NI CHAMBER & BDO NI

Quarterly Economic Survey Summary

Q1 2022

WWW.NORTHERNIRELANDCHAMBER.COM
Overview

There were some signs of weakening in the COVID recovery path for Northern Ireland businesses in Q1 22 dominated by huge cost pressures, particularly for manufacturing, weakening cash flow and profitability and putting firms under growing pressure to raise prices.

The Q1 22 QES findings suggests that members are less confident around turnover growth over the next year with 60% expecting their business turnover to grow in 2022, down from 70% in Q4 21. Inflationary pressures from mounting business costs, largely from high raw material costs but also pressure to raise wages, are causing significant concern with manufacturers particularly affected. Expectations to raise prices are highest on record with a greater share of businesses in Northern Ireland expecting to raise prices in the next 3 months compared to all other UK regions.

After reaching record lows across all key indicators in Quarter 2 2020 with the onset of the COVID-19 pandemic, 2 years on almost all key indicators are positive meaning more firms are reporting increases in sales, exports and employment than those reporting a fall. By comparison one year ago in Q1 2021 almost all key indicators were negative. More businesses are reporting increased UK sales (37%) in the last 3 months compared to those reporting falling sales (19%). This is also the case for those exporting (34% increase vs. 19% decrease).

However, there are still challenges with 50% of businesses operating below capacity (52% Q4 21). Also, in Q1 22 30% of firms still remain negatively affected by the pandemic and 19% are just covering costs or are in difficulty. EU exit has also presented a new set of challenges over the last year with many businesses affected by increased costs.

Two in 3 (67%) are trying to recruit (although recruitment intentions did dip for the first time since Q2 20). However, 89% are experiencing recruitment difficulties and for 38% wage pressures are feeding into expectations to raise prices.

The most striking issue in Q1 22 is the extent to which inflationary pressures are impacting on businesses, particularly manufacturers. 77% expect to raise prices in the next 3 months driven in large part by high raw material costs. Almost 4 in 5 (77%) cite rising raw material costs as the main driver of price rises. Cash flow and profitability for manufacturers is particularly negatively affected.

Almost all key indicators are positive meaning more firms are reporting increases in sales, exports and employment than those reporting a fall.
Manufacturing

It has been a concerning start to 2022 for Northern Ireland manufacturers with confidence challenged against the severe cost pressures that the sector is facing. While almost all key indicators remain positive suggesting more firms are growing sales and jobs, three key indicators turned negative in Q1 22 – cash flow, confidence around profitability and capital investment intentions. The sector’s weakest indicator is cash flow. Northern Ireland’s regional position has worsened after what had been quite a positive position coming out of COVID. Northern Ireland is the bottom-ranking region in terms of domestic sales, confidence both in turnover and profitability growth in the next 12 months and investment intentions. Inflationary pressures are very severe for the sector. 88% of manufacturers are expecting to raise prices, highest across the UK regions, with 95% citing rising raw materials costs as the key driver. In addition, pressure from pay settlements (43%) remains one of the highest across the UK regions (UK 36%).
Services

The service sector recovery continues although cost pressures dominate for the sector also. Sales and export indicators improved in Q1 22 and all key indicators are positive with the exception of cash flow which is zero. The sector’s regional performance remains positive and is particularly strong around export sales/orders. Expectations around employment growth are highest on record and Northern Ireland is the strongest regional performer in terms of investment in training. However, expectations to raise prices are highest on record (86%) and inflation continues to grow as a concern (85% Q1 22 vs. 76% Q1 21).
Recruitment

Q1 22 recorded its first dip in recruitment intentions since pre-COVID. 74% of manufacturers (80% Q4 21) and 65% of services (68% Q4 21) are trying to recruit. This had fallen to just 27% of manufacturers and 21% of services in Q2 20. Expectations around employment growth in the next 3 months is positive but has fallen slightly in manufacturing after a strong COVID recovery.

Recruitment difficulties remain one of the most persistent and growing concerns among members. In Q1 22 91% of manufacturers and 86% of services are finding it difficult to get staff. This also represents the highest share of manufacturers experiencing recruitment difficulties on record.
Confidence and Investment Intentions

Confidence around turnover prospects for businesses in the next 12 months has been improving after the striking collapse in confidence brought about by the pandemic. After a positive end to 2021, Q1 22 has begun on a more mixed note with a dip in confidence around turnover growth for manufacturers and small improvement for services although both are still better than the pre-COVID period of 2019/20. The manufacturing turnover confidence balance fell to +36% in Q1 22 (+51% Q4 21) but increased for services to +55% (+42% Q4 21). Confidence around profitability in the next 12 months remains a weaker indicator and weakened further for manufacturers in Q1 22. The balance was -6% for manufacturers in Q1 22 (+1% Q4 21) meaning that more manufacturers are expecting profitability to fall compared to those expecting it to rise in the next 12 months. The corresponding figure for services was more positive at +24% (+11% Q4 21).
Confidence in profitability growth over next 12 months

Investment intentions remain positive for both manufacturing and services around training in Q1 22 at +18% (+24% Q4 21) for manufacturers and +33% (+26% Q4 21) for services. However, investment intentions around capital have contracted sharply for manufacturers, down from +30% in Q4 21 to -5% in Q1 22. It is still much better than the series low in Q2 2020 (-52%) but represents a significant fall over the quarter after what had been a very positive recovery. Investment intentions have also fallen for services but remain marginally positive at +4%.
Cash flow

Cash flow, a key indicator of business health, is typically one of the weakest performing key indicators in the Northern Ireland QES. The balance of businesses reporting an improving cash flow position was already negative going into the COVID-19 crisis. The balance did fall significantly during Q2 2020 but had been improving although this has stalled in recent quarters. In Q1 22 there has been a concerning dip in manufacturers cash flow position with a negative balance of -26% (+4% Q4 21) meaning that more manufacturers are reporting a deteriorating cash flow position than those reporting any improvement. This is the worse cash flow position across the 12 UK regions (next lowest is the North East at -19%). In services the balance also deteriorated to 0% (+2% Q4 21), although to a much lesser extent than manufacturing.
Change in cash flow position over the last 3 months
Prices

Expectations to raise prices are highest on record (2008), pre the Financial Crash and are particularly acute for manufacturers. In Q1 22 88% of manufacturers (83% in Q4 21) and 66% of services (60% Q4 21) expect to raise prices in the next 3 months. This is largely down to rising raw material costs which are affecting 95% of manufacturers. The NI Manufacturing sector recorded the highest expectations to raise prices compared to all other UK regions in Q1 22. There is also growing pressure on prices because of pay settlements for both manufacturers and services firms. Inflation is a concern for 86% of members in Q1 22, up from 76% in Q4 21.
Regional Position

Northern Ireland suffered one of the largest collapses in key indicators across the 12 UK regions in Q2 2020. Manufacturing had been recovering relatively well vis-à-vis the rest of the UK regions and the services position had also been improving. However, in Q1 22 the manufacturing position has weakened with Northern Ireland in the bottom 3 performing UK regions for 6 of the 11 key indicators (1 in Q4 21). In services Northern Ireland is in the bottom 3 performing regions for 1 of the 11 key indicators (4 in Q4 21).

The weakness of the manufacturing indicator on cash flow relative to other UK regions stands out with a negative balance of -26%pts meaning that more businesses are reporting a deteriorating cash flow balance than those reporting an increase. Confidence around profitability and domestic sales performance is also lowest across the regions. Investment intentions are among the lowest across the regions in both the manufacturing and services sectors. Northern Ireland’s service sector performance on exports is strong, ranking first across the regions on this metric. Interestingly, Northern Ireland’s strongest regional performance in manufacturing is also on exports, ranking 6th out of the 12 UK regions in terms of export orders over the next 3 months.
Brexit Watch

Following the EU Referendum on 23rd June 2016, a series of questions has been asked every quarter through the QES aimed at understanding the impact of the UK’s vote to leave the EU on Northern Ireland businesses and the wider economy. This had shown a largely negative impact on business performance, investment plans and confidence and the employment of EU workers in Northern Ireland in the build up to EU exit. There had been significant concerns around Brexit preparation prior to EU exit because businesses did not know what they were preparing for and then how the practical outworkings of the new arrangements following the end of the transition period on 31st December 2021 would unfold. The COVID-19 pandemic set the business adjustment process back further as businesses had to prioritise the COVID-19 fall out on their business over any EU exit preparations. The Northern Ireland/Great Britain trading relationship post transition had been an increasing concern.

New arrangements came into place on the 1st January 2021 including the Northern Ireland Protocol that gives Northern Ireland different status from the rest of the UK in that it remains part of the EU’s single market for goods. A number of questions have been asked since about member experiences of the new arrangements over the first year.

The adjustment to new trading arrangements has been challenging for many businesses trading externally, although that appears to be improving. In Q1 22 65% said that they had adapted to the new trading arrangements (52% in Q2 21) while 29% are finding trading...
conditions challenging (down from 37% in Q2 21). A smaller share of businesses is finding the new trading arrangements extremely challenging (8% vs.15% Q4 21).

In terms of dealing with the new arrangements since EU Exit and the introduction of the Protocol, around half of members (48%) have had to use existing/new staff resources and/or pay for external support to deal with new trading arrangements. One in 3 members (36%) have had to divert internal resources to specifically to deal with the new rules and paperwork involved.

Can you provide an indication of how much, if anything, your business costs have increased by in the last year that you would directly attribute to EU Exit?

<table>
<thead>
<tr>
<th>Percentage Range</th>
<th>Q2 21</th>
<th>Q1 22</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>1% to 3%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>4% to 5%</td>
<td>13%</td>
<td>19%</td>
</tr>
<tr>
<td>5% to 10%</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>10% or more</td>
<td>14%</td>
<td>16%</td>
</tr>
<tr>
<td>Not possible to say</td>
<td>33%</td>
<td>30%</td>
</tr>
</tbody>
</table>

How has your business adapted to new trading arrangements post EU Exit?

- Adapted well: 37% (Q2 21) vs. 33% (Q1 22)
- Found it difficult but dealing with it now: 28% (Q2 21) vs. 19% (Q1 22)
- Continuing to find it difficult: 21% (Q2 21) vs. 21% (Q1 22)
- Posing significant challenges: 16% (Q2 21) vs. 16% (Q1 22)
- Other: 6% (Q2 21) vs. 5% (Q1 22)
- Not Sure: 5% (Q2 21) vs. 5% (Q1 22)
The QES has been monitoring the impact of the COVID-19 pandemic on members since Q2 2020.

Members’ initial reaction to the COVID-19 crisis was very stark emphasising the complete unknown in what lay ahead for business as the pandemic’s impact unfolded. The Q2 2020 findings highlighted that at that early stage in the pandemic, 77% of members had furloughed staff and 1 in 2 members intended to reduce staff. At that point almost 1 in 5 suggested that their business might not survive the fall out of the pandemic.

Over subsequent quarters the survey evidence has shown gradual signs of improvement in sentiment around the impact of the pandemic on business performance. Q1 22 is not just as positive as Q4 21 although most businesses are trading positively (79% vs. 82% Q4 21). However, 18% are just covering costs/struggling (15% Q4 21) and 2% are on the verge of closure (1% Q4 21). There is still a sizeable minority of businesses, almost 1 in 3 (30%), that still haven’t recovered to pre COVID trading levels as yet which has been persistent over the last few quarters. In Q1 22 34% are performing better than pre-COVID with 36% performing about the same. All restrictions were lifted on the 15th February 2022 and this has made a positive difference to trading conditions for almost 50% of businesses.
Working Model & Wages

Going forward 50% of members expect to offer a hybrid model of working involving a combination of home and office/premises based working while 44% expect staff to work full-time in the office/premises. Just 6% will expect staff to work at home as much as possible. More manufacturers (52%) will expect full-time working in premises compared to services (42%). Almost 1 in 3 (31%) members with staff have found it difficult to get people back to work.

Average Wage Increases Expected in 2022

<table>
<thead>
<tr>
<th>Percentage Range</th>
<th>Expected Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>No increase expected</td>
<td>15%</td>
</tr>
<tr>
<td>Up to 2%</td>
<td>10%</td>
</tr>
<tr>
<td>2% to 3%</td>
<td>17%</td>
</tr>
<tr>
<td>3% to 4%</td>
<td>16%</td>
</tr>
<tr>
<td>4% to 5%</td>
<td>21%</td>
</tr>
<tr>
<td>More than 5%</td>
<td>21%</td>
</tr>
</tbody>
</table>
NI Chamber Perspective

“Businesses are trading in a hugely complex economic climate, including a perfect storm of cost pressures that now also has to take into consideration the fall-out of the war in Ukraine.

“The most striking issue is the extent to which inflationary pressures are impacting on businesses, especially manufacturers. Deteriorating cash flow positions are concerning, as this leaves firms more vulnerable to economic shocks, including the damaging impact of soaring energy bills, higher inflation, and tax increases.

“Northern Ireland has had skills gaps for years, but the skills crisis is now becoming tangible, to the extent that in Q1 22, 91% of manufacturers and 86% of services were finding it difficult to get staff.

“While it is good to see that a majority of businesses were trading positively in Q1, there is concern that our recovery from the pandemic is slowing down, as a result of significant cost pressures businesses in all sectors are facing. The current cost of doing business crisis is squeezing firms’ finances, driving further increases in prices and fuelling the cost-of-living crisis. Today’s report is further evidence of the need for the UK Treasury to revisit some of the opportunities to support businesses which were missed in the Chancellors Spring statement, including postponing the damaging National Insurance increase.”

Ann McGregor, Chief Executive
"If recent years have taught us anything, it’s that the business community needs to be prepared for the unexpected and must be able to quickly adapt to changing circumstances.

“That said, and even with inflationary pressures and recruitment challenges in the marketplace, it is reassuring to see such positivity in these results.

“There is a lot to welcome within last quarter’s survey results, with almost all indicators being positive, and firms reporting increased sales and greater confidence around turnover expectations, investment intentions and growth, along with plans for job creation and employment with over two in three firms seeking to recruit.

“However, inflationary pressures loom large for many. Costs are going up, and with 86% of businesses under pressure to increase wages, so prices will also have to go up, with concerns about profit margins being squeezed. Businesses appear to be using their cash reserves to get through this period of high inflation, but this cannot be maintained for long. As a result, 77% of respondents expect to raise prices in the next three months and if not brought under control, inflationary pressures could lead to product shortages and potentially delays in capital projects.

“We also continue to face an issue that existed even before the pandemic hit, with 89% of those businesses that are recruiting facing difficulties in attracting suitable candidates, it’s clear that these problems have been compounded over the last two years. The incoming Northern Ireland Executive will need to address this issue with urgency if the economy is to continue to grow.

“As businesses return to their offices and workplaces, with 50% planning a hybrid model and 44% aiming to bring staff back to the workplace fulltime, it is notable that over three in ten employers are finding it difficult to get people back to work.

“As these findings allow us to reflect on how far we have come, we should recognise how well so many firms have emerged from the battle with the pandemic, and we must continue to channel that same level of innovative thinking and harness our resolve that served us so well with Covid, to ensure we are able to deal with the challenging days ahead.”

Brian Murphy, Managing Partner
About NI Chamber

Helping businesses grow locally and internationally

Northern Ireland Chamber of Commerce and Industry (NI Chamber) is an award winning, quality assured business support organisation with over 235 years commitment to the Northern Ireland economy. It is a well-known network for business with a membership of 1,200 businesses representing over 105,000 employees.

The organisation’s membership spans corporates, SMEs and micro businesses across all sectors, from manufacturing to agri-foods, to ICT and the professions.

NI Chamber supports businesses through networking and events; growth initiatives and export support; articulating the views of business to Government; sharing best practice and knowledge; and providing a number of promotional opportunities for business via the NI Chamber website and Ambition magazine.

Accredited by British Chambers of Commerce, NI Chamber is also part of a global network of Chambers, enabling it to directly support export development. NI Chamber also works on an all-island basis with the Chamber network in the Republic of Ireland to develop all-island trade.

Visit the NI Chamber website at www.northernirelandchamber.com

About BDO Northern Ireland

Based in Belfast city centre, BDO Northern Ireland has been in operation for 30 years.

Whilst part of the BDO international network, BDO Northern Ireland is an independently owned partnership who specialises in helping businesses, whether start-ups or multinationals, to grow.

As a member of the BDO network, BDO NI is part of the largest European led Audit, Tax and Advisory practice.