ECONOMIC SURVEY

QUARTER 3
2022

North East England
Chamber of Commerce

IN ASSOCIATION WITH

Durham
University
Business School

FOREWORD

Our Quarter 3 findings tell a tale of two halves: a complex picture with some small glimmers of hope as well as some big causes for concern.

Cashflow remains significantly depressed and businesses' top three concerns have followed the pattern set in the previous quarter - with inflation, energy prices, and staff costs all hitting new highs.

Whilst there is evidence of a little more stability and positivity overall than earlier in the year, there is, undoubtedly, still an overall trajectory of decline across many measures of business health over the last 12 months. This is of particular concern as we know that a year ago businesses were, of course, still feeling the effects of the pandemic and working towards a hard-fought recovery. These findings were also gathered during a period of significant policy change. The survey closed shortly after the Government's announcement of its Energy Relief scheme for businesses and non-domestic users, a policy our members' welcomed with caution as it only provided an initial six months of support. We will be using your responses to our new questions on energy usage to inform our lobbying on the Government's next steps: thank you to everyone who contributed these vital, local insights.

The survey did however close before the Government's Mini-Budget. Therefore it reflects businesses views on energy, inflation and staff pressures before the most recent policy announcements, other interventions and market response. It is going to be more important than ever in Quarter 4 that we gather even more intelligence and insight – so that we can work together on solutions as we navigate a difficult winter ahead.

Thank you to everyone who has shared their intelligence and our partners at Durham University Business School for helping us make sense of the picture – once again, we are stronger together.

Andrew Haigh
Chamber president

OVERVIEW

A future perspective

The third quarter Economic Survey was undertaken against a challenging background of economic concerns. Consumer price inflation was 9.9% p.a. in August, down slightly from the previous month but a steep rise since March 2021 when annual inflation was 0.7%. Much of this increase has been driven by energy and food price rises, but wage inflation has also been picking up standing at 6% p.a. in July for the private sector. This is still below price inflation, so workers experienced a fall in real terms. UK GDP growth has been significantly declining quarter-on-quarter since the end of 2021, with Britain expected to be in recession very soon. This decline is against a backdrop of the expected significant bounce back in demand following the crash in GDP during the worst of the pandemic. However, the change in UK GDP in Q2 2022 was still 0.2% below comparative figures of Q4 pre-pandemic in 2019. At the end of September, the OECD forecasted 0% GDP growth for the UK in 2023, lower than any other country except Germany. The IMF categorised the UK at the bottom of this league table. In contrast, UK unemployment decreased 0.2% May-July to 3.6% (4.7% in the North East, the highest in the UK), settling at the lowest rate since 1974. In contrast UK economic inactivity, reflecting those people leaving the labour market and not seeking employment, rose by 0.4%. In the North East the rise was 0.5%, taking the region to 25.3% of the working age population being unavailable for work, the highest rate in England. Thus, it is not surprising that the North East Quarterly Economic Survey placed inflation, energy prices and staff costs at the top of business concerns for Q3.

On 23rd September the new Chancellor of the Exchequer delivered his Growth Plan. The essential elements were helping to cap energy costs, with a new but short-term six-month Energy Relief Scheme for business; and attempts to drive higher growth through expanding the supply side of the economy. However, the main policy changes to do this were more aligned with boosting demand rather than supply.

The Bank of England is now expected to maintain pressure on higher borrowing costs through increases in the base rate – in part offsetting any expansion in domestic demand planned in the Mini-Budget. At the same time business energy bills are rising significantly (even with Government help). The consensus is therefore that households will spend less in the next 12-18 months, with businesses also facing a very challenging environment. Little by way of fundamental changes to productivity growth were provided. Arguably the main emphasis should be through underlying supply-side change, not short-term demand-led growth. And until the OBR forecasts are available in a few weeks' time, instability and uncertainty leading to higher risk impacting on business planning will likely be an ongoing feature in the UK. Whether this belief that higher spending by the wealthier will 'trickle-down' to benefit everyone leading to 'levelling-up' and the supply-side rebalancing of the UK spatial economy is therefore yet to be seen.

Prof. Richard Harris
Economics department
Durham University

KEY INDICATORS

INDICATOR	ALL COMPANIES	CHANGE ON LAST QUARTER	CHANGE ON LAST YEAR	MANUFACTURING	SERVICE
UK sales	11.2	-5.3 ▼	-16.1 ▼	5.0	14.7
UK orders	6.3	-5.9 ▼	-22.5 ▼	0.0	10.3
Export sales	8.3	11.7 ▲	8.3 ▲	20.0	-2.0
Export orders	3.1	4.8 ▲	0.2 ▲	12.8	-5.9
Plant investment plans	4.4	7.7 ▲	-8.2 ▼	-7.0	12.8
Training investment plans	10.1	3.1 ▲	-5.0 ▼	1.7	14.9
Cashflow	-17.4	9.8 ▲	-7.4 ▼	-25.9	-12.6
Current prices	54.0	37.3 ▲	30.8 ▲	57.1	52.3
Future prices	46.9	-6.0 ▼	9.6 ▲	40.7	50.0
Current workforce	13.3	-41.0 ▼	-21.7 ▼	8.8	15.6
Future workforce	30.1	-18.0 ▼	-11.8 ▼	23.3	33.6
Future profitability	-1.7	-1.7 ▼	-31.0 ▼	0.0	-2.5
Future turnover	29.4	-12.1 ▼	-21.4 ▼	32.8	27.7

The economic survey is carried out by the North East England Chamber of Commerce in partnership with Durham University Business School. This survey was conducted during August and September 2022 and is based on responses from 180 businesses. Data was compiled before the Government's Mini-Budget on 23 September 2022.

Methodology

Every quarter we ask businesses about each of these key indicators. For current indicators (e.g., UK sales, cashflow), they are asked whether these have increased, decreased, or stayed consistent throughout the past three months. For the future indicators (e.g., future workforce, future turnover), they are asked whether they think these will increase, decrease, or stay consistent over the next three to 12 months. The values above are the 'balance' of the amount of 'increase(d)' and 'decrease(d)' answers we received.[1]

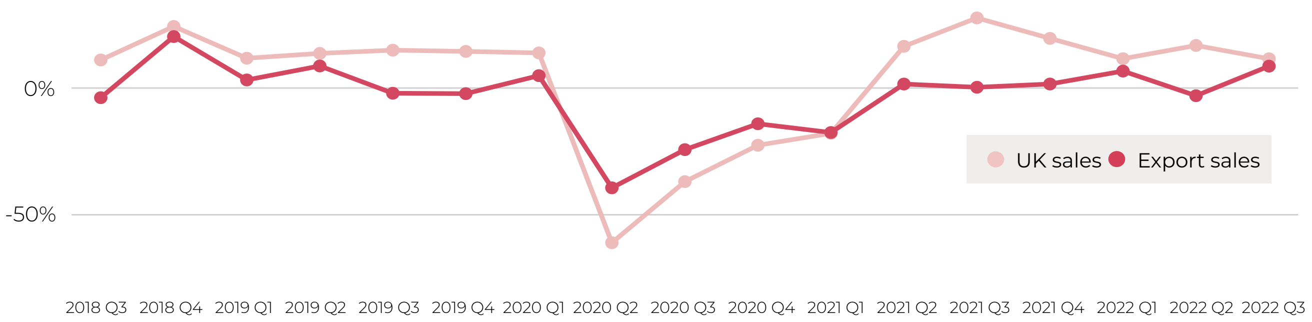
Key insights:

- Whilst the overall picture of business conditions is slightly healthier in Q3 compared to Q2 there remain some significant indicators of concern.
- Inflationary pressures are affecting a number of indicators. Cashflow remains significantly depressed following trends set in the previous quarter at -17.4%. This is driving prices into positive territory but depressing future profitability considerably for both services and manufacturing firms.
- Most recruitment indicators began to decline in Q3 when compared to Q2 providing an early indication of a loosening of labour markets locally.
- The mixed picture in relation to UK and export orders and sales is likely to reflect a number of national and international economic and trade factors – and presents inevitable concerns for overall business health.
- Utilities, labour costs and fuel are the three main price pressure concerns for the quarter, with some notable variation in the order of priority for services and manufacturing firms.
- Businesses' top three concerns remain inflation (89.3%), energy prices (88.2%), and staff costs (73.0%) – following trends set in Q2 of this year.
- Whereas last quarter manufacturing firms appeared less optimistic than services firms in general, the picture is more mixed in Q3. Manufacturing firms are demonstrating notably less optimism around cashflow and workforce: services firms are slightly more concerned about future profitability and exporting.

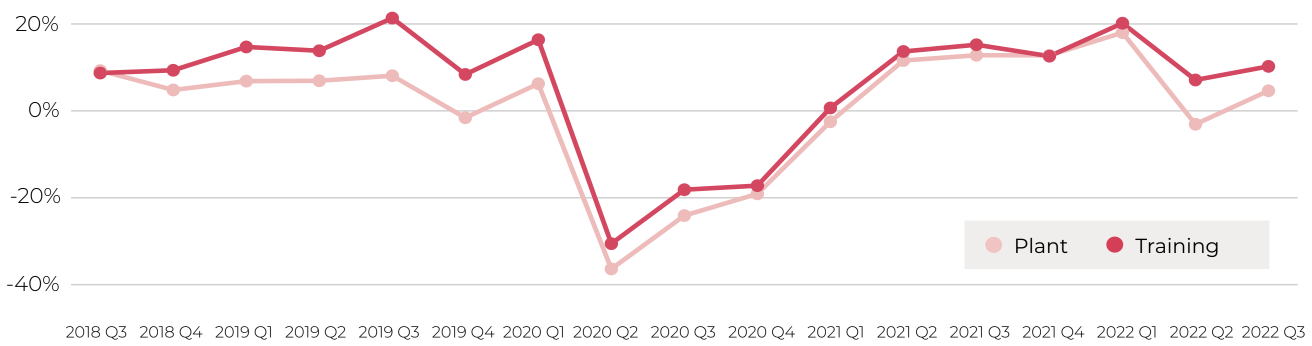
1 The number of businesses providing responses in the All Companies analysis is not necessarily equal to the sum of those providing responses for the two broad sectors of services and manufacturing, as not all respondents provide details of the industry in which they operate. Where data analysis involves more than two variables, and where three or less companies have provided information, data has been withdrawn from the survey in order to protect the anonymity of companies, and to provide accurate analysis.

KEY INDICATORS

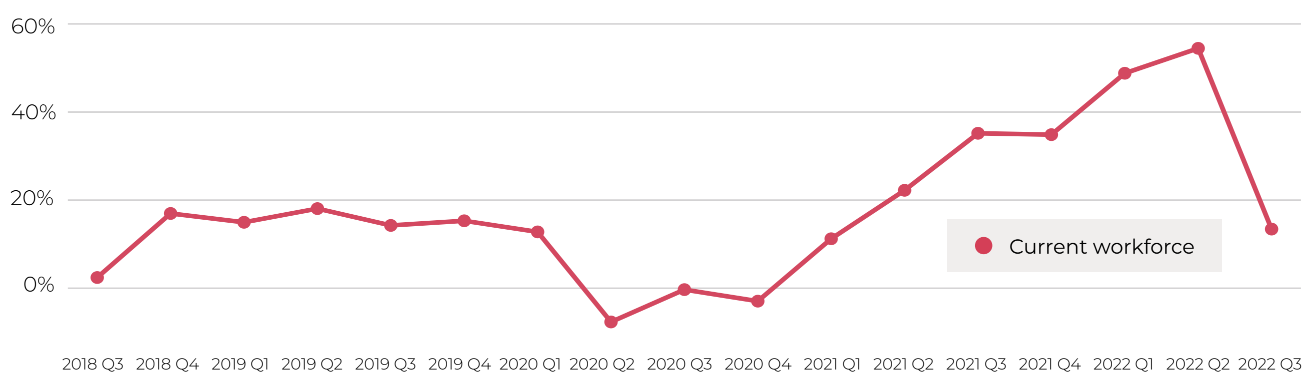
FIVE YEAR TREND - SALES



FIVE YEAR TREND - INVESTMENT



FIVE YEAR TREND - WORKFORCE



Cost pressures have overtaken recruitment challenges as businesses' biggest pressure.

Recruitment
Most recruitment indicators began to decline in Q3 when compared to Q2 providing an early indication of a loosening of labour markets locally.

65.2% of respondents attempted to recruit full-time staff in Q2, a decrease from the previous high recorded last quarter of 70.4%. This was also a slowing of the upward trend across the last 12 months from the levels recorded in Q3 2021 (58.0%).

The recruitment of part-time staff, at 34.0%, was almost identical to Q2 (34.3%), and close to the level recorded in Q3 last year (37.4%) demonstrating a fairly stable position overall. This was also true of the recruitment of permanent staff: 58.6% of respondents attempted to recruit permanent staff, a slight increase on figures recorded last quarter (55.6%) and an increase on Q3 last year (53.3%).
The only area of recruitment to change significantly was the recruitment of temporary staff. At 31.3% in Q3 it was considerably higher than Q2 (20.4%). It had also increased when compared to Q3 last year (26.6%).

Price pressures
Utilities, labour costs and fuel were the three main price pressure concerns for the quarter, with some notable variation in the order of priority for services and manufacturing firms.

Overall the proportion of members facing price pressures from utilities was 79.9% (Q2: 77.6%), followed by labour costs at 68.9% (Q2: 72.0%) and fuel at 68.1% (Q2: 77.6%).[2] However, for manufacturing firms raw materials were the primary price pressure concern at 85.7%. This contrasted with service sector businesses which identified utilities as their main area of concern at 76.3%. Service sector firms also identified other overheads as their third priority in terms of cost pressures at 64.3%.

The proportion of members facing price pressures from raw materials (60.5%) rose from the levels recorded last quarter (53.3%) and significantly increased on the same period last year (46.5%), reflecting the combined pressures of inflation and supply issues. Price pressures as a result of finance costs were essentially stable quarter-on-quarter at 41.7%, but up significantly on Q3 2021 (27.0%).

[2] These three categories of question are new as of Q2 2022 so historic data is not available.

CONCERNS KEY INDICATORS

INDICATOR	ALL COMPANIES	CHANGE ON LAST QUARTER	CHANGE ON LAST YEAR	MANUFACTURING	SERVICES
Crime	16.1	4.5 ▲	-1.9 ▼	12.0	18.2
Congestion	15.6	-1.4 ▼	4.0 ▲	14.0	16.5
Interest rates	47.5	-10.0 ▼	21.8 ▲	40.0	51.5
Exchange rates	40.3	13.2 ▲	18.1 ▲	48.1	35.8
Business rates	47.4	12.6 ▲	16.4 ▲	39.6	51.5
Taxation	44.8	-6.3 ▼	-3.9 ▼	51.9	41.0
Competition	37.7	-2.7 ▼	0.4 ▲	32.7	40.4
Energy prices	88.2	-4.0 ▼	38.2 ▲	89.8	87.4
Staff shortages	58.1	-7.5 ▼	0.7 ▲	54.5	60.0
Staff costs	73.0	-2.0 ▼	15.9 ▲	72.7	73.1
Red tape	31.3	-4.7 ▼	-10.8 ▼	23.5	35.4
Inflation	89.3	-6.7 ▼	30.0 ▲	86.2	90.9

Inflation and energy continue to be businesses' overriding concerns.

Perceptions
Perception scores reflect whether issues affecting members and their business activity are of greater concern now compared to last quarter. The scores above represent the proportion of respondents who indicated they were more concerned about these issues compared to last quarter.

Once again, businesses' top three concerns were inflation (89.3% dropping only slightly from 96.0% last quarter), energy prices (a priority for 88.2% of respondents, a drop of only 4% on last quarter), and staff costs (73.0% compared 75.0% at the last quarter). Looking at the previous figures, there is a clear upward trend in the percentage of businesses worrying more about these factors over the past year. The gap between services and manufacturing firms, which was more pronounced last quarter on these indicators, has also narrowed demonstrating again the regions' firms coalescing around the same core set of concerns.

Staff shortages remain in 4th position this quarter, falling slightly from 65.6% in Q2 to 58.1% in Q3. Combined with anecdotal feedback this suggests a slight loosening of the labour market locally: whilst retention and recruitment remain a concern, some businesses also appear to be slowing down recruitment activity in a response to the increasingly challenging economic climate. Interest rates and taxation are at some of the lowest levels of concern seen this year at 47.5% and 44.8% respectively. However, survey data was gathered one week in advance of both the Bank of England's latest base rate increase and the Government's Mini-Budget: we expect these policy interventions to have a significant impact on our Q4 findings.

The majority of other indicators stayed in broadly similar territory to Q2. This is with the exception of business rates which rose from 9th position in Q2 (34.8%) to 6th position in Q3 (47.5%) and exchange rates which rose from 10th to 8th place in the ranking this quarter with a significant jump in concern from 27.1% to 40.3%.

Energy Usage
In Q3 2022, 88.2% of our respondents were concerned about energy prices, closely following trends established in Q2. By sector, this was 89.8% of manufacturing businesses and 87.4% of service businesses responding to the survey.

73.3% of businesses said they had taken action to try to reduce expenditure on energy, only slightly down on the 82% of respondents who had reported the same action in Q2.

Of those respondents:

- 76% said they were reducing energy usage by turning off equipment
- 74% were encouraging staff behaviour change to improve efficiency
- 40% were investing in new, more energy efficient equipment
- 24% were switching tariff or provider
- 20% were investing in energy efficiency measures (e.g. insulation)
- 18% were changing work patterns to reduce energy usage on site
- 16% were using local energy generation (e.g. solar panels)

Similarly to Q2, responses demonstrated two broad categories of action: mitigation and adaptation. In terms of mitigation, encouraging staff to adopt behaviours to lower consumption was common, as was reducing consumption by downsizing office space. Comments included:

“We’ve moved to an office with energy and internet included in the cost of rent - effectively fixing our costs.”

“We have reduced trips to client sites - going back to the remote activities we adopted in the pandemic where possible and are being more active in managing meetings to reduce trips.”

In terms of adaptation and innovation there were some very positive examples of businesses using current energy pressures to explore or invest in greener energy, office and plant alternatives. Respondents provided the following comments:

“Installed 475 solar panels on the roof”

“Developing our own green energy systems that can provide power supply and heating. We are currently building the prototypes and will test these early next year”

“Moving into an eco-building in January”

“Considering investment in CHP [Combined Heat and Power systems]”

On 8 September 2022 the Government announced the Energy Bill Relief Scheme to provide a six-month support scheme for businesses and other non-domestic energy users, as well as a three-month review to identify targeted sectors for further support into 2023.

We will be using these findings to inform our response to Government. To add your voice to that conversation please contact Thomas Lonsdale, knowledge and research executive **thomas.lonsdale@neechamber.co.uk**

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