Lloyds TSB | Commercial

Business in Britain

A Survey of Business Opinions and Trends | 39th edition January 2012

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A Survey of Business Opinions and Trends

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Introduction.

Welcome to the latest edition of our Business in Britain survey, which offers an invaluable guide to the performance and expectations of businesses, covering principally the SME market. The latest survey has canvassed opinions of 1,811 businesses covering all industry sectors and regions of the British economy.

The challenges facing the economy have increased since the last survey. Six months ago, we mentioned that the economic recovery was fragile, but intact. However, the growing concern surrounding the euro zone debt crisis and the lack of a comprehensive solution are having a significantly negative impact on our economic prospects.

Business confidence has fallen to the lowest level since mid-2009 when the economy was just emerging from the recession, driven by weaker expectations regarding demand, sales and profits. As such, the next six months could see broadly flat growth. Domestic demand conditions remains the key factor cited by businesses as the biggest threat to their business. Further, the anticipated fall in total sales and demand means that investment and employment trends are expected to remain weak.

On a positive note, our survey suggests that businesses' expectations regarding exports to the rest of the world (outside Europe) remain strong, supporting business confidence particularly in the manufacturing sector, where employment trends are still improving and investment spending is expected to be maintained.

Regionally, business confidence improved in Yorkshire and the North West, but fell elsewhere. From a sectoral perspective, business confidence improved only in 'other' services, which includes the public sector, suggesting that the fall in overall confidence since the last survey is driven primarily by businesses in the private sector.

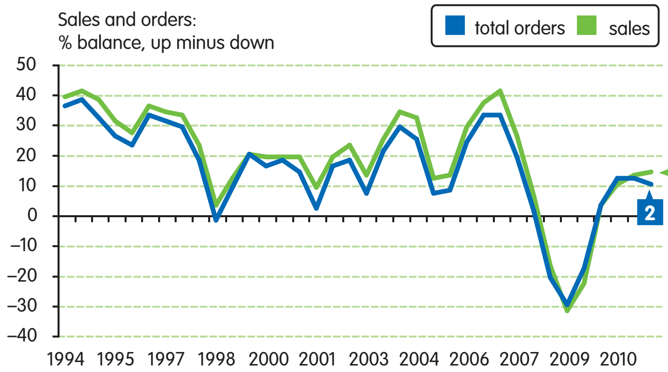
I would like to thank all those firms that have assisted us in providing such a comprehensive view of developments in the UK economy by taking the time to participate in the survey. I look forward to supporting them through these challenging economic circumstances and wish them every success in 2012.

John Maltby
Managing Director,
Lloyds TSB Commercial

Recent trends in the SME market.

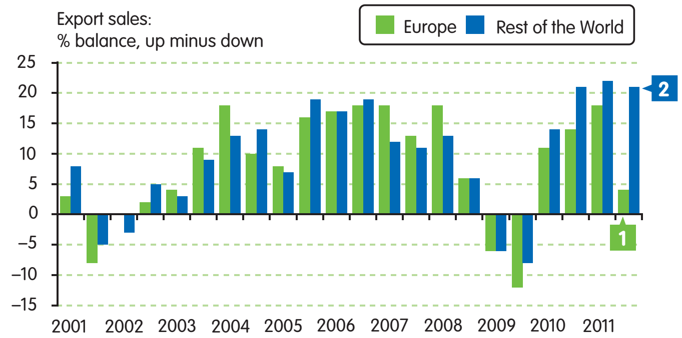
Downside risks to the economic recovery have increased.

Sales, orders and export sales balances over the last six months.



1. The net balance for overall sales in the past six months rose marginally by one point to **14%**, with 41% of businesses reporting stronger sales and 27% reporting weaker sales. The improvement in sales was less than had been hoped for in light of the previous survey and the net balance remains below the long-term historical average of 19%.

2. The net balance for total order book levels in the past six months fell two points to **10%**, indicating that growth in overall demand has weakened. Thirty-five percent of businesses reported stronger orders, while 25% said that orders had fallen.



1. The net balance for export sales to Europe in the past six months fell sharply by 14 points to a two-year low of **4%**, reflecting the impact of the sovereign debt crisis.

2. In contrast, export sales to the rest of the world (outside Europe) remained strong, with the net balance declining marginally by one point to **21%**.

Export sales are expected to weaken.

Expectations for total sales and orders in the next six months fell to their weakest levels for two-and-a-half years. The net balance for total sales fell nine points to 15%, while the net balance for total orders declined eight points to 14%.

	2012 H1	2011 H2
Expected sales: up	38%	43%
Expected sales: down	23%	19%
Balance	**15%**	**24%**

	2012 H1	2011 H2
Expected orders: up	32%	36%
Expected orders: down	18%	14%
Balance	**14%**	**22%**

The net balance for expected export sales in the next six months fell 13 points to a two-year low of 25%. This was driven by a marked decline in the net balance for expected sales to Europe, while the net balance for expected sales to the rest of the world fell only slightly. The net balance for expected imports also fell quite significantly, reflecting weak domestic demand.

	2012 H1	2011 H2
Expected exports: up	38%	46%
Expected exports: down	13%	8%
Balance	**25%**	**38%**

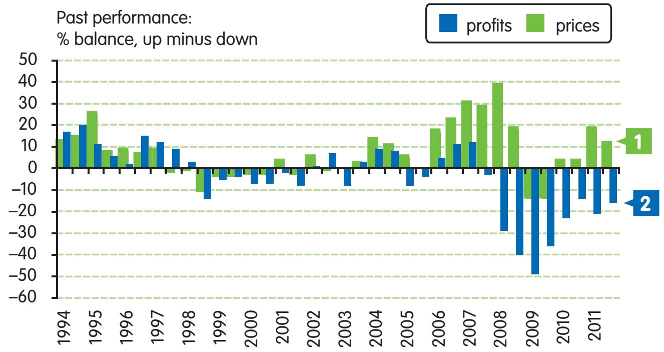
	2012 H1	2011 H2
Expected imports: up	35%	38%
Expected imports: down	16%	8%
Balance	**19%**	**30%**

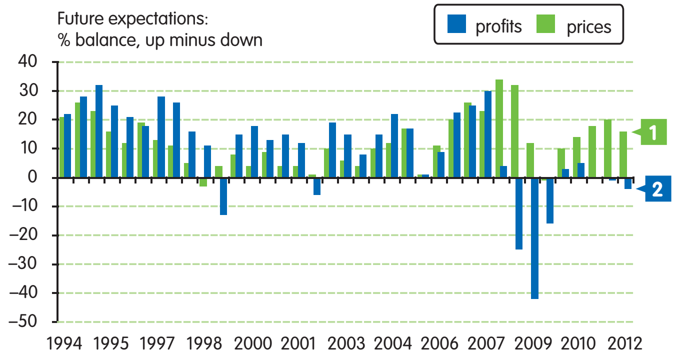
The euro area debt crisis has weighed on overall economic activity.

Overall economic activity held up, but was nevertheless sluggish in the past six months, as anticipated in the previous Business in Britain survey. Export sales to Europe, however, were somewhat weaker than expected, reflecting the impact of the sovereign debt crisis. Looking ahead to the next six months, overall economic activity is expected to weaken, leading to broadly flat or even slightly negative growth.

Price pressures have eased slightly.

Prices and profits: past performance and future expectations.



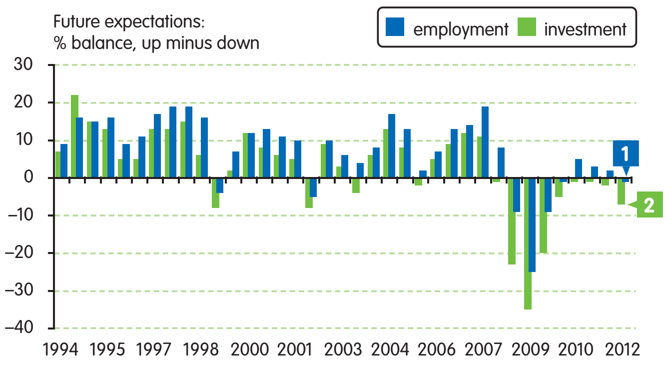


1. The net balance for prices charged in the past six months fell seven points to **11%**, a weaker outturn than that expected in the last survey.
2. The net balance for profits in the past six months rose five points **–16**%, but remained significantly negative, suggesting that higher costs are continuing to impact on margins.

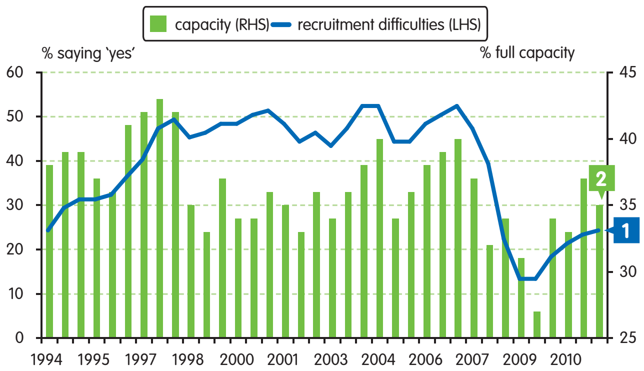
1. Looking ahead, the net balance for expected prices charged in the next six months fell four points to **16%**.
2. The net balance for expected profits in the next six months remained negative for the second consecutive survey, falling three points to **–4%**, which is the weakest level for two-and-a-half years.

Hiring and capital spending intentions have declined.

Investment, employment and capacity trends.



1. The net balance for expected employment in the next six months fell three points to **–1%**. Only 16% of businesses said that they intended to increase staff numbers, compared with 17% that expected to reduce them. The vast majority (64%) anticipated no change in employment.
2. The net balance for investment spending in the next six months fell five points to **–7%**, the weakest outturn for two-and-a-half years. Only 17% of businesses said they planned to increase investment, while 24% intended to reduce it. Just under a half (49%) of businesses said they planned to keep capital expenditure levels unchanged.



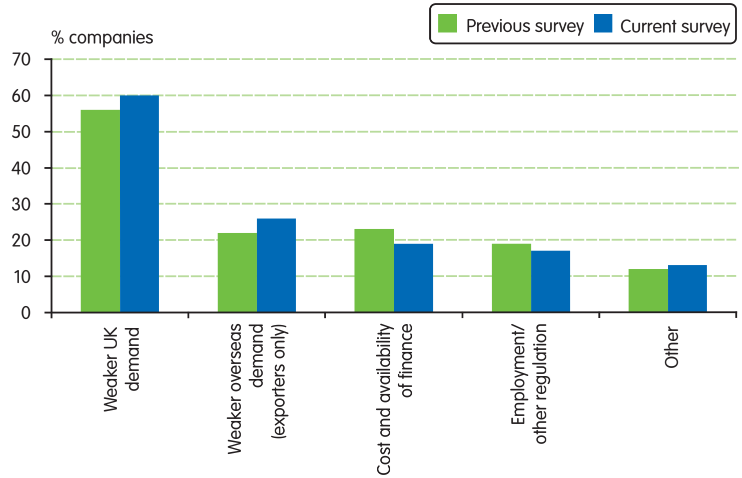
1. The percentage of businesses reporting difficulties in recruiting skilled labour rose marginally by one point to **24%**, but this remains well below the long-term average of around 38%.
2. The proportion of businesses reporting that they are operating at full capacity fell two points to **35%**, with the decline consistent with weakening overall demand.

Higher costs weigh on profitability.

Upward pressures on prices charged have eased since the last survey, but only slightly, while profit margins remain under pressure. With the demand backdrop staying weak or weakening further, the majority of firms expect to keep staff levels unchanged in the next six months, while the proportion of businesses citing difficulties in recruiting skilled labour remained well below the long-term average. Less than a fifth of businesses expect to increase capital spending, while about half of firms intend to maintain current levels of investment.

Weaker domestic demand remains the biggest threat to businesses.

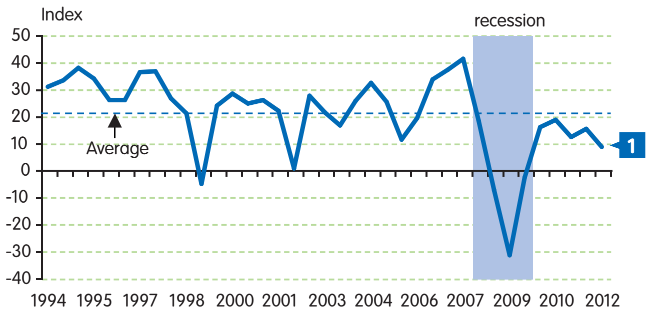
Greatest threat to businesses in the next six months.



Weaker domestic demand remains the greatest threat to businesses in the next six months, cited by **60%** of businesses, up from 56% in the previous survey. Weaker overseas demand also rose in the latest survey, mentioned by **26%** of businesses (exporters only) as the greatest threat. The proportion reporting the cost and availability of finance fell four points to **19%**, while **17%** cited employment/ other regulation.

Overall economic activity is likely to be weak in the next six months.

Business confidence.



1 Our measure of overall business confidence, which tracks total sales, orders and profits expectations in the next six months, fell seven points to **8**, the weakest level since the mid-2009 survey when the economy was just emerging out of the recession.

Summary – the economic environment will become more challenging in the next six months.

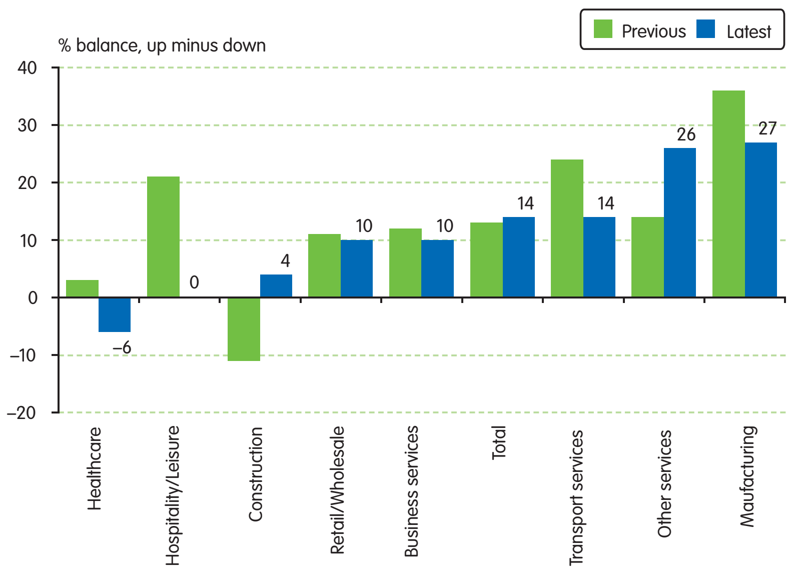
Downside risks to economic growth have intensified in recent months owing mainly to the impact of the euro area sovereign debt crisis. However, export sales to countries outside the euro area remained strong and overall sales were the strongest in the manufacturing sector. The fall in overall business confidence in our survey, however, suggests that economic growth may be broadly flat or even slightly negative in the next six months.

Weak demand, particularly on the domestic front but increasingly also from abroad, remains by far the greatest threat to businesses. Price pressures have eased, but only slightly, while profit margins are still being squeezed by high non-labour costs. The more challenging economic environment means that most businesses are not expecting to increase staff levels in the next six months, while less than a fifth intend to raise capital spending. Manufacturing was the only sector anticipating a net improvement in employment, while investment trends remained stable, in contrast to declines in most other sectors.

The industrial picture.

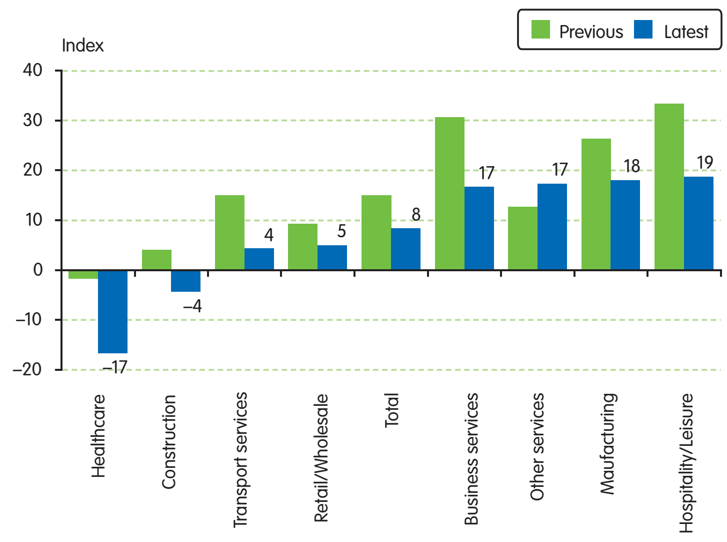
Business confidence fell in almost all sectors.

Sales over the last six months.



The net balances for sales in the past six months remained the strongest for the manufacturing sector. However, it fell across all sectors, except for other services (which includes the public sector) and construction. Hospitality & leisure registered the biggest fall, with the net balance declining to 0 from 21 in the last survey. Transport services and manufacturing also saw notable falls, though the respective net balances remain above the all-sector average.

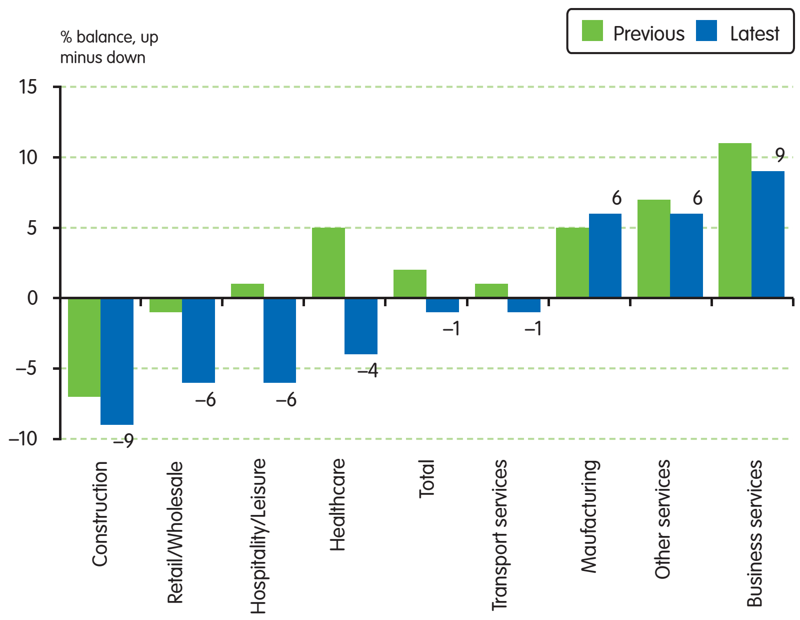
Business confidence.



Overall business confidence, which tracks total sales, orders and profits expectations in the next six months, declined in all sectors except other services which recorded a slight improvement. Confidence fell most in the hospitality & leisure and healthcare sectors, although the former remains the most confident sector, while the latter is by far the least confident.

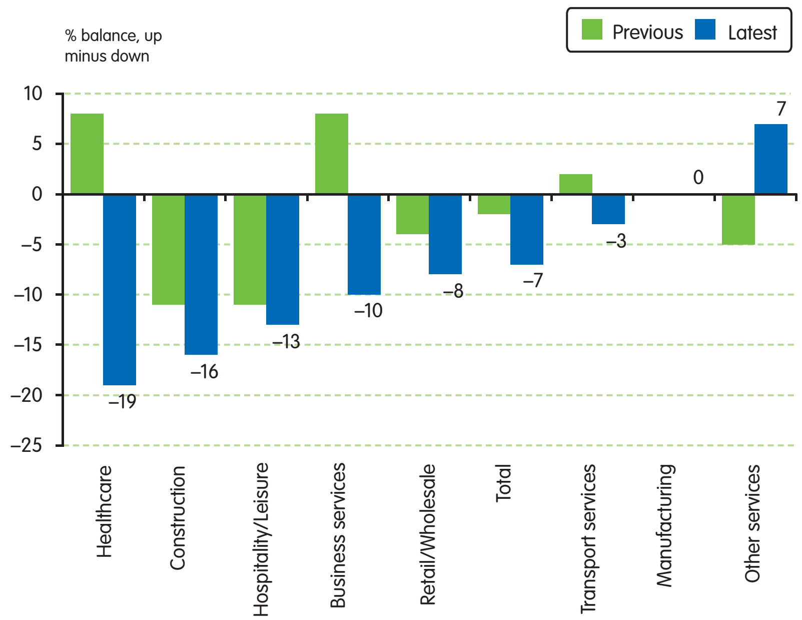
Investment trends are negative in all sectors except other services and manufacturing.

Employment in the next six months.



Manufacturing is the only sector to record an improvement in the net balance for employment in the next six months, though the rise was marginal. Business services remains the most confident about employment prospects, though sentiment fell slightly compared with the previous survey. Healthcare and hospitality & leisure registered the largest declines in employment prospects, while construction remained the least confident overall.

Capital spending in the next six months.

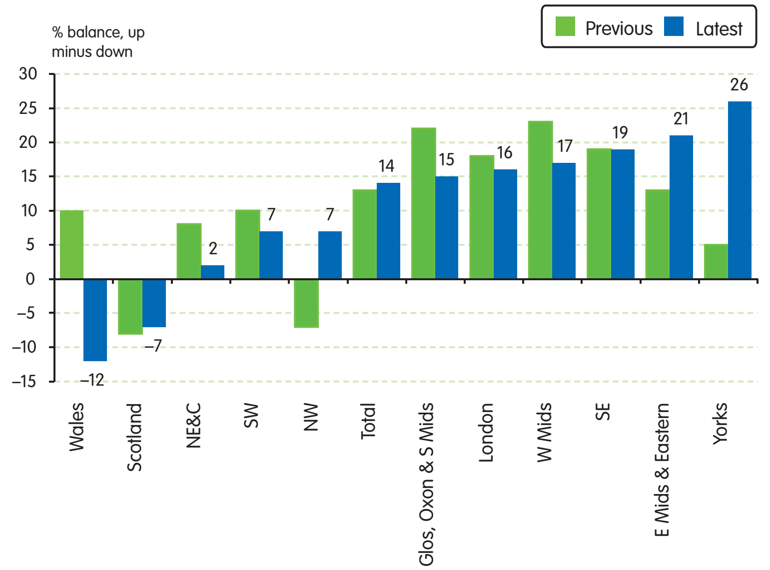


In terms of investment intentions in the next six months, the largest declines in the net balances were in healthcare and business services. Healthcare and construction have the weakest investment prospects. Other services is the only sector to record an improvement in capital spending plans, reflecting in part an improvement in investment intentions in the public and real estate sectors compared with the previous survey. The manufacturing sector is also expected to maintain investment levels.

The regional picture.

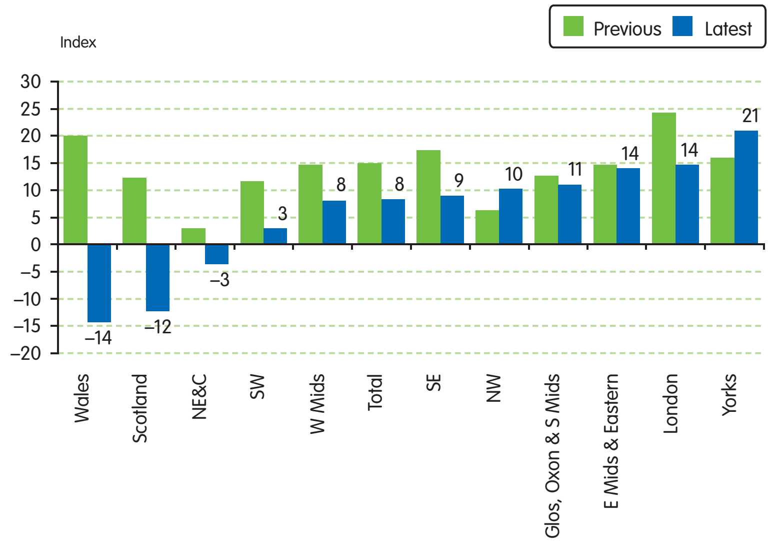
Business confidence is the strongest in Yorkshire and London.

Sales over the last six months.



Yorkshire and the North West recorded the biggest improvements in the net balances for sales in the past six months, while Wales saw the largest fall. Sales were the strongest in Yorkshire and the East Midlands & East and the weakest in Wales and Scotland.

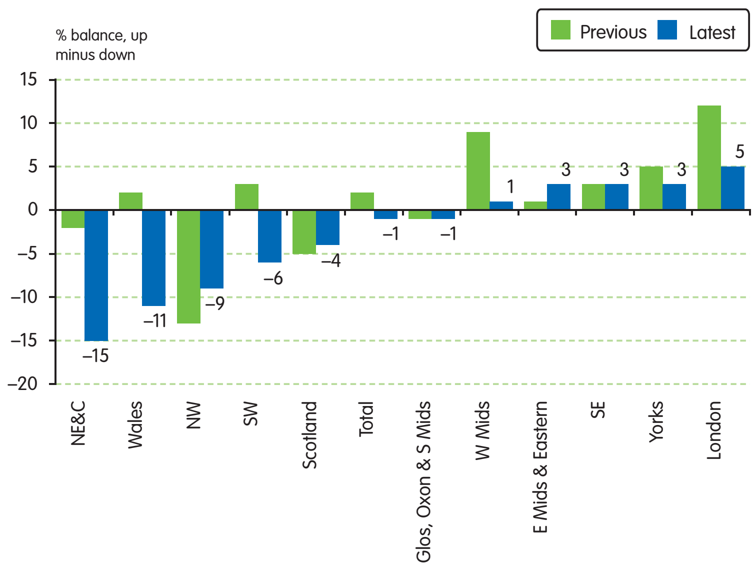
Business confidence.



Business confidence, which tracks total sales, orders and profits expectations in the next six months, was the strongest in Yorkshire, pushing London into second place. Yorkshire and the North West were the only regions to record an improvement in business confidence. Wales and Scotland registered the steepest falls in business confidence.

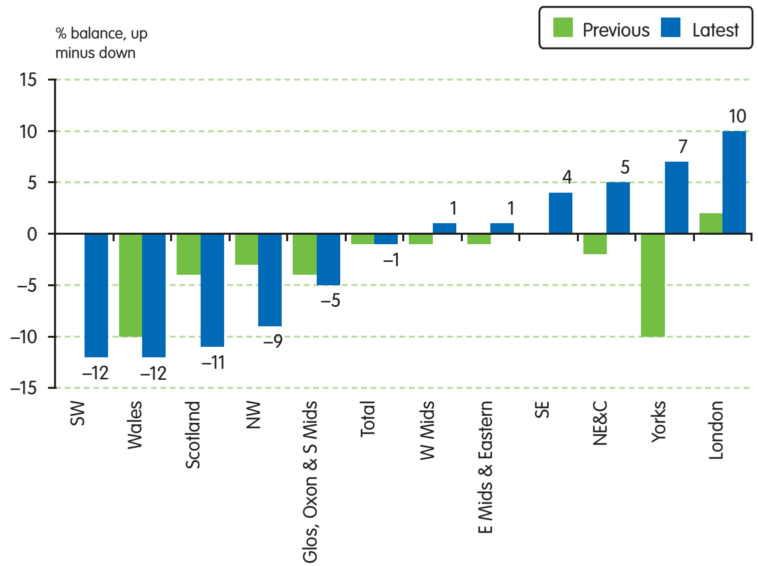
Employment prospects are weakest in the North East & Cumbria and Wales.

Employment in the next six months.



Employment prospects fell in most regions and rose only marginally in regions where they improved. The North East & Cumbria and Wales saw the biggest falls in expected staff levels to become the least confident regions regarding job prospects. London was the most confident about employment in the next six months, though sentiment has weakened compared with the previous survey.

Capital spending in the next six months.

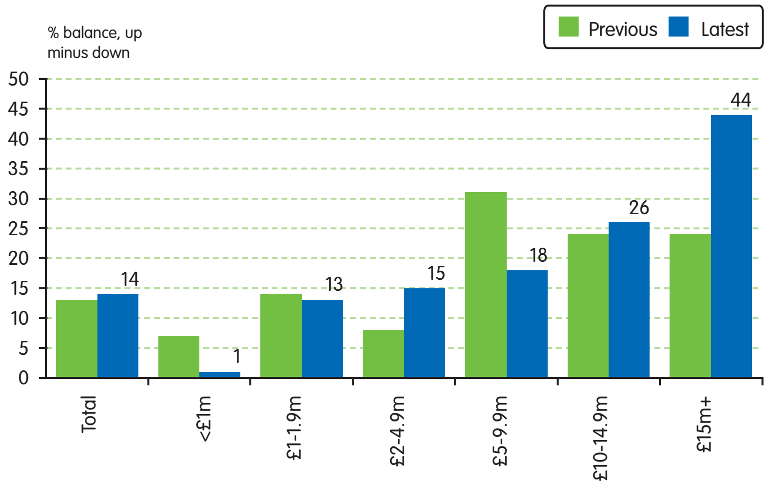


Investment intentions improved the most in Yorkshire and it is now second only to London in terms of capital spending plans for the next six months. The South West registered the largest fall in anticipated investment. Businesses in the South West and Wales are now the least likely to increase capital spending in the next six months.

Analysis by size of firm.

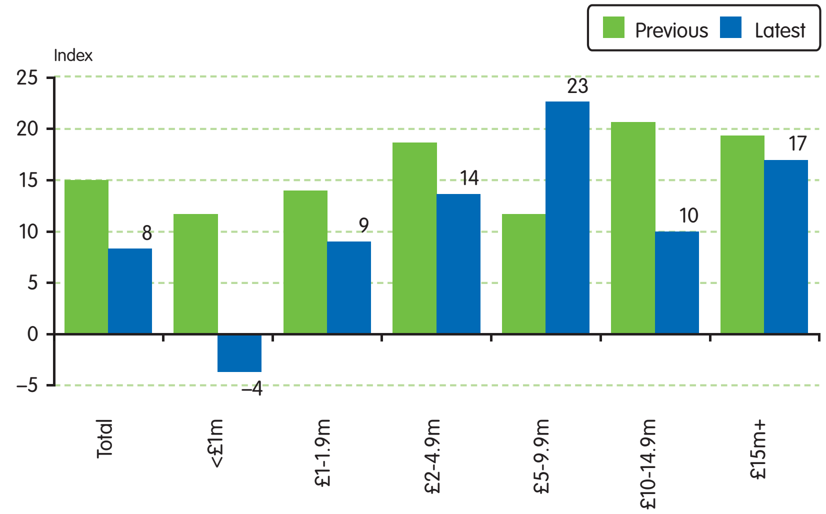
Business confidence weakened in most turnover categories.

Sales over the last six months.



Businesses with turnover above £15m registered a marked improvement in sales in the past six months. The net balance, however, fell the most for businesses with turnover of between £5m and £9.9m. Sales for businesses with turnover below £1m were the weakest, though the net balance remained positive.

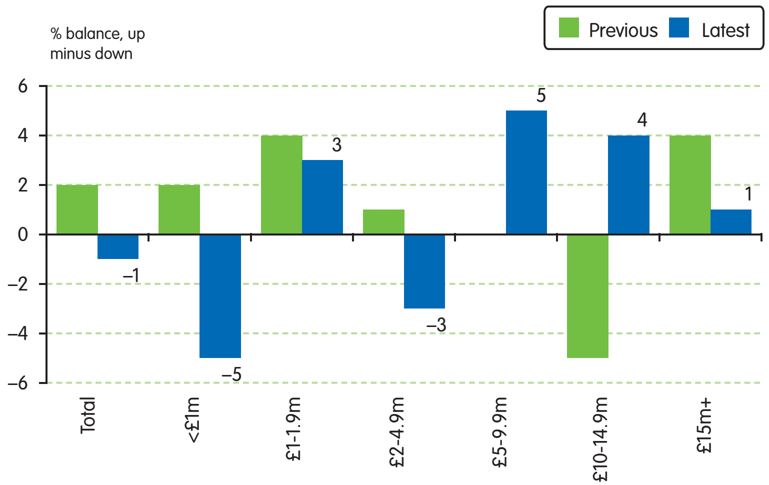
Business confidence.



Business confidence, which tracks total sales, orders and profits expectations in the next six months, fell for businesses in all turnover categories, except for those with sales between £5m and £9.9m. Confidence was the weakest for businesses with turnover below £1m.

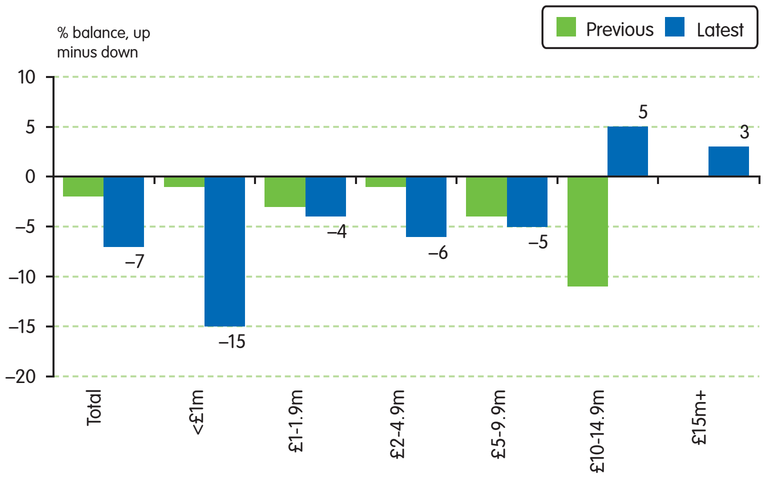
Employment prospects are weakest for businesses with turnover below £1m.

Employment in the next six months.



Employment prospects improved for businesses with turnover of £5m to £9.9m and £10m to £14.9m, but fell elsewhere. Businesses with turnover below £1m recorded the largest fall in anticipated staff levels for the next six months.

Capital spending in the next six months.



Intentions to raise capital spending improved for businesses with turnover of £10m to £14.9m and over £15m. There was a notable fall, however, in investment intentions of businesses with turnover below £1m.

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