

COMMERCIAL BANKING

BUSINESS IN BRITAIN

A survey of business opinions and trends

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INTRODUCTION



Tim Hinton
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Welcome to the latest instalment of the bi-annual Lloyds Bank Business in Britain survey, which is now in its 24th year. The survey offers revealing and timely insights on the recent performance and expectations of domestic businesses up and down the country and across all sectors of the economy. This latest survey draws on the experiences and opinions of 1,500 companies, predominantly small to medium enterprises (SMEs).

After nearly three years of above-trend growth, economic activity is stabilising and British businesses continue to have relatively upbeat views about the economic outlook in the short-term. The prospects for profits, capital expenditure and hiring have all declined a little, as you may expect for a recovering economy at this stage – but they all remain close to recent highs and are still consistent with solid economic growth.

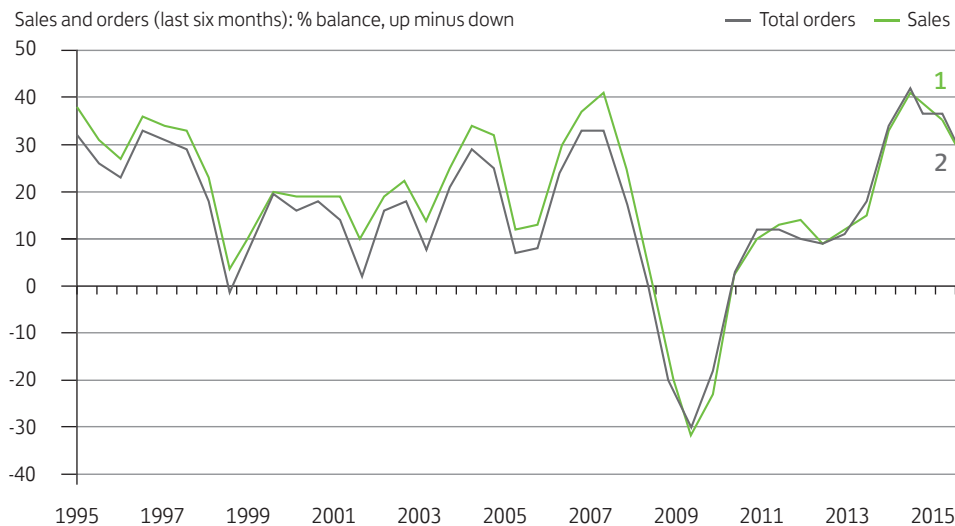
The slower momentum should help to ease pressure on business capacity which our respondents suggest has risen to a record high. Indeed, such pressures may help to explain a notable increase in expectations of higher interest rates over the coming six months. However, it is reassuring to see that British businesses remain fairly confident about their prospects, which suggests that they are well prepared.

I would like to thank all of the companies that have taken the time to participate in this survey, helping to provide valuable insights on the recent trends and future developments in the UK economy. I wish you every success in 2016 and beyond.

RECENT TRENDS IN THE SME MARKET

SALES AND ORDERS ACTIVITY EDGED A LITTLE LOWER IN THE LAST SIX MONTHS

TOTAL SALES AND ORDERS BALANCES OVER THE LAST SIX MONTHS



1. The net balance for overall sales in the last six months fell by five points to **30%**, as 48% of companies reported that sales activity had risen, while 18% stated weaker sales.
2. The net balance for incoming new orders in the last six months fell by seven points to **30%**, reflecting stronger demand in 45% of companies and weaker demand in 15%.

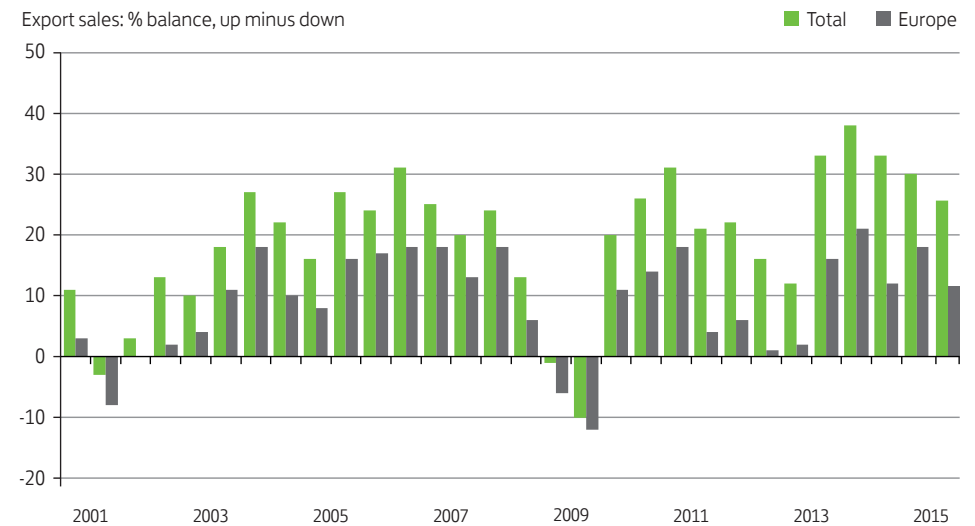
30%

The net balance for overall sales in the last six months fell from 35% to **30%**.

30%

The net balance for incoming orders in the last six months fell from 37% to **30%**.

EXPORT SALES BALANCES OVER THE LAST SIX MONTHS



1. The net balance for total exports in the last six months fell by 4 points to **26%**, the weakest level since 2013. Forty-three percent of exporters reported stronger external activity, while 17% cited weaker exports.
2. The net balance for exports to Europe in the last six months fell by 6 points to **12%** and remains weaker than global exports. Thirty-four percent of firms that export to Europe said that activity had strengthened compared with 22% that indicated weaker exports.

26%

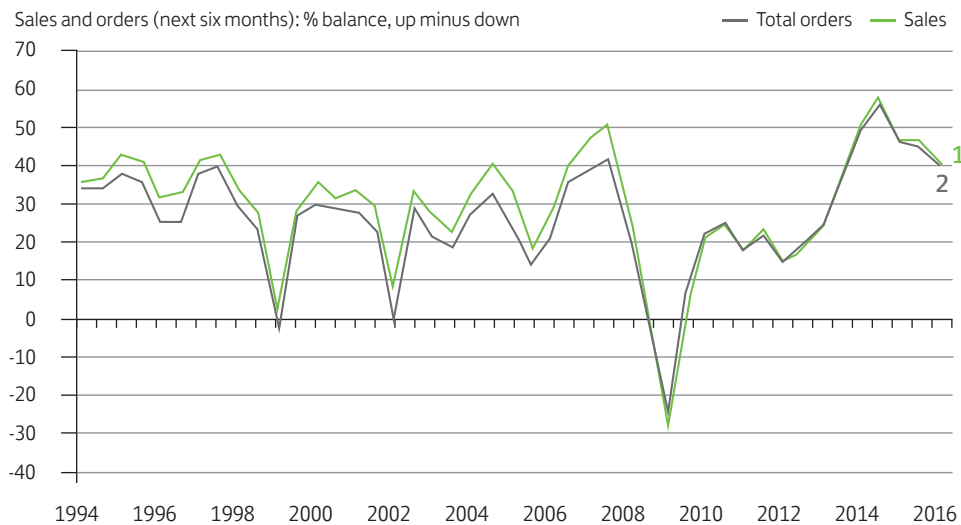
The net balance for global exports in the last six months fell from 30% to **26%**.

12%

The net balance for exports to Europe in the last six months fell from 18% to **12%**.

EXPECTATIONS FOR SALES AND ORDERS FOR THE NEXT SIX MONTHS ALSO EASED

EXPECTED SALES AND ORDERS BALANCES FOR THE NEXT SIX MONTHS



1. The net balance for expected overall sales for the next six months fell by six points to **41%**. Fifty-three percent of firms expect sales activity to rise, while 12% anticipate weaker sales.
2. The net balance for expected new orders for the next six months fell by five points to **40%**, as 50% of companies foresee stronger demand and 10% expect weaker orders.

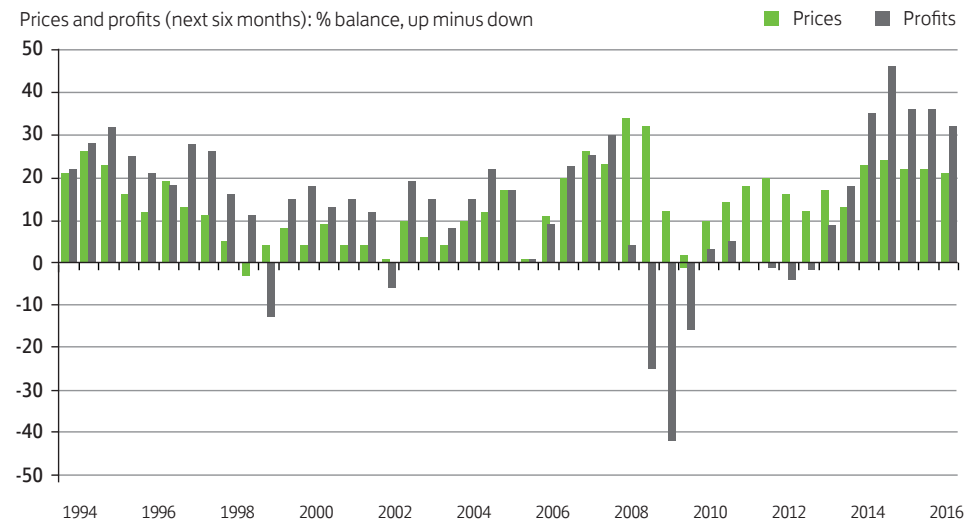
41%

The net balance for expected sales for the next six months fell from 47% to **41%**.

40%

The net balance for incoming orders for the next six months fell from 45% to **40%**.

EXPECTED PRICES AND PROFITS BALANCES FOR THE NEXT SIX MONTHS



1. The net balance for expected prices for the next six months edged down by 1 point to **21%**. Thirty percent of companies expect to raise their prices, while 9% anticipate price reductions.
2. The net balance for expected profits for the next six months fell by four points to **32%**, with 46% of companies predicting an improvement and 14% foreseeing a fall.

21%

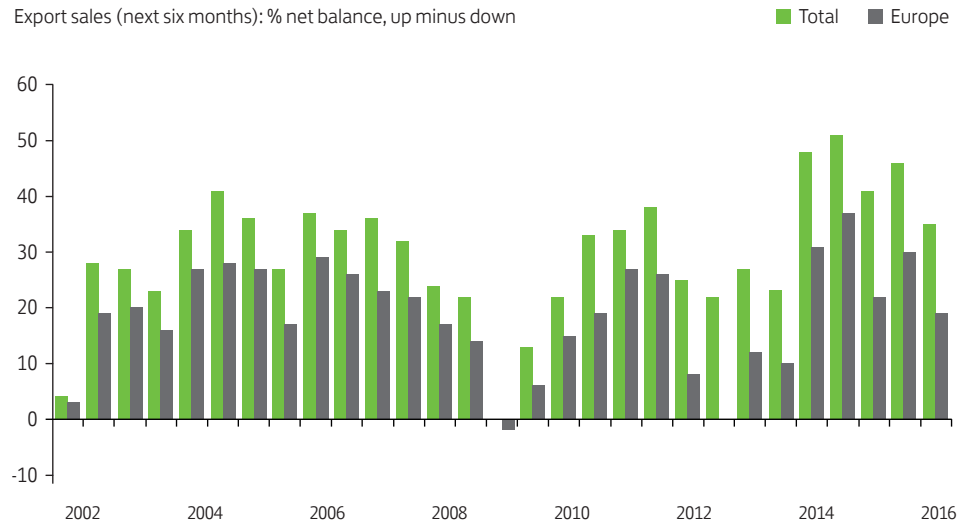
The net balance for expected prices for the next six months fell from 22% to **21%**.

32%

The net balance for expected profits for the next six months fell from 36% to **32%**.

EXPORT OPTIMISM HAS FALLEN BACK

EXPECTED EXPORT SALES BALANCES FOR THE NEXT SIX MONTHS



1. The net balance for expected total exports for the next six months fell by 11 points to **35%**. Forty-seven percent of exporters are preparing for stronger export activity, while 12% anticipate weaker external activity.
2. The net balance for expected exports to Europe for the next six months fell by 11 points to **19%**, as 37% of firms expect stronger activity and 18% foresee a decline.

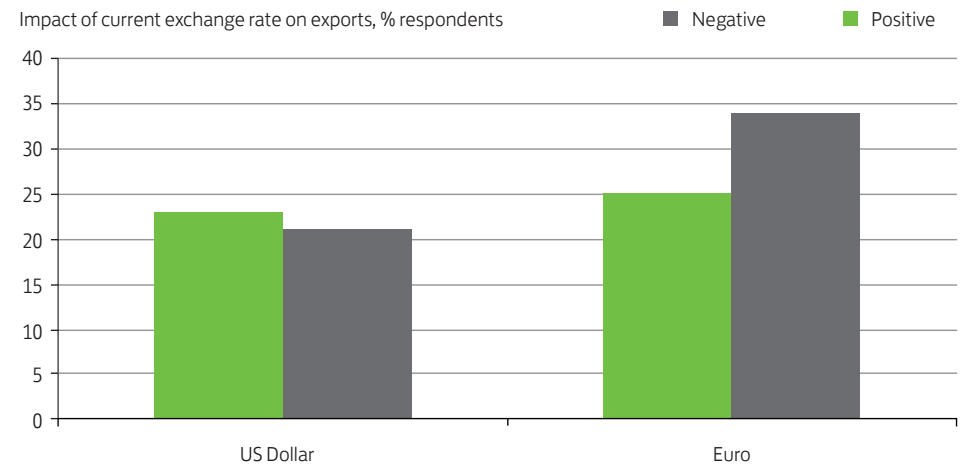
35%

The net balance for expected global exports for the next six months fell from 46% to **35%**.

19%

The net balance for expected exports to Europe for the next six months fell from 30% to **19%**.

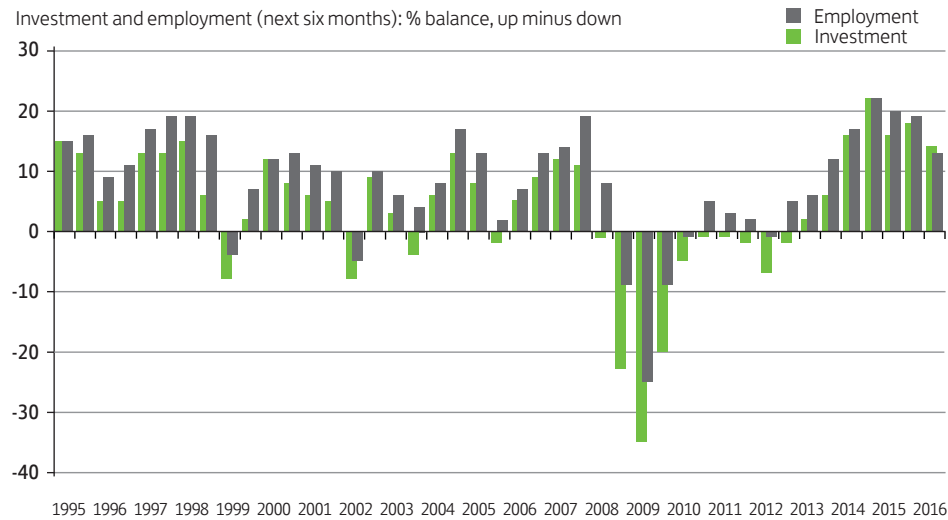
IMPACT OF THE EXCHANGE RATE ON EXPORTS



1. US dollar: Twenty-three percent of companies indicated that the value of the pound against the US dollar was having a positive impact on their exports, while a similar proportion of 21% said that the impact was negative.
2. Euro: Exporters were more concerned about the negative impact of the strength of the Euro than the US dollar. Thirty-four percent of firms said that the value of the pound against the Euro was having a negative impact on their exports, while 25% reported a positive impact.

HIRING AND INVESTMENT INTENTIONS SOFTENED BUT REMAIN SOLID

INVESTMENT AND EMPLOYMENT TRENDS



1. The net balance of companies anticipating an increase in headcount over the next six months eased for the third consecutive survey, softening by 6 points to **13%**. Twenty-six percent (down from 31%) of respondents expect to increase staff numbers, while 13% (up from 12%) envisage a decline. Despite the latest slip, the net balance remains well above its long-term average of 9% and is consistent with further employment gains in the first half of 2016.
2. The net balance for planned capital expenditure over the next six months also declined, falling from 18% to **14%**. The share of companies who foresee an increase in outlays fell from 30% in the last survey to 28%, while 14% (up from 12%) anticipate a reduction. The net balance remains above its long-term average and is consistent with a continuation of the recovery in investment spending.

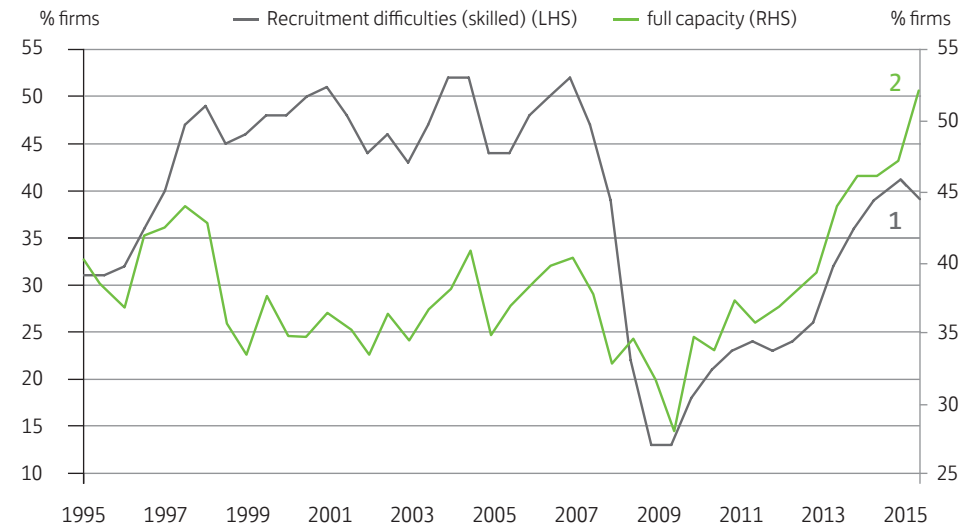
13%

The net balance for staffing levels over the next six months declined by 6 points to **13%**.

14%

The net balance for planned capital spending fell back from 18% to **14%**.

RECRUITMENT FRICTIONS AND CAPACITY TRENDS



1. After rising unrelentingly over the last three years, the percentage of businesses reporting difficulties in recruiting skilled workers over the past six months edged down from its post-crisis high of 41% to **39%**. This suggests that the pace of labour market tightening may have slowed a little over the second half of the year which may help to ease underlying inflationary pressures.
2. On the other hand, the share of businesses indicating that they are operating at full capacity rose to an all-time high of 52%, up from 47% in the previous survey. In principle, this could impart upward pressure on inflation over the coming months as the extent of overall slack in the economy continues to diminish.

39%

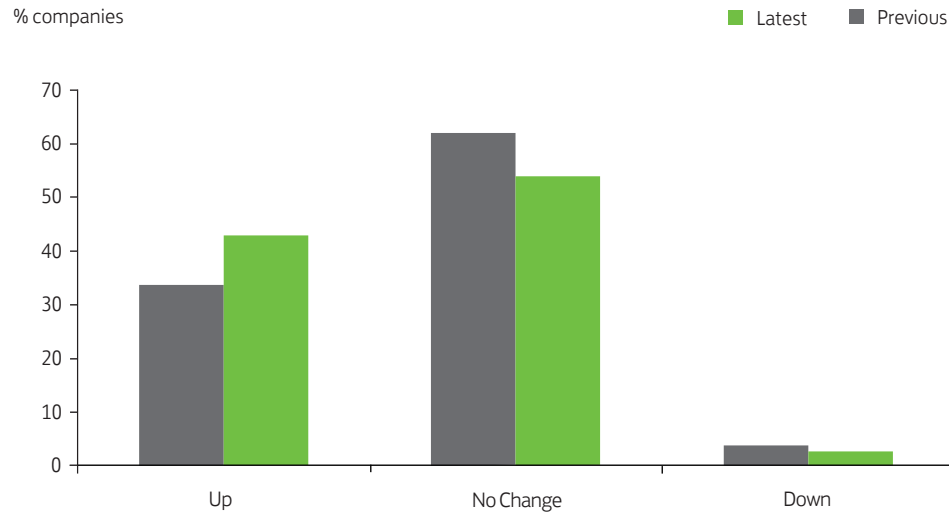
The share of businesses reporting difficulties in recruiting skilled workers in the past six months decreased from 41% to **39%**.

52%

The share of businesses reporting that they are operating at full capacity rose from 47% to **52%**.

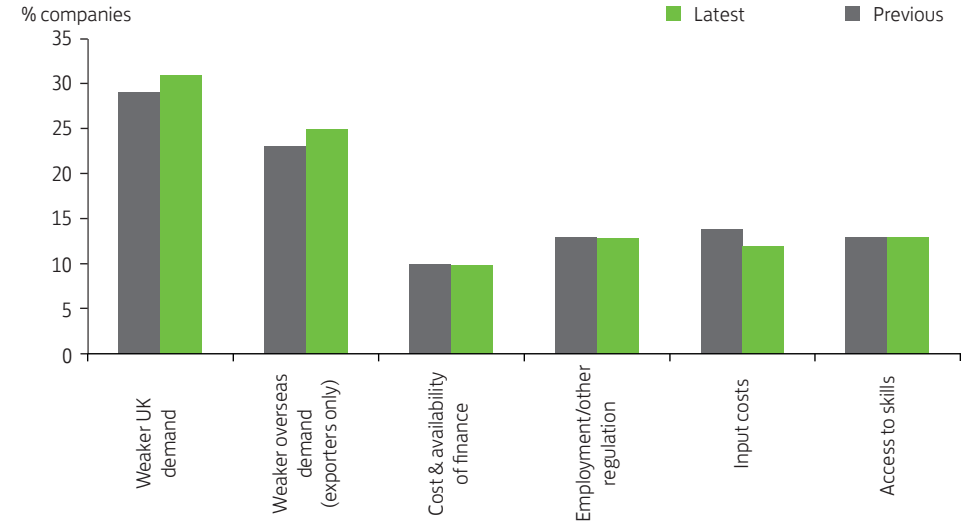
EXPECTATIONS OF HIGHER INTEREST RATES HAVE CLIMBED BUT WEAKER DEMAND SEEN AS STRONGEST BUSINESS THREAT

INTEREST RATE EXPECTATIONS



The net balance for interest rate expectations over the coming six months increased from 30% to **40%**. This reflected a rise in the percentage of firms anticipating an increase from 34% to 43%, while 3% (down from 4%) foresee lower interest rates.

GREATEST THREAT TO BUSINESS OVER THE NEXT SIX MONTHS



Firms continue to identify weaker UK demand as the main threat with the share rising to 31% from 29%. A similar pattern is seen among those firms that export, showing a rise to 25% from 23%, sharing a worry about weaker overseas demand. Concerns about export prospects to the Euro area have increased the most, followed by the Asia-Pacific, while exports to other parts of the world, including North America, are expected to hold up better. Aside from worries about demand, companies were the most concerned about access to skills and employment & other regulation, both cited by 13% of respondents, while the share highlighting input costs declined to 12% as commodity prices have fallen.

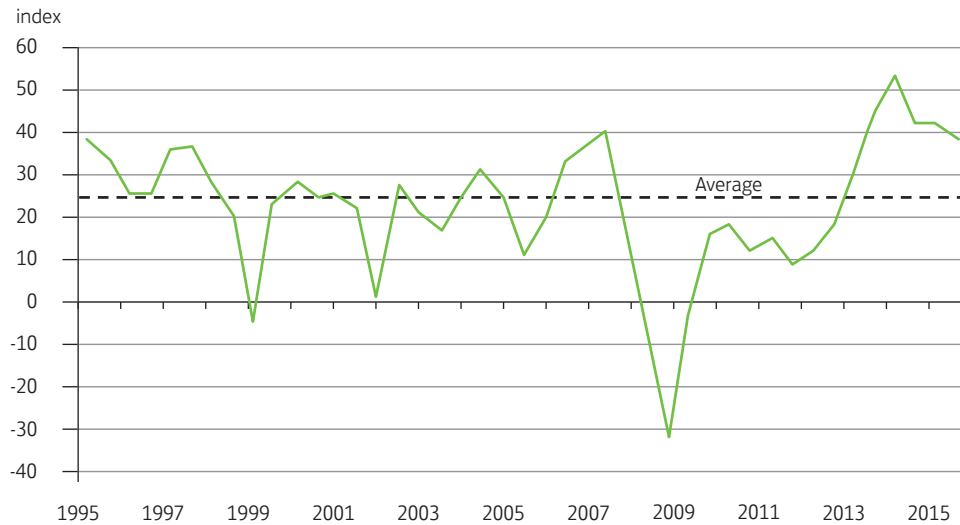
The proportion citing the cost & availability of finance stayed at 10%, which is the lowest level since the economy emerged from the financial crisis.

40%

The net balance of businesses reporting that they expect interest rates to increase over the next six months has risen from 30% to **40%**.

OVERALL BUSINESS CONFIDENCE EASES BUT REMAINS CONSISTENT WITH ROBUST ACTIVITY

BUSINESS CONFIDENCE



SUMMARY

Despite the broad easing in sentiment, which is consistent with a maturing economic recovery after three years of above-trend growth, companies in our survey continue to have upbeat views about the outlook for economic activity over the next six months. While expectations of higher interest rates over the next six months have increased, firms seem relatively unperturbed by the prospect. Profit, investment and hiring prospects remain solid and just over half of all our respondents are operating at full capacity, a record high and up from less than one-in-three, five years ago. This suggests that spare capacity in the economy continues to narrow.

Our measure of overall business confidence is an average of the net balances for expected sales, orders and profits over the next six months. After holding steady at 43% in the previous survey, this index has dipped to **38%**. Despite the retracement since its recent peak of 53%, the index remains consistent with a continuation of the robust pace of economic activity seen over the last three years.

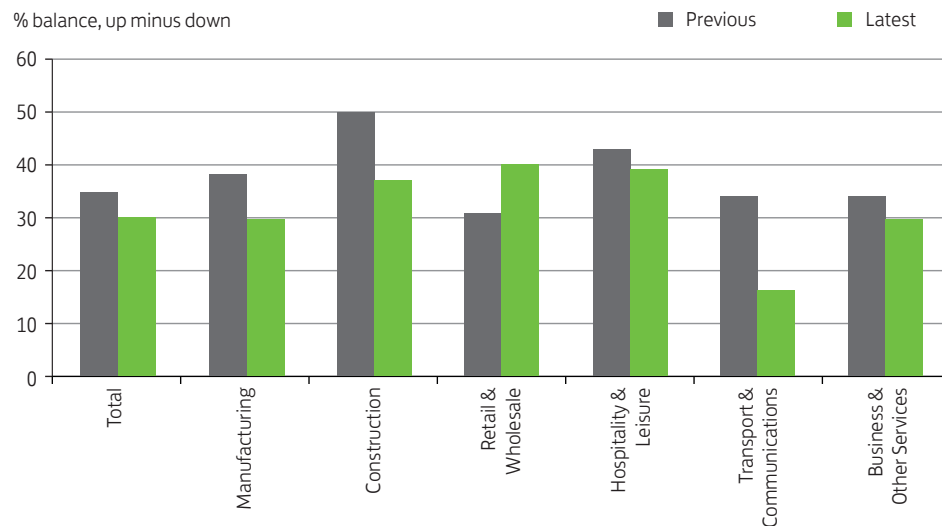
38%

The average of the net balances of expected sales, orders and profits declined from 43% to **38%**.

THE SECTORAL PICTURE

RETAIL & WHOLESALE ACTIVITY HAS STRENGTHENED

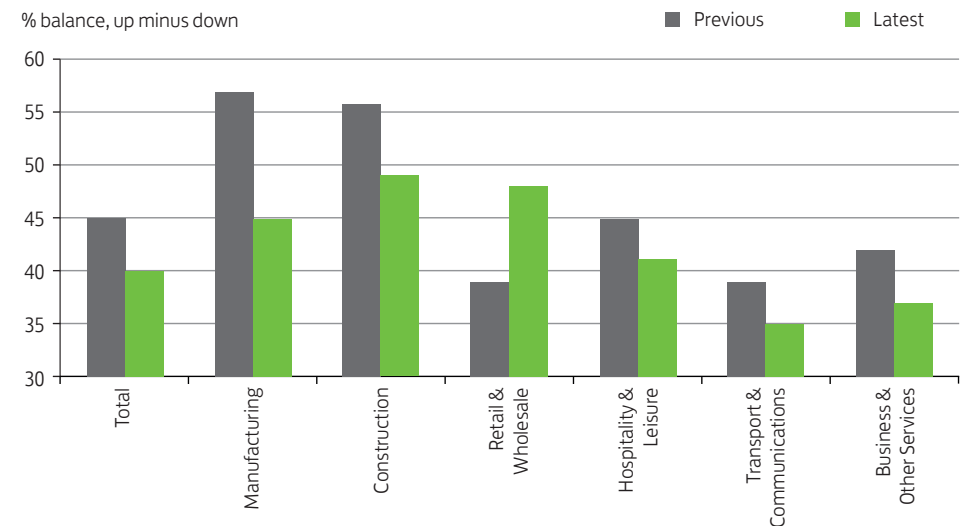
SALES OVER THE LAST SIX MONTHS



The decline in the overall net balance for sales over the past six months was replicated across most sectors. Manufacturing (down 8 points to 30%), construction (down 13 points to 37%) and transport & communications (down 18 points to 16%), all saw particularly large declines. However, the levels of the indices of the first two of these are still near historic highs.

Hospitality & leisure (down 4 points to 39%) and business & other services (down 4 points to 30%) experienced more modest declines. Retail & wholesale (up 9 points to 40%) was the only sector to see a rise in the sales balance. That outperformance is consistent with other evidence that consumer spending has recently been one of the key drivers of UK economic growth.

ORDERS IN THE NEXT SIX MONTHS

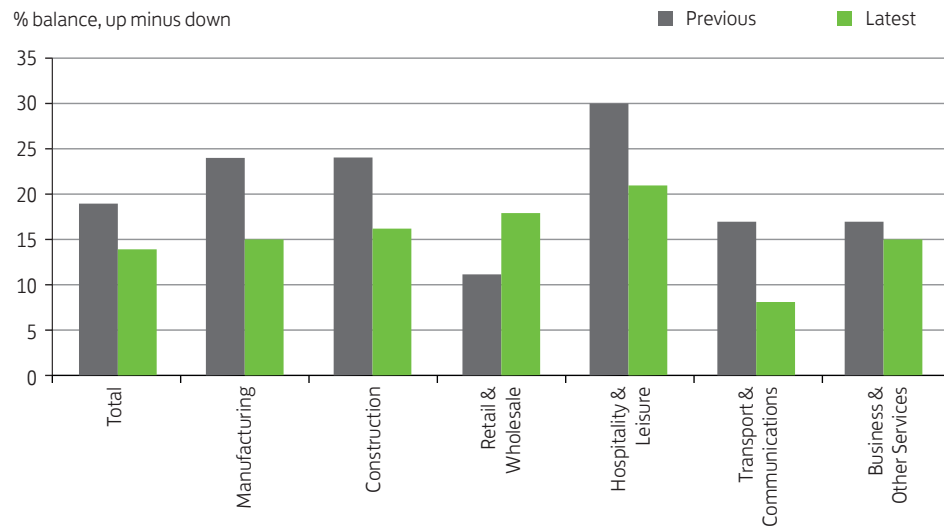


A similar pattern can be seen in orders for the next six months, with the balances for all sectors contracting except for retail & wholesale (up 9 points to 48%). Manufacturing (down 12 points to 45%) and construction (down 7 points to 49%) saw the largest declines. The falls in hospitality & leisure (down 4 points to 41%), transport & communications (down 4 points to 35%) and business & other services (down 5 points to 37%) were less marked.

Given other indications that weak international trade and sterling's appreciation against the Euro has been hurting manufacturing activity, the weakening in orders in that sector is not unexpected. However, the slowdown in other areas suggests that domestic demand growth may also be decelerating, although in most cases the level of orders remains relatively high.

SECTORS MORE RELIANT ON DOMESTIC DEMAND ARE FARING BETTER

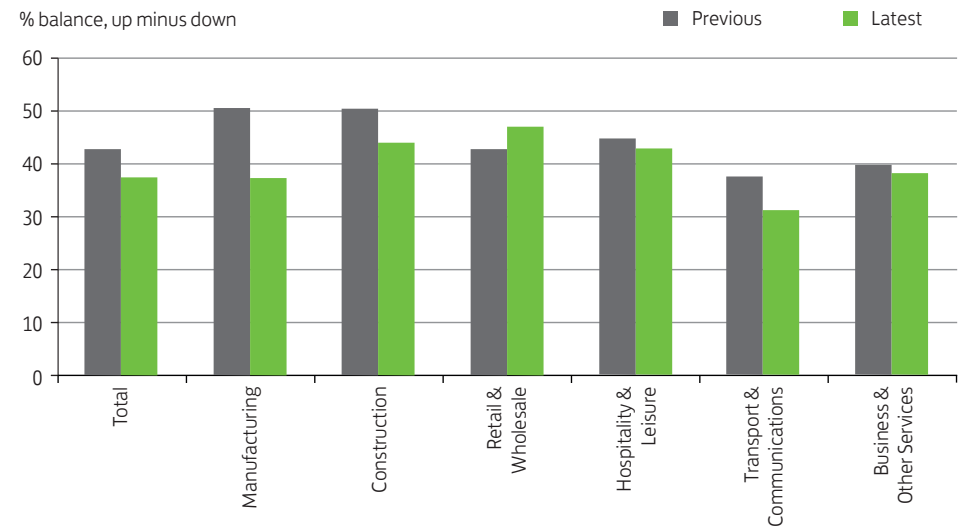
CAPITAL SPENDING IN THE NEXT SIX MONTHS



The decline in sales and orders is also reflected in capital spending plans for the next six months, which, with the exception of retail & wholesale, are all lower than they were in July 2015. Manufacturing (down 9 points to 15%), hospitality & leisure (down 9 points to 21%), transport & communications (down 9 points to

8%) and construction (down 8 points to 16%) all saw fairly significant falls. In contrast, the decline in expectations in business & other services was less sizeable (down 2 points to 15%). The increase in retail & wholesale (up 7 points to 18%) took capital spending expectations in that area to a new post-recession high.

BUSINESS CONFIDENCE OVER THE NEXT SIX MONTHS



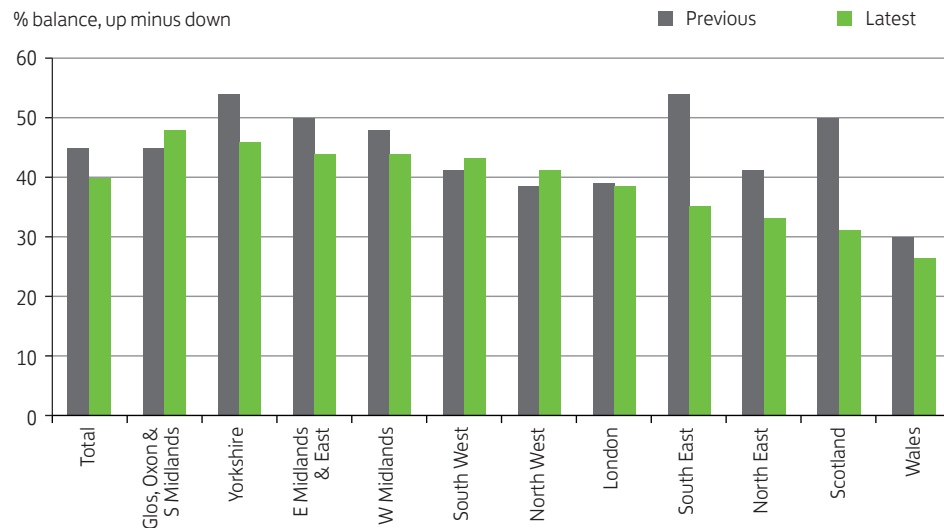
Business confidence for the next six months has fallen in every sector with the exception of retail & wholesale. The decline in manufacturing confidence has been particularly marked (down 14 points to 37%), its lowest level since mid-2013. This at least in part probably reflects ongoing concerns about the difficulties for exporters. Construction (down 6 points to 44%),

transport & communications (down 6 points to 32%), business & other services (down 2 points to 38%) and hospitality & leisure (down 1 point to 43%) all saw more modest declines. While confidence in the retail & wholesale sector rose (up 4 points to 47%), it remains below its mid-2014 high for this economic cycle.

THE REGIONAL PICTURE

ORDERS AND SALES HAVE WEAKENED SHARPLY IN THE SOUTH EAST

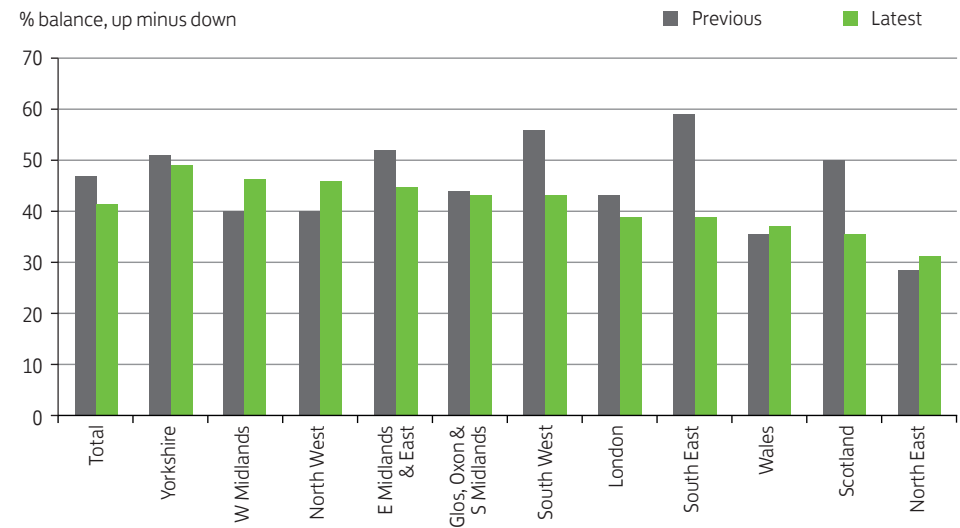
ORDERS IN THE NEXT SIX MONTHS



The current survey has seen expected orders fall in all but three British regions. The exceptions are Gloucestershire, Oxfordshire & the South Midlands (up 3 points to 48%), the North West (up 3 points to 41%) and the South West (up 2 points to 43%). Amongst the other 8 regions the largest falls were seen in the South East (down 19

points to 35%) and Scotland (down 19 points to 31%), while the smallest decline was in London (down 1 point to 38%). Despite only a small further decline in the latest survey the level of sentiment at 26% remains lowest in Wales, while it is highest in Gloucestershire, Oxfordshire & the South Midlands.

SALES IN THE NEXT SIX MONTHS

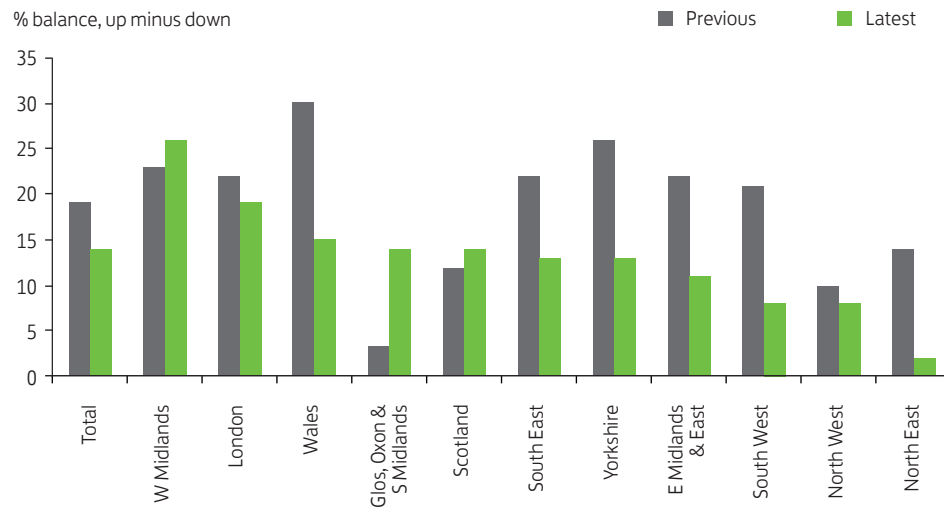


The net balance of firms that anticipate an increase in sales over the next six months increased in only four regions, the West Midlands (6 points to 46%), the North West (6 points to 46%), the North East (2 points to 31%), and Wales (1 point to 37%). Amongst the other seven regions the South East (down 20 points to 39%) saw the largest fall in expected

sales, while Gloucestershire, Oxfordshire & the South Midlands reported the smallest decline (down 1 point to 43%). Despite their small rises in expected sales in the most recent survey Wales and the North East, along with Scotland still have the lowest levels of expectations, while sentiment is most positive in Yorkshire & the Humber.

OVERALL CONFIDENCE IS LOWEST IN THE NORTH EAST, WALES & SCOTLAND

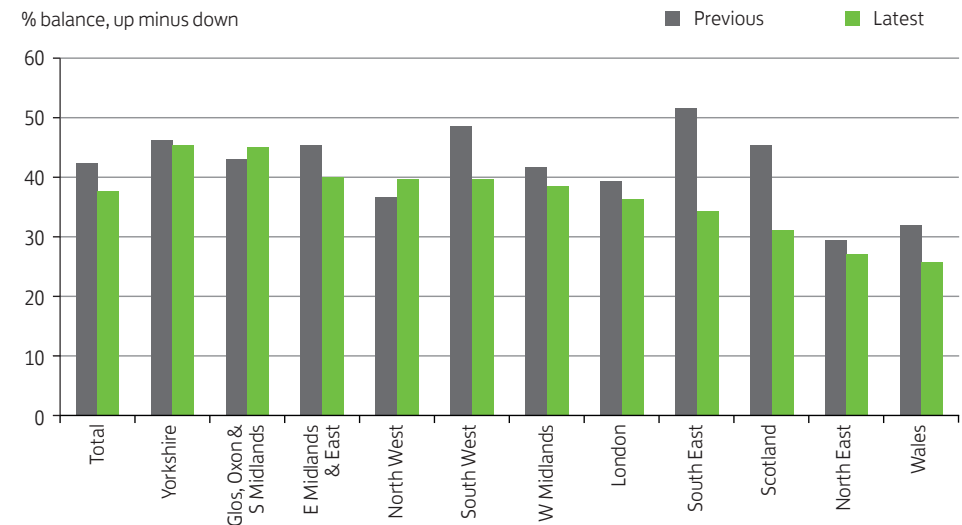
CAPITAL EXPENDITURE IN THE NEXT SIX MONTHS



The net balance of businesses that anticipate increasing capital spending is up in only three regions Gloucestershire, Oxfordshire & the South Midlands, the West Midlands, and Scotland. Amongst the other regions five have seen particularly large falls in expectations of more than 10 points. The balance of firms

expecting to boost investment spending has fallen sharply over the last eighteen months and for some regions now stands at relatively low levels. The regions with the lowest balances are the North East, the North West and the South West, while the West Midlands and London have the highest.

BUSINESS CONFIDENCE



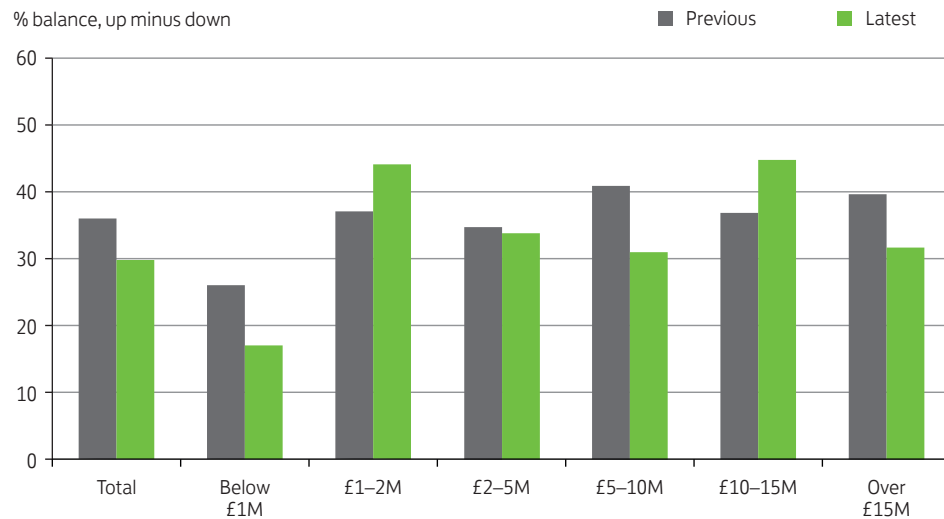
Overall business confidence declined in nine regions and rose modestly in two. The increases were in the North West and in Gloucestershire, Oxfordshire & the South Midlands. The largest decline in confidence was in the South East (down 17 points to 34%), and Scotland (down 14 points to 31%). Confidence, particularly in

some regions, is now appreciably below its level of eighteen months ago, although that is partly because confidence was unusually high at that point. Confidence is lowest in Wales, the North East and Scotland, while it is highest in Yorkshire & the Humber, and Gloucestershire, Oxfordshire & the South Midlands.

ANALYSIS BY SIZE OF FIRM

EXPECTED ORDERS HAVE INCREASED AMONG FIRMS WITH £1M-£2M AND £2M-£5M ANNUAL TURNOVER

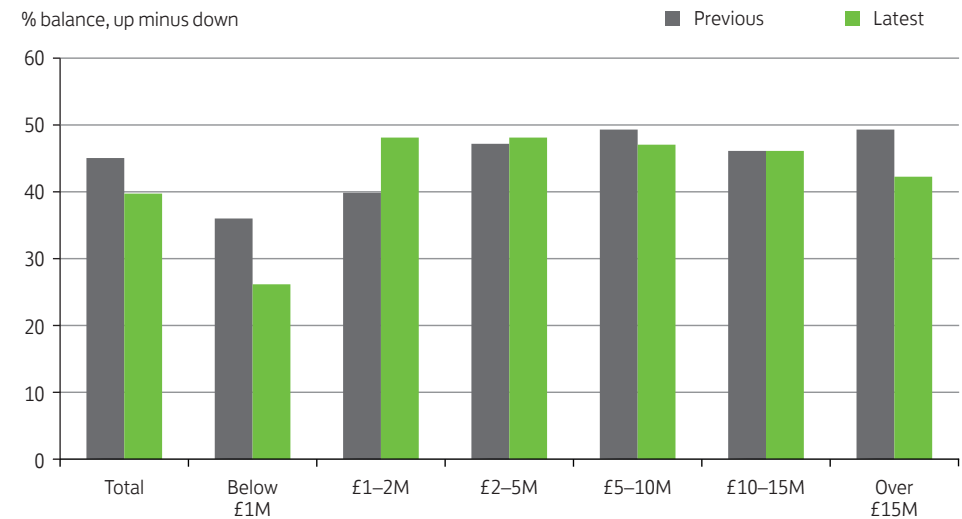
SALES OVER THE LAST SIX MONTHS



The decline in the overall net balance for sales over the past six months was not replicated across all company sizes. The exceptions were those with annual turnover in the £1m-£2m and £10m-£15m bands whose readings rose by 7 points to 44%, and 8 points to 45%, respectively.

These firms also had the highest net balances. On the other hand, the sharpest declines were reported among those firms with less than £1m and £5m-£10m sales whose net balances declined to 17% and 31% respectively.

ORDERS IN THE NEXT SIX MONTHS

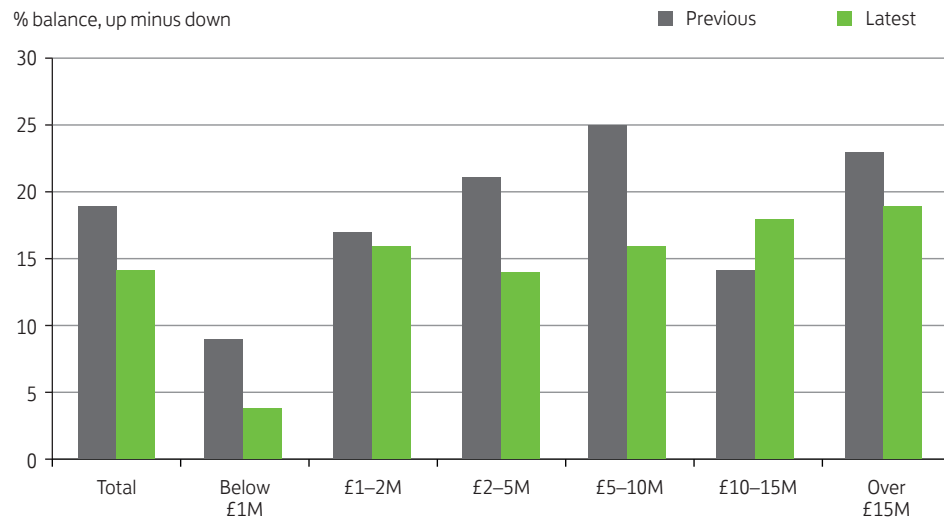


Similar to sales over the last six months, a differing picture across company sizes is reported for expected orders over the next six months. In particular, companies in the £1m-£2m and £2m-£5m bands bucked the overall 5-point decline in orders with 8-point and 1-point rises, to 48% in both cases, while

the balance remained at 46% in the £10m-£15m segment. Firms in the smallest turnover category of below £1m reported the largest decline of 10 points to 26% followed next by a 7-point decline among those in the highest band who have over £15m in sales.

BUSINESS OPTIMISM ABOUT THE NEXT SIX MONTHS IS HIGHEST FOR FIRMS IN THE £1M–£2M TURNOVER BAND

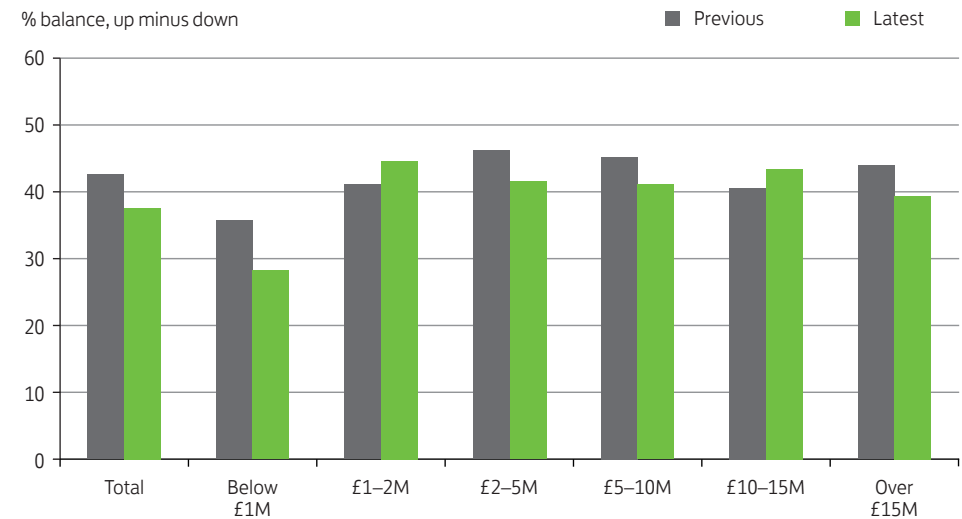
CAPITAL EXPENDITURES IN THE NEXT SIX MONTHS



With the exception of firms in the £10m-£15m turnover category, the softening in overall expectations about capital expenditures has been replicated across all the turnover bands,

although the size of the declines ranges between 1 and 9 points, with the largest falls in the £2m-£5m and £5m-£10m groups.

BUSINESS CONFIDENCE IN THE NEXT SIX MONTHS



Overall business confidence has strengthened among firms in the £1m-£2m and £10m-£15m bands while falling elsewhere. With the exception of the smallest companies, all firms

reported net balances in the 39%-45% range with the highest score belonging to those with sales of £1m-2m, followed by the £10m-£15m category at 43%.

Find out more

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