

Quarterly Economic Survey

Leeds, York and North Yorkshire

Quarter 2 2011



Foreward

We are pleased to be working again with the Leeds, York and North Yorkshire Chamber of Commerce to provide data on the state of the Yorkshire economy. The response rate to the survey has improved significantly this quarter giving us the largest and most representative portrait of the regional economy. So a big thank you to all the people and firms that participated in the survey.

Turning to this quarters' results, overall, the largest body of evidence indicates most firms' performance has plateaued over the last three months. There are some 'pockets' of growth, especially in the manufacturing sector. However, some firms are still experiencing declining sales, although this would seem to be less than in previous surveys. At one level the evidence points to most firms having reached some level of stability, albeit one that is far from optimum.

Another interpretation is that the local economy is at a turning point, where the future direction is far from certain. For firms to expand, market conditions need to improve. Without this there is a danger that the current lull could persist longer-term.

- Dr. Andrew Robinson, Leeds University Business School

Methodology

The fieldwork and analysis of this special report is the product of a new partnership between the Leeds, York and North Yorkshire Chamber of Commerce and researchers at Leeds University Business School. The Quarterly Economic Survey fieldwork was conducted via email and telephone. There were 857 respondents of either business owner/senior manager status.

Balance figures, referred to throughout this report, are determined by subtracting the percentage of companies reporting decreases in a factor from the percentage of companies reporting increases.



Results Summary

Fragility of the UK market persists into the second quarter of 2011

- Across the manufacturing and service sectors, UK sales and orders have fluctuated over the past year as periods of growth are followed by decline, and vice-versa.
- Compared to Q1 2011 results, there has been a slight decline in the service sector's sales (-4%) and advanced orders (-4%) and manufacturing's advanced orders (-1%). The 17% increase in manufacturing sales partially reverses the 21% decrease reported in Q1.
- The results show that manufacturers are doing better than services and future sales suggest that this may continue and possibly widen.

Overseas markets continue to present opportunities for exporting businesses

- Although manufacturing exports fell slightly on Q1 they still remain strong, with 52% seeing an increase in sales over the last three months
- Manufacturers are more likely to export than services - 57% compared to 23% - and this quarter's results suggest that the majority of the sector's growth is coming from international trade.
- Exporters within the service sector are also reporting healthy sales and orders and the international market is treating service providers more favourably than the UK market. There has been an improvement on Q1 and 36% are experiencing an increase in international sales.
- Exporters are performing better in the UK market than their non-exporting counterparts

Business Confidence Remains High Despite Weak Domestic Market

- The majority of service providers and manufacturers believe that their turnover (58% and 70%) and profitability (59% and 54%) will improve over the next 12 months.
- Manufacturers are more optimistic than service providers, which is reflective of their stronger performance in both the UK and international markets.
- Manufacturing's increase in profit expectations may be also associated with a reduction in cost pressures as 10% fewer businesses are concerned about inflation than in Q1.

Manufacturers lead way in job creation, but experience recruitment difficulties

- Service sector job creation remains weak with only one in five businesses increasing the size of their workforce, compared to one third of manufacturers. Overall, the majority of businesses are maintaining their current levels of employment.
- There is a strong association between improved performance and job creation in the manufacturing sector as half of those experiencing an increase in sales have also increased their workforce, compared to 37% of service providers.
- There is a clear skills gap in the manufacturing sector as almost half of recruiting businesses report difficulties in finding suitable staff, particularly skilled and technical workers (69%). This problem is also evident amongst service providers although to a lesser degree.

Service Sector Struggle is Evident as Two-Thirds Operate below Full Capacity

- With 55% of manufacturers and 65% of services operating below capacity, it raises the possibility that any growth may not lead to greater employment.
- Cash flow has improved on Q1 2011; however, it is still an issue as more businesses are experiencing a decrease rather than an increase and it is hitting smaller firms the hardest.
- Investment plans across both sectors have largely remained constant.

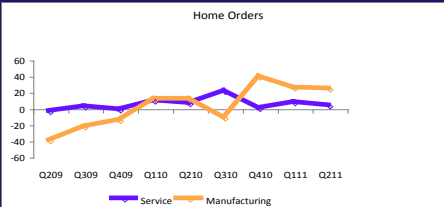
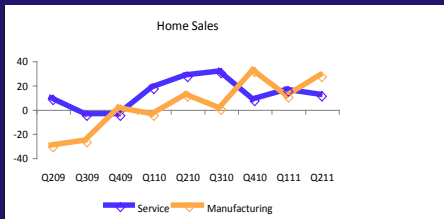


UK Market

Q | Over the past three months in your UK market...

Sales have: *Increased / Remained Constant / Decreased*

Orders & Advance Bookings have: *Increased / Remained Constant / Decreased*



The modal response for manufacturing sector domestic sales and orders is 'increased', at 43% and 42%, respectively. Only one in five manufacturers say that domestic orders have decreased and slightly less report a decrease in domestic sales.

There is an overall net increase of +27% for domestic sales, which is up +17% on the previous quarter and partially reverses the -21% decline in Q1. The net balance for domestic orders is +24% which is down -1% on Q1 2011, making it the second consecutive quarter of decline after six previous quarters of growth.

The modal response for the service sector for both domestic sales and orders is 'remained constant', at 38% and 36% respectively. The number of service providers reporting an increase in UK sales is 9% lower compared to manufacturers, the gap between the sectors widens to -17% for increases to UK orders.

The net balance for both domestic sales and orders fell 4% on the previous quarter, after having increased by 7% and 8% in Q1.

The fragility of the domestic market persists into the second quarter of 2011. Across both the manufacturing and service sector, UK sales and orders have fluctuated over the past year as periods of growth are followed by decline, and vice-versa – supporting the notion that the economic recovery is 'consistently choppy'. This volatility is not exclusive to Leeds, York and North Yorkshire as there is a similar erratic trend in the national QES results leading up to the last quarter.

Despite these fluctuations, the net balances for both sectors remain in positive territory and the majority of businesses are experiencing either an increase or constant level of sales. This is an encouraging indication that the market is improving; however, the weak advance custom reported by the service sector is of concern.

The results show that manufacturers are doing better than services and future sales suggest that this trend will continue and possibly widen. Year on year, manufacturers have seen an increase in UK sales and orders, which is in contrast to the annual decline reported by the service sector.

The fragility of the UK market appears to be hitting micro-business and sole traders the hardest with just over one quarter experiencing an increase in advance orders. For the second consecutive quarter, this category has the largest decrease in both UK sales and orders compared to other size businesses. Interestingly, none of the large businesses that were surveyed have reported a decrease in UK orders.

Overseas Markets

In contrast to fragile UK market, the international market continues to present exporters with opportunities for growth – particularly those in the manufacturing sector. The manufacturing sector is more likely to export than service - 57% compared to 23% - and this quarter's results suggest that the majority of the sector's growth is coming from international trade. However, it does appear that the robust growth experienced by the sector in previous quarters is beginning to slow, and the fall in advanced orders suggests that this may continue into the third quarter of 2011.



Overseas Markets

Q | Over the past three months in your overseas market...

Sales have: *Increased / Remained Constant / Decreased*

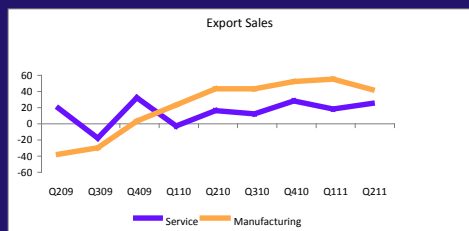
Orders & Advance Bookings have: *Increased / Remained Constant / Decreased*

After two consecutive periods of growth, the manufacturing sector's net balances for overseas sales and orders have fallen by -13% and -16%, respectively.

Over half of exporting manufacturers are experiencing an increase in overseas sales and orders, and only 13% report a decrease.

Service exporters have seen some improvements in overseas trade on the previous quarter. The 7% increase in overseas sales partially reverses the decline experienced in Q1 and the 4% increase in advance orders is the second consecutive quarter of growth.

In both overseas sales and orders, the modal response for service exporters is 'remained constant' (50%). 36% are experiencing an increase in international sales and 34% report an increase in advanced orders, which is 16% and 20% lower than the balances reported by manufacturers.



Service exporters are also reporting healthy sales and orders and the international market is treating the sector more favourably than the UK market. The increase in advanced orders suggests that this growth will continue in to the next quarter, although the differential performance between services and manufacturers is expected to continue in the near future.

Small and large-sized exporters are experiencing a more stable performance than medium and micro-sized exporters in both overseas sales and orders. Interestingly, businesses which sell to the overseas markets are experiencing better UK sales than their non-exporting counterparts. Amongst exporters, the modal response for both UK sales and orders is increased, however, amongst non-exporters, the modal response is 'remained constant'.

Employment

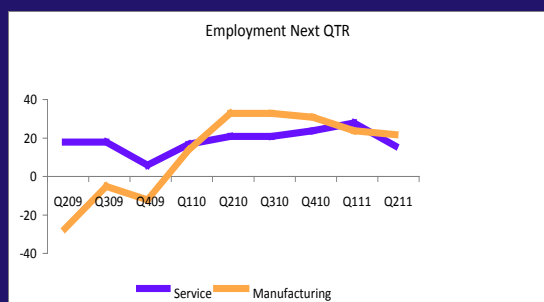
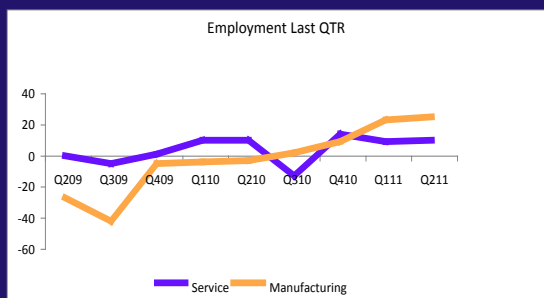
Employment levels for both sectors remain fairly flat with the majority of firms maintaining their current levels of employment. However, some job creation is taking place which is primarily being led by the manufacturing sector.

It is encouraging that both sectors remaining in positive balances as it signifies a net increase in overall employment in Leeds, York and North Yorkshire; however, there is evidence that a small minority of firms are still making redundancies or not recruiting replacements for staff that leave.

The fact that manufacturers are reporting better employment results than services could be attributed to the sector's stronger performance in the UK and international markets, which is now translating into new jobs. There is a strong association between improved performance and job creation in the manufacturing sector as half of those experiencing an increase in sales have also expanded their workforce, compared to 37% of service providers.



Employment



Q | Over the past three months has your workforce: *Increased / Remained Constant / Decreased*

Over the next three months will your workforce: *Increase / Remained Constant / Decrease*

Have you experienced any difficulties recruiting staff? *Yes/No*

Which of the following categories of staff did you have difficulties recruiting? *Skilled Manual or technical/ Professional or Managerial/ Clerical/ Semi-Skilled or Unskilled*

In Q2 2011, manufacturers report a 2% increase in their employment balance for the last quarter; however, there is a 2% decrease in their employment expectations for Q3 2011.

The modal response for the sector for both 'last quarter's' and 'next quarter's' employment is 'remained constant' and approximately three times as many employers expect their workforce to increase as opposed to decrease. Of the manufacturers that have attempted to recruit over the past 3 months, 45% had difficulties recruiting staff and over two-thirds of those respondents said that these were experienced when trying to hire skilled-manual and technical staff.

In the service sector the employment balance for last quarter increased marginally from +7% to +8%; this is in sharp contrast to employment expectations, which is fall of -1.2% on the previous quarter.

Like manufacturers, the modal response for the service sector is 'remained constant' for both 'last quarter's' and 'next quarter's' employment; however, less service providers are seeing an increase in their workforce than manufacturers. For 'last quarter's' employment there is a 14% difference between the two sectors and for 'next quarter's' there is a 7% difference.

Of the service providers that have attempted to recruit staff over the past three months, 40% experienced difficulties recruiting staff. 45% of these difficulties were when trying to hire professional or managerial staff and 38% were for skilled manual and technical staff.

Whilst manufacturers are leading most of the job creation, there is evidence that the pace of this growth could be beginning to slow, as employment expectations for next quarter are weaker than in Q1 and the balances for home and overseas trade have fluctuated over the past two quarters.

In terms of business size, small and medium sized companies are reporting the highest percentage of job creation, 35% and 33% for last quarter and 28% and 34% for next quarter. Micro-businesses report the lowest percentage of workforce increases, which is understandable considering the significance of a new recruit to a business with ten or less employees. However, it is also the most stable group with 78% saying that their workforce remained constant over the last quarter compared to 50% of small businesses, 45% of medium businesses and 48% of large firms.

There is a clear skills gap in the manufacturing sector as almost half of recruiting businesses report difficulties in finding suitable staff, particularly skilled and technical workers. This problem is also evident amongst service providers although to a lesser degree.



Confidence

Q | Do you believe over the next 12 months...

Turnover Will: Improve / Remain Constant / Worsen

Profitability Will: Improve/ Remain Constant / Worsen

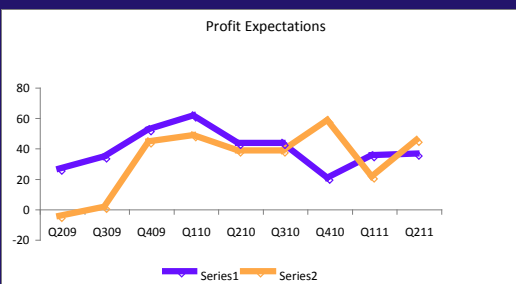
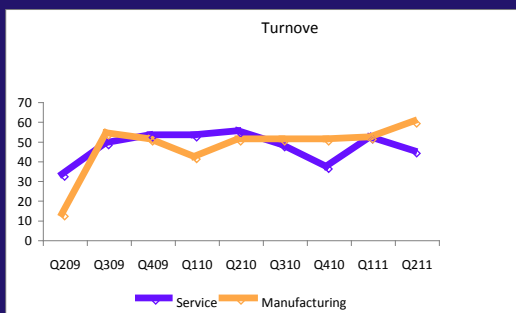
Is your business currently under pressure to raise its prices

from any of the following: Pay Settlements/ Raw Material Prices/

Finance Costs/ Other Overheads

Please indicate which of the following factors are more of a concern to your business than three months ago: Interest Rates/

Exchange Rates/ Business Rates/ Inflation/ Competition/ Taxation



Manufacturers' turnover expectations have increased from +51% to +59% in Q2 and their profit expectations have increased from +20% to +44%. The majority of the sector believes that their turnover and profit expectations will improve over the next 12 months – 70% and 59%.

The majority of manufacturers expect their prices to remain constant over the next three months, while 37% will see the cost of their product increase. 89% of businesses are under pressure to raise prices due to the rising cost of raw materials and inflation is more of a concern to 55% of businesses than it was three months ago.

In the service sector, turnover expectations have fallen 7% to +41% and profit expectations have increased 1% to 35%. The majority of businesses are confident that their turnover and profit expectations will improve over the next 12 months – 58% and 54%.

22% of service providers expect their prices to increase over the next 3 months compared to 71% who say that they will remain constant. 61% say that overheads (such as fuel, rent and utilities) are the biggest price pressure and competition is the biggest concern for over half of service providers.

Despite the fragility of the markets, business confidence remains high. Manufacturers are more optimistic than service providers, which is reflective of their stronger performance in both domestic and overseas markets. However, the decline in advanced orders for both the UK and international markets suggests that this level confidence may not continue into the next quarter. The sector's sharp increase in profit expectations may also be partially associated with the reduction in cost pressures, as fewer businesses see inflation as a concern compared to Q1.

Manufacturer's turnover expectations have remained fairly constant since Q2 2010 up until this quarter's rise. In contrast, their profit expectations have fluctuated significantly which could be attributed to cost pressures as the sharp fall in Q1 2011 correlates with the rise in CPI inflation to above 4%. Service sector confidence has been unstable since Q2 2010 and reached its annual nadir in Q4 2010, after the Government announced its Comprehensive Spending Review.

As expected, there is a clear correlation between increased sales and improved confidence in turnover, however, around a third of respondents experiencing a decline in sales expect their turnover improve in the future. Whilst this could suggest that businesses are confident about future opportunities and their markets, it also raises doubt over whether these expectations are realistic, particularly considering the weak advanced orders reported in the UK market.



Investment, Capacity & Cashflow

Q | Over the past three months what changes have you made to your investment plans for...

Plant/Machinery/Equipment: *Increased/ Remained Constant / Decreased*

Training: *Increased/ Remained Constant / Decreased*

During the past three months has your cash flow:

Increased/ Remained Constant/Decreased

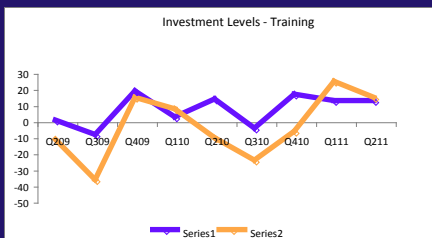
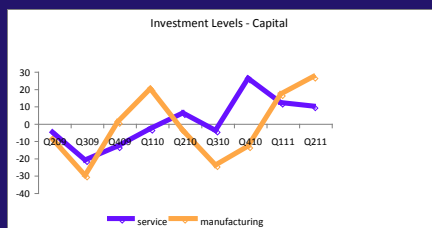
Are you currently operating at: *Full Capacity/Below Capacity*

Manufacturers report a 10% increase in the net balance for investment in plants, machinery and equipment, but a 10% fall in the net balance for investment in training. The modal response for both types of investment is remained constant – 52% and 65%.

Over half of the sector is operating below full capacity and 28% report a decrease in cash flow compared to 25% reporting an increase.

Investment in training by service providers remains unchanged on the previous quarter and there has been a slight decline (2%) in investment in plants, machinery and equipment.

65% of the service sector is operating at below full capacity and 29% report a decrease in cash flow compared to 26% reporting an increase.



The opportunities in overseas markets are also translating into improved business confidence, as turnover and profitability expectations amongst exporters is 11% higher than businesses that do not trade internationally.

Medium-sized companies have the lowest percentage (56%) predicting turnover increase; however, it also reports the highest percentage (60%) expecting profitability to improve. Large companies have the lowest percentage predicting a decline in turnover and profitability - 6% for both balances.

Investment Capacity & Cashflow

Investment plans across both sectors have largely remained constant; however, it is encouraging that there is a net increase in both balances after they sunk into negative territory for much of 2010. There are signs that improved confidence is resulting in more businesses investing in their future as those businesses reporting an increase in profitability are over twice more likely to invest than those expecting their profit to remain constant or decrease.

Although cash flow situations have improved since Q1, it is still an issue as more businesses are experiencing a decrease than an increase and it is hitting the smaller firms the hardest.

Both sectors are experiencing near identical results, showing that the differences in sales and exports are not reflected in cash flow and the results show that 22% of manufacturers with increased sales are experiencing a decrease in cash flow. Cash flow is significantly stronger amongst businesses that trade internationally as 31% of exporters are experiencing an increase compared to 24% of non-exporters.

With the majority of businesses -Training operating at below capacity it raises the possibility that any growth may not lead to greater employment. The results show only 16% of businesses below capacity are planning to increase their workforce and 15% are planning to decrease it, this is compared to the 34% of businesses above capacity that are planning to increase their workforce and the 9% planning to decrease it. The struggle within the service sector is clearly evident as two-thirds are operating below capacity compared to 52% of manufacturers.





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