Economic Research Digest Quarter 2 2022

Department for the Economy
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The **Economic Research Digest** monitors recently published research across a number of economic areas relevant to the work of the Department for the Economy such as competitiveness, innovation, enterprise, trade, FDI, tourism and infrastructure. The Skills Research Digest deals separately with recently published skills and labour market research.

In each case, we provide a short summary of the key points and web links to the full article or report*. A full list of sources can be found at the end of the publication.

Highlights this quarter include:

- The Industry Outlook Survey published by the Financial & Leasing Association (FLA) noted that despite higher levels of inflation, taxes and interest rates squeezing the disposable income of households, 74% of FLA respondents expected an increase in new business over the next twelve months.
- According to the UK Economic Outlook published by CBRE, in February 2022, the UK economy exhibited month-on-month growth of 0.1%, following on from growth of 0.8% in January.
- According to the Department for Business, Energy and Industrial Strategy's UK Energy Trends document, gas exports to Belgium and the Netherlands increased and as these interconnectors are bidirectional, their increased utilisation resulted in an 11% reduction in total UK imports.

** Links are correct at the time of publication; however, it is likely that some will break over time. The list of sources has more general links, which should help the reader to track down the*

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Economic Outcomes

COMPETITIVENESS

The State of UK Competition Report April 2022 **published by the Competition & Markets Authority and commissioned by the Chancellor and Business Secretary, assess' the state of competition in the UK.**

- This Competition Report analyses relevant indicators to understand the strength of competition within the UK. Static indicators reflect the state of competition at a particular point in time and include concentration and business profitability, whilst dynamic indicators reflect change over time, including rates of firm entry and exit The C5 measure, which shows the average market share of the 5 largest firms in each industry, illustrates that despite concentration falling (and hence competition strengthening) levels remain above those seen prior to the 2008 financial crisis. Profitability is also higher than it was prior to the 2008 financial crisis, which suggests that competition is weaker. Average markups over marginal costs have increased from just over 20% in 2008 to approximately 35% in 2020, with a higher increase in markups exhibited for the 10% of most profitable firms.
- Common ownership, which refers to companies in the same market being controlled by the same owners, has been proven to reduce or even eliminate the commercial incentive for competition. Despite only 160,000 of the 2.6 million businesses analysed being part of common ownership, it was more prevalent in both larger businesses and certain sectors. This included mining and quarrying where almost 30% of businesses were part of a common ownership group.
- Digitalisation has created benefits for consumers however the sustained duration of Google, Meta and Apple's high profitability and market share means that the market performs poorly in terms of static and dynamic indicators. The weak competition deriving from the monopolisation of the digital market reduces innovation and choice, leads to consumers giving up more data than they would like and businesses paying more for digital advertising than they would in a competitive market.
- Improving competition is also seen as a key component in improving productivity, which has alarmingly only increased annually by 0.3% in the UK since the financial crisis. Competition is viewed to drive productivity by forcing managers to be more efficient, ensuring more productive firms increase their market share and driving firms to innovate.
- The effects of concentration, a key metric of competition, have been shown to have a disproportionate impact on poorer households. Poorer households spend a greater proportion of their income on essential goods and services, and these households face markets that are approximately 30% more concentrated (and thus these firms face less competitive pressure) than the markets faced by the richest households. Despite analysis showing the negative correlation between the consumption of essential goods and market concentration, no reasons have been suggested as to why these industries are relatively more concentrated.

PRODUCTIVITY AND GROWTH

UK Economic Outlook April 2022 **published by PwC provides the latest analysis of the UK economy and considers how the war in Ukraine will impact UK real GDP growth and consumer price inflation.**

- Economic output in January 2022 was 0.8% greater than the pre-pandemic level in February 2020. This follows on from a 1.3% quarter-on-quarter expansion of GDP in Q4 of 2021, driven significantly by the performance of the services sector. The 1.5% quarter-on-quarter growth in services is derived from transport and healthcare activities and counteracts the 0.2% reduction in production output in the same quarter, attributable to a contraction in energy supply and extraction activities.
- The UK's GDP growth in Q4 2021 was primarily driven by improvements in the trade balance, including a 4.9% increase in quarter-on-quarter exports. Additionally, household consumption contributed 0.3 ppts to GDP growth in Q4 of 2021 following an increase in spending on transport, net tourism, clothing, and footwear.
- Despite unemployment being at a record low, employment still remains below pre-pandemic levels with the economic inactivity rate remaining 1.1 ppts higher than before the pandemic. 90% of the

increase in economic inactivity is associated with workers over the age of 50 and who are therefore closer to retirement age and are less likely to re-join the workforce.

- The war in Ukraine has had two key impacts on the UK economy: higher energy and commodity prices and disruption of supply, financial contagion and lower trade and investment flows.
- Russia accounts for 10% of global oil production and 40% of Europe's natural gas imports. Furthermore, both Russia and Ukraine are producers of commodities needed for car batteries, food, and fertilisers. It is expected that the impacts will result in higher food and energy prices and cost pressures are expected to build in industries reliant on Russian commodities.
- The higher degree of political uncertainty can cause financial markets to become volatile, leading to higher risk premiums, debt yields and potential slower credit growth. Due to Russia and Ukraine only accounting for 1.9% of global GDP, the impact through trade and investment is not anticipated to be large.

LIVING STANDARDS, WELLBEING AND PROSPERITY

The Living Standards Audit 2022 **published by the Resolution Foundation outlines learning opportunities from historic trends in UK incomes and outlines comparisons with other countries.**

- While the current inflation shock stems from the Covid-19 pandemic, the war in Ukraine and supply chain issues, it is also important to look at longer-term trends. Prior to the aforementioned events reducing inflation-adjusted earnings, there was existing income inequality in the UK which is why such large policy interventions were needed to protect households.
- Over the last two decades the UK has had a "twin household income problem," which refers to the simultaneous low growth and high inequality experienced in the United Kingdom. Between 2004 and 2019, GDP per capita was the weakest since the Great Depression and there was exceptionally low growth in income distribution. This inequality exists not just historically but in terms of international standards, with the UK amongst the most unequal rich nations for both market incomes and incomes after taxes and benefits.
- However, it is widely accepted that GDP per capita and disposable incomes are not complete measures of living standards. Between 1961 and 2019/20 typical real household income after housing costs (considered a good proxy for household living standards) grew by an average of 1.9% per year and 20% each decade. GDP per capita has also grew by an average of 1.3% over the past two hundred years which exemplifies relatively steady growth over the long-term.
- The Gini coefficient, which measures income distribution across a population, shows little to no change in overall income inequality in the UK over the past two decades. Income inequality is also high compared to other rich nations, with the UK sitting near the top of the OECD's rankings for income inequality in terms of both market income and disposable income. The poor income growth experienced in the UK in the previous two decades meant that going into the pandemic and the following inflation spike, households had a relatively low level of financial resilience.
- There is a strong relationship between median hourly earnings and median disposable income and subsequently, the UK's income gaps with other countries are matched by earnings gaps. The UK had one of the lowest rates of growth in real earnings of any OECD country between 2007 and 2019, illustrating its poor international performance. Household earnings also have grown historically with real earnings and both in turn mirror productivity. With pay growth and productivity both being key drivers of living standards improvements, the slowdown over the last twenty years is a significant cause for concern.
- To improve overall income inequality, benefit incomes must grow as well as earnings growth. A 15% rise in all workers' earnings would impact disposable incomes differently across households and result in a rise in relative poverty, reflecting that not all adults work and workers are not shared equally across rich and poor households. Therefore, earnings make up a smaller proportion of poorer households' incomes than richer households. The UK's benefit policies are one reason there was virtually no income growth for the poorest households between 2004-05 and 2019-20 and why households offered little resilience to the storms of the early 2020's.

Innovation and Enterprise

INNOVATION

UK Innovation Survey 2021: Report covering the survey period 2018 to 2020 **published by the Department for Business, Energy & Industrial Strategy reports on UK businesses and compares innovation to previous surveys.**

- In 2018-2020, 45% of UK businesses were innovation active, compared to 38% in 2016-2018. Large businesses (58%) were more likely to have innovated than small and medium enterprises (44% in SMEs) and this held true for each of the three types of innovation: broader, wider and process.
- England had the highest percentage of innovation active firms in the UK (46%), with Northern Ireland having the lowest (38%). All four home nations in the UK were more innovation active than they were during the previous survey (2016-2018), with Wales illustrating the largest increase of any nation (10%).
- During the same timeframe, 46% of businesses in the UK were "broader" innovators and 34% were "wider" innovators, which illustrates how firms were more likely to introduce new products as opposed to new processes.
- 58% of these broader innovators were involved in "co-operation", which occurs when two or more participants share information derived from a task or series of tasks. This represents an increase of 9% from the previous survey. Of the 58% of broader innovators involved in co-operation, 77% engaged in arrangements with suppliers, 69% engaged with private sector clients and 52% worked with other businesses in their enterprise group.
- At a regional level within the UK, businesses in Northern Ireland, Scotland and London were more likely to source information relating to innovation activities from within their own business group than businesses in other English regions or Wales.
- When compared with data from the previous UK Innovation Survey (2016-2018), computer software investment amongst businesses increased by 10% to 24%, with hardware investment increasing by 15% to 23%. There was also an 8 ppt increase in machinery and equipment investment amongst UK businesses from the previous survey, with the percentage of firms investing in this area highest in the West Midlands (20%). At 9%, London was the area with the lowest percentage of firms investing in machinery and equipment which likely reflects the dominance of the service sector in this region.
- In 2020 there was an eight ppt increase in innovation expenditure used for the acquisition of machinery, equipment, and software. Overall, innovation expenditure on R&D was unchanged from the previous survey, with the level of expenditure used for the acquisition of R&D down one ppt to 6%.
- In 2021, 6% of UK businesses reported receiving financial support for innovation activities from the UK central government, compared to 3% in 2019. Separately, 6% received financial support for innovation activities from local authorities and 1% received support from the European Union (EU). The 2021 UK Innovation Survey (UKIS) also concluded that government R&D tax credits and government grants were key factors in businesses' decisions to innovate. Firms in receipt of public support are also viewed to have greater capacity to innovate. This in turn can increase employment and turnover, which regression analysis ran on data from the 2017 survey supported.
- Innovation between 2018 and 2020 was greater in production and construction industries than in distribution and services industries. The manufacture of electrical and optical equipment remained the most innovative industry (70% of businesses), with accommodation and food services having the lowest percentage of innovation active businesses (32%).
- The two primary reasons driving innovation throughout the timeframe in question were improving the quality of a good or service (of high importance to 39% of broader innovators) and secondly, issues surrounding the Covid-19 pandemic (35% of businesses considered this a factor of high importance). Issues relating to the pandemic was also cited as the greatest barrier to innovation, with excessive perceived economic risks second.

RESEARCH AND DEVELOPMENT

***UKRI Strategy 2022-2027* published by UK Research and Innovation (UKRI) sets out long-term, high-level priorities for how they will deliver their vision for an outstanding research and innovation system in the UK.**

- To deliver a research and innovation system that is fit for the future and fully utilises the talent across the UK, the UKRI has developed a strategy which focuses on four "shifts": diversity, connectivity, resilience, and engagement.
- The ability of the UK's research and innovation system to withstand shocks, deliver long-term goals and readjust to capture new opportunities is key. To ensure this the UKRI aims to improve the financial resilience of the UK's research and innovation system by using investment, policies, and governing power to work with the UK and devolved governments. For a research and innovation sector to thrive, it must create benefits for the society that it serves and with the stakeholders that fund it. Therefore, the UKRI aims to break down the barriers between research and innovation and society as a whole and involve a wider range of people and organisations in the process.
- The UKRI's overall strategy revolves around six objectives which aim to ensure the UK has the people, institutions, infrastructures, and partnerships to be a "global science superpower with the world's most innovative economy." The objectives provide a framework on how the UK will achieve its vision and realise its principles through world-class: people and careers, places, ideas, innovation, impacts, and organisation. If the UKRI was successful with its ambition, not only would the UK secure competitive advantage in key technologies and strengthen the clusters of research and innovation excellence, but will contribute to economic growth, create jobs, and draw in private sector investment.
- The UK's R&D workforce is highly talented and skilled but to meet future needs there are long-term challenges that must be faced. With the globally mobile nature of the R&D workforce, the UK must improve its ability to attract, develop and retain talent. To make this happen, the UK must not only make the broad range of careers available within research and innovation visible, but ensure all essential skills and talents are valued and ensure the role they can have in delivering excellence is exemplified.
- Globally renowned universities and research institutes form the basis of the UK's world leading R&I status and to build on this there are several sub-priorities. The UKRI aims to strengthen clusters and partnerships, locally, nationally, and globally, by enhancing connections across R&I and strengthening clusters in key locations amongst other plans of action. The UKRI has also prioritised improving the financial sustainability of R&I organisations across the UK and securing cutting-edge infrastructures for world-class research and innovation.
- Innovation can be considered the "lifeblood" of the UK's future economic growth, through boosting productivity, helping businesses to grow and scale and high-quality job creation. Every £1 of Innovate UK grant funding is associated with £13 of follow-on Venture Capital Investment which exemplifies how many UKRI funding programmes leverage significant private sector co-investment. The UKRI's priorities in terms of delivering world-class innovation include delivering the skills, finance and collaboration opportunities needed to boost private sector investment and accelerating translation, commercialisation, and knowledge exchanges.
- The UK is one of a few nations that has the capacity in terms of research, innovation, and technological ability to lead the response to global challenges. The UKRI's priorities regarding world-class impacts are addressing major national and global challenges, harnessing the opportunities from tomorrow's technologies, and transforming sectors that are key to the future economy. These will be done by building strategic international partnerships and supporting UK participation in international research, developing the skills base to exploit transformative technologies, and building a portfolio of industry-inspired programmes to boost productivity, respectively.

SECTORS AND TECHNOLOGIES

***Northern Ireland Quarterly Sectoral Forecasts 2022 Quarter 2* published by Danske Bank evaluates the performance of the general Northern Irish economy in Q2 of 2022 and some specific sectors.**

- Given the multi-decade high inflation rates currently being experienced, the pace of growth from Q2 onwards is expected to decline as household incomes are squeezed. Danske Bank estimates growth of 3.6% in 2022 and 1.0% in 2023 for Northern Ireland, with 2022's prediction still accounting for a degree of recovery from the Covid-19 pandemic.

- Across a range of key metrics, Northern Ireland's labour market has continued to perform strongly. The 0.4% increase in the number of employee jobs in Q4 of 2021 brought the number of jobs to a new series high, and additionally the 0.4% month-on-month increase in payrolled employees in April 2022 resulted in a record high of 774,600, 4.5% more than in April 2021. April 2022 also saw a 2.4% reduction in the claimant count in comparison with the month previous and the unemployment rate between January and March 2022 fell to joint record low of 2.3%. NI's robust performance in these metrics underpins Danske Bank's expectation that employee jobs will increase by 1.2% in 2022 and by a further 0.6% in 2023.
- The UK's CPI inflation rate reached 9% in April 2022, which is mainly attributable to higher energy costs and supply chain disruption. Higher prices is also the main impact Russia's invasion of Ukraine is having on both the UK and Northern Ireland's economies. With inflation expected to peak in Q4 of 2022 and average at approximately 8.5% for the year, the real incomes of households are expected to be squeezed and whilst Danske Bank predicts inflationary pressure will ease next year, it is thought it will still exceed the BoE's 2% target.
- With the aim of improving public finances following the support schemes rolled out during the pandemic and the need to support households through the cost of living crisis, a number of fiscal policies have been introduced. National Insurance contributions increased by 1.25 ppts in April 2022, income tax allowances and thresholds have been frozen for four years and in April 2023 the main rate of corporation tax will increase from 19% to 25%. The aforementioned aids to households include a rise in the threshold at which National Insurance begins to be paid and support with energy bills and one-off payments. In terms of monetary policy, the BoE is expected to raise the bank rate to 1.5% by the end of the year. With that being said, a large part of recent inflation is attributable to global and supply-side factors such as rising energy and commodity prices and so tighter monetary policies are unlikely to reduce inflation in the short term. Furthermore, as prices for essential commodities continue to rise, demand for non-essential goods is likely to diminish which may contribute to a slowdown in overall price rises without adjusting monetary policy.
- As UK businesses in general face barriers to trade following the withdrawal from the European Union, the implementation of the NI Protocol has resulted in new processes for firms in Northern Ireland purchasing goods from Great Britain. Despite urgency for a resolution following the elections, the complexity surrounding the negotiation of a settlement means uncertainty remains.
- UK GDP data shows that despite Q1 of 2022 exhibiting growth, it was solely concentrated in the first month, with output stagnating in February and declining in March which illustrates a weakening in momentum even before inflation hit a forty year high in April. There has been a more pessimistic outlook for the overall UK economy as inflationary pressure weighs on consumer confidence, demand, and spending. The UK labour market has also tightened, as unemployment fell to 3.7% in the first quarter of the year.
- In Northern Ireland specifically, 2022 Q1's growth is expected to slow as inflationary pressure continues to weigh on consumer spending. Growth of approximately 3.6% is expected in NI in 2022, and 1.0% in 2023. As the economy continues to recover from the pandemic, the accommodation and food services and arts, entertainment and recreation sectors are expected to experience the fastest rates of growth in 2022.
- Demand for labour in NI remains relatively strong, with Danske Bank increasing their expectation of annual average number of employee jobs by 0.1% to 1.2% in 2022. However, similarly to the rest of the UK, the pace of job growth is expected to slow to approximately 0.6% in 2023. Sectors such as hospitality and tourism are expected to see relatively strong job growth this year as they continue to recover from the pandemic. The accommodation and food services sector is also likely to experience above average job growth of 2.2%, in line with the trend of consumer-focus sectors experiencing much of the growth. Despite predictions of 0.4% growth in employment in the manufacturing sector in 2022, a decline in 2023 is anticipated as skills shortages and longer-term trends to increased automation reduce employment levels in the sector.

Financial Services Survey June 2022 **published by PwC/CBI analyses key challenges facing the financial services sector.**

- The most prominent drivers of disruption to financial services (FS) firms were regulation (71%) and changes in consumer preferences (62%). In response to these and other drivers, 74% of FS firms have chosen to upskill their existing workforce to alleviate the pressure this disruption has. Regarding this upskilling, which the primary aim of is to improve workforce agility, time needed

(50%) was the greatest barrier to delivery. 43% of firms in the FS sector are also in the process of modernising their technology and IT architecture.

- Accelerating the development of products to aid the transition to net zero was the most heavily cited climate change priority for firms in the three months from June (47%). In terms of barriers to establishing a net zero target, devising a clear plan on how to achieve it was the biggest challenge, with 45% of FS firms citing this reason.
- 22% of FS firms have initiatives to support both consumer and commercial clients with the cost of living/doing business. 26% of firms have initiatives to help only consumers and 21% of firms that do not currently have any such initiatives intend to implement them in the future. Providing access to financial products (63%) and providing financial wellbeing assessments and education on products (56%) are cited by FS firms as the most beneficial actions their organisation can take to support consumers.

***Construction Output in Great Britain: April 2022* published by the ONS outlines short-term measures of output by the construction industry and contracts awarded for new construction work in Great Britain.**

- April 2022's 0.4% decline was the first monthly decline in construction output (in terms of volume, representing a £58 million fall in monetary terms) since October 2021. This decline stemmed from a 2.4% fall in repair and maintenance which was relatively high in March as there was vast amounts of repair work following storms Dudley, Eunice, and Franklin in February 2022. It is worth noting that there was a 2.9% increase in construction output in the three months to April 2022, the sixth consecutive growth in the three-month-on-three-month series, indicating that the figures seen for April 2022 may be an anomaly.
- At sectoral level, the main contributors to April's decline were private housing repair and maintenance (6.5% reduction) and private commercial new work (3.8% reduction).
- Despite there being a fall in output in terms of volume, construction was 3.3%, equivalent to £481 million, above the pre-pandemic level of February 2020. Recovery from the pandemic has been mixed at sectoral level, illustrated by a £669 million (35.6%) increase in infrastructure and a £676 million (27.2%) decrease in private commercial relative to their February 2020 levels.

ENTREPRENEURSHIP

[No relevant material sourced for this quarter's release.]

BUSINESS GROWTH

***Business insights and impact on the UK economy* published by the Office for National Statistics evaluates the impact of challenges facing the economy and other events on UK businesses.**

- In March 2022, 20% of trading businesses reported increased turnover compared to February 2022. Approximately 50% of currently trading businesses reported that they had experienced increased prices of goods, materials, or services they had bought, an increase of 11% on the previous month. Consequentially, 31% of businesses expected the price of the good or service they sell to increase in April 2022. 41% of trading businesses also cited rising energy prices as a factor in increasing prices, with accommodation and food service sector businesses (78%) reporting this reason more than any other sector. Raw material prices (33%) and labour costs (26%) were other frequently mentioned reasons.
- 58% of businesses reported that general price rises had impacted them in one or more ways. In April 2022, the absorption of costs (38%) and having to pass on increased costs to consumers (27%) were reported as having the biggest impact as a result of general price increases on businesses. Being forced to absorb costs was felt most heavily in the accommodation and food services sector and having to pass these price increases on to consumers was felt most heavily in manufacturing and again the accommodation and food services sector.
- In April 2022, 94% of businesses reported that they were trading, with 85% fully trading and 9% partially trading. Additionally, 4% of businesses had stopped trading temporarily and 2% had ceased trading permanently. Of the businesses not permanently stopped trading, 13% reported that domestic demand for goods and services was lower in March 2022 than it was the previous month. 8% reported an increase while the 47% reported no change in demand. The wholesale and retail trade, repair of motor vehicles and motorcycles and accommodation and food service activities industries reported the highest percentage of firms reporting a decrease (24%).

Additionally, the manufacturing industry reported the largest percentage of firms with increased demand (17%).

- 34% of firms in the accommodation and food service activities industry reported decreased turnover in March 2022. With no other industry reporting a higher percentage, this figure is at least partially attributable to the food and beverage service activities sub-industry. The cost of materials was cited as having the biggest impact on the turnover of currently trading businesses in March 2022. While 30% of firms cited the increased cost of materials, 25% cited economic uncertainty, 15% the cost of labour and 13% competition.
- Of businesses that did not stop trading permanently, 33% reported increased staffing costs over the previous three months and 29% of all businesses expected staffing costs to increase further in the next three months.

Agents' Summary of Business Conditions - 2022 Q2 **published by the Bank of England summarises intelligence gathered by the Bank's Agents between mid-April and late May.**

- While there was growth in the value of consumer spending during the timeframe examined, this was attributable to generally higher prices. Growing pressure on real incomes drove retail sales volumes down while consumer service demand remained more robust.
- There were a number of key signs of consumers spending more cautiously across a range of markets which reflects the aforementioned pressures on the real incomes of households. Discount fashion retailers reported stronger sales than those in the higher-priced segment of the market, supermarket contacts have reported consumers switching to lower-priced alternatives and discount stores have gained market share. Contrastingly, contacts in the leisure and hospitality sectors have reported solid demand.
- Contacts in business services reported that their growth in turnover, which was primarily driven by higher volumes and fees, was hampered by labour shortages. Litigation and employment law performed exceptionally well in a generally strong professional and financial services sector. IT services continued to experience increased demand from April to May 2022, however staff shortages again were deemed to hamstring the pace of growth.
- Output growth in manufacturing decreased slightly as output was constrained by a shortage of materials and components, with Russia's invasion of Ukraine deemed to worsen existing supply shortages resulting from Covid-19 lockdowns in China. Steel, agricultural and food products, electric vehicles, IT equipment and fibreglass are products that were viewed to be in short supply. When viewed holistically, the aforementioned supply shortages as well as acute labour shortages have led to increased work backlogs and longer delivery times, particularly in the automotive sector.
- The BoE has twelve agencies that have private and confidential discussions with at least 700 firms (contacts) each reporting period. In Q2 of 2022, contacts expected supply chain disruption to persist into 2023, with firms have taking actions such as switching suppliers, adapting their inputs, and holding more stock in order to minimise the negative impacts. In addition to increased difficulty obtaining materials, their cost has also increased. This in conjunction with labour shortages has led to weakened output growth in the construction sector. Delays and cancellations were most prominent with commercial projects, with the construction of private and public infrastructure, and health and education projects impacted less. During the timeframe in question, demand for the construction or refurbishment of office space remained strong, supported by demand for premises that meet environmental and hybrid-working requirements. However, contacts expected demand for construction projects to slow as rising costs put projects on hold. Furthermore, the squeeze on households' budgets is expected to hamper demand for both new homes and home improvements.
- In terms of investment, intentions remained positive and continued to return to "normal" levels. IT and automation and the refurbishment of office spaces were the areas contacts reported investment spending, with contacts, especially in manufacturing, increasingly considering investing in energy-saving measures. Despite this, a shortage of materials, components and labour coupled with rising costs have held back investment activity relative to investment intentions.
- Contacts reported a tightening in credit conditions, especially for SMEs (small-medium enterprises) and for firms in the automotive, retail, construction, and hospitality sectors. Increased credit demand was driven primarily by demand for working capital and asset finance, and credit conditions remained generally accommodative for low-risk borrowers and asset-backed lending. The previously mentioned increase in demand for working capital came predominantly

from firms in the agriculture, manufacturing, energy, construction and wholesale and transport sectors, mostly due to rising input costs and supply-chain delays.

- A sizeable proportion of contacts reported struggling to fill vacancies as demand continued to grow, with the proportion of firms who expect they will have to increase pay to retain staff growing. Contacts reported a 10% increase in starting salaries, with job turnover rates increasing as staff accept offers to switch companies for a significant pay rise.
- Despite firms mostly passing on input price inflation to consumers in the form of higher prices, contacts reported that margins were below normal on average. The passing on of increased costs to consumers was particularly evident in energy-intensive sectors such as food and chemicals. In addition to material and commodity price pressures remaining high, price pressures for imported finished goods also remained elevated, particularly for food, medical supplies, and other durable consumer goods. Supermarket contacts reported that despite expecting food price inflation to rise by 5-8%, they did not intend to fully pass on these costs to consumers to retain market share.

***Industry Outlook Survey* published by the FLA (Finance & Leasing Association) gauges the opinions of senior executives across the asset finance, consumer finance and motor finance markets on the outlook of the UK economy and the markets they represent.**

- Despite higher levels of inflation, taxes and interest rates squeezing the disposable income of households, 74% of respondents expected an increase in new business over the next twelve months. However, this figure does represent a softening of expectations (86% in Q1 2022) and 42% of respondents expect their growth to be less than 10% compared to 31% in the previous survey. The inflationary pressure building following the pandemic and Russia’s invasion of Ukraine (which is expected to persist for another twelve months before easing) is expected to cause the largest fall in real disposable household incomes on record and respondents from all three divisions (Asset Finance, Consumer Finance and Motor Finance) have raised concerns about what impact the “cost of living crisis” will have on consumer confidence and demand. Generally, respondents showed optimism regarding opportunities for growth, with demand for credit from certain households expected to increase as there was still pent-up demand in the wake of the pandemic
- The AFD (Asset Finance Division) is supported by a strong used car market, and it is hoped that the resolution of supply chain issues will not only allow the new car market to rebound but will provide opportunities for growth for the wider AFD. There were additional opportunities for growth in this division through the adoption of digitalisation and meeting government net-zero targets.
- The industry’s optimism surrounding the UK economic outlook has declined since 2022’s Q1 survey. Only 20% of respondents expected an improvement in economic conditions in the next twelve months compared to 57% in Q1, with concern primarily deriving from the impact of the cost of living crisis on consumer demand and supply shortages.
- IT, underwriting, compliance, credit risk and analytics were just a few areas of expertise in which member companies had difficulty hiring staff. Between the Q1 and Q2 surveys, there was a 9% reduction in respondents who expected an increase in their firm’s employment in the next twelve months.
- 84% of respondents expected some increase in the number of customers in arrears over the next twelve months, which is a marked increase from the 58% figure seen in Q1’s survey. 89% of respondents also expected an increase in the number of business insolvencies over the next twelve months, although 76% expect this increase to be slight.

BUSINESS REGULATION

***Review of Ofgem's regulation of the energy supply market* published by Ofgem outlines the findings of Oxera’s independent “lessons learnt” review of Ofgem’s role in the recent supplier failures in the UK retain energy market.**

- Ofgem’s principal objective across all its regulation of the electricity and gas markets is to protect the interests of existing and future consumers. In relation to the supplier market, there are two secondary objectives which are to promote effective competition and to “have regard to the need to secure that license-holders are able to finance their licensed activities.”
- As well as complying with statutory duties and primary legislation, Ofgem acts regarding policy direction from government, especially the Department for Business, Energy & Industrial Strategy

(BEIS) and its predecessors. The direct effects drive how Ofgem designs specific regulatory interventions, and the indirect effects are also potentially significant.

- This assessment of Ofgem's regulation of the energy supply market spans across the full lifecycle of a failed supplier, from entry to exit. New market entry arrangements came into force following the Supplier Licensing Review in June 2019, which significantly deterred new entry. Previously, market players did not need to provide a robust business model or provide evidence that they possessed sufficient financial reserves or adequate levels of total or working capital. Following the introduction of the new entry arrangements, there was no more than one new entrant in each subsequent quarter.
- Ofgem's ongoing requirements (prior to the Supplier Licensing Review) consisted of the following two approaches: monitoring proxy indicators of financial risk and informing suppliers of the importance of communicating with Ofgem as a priority if they have concerns about their financial position.
- Exit arrangements cover the processes and legislation in place to manage a supplier's exit from the market. In the case of insolvency, the failed supplier's customer book is allocated to another supplier determined by a bidding process or to a temporary special administrator if the failed supplier is too large.
- Low costs of exit in the energy supplier market have created somewhat of a moral hazard. There are no requirements for license-holders to enter with or maintain a predefined level of capital and with the ability to build a short-term liquidity buffer through customer prepayments, the lack of need for significant shareholder capital has been described as making entry into the energy supply market as a "free bet" in some stakeholder interviews.
- In the final guidance on the FRP (Financial Responsibility Principle) which was announced in 2020 as part of the Supplier Licensing Review, Ofgem stated that it would adopt a risk-based approach, allocating more regulatory resources to scrutinise the high-risk suppliers which was intended to protect consumers and reduce the potential costs of mutualisation.
- Until 2014 the six legacy suppliers accounted for over 90% of market shares. Non-legacy suppliers increased their market share to approximately 30% in 2019 and to 40% in 2020 (when considering OVO's acquisition of SSE). Supplier exits began in 2019 and in 2021, rising wholesale prices resulted in 30 supplier exits. Using current ratios as a measure of liquidity, low liquidity was positively correlated with a higher incidence of failure amongst energy market suppliers. Furthermore, failed companies in the pre-pandemic period had a higher credit balance as a proportion of total assets and this trend continued in the pandemic era.
- A number of regulatory options at Ofgem's disposal have been identified that could have mitigated the risks of failure, the cost of failure or both. These options include requiring a substantial commitment of shareholder equity prior to market entry, setting, and monitoring minimum levels of capital adequacy, requiring a higher degree of assurance from directors of a supplier in relation to its business model and requiring the company's auditor to write a report to the regulator annually on their assessment of solvency and any risks to it.
- Overall, Oxera suggests that there is a spectrum of options available between two distinct policy options. Firstly, Ofgem could introduce a number of regulatory policies that reduce or eliminate both the ability of and the incentive for suppliers to pursue riskier business models with lower levels of capital. Alternatively, instead of constraining companies' behaviour, Ofgem could undertake frequent and rigorous monitoring of companies' financial resilience, including stress-testing business models.

Succeeding Globally

TRADE

***UK Trade: April 2022* published by the ONS outlines key trends in UK exports and imports and analyses a host of trade related data.**

- The total value of goods imported to the UK rose by £0.4 billion in April 2022 compared to the month previous. This figure can be broken down into a 4.2% (£1.1 billion) increase in imports from EU countries and a 2.6% (£0.7 billion) reduction in imports from non-EU countries. Exports from the UK grew by £2.2 billion or 7.4% in the same timeframe, with this increase driven primarily by a £1.2 billion increase in exports to EU countries. As a result, EU exports have reached the highest levels since records began following three consecutive months of increases.

Economic sanctions placed on Russia following their invasion of Ukraine has resulted in exports to and imports from both reaching their lowest levels since January 1999 and March 2004, respectively.

- In terms of specific commodities, imports from the EU of machinery and transport equipment increased by £0.8 million in April in comparison to the month previous, with this increase offset by falling imports of fuel from the EU. The increase in exports to the EU is partially attributable to a £0.6 billion increase in machinery and transport equipment exports and a £0.5 billion increase in exported fuels.
- With the exclusion of precious metals, the UK's trade in goods deficit widened by £7.1 billion to £24.3 billion in the three months to April 2022 compared to the three months to January 2022. When comparing the same time periods again, estimations show a £3.2 million increase in the trade in services surplus.
- It is worth acknowledging the implementation of a data collection change by HMRC (HM Revenue and Customs) in January 2022, impacting the measurement of imports from the EU to Great Britain. While the move from the Intrastat survey means that EU to GB import statistics from January 2022 are no longer comparable to previous months, there is an improvement in coverage and the circa 7% of trade by value that previously fell below the Intrastat value threshold is now included.
- The UK leaving the EU, the following period of adjustment and the Covid-19 pandemic have all, amongst other things, caused higher levels of volatility in trade statistics over the last two years, making it difficult to assess whether trade movements reflect short-term trade disruption or long-term supply chain adjustments.

INWARD INVESTMENT

***Business investment in the UK: January to March 2022 revised results* published by the ONS estimates short-term indicators of investment in non-financial assets, business investment and asset and sector breakdowns of total gross fixed capital formation.**

- In Q1 of 2022 business investment declined by 0.6%, with gross fixed capital formation (GFCF) increasing by 3.8% (revised down from a provisional estimate of 5.4%), which illustrates a rise in total business and public sector investment. Other building and structures, and transfer costs were the two GFCF components with the largest downward contribution to the GFCF estimation. The level of business investment in Q1 2022 was 9.2% below the level seen in Q4 of 2019, which is considered "pre-pandemic"
- The slower return to pre-pandemic levels of business investment compared to GFCF reflects the different patterns of investment by government and businesses observed throughout the pandemic. Transport has been identified as the weakest asset in terms of returning to pre-pandemic levels for both business investment and GFCF and this has been the case since Q1 of 2020, having been impacted heavily by a global shortage of semi-conductors. Contrastingly, investment in ICT equipment and other machinery has returned to pre-pandemic levels in Q2 of 2021 and coincides with the availability of temporary tax relief on qualifying capital asset investment, the impact of which was most likely reflected in the aforementioned areas. Companies have increasingly invested in automation which is likely due to the tightness of the UK labour market.
- The majority of G7 nations have now returned to positive growth relative to pre-pandemic, with the USA and Canada exhibiting this from as early as Q4 of 2020. The UK has lagged behind, with GFCF only returning to positive growth in Q1 of 2022 and lags behind the G7 average of 3.6%.

TOURISM

[No relevant material sourced for this quarter's release.]

Economic Infrastructure

ENERGY

[Energy Trends UK, January to March 2022](#) published by the Department for Business, Energy & Industrial Strategy outlines information on energy production, trade, and consumption in the UK for total energy and by specific fuels.

- Renewable generation increased by 9.3% in Q1 of 2022 compared to the same period in 2021, which is attributable to a 6.5% year-on-year increase in capacity and more favourable weather conditions. Both demand and production fell for energy in Q1 of 2022. On the demand side, strong renewable generation and warmer temperatures displaced gas used for electricity generation and heating. In terms of production, the failure of primary oil production to recover following maintenance work carried out on the UK's Continental Shelf in the summer of 2021 drove the reduction.
- Q1 2022 saw total production of energy drop to 29.3 million tonnes of oil equivalent, which was 2.1% lower than the same period in 2021. Coal, oil and bioenergy and waste production all fell, which was offset by a rise in gas, nuclear and wind, solar and hydro production. Total final energy consumption was 0.8% higher than Q1 of 2021, with consumption returning to pre-pandemic levels for most sectors with the exemption of transport (which rose by 31%).
- Despite a 0.5% increase in coal demand for coal-fired electricity generation in Q1 2022 compared to the same period a year previous, which represents an absolute increase, coal's place in the generation mix is close to historic lows. The seasonal peaks usually observed in winter months are diminishing as coal-fired generations becomes less economically competitive and gas and renewable sources displace it.
- The UK's net imports of primary oils was equivalent to approximately 3.4 million tonnes in 2022 Q1, with the two thirds increase aiming to meet increased refinery demand. Despite the increase, levels remain approximately 6.6% below the pre-pandemic levels of Q1 2019. Final consumption increased by a fifth which was partially attributable to the continuing recovery of the transport sector.
- Demand for natural gas fell by approximately 12% in Q1 of 2022 in comparison with 2021 Q1, largely driven by a fall in the amount of gas used for domestic and electricity generation purposes. Domestic consumption declined by 17% due to generally warmer weather conditions which reduced the need for domestic heating. Gas exports also nearly doubled as the UK's regasification infrastructure fed European gas supply. Specifically, exports to Belgium and the Netherlands increased and as these interconnectors are bidirectional, their increased utilisation resulted in an 11% reduction in total UK imports.
- Warmer weather resulted in a 1.2% decrease in total electricity consumption in the UK in Q1 of 2022 compared to the same time a year previous. Another contributing factor is the fact that in Q1 of 2021 a national lockdown was in place. Domestic consumption, for similar reasons, was down 6.1% to 30.8 TWh (terwatt hour) which was counteracted by increased consumption in non-domestic sectors. Electricity consumption in the industrial sector increased by 3.0% compared to 2021 Q1 and consumption by other final sectors increased by 2.0%.

TELECOMS

[Telecommunications Market Data Update Q4 2021](#) published by Ofcom highlights some of the key trends emerging this quarter from data collected on the UK telecommunications sector.

- In Q4 of 2021, there was a £42 million reduction in fixed voice service revenues, which represented a 2.8% decrease from the previous quarter and a £230 million year-on-year reduction. BT dominated the market with a 49.6% share of these fixed voice service revenues. Fixed originated call volumes fell by three billion million minutes compared to Q4 of 2020, which is largely attributable to the increased call volumes during the early stages of the pandemic. Total call volumes in 2021 were 14% lower than in 2020, equivalent to 40.3 billion minutes.
- At the end of Q4 2021 there were 27.7 million fixed broadband lines, a 0.4% increase from the previous quarter and a 1.4% increase from the same period in 2020. The number of cable broadband lines on the other hand fell by 26,000 (0.5%) in the same timeframe.

- Mobile telephone services generated £3.1 billion in retail revenue in 2021 Q4, £13 million more than the previous year. The average monthly revenue of each subscriber throughout that period was £12.29, with pre-pay subscribers generating less revenue than post-pay subscribers (£9.53 difference). The number of active mobile subscriptions in Q4 2021 was 85 million (with the exclusion of M2M, machine-to-machine) and the number of mobile-originated voice call minutes decreased by 3.8% to 46.5 billion minutes year-on-year. There was also a decline of 0.7 billion year-on-year in mobile messages and a drastic increase of 25.9% in data usage.

AIR ACCESS

***Overseas travel and tourism: April 2022 provisional results* published by the Office for National Statistics estimates visits to the UK by overseas residents, air visits abroad by UK residents and spending estimates by travellers, using the International Passenger Survey and administrative sources of passenger travel**

- In April 2022 there were approximately 2.1 million overseas visitors to the UK, 27 times more than the figure of 88,000 in the same month in 2021. At circa 800,00 visits, the most common reason for overseas visits to the UK was "visiting friends or relatives". Spending by overseas residents in the UK was also up from April 2021 to £1.7 billion, 14 times as much. These significant increases are largely attributable to the easing of Covid-19 travel restrictions virtually worldwide. However, visits to the UK were still down 33% from the figure of 3.2 million seen in April 2019 (pre-pandemic).
- April 2022 also saw UK residents make 5.6 million visits overseas, where they spent £4.1 billion. In comparison to April 2021, the number of trips and the amount spent was twenty times greater in 2022. 61% of these trips overseas were for a holiday (3.4 million) which was a majority, followed by visiting friends and family.

Government

Northern Ireland

[No relevant material sourced for this quarter's release.]

ENGLAND

[No relevant material sourced for this quarter's release.]

SCOTLAND

***State of the Economy* published by the Scottish Government presents new analysis on how the economy has been impacted by the three recent economic shocks: Covid, EU Exit and the war in Ukraine.**

- Scotland's GDP grew by 0.4% in February 2022 and is now exceeding its pre-pandemic level (February 2020) by 1.3%. The labour market has also remained strong, with unemployment falling to a series low of 3.2% and the number of payrolled employees rising to exceed pre-pandemic levels by 29,000. However, labour market conditions have been tight with high vacancy rates and demand for staff. While this has applied upward pressure on nominal wages, they have not kept pace with inflation and Scottish households are seeing their real incomes fall.
- Trading conditions for firms have also been challenging. Supply chain issues are persisting and the war in Ukraine is putting upward pressure on global commodity prices and energy prices. Scottish government analysis has also indicated that the UK's withdrawal from the EU has resulted in a drop in trade intensity and openness which is contributing to higher input costs.
- The Covid-19 pandemic shocked the economy and caused a 3.1% reduction in global output in 2020. There was a rebound in 2021 as global output grew by 6.1% and global industrial production and trade in goods continued to strengthen until February 2022 when the economic outlook was impacted by the war in Ukraine. Rising energy prices and supply chain disruption caused global inflation to spike in 2021 and Russia's invasion exacerbated these inflationary pressures.

- Prior to 2022, Scotland exported £300 million worth of goods to Russia, which supported Scottish GDP by £250 million (0.2%). Of this £250 million impact on GDP, £170 million of the impact was the direct impact on output from reduced exports, while the rest consisted of indirect impacts on supply chains and reduced wages in the economy. Although the overall impact the sanctions placed on Russia have had on the Scottish economy is small, the impact is more pronounced for certain sectors such as the manufacturing of machinery and equipment and the information services sectors.
- Scotland's growth in February was primarily driven by growth in the services sector (+0.7%) and the production sector (+0.3%). Within the strongly performing services sector, consumer facing services increased by 2.1% over the month. This growth was attributable to 8.1% growth in the accommodation and food sector which has been aided by the easing of restrictions since the turn of the year.
- Output across the production sector, mainly driven by electricity and gas supply, grew by 0.3% in February. Output in construction declined by 0.1% as supply chain issues and the cost and availability of materials stifled growth simultaneously.
- The Purchasing Manager's Index (PMI) indicated a fourth consecutive month of accelerating business activity growth in April. This growth consisted of a pick-up in manufacturing production which was offset by a slight decline in growth in the services sector. Another positive indicator of business activity was the improvement in trading capacity. At the beginning of May business survey evidence showed that all firms in the Information and Communication, Transport and Storage and Professional, Scientific and Technical Activities sectors were trading fully.
- The cumulative effects of the pandemic, supply chain disruption and inflationary pressure have created challenging conditions for business investment. The uncertainty resulting from these conditions has painted a mixed picture for business investment within Scotland. Q1 of 2022 saw strengthening growth in business investment across construction, manufacturing, and financial and business services, while retail and wholesale for example remained negative.
- Despite challenges arising from the pandemic and the UK's withdrawal from the EU, Scotland's international trade in goods showed signs of strengthening over the course of 2021. Goods exports, including oil and gas, increased by 1.6% to £27.0 billion although remains 20% below pre-pandemic levels. Business survey data for April 2022 also outlines an increase in the share of Scottish businesses that are exporting less than normal for the time of year, up to 26%. This increase from 20% at the start of 2022 likely reflects the negative impact of supply chain disruptions which have been exacerbated by the war in Ukraine and recent Covid-19 restrictions in China.
- By taking a weighted average of countries whose trade closely reflects what Scotland's was before the Trade and Cooperation Agreement (TCA) was implemented, a synthetic control was developed to compare Scotland's trade of goods with the EU with what it would have been without withdrawal from the EU. While tariffs were not introduced with the EU, it is expected that the cost of trading with EU countries would rise for Scottish businesses, and this is supported by the statistically significant reduction in imports in 2021 (down 18% to 25%). In cash terms, exports to EU countries were also down by approximately £200-£300 million.
- For January to March 2022, employment was 75.6% which represents a 1.3 ppt increase over the year and economic inactivity was also down 0.3 ppts. Scotland's relatively strong labour market was further illustrated by a claimant count which continued to trend downwards and sits 47% below its pandemic peak. Following volatility throughout the pandemic, PAYE monthly pay growth stabilised in Scotland at the beginning of 2022, with growth of 1.0% in March and 6.8% annually.
- Despite this, real earnings have suffered with a CPI inflation rate of 7.0% in March which rose to 9.0% in April. This inflation, which has presented a severe cost of living crisis, was seen most notably in electricity and fuel prices (+69.6%) and transport prices (+13.5%). By the second half of 2022 inflation is expected to exceed 10.0%, with the war in Ukraine which has resulted in increased global commodity prices exacerbating inflationary pressure.

WALES

[No relevant material sourced for this quarter's release.]

REPUBLIC OF IRELAND (ROI)

[No relevant material sourced for this quarter's release.]

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