REGIONAL INTELLIGENCE SNAPSHOT FOR THE SOUTH EAST

November 08

SEEDA South East England Development Agency — Working for England's World Class Region

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SUMMARY OF ECONOMIC CONDITIONS

- The latest evidence from businesses and business representative organisations points to **slightly weaker economic conditions** in the South East.
- The **volume of output and volume of new orders** (both domestic and export orders) **have weakened** over the past month. EEF South reports that the November **volume of output in manufacturing** appears to be significantly lower than in October. Weakening global demand, and in particular demand from Europe have resulted in significantly **lower volume of export orders**.
- Reported **employment levels are marginally lower** than in October, and in line with the latest data from National Statistics.
- Input prices have started to ease, with **prices charged to consumers lower than in October**. Severe competition for new business is the main factor behind lower prices.
- **Cost cutting is high on businesses' agendas** - due to falling sales companies are increasingly making plans for redundancies.
- **R&D investment is mostly flat**, with high-tech manufacturing firms in parts of the region **expecting a squeeze on spending** as cashflow gets tighter.

Economic scores* (previous month compared to this month)

Sales volume			Investment			Employment		
Consumer prices			Costs			Labour costs		

KEY CHALLENGES AND HOTSPOTS

- **Cashflow remains a key challenge** due to falling sales, late payments and shortage of credit.
- **Access to finance is continuing to prove difficult**, particularly for small businesses and some exporters. Difficulties in renewing loan arrangements, higher overdraft interest rates or a summary withdrawal of overdrafts are some of the issues still commonly reported by businesses, although there is some anecdotal evidence that in several areas bank lending has increased. Ease of access to credit and terms of credit differ substantially between financial institutions and this is causing 'time challenges' for businesses if they approach the 'wrong' bank.
- **Several sub-regional centres** with high concentrations of transport, financial services and property related activities **appear to be particularly exposed to the first-order effects** of the downturn.
- **Uncertainty over the likely length of the downturn** is causing concern. According to the RDA survey almost two thirds of companies in the South East now expect the **business climate in which they operate to deteriorate** in the next 12 months. **Larger companies** appear to be faring better than SMEs, but there is a general view that a 12 month recession would be survivable, while a more prolonged downturn would be extremely challenging.

BUSINESS SPECIFIC INTELLIGENCE / INFORMATION ON KEY QUESTIONS

- The **impact of the credit crunch and the downturn in economic activity** is **still relatively contained to a handful of sectors**, with **some sectors still performing strongly** (see Annex A1) but the general expectation is that as consumer spending slows down its **impact will start spreading to the wider economy**.
- Customer service teams at **Business Link** have seen **a significant increase in number of inquiries**.

SOUTH EAST ENGLAND DEVELOPMENT AGENCY

REGIONAL ECONOMIC UPDATE – November 2008

Annex – Sectoral Overview

Investment is holding up in parts of the region. In Milton Keynes, investment inquiries in October were 18% up on October of last year, with 9 successful investments in the town in October generating some 1,370 jobs.

Construction: remains depressed with little sign of improvement, at least in the private housing market, whilst increased public sector contracts are keeping some construction firms' order books full. Housing market conditions continue to deteriorate and instability in financial markets is being felt throughout the industry. High materials costs are squeezing margins, placing additional pressure on firms facing dwindling demand. Deferred contracts are quickly undermining immediate and future delivery capacity and confidence. Forward sales appear to be up to 40% down, with employment levels continuing to fall, reflecting weaker workloads.

Financial services: prolonged uncertainty within the global financial markets and a merger of HBOS and Lloyds TSB have led to 'restructuring' within the financial sector in the UK and in a number of 'hot-spots' largely within the 'Inner South East' of Surrey, Oxfordshire, Buckinghamshire, and in Brighton & Hove, parts of Kent and Hampshire. The South East's labour market and wider economy (through consumer spending) is exposed to any significant re-structuring of financial services in London (e.g. about 1,700 residents in Berkshire have already been affected by City banking job losses).

Manufacturing: faced with falling demand the **automotive sector** continues to struggle, with demand for cars down 20% and demand for commercial vehicles down by 30-40%. Businesses are laying off agency staff, cutting shifts and production levels. As a result of a further slowdown in domestic and global demand the **engineering** sector reported a sharp slowdown in output volumes. The number of employers reducing their workforce is on the increase, whilst investment intentions and prices in both domestic and export markets are lower. Depreciating currency in theory ought to boost the competitiveness of export orientated businesses. However, slowing global demand (and in particular from the Eurozone, which is technically in recession) has led to export new order volumes now showing negative trend, leading to a weaker outlook for the sector.

Retail: both sales and footfall are down across most sub-regions, with discretionary spending significantly lower and discount shops reported to be faring better. Small independent retailers are struggling in the face of competition from larger firms who can afford to cut prices and may be better able to access finance. While in some areas shop refits are continuing, other town centres are seeing rising numbers of shop closures.

Transport: Reduced demand from airlines is affecting companies in the supply chain around Gatwick and Heathrow airports in particular, but airlines themselves have made few if any redundancies in the past month. A general slowdown in economic activity is having an impact on several major ports in the South East and in particular on Southampton and Dover.

Tourism: the picture in this sector is mixed. So far performance has held up remarkably well despite poor weather and economic downturn. Visitor numbers are still strong in popular tourist destinations such as Canterbury, partially helped by the strength of the Euro against the pound. However, the Tourism South East Business Confidence Survey indicates that most businesses are anticipating difficult trading conditions next year. As consumers hold back on discretionary leisure spend, short breaks and visits to commercial attractions are also expected to be adversely affected. Conversely, many of the region's caravan and camping businesses and self catering operators are reporting better sales, reflecting the national picture.

Agriculture: Record borrowing in the sector could make it vulnerable to future rate rises. Anecdotal evidence shows that many farmers are seeing migrant workers return home to Eastern Europe (although evidence from West Sussex suggests that some of these migrants are now applying to return to the UK as the economies of their home countries feel the effects of the downturn).

Other business services: Clients are cautious about spending, and some firms are struggling because of clients' late payments. Solicitors are seeing a drop in property law related business, but increased enquiries on redundancy.

Environmental services and technology: activities related to construction e.g. contaminated land remediation have slowed down. Wind energy continues to grow with increasing recruitment and increasing global demand. Waste management is generally doing well but some commodity prices for recycled materials have reduced, so this is affecting companies that collect and reprocess recyclates, and larger companies making capital investments are finding it harder to secure capital, thus slowing down investments. Investment funds are still doing deals/raising funds but IPOs are slowing down due to stock market volatility; some smaller companies are struggling to maintain cashflow.

Healthcare: is struggling mainly because of lack of investment. With tight lending criteria businesses cannot re-fund their operations as they would have expected under normal circumstances. The health sector is very investment-hungry and spends around 30% turnover on research and development. Many companies have products which may take up to 10 years to come to market and need to be funded for this length of time. The companies who are struggling are some of the best known biotechs, not the small start – ups, although these are also faced with difficult trading conditions.

Digital media: the impact of the downturn in the digital media sector is being delayed by the long lead time for the creation of projects. From computer software, feature films, to computer games there is an average lead time of 18 months plus to delivery so there is work in the pipeline. The feature film industry in Hollywood has lost $12billion of investment from the banking community so it is anticipated that there will be less film production in the region from the average South East position of £100million a year.

Security sector: budgets across the board are being squeezed or cancelled in the security technologies sector, with, in some cases, specific focus on a number of Security Technology projects. In the short term it will be more difficult for SMEs to see breakthroughs in terms of new technology launches and especially fund raising. Many funds have stopped looking at new investment opportunities and are refocusing their efforts on the management of their existing investment portfolios. A number of firms have cut back on their research capabilities and made redundancies in their research staff levels accordingly. Investment in security technology is being significantly reduced.

Leisure marine industry: is highly exposed to consumer stress, since sales largely depend on levels of disposable income. However, this stress is not evenly distributed, and appears to be concentrated on the small and medium-sized yacht and powerboat markets. Sales here are driven by customers ‘trading up’ and this process has been severely hit by consumers’ risk aversion in the current climate. Although the Southampton Boat Show reported sales only slightly down on previous years, it is believed that margins were significantly lower. Two major builders have announced major redundancy programmes in the past two months. Smaller companies are being especially hard hit by a widespread lack of overdraft facilities from banks.