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South East Economy Review

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Contents

Executive Summary

UK and South East economic trends

- The 18-month long global recession bottomed out in spring 2009 and the economy has been gradually heading towards **recovery** since summer 2009. Following six consecutive quarters of negative growth, the UK economy emerged from its deepest and longest recession for 60 years in the final quarter of 2009, with **output growth** of 0.3%.
- At UK level, the **production and construction sectors** saw the largest drop in output in absolute terms over the course of the recession, but the relatively large contribution that the **service sector** makes to the UK economy means that services made a greater contribution to the overall GDP decline.
- In the South East, **business activity** has shown sustained growth in recent months, largely driven by a strong increase in manufacturing output. The proportion of firms reporting improvement in the business climate also increased over the course of 2009. However, **profit margins** continue to be squeezed as sales fall, customers demand lower prices, and input costs increase.
- **Smaller companies** in the region have been hardest hit by the recession, particularly in the manufacturing, construction and distribution sectors. Smaller firms still face difficulties in accessing credit from banks.
- The volume of **new orders** has been increasing at its fastest rate for more than two years in the South East, as a positive signal of future growth. At the same time, following a large drop in **business investment** over the course of the recession, there are signs that investment is picking up amongst South East businesses.

Labour market performance

- Since the third quarter of 2009 we have witnessed signs of stabilisation in the South East labour market, with a noticeable slowdown in the fall in employment and rise in unemployment which characterised the early stages of the recession. The drop in the **employment rate** and rise in the **unemployment rate** in the South East were just below the UK average in the first three quarters of 2009. Meanwhile, the **claimant count** has been broadly stable in the South East since early 2009.

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- During the recession there has been an increase in the number of people who are **'involuntarily inactive'** – that is, they would like to work but are unable to find a job and may be ineligible to claim unemployment benefit. Growth in the size of this 'hidden unemployed' group is of concern, since they are further away from the active labour market and support services to help them return to work.
- However, during the recession the flow of people from **inactivity** to **unemployment** reached a 10-year high. In other words, the rise in unemployment seen during the recession is not only due to people losing their jobs but also people moving back into the labour market after previously being economically inactive.
- Apparent stabilisation in the labour market in part reflects firms' more flexible responses to staffing in the recession. Businesses have been making extensive use of short-time working, sabbaticals, temporary contracts and pay cuts to avoid the financial costs and loss of skills involved in laying staff off. As a result, there was an increase in the proportion of **part-time and temporary employees** in the workforce during the recession, as well as an increase in the proportion of people working part-time or on temporary contracts because they were unable to find full-time or permanent jobs.
- Men appear to have fared worse than women during the recession, with **male employment** falling sharply while women's tended to rise from spring 2009, while unemployment amongst men continued to rise throughout the recession while **women's unemployment** remained relatively stable. The differences partly reflect the large number of job losses in the male-dominated manufacturing and construction sectors, but also the rise in part-time and temporary employment, which tends to involve more women than men.
- From April 2009 there was a marked reduction in the number of large **redundancy notifications** in the South East. The majority of large redundancies in the six months to January 2010 were in the service sector (70%), although manufacturing accounted for 20% of all redundancies, which is significantly higher than this sector's share of employment. The largest falls in **employee jobs** in the year to October 2009 were in the manufacturing and construction sectors in the South East, though the rate of job losses was greater in the UK.
- The fastest increase in unemployment in the South East during the recession has been amongst people employed in **lower skilled occupational groups**, such as sales and customer service roles and process, plant and machinery operatives.
- The increase in **unemployment amongst young people** during the recession is a subject of considerable concern. The rate of increase in total Jobseekers Allowance claimants in the 18-24 age group in the past year has been in line with the average for other age groups. However, the number of people aged 18-24 who have been unemployed for more than 6 months or more than a year has increased at a faster rate than all other age groups.
- Earlier in the recession the fastest increases in the unemployment rate were **in large urban centres** and parts of the **Inner South East**, due to large-scale redundancies in the service sector as well as job losses in London which affected commuters resident in these areas. However, in the past three months **coastal areas** of the South East have seen the fastest increase in the unemployment rate, partly because unemployment tends to be higher in the winter months in areas with a high dependence on seasonal employment.

Future prospects for the South East and UK economies

- There have been encouraging signs of an improvement in **business and consumer sentiment** in recent months. The world's **stock markets** have recovered well from their low point in March 2009, while **consumer confidence** in the UK began to pick up in the second half of 2009 and **retail sales** grew (helped in part by heavy discounting). However, consumer sentiment remains fragile, and households are saving an increasing proportion of their income. This is of concern as the strength of the recovery depends in part on levels of consumer spending.

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- **House prices** in the South East have been increasing for three consecutive quarters. However, they are still 15% below their peak in quarter 3 2007, and to some extent a shortage of stock has underpinned the recent price increase.
- The **commercial property market** remains subdued. Although new development starts have fallen back, the supply of commercial floorspace still significantly exceeds demand, and as a result vacancy rates increased sharply in 2009, while rents fell sharply, leading to plunging income for property companies. However, confidence in new sales and lettings activity improved in the final quarter of 2009.
- **Business confidence** in the South East improved strongly in the last quarter of 2009, with firms generally more optimistic than the national average. Larger companies tend to be less optimistic than smaller ones, perhaps because they are concerned about failure of smaller firms in their supply chains. Firms in the construction, distribution and hospitality sectors were least optimistic about the future business climate in December 2009. Meanwhile, companies in Surrey, Berkshire, Hampshire and West Sussex tended to be more optimistic about the business climate than those in other counties.
- One note of caution comes from the fact that the proportion of South East firms reporting that they are not well placed to weather any **further downturn** in economic conditions in the next 12 months increased significantly between June and December 2009. Smaller firms, and those operating in the construction, distribution and hospitality sectors are least positive.
- Both survey and anecdotal evidence suggests that firms are hopeful of strong growth in **new orders** and hence in **output** in the coming months. Around one third of South East businesses expect their volume of output and domestic orders to be higher in 2010 than in 2009.
- Although business are still shedding staff, the pace of **employment** decline is slowing, and firms in the South East expect staff headcount to rise at a faster rate than the UK average in 2010. Employment growth is expected to be driven by large companies and those operating in financial and business services and the manufacturing sector.
- **Investment intentions** are generally picking up, but slowly, as firms remain cautious. A quarter of South East companies plan to increase their overall level of investment in 2010, but a further quarter expect to reduce their investment. Most new investment is expected to be focused on **marketing and sales**, but the proportion of companies planning to invest more in **training and retraining** has also increased. Capital investment intentions remain low.
- **Access to finance** and **cash flow** remain problematic for many South East businesses, and could hamper further investment and business growth. Delayed payments continue to be a concern, and there are reports that the banks remain risk averse, particularly when lending to smaller firms and companies in the construction and manufacturing sectors.
- The South East, together with London, is expected to lead the fragile recovery in 2010, with **GVA growth** above the UK average up to 2016 (though below the pre-recession average). The region's relatively good performance could be explained in part by its smaller concentration of employment in manufacturing and construction – sectors which were hit hardest by the recession.
- All **South East counties** are expected to outperform the UK average for GVA growth in 2010, with Experian projections suggesting that growth will be led by Sussex, Berkshire, Buckinghamshire and Surrey.
- **Employment in the South East** is forecast to return to growth in **2011**, at a modest pace, well below the pre-recession rate of growth, though faster than the UK average. Growth in 2011 is expected to be driven by Buckinghamshire, East Sussex and Surrey, according to Experian forecasts.
- **Unemployment** in the South East is expected to peak in **2010**, before falling back to the levels seen after the recessions of the early 1980s and early 1990s. However it is unlikely to return to the low levels seen in the early 21st century at all. This is partly because this period was an exceptional time, with strong economic growth and good support for job creation in both the public and private sectors.

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1. Introduction

This report follows on from the *South East Economy Review* published in June 2009, which outlined the progress of the recession up to that point, highlighting how it had affected general economic conditions and business performance in the South East, as well as its impact on the labour market. Signs that the pace of decline in the economy was slowing were evident last June, and were reported on in the last *Economy Review*.

This new report focuses mainly on the period between June and December 2009, with comparisons drawn over a whole year where this is more appropriate. Section 2 focuses on the impact of the later stages of the recession on different sectors of the South East economy, and includes analysis of the early recovery at UK level, as well as signs of improving business performance in the South East, with growth in business activity, new orders and investment.

Section 3 covers labour market trends, focusing on the extent to which we have seen stabilisation in the labour market in the past 6 months, as firms adopt flexible approaches to staffing in order to retain skilled employees in preparation for the upturn. We also assess how labour market performance varies by gender, age, occupation, sector and sub-region.

Future prospects for the South East economy are outlined in Section 4, which includes improvements in consumer confidence, signs of recovery in the housing market, and businesses' assessment of prospects for the business climate, staffing and investment in the coming months. Finally, the most recent independent projections for regional GVA and employment in the short to medium term are presented.

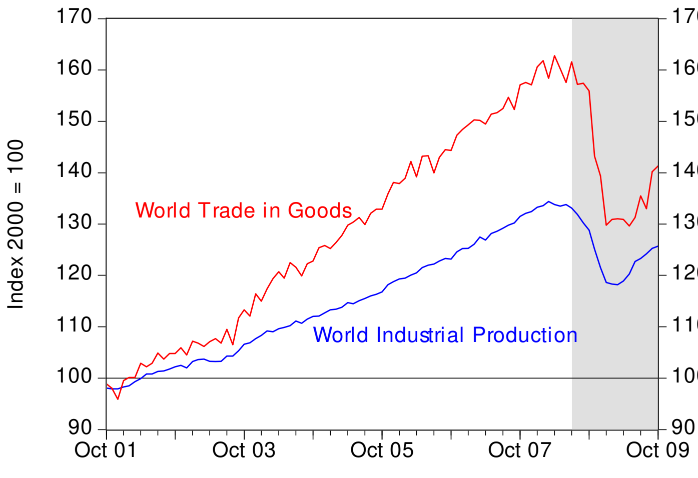
2. UK and South East economic trends

The recovery returned in most advanced economies by the second and third quarters of 2009, after nearly 18 months of economic downturn.

Since the summer and early autumn of 2008 a series of unexpected events has severely affected the growth of the UK and global economies. The collapse of one of the largest US investment banks (Lehman Brothers) and the near-collapse of other major banks in the developed world led to an unprecedented liquidity squeeze (also known as 'credit crunch') last seen in the early 1930s. The financial crisis soon spread out and had an immediate impact on the 'real economy' (output, trade and employment). Firms reacted to the lack of credit by holding back capital spending and consumers held back on major purchases. The recession hit both developed and developing countries as the global integration of supply chains (particularly in the manufacturing sector) helped to transmit the shock around the world more rapidly and extensively than in previous recessions.

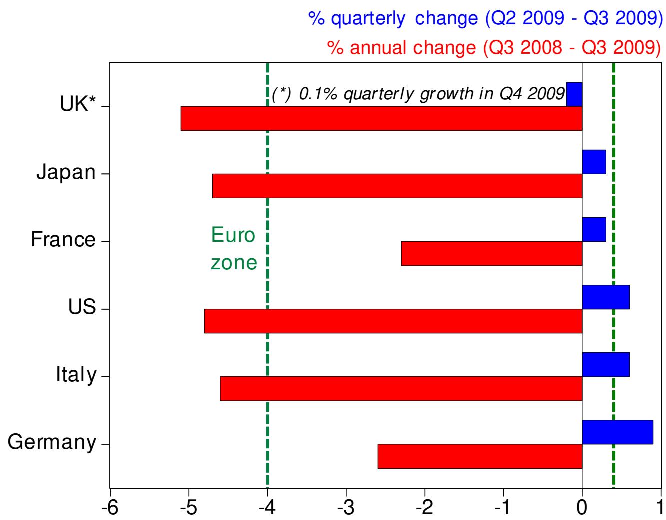
A seven-year period of world growth was suddenly interrupted in mid-2008 by a sharp and synchronised fall in global economic activity (Figure 2.1). World industrial production had increased by more than 30% between 2000 and 2008, before falling by around 15 percentage points in the 9 months up to March 2009. The increasing globalisation of industrial supply chains meant that the downturn had an even more severe impact on international trade. Indeed, after having grown by around 60% between 2000 and 2008, world trade in goods fell dramatically, by more than 30% in the 10 months up to May 2009.

Figure 2.1: World Industrial production and World Trade in Goods (volume)



Source: CPB Netherlands Bureau for Economic Policy Analysis

Figure 2.2: Return to GDP growth in the developed world



Source: EUROSTAT 2009

These unprecedented events prompted unprecedented policy responses, as G20 leaders at the London Summit recognised that 'acting together strengthens the impact and the exceptional policy actions announced so far must be implemented without delay'. Major economies' central banks immediately responded to the credit crunch by injecting large volumes of cash into the financial markets to try to get the money supply moving again and thus restore liquidity and business confidence. As a result of the financial bailout, the 18-month long economic recession bottomed out in spring 2009 and the economy has been gradually heading towards recovery since summer 2009.

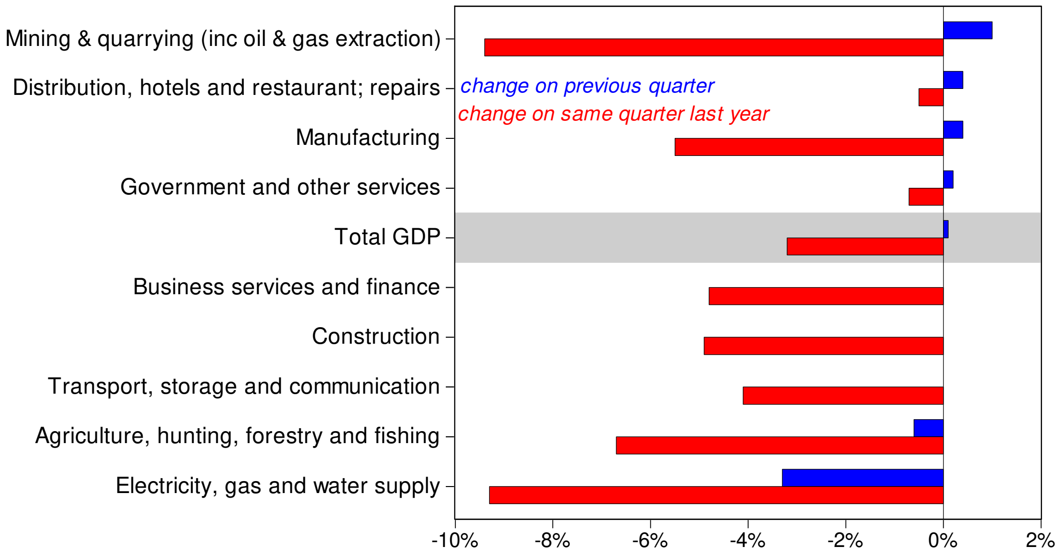
Moreover, in the three months up to October 2009, world trade was up by 4.6% compared to the preceding three months, as shown in Figure 2.1, while world industrial production was up 2.4% on the previous three months. According to the IMF, however, world GDP is projected to have contracted by 0.8% in 2009 - the first full-year decline in the post-war period - and advanced economies' output is expected to fall by 3.2% for the same year. For instance, the inter-annual contraction in output in the UK (-5.1%), Germany (-4.8%) and Italy (-4.6%) was even greater than in the Eurozone as a whole (-4.0%), for the third quarter of 2009 (Figure 2.2).

However, a number of large advanced economies pulled out of the recession in quarter 3 2009, while the UK remained the last major economy still suffering from economic downturn by then. Germany (0.7%), Italy (0.6%), US (0.6%), France (0.3%) and Japan (0.3%) showed positive growth rates for the third quarter 2009, compared to the previous quarter, whilst the UK recorded a drop by 0.2% for the same period (Figure 2.2). In any case, preliminary output estimates for the fourth quarter of 2009 signal a potential risk of 'double-dip' recession in 2010 for the developed world as two of the largest exporters, Germany and Japan, are expected to record flat growth rates after the recovery in the second and third quarters of 2009.

The UK came out of economic recession in the last quarter of 2009 with a marginal growth rate of 0.3%. The latest figures from the Office for National Statistics show that UK output recorded a slightly positive growth of 0.3% in the fourth quarter of 2009, after 6 consecutive quarters of negative growth.

As Figure 2.3 shows, most sectors of economic activity in the UK saw a very weak recovery during the fourth quarter of 2009, with a few industries recording flat or even negative growth. Mining and quarrying recorded the largest quarterly growth (1%), presumably due to seasonal factors in the oil and gas extraction industry, although it contributed only marginally to overall output growth. By contrast, output in Distribution, hotels and restaurants (including retail) grew by just 0.4% in the last quarter 2009, compared to the previous one, but became the largest contributor to the GDP growth. The growth in this sector was due mainly to the increase in retail and motor trade activities, which were boosted by the combined effect of two economic policies. On one side, the imminent VAT increase in January 2010 encouraged consumers to bring forward their Christmas spending. On the other side, the car scrappage scheme that has been implemented by the government over the past few months gave a further boost to car sales. Moreover, the distribution, hotels and restaurants (including retail) sector showed the smallest annual fall in output (-0.5%) of any sector of the UK economy.

Figure 2.3: UK Output Growth by Sector (fourth quarter 2009)



Source: National Statistics, 2009

Manufacturing output also increased by 0.4% for the same period, driven by two main factors. On the one hand, anecdotal evidence suggests that the current depreciation of sterling (down 25%) enhanced exports of manufactured goods. On the other hand, the car scrappage scheme also gave a further boost to the automotive industry to increase stocks. However, the contribution of manufacturing to the UK economic recovery has not been as large as the one made by the government (and other services) sector, where output increased by 0.2% in the fourth quarter of 2009 compared to the third quarter.

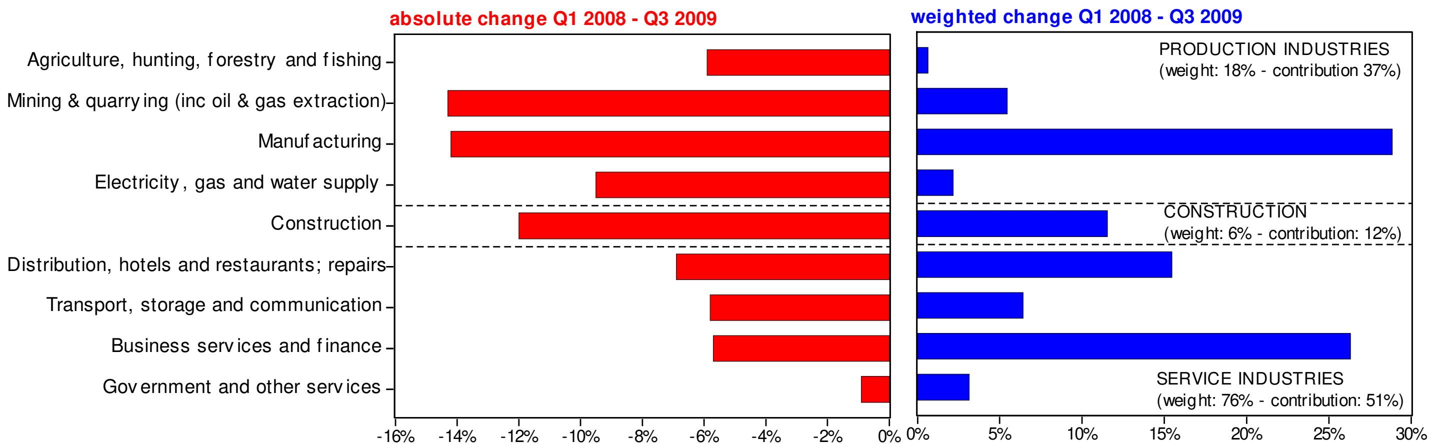
The largest output drop in the last quarter of 2009 was recorded in the electricity, gas and water supply sector. Gross Value Added (GVA) in this sector fell by -3.3% compared to the previous quarter and -9.3% on the year, as shown in Figure 2.3. This was contrary to expectations of increases in electricity and gas supply given the severe weather conditions.

Transport, storage and communications along with the business services and finance sectors recorded flat output growth in the last quarter of 2009 (Figure 2.3). Construction also showed flat output growth for the same period of time despite being the only sector that recorded positive quarterly growth (1.9%) in the third quarter of 2009.

Production industries were most severely affected by the economic downturn, although service industries made a major contribution to the output decline in the UK. Over the course of the economic downturn, UK GDP decreased by 6.2%, with the production industries recording a fall of 14%, while the service industries only contracted by 4.5% between the first quarter 2008 and the third quarter 2009. Within the production industries, manufacturing and mining and quarrying activities (including oil and gas extraction) were hardest hit by the economic recession in absolute terms. As Figure 2.4 illustrates, output in both sectors plummeted by around 14%, which was the largest overall fall in output of any sector, from peak to trough. Electricity, gas and water supply also showed a substantial drop in output, by nearly 10%, for the same period of time.

Within the service industries, distribution, hotels and restaurants (including retail and repairs) recorded the largest fall (-6.9%) from peak to trough, given that customers held back their spending with the onset of the economic recession. Output in the transport, storage and communications sector also fell by 5.8% for the same period, which is primarily linked to reduced activity in the manufacturing and distribution (wholesale and retail) sectors. Surprisingly, the drop in business services and finance output (-5.7%) was below the all-sector average – contrary to expectations at the beginning of the recession when most analysts and policy makers expected that this sector would be hardest hit. Less surprising is the fact that government (and other services) output only fell by less than 1%, mainly due to the fiscal policy of stimulus spending, which is likely to have compensated for a larger fall in other service industries.

Figure 2.4: Sectoral growth and contribution to GDP fall (-6.2% from peak to trough)



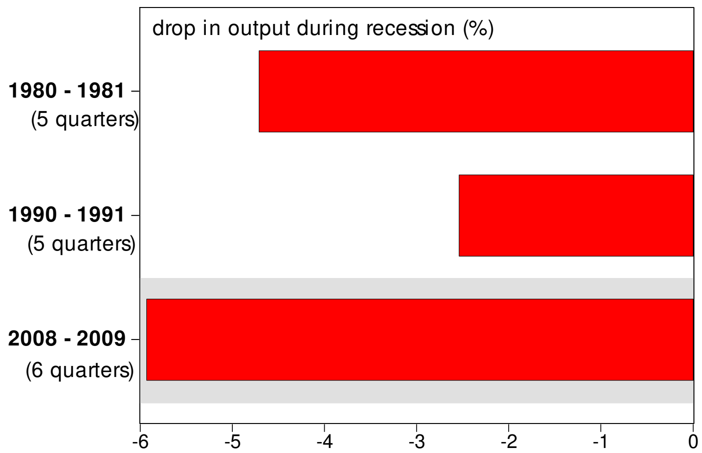
Source: SEEDA estimates on the base of National Statistics 2009

Construction is usually one of the more sensitive sectors as any fluctuation in the economic cycle tends to have a significant impact on long-term investment decisions. That is the reason why construction output in the UK has been severely affected by the economic downturn and recorded a substantial fall of 12% between the first quarter of 2008 and the third quarter of 2009.

The GDP decline seen in the service industries was lower than that in the production and construction sectors, yet the relatively large contribution that the service sector makes to the UK economy means that services played a significant role in the overall GDP decline. The unprecedented fall in UK output (-6.2%) from peak to trough was largely driven by contraction in service sector output, which contributed more than half of the overall GDP drop between the first quarter of 2008 and third quarter of 2009 (Figure 2.4). Despite the fact that business services and finance was the activity least affected by the economic downturn, its contribution to the GDP decline was nearly as large (26.3%) as the manufacturing sector (28.9%), which showed the largest percentage falls in output from peak to trough. Overall, the performance of these two sectors accounted for more than half the drop in UK GDP during the economic downturn.

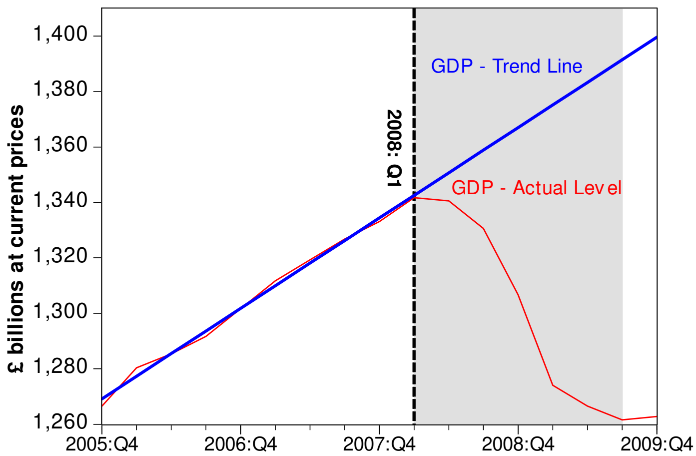
The steepest and longest UK economic downturn over the past 60 years has dramatically affected the pre-recession growth path. The GDP drop in the third quarter of 2009 made the current recession the deepest and longest one since quarterly figures were first compiled in the 1950s, as the UK economy endured six consecutive quarters of negative growth before coming out of recession in the last quarter of 2009.

Figure 2.5: Current and previous UK recessions compared



Source: National Statistics, 2009

Figure 2.6: UK GDP growth / loss



Source: SEEDA estimates on the base of National Statistics 2009

The difference with previous recessions is that the extent of the downturn has clearly been worse. In terms of speed, during the current downturn GDP dropped at a quarterly rate of 1%, while in the recessions of 1980-1981 and 1990-1991 output fell by an average of 0.8% and 0.4% per quarter, respectively. Indeed, UK GDP fell dramatically by 2.5% in the first quarter of 2009, which was as much as the entire contraction in output in the 1990-1991 recession that lasted for five quarters. In terms of length, in the previous post-war recessions GDP returned to positive quarterly growth in the sixth quarter following the onset of the downturn. By contrast, in the sixth quarter of the current recession GDP continued to fall, although the rate of decline decreased. In terms of scale, Figure 2.5 shows that the cumulative GDP drop was 5.9 percentage points below its pre-recession level in 2008. This compares to equivalent figures of 4.7 percentage points for the same period in the 1980-1981 recession and 2.5 percentage points in the 1990-1991 recession.

If the recession had not occurred and the UK economy had kept on growing (at the same rate as in 2006 and 2007), then GDP should have increased to £1,400 billion in the fourth quarter of 2009. Instead, the latest

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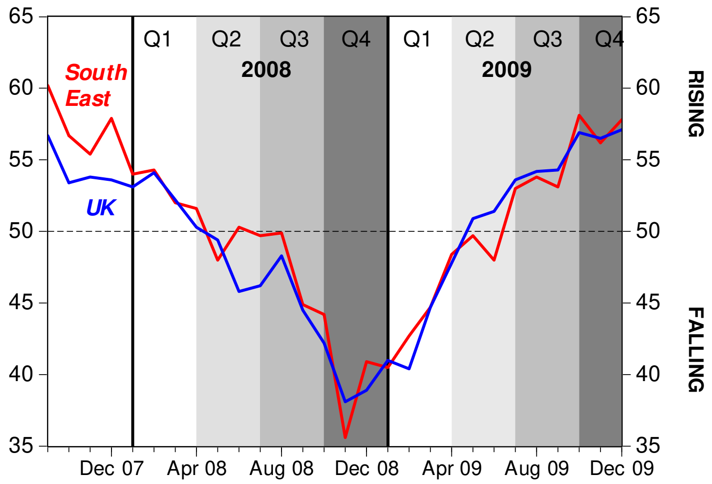
figures for the UK economy show that the actual level of output fell to £1,263 billion, which represents around 10% GDP loss for that quarter (Figure 2.6).

Business performance has improved, but with variation by sector, location and business size

Business activity in the South East has improved faster than the UK as a whole, although uncertainty is still an issue. Business output in the South East rose for the sixth consecutive month in December 2009 and pointed to a robust rate of expansion, according to the Purchasing Managers' Index (PMI).[1] At 57.8, up from 56.2 in November, the seasonally adjusted Business Activity Index signalled a robust and accelerated rate of growth (Figure 2.7). In the 5 months to September 2009 the South East PMI had been lagging slightly behind the UK index. However, the figures for the three months to December 2009 show that, on average, the month-on-month recovery of business activity in the South East was slightly faster than that seen in the wider UK economy.

Anecdotal evidence for the last few months suggests that output growth in the region is primarily attributed to, firstly, the recovery of major European economies driving up exports from the South East and, second, higher levels of incoming new business and new contract wins. The trend is particularly marked for manufacturers, who signalled a stronger increase in output than service providers. This is corroborated by the South East FSB October Snap Poll[2] which showed that over the previous two months, trade improved for 26% of companies, up from 23% in August 2009.

Figure 2.7: Business Activity (output), UK and South East companies



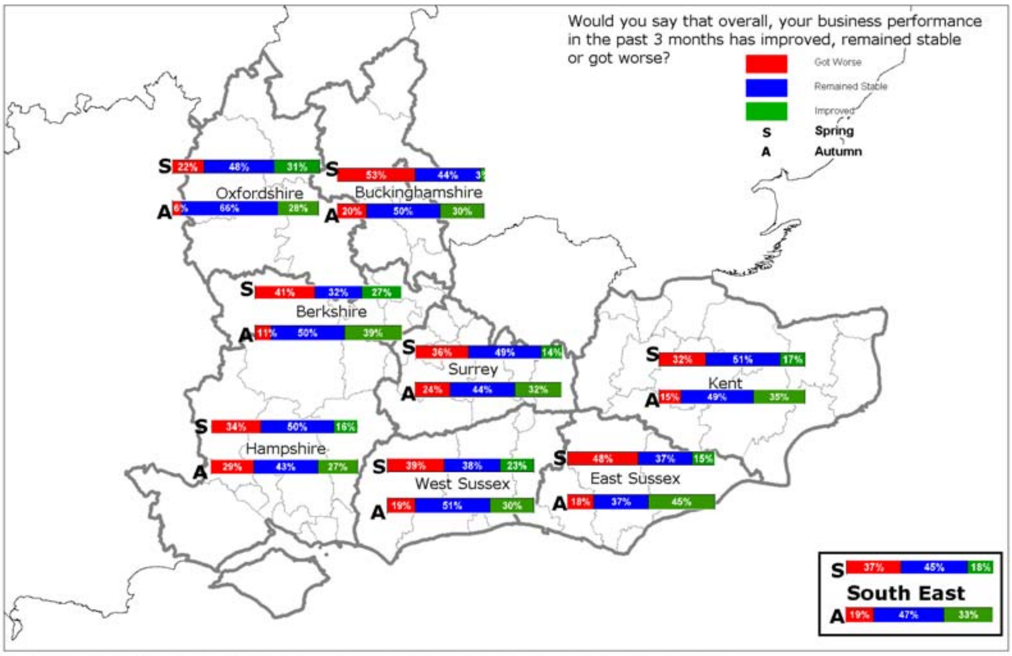
Source: RDA PMI, December 2009

SEEDA's business survey[3] of some 600 businesses across the region in October 2009 showed that conditions had improved for business over the previous 3 months (Figure 2.8). The proportion of firms in the South East reporting that the business climate had deteriorated fell from 37% in spring 2009 to 19% in the autumn. Well over a third (33%) of businesses reported improved performance in autumn 2009, up from 18% for the previous survey. Overall, the net balance[4] for business performance in the South East was positive (14%) for autumn 2009, compared to a negative score (-19%) in spring 2009.

[1] Although it is worth mentioning that in recent months the PMIs have tended to be more optimistic than official statistics.
[2] Federation of Small Business (FSB) Snap Poll, November 2009.
[3] Business Survey Quarterly Snapshot, October 2009.
[4] Equal to the difference between the percentage of companies reporting improved conditions and the percentage of firms reporting deterioration.

At county level some 30% of businesses in Buckinghamshire and 45% of businesses in East Sussex reported improvement in autumn 2009 compared to only 3% and 15% of businesses, respectively, in spring of that year. Companies in Kent reporting that business performance improved outnumbered those reporting that performance got worse in autumn 2009. Conversely, the proportion of businesses in Hampshire that reported worsening performance (29%) outweighed those stating improving performance (27%). Domestic orders had remained stable or increased for 57% of surveyed businesses in the three months to October 2009.

Figure 2.8: Business Performance by County, over previous 3 months



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However, profit margins continue to be squeezed as sales fall and customers continue to demand lower prices. SEEDA's business survey reported that some 42% of businesses in the region had seen a reduction in turnover in autumn 2009. Indeed, some companies are facing price inflation for a number of raw materials[5], while competitive pressures prevent them from passing on a higher proportion of their increased costs to customers, as indicated in the PMI Report for December 2009. In the long term businesses will not be able to keep on absorbing rising input prices that lower their profit margins. Some 27% of firms are expecting to charge higher prices to customers compared to 14% of firms expecting not to do so over the next 12 months, according to the latest RDA National Business Survey (December 2009).

Smaller companies in the region have been hardest hit by the recession, particularly in the Manufacturing, Construction and Distribution & Catering sectors. The differences in performance across the region are largely driven by differences in industrial structure as well as average business size. Manufacturing and construction related activities in the South East were affected by the economic downturn to a greater extent than service activities during the spring of 2009[6] (Figure 2.9). According to the most recent SEEDA business survey (October 2009), the proportion of manufacturing and construction firms reporting worsening performance declined to 21% over the previous 3 months (down from 54% in spring 2009), although getting access to finance was still difficult.

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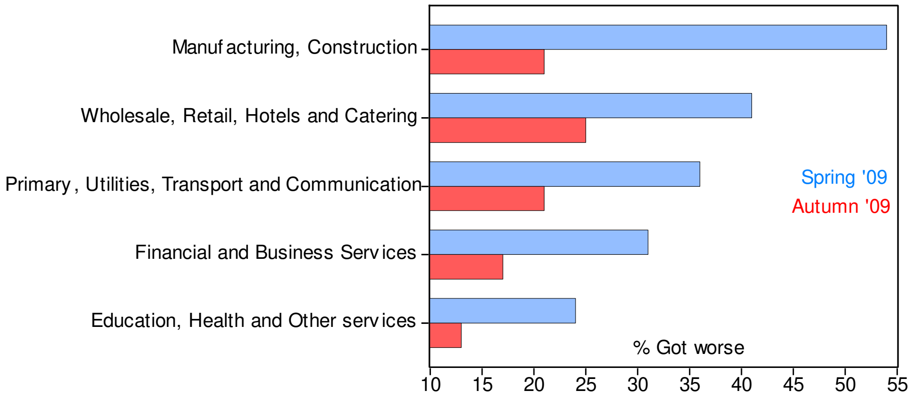
[5] As a result of higher oil prices and goods with high import content.

[6] However, Manufacturing and Construction only account for 16.6% of South East GVA while Services industries account for more than 80% of regional output (in 2007).

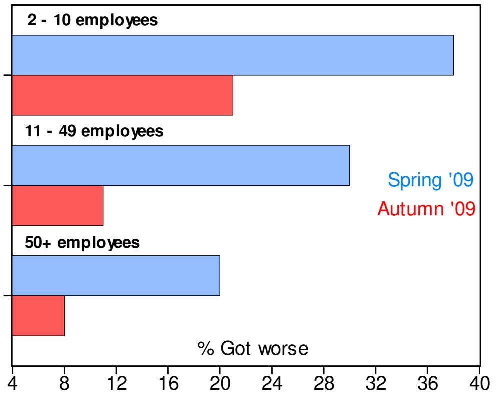
This distinctive performance is corroborated through the results regularly reported by the Engineering Employers Federation (EEF). A recent EEF South East Business Trends report shows further improvement in business conditions for manufacturing and engineering companies within the region in the last quarter of 2009. Volume of output grew significantly, with the net balance increasing to 9%, up from -19% in quarter 3 of 2009, although levels of cash flow worsened in the fourth quarter of 2009. For other sectors, SEEDA's business survey shows that the proportion of firms reporting that their performance got worse also fell significantly, to less than a quarter (Figure 2.9). Wholesale, retail and hospitality is the sector with the highest proportion of companies (25%) reporting that their business performance got worse over the three months to October.

Figure 2.9: Business performance by sector



Source: Business Survey Quarterly Snapshot, October 2009

Figure 2.10: Business performance by company size



Source: Business Survey Quarterly Snapshot, October 2009

Smaller companies have been more severely affected by the sharp fall in demand and liquidity squeeze during the economic downturn than larger companies. Figure 2.10 shows that smaller companies (with less than 10 employees) reported much lower levels of worsening performance in autumn compared to spring 2009. However, they are more than twice as likely to say that their recent business performance had deteriorated than larger companies (20% and 8% respectively) in autumn 2009. This is perhaps less surprising knowing that they form the supply chains for larger businesses and that smaller companies in the region are largely dependent on wholesale markets for funding.

Additionally, while larger companies have been raising funds by issuing corporate bonds on a large scale, smaller businesses continue to suffer from the scarcity of credit as banks are reportedly still reluctant to lend them money. Indeed, access to finance continues to be an issue for 26% of SMEs, and manufacturers are significantly more likely (35%) to face barriers in accessing finance, as reported in the Business Link South East Business Monitor for November 2009. Specifically, 28% of small firms reported an increase in the cost of existing finance in October (up from 22% in June) and 25% of companies reported higher costs for new finance (up from 22% in June), according to the latest South East FSB Snap Poll. This also has a knock-on effect on large companies through their supply chains.

The South East economy shows signs of potential fast growth. The volume of new work placed with private sector companies in the South East has risen at its fastest rate since September 2007. According to the PMI, in December 2009 incoming new business showed an improvement of 59.1 points, which is above the 50-points level signalling no change on the previous month. The seasonally adjusted Incoming New Business Index recorded a rising trend for the sixth consecutive month, which is larger than that seen in the UK as a whole (Figure 2.11).

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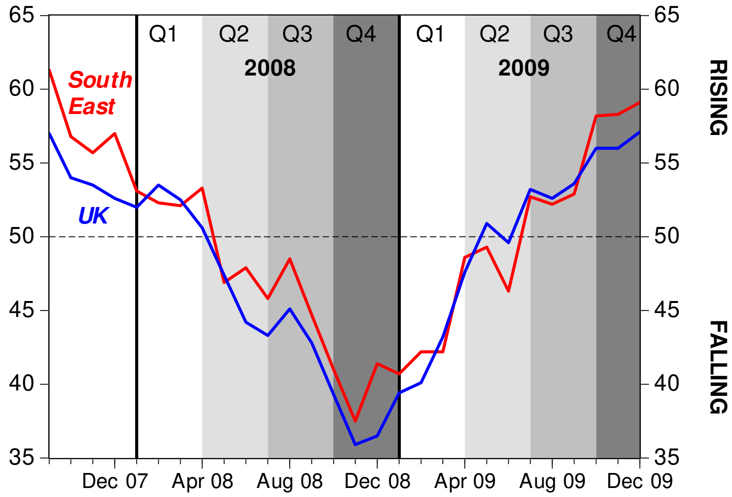
Anecdotal evidence for the past few months suggests that firmer demand in both domestic and export markets boosted client spending, particularly so in the manufacturing sector. Additionally, companies surveyed for the PMI have reported that improved client confidence has led to a number of new contract wins. Private sector firms in the South East were able to react quickly to the increases in demand and hence proceed with new projects thanks to their low use of operating capacity along with higher business investments.

Figure 2.11: New orders (incoming new business) UK and South East



Source: RDA PMI, December 2009

Overall, official statistics show that business investment in the UK has been enduring five consecutive quarters (2008:Q3 – 2009:Q3) of negative growth and saw the largest accumulated drop in investment (-24%) since the 1960s. However, the pace of decline slowed down in the third quarter of 2009 with a few increases in investment levels within construction and financial intermediation activities. This improving pattern is also observed at regional level.

The most recent results from SEEDA's business survey (Figure 2.12) indicate that, in all South East counties, companies are more likely to report that there has been higher rather than lower overall investment in their business over the last 3 months. Overall, 1 in 4 businesses in October 2009 reported having made a higher level of investment, compared to 1 in 6 businesses in the spring, while only 11% of respondents reported a lower investment level, compared to the 22% reported last spring. Companies in Oxfordshire (21%), West Sussex (20%) and Kent (19%) reported the highest net score[7] in business investment across the region. More than half of respondents in Oxfordshire reported that they had increased their investment in marketing and sales and 1 in 5 businesses reported higher investment in Plant and Machinery, which are the highest figures across the South East. The largest percentage of businesses reporting higher levels of investment for product and process development was seen in Berkshire (23%) and Surrey (23%), while Buckinghamshire recorded the largest percentage of businesses making greater investment in training and retraining (29%) over the past three months.

[7] Measured as the difference between the percentage of respondents reporting 'higher' level and those reporting 'lower' level of investment.

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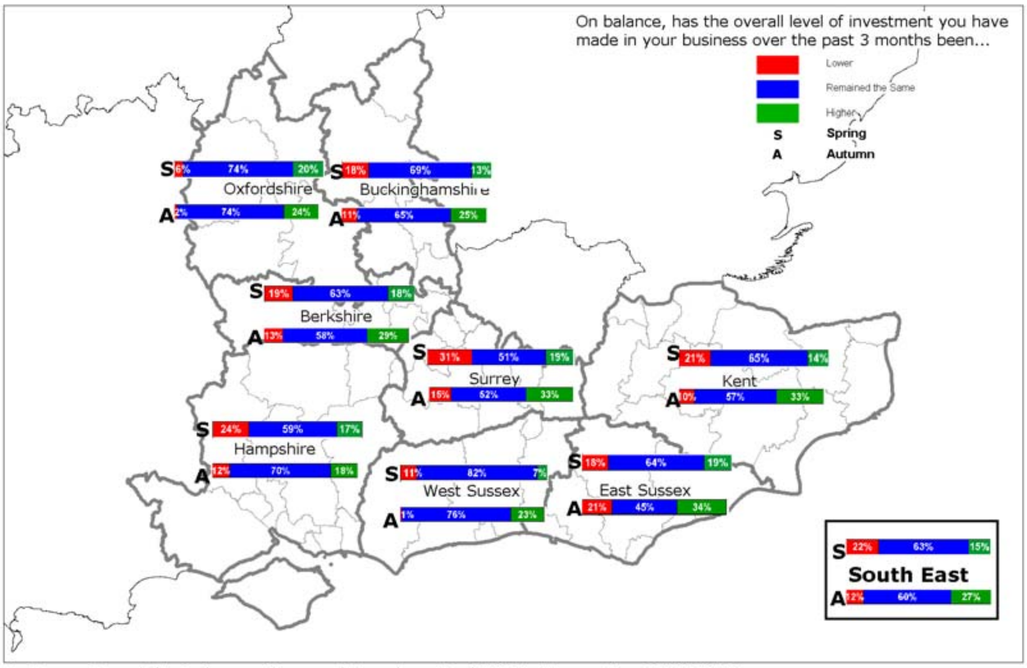
Figure 2.12: Business investment by county, over previous 3 months



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3. Labour market performance

Labour market showing signs of stabilisation in the second half of 2009

For the first year of the recession, employment in the South East (as in other regions) fell sharply, while unemployment rose significantly, as a reduction in demand and output fed through into the labour market. However, since the third quarter of 2009 we have witnessed signs of stabilization in the South East labour market. Towards the end of the year, employment began to rise slightly, while the fall in unemployment eased. Meanwhile, the number of people claiming Job Seekers Allowance has remained relatively stable since the middle of 2009, and the number of large redundancy notifications has been falling when compared to 2008. Although the most recent data suggests an increase in unemployment in the three months to December 2009 and a relatively sharp increase in the claimant count between December and January, we will need to wait for further data to see whether this trend will continue.

The labour market is normally a 'lagging' indicator of economic trends, as it takes some time for a reduction in demand and business activity to feed through into actual job losses at the individual firm level. In previous recessions employment has continued falling and unemployment has gone on rising for a number of months after the official end of the recession. It is somewhat surprising, therefore, to see signs of stabilization or even some recovery in the labour market this time. However, it is important to remember that labour market data can be volatile and it is most appropriate to look at trends over the medium to long term.

Additionally, what sets this recession apart from previous ones is firms' more flexible responses in relation to staffing. Although large-scale redundancies are sometimes unavoidable, it is expensive to make an employee redundant, and the loss of skills can be even costlier. As a result, firms have been making extensive use of short-time working, sabbaticals, temporary contracts and pay cuts to avoid laying staff off. This is reflected in the fact that so far employment has not fallen as much as anticipated and unemployment has not risen as fast and as far as feared. However, there could be further rounds of job cuts in the short to medium term, particularly given the anticipated cuts in public spending. Moreover, an increase in short-time working will have wider impacts on the productive capacity of the economy.

In this section we explore trends in economic activity and inactivity, employment and unemployment in the South East since mid-2009, as well as looking at flows between employment, unemployment and inactivity to help explain some of these recent trends. The incidence of more flexible approaches to staffing is assessed through data on part-time and temporary work. We then look in more detail at labour market trends by gender, age, occupation, sub-region and sector.

The fall in employment is levelling off. During the latter part of 2008 and the first half of 2009 employment in the South East fell significantly – by 66,000 between October 2008 and June 2009. However, since then the fall in employment has eased, and in fact employment increased by 1,000 overall between July and October 2009 (Figure 3.1).

All regions with the exception of the East of England saw a smaller drop in the employment rate between quarter 1 and quarter 3 2009 than over the year to quarter 3 2009 (Figure 3.2). The South East was just behind the UK average, with a fall of 1.1 percentage points between quarter 1 and quarter 3 2009 and a drop of 2 percentage points between quarter 3 2008 and quarter 3 2009.

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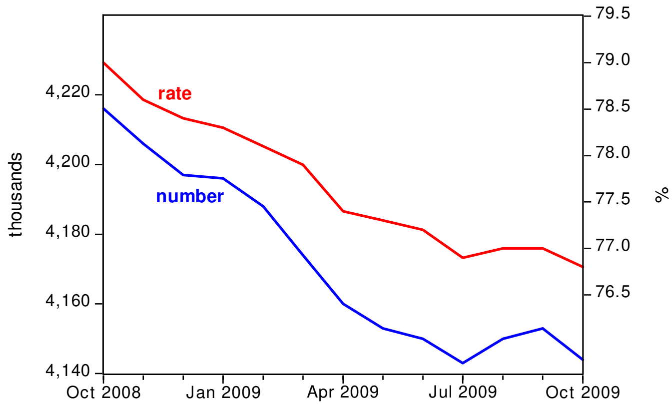
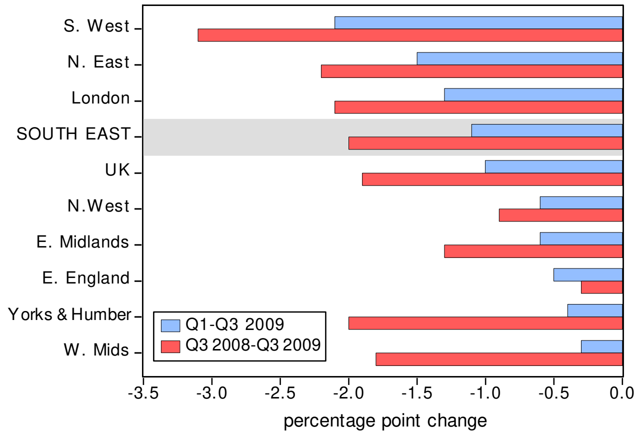
Figure 3.1: Trends in employment (number and rate), Oct 2008-Oct 2009



Source: ONS 2010

Figure 3.2: Change in employment rate, Q1–Q3 2009 and Q3 2008- Q3 2009

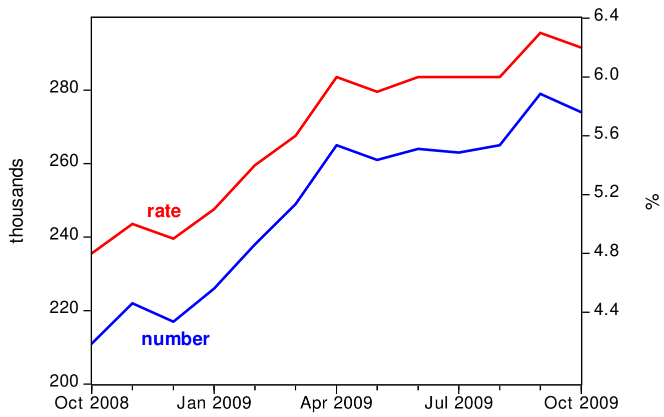


Source: ONS 2010

The rise in unemployment began to slow in spring 2009. Following a sharp rise in unemployment from the autumn of 2008 as the effects of the recession began to be felt in the labour market, the number of people out of work started to stabilize from April 2009. Between October 2008 and June 2009, unemployment in the South East increased by 53,000, whereas the total grew by just 10,000 from June to October 2009 (Figure 3.3).

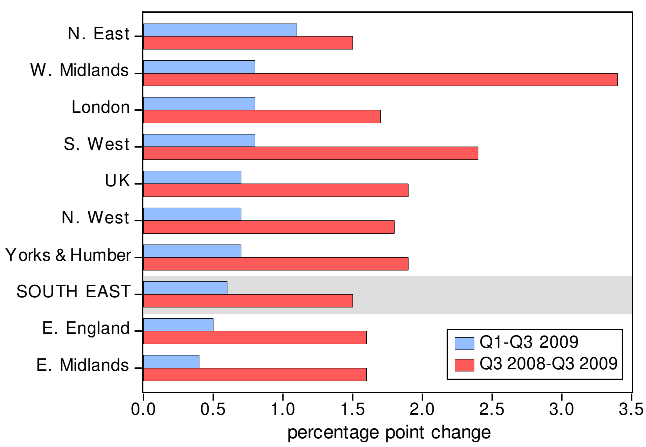
Over the year to quarter 3 2009, the South East saw the smallest rise in the unemployment rate of any region (1.5 percentage points) – the UK average was 1.9. In the more recent period, from quarter 1 2009 to quarter 3 2009, the unemployment rate in the South East rose by just 0.6 percentage points – just less than the UK average of 0.7 points (Figure 3.4). The increase in the unemployment rate in this period was greatest in the North East (up by 1.1 percentage points), while the East of England and the East Midlands saw the smallest increases (0.4 and 0.5 percentage points respectively).

Figure 3.3: Trends in unemployment (number and rate), Oct 2008-Oct 2009



Source: ONS 2010

Figure 3.4: Change in unemployment rate, Q1-Q3 2009 and Q3 2008-Q3 2009



Source: ONS 2010

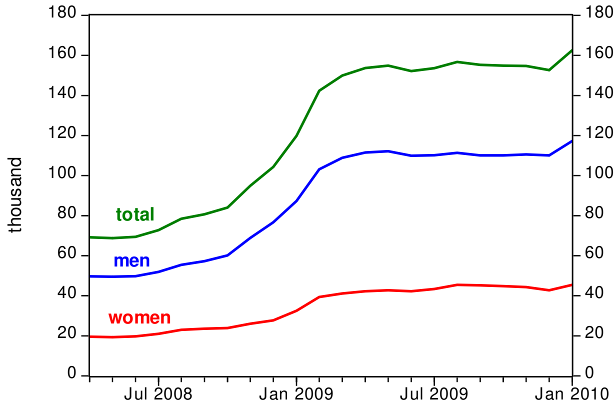
After a sharp rise early in the recession, the claimant count levelled off during 2009. Looking at an alternative measure of unemployment – the claimant count, or number of people claiming Jobseekers Allowance (JSA) – shows a relatively similar picture of a sharp rise followed by a stabilization from early in 2009 (Figure 3.5). Although the most recent figures show a relatively sharp increase in the claimant count between December 2009 and January 2010, this could be a seasonal peak, and we will need to wait for further months of data to determine whether this is a trend that is set to continue.

It is difficult to explain why the claimant count stagnated for such a long period of time. It was not due to the fact that people of working age were moving on to other benefits. The number of people claiming benefits such as Income Support, Incapacity Benefit/Employment Support Allowance and Disability Living Allowance increased at a slower rate between February and August 2009 than it did between November 2008 and February 2009.

Part of the reason could be that average incomes tend to be higher in the South East, which means that many people are ineligible to claim Jobseekers Allowance when they lose their jobs. In addition, the usual seasonal 'peak' in JSA claimants after the end of the school and college year did not materialize in late summer and autumn 2009. This can be explained in part by a number of new Government initiatives encouraging young unemployed people to undertake work experience and work placements which makes them ineligible to claim JSA.

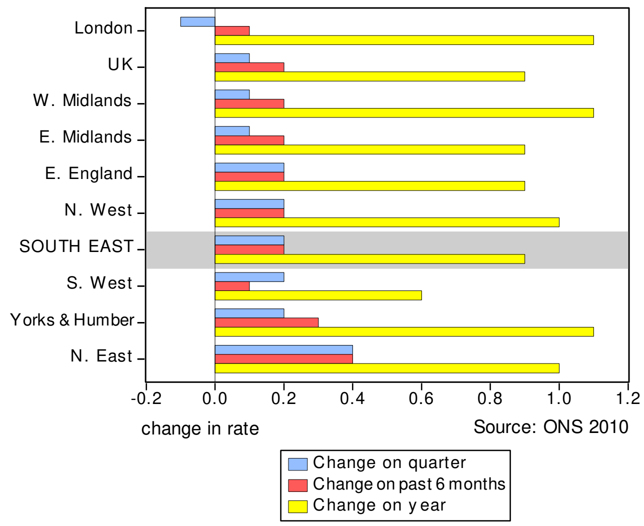
The rise in the claimant count rate in the South East was in line with the UK average over the 6 months and the year to January 2010, though slightly higher than the UK figure in the 3 months from October 2009 to January 2010 (Figure 3.6).

Figure 3.5: South East claimant count, April 2008-January 2010



Source: ONS 2010

Figure 3.6: Change in claimant count rate, by region, past quarter, past 6 months and past year



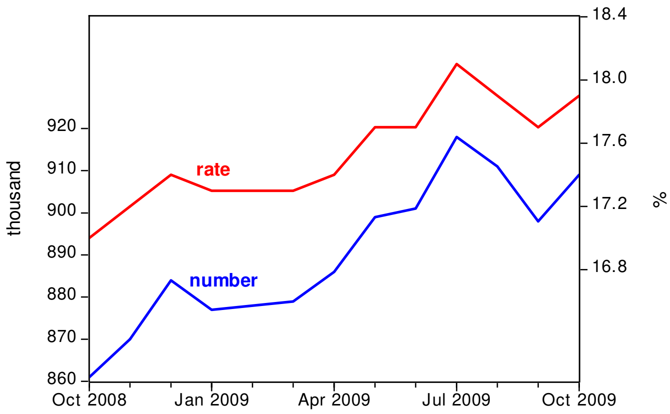
Source: ONS 2010

Economic inactivity has been rising, but not in every region. Changes in economic inactivity in response to recessions tend not to be as noticeable as changes to employment and unemployment. After the recession of the early 1980s there was a spike in inactivity more than a year after GDP stopped falling, while the 1990s recession and its aftermath were characterized by a long-term increase in inactivity.[8]

[8] TUC Recession Report, Number 8 (June 2009).

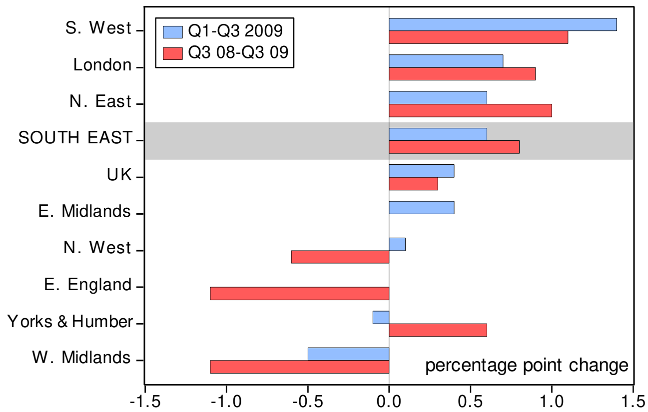
As Figure 3.7 shows, there has been a steady rise in economic inactivity in the South East since the autumn of 2008, with the number of people classed as inactive rising by 48,000 in the year to October 2009. In the more recent period, though, the level of inactivity has fluctuated, and between June and October 2009 there was an increase of just 8,000 in the region's inactive population. The inactivity rate in the South East increased by 0.6 percentage points between quarter 1 and quarter 3 of 2009 – just ahead of the UK average. Meanwhile some regions saw a reduction in the inactivity rate in this period, including the West Midlands and Yorkshire and the Humber (Figure 3.8).

Figure 3.7: Trends in economic inactivity (number and rate), Oct 2008-Oct 2009



Source: ONS 2010

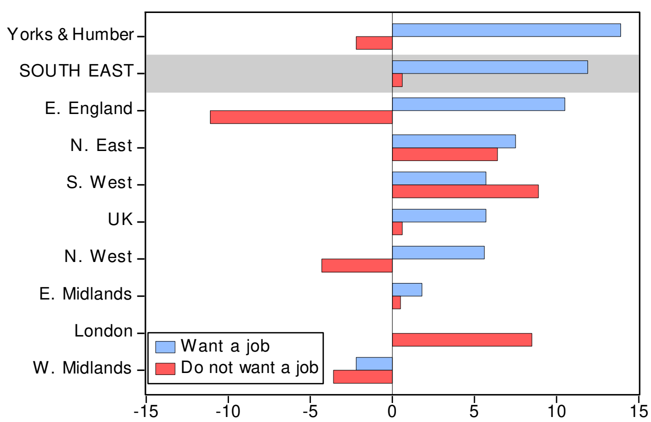
Figure 3.8: Change in economic inactivity rate, Q1-Q3 2009 and Q3 2008-Q3 2009



Source: ONS 2010

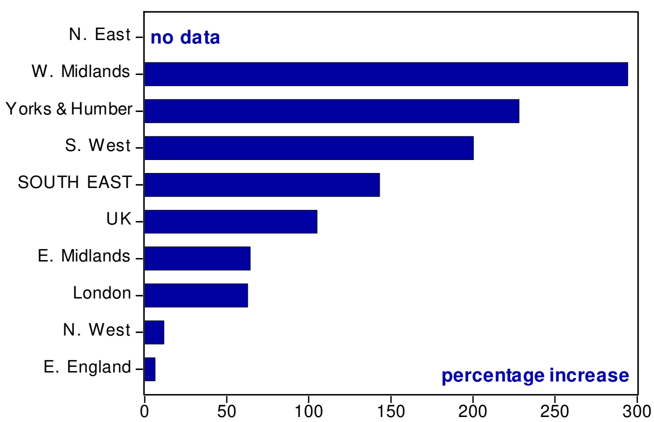
An increase in involuntary inactivity during the recession. Changes in levels of inactivity can reflect a number of factors, including the number of students or retirees in a population, and migration flows. During a recession there is often an increase in the number of people who are 'involuntarily' inactive, in that they would like to work but cannot find a job and may not be able to register for unemployment benefit. This group of people is often classed as the 'hidden unemployed', as they fall outside of the active labour market and hence are further away from support services to help them return to work.

Figure 3.9: Percentage increase in number of economically inactive people (Q3 2008 to Q3 2009)



Source: ONS 2010

Figure 3.10: Percentage increase in number of economically inactive who want a job but believe none is available (Q3 08-Q3 2009)



Source: ONS 2010

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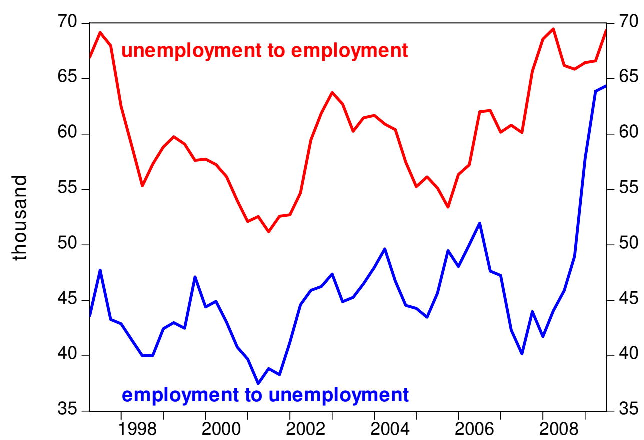
As Figure 3.9 shows, in almost all regions there has been an increase in the number of people who are inactive but would like to work. Over the past year for which data is available (quarter 3 2008 to quarter 3 2009) the number of inactive people who stated that they would like a job if one were available increased by 27,000 or 12% in the South East.[9] This is the second fastest rate of increase seen in any region, which possibly reflects the fact that larger numbers of people who have lost their jobs in the South East tend to be ineligible to claim unemployment benefit, due to higher average household incomes, and they therefore move into inactivity. The majority of regions have witnessed a fall or only a relatively small increase in the number of people who are inactive but would not like a job. In other words, as the recession has progressed, there are fewer people who have deliberately chosen to remain out of work. In the South East, the number of people in this position increased by just 3,000 or 0.6% over the year to quarter 3 2009.

Perhaps not surprisingly, there has been a significant increase in the number of people who are inactive and would like to work but believe no job is available for them (Figure 3.10). In the South East this figure more than doubled to over 9,000 in the year to quarter 3 of 2009. Greater competition for jobs in a slacker labour market during the recession means that many people find it increasingly difficult to find work – particularly those with lower skills, who find themselves in competition with people who are overqualified for the jobs they are applying for. As evidence of the greater difficulty of finding jobs during the recession, in all regions there has been a reduction in the number of people who started a job in the past 3 months. The South East saw a reduction of 44,000 (or 23%) between quarter 3 of 2008 and quarter 3 of 2009 – similar to the UK figure.

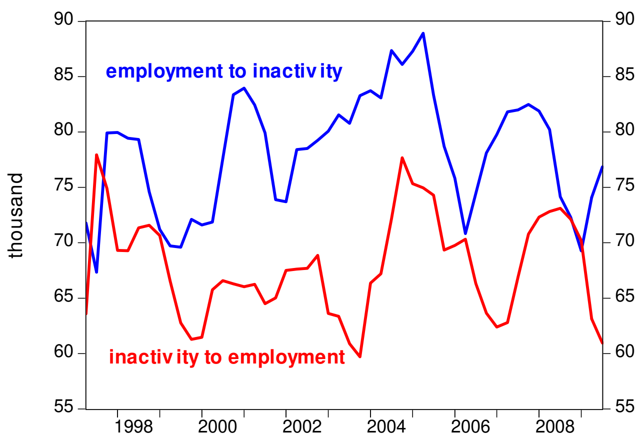
The overall performance of the labour market depends on the interaction between employment, unemployment and economic inactivity. Generally the flows of people between employment, unemployment and inactivity have been fairly constant over the past 10 years. However, since the onset of the recession there have been some notable changes in these flows. As Figure 3.11 shows, there was a sharp increase in the number of people moving from employment to unemployment – not surprising given the large number of redundancies as a result of the recession. The flow of people from employment to unemployment is now almost as great as the flow from unemployment to employment, for the first time in 10 years.

Figure 3.11: Flows between employment and unemployment, South East



Source: ONS 2010

Figure 3.12: Flows between employment and economic inactivity, South East



Source: ONS 2010

[9] Data from the Labour Force Survey via Super Cross. Note that it is preferable to compare figures year-on-year, as the data are not seasonally adjusted.

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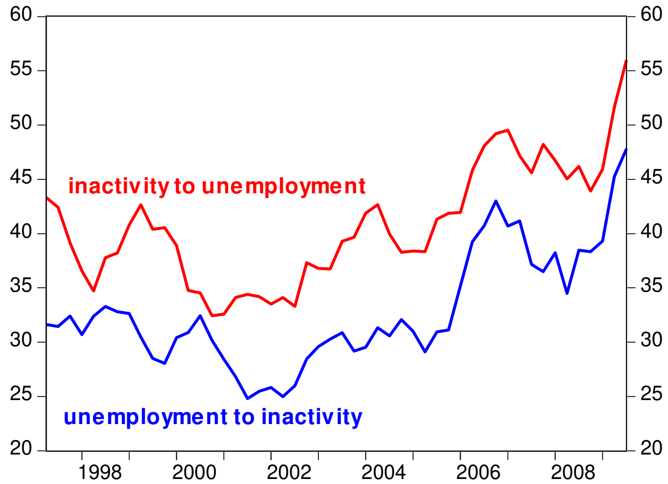
During 2009, there was an increase in the number of people moving from employment to economic inactivity in the South East, for the first time since 2006 (Figure 3.12). This suggests that there has been a growth in the number of people in the region losing their jobs and choosing not to register as unemployed (perhaps because they are ineligible for unemployment benefit or they are not hopeful of finding a job). Instead they become inactive and hence move further away from the labour market and mainstream employment support services. Meanwhile, the number of people moving from inactivity to employment is at its lowest level since 2003. This is not surprising given the greater difficulties with finding a job during a recession, particularly for those who have been out of work for some time, as many inactive people have.

During 2009 there was a sharp increase in the number of people moving from inactivity to unemployment in the South East, with the flow reaching its highest level for at least 10 years (Figure 3.13). In other words, the rise in unemployment seen during the recession is not only due to people losing their jobs but also people moving back into the labour market after previously being outside it (that is, economically inactive). This helps to explain the counter-intuitive situation whereby in the later months of 2009 both employment and unemployment rose in the South East.

The fact that larger numbers of people are moving back into active job searching after being economically inactive is potentially good news for the South East. However, as Figure 3.13 shows, flows from unemployment to inactivity also reached a high point in 2009. This could reflect the fact that, during a recession, there is a lot more 'churn' in the labour market: people flow between unemployment and inactivity as they move on and off benefits, start looking for work and then give up, and so on.

Figure 3.13: Flows between inactivity and unemployment, South East



Source: ONS 2010

Apparent stabilisation in the labour market in part reflects firms' more flexible responses to staffing in the recession. In the UK, as in many other EU countries, the contraction in GDP in percentage terms during the recession was significantly greater than the percentage fall in employment. GDP in the UK fell by 6.2% over the six quarters of the recession (quarter 2 2008 to quarter 3 2009) while total employment dropped by just 2.1%. This difference is partly due to the fact that the labour market is a lagging indicator of developments in the economy, but also because during this recession employers appear to have been adopting more flexible approaches to avoiding redundancies.[10]

[10] Eurostat Statistics in Focus, no. 79, *The impact of the crisis on employment* (Eurostat, 2009).

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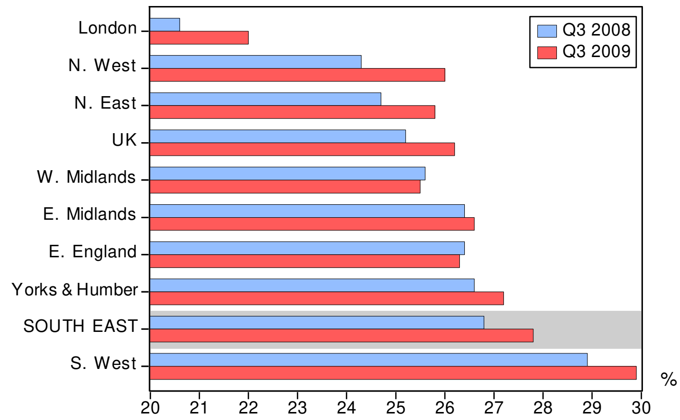
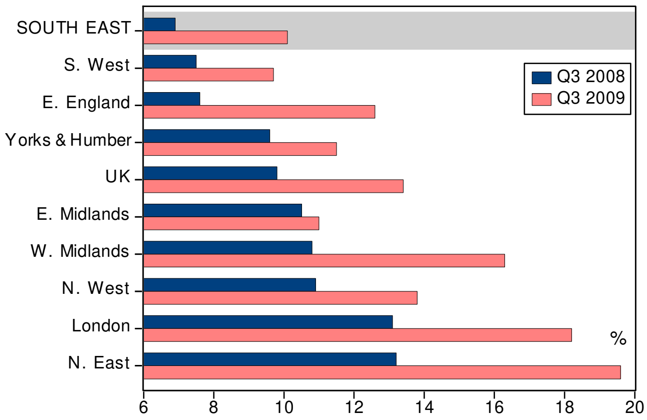
As evidence of this, the long-run trend for a reduction in the number of temporary and part-time workers in the UK since the late 1990s was reversed during the recession. At the same time, the proportion of temporary workers employed in temporary jobs because they are unable to find permanent positions has been increasing.[11] As Figure 3.14 shows, in almost all regions there has been a small increase in the proportion of employees working part-time between quarter 3 2008 and quarter 3 2009. The South East has one of the largest shares of part-time employees of any region, and saw this proportion increase from 27% to 28% in the year to quarter 3 2009. The proportion of part-time employees who are unable to find a full time job has also increased significantly since the recession began (Figure 3.15). In the South East in quarter 3 2009, there were 38,000 more people working part-time because they could not find a full-time job than one year previously.

Figure 3.14: Part-time employment as a percentage of total employment, Q3 2008 and Q3 2009 compared



Source: ONS 2010

Figure 3.15: Proportion of part-time workers who could not find a full-time job, Q3 2008 and Q3 2009 compared



Source: ONS 2010

Similarly, in most regions there has been an increase in the proportion of temporary employees in the workforce and the percentage of temporary workers who are unable to find permanent employment (Figures 3.16 and 3.17). Between quarter 3 2008 and quarter 3 2009 the percentage of the workforce employed in temporary posts in the South East increased slightly, from 5.7% to 5.8%, while the proportion of temporary workers unable to find permanent posts increased from 20% to 24% (an increase of 8,000) in the year to quarter 3 2009.

As evidence of employers' more flexible approach to staffing in the recession, the CBI Employment Trends Survey for 2009 found that the majority of the 700 firms surveyed across the UK had made or were planning to make changes to working patterns in order to reduce labour costs, but to avoid the expense of making staff redundant (estimated at £12,000 per employee). The most popular strategies were to increase the use of flexible working and make cuts in the use of agency staff and overtime.[12]

[11] TUC Recession Report, no. 8 (June 2009).
[12] CBI *Employment Trends 2009: Work patterns in the recession* (June 2009).

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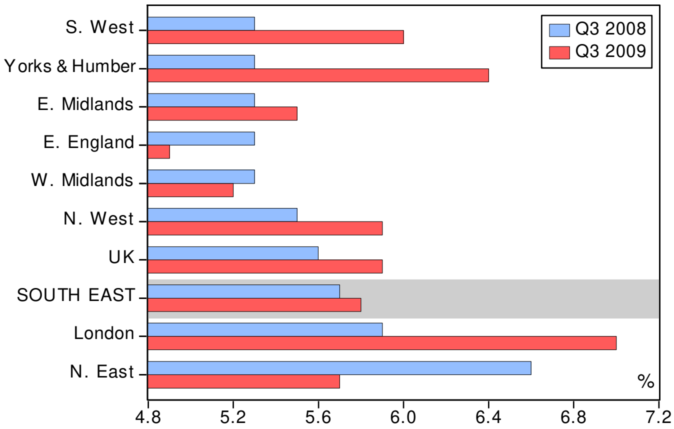
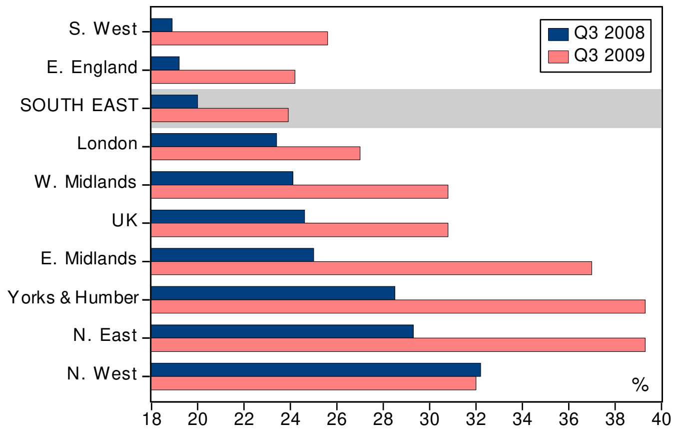
Figure 3.16: Temporary employment as a percentage of total employment, Q3 2008 and Q3 2009 compared



Source: ONS 2010

Figure 3.17: Proportion of temporary employees who could not find a permanent job, Q3 2008 and Q3 2009



Source: ONS 2010

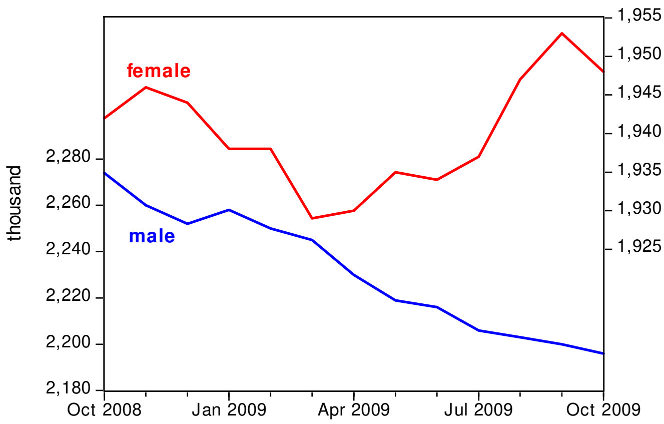
Labour market performance varies by gender, sector, occupation and sub-region

Although there are signs of stabilization in the South East labour market overall, this disguises significant differences in the performance of different sub-regions and industries and in the experience of men and women and people employed in different occupations.

Men's employment appears to have fared worse than women's during the recession. Over the course of the recession employment amongst men declined relatively sharply in the South East (by 78,000 in the year to October 2009), while male unemployment continued to rise. By contrast, women's employment fluctuated, but tended to rise from spring 2009, while unemployment amongst women remained around 100,000 during 2009 (Figures 3.18 and 3.19).

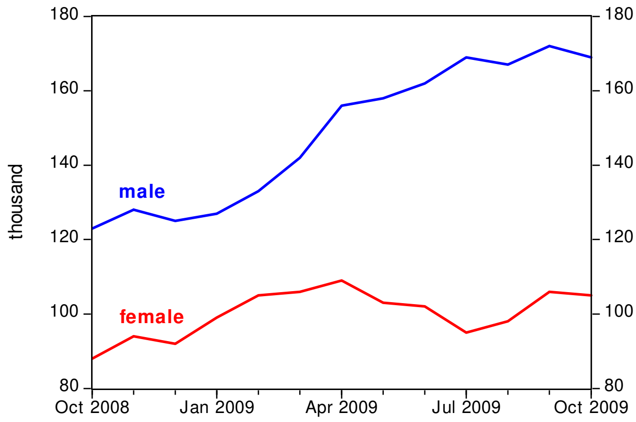
A continued fall in employment amongst men partly reflects the fact that the largest number of job losses, particularly in the early months of the recession, were in the male-dominated manufacturing and construction sectors. More recently, the rise in women's employment could be connected to the fact that employers are increasingly recruiting staff on a part-time or temporary basis, in order to cut costs and deal with a period of economic uncertainty. Women are more likely than men to be employed on part-time or temporary contracts. In the South East, 46% of women in employment work part-time, compared to just 16% of men. From the spring of 2009, the rise in male unemployment slowed, which could be related to the fact that by this stage of the recession businesses were keen not to make further job cuts, in order to avoid losing a core of skilled staff which could assist in preparation for the upturn.

Figure 3.18: Trends in male and female employment, Oct 2008-Oct 2009



Source: ONS 2010

Figure 3.19: Trends in male and female unemployment, Oct 2008-Oct 2009



Source: ONS 2010

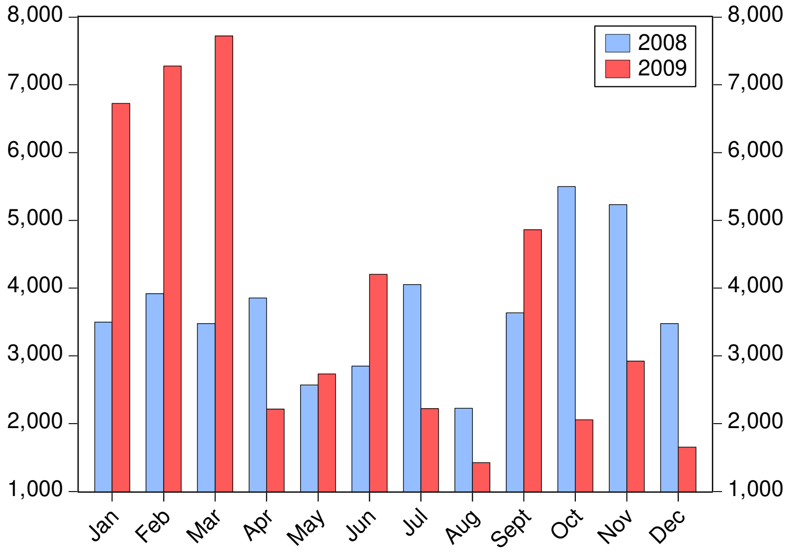
Redundancy notifications fell in the nine months to January 2010, though with significant differences between sectors and sub-regions. From April 2009, there was a marked reduction in the number of large redundancies notified to BIS.[13] While in the first three months of 2009 redundancy notifications totalled between 6,000 and 8,000 per month in the South East, between April and December the monthly totals tended to lie between 2,000 and 3,000. Similarly, in the first quarter of 2009, total redundancy notifications were significantly higher than the same months in 2008, but for the rest of 2009 total notifications tended to be lower than in the same period in 2008 (Figure 3.20).

Looking specifically at the 6 months to January 2010, the largest number of redundancy notifications were recorded in Berkshire (6,200 between June 2009 and January 2010), although in part this can be related to the significant number of head offices located in the area, which can mean that the total number of redundancies actually taking place in Berkshire is overestimated. Significant numbers of redundancies were also notified in Hampshire and the Isle of Wight and Kent and Medway (4,000 and 2,500 respectively). This is less surprising given that these sub-regions have the largest number of employees (Figure 3.21).

The majority of large redundancies in the past 6 months have been in the service sector. There were more than 14,000 redundancy notifications in this sector, compared to just over 6,000 in the production and construction industries. The financial and business services sector accounted for one third of all large redundancy notifications between June 2009 and January 2010, while manufacturing represented 20% of all notifications. This is significantly more than manufacturing's share of total employment in the South East (9%), which confirms that the sector has been particularly badly affected by job losses during the recession.

[13] These figures come from HR1 forms, so they only capture job losses of more than 20 employees. Moreover, in some cases the redundancies are not scheduled to take place for a number of months, if indeed they happen at all. Because firms tend to announce redundancies at their headquarters, the actual job losses in some cases may be taking place outside the South East. Finally, in some cases changes of contract are recorded as 'redundancies'. It is important to bear these caveats in mind when interpreting these data.

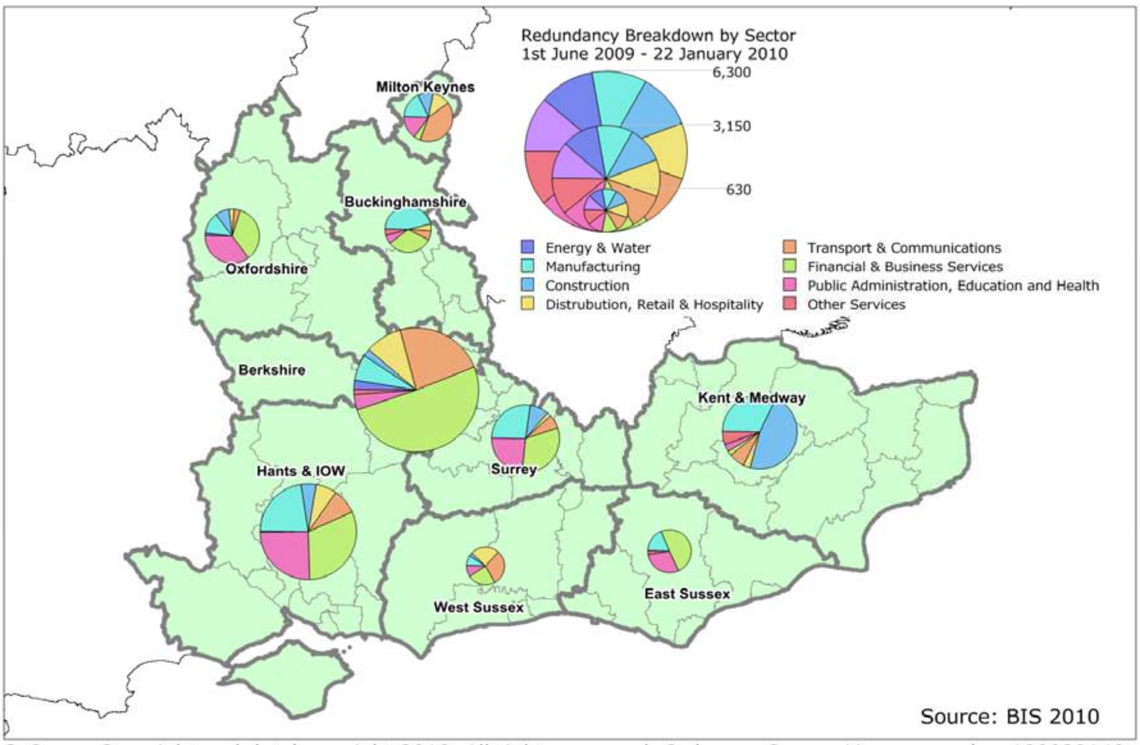
Figure 3.20: Total number of redundancy notifications by month, 2008 and 2009 compared



Source: BIS HR1 data, 2008-09

As a reflection of the local industrial mix, the majority of redundancy notifications in Kent and Medway have been in construction and manufacturing, while in Berkshire, Oxfordshire, Hampshire and Surrey the service sector accounted for the majority of redundancy notifications in the past 6 months.

Figure 3.21: Redundancy notifications by sub-region and sector, June 2009 – January 2010



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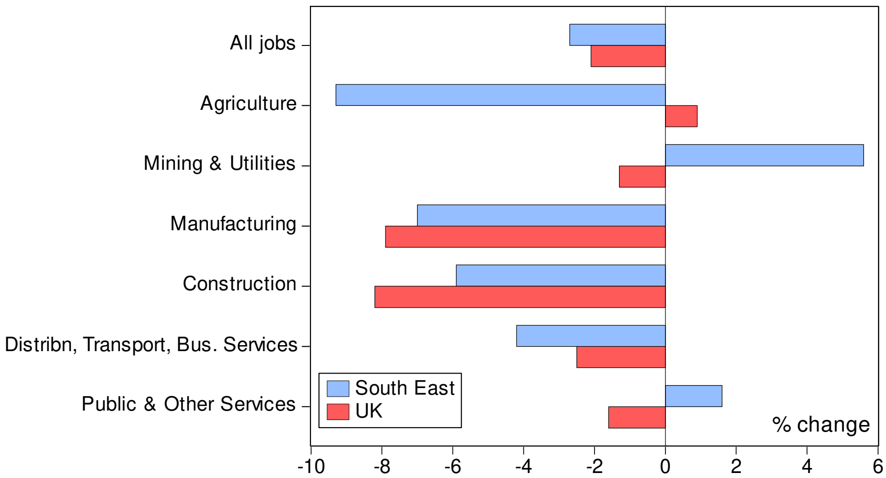
Jobs numbers have fallen in all sectors except mining and utilities and public services. Given the growth in redundancy notifications and the decline in employment it is not surprising that the number of jobs[14] available in the economy fell in the year to September 2009, as employers cut back on job creation and recruitment. The largest falls in employee jobs have been in the manufacturing and construction sectors – not surprising given the large numbers of redundancies experienced in these industries during the recession.

In the majority of sectors, the South East has fared better than the UK, with the number of jobs falling at a slower rate, while in the Mining and Utilities and Public Services sectors there has been an increase in jobs numbers in the South East in contrast to the UK. The only sectors where the South East has seen a faster drop in employment than the UK are private services – which could be explained by the greater concentration of financial and business services in the region, which were hit hard early on in the recession – and Agriculture, although in this case small numbers make the percentage change appear artificially large (Figure 3.22).

Figure 3.22: Percentage change in employee jobs, by sector, Sept 2008 – Sept 2009



Source: ONS 2010

The fastest increase in unemployment has been amongst people employed in lower skilled occupational groups. As well as variation in the rate of job losses by sector, people working in different occupational groups have been affected differently by the recession. In the early months of 2009, people from higher-skilled occupations accounted for a growing proportion of new JSA claimants in the South East. This partly reflects the fact that as the recession progressed and firms were forced to lay off increasing numbers of staff, those with higher skills were not immune from job cuts. Additionally, the recession affected all sectors of the economy, including financial and business services, which traditionally has employed a larger number of 'white collar' workers.

However, if we look at JSA claimants as a percentage of the total workforce in each occupational group, over the course of the recession, the largest increases were in lower skilled occupational groups, as Figure 3.23 shows. As might be expected, a larger proportion of the workforce in sales, process and elementary occupations is claiming JSA at any one time, but between October 2008 and October 2009 these groups also saw the largest increase in the percentage of claimants. For example, the proportion of people employed in sales and customer service occupations and claiming JSA doubled in the year to October 2009, from 4% to

[14] Note that the workforce jobs figures are primarily based on estimates by employers. By contrast the Labour Force Survey provides estimates of the number of people in employment based on individuals' responses. Individuals with more than one job can be counted twice in the workforce jobs data.

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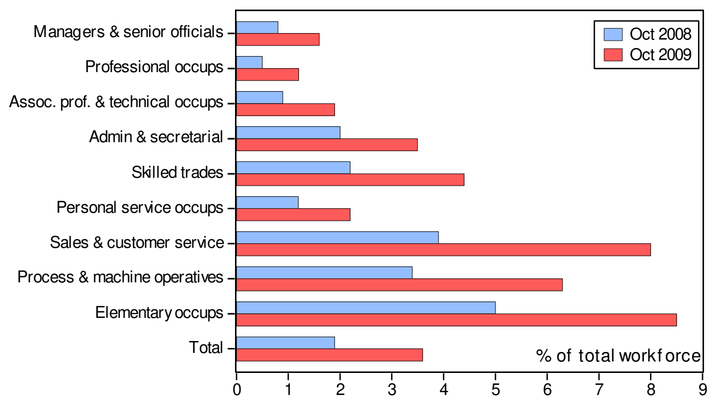
8%. Meanwhile, the proportion of JSA claimants amongst the workforce in elementary occupations increased by 3.5 percentage points in the same period, from 5% to 8.5%. By contrast, the proportion of managers and professionals claiming JSA increased by less than one percentage point, to just 1.6% and 1.2% respectively in October 2009.[15]

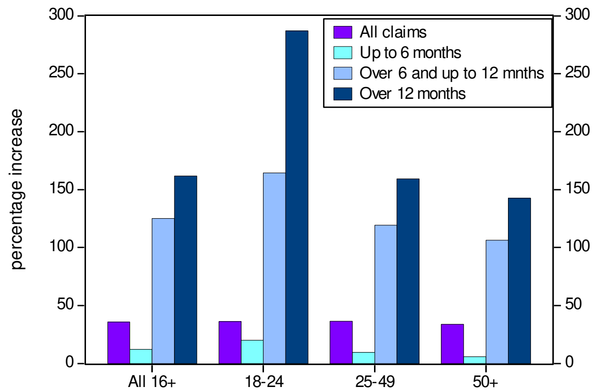
Long-term unemployment amongst young people has increased at a faster rate than for other age groups. The extent to which the recession has had a disproportionate impact on young people is a subject of considerable interest and concern. As Figure 3.24 shows, the rate of increase in total JSA claimants in the 18-24 age group in the past year has been in line with the average for other age groups (around 36%). However, what is of concern is that the number of people aged 18-24 who have been claiming JSA for more than 6 months, and particularly, for more than a year, has increased at a faster rate than all other age groups. The number of 18-24 year olds claiming JSA for more than 6 months increased by 164% in the past year, while the number claiming for over a year almost trebled in the same period, from 5,200 to 13,500. This is of concern, as the longer that potential new entrants to the labour market remain out of work, the more difficult it will be for them to move into employment as they will not have up to date skills and experience.

Figure 3.23: % of workforce claiming JSA, by occupation, Oct 2008 and Oct 2009 compared



Source: ONS 2010

Figure 3.24: Annual percentage increase in JSA claimants by age and duration, January 2009 to January 2010



Source: ONS 2010

The type of work that young people do makes them particularly vulnerable in the labour market. Younger workers now tend to be concentrated in low-wage, low skill and less secure employment in a narrow range of service industries. In 2008, 12% of 18-24 year olds in the UK were employed in temporary jobs, and of those not in education, 40% could not find permanent work. More than a third (36%) of 18-24 year olds worked in the distribution, hotels and restaurants sector, while around half of young people in this age group were employed in personal services, sales and customer service and elementary occupations.[16] There have been significant job cuts in the service sector in recent months, and within this sector it is the industries employing more young people (such as hotels and restaurants) that have seen some of the severest impacts.

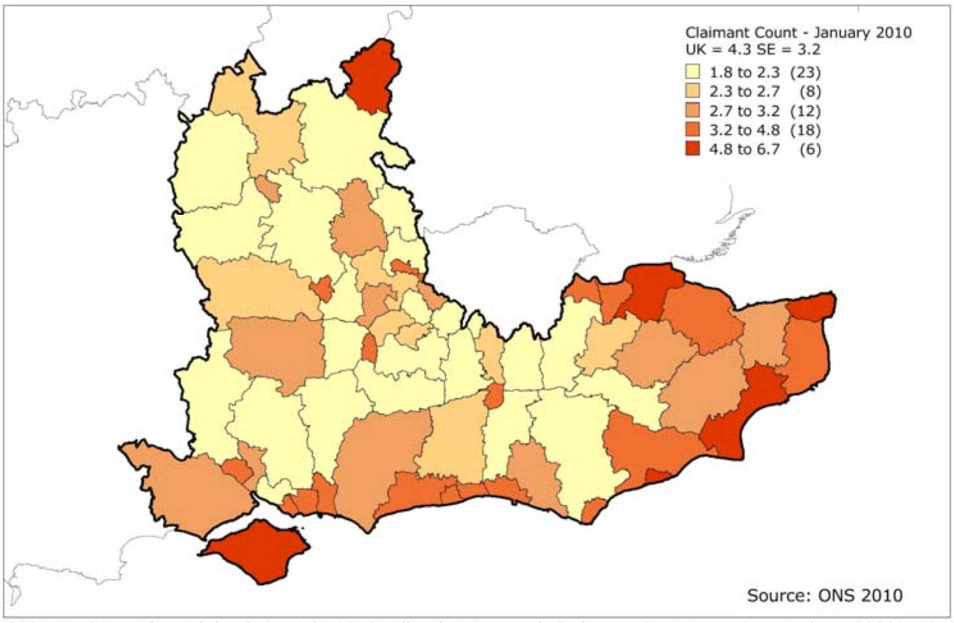
Unemployment rates are highest in coastal areas and some urban centres in the Inner South East. A useful way to compare the performance of different local authorities within the South East is to consider the claimant count rate and how it has changed in recent months. According to the most recent figures (for

[15] The 'total workforce' in each occupational group is calculated as the number of people employed in that group according to the Labour Force Survey plus the number of people claiming JSA who previously worked in that occupational group.
[16] ONS, Young people and the labour market', in *Economic and Labour Market Review*, Vol. 3, No. 4 (April 2009).

January 2010), unemployment rates are highest in coastal parts of the region and in Kent, with several urban areas in the Inner South East, such as Milton Keynes and Reading, also exhibiting high rates (between 4% and 7%), Figure 3.25.

In the case of coastal areas, high rates of unemployment can be explained in large part by industrial structure. A number of coastal districts have an above average concentration of manufacturing, construction and distribution and transport related activities which were disproportionately affected by redundancies during the recession. There also tends to be a greater concentration of lower skilled jobs in coastal areas, as well as in larger urban centres. Since people employed in these kinds of jobs tend to be more vulnerable to redundancy in a recession, this also helps to explain the higher unemployment rates in these parts of the South East.

Figure 3.25: Claimant count unemployment rate, South East local authorities, January 2010



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Earlier in the recession the fastest increases in the unemployment rate were in large urban centres and parts of the Inner South East, but in the past three months coastal areas have seen the fastest increases. Looking at change over the past 12 months (to January 2010), the fastest increases in the claimant count rate, broadly speaking, have been in peripheral areas of the region – in some coastal parts of Kent, Sussex and Hampshire – as well as in larger urban areas, including Slough, Reading, Milton Keynes and Hastings. In Slough and Hastings, for example, the claimant count rate increased by 1.7 percentage points, while in Reading the increase was 1.5 percentage points (Figure 3.26).

However, a slightly different pattern emerges if we look only at change over the past quarter (October 2009 to January 2010), where the fastest increases in the claimant count have been in coastal areas of Kent, Sussex and Hampshire (Figure 3.27). This is partly due to seasonal factors, in that there tend to be fewer jobs available in coastal areas outside the summer tourist season. Earlier in the recession, there were significant increases in the unemployment rate in parts of the Inner South East, partly reflecting large-scale job losses in London, which affect the claimant count figures as commuters who lose their jobs will claim JSA in their place of residence. There were also significant increases in the claimant count in large cities, partly due to the greater concentration of low-skilled jobs in these areas, which are more vulnerable during a recession, and also due to large numbers of redundancies in the service sector. Recent months have seen fewer redundancies in these areas, while the London labour market has started to stabilize, so the rise in unemployment in the Inner South East has been more muted. Indeed, in some parts of Berkshire, Buckinghamshire and Surrey there was a decline in the claimant count rate over the three months to January 2010.

Figure 3.26: Change in claimant count rate, January 2009 – January 2010

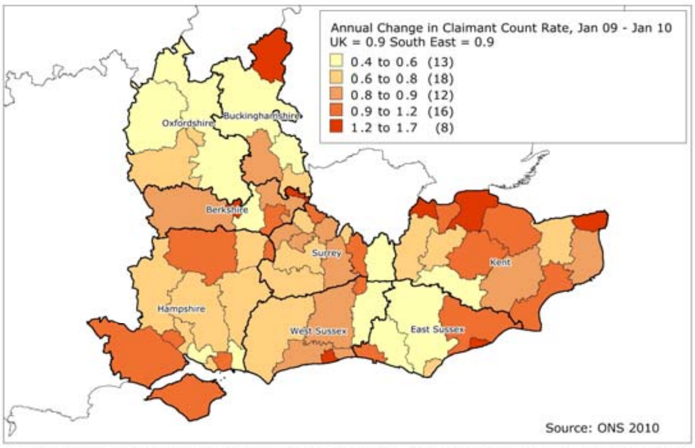

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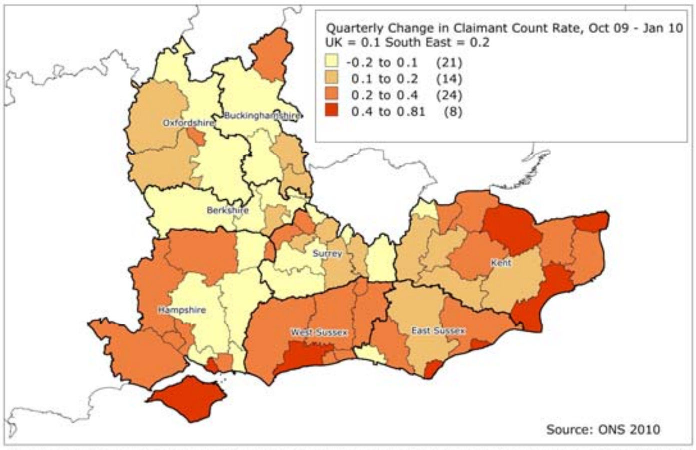
Figure 3.27: Change in claimant count rate, October 2009 – January 2010



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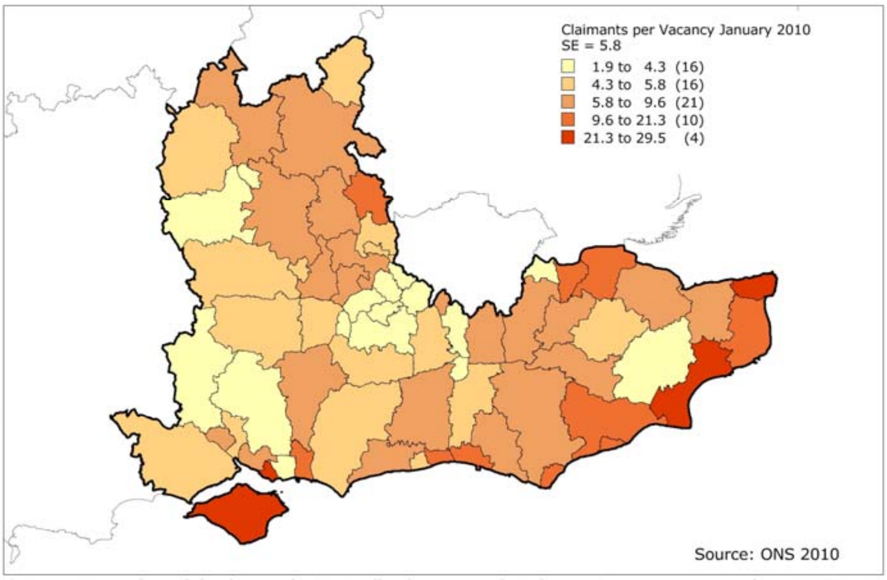
The number of JSA claimants per vacancy is highest in coastal areas of the South East. In recent months, the relatively slow rise in the claimant count, coupled with an increase in the number of vacancies notified to Jobcentre Plus, has meant that the claimant to vacancy ratio has gone down. Between January 2009 and January 2010, the number of vacancies in the South East more than doubled, from 14,000 to 28,200, while the number of claimants per vacancy fell from 9 to 6.

This overall figure masks significant sub-regional variation, however. The number of JSA claimants per vacancy is particularly high in some coastal parts of Kent and Hampshire, including the Isle of Wight, which is likely to be a reflection both of recent large redundancies in these areas and relatively limited employment opportunities locally (Figure 3.28).

Figure 3.28: Number of Jobseekers Allowance claimants per vacancy, January 2010



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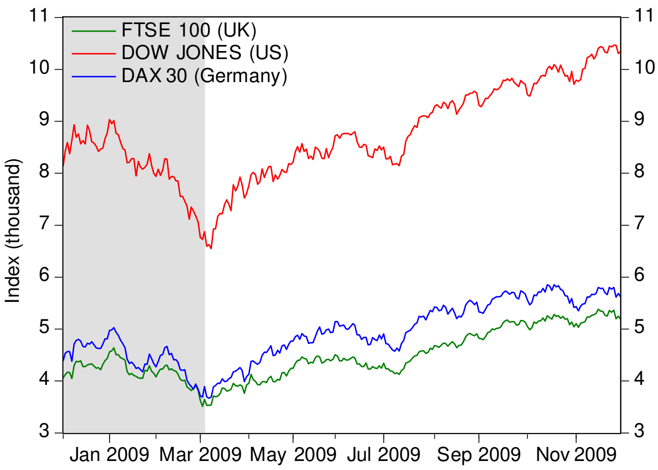
4. Future prospects for the South East and UK economies

On the road to recovery – economic conditions have improved a great deal, but the economy remains fragile

Over the past year a number of backward looking indicators, such as estimates of GDP growth and labour market data, have pointed to a continued deterioration in economic conditions. However, in the past few months a number of forward looking indicators, which will be discussed below, have started to point to an improvement in consumer and business sentiment, which was accompanied by some improvements in the housing market and a gradual recovery of the stock markets.

Confidence has returned to global financial markets. The coordinated policy response has prevented a 1930s style depression that was feared by analysts and policy makers. The major stock markets, which appeared to have reached the bottom in early March, have recorded a sharp recovery since then (Figure 4.1). In the eight months up to November 2009, the FTSE 100 in Britain increased by nearly 40% - one of the fastest rates of increase in its history.

Figure 4.1: Major stock markets, Dec 2008 – Dec 2009

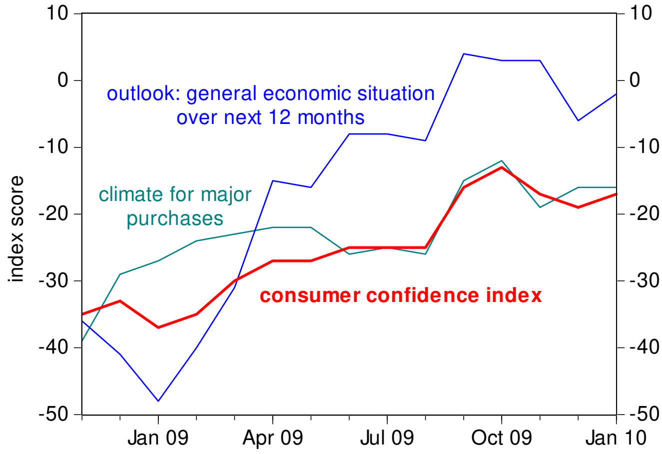


Source: FTSE 2009

Consumer confidence has improved a great deal over the summer, but remained fragile at the beginning of 2010. According to the GfK NOP consumer survey, consumer confidence in the UK started to pick up strongly in the second half of 2009. Although still heavily in negative territory, in January the index was -17 points, compared to -25 in June 2009 and -33 in December 2008. However, the fragility of any putative upswing in sentiment was demonstrated by the fact that in the last two months of 2009, consumer confidence declined again slightly, before moving up cautiously in January 2010 (Figure 4.2).

Again, sentiment remains fragile for the component of the index measuring people's expectations for the general economic situation over the next twelve months. Overall, the index improved strongly, from -41 in December 2008, and returned to positive readings in September 2009. However, in December 2009 the index measuring people's expectations moved into negative territory again, and remained negative at the start of 2010 (Figure 4.2). The component of the index measuring the climate for major purchases remained in negative territory at the beginning of 2010: the index was -16 points in December and January. However, this compares relatively well to its level in June 2009 (-26) and December 2008 (-29).

Figure 4.2: Consumer confidence, outlook and climate for major purchases



Source: GfK NOP Consumer Confidence Barometer 2010

As can be seen in Figure 4.2, people's expectations for the general economic situation for the next 12 months are much more positive than both the current overall consumer confidence and the climate for major purchases (both have developed a relatively similar pattern since the middle of 2009). At regional level, consumer sentiment improved across all regions in quarter 3 2009, but remains at weak levels, with the South East slightly below the UK average, according to Experian.[17]

A recovery from the recession depends in part on consumer spending, but households are saving an increasing share of their income. Household consumption accounts for around two thirds of aggregate spending in the UK economy. So decisions by households on whether to spend or save are a key influence on the economic outlook. The household income to saving ratio more than tripled between quarter 3 2008 and quarter 2 2009, from 1.7% to 5.6%. Job uncertainty, stagnant wage growth and continued difficulties in obtaining affordable credit make a rise in saving likely to continue into the next year. The trend may be even more likely given that the current recession followed a prolonged period of economic stability and low unemployment, when many households kept precautionary saving at a low level (but the ratio went into negative territory only last year, at -0.5% in quarter 1 2008). However, there is still some way to go to beat the 12% peak seen in 1992 following the last recession (Figure 4.3).

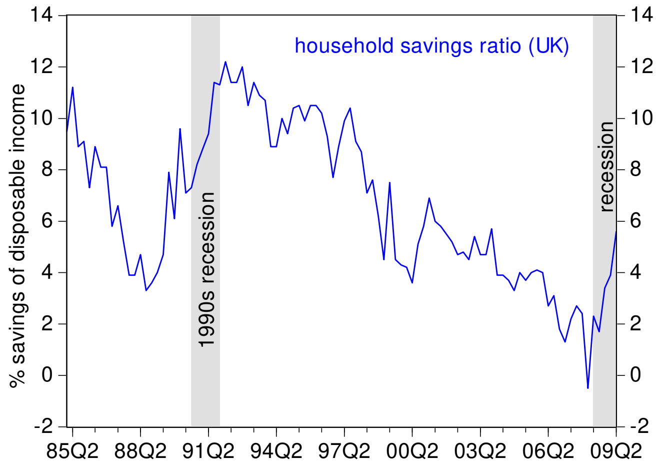
Given the relative reliance on consumer spending, it was encouraging that in November 2009 retail sales grew at their fastest pace in two years. Also encouraging is the underlying improvement in sectors related to the housing market (particularly retailers selling white goods and furniture). It is possible, however, that sales were, to an extent, exaggerated by the festive season, and by spending brought forward given the rise in the VAT rate in January. Indeed, the UK high street reported a slight fall in year-on-year sales in early January 2010, disappointing retailers' predictions and ending a three-month run of sales growth. According to the latest CBI Distributive Trades Survey, 28% of retailers said that the volume of sales in the year to early January had risen, while 36% said it had dropped. However, the weak sales during the traditional 'New Year sales' period are likely to have been influenced by the UK's extreme cold snap. Looking ahead to February, retailers expected that sales would be largely unchanged on their levels of a year ago.

However, anecdotal evidence for the South East suggests that Christmas and New Year trading was strong for many high street retailers in the South East. For example in Reading, footfall was down only 2% on the

[17] Experian Quarterly Regional Leading Indicators Monitor November 2009.

previous year in December, despite the heavy snow. Footwear and catering outlets performed particularly strongly.[18]

Figure 4.3: Household savings ratio



Source: ONS 2009

Another reason why retail sales have kept up reasonably well might be that businesses have kept prices down as an incentive for customers to buy goods. In other words, retail sales have held up fairly well as a result of discounting rather than growth in underlying demand. However, as customers keep demanding low prices, businesses lament further squeezes in profit margins.[19] The latest RDA National Business Survey from December, for example, shows that 61% of businesses in the South East reported lower profit margins in the last 12 months, while only a small proportion (12%) reported higher profits. Moreover, 37% of the surveyed firms expect their profit margins to be lower in the next 12 months, and only a fifth expect higher profits.

It is not surprising, then, that more and more firms report strengthening competition. Quarter 4 2009 survey results from the Institute of Chartered Accountants in England and Wales (ICAEW) show that 40% of companies report that increasing competition has had a negative impact on company performance over the last 12 months. Responses to the December SEEDA Purchasing Managers Index (PMI) survey suggested that competitive pressures remained a constraint on firms' pricing power, often preventing them from passing on higher input costs to customers.

The housing market in the South East started to recover in the second quarter of 2009. The downturn in the labour market, stagnant wage growth, general insecurity about the (personal) economic future, together with the liquidity squeeze, which forced UK financial institutions to ration their lending, lead to a considerable reduction in UK house prices. Just a couple of years ago the OECD had argued that house prices in the UK were overvalued by as much as 30%. It was furthermore argued that a fall in house prices of around 22% would be needed to bring prices back to 'sustainable' levels.

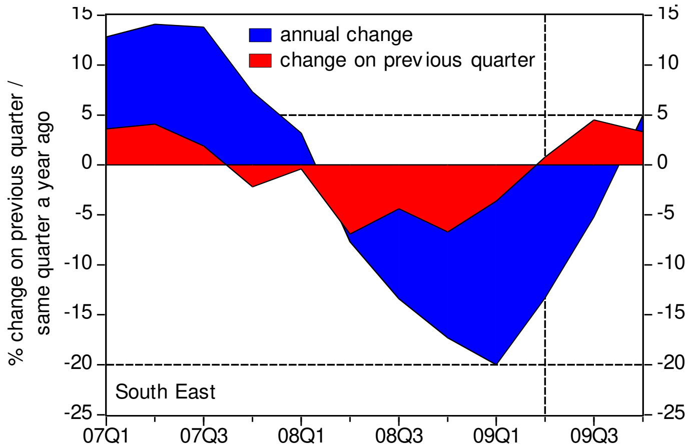
In the first quarter of 2009, Halifax's house price index for the South East had declined to a record low of -20%, compared to the same quarter a year before. However, although still declining, the pace of decline had started to ease in the second quarter of 2009, and house prices in the South East have since been increasing for 3 consecutive quarters, ahead of the UK as a whole. Moreover, the latest data shows that in quarter 4

[18] Berkshire Economic Strategy Board, Berkshire Economic Commentary (January 2010).
[19] See SEEDA, Regional Intelligence Snapshots.

2009, prices in the South East were higher than a year before, and the index increased by 5% compared to the same quarter of the previous year (Figure 4.4). Equally, after a sharp fall the numbers of UK mortgage approvals, which started to tumble towards the end of 2007, the numbers of mortgage approvals have been on the increase since the beginning of 2009 (Figure 4.5).

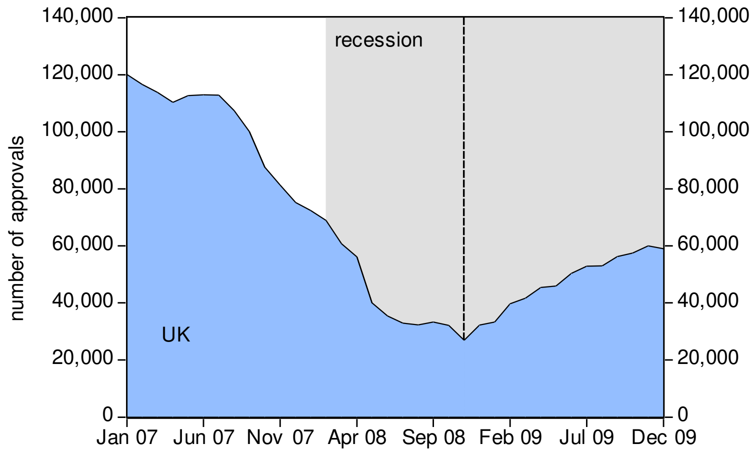
Nonetheless, house prices in the South East are still 15.2% below their peak in quarter 3 2007, and the number of UK mortgage approvals is some 50% below peak levels (Figures 4.4 and 4.5). However, it is likely that, to some extent, a shortage of stock has underpinned the recent increase in South East house prices. Of concern is therefore the reduction in housing starts in the South East, down by 38% in 2008/09 compared to 2007/08, according to CLG.

Figure 4.4: Halifax house price index



Source: HBOS 2010

Figure 4.5: Mortgage approvals



Source: Bank of England 2010

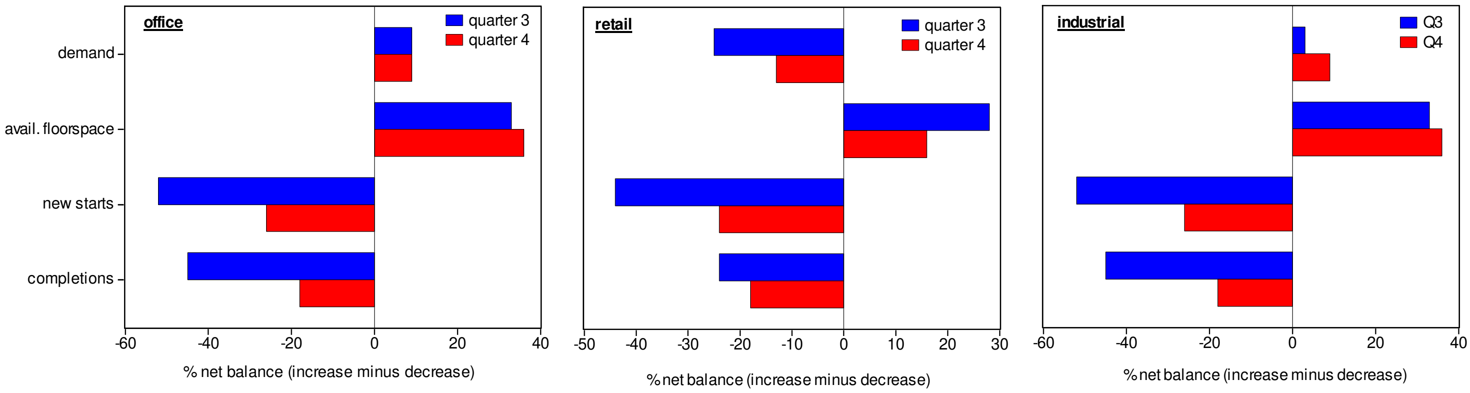
The improvement in the housing market has been accompanied by subdued development in the commercial property market, with some mismatch between demand and available floorspace. Despite some modest improvements in overall lettings demand, growth in the amount of available floorspace for commercial occupation in the South East continued to rise in the fourth quarter of 2009, although at a slower pace compared to the previous quarter, according to the Royal Institution of Chartered Surveyors (RICS) quarter 4 2009 survey.

In its biannual Financial Stability Report in December 2009 the Bank of England noted that vacancy rates had risen sharply to 12.6%, up from 3.6% in the year to October. Tenants continue to have the upper hand in lease negotiations, with landlord incentive packages rising at a similar pace across all sectors. Not surprisingly, rents have fallen sharply, leading to plunging income for property firms and raising the possibility of more companies in this sector failing to repay loans. The Bank of England warned that outstanding commercial property loans reached over £250bn at the end of September 2009, which was six times higher than in 1999. Commercial property prices have plummeted by almost 50% from the market's peak in July 2007, although some so-called prime assets (mainly in London) have recovered in the last six months.

Looking at the different components of the commercial property sector, there have been mixed developments in office, retail and industrial space in the South East. According to the RICS commercial property market survey for quarter 4 2009, demand for office space in the South East increased in quarter 4, whilst the amount of available floorspace rose at a much slower pace compared to the previous quarter (see Figure 4.6). Demand for retail space remained negative in the fourth quarter of 2009, whilst the available floorspace increased, though again at a much slower pace. Demand for industrial premises, on the other hand, rose just slightly in quarter 4, but available floorspace increased slightly more than in the previous quarter.

A combination of fading business property demand, together with the continuous challenge for investors to access new lines of credit in an uncertain economic environment (as mentioned, there are still high levels of debt amongst property companies) led to a further decline in the completion of commercial property space in quarter 4 2009, though the rate of decline eased somewhat compared to the previous quarter. Nonetheless, this also had a knock-on effect on new development starts across all sectors, which equally fell back, but again at a much slower rate (Figure 4.6). However, this may ease the upward pressure on the available floor space and vacancy rate in the coming year.

Figure 4.6: Commercial property market performance in the South East, Q3 and Q4 2009

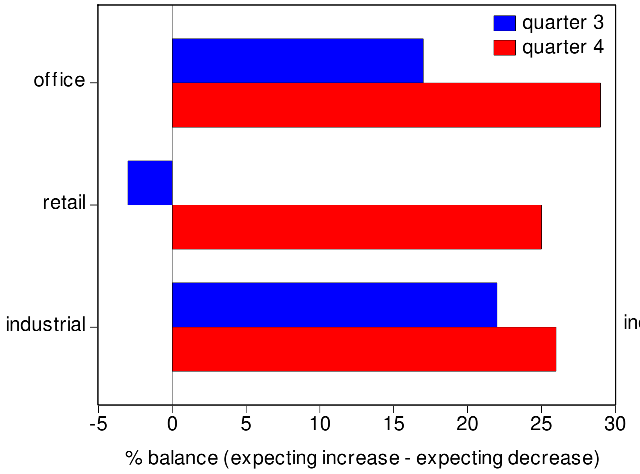


Source: RICS 2009

However, as can be seen in Figure 4.6 above, even though new developments have generally decreased, available floorspace has tended to increase. With demand staying low, there still seems to be a large mismatch between the supply of commercial property and demand for it, suggesting improvement in this sector is still some way off.

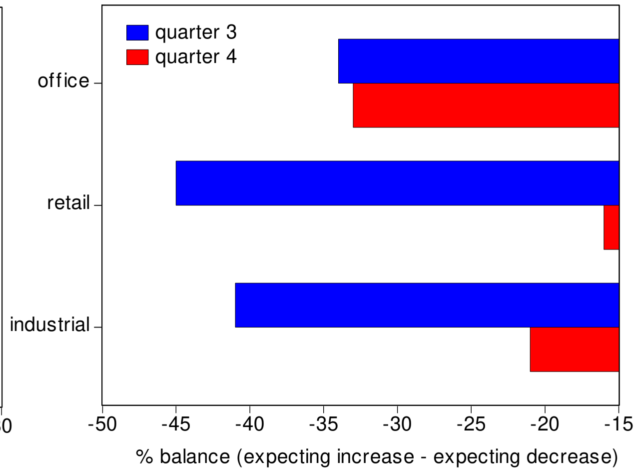
Confidence in future sales and lettings activity for the next quarter (Q1 2010) improved in the fourth quarter of 2009. Confidence in the outlook for lettings activity in all three sectors moved higher in the final quarter of 2009, with surveyors anticipating robust rises in lettings activities, especially in the retail market, where optimism turned positive again in the fourth quarter (Figure 4.7). While rental expectations point to a deceleration in future rental falls, especially in the retail and industrial sectors, all sectors expect further declines in rental yields (Figure 4.8).

Figure 4.7: Confidence in sales and lettings of space to occupiers, Q4 2009



Source: RICS 2009

Figure 4.8: Expected change in rental levels, Q4 2009

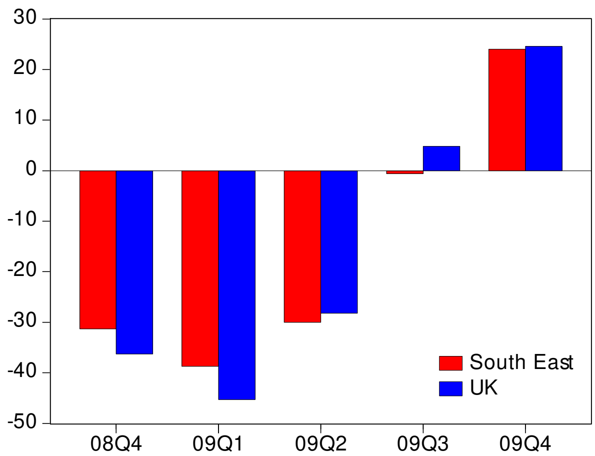


Source: RICS 2009

Business confidence is returning in all sectors.

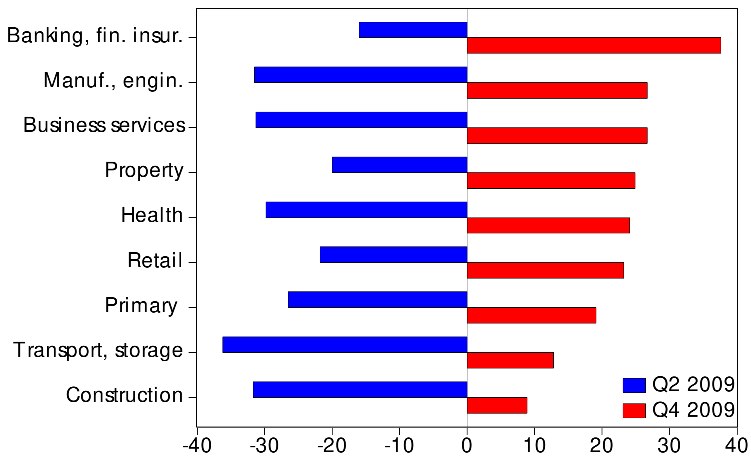
A growing number of companies in the South East are more optimistic about the near future, as the business climate picked up strongly at the end of 2009. Business confidence for the next 12 months jumped up in quarter 4 2009, according to the ICEAW South East Business Confidence Monitor. The Confidence Index increased strongly over the last quarter of 2009, to 24.0 points, up from a negative figure (-0.6) in quarter 3 2009, and is in line with the UK average (Figure 4.9). This brings the index to its highest level since quarter 2 2004. At UK level the index turned positive for all sectors in the last quarter of 2009, although optimism varies quite strongly between sectors. On average nationally, banking, finance & insurance companies are significantly more optimistic (37.6) followed by business services, manufacturing and engineering. Companies in the construction and transport sectors are the least optimistic (Figure 4.10).

Figure 4.9: Business confidence Index, South East and UK



Source: ICAEW 2009

Figure 4.10: Business confidence by sector (UK)



Source: ICAEW

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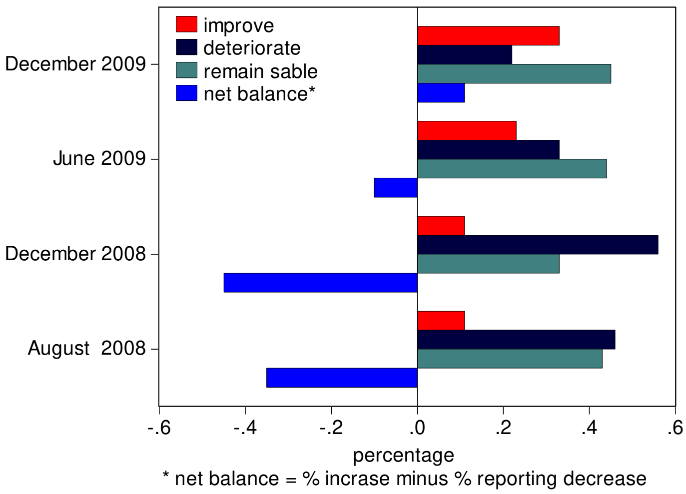
This is corroborated by our own survey evidence, according to the latest RDA National Business Survey from December 2009.[20] A third of South East companies (33%) expect the business climate to improve in the next 12 months, up from less than a quarter (23%) in June 2009 and 11% in March. While 22% of firms in the South East still expect the business climate to get worse in the next 12 months, this is significantly lower than in June 2009 when a third were gloomy about the outlook for the next year (Figure 4.11). However, overall, South East businesses are notably more optimistic than the national average. This is generally corroborated by the FSB South East Snap Poll: when asked how confident companies are about the prospects for their business in the next 6 months, the percentage of "very confident" companies climbed up from 2% in August to 16% in October, whilst the proportion of "not confident" firms declined from 31% to 24% in October.

Companies across the size range are equally optimistic about future improvement in the business climate. However, there are some differences if we look at the percentage expecting the climate to deteriorate. Here, large companies (50+ employees) are significantly more pessimistic than smaller ones. This is somewhat surprising, given that large companies were significantly more likely to report that their overall business performance had improved in the last 12 months. However, the findings may partly be explained by the fact that large companies could fear a knock-on-effect from on average less well performing SMEs, through their supply chains.[21]

Figure 4.11: Business climate in the South East: expectations for the next 12 months



Source: RDA National Business Survey

Companies operating in different sectors are somewhat divided in their optimism: firms in primary industries, manufacturing, financial & business services, and companies providing services mainly for the public are more optimistic than average about the future business climate. Firms in construction, distribution and hotels and catering, on the other hand, are still rather gloomy about the business climate (Figure 4.12). However, there has been some notable improvement in the December survey, particularly for companies operating in manufacturing and primary activities. These are much more positive about the next 12 months than they were in June 2009 (Figure 4.13).

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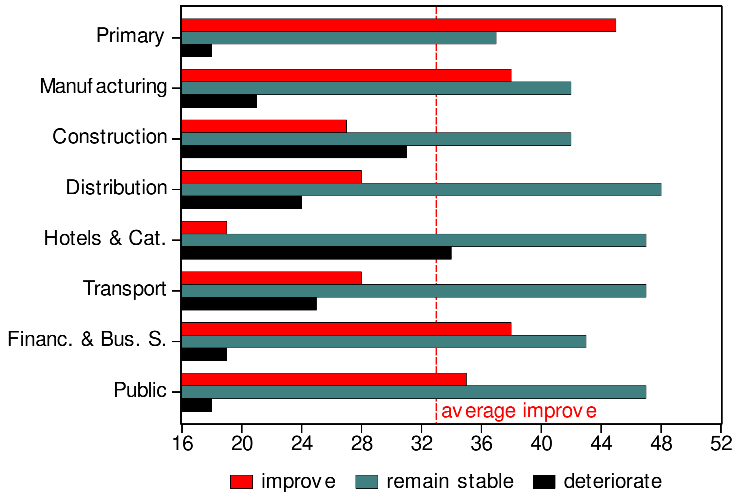
[20] See: http://www.seeda.co.uk/news-and-publications/publications/research-and-economics-businesssurveys

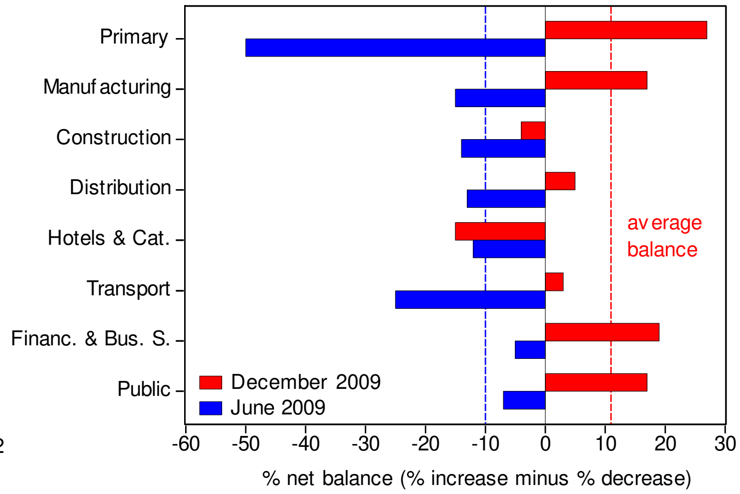
[21] See Regional Intelligence Snapshot for the South East, November 2009.

Figure 4.12: Business climate by sector: expectations for next 12 months



Source: RDA National Business Survey December 2009

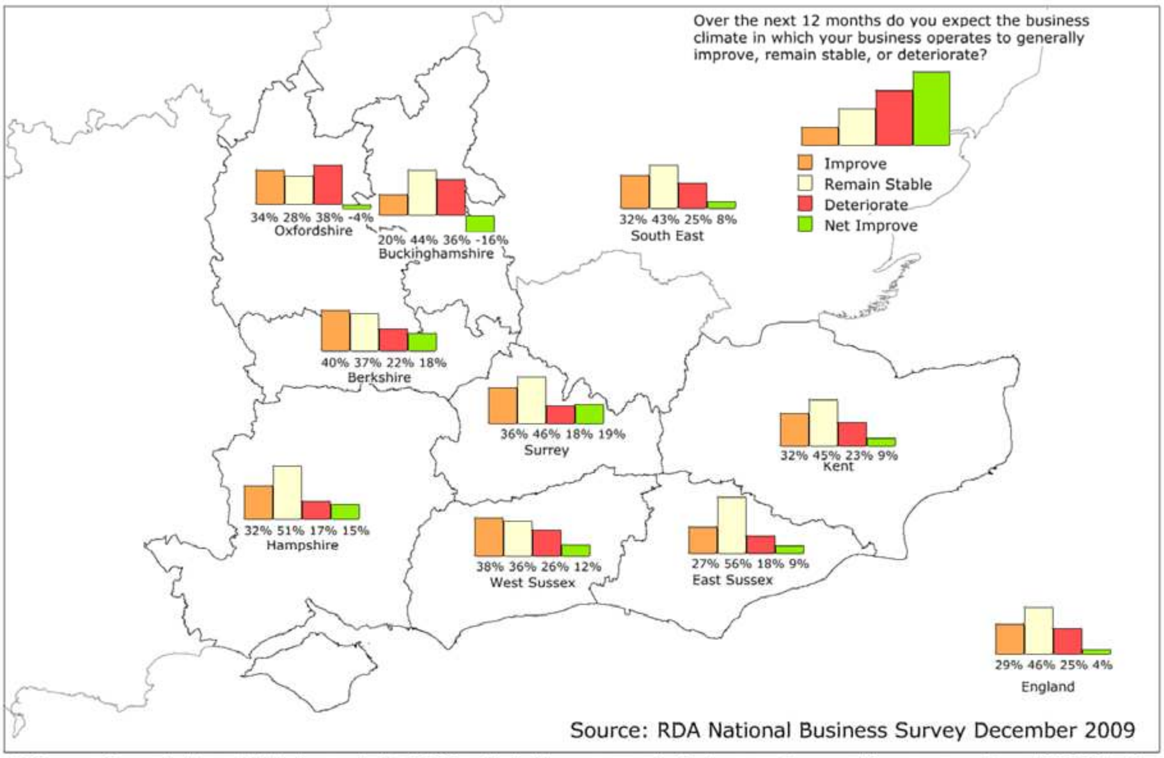
Figure 4.13: Business climate by sector: net balance, June and December 2009



Source: RDA National Business Survey December 2009

At sub-regional level, businesses located in Surrey, Berkshire, Hampshire and West Sussex are on balance more optimistic about the business climate in the next 12 months (on balance these counties reported a better business performance over the last 12 months too, apart from Hampshire). However, relatively high proportions of firms in Buckinghamshire and Oxfordshire expect the business climate to deteriorate in the coming 12 months (Figure 4.14).

Figure 4.14: Business climate in the South East by county (next 12 months)



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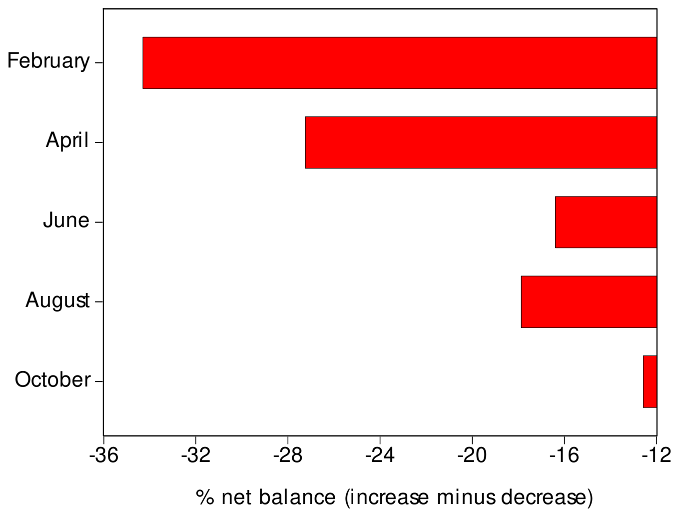
However, there is some evidence that businesses may be slightly more optimistic in the short term than in the medium term. According to SEEDA's Business Snapshot survey for October 2009, which looks at the shorter time frame of 3 months, more businesses (40%) were confident about the business climate in the next 3 months (compared to 32% for the 12 months outlook). Just 10% expected the business climate to get worse in the next 3 months (compared to 22% looking ahead to the next 12 months). It may also be the case that companies expected the pre-Christmas sales to provide some boost to business performance, but the outlook for the next year as a whole remains comparatively subdued. For example, the wholesale and retail trade sector was the driver behind the anticipated improvement in overall business climate (Business Snapshot survey): companies in this sector were more optimistic about the next 3 months than all other sectors (apart from agriculture).

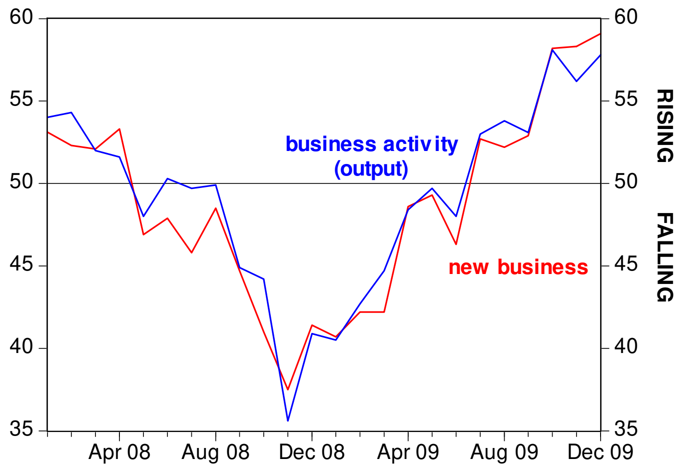
Firms' optimism about future output and new orders appears encouraging. There is increasing evidence, both from survey and anecdotal sources, that companies are more hopeful for their order books to fill up again and thus help increase firms' overall output. Indeed, there was some good improvement over the summer of 2009, and on this basis companies seem to remain optimistic that conditions will improve further. The Federation of Small Businesses (FSB) Snap Poll survey for the South East shows that, although the net balance is still in negative territory, the number of companies reporting a rise in trade increased strongly over the course of 2009 (Figure 4.15). This is corroborated by the South East Purchasing Managers Index (PMI): both new orders and business activity (output) have been rising for six consecutive months (Figure 4.16; readings above 50 signal growth). This was generally attributed to stronger demand and improved confidence which led to an increased willingness amongst clients to proceed with new projects. Furthermore, in December 2009 the index for new orders rose to its highest level since September 2007, suggesting a strong rate of expansion.

Figure 4.15: Trends in trade over previous 2 months, South East small businesses



Source: FSB South East Snap Poll 2009

Figure 4.16: South East Purchasing Managers Index (PMI), output and new orders



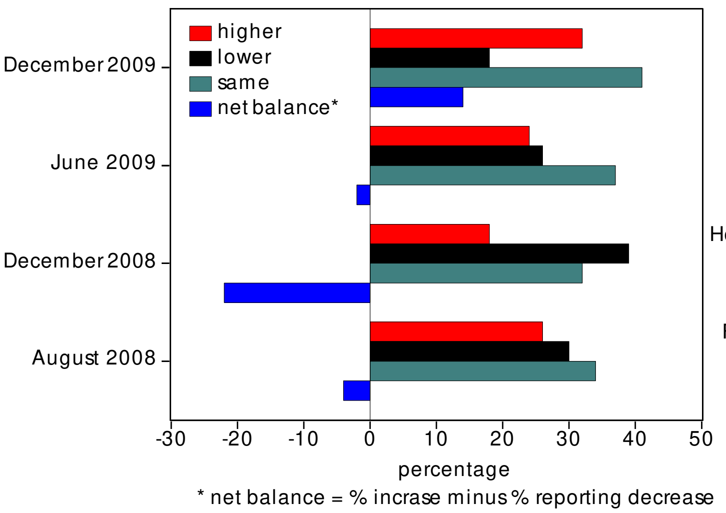
Source: Markit SEEDA PMI 2010

There is anecdotal evidence showing that some companies, particularly manufacturers, have already benefited from the depreciation of sterling along with the early recovery of major economies within the Eurozone, which have helped to give a boost to exports. According to the EEF Business Trends Survey for the South East, the balance for total new orders was at 16% in quarter 4 2009, compared to -24% for the previous quarter. A balance of 6% reported increased domestic orders, following -38% for quarter 3. The volume of new export orders also improved in quarter 4 2009. The balance was 3% in quarter 4, following -19% for the previous three months.[22]

All these positive signals seem to be filtering through to companies' expectations for the future. According to the RDA National Business Survey for December 2009, one third of South East businesses expect their volume of output to be higher in the next 12 months - significantly more compared to a quarter of firms in June. However, there are still 18% expecting output decline (compared to 26% in June), while 41% expect output to remain at least stable (Figure 4.17).

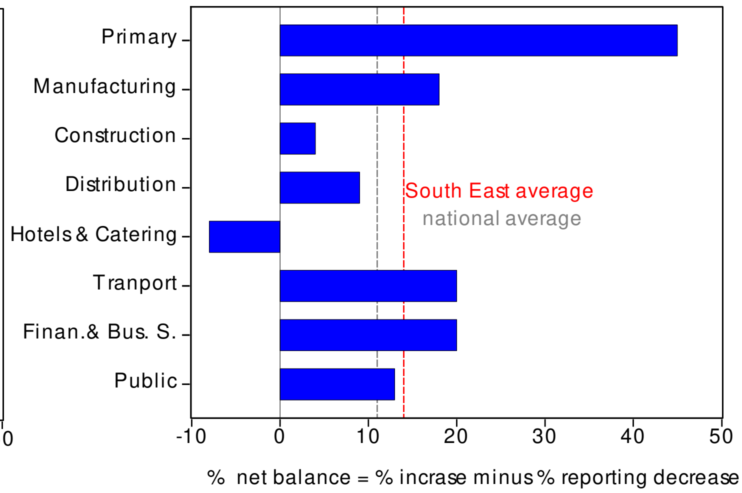
The short term outlook, as captured by the October Business Snapshot survey, was slightly more positive, with 34% of companies expecting higher output and only 9% lower levels, in the following 3 months. Companies in financial & business services, transport and manufacturing were the most optimistic, whilst firms in the construction, hotels & catering and distribution sectors tended to be less optimistic than the average. Hotels and catering was the only sector to have remained in negative territory (net balance), Figure 4.18. This may be partly explained by the fact that this sector reported the strongest decline in business performance over the last 12 months. This is not surprising, given that customers (both private and business) are keeping their spending tight, focusing on the most important investments / spending.

Figure 4.17: Expected volume of output, next 12 months, South East



Source: RDA National Business Survey

Figure 4.18: Expected volume of output, by sector (net balance)



Source: RDA National Business Survey

At sub-regional level, companies in West and East Sussex, Berkshire and Hampshire appear to be on balance more optimistic about improvements in output, which is broadly mirrored in the overall business climate. Overall, compared to the national average, companies in the South East tend to be more optimistic about their future volume of output (net balance of 14% compared to 11% nationally).[23]

The trend in firms' expectations for domestic orders is broadly similar to the overall outlook for output and the wider business climate: 29% of companies expect higher domestic orders in the next 12 months, up from 21% in June. However, 17% still expect domestic orders to decline in the next 12 months, although again there was a considerable improvement compared to the 27% in June. Export orders are expected to increase by

[22] Balance = Percentage reporting an increase minus percentage reporting decrease. EEF = the manufacturers' organization the Engineering Employers Federation.
[23] Please note that the sample size can be small for some counties, so figures should be treated with some caution.

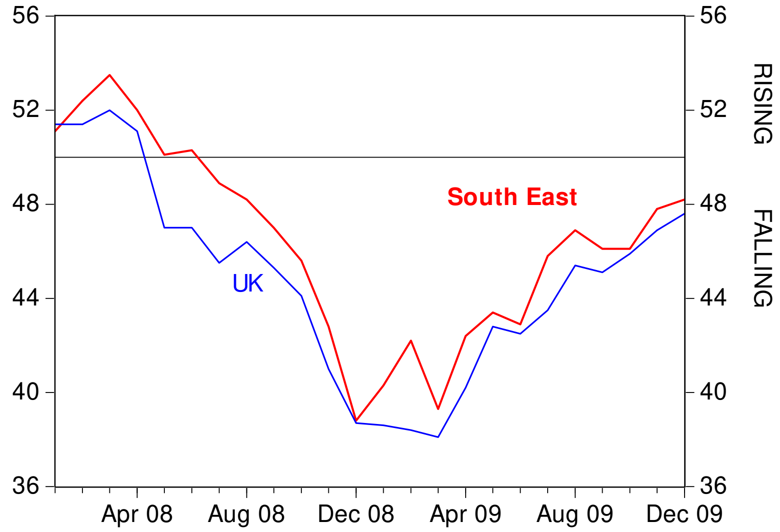
36% of businesses, whilst 20% expect export orders to decline in the next 12 months, and 45% anticipate no change.[24]

The positive trend in expectations for new business is corroborated by the sales index from the ICAEW Business Confidence Monitor quarter 4. The national index for expected trends in sales in the next 12 months increased to 4.0, compared to -2.1 for the past 12 months. The index for expected trends in exports increased to 3.3 compared to 0.8 for the last 12 months.

Employment is still falling, but firms in the South East are more positive about employment growth. Although employment fell for the 18th consecutive month, the pace of decline eased to its slowest since August 2008, according to the December SEEDA PMI (Figure 4.19). This is corroborated by the South East EEF Business Trends Survey: whilst still decreasing, the numbers employed in manufacturing have shown signs of improvement. The net balance was -3% in quarter 4, in comparison to -26% for quarter 3.[25]

There is evidence that the improved optimism started to feed through to companies' intentions to increase the number of people on their payroll. Compared to other UK regions, firms in the South East expect the second fastest rate of growth for number of employees, according to the ICAEW Business Confidence Monitor for quarter 4 2009, where South East businesses expect staff headcount to increase by 1.4% over the coming 12 months compared to a UK average increase of 0.8%. Further, according to this survey, over the last year firms in the South East have cut headcount by 1.3% compared to a UK average decline of 2.2%.

Figure 4.19: South East Purchasing Managers Index: Employment



Source: Markit SEEDA PMI 2010

On the other hand, according to the latest results from the RDA National Business Survey, the outlook for employment in the South East is just in line with the national average, and any anticipation for growth in some companies is balanced out by expected decline in others: some 15% of companies in the South East expect higher employment levels in the next 12 months – the same as the percentage of companies expecting to reduce employment (16%). According to the latest RDA National Business Survey, any growth in employment may be driven by large companies and those operating in financial & business services and the manufacturing sector.

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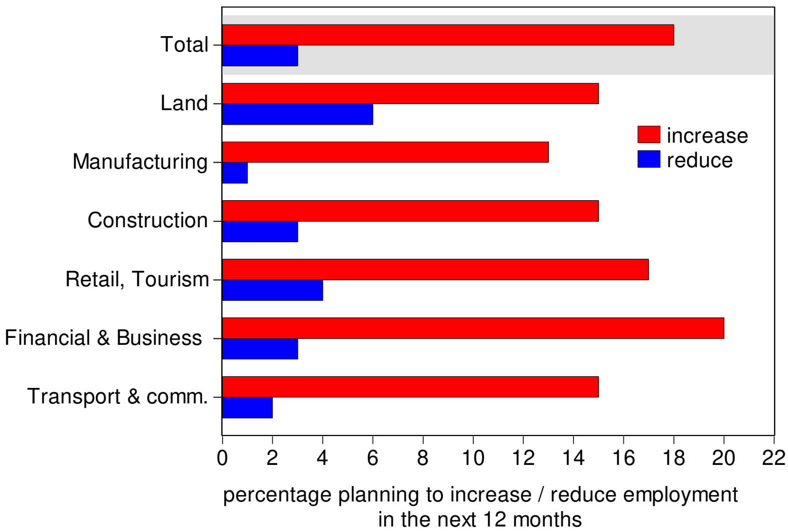
[24] NOTE: figures relate to those companies for whom export orders are applicable (not applicable for 68% of the surveyed companies).
[25] Net balance = % reporting increase minus % reporting decrease.

However, survey results are volatile to some extent, and when split by sector or sub-region the sample size can become fairly low. In fact, if we look at the latest Business Link South East Business Monitor (for which fieldwork was conducted in November 2009) the outlook for SME employment looks much more positive, with 18% of SMEs in the South East expecting to take on staff in the next 12 months, and only 3% expecting to reduce staffing over the next 12 months. Again, employment growth is likely to be driven by the financial and business services industry (Figure 4.20).

Companies are significantly more likely to plan on increasing the number of people on their payroll if their overall business performance has shown good improvement over the past 12 months. However, in the next 12 months, some 18% of companies still expect to reduce working hours or staff as a direct result of the current economic conditions, according to the RDA National Business Survey. This represents relatively little improvement compared to June 2009 (21%). The proportion of firms who plan to cut staff salaries to keep business afloat has slightly declined, and is now at 9%, compared to 13% in June.

Figure 4.20: South East employment outlook, next 12 months



Source: Business Link South East Business Monitor

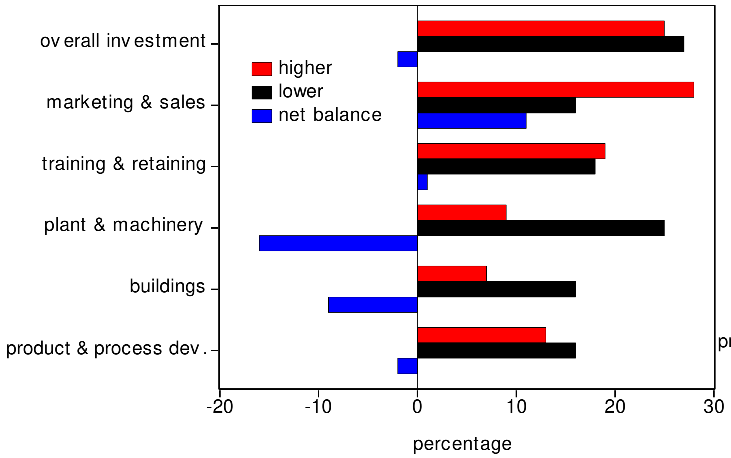
Investment intentions are generally picking up, but slowly, as firms remain cautious. According to our latest survey evidence from the December RDA National Business Survey, a quarter of companies plan to increase their overall level of investment, which is little improvement compared to June (22%). Furthermore, the overall investment intentions are more than off-set by the proportion of companies who expect to reduce their investment in the next 12 months (27%), Figure 4.21. This is in line with the national average. The outlook in the FSB South East Snap Poll from October 2009 was even bleaker: 48% of the surveyed companies said that they had no investment intentions in the next 6 months, up from 29% in June.

According to our own survey results and corroborated by anecdotal evidence, companies' main focus will be on marketing and sales, which seems to be one of the main survival strategies as firms seek to promote their products to maximise revenue while reducing costs elsewhere. However, it appears that this approach was more important in the middle of the year (40% planned to increase their marketing and sales spending in June) and that perhaps these activities have either been successful or there is now limited scope for further investments in marketing and sales. This is corroborated by results from the FSB South East Snap Poll: when asked whether they had any plans to expand their business in the next 6 months, the percentage of firms planning to invest in marketing was highest in October 2009, at 15%, and had decreased from 18% in June.

In other areas, businesses expect to cut costs: the percentage of companies planning to increase investment in plant and machinery is significantly off-set by those expecting to cut spending, and investment intentions in plant and machinery have further deteriorated compared to June. This is equally the case for investment in buildings, although at a lower level (see Figure 4.22). The net balance for investment in product and process development also turned negative, if less severe (-2%, compared to 3% in June).

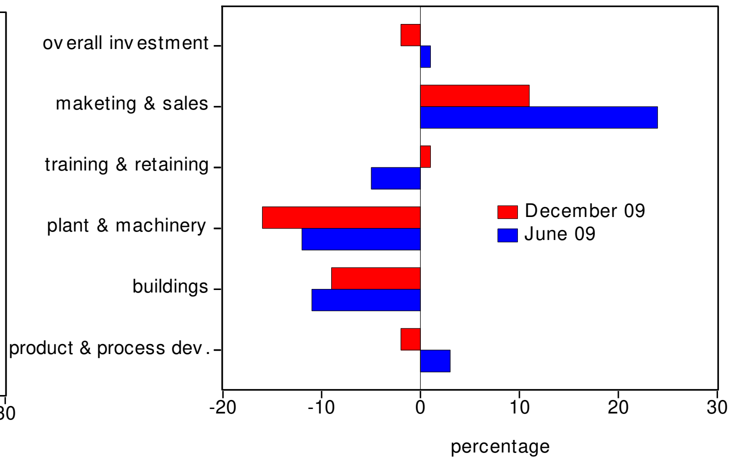
However, there are some tentative signs that businesses are preparing for the upturn, as the proportion of companies planning to invest in training and retraining has improved gradually over the last year, if sluggish: according to the RDA National Business Survey from December, 19% of firms plan to invest in training and retraining in the next 12 months, up from 15% in June. On the other hand, largely anecdotal evidence indicates that many companies are struggling to source the required funding for training.

Figure 4.21: Investment intentions for next 12 months, South East businesses



Source: RDA National Business Survey December 2009

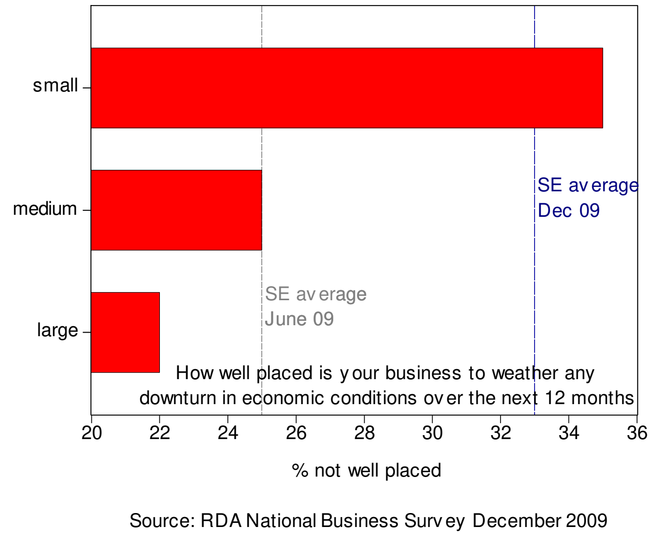
Figure 4.22: Investment intentions, December 2009 compared to June (net balance)

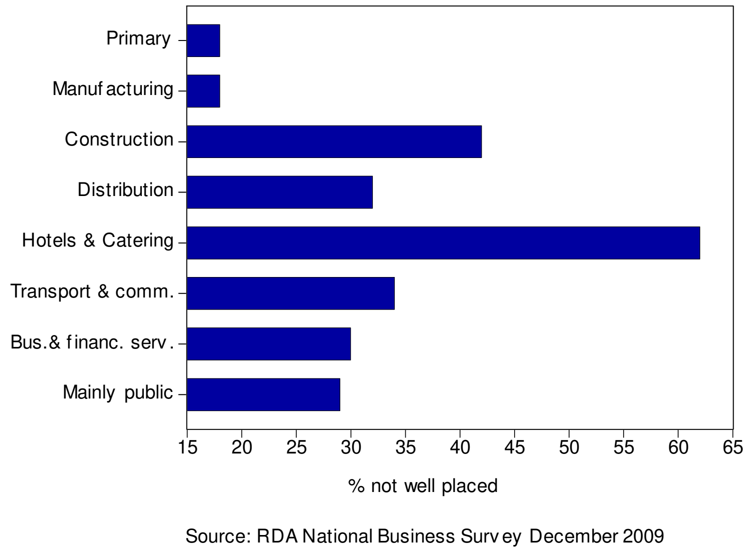


Source: RDA National Business Survey December 2009

One note of caution comes from responses to the question of how well placed businesses are to weather any further downturn in economic conditions in the next 12 months. The proportion of companies reporting that they are not well placed to weather any further downturn increased significantly, from a quarter in June to a third in December, just slightly better than the national average. Small firms are significantly more likely than large firms to regard their own position as not well placed, which is somewhat concerning since small firms account for the majority of businesses in the South East. Companies operating in the business and financial services industries are more positive, as are private companies providing services to the public sector, whilst companies in the construction and hotels & catering sector are significantly more anxious about any further downturn (Figure 4.23). This is of concern given that the threat of a "double-dip" recession, as discussed previously, remains realistic and as such could have a severe affect on some companies' ability to survive.

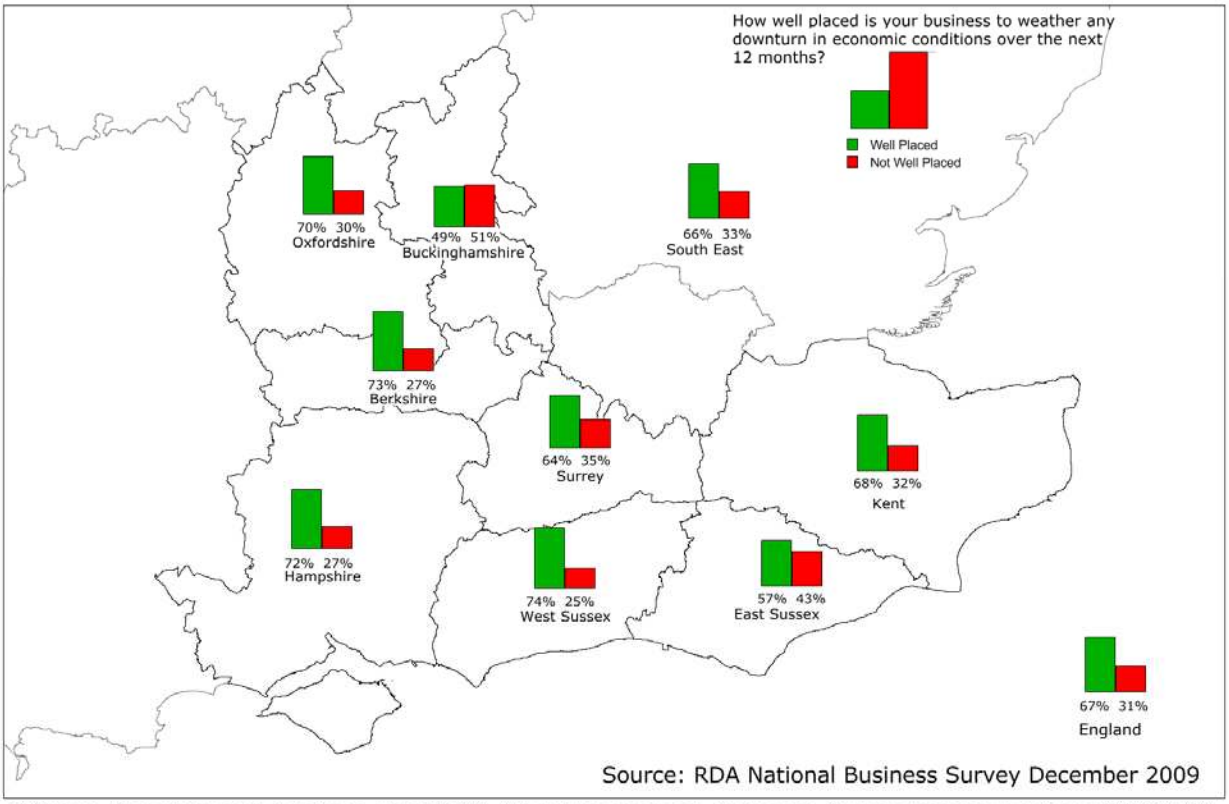
Figure 4.23: Can South East companies weather any further downturn? (By size and sector)





Companies in Berkshire and West Sussex tend to feel more confident, whilst firms in Buckinghamshire and Surrey are more likely to see themselves in a poor position to weather any further downturn (companies in Buckinghamshire were significantly more likely to report worsening business conditions over the last 12 months), Figure 4.24.

Figure 4.24: How well placed are companies to weather any further downturn



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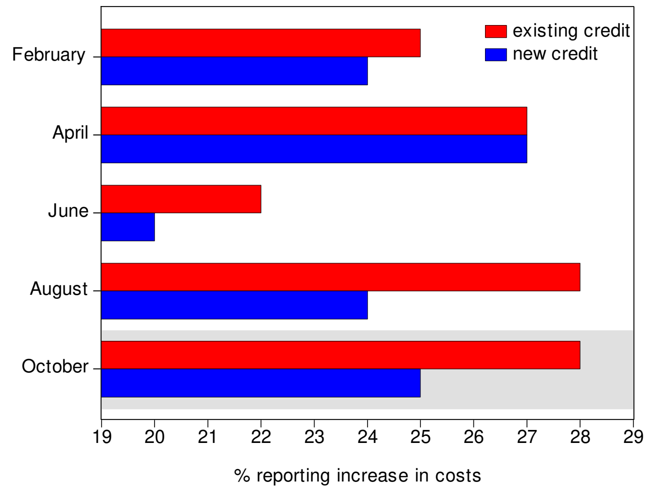
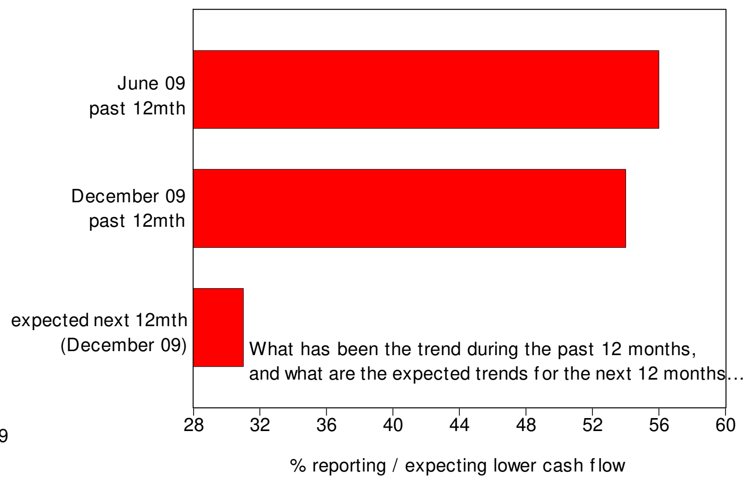
Access to finance continues to be a major challenge and might hamper the upswing. Although we have seen some good improvement in many aspects over the last 6 months, economic conditions remain fragile. The cost of finance and levels of cash in the business are still proving a major challenge to companies in the South East, and this may act as a barrier to expansion and upswing. According to the latest South East FSB Snap Poll, 28% of companies reported an increase in the cost of existing finance in October (up from 22% in June). Some 25% report higher costs for new finance (up from 20% in June), Figure 4.25. This is corroborated by our own survey results. Anecdotal evidence furthermore suggests that the banks continue to be risk averse. The problem is exaggerated by business customers delaying payments. According to our Business Snapshot Survey from October 2009, 4 out of 10 companies reported customers delaying payments, and 26% said it had been necessary to delay payments to their own suppliers. As a consequence, cash in the business is a concern for many companies in the South East: 54% of firms report lower cash in the business, and only 13% report higher levels, according to the RDA National Business Survey from December. There has been little improvement compared to June (56% lower, 11% higher cash-flow). However, looking to the future, almost a quarter of the surveyed companies expect the level of cash-flow to improve in the next 12 months, but still almost a third expect deterioration (Figure 4.26).

Figure 4.25: Percentage of South East businesses reporting increases in the cost of finance



Source: FSB Snap Poll Survey South East 2009

Figure 4.26: Percentage of South East businesses reporting / expecting lower cash flow

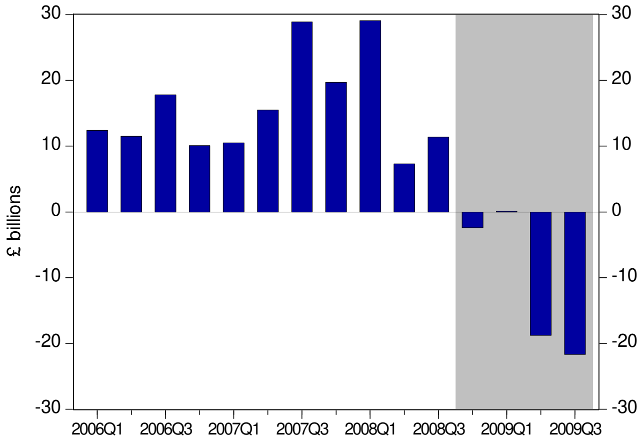


Source: RDA National Business Survey December 2009

Bank lending has improved, but remains challenging. This could put a further strain on business performance. Problems in accessing finance or low cash-flow are having an impact on SME performance, with small businesses more likely to have seen worsening performance. This also has a knock-on effect on large companies through their supply chains. Anecdotal evidence suggests that companies in the construction and manufacturing sector find it particularly difficult to access funding as the uncertainties in the economy remain.

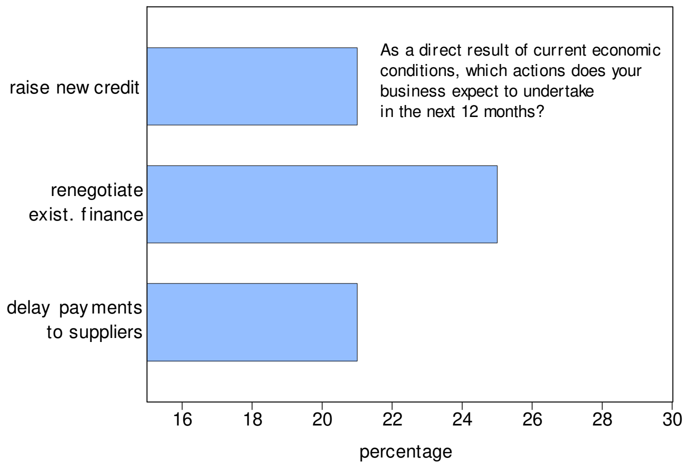
However, commercial lending to companies in the UK has remained subdued since the recession began. The flow of net lending to business fell again in the third quarter 2009, affecting all the main sectors of the economy - a pattern not seen over the past 12 years (Figure 4.27). This is particularly worrying if we look at the latest survey evidence. A considerable proportion of companies plan to raise new sources of finance or credit or renegotiate existing finance as a direct result of the current economic conditions. Moreover, a fifth of companies expect that they will have to delay payments to suppliers in the next 12 months, according to the RDA National Business Survey from December (Figure 4.28).

Figure 4.27: UK bank lending



Source: Bank of England 2009

Figure 4.28: Financial plans for next 12 months, South East businesses



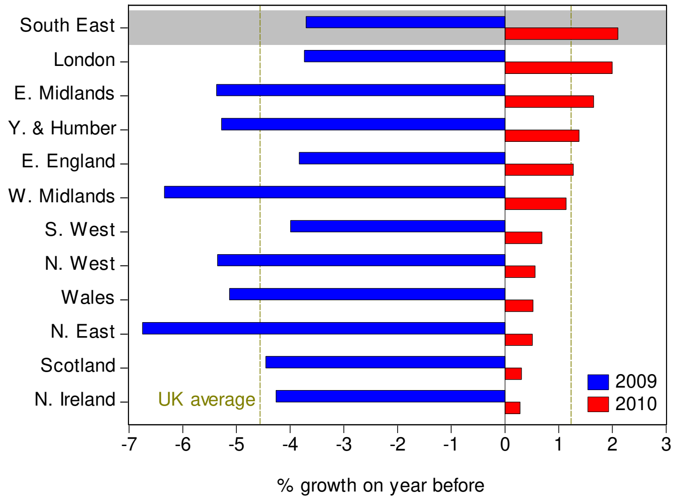
Source: RDA National Business Survey December 2009

Outlook: The South East economy in the short- to medium term

The South East, together with London, is expected to lead the fragile recovery in 2010, and to maintain its place as one of the most dynamic regions in the UK. The latest autumn forecast by Experian expects the South East economy in 2009 to decline by -3.7%, less than any other UK region. Forecasters are equally more positive for the South East's near future, and expect the region to return to growth in 2010, at 2.1%, which is the highest rate of any region (1.3% at national level, Figure 4.29).

In the medium term Experian expect GVA in the South East to grow by 2.9% on average per year (up to 2016), above the national average of 2.3%. However, forecasts are of a volatile nature, particularly at a time of economic uncertainty, and it is preferable to pay less attention to specific figures and more to the general direction and magnitude of change. Ultimately, growth is led by a number of often unpredictable factors and there remains significant scope for regional policies to shape the future of an area. Experian's revised autumn forecast, for example, expects the South East economy in 2010 to grow at a significantly faster pace than what was previously predicted in spring (2.1% compared to 0.7%). On the other hand, the decline in output in 2009 is now expected to have been slightly more severe than earlier estimated (-3.7% compared to -3.2%).

Figure 4.29: Forecast regional output growth, 2009 and 2010

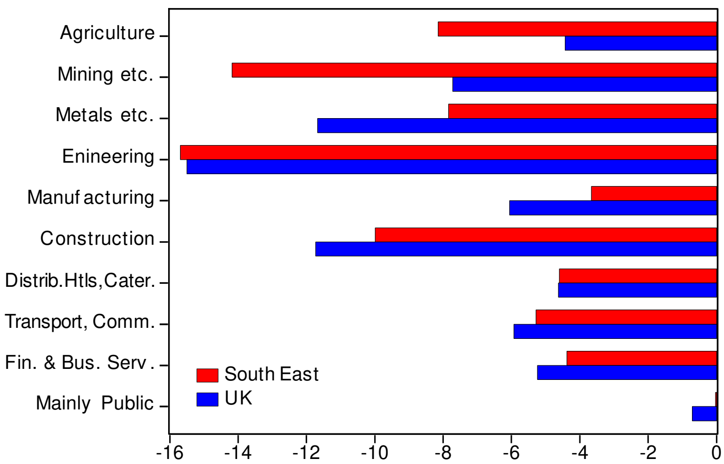


Source: Experian Autumn 2009

The comparatively good performance of the South East region may be partly explained by the fact that those sectors which have been hit hardest by the recession, i.e. manufacturing and construction, make a smaller contribution to the region's output, in contrast to the economies of the northern regions. Regions to the south have been cushioned from the impact of the recession somewhat, following the significant amount of public funding injected into the financial services sector to prevent further losses. This sector accounts for a significant proportion of output and employment in the South East. Another reason may be that households in the north are more financially constrained, face higher rates of unemployment and are seeing less of a recovery in wealth than their counterparts in the south, which leaves consumers in these regions more exposed to the effects of the recession.

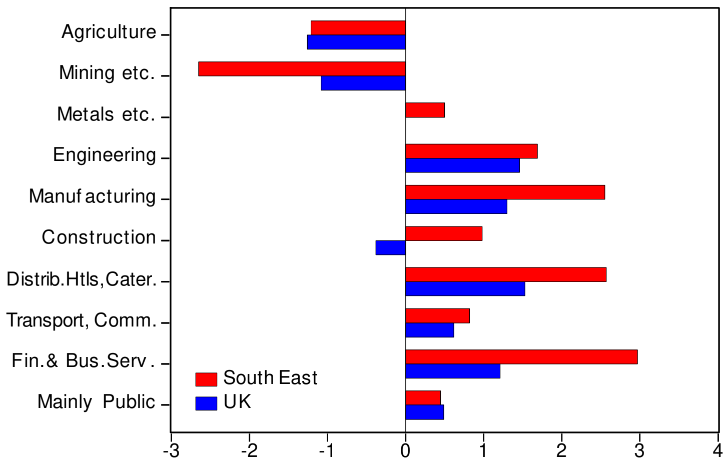
Indeed, looking at the performance of individual sectors, according to Experian, output in manufacturing and construction has declined at a faster pace at national level, while business and financial services in the South East, which already contribute a higher share of the region's GVA, are expected to grow at a faster pace in 2010, compared to the UK as a whole (Figures 4.30 and 4.31).

Figure 4.30: GVA growth 2009, forecast



Source: Experian Autumn 2009

Figure 4.31: GVA growth 2010, forecast



Source: Experian Autumn 2009

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Significant disparities in economic performance at the sub-regional level are projected for 2010. The disparities in economic performance within the South East are greater than those within any other UK region. The latest projections from Experian highlight the depth of the downturn within the South East, with some stark differences in the expected rates of growth between the South East counties this year. However, despite a sharp contraction in GVA, all sub-regions in the South East are now expected to outperform the UK average this year. Experian expects growth to be led by West Sussex, Berkshire, East Sussex, Buckinghamshire and Surrey, with growth rates above the South East average in 2010. On the other hand, in 2009, GVA in Hampshire, Buckinghamshire, Surrey and Berkshire is expected to have declined at a faster rate than the regional average (Figures 4.32 and 4.33).

Figure 4.32: GVA growth forecast 2009, South East counties

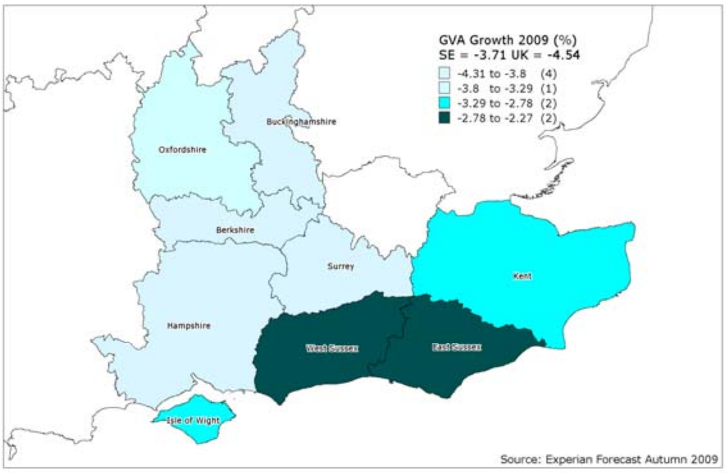

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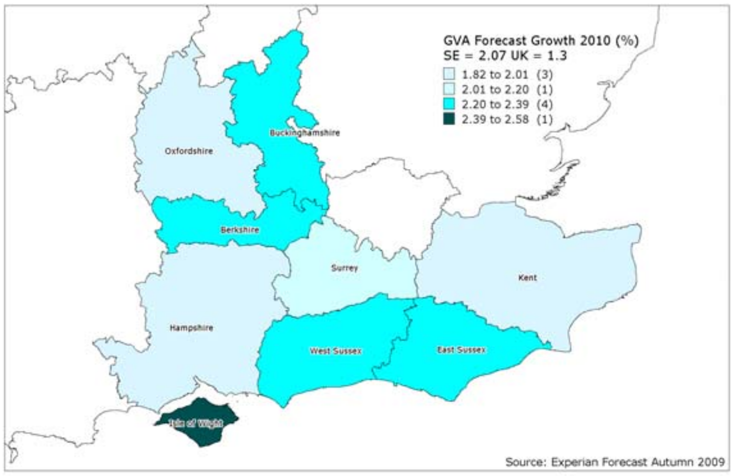
Figure 4.33: GVA growth forecast 2010, South East counties



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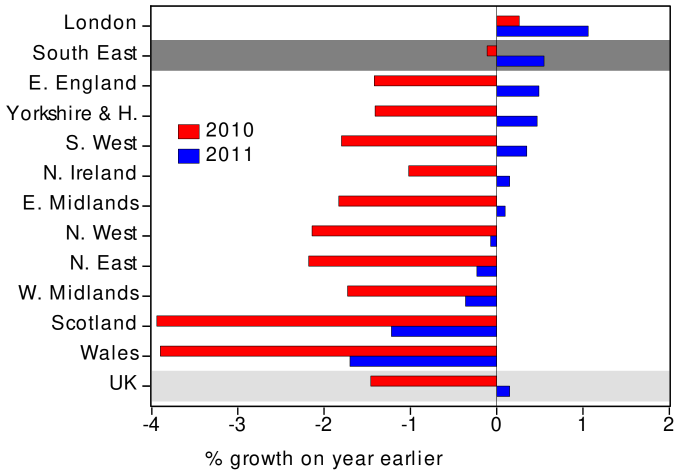
Employment growth is forecast to lag behind GVA improvement, but likely to perform better than at national level. While it is widely expected that GVA will return to low growth in 2010, it is likely that employment will lag behind for another year, and is forecast to pick up in 2011. According to the latest Experian forecast, employment in the South East could be almost stagnant in 2010 (-0.1%) and should return to growth in 2011, although at a modest pace (0.6%). In fact, the South East seems to be faring better than any other UK region, apart from London (see Figure 4.34). Employment growth is likely to be driven by banking & insurance, property related activities, retailing, and the public sector[26], according to Experian.

Over the medium term employment is expected to grow at 0.8% on average per annum (up to 2016), a much lower rate than in the years before the recession. At sub-regional level, employment growth in 2011 is expected to be driven by growth in Buckinghamshire, East Sussex and Surrey. However, whilst overall employment in the South East as a whole is expected to shrink in 2010, a few counties are forecast to experience slight growth this year, according to Experian (Figure 4.35).

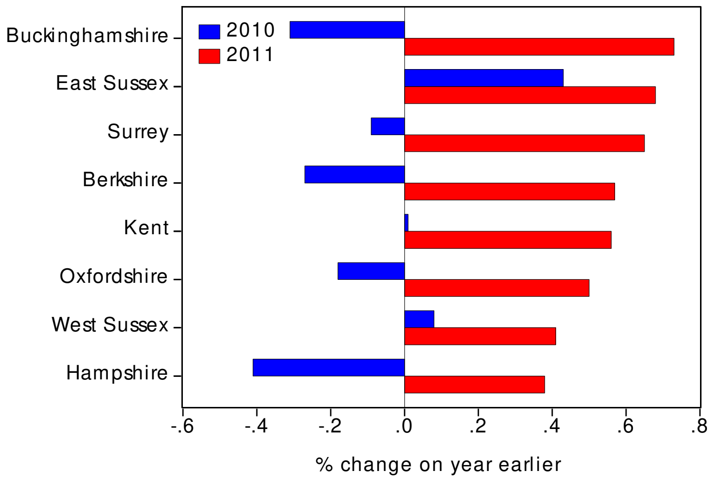
[26] Though note that the anticipated cuts in public spending could have a significant impact on employment in the public sector, making these forecasts perhaps overly optimistic.

Figure 4.34: Regional employment growth: forecast 2009 and 2010



Source: Experian Autumn 2009

Figure 4.35: Sub-regional employment growth: forecast 2009 and 2010



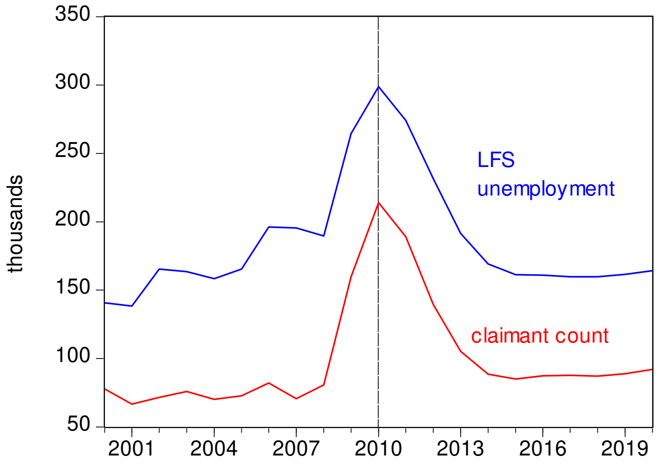
Source: Experian Autumn 2009

Unemployment in the South East is expected to reach its peak in 2010. Experian's forecasts suggest that unemployment in the South East will peak in 2010. However, unemployment is unlikely to fall back to the levels seen in the early years of this century, when fewer than 80,000 people were claiming Jobseekers' Allowance at any one time and the Government's preferred survey-based measure of unemployment rarely exceeded 160,000 (Figure 4.36). For comparison, the claimant count in the South East currently stands at almost 160,000 in 2009, while the survey-based measure of unemployment (LFS unemployment) has reached 265,000, according to Experian.

There are a number of reasons why unemployment will not fall back to its pre-recession levels. The early part of the 21st century was an exceptional time, with strong support for job creation in both the public and private sectors, helped by unusually strong economic growth. Following the current recession there are likely to be fewer opportunities for job creation, as staff cuts in the public sector are implemented and restructuring in industries like financial services means that fewer new jobs will be available than in the pre-recession years. Moreover, the population of the South East is projected to continue growing strongly, and at a faster rate than the UK average. This means that employment growth may not always keep pace with the rise in population, which suggests that a growing number of people will register as unemployed in future years.

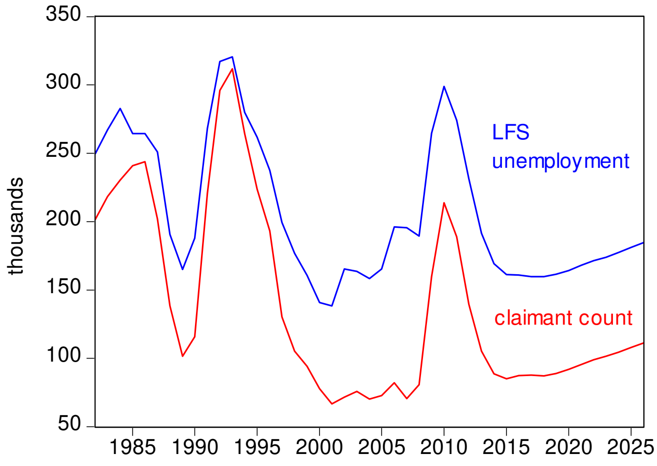
However, it is important to put these trends in a longer-term perspective. While unemployment may not reach the lows seen in the early years of the 21st century again, Experian forecasts suggest that it will fall back to the levels seen after the previous recessions of the early 1980s and early 1990s (Figure 4.37).

Figure 4.36: Unemployment forecast, South East



Source: Experian Autumn 2009

Figure 4.37: Unemployment: long-term trend and forecast



Source: Experian Autumn 2009

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5. Conclusion

The UK pulled out of recession in the final quarter of 2009, and business optimism has improved a great deal over the last two quarters. In the South East, business activity has now increased for six consecutive months, most recently at its fastest pace for two years. This was underlined by an equally strong increase in new business to South East companies, which started to increase in July 2009.

However, there is some strong evidence to suggest that firms will remain cautious in the months to come, holding back on any major decisions. In reality this means that business investment will remain at relatively low levels, as companies wait and see how the general economy fares and with this their prospects for new business commissions. In the same way there is good reason to expect low recruitment activity; indeed it is likely that employment will decline further in 2010, though at a much slower rate than during the recession.

Consumer confidence too has improved to some extent, and consumers are generally more optimistic about their economic situation in the next 12 months than they were just 6 months ago. However, consumers are likely to refrain from making major purchases as long as job uncertainties remain and household income growth remains sluggish (or even declines as a result of reduced working hours). However, this cautiousness might ease slightly during 2010 once redundancies slow, if income begins to rise again, and the housing market shows further improvement.

Nonetheless, the South East is well positioned to rebound and if fears of a "double dip" recession prove unfounded, we are likely to observe the South East region once again as one of the leading UK regional economies.

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