Locally focused, nationally represented –

Herefordshire and Worcestershire Chamber of Commerce

Q4 2014 Economic Review

SUMMARY

"The Quarterly Economic Survey for Q4 2014 shows that there are solid improvements in key domestic and export balances. Recovery in Q4 was stronger for manufacturing than services, which shows the buoyancy and strength of the sector locally. Local results show that our economy is continuing to grow at a steady pace, with domestic balances still at historically high levels.

In addition to this, there are strong signs that local businesses are beginning to regain confidence that the economy is truly recovering. Confidence in turnover and profitability has increased, along with recruitment intentions, most notably in the recruitment of full-time staff, which is a good sign moving forward."

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

GENERAL NATIONAL OVERVIEW

The Q4 2014 results of the QES show improvements in most of the key manufacturing and services balances. The Q4 recovery was stronger in manufacturing than in services, but this partly reverses larger falls in manufacturing balances in the previous quarter. There are exceptions to the general pattern of positive results, with some balances declining in Q4. In manufacturing, there were declines in profitability confidence, employment expectations and in cashflow. In services, we saw falls in employment expectations and in cashflow. But most of the declines were small. The most important message in this survey points to solid improvements in the key domestic and export balances, for both sectors. The backward-looking employment balances rose to all-time highs in both sectors. Capacity utilisation also remains high. While intentions to raise prices are up for both manufacturing and services, they remain moderate and are weaker than earlier in 2014.

The national domestic balances improved in Q4 2014 for both manufacturing and services. All the domestic balances are again higher than their average 2007 pre-recession levels and all are relatively high by historical standards. The manufacturing sector's net balance for domestic sales rose from +23% in Q3 2014 to +36% in Q4 2014, still six points below the record high reached in Q2 2014. The balance for manufacturers' domestic orders rose from +24% in Q3 2014 to +38% in Q4 2014, still lower than the record highs reached earlier in the year. The services sector's balance for domestic sales rose from +35% in Q3 2014 to +38% in Q4 2014, the same level as in Q4 2013, and a historically high level. The net balance for services domestic orders rose from +29% in Q3 2014 to +33% in Q4 2014, the same level as in Q1 2014.

All the national export balances, in both manufacturing and services, recovered in Q4 2014, partly reversing the fall in the previous quarter. But in both sectors the Q4 export balances were still below levels recorded earlier in 2014. In manufacturing, the Q4 2014 export balances are equal to their average 2007 pre-recession levels. In services, the export balances are higher than their average 2007 levels. The manufacturing balance for export sales increased by 10 points in Q4 2014, to +26%. The manufacturing balance for export orders rose by nine points in Q4, to +23%. The net services balance for export sales rose by one point in Q4, to +22%. The services export orders balance rose by seven points in Q4 2014, to +25%.

The backward-looking national employment balances rose for both manufacturing and services in Q4, and are at all-time highs for this survey. But the forward looking employment expectations balances fell slightly in Q4 in both sectors. The employment expectations balance is higher than in 2007 for manufacturing, but slightly lower than in 2007 for services. The backward-looking manufacturing employment balance rose four points in Q4, to +36%. The forward-looking manufacturing employment expectations balance fell one point, to +33%, still a high level. The backward-looking service employment balance rose four points in Q4, to +32%. The service employment expectations balance fell three points, to +27%, still a relatively high level.

The manufacturing investment balances increased noticeably in Q4. In the services sector, the investment balances recorded very small changes. The balance of manufacturing firms that have revised upwards their plans to invest in plant & machinery rose seven points in Q4, to +36%, just below the all-time high recorded in Q1 2014. The balance of manufacturing firms that have revised upwards their plans to invest in training also rose seven points, to +39%, an all-time high. The balance of service firms that have revised upwards their plans to invest in plant & machinery edged up one point, to +21%, a lower level than in Q1 2014, but still relatively high. The balance of services sector firms that have revised upwards their plans to invest in training stayed unchanged, at +26%, a lower level than in Q1 2014, and also lower than in 2007.

The national confidence balances recorded mixed movements in Q4. In manufacturing, one balance rose and the other fell. In services, both confidence balances improved in Q4. But the confidence balances remain relatively strong, and are still higher than their average 2007 pre-recession levels in both manufacturing and services. Confidence that manufacturing turnover will improve in the next 12 months rose from +60% in Q3 to +62% in Q4, but is still lower than in the first two quarters of 2014. Confidence that manufacturing profitability will improve in the next 12 months fell from +54% in Q3 +45% in Q4, the lowest level since Q2 2013. Confidence that services sector turnover will improve in the next 12 months rose from +56% in Q3 to +60% in Q4, the same as in Q1 2014 and a relatively strong level. Confidence that services sector profitability will improve in the next 12 months rose marginally, from +45% in Q3 to +46% in Q4, slightly lower than in Q1 2014 but still a relatively strong level.

The share of manufacturing firms operating at full capacity edged up by one point in Q4, to 41%, a relatively high level but lower than in most of the periods since mid-2013. The percentage of service firms operating at full capacity remained unchanged in Q4, at 46%, a very high level.

The Q3 cashflow balances worsened slightly in Q4, but remained satisfactory and above 2007 pre recession levels for both sectors. The manufacturing cashflow balance fell two points in Q4, to +15%. The services cashflow balance edged down one point in Q4, to +21%, just below an all-time high.

Intentions to raise prices rose slightly in Q4, but in both sectors the balances are well below 2007 pre-recession levels. The balance of manufacturing firms reporting pressure to raise prices rose three points in Q4, to +21%, still a lower level than in Q1 2014. The balance of service firms expecting to raise prices rose two points, to +24%, also a lower level than in Q1 2014.

OVERVIEW LOCAL LEVEL

The national Q4 results show that manufacturing and services firms have reported strong growth to end 2014. The manufacturing sector has had increases in the balances for domestic sales, export sales, recruitment intentions and turnover confidence.

Locally, the domestic balances for both manufacturing and services remain at historically high levels.

The national balances for recruitment intentions have risen in Q4. Locally, plans to increase workforce remain consistent for both the manufacturing and services sectors.

Locally, the turnover and profitability will improve for the manufacturing sector. Turnover will decrease for the service sector although the results show that profitability will improve.

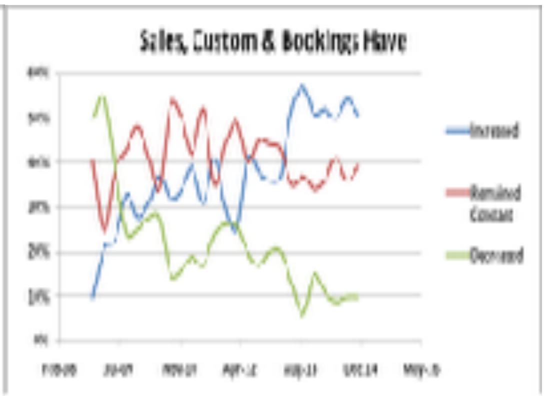
The main causes of price increase were exchange rates and corporation tax. For the local manufacturing and services sector exchange rates and competition were the main causes of price increases.

Concerns locally are corporation tax, exchange rates and business rates.

DOMESTIC SALES

SALES, CUSTOM AND BOOKINGS

The domestic sales balance is 41%, which is 3% lower than Q3. All the domestic balances remain at historically high levels in both sectors. Increased sales were reported by 51% of local businesses, just 3% lower than the previous quarter. 39% reported their sales figures have remained constant which is up slightly on last quarter.



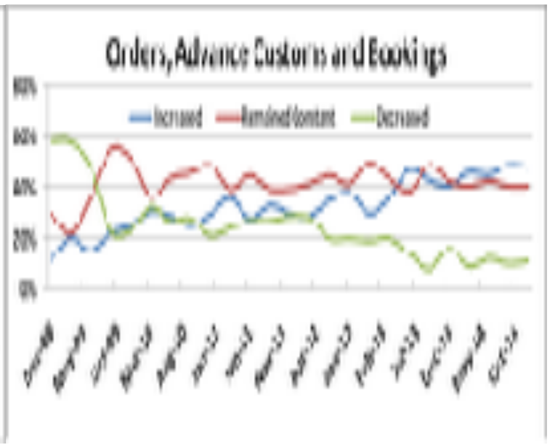
52% of local manufacturing saw an increase in sales (up 2% from Q3). Nationally the manufacturing domestic sales increased substantially. Figures for the local service sector show an increase of 49% (down 6% on Q3). Nationally, the services domestic sales also rose.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

Overall figures show a 48% increase for orders and advance bookings in the domestic market (which is down 1% from Q3). This shows positivity in orders and bookings. The balance is at 37% (Q3 the balance was 39%).

50% of local manufacturing saw an increase in orders, the same as last quarter. Nationally, manufacturing domestic orders increased.

The local service sector figures show 44% reporting an increase in orders, the same as Q2, 44% with orders remaining constant and 8% with decreasing orders over the last three months. Nationally, service domestic orders increased.



EXPORT SALES

SALES, CUSTOM AND BOOKINGS

40% saw export sales increase, which is 5% higher than the last quarter. 49% of companies saw a decrease in their overseas sales, custom and bookings.

Local manufacturers reported 35% increased sales, this has increased 6% on Q3, 10% decreased sales and 25% experienced constant overseas sales which is 10% lower than Q3. Local service sector sales figures were lower at 16% increased sales, 4% decrease but with 27% remaining constant. Nationally, export sales rose for both sectors.

ORDERS/ADVANCE CUSTOM AND BOOKINGS

The balance for overseas orders has increased 8% to 28%. There has been an increase in orders from 35% in Q3 to 39% in Q4.

OVERVIEW - EMPLOYMENT

Changes to Workforce

The workforce change balance has increased to 55% (37% higher than Q3). There was a 63% increase in workforce in Q3, 36% higher than Q3.

29% of companies responding reported plans to increase their workforce over the next three months (previous quarter was 31%), with just 5% with plans to decrease the workforce, just 1% higher than Q3.

ATTEMPTS TO RECRUIT

75% have attempted to recruit full-time staff, an increase of 1% on the last quarter. Employing permanent positions has decreased 13% on the previous quarter. There is 4%

decrease on last quarter for filling temporary positions. Taking a closer look at the local level we see that 58% of local manufacturers have attempted to recruit in the last quarter which is just 4% lower than the last quarter and 45% in the service sector, which is up 1% on Q3.

The recruitment of permanent staff in Q3 has decreased 13% to 41%. Recruitment of part-time staff has decreased 3%. Full-time staff recruitment is at 75%, which is a 1% increase on the last quarter.

36% of local manufacturers have seen an increase in their workforce, which is a 2% increase on Q3. Turning to the local service sector, 26% increased their labour force, which is a 4% increase on last quarter.

RECRUITMENT DIFFICULTIES

Recruitment difficulties were experienced by 53% of businesses, 4% higher than Q3.

37% of local manufacturers (a decrease of 4%) and 22% 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 24%, just a 1% decrease on last quarter.

There were high percentages for the local manufacturing and service businesses reporting they expect their workforces to remain on the same level. 64% of local manufacturing and 65% of local services sector businesses believe they will maintain their current staff levels.

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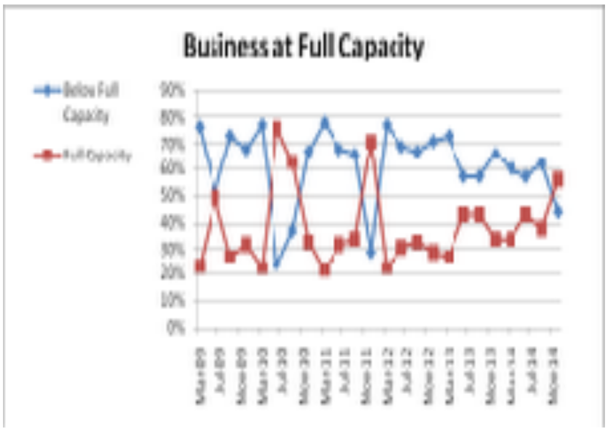
Nationally, employment expectations to take on more staff increased for both sectors, at an all time high.



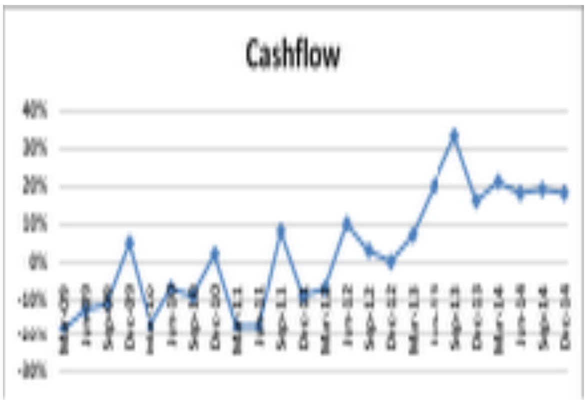
CAPAPCITY CONSOLIDATION, CASHFLOW & INVESTMENT

Capacity

The full capacity balance has increased from the last quarter to 56% by 18%.

44%of local businesses reported to be operating below full capacity, a decrease of 18%. Turning to local manufacturers, 41% stated over the last period they operated at full capacity and 56% reported to be operating below full capacity. Figures in the service sector show that 53% are operating below full capacity and 43% operating at full capacity.

CASHFLOW



Regarding the cashflow balance this has decreased 1% to 18%.

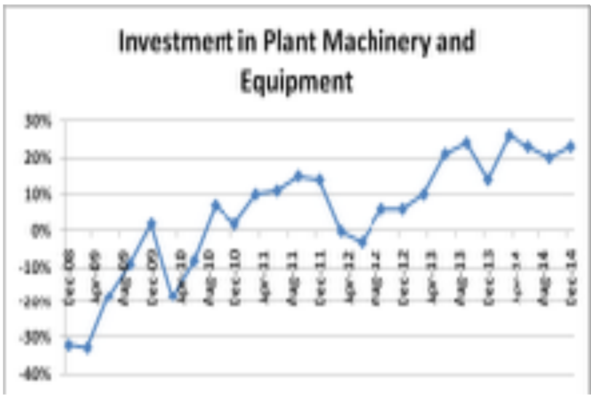
32% reported an improved cashflow experience, 4% lower than Q3 and 52% stated their cashflow remained the same which is up 5% from the previous quarter.

35% reported improved cashflow figures in the service sector and 27% reported improved cashflow in the manufacturing sector. Nationally, in the manufacturing sector, the cashflow balance fell 2 points to +15% and the service sector cashflow balance fell to +21%.

INVESTMENT

Overall the investment balance is -33%. Investment in plant machinery and equipment is up slightly to 23%. Investment in training is the same as the last quarter.

54% of local manufacturer's have seen investment in plant machinery and equipment remain the same. 70% 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 4% to 24%. 27% of companies surveyed experienced pressures to raise their prices, which is the same as last quarter.

3% reported they expect prices to decrease over the next quarter. 70% anticipate their price levels to remain unaffected. 26% of local services and 26% of local manufacturing firms expect prices to rise.

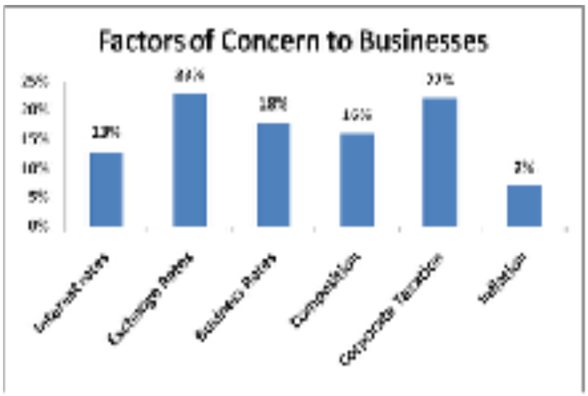
Overall, exchange rates and corporation tax were mentioned as main contributors to price increases. This is a change to the previous quarters where raw materials and other overheads were the main contributors. Local manufacturing and service sectors mention that exchange rates and competition were the main contributors to price raises.

BUSINESS CONFIDENCE

Both the turnover and profitability balance have decreased. Turnover confidence decreased 6% from Q3 (from 82% to 76%). Confidence regarding profitability also decreased by 3%.

77% of local manufacturers are expecting an increase in turnover, 4% higher than Q3 and 69% believe profitability will improve, 2% higher than Q3. Confidence figures for the local service sector has decreased for turnover as 71% believe they will see an improvement of turnover (10% lower than Q3) and expectations of profitability has increased as 68% expect profitability to increase. Nationally, confidence that manufacturing profits will improve in the next 12 months fell in Q4 at the lowest level since Q2, 2013.

Confidence that the services sector profitability will improve in the next 12 months rose marginally in Q4 at a relatively strong level.



FACTORS OF CONCERN TO BUSINESSES

The main factors of concern for businesses are, exchange rates, corporation tax and business rates (23%, 22% and 18%).

Locally, the manufacturing and service sector also state that competition is a factor of concern.

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Summary 4th Quarter 2014

The Q4 2014 results point to continued economic growth, with welcome improvements in most key areas. But many balances still remain below the higher levels seen a few quarters ago, indicating that the pace of GDP expansion is easing overall. Even so, the widespread improvements in Q4 support the hope that the setbacks seen in Q3, do not foreshadow the start of a worsening downward trend. The positive results of this survey support our view that UK GDP growth will stabilise at a level well above 2 per cent, and our medium-term growth will be slightly higher in the next few years than envisaged in the OBR forecast accompanying the recent Autumn Statement. However, the UK economy is facing many challenges. The current account deficit is unacceptably large, and the rebalancing of the UK economy towards net exports and investment must be accelerated. UK growth cannot rely permanently on consumer spending and on unsustainable deficits and debt levels. To underpin the recovery, policy mistakes must be avoided. With inflation likely to stay around 1% for much of the next year, the MPC must reassure business that rates will only start edging up if and when circumstances require such a move.

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

“British businesses are well placed to grow in 2015 – a testament to their hard-work and resilience. It is particularly pleasing to see the manufacturing sector bounce back, despite signs of a slowdown in recent months. However we must aim for growth that is sustainable for the long-term, rather than settle for second best.

“With employment and investment intentions at historically high levels, businesses are gearing up for a big year in 2015. It is now vitally important that firms are able to convert their growth ambitions into reality. Strengthening our business finance system, which constrains the growth aspirations of too many firms, will remain a decisive factor in securing a sustainable recovery. Low interest rates and reduced regulation will also go a long way to creating an environment that encourages enterprise and wealth creation.

“In spite of our survey showing an improvement in export balances, the UK’s lacklustre export performance and severely adverse current account balance, continue to act as drag anchors on GDP growth. This need not remain the case - lack of growth finance, patchy help on the ground in overseas markets, and a never-ending churn of short-term support schemes must be addressed without delay.

“The UK’s economic recovery still faces several obstacles, intensified by the uncertainty of the upcoming general election. Businesses are bouncing back, but their optimism may not last if political point scoring outweighs sound economic policies. It is imperative that all political parties use the forthcoming election campaign to outline their plans to support long-term business growth and investment.

"If current and future governments do the right things, there is no reason why the UK should not enjoy sustainable growth driven by re-energised and dynamic businesses. The UK economy is orientated towards the service sector, which is driven principally by people rather than equipment and machinery. The free movement of people in the EU means that capacity is no longer the barrier to growth it once might have been, and upward pressure on wages is much less likely to occur. With no signs of inflation and no upward pressure on wages, there is no justification for an early rise in interest rates."

David Kern, Chief Economist at the BCC, said:

"The latest results support our view that UK growth will stabilise well above 2%, and that Britain's medium-term economic growth will be slightly higher in the next few years than the recent OBR forecast predicted.

"However, many balances remain below the high levels seen earlier this year, indicating that the overall pace of GDP expansion is easing. In the face of a weak eurozone growth and domestic policies aimed at stabilizing our public finances, a slowdown in economic growth may yet occur in 2015 and 2016, despite increased strength and optimism from businesses.

"Despite a slight improvement at the end of 2014, the current account deficit is unacceptably large. The UK needs a long-term push to rebalance the economy towards net exports and investment, rather than relying too heavily on consumer spending to keep growth going. With inflation likely to stay around 1% for much of the next year, the MPC must delay interest rate rises for the time being."