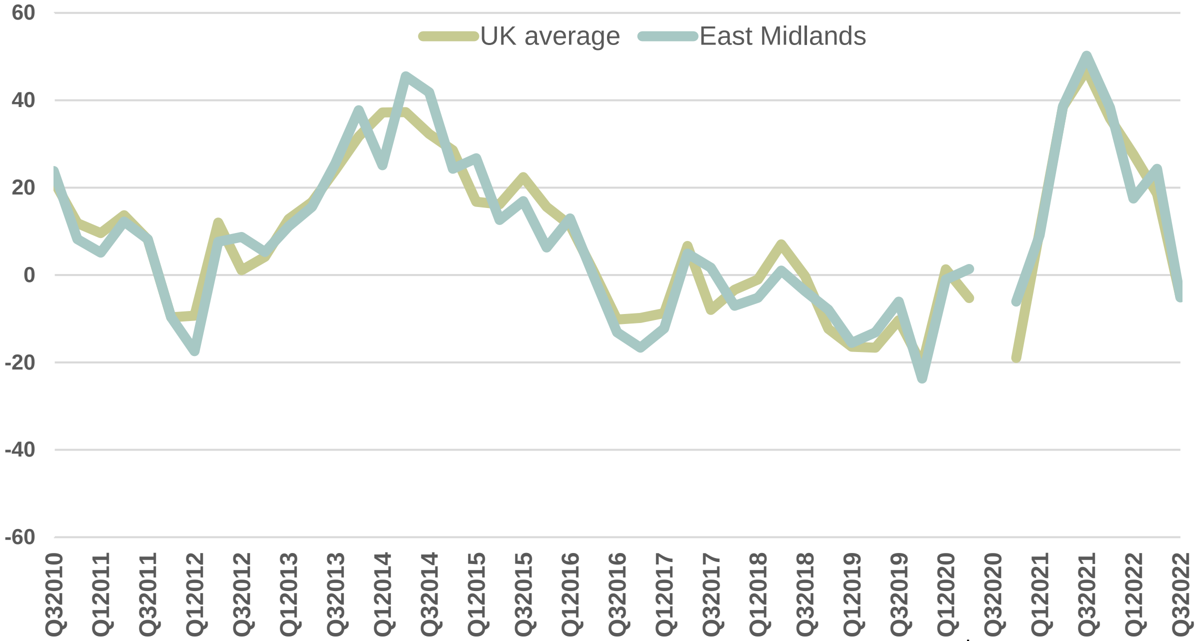
Q3 2022 - Business confidence weakens markedly in the East Midlands

The latest Business Confidence Monitor (BCM) shows business confidence falling into negative territory across the UK, as companies face a cost of doing business crisis, alongside the cost of living crisis that consumers are facing.

The results are based on telephone interviews with ICAEW Chartered Accountants that took place between 25 April and 15 July 2022.

- **The Business Confidence Index for the East Midlands has fallen into negative territory for the first time since the peak of the pandemic.**
- **This is despite businesses achieving near record rates of domestic sales growth. Companies also expect stronger export performance in the 12 months ahead.**
- **The severe weakening of sentiment reflects growing challenges faced by businesses. Issues surrounding the availability of skills are more widespread in the East Midlands than elsewhere in the UK, while staff turnover remains a prominent concern.**
- **Linked to these difficulties, labour costs have increased markedly for companies in the region, with average total salary growth rising at its fastest rate in over a decade.**
- **Other problems include increasing concern over government support and the tax burden.**
- **Businesses also face increasing pressures in terms of input costs. Annual input price inflation is running at its sharpest pace since the survey began. In turn, companies have increased selling prices significantly.**
- **Although investment spending has increased over the last year, businesses plan more modest rises in capital investment over the next 12 months.**

Business confidence in the East Midlands



* = data unavailable for Q3 2020

The Business Confidence index for the East Midlands continues to fall from its peak in Q3 2021 and now stands at -5.1. This decline into negative territory reflects a wide range of growing challenges faced by businesses, especially regarding labour market difficulties and the rising costs of production.

Domestic sales and exports growth

Despite the fall in overall confidence, sales performance for businesses in the region is currently still strong. Domestic sales are growing at 6.5% year-on-year, only marginally slower than the record rate recorded in the previous quarter. Businesses, however, anticipate a slight slowing of domestic sales to 5.1% growth in the year to Q3 2023.

Export growth over the past year has been more modest. Sales are rising by 2.1%, year-on-year, in Q3 2022. However, companies expect exports to increase at the sharper pace of 3.3% over the next 12 months, a rate that, if achieved, would mark a return to pre-pandemic trends.

Business challenges

The range of challenges faced by businesses, especially on the supply-side, is weighing on their sentiment and may be acting as an obstacle to meeting sales projections. The proportions of businesses reporting the availability of non-management skills (53%) and management skills (36%) are both at all-time highs for the region, and are both higher than anywhere else in the country. Staff turnover is also a widespread issue for businesses, with 46% of East Midlands companies citing this as a growing challenge.

The tax burden has also emerged in recent quarters as a prominent challenge for businesses in the region. Historically this has only been a minor issue, but the proportion of businesses in the East Midlands reporting the issue has now surged to 38%. This is the highest rate in the region since the survey began in 2004 and is currently higher than anywhere else in the country. The percentage of companies reporting government support as a growing challenge (16%) is also higher than elsewhere in the UK, and is more than double the region's historical average.

Labour market

Challenges faced in the labour market help to explain why average total salary growth is at its highest rate in over a decade, at 2.8%. And companies expect an even sharper rise of 3.2% over the next year, which implies that existing labour market frictions are not likely to subside quickly. However, despite the difficult recruitment environment, businesses in the East Midlands have achieved a higher rate of employment growth (2.2%) than the historical average for the region. Businesses plan a further 2.8% rise over the next 12 months.

Input and selling prices, and profits growth

In addition to rising labour costs, input cost pressures have risen substantially for businesses in the East Midlands, reflecting rising raw material and component prices. Against a backdrop of surging energy costs and ongoing supply chain disruptions, particularly in the region's large manufacturing base, annual input price inflation reached 5.1% in Q3 2022. This is the fastest rate since the survey began. A similar pace of 4.9% is expected over the next year, implying that here, too, companies expect current problems to persist.

Faced with rising costs but also improving sales, businesses have lifted selling prices by 3.3% over the last year, with the same increase planned in the next 12 months. This is the sharpest gain in selling prices in the East Midlands since the survey began in 2004.

The net effect of rising sales and selling prices, along with higher costs, is that profits growth remains in positive territory. Indeed, profits were 4.0% higher, year-on-year, in Q3 2022 compared to the previous 12 months. This is comfortably above the region's pre-pandemic trend. A further 5.2% rise is expected over the next year.

Investment

Supported by rising profits, businesses have increased their investment spending over the last year. Capital investment spending has risen by 2.6% in the year to Q3 2022, while Research & Development (R&D) budgets are up by 1.8% over the same period. However, reflecting the weakening of the Business Confidence Index, the outlook for investment is somewhat muted for the year ahead, something that may have adverse implications for the competitiveness of businesses. Businesses plan to moderate capital investment growth to just 1.3%. And while R&D budgets are expected to increase at the marginally faster pace of 2.0%, this would only just mark a return to pre-pandemic rates of growth.