Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q3 2015 Economic Review

SUMMARY

"It's a mixed bag for the West Midlands this quarter; it is extremely promising to see business continuing to show confidence in turnover and profitability among both the manufacturing and services sectors. However the issue of recruiting skilled staff has been made sharply evident this quarter among both sectors, with half of businesses from each sector having serious trouble recruiting. These figures highlight how the national skills shortage is affecting the region."

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

GENERAL NATIONAL OVERVIEW

The domestic manufacturing balances for sales and orders were both static in Q3 2015, after weakening markedly in Q2. The balance of manufacturers reporting improved domestic sales was +20% in Q3 2015, the same as in Q2 2015 and the joint lowest level since Q2 2013. The balance of manufacturers with improved domestic orders stood at +18% in Q3, unchanged from Q2 and also the joint lowest level since Q2 2013. The service sector's balance for domestic sales rose from +31% in Q2 2015 to +36% in Q3 2015, the highest level since Q4 2014. The service balance for domestic orders stood +29% in Q3, also unchanged from Q2.

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 recorded mixed movements in Q3 2015. In both manufacturing and services, the balances of firms which grew their work forces in the previous three months strengthened, while the balance of firms anticipating growth over the next three months weakened. The backward-looking manufacturing employment balance rose eight points in Q3 2015 to +28%. The forward-looking manufacturing employment expectations balance fell five points in Q3, to +22%, the lowest level since Q2 2013. The backward-looking service sector employment balance rose two points in Q3 2015 to +24% while the forward-looking service employment expectations balance fell six points in Q3 to +24%, the lowest level since Q2 2013.

Most national investment balances weakened in Q3 2015. The balance of manufacturing firms that have revised upwards their plans to invest in plant & machinery fell three points in Q3 2015, to 18%, the lowest level since Q1 2013. The balance of manufacturing firms that have revised upwards their plans to invest in training fell six points in Q3 to +20%, the joint lowest level since Q1 2013. The balance of service firms that have revised upwards their plans to invest in plant & machinery fell three points in Q3 2015 to +17%%, the joint lowest level since Q2 2013. The balance of service firms that have revised upwards their plans to invest in training stood at +27% in Q3, unchanged from Q2.

The national confidence balances also weakened for both sectors in Q3 2015, but the falls were considerably larger among manufacturers. The balance of manufacturing firms which are confident that turnover will improve in the next 12 months fell from +51% in Q2 to +43% in Q3, the lowest level since Q4 2012. The balance of manufacturing firms who are confident that profitability will improve in the next 12 months fell from +45% in Q2 to +32% in Q3, also the lowest level since Q4 2012. The balance of service sector firms confident that turnover will improve in the next 12 months fell slightly from +55% in Q2 to +54% in Q3. For service sector profitability confidence, the balance fell from +45% in Q2 to +42% in Q3.

Capacity utilisation rose slightly in both manufacturing and in services. The percentage of manufacturing firms operating at full capacity increased to 36% in Q3 2015. The percentage of service firms operating at full capacity also rose to 48%, a historic high.

The balance of firms reporting improved cash flow weakened slightly in Q3 2015 for both the manufacturing and services sectors. The balance of manufacturers reporting improved cash flow fell to +9% from +11% in Q2, the lowest level since Q2 2013, and lower than its average 2007 pre-recession level. The balance of service sector firms reporting improved cash flow fell to +16%, but this is still higher than in 2007.

Intentions to increase prices fell sharply in the manufacturing sector and increased slightly for service firms. The balance of manufacturing firms reporting that they intend to raise prices fell significantly to +8% from +23% in Q3, the joint lowest level since Q4 2009. The balance of service sector firms expecting to raise prices rose three points in Q3 to +23%.

OVERVIEW LOCAL LEVEL

The local Q3 combined manufacturing and service sector results show a decrease in the domestic sales and orders balances, where nationally the balances have remained static. The increase in sales has remained the same but the increase in orders has fallen since the last quarter.

The national employment balances recorded mixed movements in Q3 2015. In both manufacturing and services, the balances of firms which grew their work forces in the previous three months strengthened while the balance of firms anticipating growth over the next three months weakened for both manufacturing and services. Locally, the balance of firms which grew their workforce in the previous three months remained the same as last quarter and the balance of firms anticipating growth over the next three months 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.

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, other overheads and in this quarter pay settlements also have a high percentage.

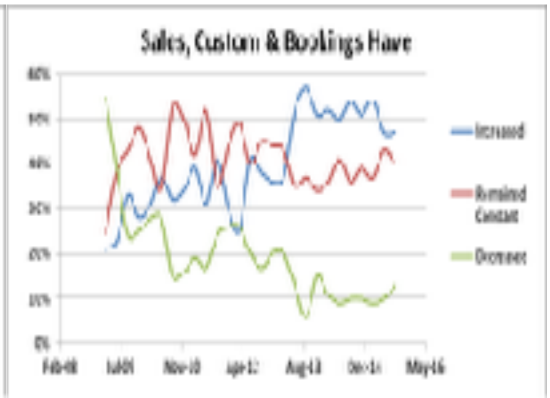
Concerns locally are competition, exchange rates and business rates. Last quarter main concerns were competition, exchange rates, business rates and corporation tax.

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

The domestic sales balance is 34%, a decrease of 3%. 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.

Locally, the increase domestic sales remain at the same percentage (47%).

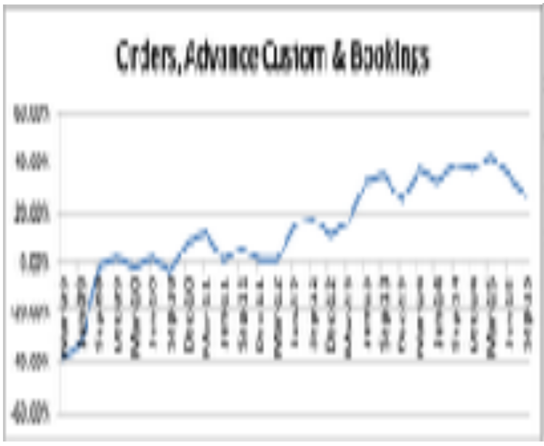


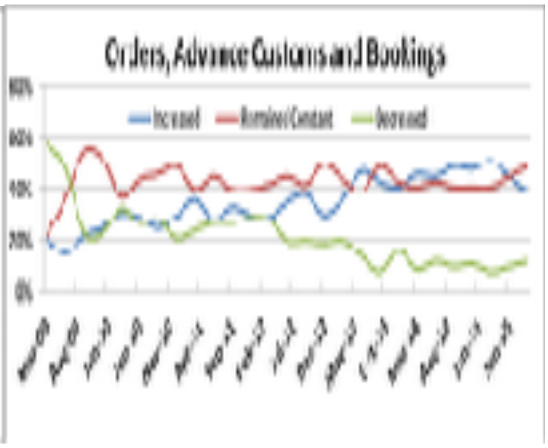
ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 39% increase for orders and advance bookings in the domestic market (which is down 6% from Q2). The balance is at 27% (Q2 the balance was 35%).

36% of local manufacturing saw an increase in orders, 6% lower than last quarter. Nationally, manufacturing domestic orders are static compared with Q2.

The local service sector figures show 37% reporting an increase in orders, 6% lower than Q2, 45% with orders remaining constant and 12% with decreasing orders over the last three months. Nationally, the balance for service domestic orders remained unchanged from Q2.





EXPORT SALES

SALES, CUSTOM AND BOOKINGS

39% saw export sales increase, which is 4% lower than the last quarter. Only 12% of companies saw a decrease in their overseas sales, custom and bookings, down 2% on last quarter.

Local manufacturers reported 27% increased sales, down just 1% from Q2, 15% decreased sales and 31% experienced constant overseas sales which is 4% lower than Q2. Local service sector sales figures were lower at 17% increased sales, 3% decrease but with 22% remaining constant.

Nationally and locally export balances weakened.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

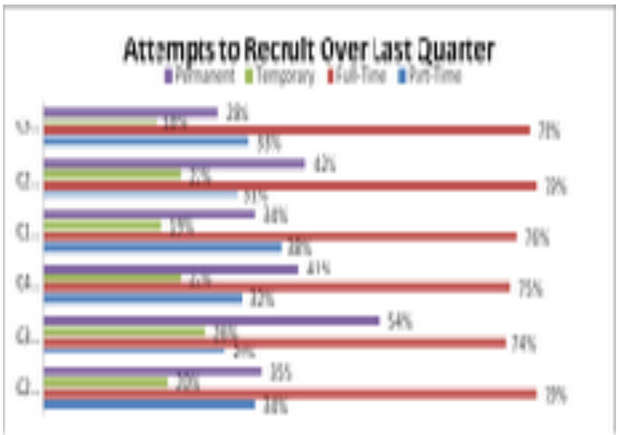
The balance for overseas orders has decreased 17% to 20% in Q3 2015 (37% in Q2). There has been a decrease in orders from 45% in Q2 to 35% in Q3.

OVERVIEW - EMPLOYMENT

Changes to Workforce

The workforce change balance has remained the same as Q2 at 23%. There was a 30% increase in workforce in Q2, just 3% lower than Q2.

27% of companies responding reported plans to increase their workforce over the next three months (previous quarter was 35%), with just 8% with plans to decrease the workforce, 5% higher than Q2.



ATTEMPTS TO RECRUIT

78% have attempted to recruit full-time staff, a decrease of 1% on the last quarter. Employing permanent positions has decreased 14% on the previous quarter to 28%. There is 4% decrease on last quarter for filling temporary positions. Taking a closer look at the local level we see that 59% of local manufacturers have attempted to recruit in the last quarter which is 2% lower than the last quarter and 46% in the service sector, which is down 3% on Q2.

34% of local manufacturers have seen an increase in their workforce, which is a 4% decrease on Q2. Turning to the local service sector, 27% increased their labour force, which is a 2% decrease on last quarter.

RECRUITMENT DIFFICULTIES

Recruitment difficulties were experienced by 54% of businesses, down 2% from Q2.

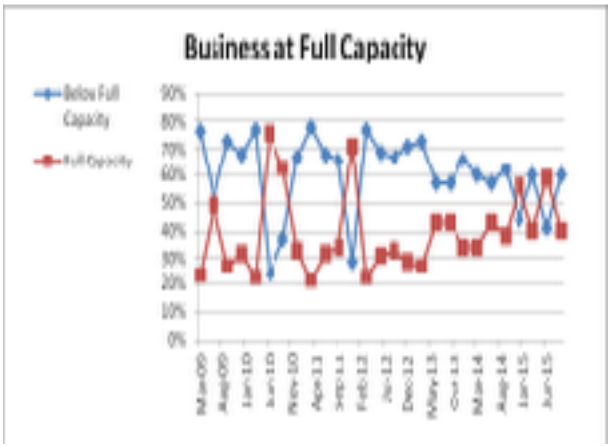
58% of local manufacturers (19% higher than last quarter) and 26% of local services (a decrease of 1%) have reported recruitment problems.

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 19%, a 13% decrease on last quarter.

A high percentage from the local manufacturing sector report that they expect their workforce to remain constant 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.



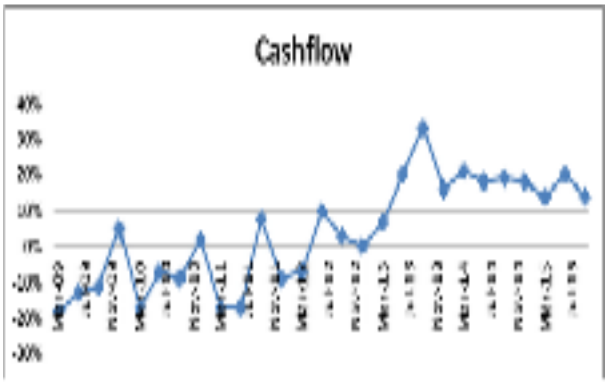
CAPACITY CONSOLIDATION, CASHFLOW & INVESTMENT

Capacity

The full capacity balance has decreased to 40% (down 19% from the last quarter).

60% of local businesses reported to be operating below full capacity, an increase of 19%. Turning to local manufacturers, 34% stated over the last period they operated at full capacity and 66% reported to be operating below full capacity. Figures in the service sector show that 39% are operating below full capacity and 53% operating at full capacity.

CASHFLOW



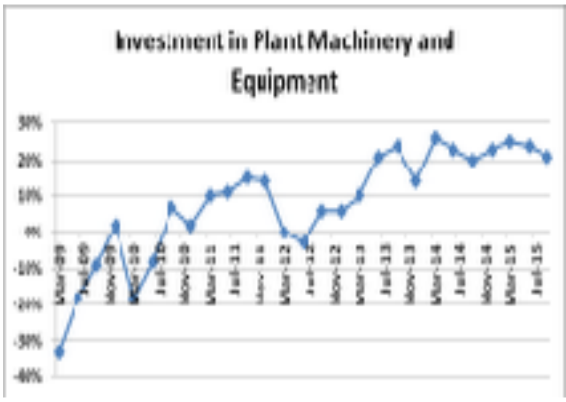
Regarding the cashflow balance this has decreased 6% to 14%. 33% reported an improved cashflow experience, the same as Q2. 48% stated their cashflow remained the same which is down 6% from the previous quarter.

30% reported improved cashflow figures in the service sector and 36% 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 -31%. Investment in plant machinery and equipment is down 3% to 21%. Investment in training is down 8% to 21%.

61% of local manufacturer's have seen investment in plant machinery and equipment remains the same, the same as last quarter. 67% of local services have seen investment in training remain the same, down just 1% on last quarter.



EXTERNAL FACTORS

PRICE PRESSURES

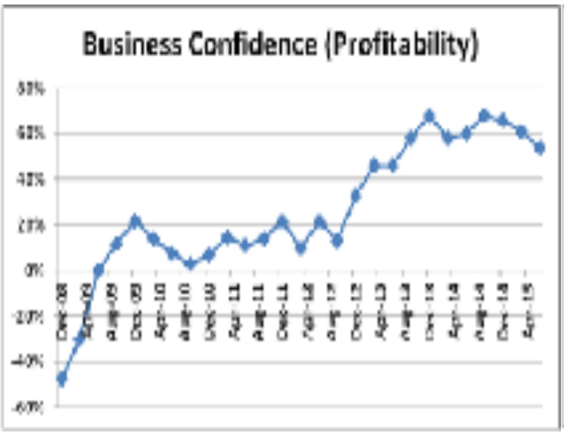
The balance figure for pressure on businesses to raise prices has decreased by 1% to 14%. 21% of companies surveyed experienced pressures to raise their prices, which is just slightly higher than the last quarter.

7% reported they expect prices to decrease over the next quarter. 72% anticipate their price levels to remain unaffected, down 5% on the last quarter. 21% of local services and 17% of local manufacturing firms expect prices to rise.

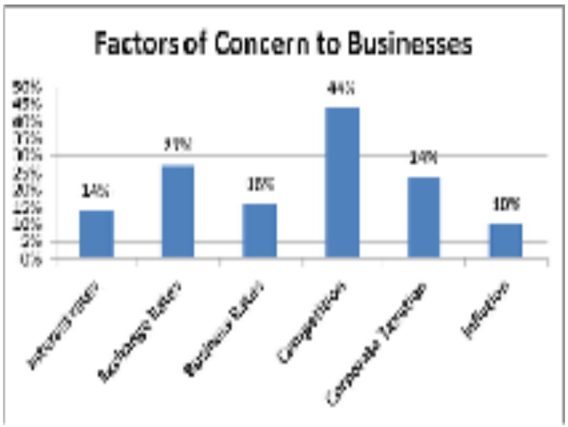
Overall, raw materials and other overheads were mentioned as main contributors to price increases which are the same as the last few quarters'. Factors of concern to businesses were competition, exchange rates and corporate tax.

BUSINESS CONFIDENCE

The turnover balance has decreased 9% to 58%. The profitability balance has decreased 7% to 47%.



61% of local manufacturers are expecting an increase in turnover, 8% lower than Q2 and 59% believe profitability will improve, 2% lower than Q2. Confidence figures for the local service sector show that 57% expect turnover to improve. (10% lower than Q2) and expectations of profitability show that 55% expect profitability to increase (this is 5% lower than Q2).



FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are competition, exchange rates, and corporation tax (44%, 27% and 24%).

Locally, the manufacturing and service sector state that competition, exchange rates and corporation tax are their main factors of concern.

Summary 3rd Quarter 2015

Overall, the results signal moderate economic growth over the next year, but the UK recovery is facing serious challenges. In both manufacturing and services, most key balances were weaker in Q3 2015 than in Q2, but there were a few improvements. In services, there were improvements in the domestic sales balance and employment balance. However, all the other key service balances worsened between Q2 and Q3: for exports, confidence, investment in plant & machinery, employment growth expectations, and cash flow. Even so, the falls in the Q3 service balances are in general smaller than the declines in the manufacturing balances. In the manufacturing sector, the balances for exports, investment, confidence, employment expectations and cashflow all recorded falls between Q2 and Q3. The domestic manufacturing balances for sales and orders were both static in Q3 2015, after weakening markedly in Q2 2015. The main exception to the pattern of weaker manufacturing balances was a Q3 improvement in the balance of manufacturers who expanded their workforce. Intentions to increase prices also fell sharply for manufacturers and the percentage of firms operating at full capacity increased slightly in both sectors.

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

“These latest survey results are somewhat disappointing, as both manufacturing and service firms experienced dampened growth. The real area of concern is manufacturing. Confidence is low, as growth continued to fall, and our measure of manufacturing export growth hit a six year low. Services growth, on the other hand, dipped only slightly and overall trends show the sector remains relatively strong and stable.

“Global uncertainty, weakened demand from China and the strength of the pound are some of the factors likely hindering manufacturers’ performance. If the manufacturing sector has entered a prolonged period of slow growth, then closing the trade deficit and improving the current account deficit will become more difficult.

“If we want to make sure this period of two-tier growth is only temporary then we must help businesses get access to the working and growth capital that they require. We must also deal with the intensifying skills gap, which is holding British businesses back. The Chancellor’s Spending Review is the opportune time to tackle these shortcomings, not only for manufacturers but for all companies. Only action to help fix the fundamentals – skills, infrastructure and access to capital – can help end the UK’s two-tier growth pattern and ensure all businesses can grow.”

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

“The Q3 2015 results point to moderate growth in the UK economy over the next year, driven mostly by services and by domestic demand. Overall, however the results are disappointing. Most key balances, for both manufacturing and services, are weaker in Q3 than in Q2. It is particularly concerning that the exports and confidence balances have weakened in both main sectors. The results suggest that the pace of GDP growth has decelerated slightly in Q3 2015.

“The manufacturing sector is facing major obstacles, while the service sector is more resilient overall. The Q3 falls in the manufacturing balances are in general larger than the declines in the service balances. In absolute terms, the manufacturing balances are weaker overall than the service balances. The exceptionally feeble manufacturing export balances are a stark reminder that rebalancing the economy and promoting exports in services must be national priorities.

"While we must not forget the strengths of the UK economy – after all we have higher growth than in most G7 economies and a dynamic and flexible labour market - the recovery is still fragile. Given the uncertain global situation, it is important to avoid unnecessary risks. The MPC should keep interest rates at their current low levels until well into 2016."

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."