

Summary of economic conditions

- The South East economy continued on the path to recovery in December. According to the most recent Purchasing Managers' Index (PMI), there was a **strong increase in business activity in the South East in December**. This was driven by a further expansion of new business, which rose at the fastest rate for 2 years.
- Survey evidence suggests that **business confidence continued to pick up at the end of 2009**. The ICAEW Business Confidence Index for the South East reached its highest level since 2004 in quarter 4 of 2009. According to the latest RDA Business Survey (December 2009), 33% of companies in the South East expect the business climate to improve in the next 12 months, up from 23% in June and just 11% in March. While more than one fifth of firms in the region still expect the climate to deteriorate in the next 12 months, this is significantly lower than in June, when a third of businesses were gloomy about the 12-month outlook.
- **More firms now expect an improvement in output, new domestic and export orders and turnover** in the coming 12 months than expect a deterioration. Business Link's South East Business Monitor Survey in November 2009 found that almost half of SMEs expect their turnover to rise in the next 12 months, and 44% expect to see an improvement in business conditions in their sector.
- **Manufacturers reported signs of improving conditions in quarter 4 2009**. EEF's South East Business Trends Survey for quarter 4 showed a positive balance of 9% of firms seeing an increase in output volumes (compared to -19% in quarter 3). New domestic and export orders also picked up in quarter 4. However, a majority of manufacturers expect volume of output and export orders to fall again in the first quarter of 2010.
- **Signs of stabilisation in the labour market are continuing, with a rise in employment of 4,000 in the three months to October**. The monthly PMI survey for December 2009 showed employment falling at the slowest rate since August 2008 as demand across the economy recovers. Prospects for employment appear cautiously optimistic, with 18% of SMEs in the South East Business Monitor planning to take on staff in the next year and only 3% expecting lay-offs. Redundancies fell from 2,400 in November to 1,300 in December, while the claimant count was down slightly in November.

Key challenges and hotspots

- More than 19,200 Business Link health checks have been delivered in the South East since October 2008. The most significant challenge facing firms in receipt of Health Checks is **finding new clients and markets**, followed by **access to finance**. Although many SMEs are striving to avoid increasing debt at present, many are concerned about continuing problems with accessing credit once demand picks up.
- **Investment intentions remain low**. In the three months to December 2009, 30% of firms in Surrey reduced their level of capital investment, while 27% cut expenditure on research and development. **Only a quarter of firms in the South East plan to increase overall investment in the next 12 months** according to the RDA Business Survey for December – only a slight improvement on June's figure of 22% - while 27% plan to cut investment. Marketing and sales is the only area where more companies expect to increase investment than to cut spending.
- Although there is evidence that firms are passing some price increases on to customers, the **continued rise in input prices is causing a further squeeze on businesses' cashflow**.

Business specific intelligence / information on key questions

- According to the RDA Business Survey, **firms being supported by Business Link appear to be faring better than the overall business population in the South East and are notably more optimistic about the business climate**. 29% of Business Link customers reported improved business performance in the 12 months to December 2009 compared to 20% of all South East businesses. Over the next 12 months, 41% of Business Link customers expect an improvement in business conditions compared to 33% of all businesses. Business Link customers tend to have been less affected by cost increases, and a larger proportion plan to increase levels of investment in the next 12 months (33% compared to 25% of all businesses).
- Although the rise in redundancies has slowed, Business Link reports that this has not yet been followed by a rise in recruitment. Meanwhile **demand for and interest in training and up-skilling is reportedly low**, especially amongst smaller companies. The RDA Business Survey suggests that **any growth in employment in the next 12 months is likely to be driven by larger companies**, and firms operating in the financial and business services and manufacturing sectors. See annex for further sectoral information.

Sectoral Overview

Manufacturing

According to the PMI (Purchasing Managers' Index) South East private sector firms reported an increase in output for the sixth consecutive month in December 2009. At 57.8, up from 56.2 in November, the seasonally adjusted Business Activity Index signalled a solid rate of expansion in the region. This has been primarily attributed to higher levels of incoming new business in the manufacturing sector.

The latest national survey released by EEF (30th November 2009) shows that Britain's manufacturers are finally beginning to feel some relief from the combined efforts of the Bank of England and the government to unblock bank lending. The survey points out that fewer companies have seen a reduction in the availability of new and existing credit facilities, which implies lines of credit and finance are freeing up. Indeed, the proportion of companies reporting higher fees on existing lines of credit fell to 28% from 43% in the third quarter 2009. Similar conditions are evident in the South East, as anecdotal evidence from the Institute of Chartered Accountants in England and Wales (ICAEW) shows that by the end of 2009 some banks were starting to lend again and some venture capitalists were starting to become active again in high-risk and overseas expansion related activities. For example, **Circassia**, a chemical & pharmaceuticals firm of Oxford, has raised £15 million to fund the development of allergy treatments. Moreover, the engineering company **Astrium** has won a £456 million contract to manufacture four television satellites for SES, thereby securing hundreds of jobs in Portsmouth and Stevenage while, at the same time, **Manor Grand Prix** has sold an estimated £ 10 million stake in its motor racing business to private equity firm LDC and thus is creating 60 jobs in Bicester as well as 45 in Rotherham.

In more negative news, the rise in price inflation is primarily affecting businesses' profit margins rather than consumers' purchasing power in the South East. The PMI estimates for December reveal that input price inflation in the South East private sector rose to 54.8 index points¹, whilst output price inflation grew only marginally up to 50.9 index points. Respondents in the manufacturing sector commented on higher prices paid for a number of raw materials, often linked to shortages at suppliers, while competitive pressures remained a constraint on their pricing power, preventing them from passing on a higher proportion of their increased costs to customers. The lower profit margins in specific sectors have led some companies to continue downsizing their staff. For example, **NXP Semiconductors** is said to be planning to shed up to 110 jobs at its electronics plant in Southampton, following a merger with Trident Microsystems.

Construction / property

Despite some improvements in the number of customers applying for mortgages, the economic downturn in the housing market has continued to have an adverse effect on the supply chain, ranging from property developers, architects, building services, brickworks, electrical, plumbing, heating, doors & window installation, gardening & landscape, estate agents to house removals, as reported in Berkshire.

Business intelligence in Surrey reports some property-related investment in the retail sector. For instance, Guildford saw before Christmas the arrival of three national brands to town centre units - **Superdry**, **TK Maxx** and **Cotswold Outdoor Ltd**. The moves are expected to revitalise the Friary Street retail estate, much of which has lain empty for most of 2009 when the retail sector was hit by the recession. Vacancies on many of Surrey's key high streets are still much higher than normal however.

¹ Readings above 50 signal an increase or improvement compared to the previous month.

Financial and Business Services

There is a mixed picture in this sector overall. Despite the increased confidence of manufacturers about the improving credit conditions, not all companies in the banking sector have been performing equally well across the South East. For instance, business specific intelligence includes the news that **Santander**, the Spanish private bank, is to set up a new office at 1 Dorset Street in Southampton, which could lead to the creation of up to 40 jobs. However, employment in the business & financial services sector in Brighton now appears to be more vulnerable as increasing lay-offs are anticipated over the next 12 months, according to the latest information from Brighton and Hove Economic Partnership. Business specific intelligence reports that **Lloyds Banking Group** is to close its call centre at Brighton in May 2010, with the loss of 373 jobs.

A similar picture is seen in the business services industry as some firms have been going through restructuring processes in order to cope with the economic downturn. For instance, **Buchanans** of Southampton is to merge with James Cowper to be part of a combined accountancy group with 175 staff while **Platinum Portfolios**, the Eastbourne-based independent financial adviser, has recently been acquired by Perspective Financial for undisclosed terms.

Retail and hospitality

Christmas and New Year sales this year, although significant, were not enough to give a boost to the retail sector as a whole, which has been hard hit by economic recession. For instance, footfall in Brighton city centre fell by as much as 37% in December 2009 compared to the same period the previous year. Anecdotal evidence suggests that customers in the South East are shopping around for the best price and expecting reductions and they are still very cautious. As a result, retailers in Berkshire have tried different approaches to attract shoppers. Instead of having an early sale, they have had days or weekends of promotions (e.g. **Bentalls** had two 20% off days on Thursdays and **BHS** had a '20% off' weekend). Anecdotal reports so far indicate strong trade for Surrey's retailers in the run-up to Christmas and in the New Year sales. In Waverley, the Christmas markets reported busy trading with around 10,000 attendees, but feedback from stall holders indicated that it was harder to make a sale.

In the tourism industry the picture is mixed. Surrey Economic Partnership reports that the local tourism industry should be benefiting from the strength of the Euro but general feedback from Enterprise First suggests that it is not benefiting as well as expected. Information from Visit Surrey shows the sector is 25% down on Business tourism and up 4% on Leisure tourism compared to the same period a year ago. Bookings for business events are down with very few future bookings and more last minute bookings due to economic uncertainty. For example, Clandon Park reports that National Trust membership is up but revenue from events is down.

Transport

The latest RDA Business Survey (December 2009) shows that 63% of South East businesses reported an increase in transport costs over the past 12 months and 60% of respondents are expecting further increases over the next 12 months, mainly as a result of increasing fuel costs. The possibility of expected higher returns (derived from higher prices) could explain the relatively large number of planned and completed investments in the South East. For instance, **Hitachi Javelin** high-speed train service launched a full timetable covering Ashford on December 14th. **Network Rail** has unveiled plans to invest £10 million in improvements to Oxford railway station by 2011, including a new platform. Meanwhile, the Harbour Board has put forward plans to privatise the **Port of Dover**. Talks are taking place with the Department of Transport and the Treasury and a scheme to bring in a private investor is to be submitted in 2010.

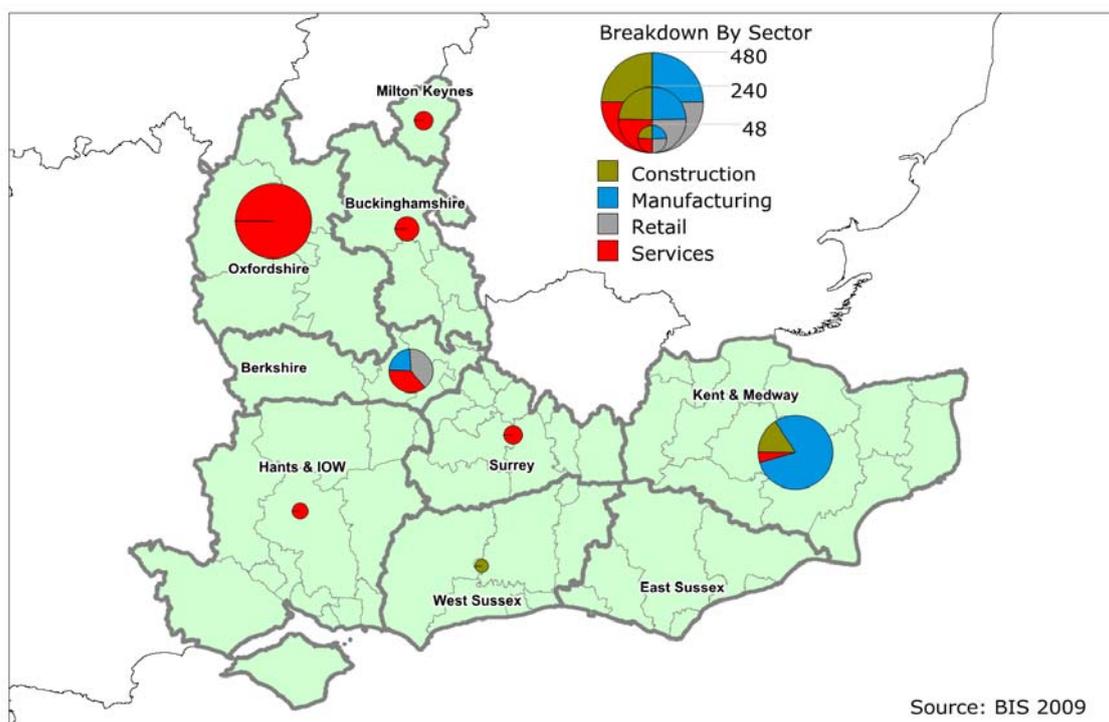
Rural

According to Surrey Economic Partnership, the county's LEADER programme is making good progress in allocating grant funding although many rural businesses are unable to commit the matched funding due to the economic downturn. Many village shops are struggling but the message

from farm shops has been more positive. The message from farmers with livestock seems to be more positive (largely due to a gradual return of pricing power) but for farmers of primary crops such as corn, the picture is less positive, with food prices being low and affected by world supplies. Moreover, the growing public interest in 'buying local' has positively impacted on local producers.

Redundancy Notifications: According to HR1 data, there was a notable fall in the number of redundancy notifications between November and December 2009. Total notifications decreased from approximately 2,400 in November to almost 1,300 in December.²

**Redundancy notifications by sub-region, volume and sector
December 2009 (Source: HR1 data via BERR / Job Centre Plus)**



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The service sector continues to account for the greater proportion of redundancies, totalling 56% of all notifications in December (down from 70% in November). The manufacturing sector continues to account for a far greater proportion of redundancy notifications than its share of total regional employment. Almost a third (31%) of all notifications in December were in the manufacturing sector, whereas less than 10% of employees in the South East work in this sector.

The largest number of redundancy notifications were recorded in Kent and Medway and Oxfordshire, with the latter being entirely changes of contract in the education sector. Berkshire's share of large redundancies increased slightly, from 10% in November to 13% in December, while the proportion of large redundancies recorded in Hampshire and the Isle of Wight fell from 30% in November to just 3% in December. There were no large redundancy notifications recorded in East Sussex in December. The relatively high concentration of small firms in this county means that smaller redundancies are more common, and these are not picked up on HR1s.

² Note that this data only captures redundancies of more than 20 employees; some of the job losses are not scheduled to take place until later in 2009; and in some cases the redundancies are happening in another region but are registered in the South East because it is home to the company's headquarters.