survey.

Intentions to raise prices rose slightly in Q3 in both sectors. The balance of manufacturing firms reporting pressure to raise prices rose one point, to +18%. The balance of service firms expecting to raise prices rose three points, to +22%.

OVERVIEW LOCAL LEVEL

The national Q3 results show continued growth but signs of slowdown are noticeable in manufacturing. All the key domestic and export balances declined in Q3. For services, there is also a decline in export balances between Q2 and Q3.

Locally, the domestic balances for both manufacturing and services have increased slightly.

The national balances for employment and future hiring rose in Q3. Locally, both the local manufacturing and services sector have seen an increase in workforce.

Both the manufacturing and services sector expect to see an improvement in both profitability and turnover.

The main causes of price increases were other overheads and raw material prices.

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

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

The domestic sales balance is 44%, which is 3% higher than Q2. All the domestic balances remain at historically high levels in both sectors. Increased sales were reported by 54% of local businesses, 4% higher than the previous quarter. 36% reported their sales figures have remained constant.

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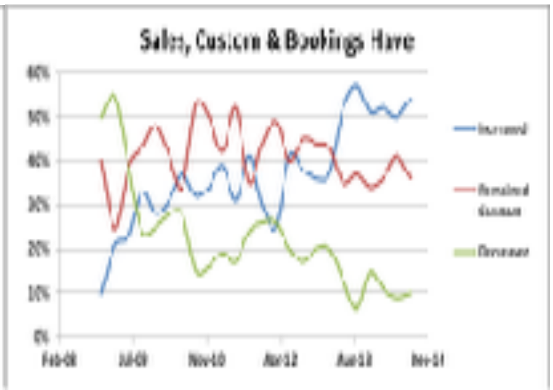


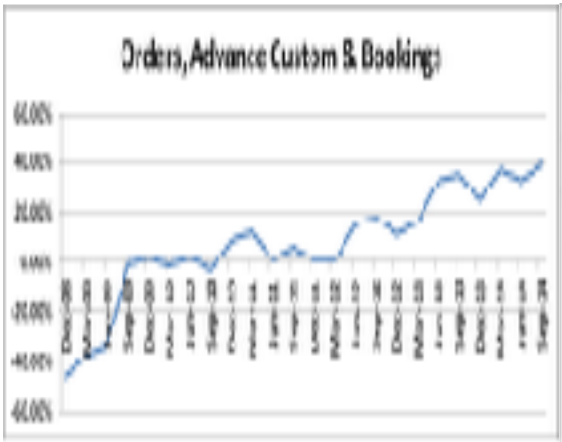
50% of local manufacturing saw an increase in sales (up 3% from Q2). Nationally the manufacturing domestic sales balance fell sharply. Figures for the local service sector show an increase of 55% (up 3% on Q2). Nationally, the services domestic sales remained unchanged but still at a high level.

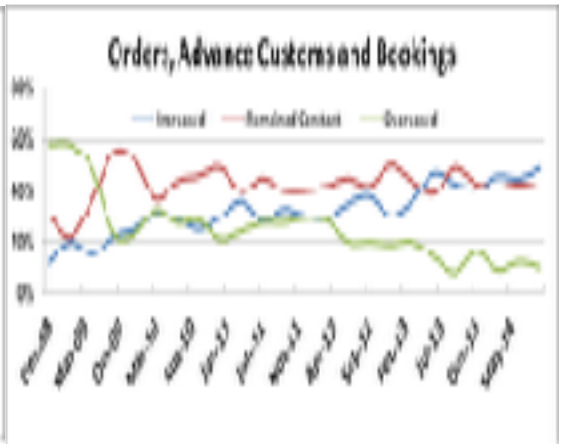
ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 49% increase for orders and advance bookings in the domestic market (which is up 4% from Q2). This shows positivity in orders and bookings. The balance is at 39% (Q2 the balance was 33%).

50% of local manufacturing saw an increase in orders, 3% higher than in Q2. Nationally, manufacturing domestic orders fell.

The local service sector figures show 44% reporting an increase in orders, 2% higher than Q2, 40% with orders remaining constant and 8% with decreasing orders over the last three months. Nationally, service domestic orders fell slightly.





EXPORT SALES

SALES, CUSTOM AND BOOKINGS

35% saw export sales increase, which is 8% lower than the last quarter. Just 13% of companies saw a decrease in their overseas sales, custom and bookings.

Local manufacturers reported 29% increased sales, this has dropped 7% on Q2, 7% decreased sales and 35% experienced constant overseas sales which is consistent with Q2. Local service sector sales figures were lower at 8% increased sales, 4% decrease but with 16% remaining constant. Nationally, export sales decreased significantly for both sectors.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

The balance for overseas orders has decreased slightly to 20%. There has been a decrease in orders from 37% in Q2 to 35% in Q3.

OVERVIEW - EMPLOYMENT

Changes to Workforce

The workforce change balance has decreased to 18% (6% lower than Q2). There was a 27% increase in workforce in Q3, 4% lower than Q2.

31% of companies responding reported plans to increase their workforce over the next three months (previous quarter was 32%), with just 6% with plans to decrease the workforce, the same figure as Q2.

ATTEMPTS TO RECRUIT

74% have attempted to recruit full-time staff, a decrease of 5% on the last quarter. Employing permanent positions has increased 19% on the previous quarter. There is an 6% 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 similar to the last quarter and 44% in the service sector, which is down 7% on Q2.

The recruitment of permanent staff in Q3 has increased by 19% to 54%. Part-time recruitment has decreased 4%. Full-time staff recruitment is higher at 74%, which is a 5% decrease on the last quarter.

38% of local manufacturers have seen an increase in their workforce, which is an 11% increase on Q2. Turning to the local service sector, 22% increased their labour force, which is an increase on last quarter.

RECRUITMENT DIFFICULTIES

Recruitment difficulties have increased by 31% on the previous quarter. 57% of businesses experienced difficulties recruiting. 41% of local manufacturers (an increase of 2%) and 23% of local services (a decrease of 3%) 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.

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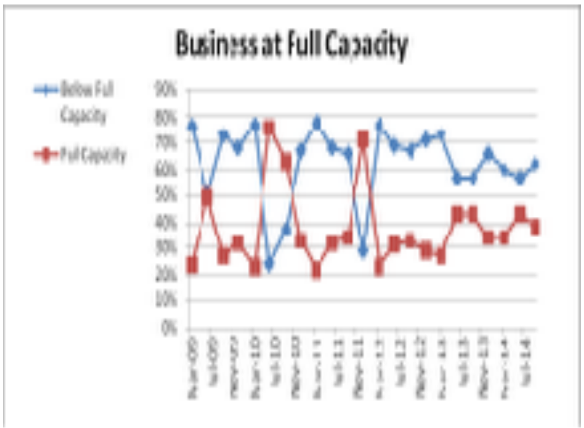
EXPECTATIONS TO RECRUIT NEXT QUARTER

The balance for changes to workforce is 25%, just a 1% increase on last quarter.

There were high percentages for the local manufacturing and service businesses reporting that they expect their workforces to remain on the same level. 60% of local manufacturing and 64% of local services sector businesses believe they will maintain their current staff levels. Nationally, employment expectations to take on more staff increased for both sectors.

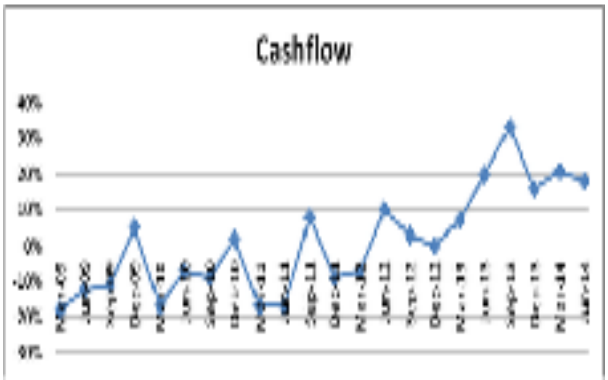


CAPAPCITY CONSOLIDATION, CASHFLOW & INVESTMENT

Capacity

The full capacity balance has decreased from the last quarter to 38%.

62% of local businesses reported to be operating below full capacity. Turning to local manufacturers, 40% stated over the last period they operated at full capacity and 59% reported to be operating below full capacity. Figures in the service sector show that 61% are operating below full capacity and 36% operating at full capacity.



CASHFLOW

Regarding the cashflow balance this has increased 1% to 19%.

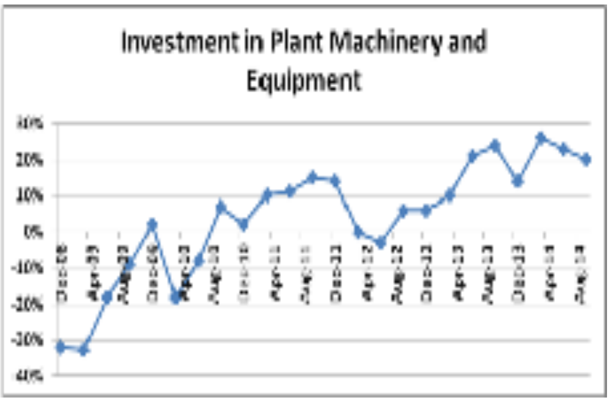
36% reported an improved cashflow experience, slightly higher than Q2 and 47% stated their cashflow remained the same which is down 9% from the previous quarter.

38% reported improved cashflow figures in the service sector and 26% reported improved cashflow in the manufacturing sector. Nationally, in the manufacturing sector, the cashflow balance remained at +17% but service sector cashflow balance increased to +22%.

INVESTMENT

Overall the investment balance is -26%. Investment in plant machinery and equipment is down slightly to 20%. Investment in training is up just 1% from the last quarter.

64% of local manufacturer's have seen investment in plant machinery and equipment remain the same. 73% of local services have seen investment in training remain the same.



EXTERNAL FACTORS

PRICE PRESSURES

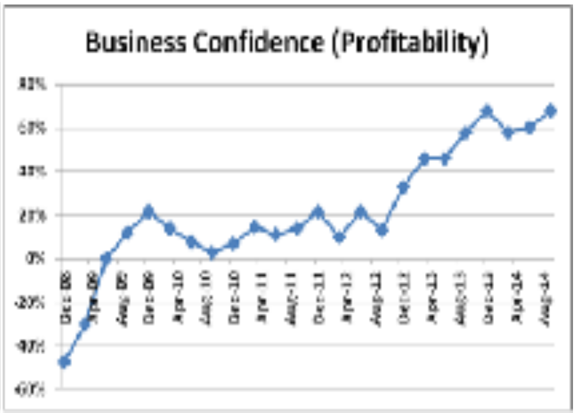
The balance figure for pressure on businesses to raise prices has decreased by 1% to 20%. 24% of companies surveyed experienced pressures to raise their prices, which is the same as last quarter.

4% reported they expect prices to decrease over the next quarter. 72% anticipate their price levels to remain unaffected. 25% of local services and 20% of local manufacturing firms expect prices to rise .

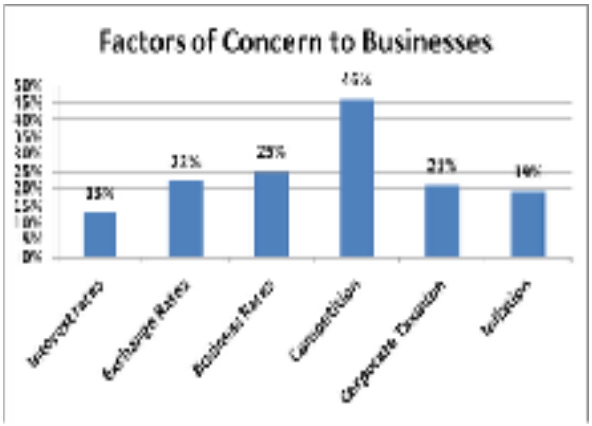
Overall, raw materials and other overheads were mentioned as main contributors to price increases. This is similar to the previous six quarters now. Local manufacturing and service sectors mention that raw materials and other overheads were too the main contributors to price raises.

BUSINESS CONFIDENCE

Both the turnover and profitability balance have improved. Turnover confidence increased 5% from Q2 (from 77% to 82%). Confidence regarding profitability also increased by 7%.



73% of local manufacturers are expecting an increase in turnover, 6% higher than Q2 and 67% believe profitability will improve, 6% higher than Q2. Confidence figures for the local service sector has increased for turnover as 81% believe they will see an improvement of turnover (higher than Q2) and expectations of profitability has increased as 74% expect profitability to increase. Nationally, confidence in future profitability remains high for manufacturing and services sectors.



FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are competition, business rates, exchange rates and corporation tax (46% and 25% and 22% and 21%).

Competition and corporation tax have been major concerns for companies over many quarters now.

Summary 3rd Quarter 2014

There are signs that the pace of expansion is slowing, but overall the Q3 2014 results point to continued economic growth. In the manufacturing sector, the domestic and export balances are lower

than in Q2 2014. In the service sector, the domestic balances remained virtually unchanged in Q3, but there was a marked decline in the service export balances between Q2 and Q3. The domestic and export balances of the manufacturing sector are now lower than their average 2007 pre-recession levels. But in the service sector, the Q3 domestic and export balances are still higher than their average 2007 levels. There are other positive features, notably stronger Q3 balances for employment and employment expectations for both manufacturing and services. Also, all the confidence and employment balances are still higher than their 2007 pre-recession levels. The Q3 cashflow balance is stronger than in Q2 for the service sector, but is unchanged in manufacturing.

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

"The British economy has strengthened significantly since the recession but to say that strong growth cannot be sustained indefinitely is simply not good enough. To avoid sinking back into mediocrity we must steer clear of measures that dampen business confidence and press ahead with reforms to the business environment.

"As we predicted in our economic forecast, the strong upsurge in UK manufacturing at the start of the year appears to have run its course. We may be hearing the first alarm bell for the UK economy, but this need not be the case. The share of manufacturing firms operating at full capacity fell in Q3, signalling that there is more spare capacity in our production sector than previously thought. Concerns over the strength of the pound are also high and rising. Together with a worsening outlook for the eurozone, these factors reinforce the case against an early interest rate rise.

"The disappointing decline in exports highlights that we must do something radically different. Britain faces a major challenge in improving its trade performance, so we must waste no time in supporting trade opportunities to overseas markets which offer sustained growth. Only a concerted national campaign and sustained investment will allow more UK firms to look beyond our shores for growth opportunities.

"If we in Britain are serious about promoting business investment we must remove some longstanding barriers. Access to growth finance for small, ambitious firms remains insufficient. The business rates firms pay are the highest in Europe and a major disincentive for investment. We are calling on the government to freeze business rates for all companies until 2017's planned full revaluation of premises, and perform a review and reform of the broken business rates system by 2022."

David Kern, Chief Economist at the BCC, said:

"These results point to continued UK economic growth, but the pace is easing. The signs of the slowdown are particularly noticeable in manufacturing, where all the key domestic and export balances recorded declines in Q3. The multiplier effects of a rise or fall in industrial production are important, not least for those regions of the UK whose traditional dependence on manufacturing industries remains high.

"Services remain more resilient than manufacturing, but there were disappointing declines in the service export balances between Q2 and Q3 2014. In contrast the Q3 results are positive for employment, cashflow and business confidence.

"Noticeable falls in all the export balances and increased signs of slower growth require a forceful policy response. UK growth cannot rely permanently on consumer spending, and on unsustainable current account and budget deficits. Unless exports and investment play a bigger role in growth, the recovery will stall.

"With inflation well below target and with earnings still rising annually by less than 1pc, it is clearly unjustified to endanger the recovery with a premature increase in official interest rates. To sustain growth, the MPC must reassure businesses that rates will only start edging up if and when objective circumstances require such a move. On its part, the Government must strengthen support for exporters and improve access to finance for growing businesses."