**ECONOMY’S BUILDING BLOCKS IN SHORT SUPPLY**

**THE STATE OF THE ECONOMY, AUTUMN 2014**

**A benefit of ICAEW membership is the opportunity it offers to share business insight with other members. The ICAEW/Grant Thornton Business Confidence Monitor (BCM) analyses the views of up to 1,000 business members to inform each quarterly report and quarterly economic forecast. The fact that the BCM has, over a decade, been a consistently reliable economic indicator demonstrates that members are well placed to assess prospects for UK economic growth.**

**The recently published BCM and Economic Forecast reports for Q3 2014 show that businesses are still very positive overall, but more realistic about the prospects for UK economic growth over the next 12 months than in previous quarters. Confidence in construction and IT and technology sectors is particularly high: businesses in both of these areas of the economy predict some of the fastest increases in sales and employment of any sector over the next year.**

**Economic growth**

While wehave slightly revised down our 2014 economic growth forecast from 3.4% to 3.2%, the UK still looks set to be the fastest growing G7 economy this year. This revision reflects what looks like a challenging environment for exports. Weakness in the Eurozone means the prospect of a trade-led recovery anytime soon looks slim. Exports have risen by 3.5% over the past 12 months compared to growth of 4.5% in domestic sales.

Our forecast for 2015 shows economic growth dipping but remaining solid at 2.6%. Growth will be curbed next year by a slight slowdown in business investment in addition to declining government spending in the next parliament.

**The labour market**

The UK’s labour market continues to go from strength to strength, with the unemployment rate standing at 6.4% in Q2 2014 – the lowest rate since late 2008. We expect the unemployment rate to average 6.2% for the year as a whole with a further fall to 5.5% in 2015. The unemployment forecast suggests that the amount of slack in the labour market will diminish over the coming quarters. The tightening of the labour market is leading to skills shortages: this quarter, 18% of businesses report that finding workers with non-management skills is harder than a year ago, and larger companies report that staff retention is a greater challenge than a year ago: 27% of FTSE 350 companies report an increase in staff turnover compared to 14% in SMEs.

**Interest rates**

With the amount of spare capacity in the economy declining, an interest rate rise from the Bank of England looks increasingly likely. On balance, we expect a rate rise to come in early 2015 rather than late 2014. Weak earnings growth and high levels of spare capacity in sectors such as manufacturing mean that the Bank is likely to wait until next year before raising rates, to ensure that recoveries in more fragile parts of the economy are not derailed.

**What our members are saying**

To complement the BCM, ICAEW Regional Directors have gathered anecdotal feedback – much of it also on the subject of UK economic growth – from meetings over the past couple of months with members. Set out below is a summary of the business-specific comments from the most recent report.

**The good news is that economic growth seems to be finding traction across most regions (although London is perceived as being dominant) and sectors:**

 ‘The UK market has performed well and is one of our best territories which is good to see. India has also been a success and China is improving after a couple of years of slowdown’ (CEO manufacturing, East of England)

‘Business is good but it is very tough. I’m pleased we have invested in our business and can now compete on price’ (CEO, East Midlands)

‘We increased turnover five-fold between 2009 and 2012. There are huge barriers to entry in our industry, and regulation is our friend; two-thirds of our revenue is repeating licence business. We now have a large investment from an American VC organisation, and we continue to innovate’ (FD, Yorkshire and Humberside)

‘We’re pretty busy. We got some benefit from the reconstruction work after the 2007-8 floods, but it’s also from new schools and public buildings. We’ve increased from two estimators to five’ (FD, Yorkshire and Humberside)

‘Business confidence from travel is good now. The £/Euro is good and makes holidays cheaper. Consumer confidence allows holidays to be booked earlier. In the recession years, people went for cheaper holidays. People are now confident they will be employed in 2015 and are booking holidays’ (Director, Travel, South East)

Those exporting to Asia are particularly upbeat, citing that ‘there is a respect for Western values and conduct… attendees at big trade shows reveal that people from Asia are looking for Western products’ (Operations & Finance Manager, Speciality plastics manufacturing, Thames Valley) and ‘UKTI is very keen to do business. The strength of the British brand overseas is underestimated’ (Consultant and Interim Senior Executive, Thames Valley)

**However, rapid growth, particularly in London and the South East, is putting pressure on resources. Skills shortages are common across sectors:**

‘in construction we went from very stable to staff being poached. We have been trying to recruit since Jan/Feb this year. Fairly newly qualified surveyors are being offered £20k extra pay to move’ (Group Finance Director, Construction, Thames Valley); ‘We are looking to recruit sales people with technical understanding of products, and good quality project managers. We had recruited a new starter but he was offered £10k to stay at his current firm’ (Finance Director, Engineering and technology, Thames Valley)

**Several members mentioned that high property prices in the South East and the significant costs involved in moving house, are negatively impacting job mobility:**

‘We have recruited engineers and chemists. Problem is not finding them but the housing costs in London’ (Operations & Finance Manager Speciality plastics manufacturing, Thames Valley). This issue is made more acute because London and the South East continue to attract businesses ‘Where is inward investment going? If it is going to the South East then it is just adding to our problems. Politicians have to get their heads around the concentration in the South East’ (Consultant, NED, Interim Finance Director, Thames Valley) and ‘recruitment of qualified staff is difficult outside main towns. It may be easy in London but not in Saxmundham’ (Member in practice, East of England)

**In the construction sector marked growth this year, after a particularly long slump, has created another issue:**

‘There is shortage of bricks. New house building has taken all the bricks in the pipeline’ (Financial Controller, Water Company, Thames Valley), a similar comment was also made by a member in Yorkshire: ’brick manufacturers can name their price – one client exceeded last year’s entire turnover in just three months and hasn’t capacity to fill all the orders that are coming in’.

**In common with the latest BCM findings, some members are beginning to feel less bullish:**

‘The recovery has not petered out but it has stuttered a bit’ (FD, West Midlands)

**Continued Eurozone weakness and sanctions against Russia are also starting to negatively affect confidence:**

‘There has definitely been a decline in optimism within our manufacturing clients over the last few months. Weak demand in the euro zone has contributed to this as many in the sector rely heavily on exports to European nations’ (Partner, Large Practice, North West)

 ‘The level of demand in Europe is really challenging and so it is hard to export and make a profit’ (Director, building materials manufacturer, South East)

‘Russia and Ukraine is a big market for us but we have had a 50 per cent drop. The Asian market is still strong. English as a Foreign Language (ELF) has picked up in the last year in Portugal and Spain’ (Director, Training Company, South East)

‘Our parent company laid people off and the reason given was Russia’ (Director, building materials manufacturer South East)

‘Sanctions against Russia are affecting our fresh food operations in countries such as Poland as Russians begin to source food from outside Europe. There’s also concern unsold food will be dumped on the European market causing a reduction in prices – good for consumers but bad for suppliers’ (FD, East of England)

**Domestic risks also remain, including the question of a future rise in interest rates:**

‘The spectre of interest rates and real salary increases has not yet been factored in by businesses’ (FD Building Society, East Midlands); ‘an increase of only a quarter or half a per cent in interest rates would push a lot of businesses into the insolvency process. A quarter of a per cent doesn’t sound a lot but if you are borrowing £5 million it can be enough to push you over the edge’ (Large firm, West Midlands)

**Finally**, there is relief that the political uncertainty around the referendum in Scotland has been averted ‘for anyone in business in the North West, the Scottish ‘No’ vote is good news – who would have wanted to see the political landscape dominated for the next 18 months by rows over the currency, Scottish pensions and the location of nuclear submarines? Never mind a costly and complex financial cost of separating the two nations’ (Managing Director, Manufacturing Business, North West) but trepidation about continued austerity post-election: ‘The fiscal deficit is the government’s first priority’ (FD, East Midlands)

[View](http://www.ion.icaew.com/Talkaccountancyblog/post/Building-blocks-of-recovery-in-short-supply) a full compilation of the quotes.

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