

3RD QUARTER 2011



The DHL / British Chambers of Commerce
TRADE CONFIDENCE INDEX



British
Chambers of
Commerce



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FOREWORD



John Longworth
Director General
British Chambers of
Commerce

The third quarter of 2011 laid bare the issues that still need to be addressed in order to truly build a sustainable recovery. Persistent economic problems in the United States and the Eurozone contributed to a sense that policymakers had still not got to grips with the hangover from the credit crunch. As a result, the wheels of the global economy have been turning that bit slower, impacting upon the UK's exporting community.

The results of the DHL/BCC Q3 2011 Trade Confidence Index indicate that order books have weakened, confidence in increasing turnover has softened and exporters' desire to expand workforces is muted. Nevertheless, the positive message is that the results do still indicate export growth, albeit at a slower pace than earlier in 2011.

The results are released just a few weeks before the Chancellor gives his Autumn Statement. This is the perfect opportunity to send the message that Government policy will match its rhetoric on helping exporters. This can be achieved by restoring the UK Trade and Investment budget to

2010/11 levels in 2012/13, supporting SME trade show attendance and making the Overseas Market Introduction Service free in 2012/13. So as not to undermine the deficit reduction plan, this can be paid for by a re-allocation of resources within the existing spending envelope.



Phil Couchman
CEO
DHL Express UK & Ireland

The results of the second DHL/BCC 2011 Trade Confidence Index highlight that exporters in the UK have been hit hard by international and domestic headwinds.

UK businesses are operating in a muted market where inflation has surged to above 5%, putting further pressure on consumers' tightening budgets. Elsewhere in the Eurozone, confidence in the sustainability of foreign debts and prevention of the financial crisis spreading to larger economies is still fuelling uncertainty.

However, despite this restrained setting, the DHL/BCC Trade Confidence Index shows there are clearly still opportunities for British businesses to expand into overseas markets. Although overall orders have slightly weakened and businesses' confidence has lessened, export figures show that activity was at its third highest level on record in Q3 2011, a fundamentally positive indicator.

We cannot underestimate the challenges ahead for exporters, particularly in the face of the serious problems facing the Eurozone, which remains a major trading partner for small businesses in the UK. Developing an exporting plan takes time: market research, financing, cultural understanding and local insight are just some of the aspects which need to be considered; which is why those businesses looking to expand globally require essential support.

Steps must be taken to support exporters, particularly SMEs, who are less able to ride the trends of the economic cycle than their larger counterparts. The government has already pledged to help this community with new export finance products, targeted support, and an enhanced role for British embassies to promote trade, but we all need to help.

Now is the time for businesses to expand into international markets. With our collective support we can help SMEs exploit the global opportunities open to them, and in turn rebalance the country's economy.



INTRODUCTION

The DHL/BCC Trade Confidence Index (TCI) is a measure of the UK's exporting health. By analysing trends in trading activity and key factors of exporting firms' performance, the TCI gives a truly comprehensive picture of the UK's internationally trading business community. The index casts new light on exporters' levels of confidence and employment intentions, and paints a picture of regional exporting performance.

Those wishing to obtain more information on the index's methodology and data sources are invited to contact the British Chambers of Commerce.

Written and researched by:

Steve Hughes, Economic Adviser

Acknowledgements:

Sarah Jarvis, design and layout

The British Chambers of Commerce

65 Petty France
St. James's Park
London
SW1H 9EU
Tel: 020 7654 5800
Fax: 020 7654 5819
Email: info@britishchambers.org.uk

www.britishchambers.org.uk

METHODOLOGY

The TCI generates its results from two data sources:

- Questionnaire responses submitted by 1,022 exporters, derived from the BCC's Quarterly Economic Survey (QES). The QES is the largest most representative business survey of its kind.
- Data generated from exporting activity that requires supporting documentation.

THE SURVEY

Fieldwork for the survey was conducted between 29 August and 21 September 2011. Results are split into the following firm size categories:

- 0-9 employees (micro firms)
- 10-49 employees (small firms)
- 50-249 employees (medium firms)
- 250+ employees (large firms)

Unless otherwise stated, results refer to all exporters responding to the survey. Where results are split between the service and manufacturing sectors, this is stated clearly in the text. Results that are not split by firm size are weighted by the contribution of firm size to total exporting turnover.

Results are represented by either a balance figure or a pure percentage figure. Balance figures are determined by subtracting the percentage of companies reporting decreases in a factor from the percentage of companies reporting increases. Where a balance figure is positive it represents growth; where it is negative, it represents contraction.

EXPORT DOCUMENTATION DATA

Many types of exports require supporting and commercial documentation to ensure the timely delivery of goods and timely payment. Chambers of Commerce administer this documentation, and have amassed a significant dataset around UK goods exports as a result.

The TCI uses data collected from this process to show both an index of documentation and regional comparisons of exporting activity.



- **Weaker economic outlook impacts on order books and exporters’ desire to increase the size of their workforce.**
- **There are tentative signs that inflationary pressures are easing, with capacity utilisation dropping, and the cost of raw materials less of a concern. Despite this, pressures to raise prices are still strong.**

The third quarter of 2011 saw increased risks facing the global economy. Problems in the eurozone escalated, as no convincing plan emerged to deal with the debt crisis, and weak data from the US increased fears about the strength of economic recovery. As a result, the three months to October saw the US credit rating downgraded, President Obama launching a job creation scheme and Ben Bernanke, the Chairman of the Federal Reserve, outlining the so-called “Operation Twist” as a new stimulus measure.

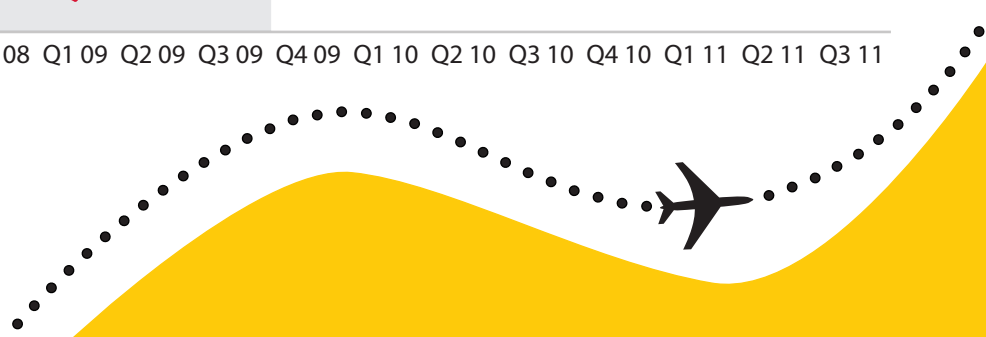
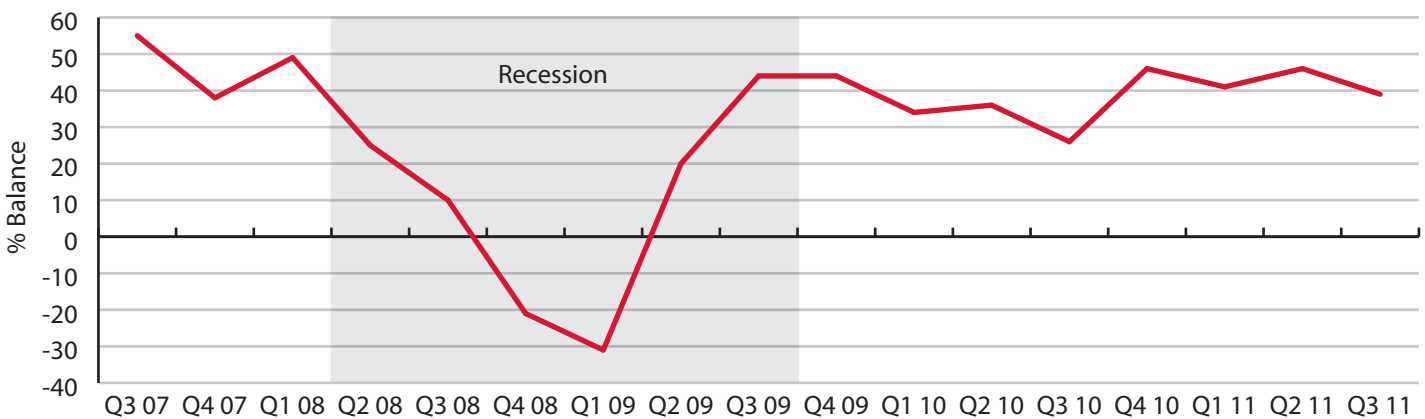
Stark reminders that the fall-out from the credit crunch is nowhere near a conclusion were extremely visible in Q3, as both the Chancellor of the Exchequer and Prime Minister openly told the eurozone economies get their house in order, and skirmishes broke out about UK financial sector reform following the final report from the Independent Commission on Banking.

These kinds of headlines translate to the real economy, and the Q3 DHL/BCC Trade Confidence Index shows that the economic outlook is more uncertain, affecting order books and attitudes to recruitment along the way. Figure One exemplifies this, showing that confidence in increasing turnover has dropped below 40 for the first time since Q3 2010. In addition, high costs are still squeezing exporters, but there are some signs that these may be easing, which should provide a little comfort for the embattled business community.

Nevertheless, the results do point towards export growth, which is a fundamentally positive indication. That is not to say that Government cannot do anything further. The Chancellor has his Autumn Statement approaching, and this can be used for:

- **Committing to restoring UK Trade and Investment’s budget to 2010 levels in financial year 2012/13, by reallocating spending within the existing Government envelope.**
- **Supporting SME trade show attendance by matching the world’s best support schemes.**
- **Making the Overseas Marketing Introduction Service reports (and other charged for UKTI service) free for SMEs through 2012/13.**

Figure One: Confidence in improving turnover in the next 12 months



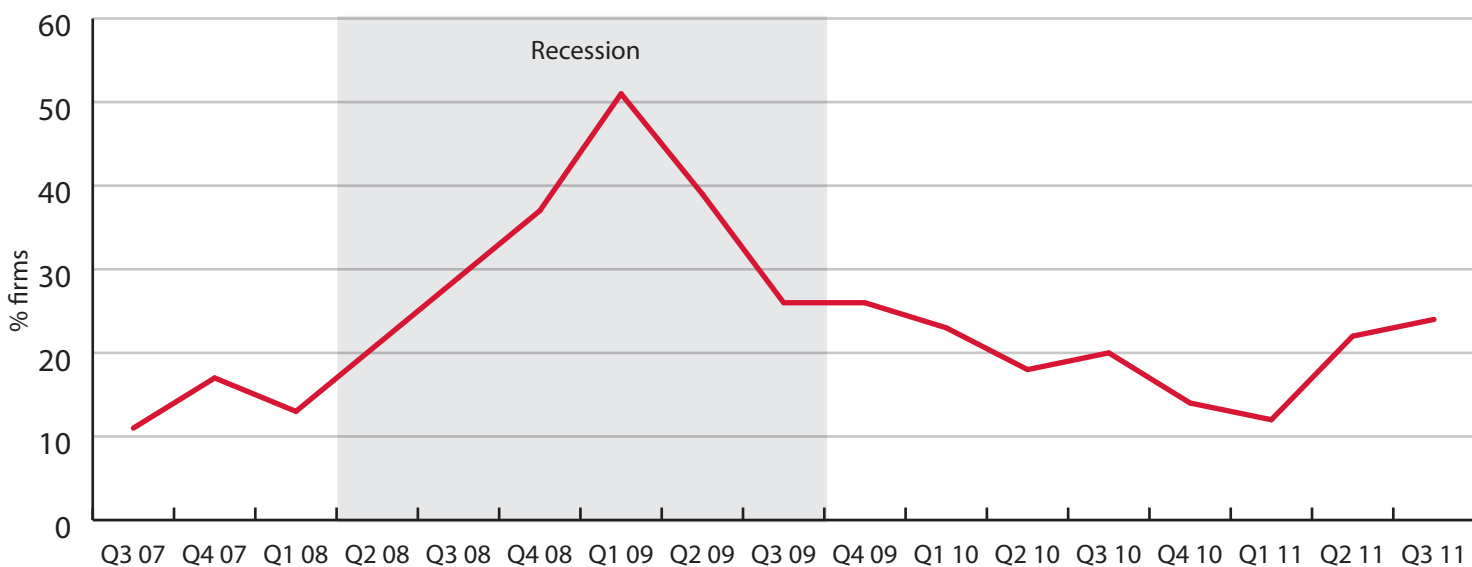
- Exporters' order books weaken in Q3 2011, but results still point to growth.
- However, weaker economic outlook dents workforce growth.
- Expectations to raise prices fall for manufacturing, but grow for services firms.

DOMESTIC, EXPORT AND EMPLOYMENT

Results in three key areas – domestic markets, export markets, and employment – indicate growth. However, the pace of growth has slowed since Q2, providing a warning that the encouraging export activity witnessed throughout 2010 may be running out of steam.

Figure Two shows that the proportion of firms reporting a decrease in export orders has increased to 24% in Q3 2011, the highest level since Q4 2009. This is up from 22% in the Q2 2011, and up from 12% in the first quarter of the year. The proportion of firms stating that their export orders had increased was at its joint lowest level since Q3 2009, at 35%.

Figure Two: % of firms reporting a decrease in export orders



Not one of the survey balance indicators for overseas, domestic and employment activity has strengthened on the quarter. The domestic sales balance fell from +15% to +14%, with the domestic orders balance falling from +14% to +9%. The export sales balance was unchanged from Q2, and the export orders balance fell from +13% to +11%. The balance representing employment over the last three months fell from +15% to +7%, and the balance representing the expectations of exporters increasing their workforce balance fell from +9% to +6%.



Breaking down the employment expectations balance into percentage figures gives an insight into exporters' perception of short term trading conditions:

- 25%** of exporters expect to increase their workforce over the next three months, unchanged from the last quarter
- 56%** of exporters expected their workforce to remain the same over the next three months
- 19%** of exporters expect to decrease their workforce over the next three months, the highest figure since the third quarter of 2010

In other words, the entire deterioration in the results from Q2 2011 to Q3 2011 is down to a shift from the category of respondents that expected their workforce to remain the same to those that expected it to deteriorate.

PRICES

When both the services sector and manufacturing results are aggregated together, the balance representing pressure to increase prices has increased on the quarter, from +25% to +30%. When the results are split, a different picture emerges. In the manufacturing sector, the prices balance fell from +49% to +41%; in the services sector it increased from +11% in Q2 to +25% in Q3 (although, the Q2 result was preceded by two consecutive quarters of balances above thirty). Figure Three shows the relationship between the two sectors over time.

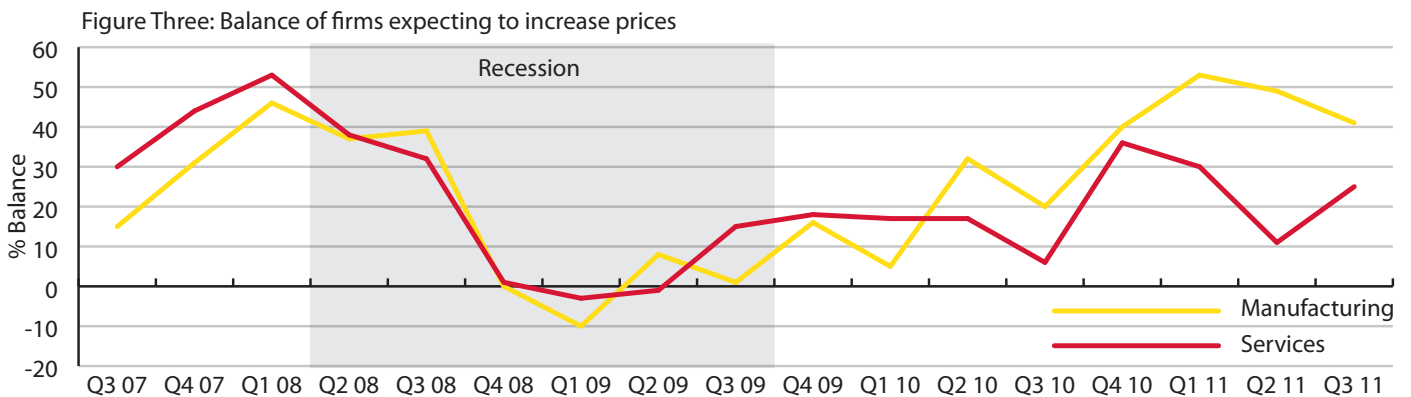
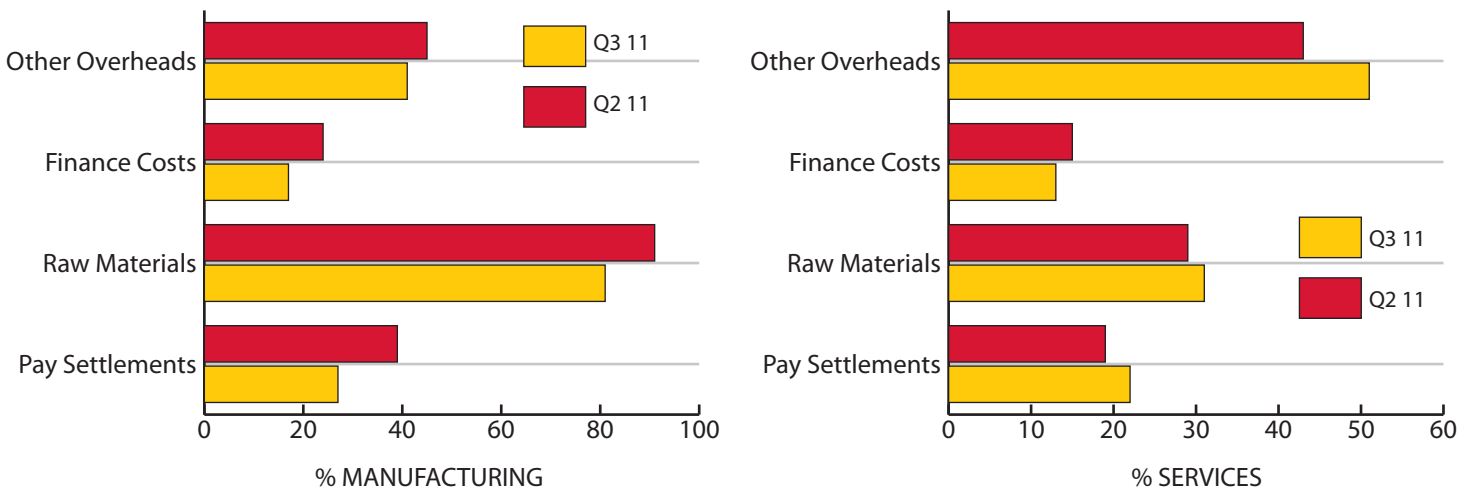


Figure Four shows the factors that exporters report are adding to pressure to raise prices. Raw materials costs still dominate for the manufacturing industry, with 81% of firms stating price pressures arising. While this is a fall from the second quarter, this indicator has now been above 80% for the last four quarters.

The proportion of firms responding to each price pressures factor fell for all four categories in the manufacturing sector. By way of contrast, only the “Finance Costs” category saw a fall in the services sector, from 15% to 13%. This is the lowest recorded result in the time series (since Q3 2007), and is the third quarter in a row that it has declined. It is difficult to establish what this means – one interpretation may be that as demand slows, investment is deferred and finance is not needed (hence making the cost of finance less of a problem); another interpretation could be that credit conditions are steadily easing.

Another point worth noting is that the “Other Overheads” category is prominent for both sectors (and is the most pressing concern for services firms). These overheads could include many things, but anecdotal evidence points clearly to the cost of utilities adding to pressure to firms’ cashflow.

Figure Four: Factors adding to pressure to raise prices



➔ All firm sizes recorded weaker export orders results than export sales results, suggesting a slowing of export growth towards the end of the year.

EXPORT SALES AND ORDERS

On both the export sales and export orders measures the smallest firms have recorded weaker absolute balances than larger firms. Table One shows a comparison of the results quarter-on-quarter for the four different firm size categories. That there are no negatives in the Q3 sales or orders

EMPLOYEE SIZE	EXPORT SALES		EXPORT ORDERS	
	2011 Q2	2011 Q3	2011 Q2	2011 Q3
0-9	+10%	+9%	+5%	+3%
10-49	+18%	+9%	+14%	0%
50-249	+26%	+17%	+22%	+9%
250+	+12%	+20%	+13%	+18%

Table One: Export sales and orders by size of firm

balances, supports the expectation of export growth. For every firm size category the orders balance is weaker in absolute terms than the sales balance, suggesting a weaker outlook for exports as the year reaches its end.

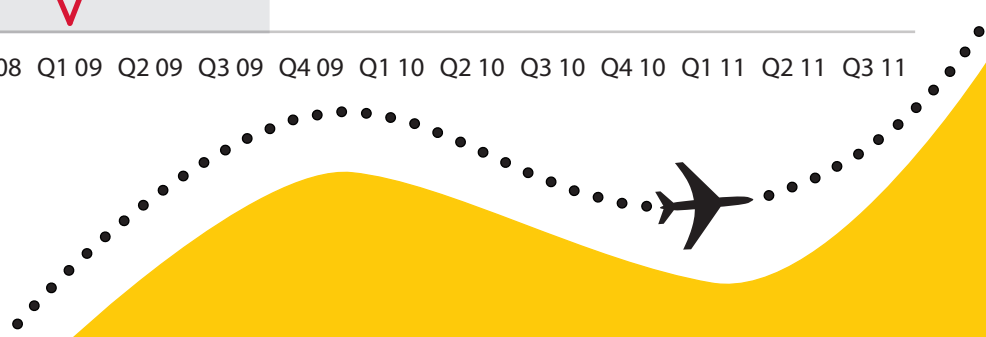
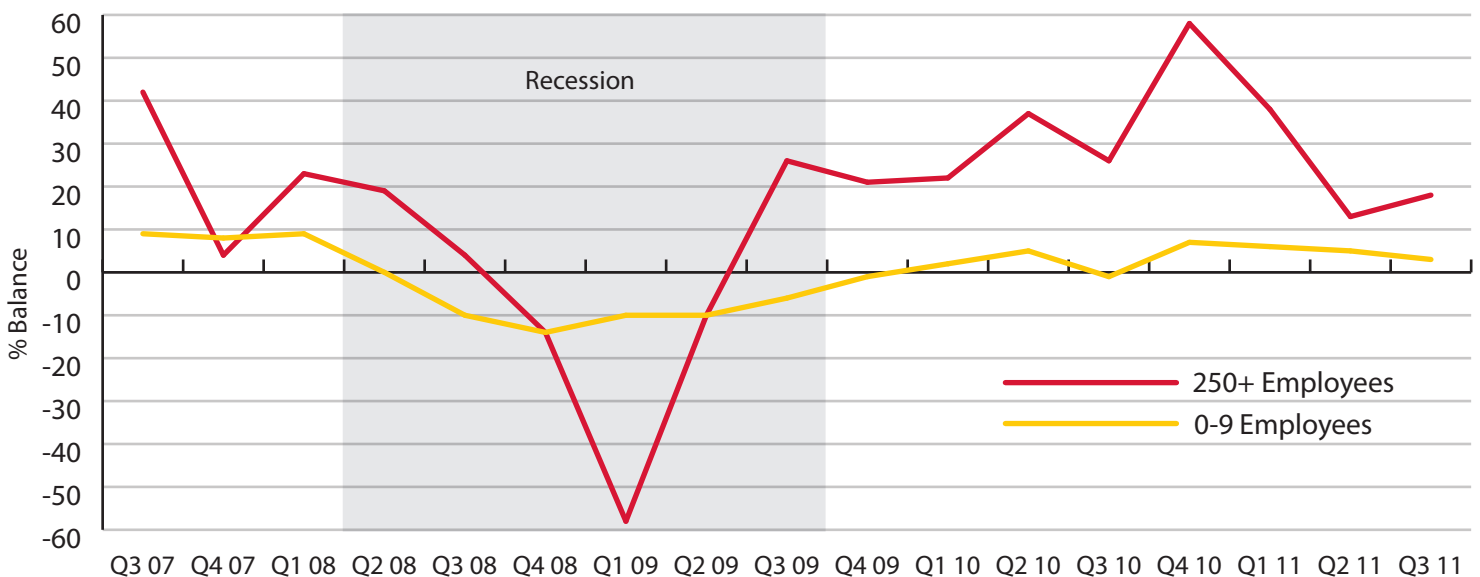
Firms with a smaller number of employees have seen a much tighter range of results over the time series than larger firms have. Table Two shows the maximum and minimum results returned over the history of the data for each of the firm size categories.

Figure Five shows the difference over time of the relative performances of the firms employing smaller numbers and those employing larger numbers. Larger exporting firms appear to ride the trends of the economic cycle with greater amplitude than their smaller counterparts.

EMPLOYEE SIZE	MINIMUM BALANCE	MAXIMUM BALANCE	RANGE
0-9	-14%	+9%	23 points
10-49	-23%	+18%	41 points
50-249	-27%	+31%	58 points
250+	-58%	+58%	116 points

Table Two: Minimum, maximum and range of orders balances by firm size

Figure Five: Balance for export orders by firm size



An explanation of documentation data can be found in the report methodology.

- Documentation numbers rise both on the quarter and on the year, indicating increased export activity.
- All regions show improvement on at least one measure of documentation growth.

NATIONAL DOCUMENTATION VOLUMES

The level of export documentation in Q3 was 3.33% higher than in the same quarter a year earlier, and was 2.98% up on the second quarter of 2011. That documentation continued to grow supports the view that export growth continued in the third quarter of the year. Indeed, in absolute numbers, the volume of export documents was the third highest on record, behind Q1 2011 and Q3 2008.

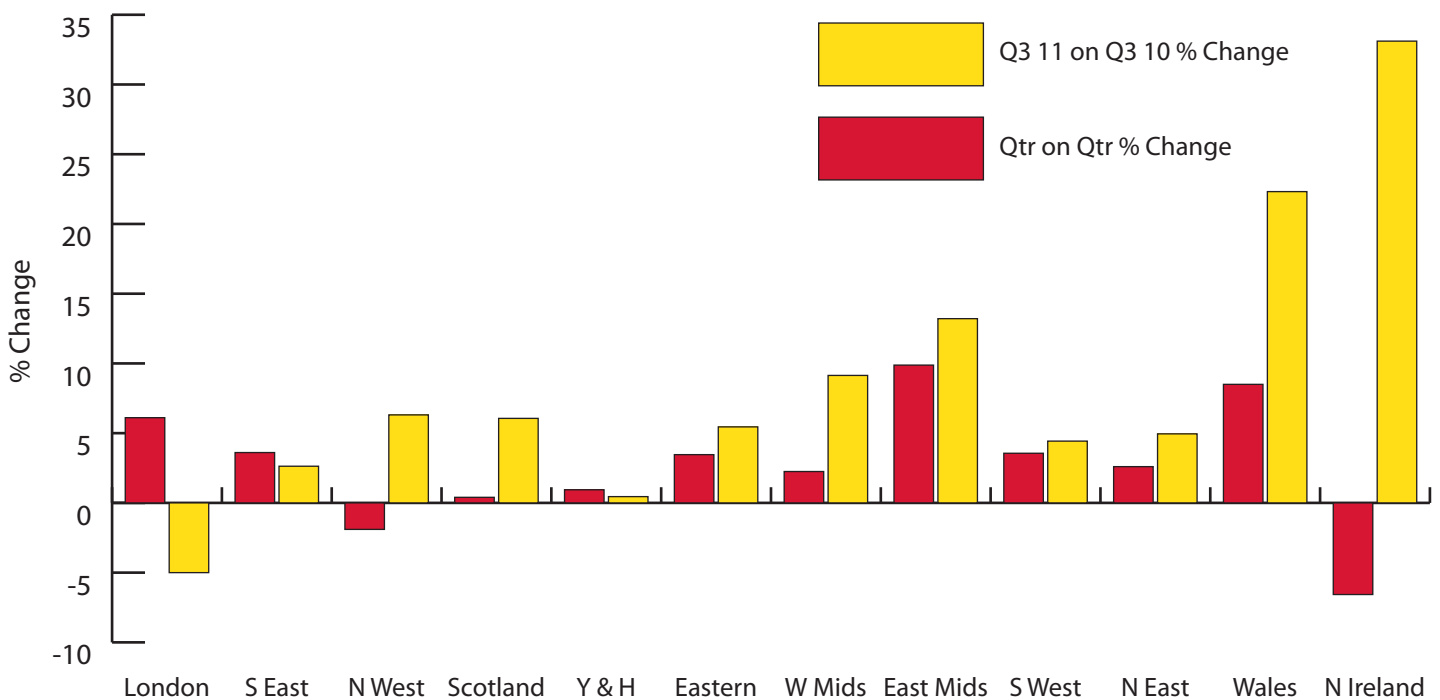
INDEX OF DOCUMENTATION

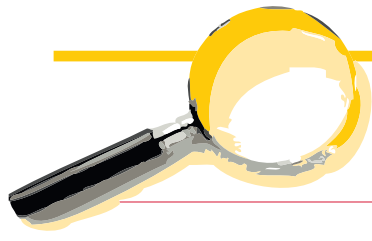
	PERCENTAGE CHANGE		
	Index number 2007 = 100	Most recent quarter on a year earlier	Most recent quarter on previous quarter
Volume index of export documentation	109.9	3.33%	2.98%

THE REGIONAL PICTURE

Only the North West and Northern Ireland recorded declines in documentation numbers quarter on quarter. Nevertheless, the North West is still the third largest region when it comes to the total number of returns, and Northern Ireland has the largest percentage increase in returns when comparing the current quarter with a year earlier.

Figure Six: % change qtr-on-qtr and yr-on-yr





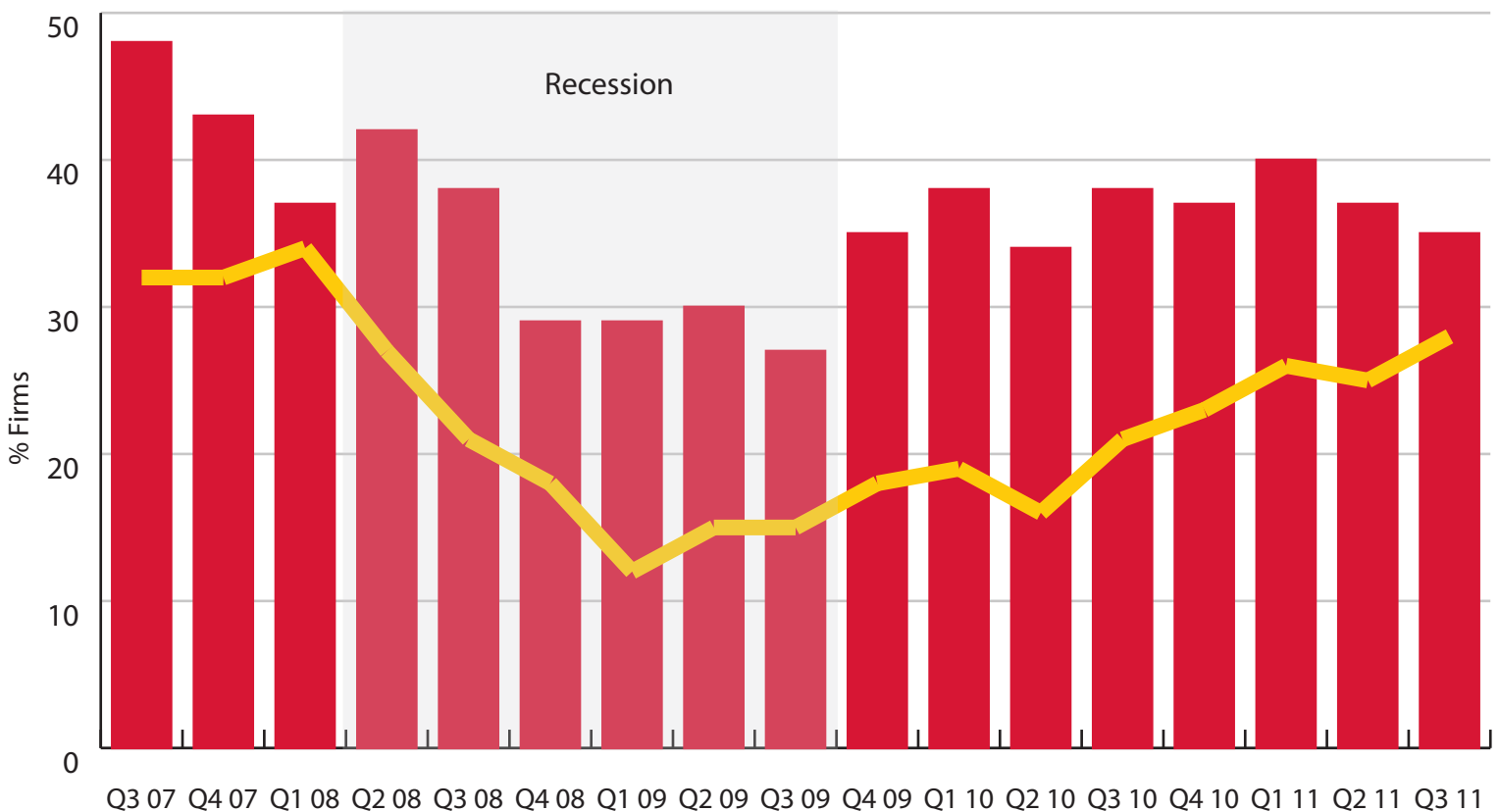
➤ **Capacity utilisation drops for the second successive quarter as the outlook for growth softens, a further indication of easing inflationary pressures.**

The extent to which total capacity is put into productive use by a business is very difficult to measure, but is nevertheless an incredibly important indicator for policymakers to analyse. It is particularly relevant for the Bank of England, and others, trying to model the outlook for inflation, and the subsequent setting of interest rates.


If capacity utilisation is high then it can create inflationary pressures (if demand increased further then higher costs could be incurred by generating extra capacity to produce more). This effect may be dampened if the economic outlook suggests buoyant demand and firms invest on the expectation of needing to increase output (this, however, is dependent on other factors as well, such as credit conditions).


Figure Seven shows the movements of the capacity utilisation result since the beginning of the series. It also shows the percentage of firms reporting an increase in investment intentions for plant and machinery. As would be expected, capacity utilisation dropped during the recession, as did the outlook for investment. Post-recession the results suggest that spare capacity slowly gets eaten up, as investment intentions began to rise.

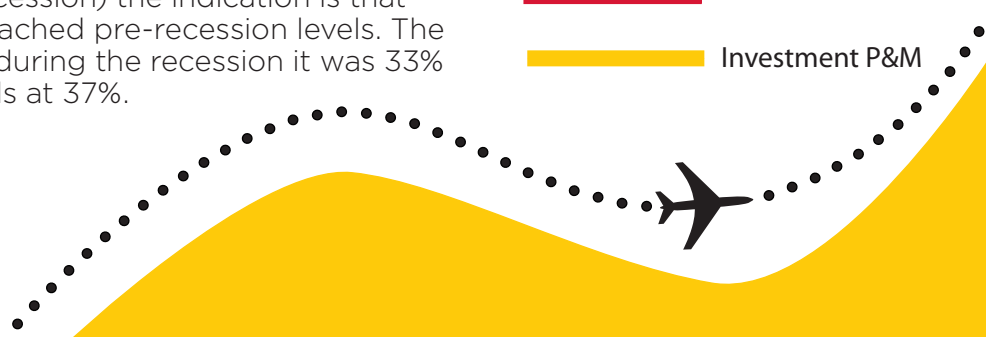
Figure Seven: % of firms operating at full capacity and improving intentions to invest in plant and machinery



Taking averages of three periods from the time series (pre recession, recession, and post-recession) the indication is that capacity utilisation has not yet reached pre-recession levels. The pre-recession average was 43%, during the recession it was 33% and post-recession it so far stands at 37%.

 % Full Capacity

 Investment P&M





British
Chambers of
Commerce

BRITISH CHAMBERS OF COMMERCE

65 PETTY FRANCE
LONDON SW1H 9EU
UNITED KINGDOM
T +44 (0)20 7654 5800
F +44 (0)20 7654 5819
info@britishchambers.org.uk
www.britishchambers.org.uk



DHL INTERNATIONAL (UK) LTD

178-188 GREAT SOUTH WEST ROAD
HOUNSLOW
MIDDLESEX TW4 6JS
UNITED KINGDOM
T +44 (0)844 248 0844
www.dhlguide.co.uk