



# SME Outlook

## Q2 2015



### Foreword

I am very pleased to introduce Aldermore's SME Outlook, giving you insights to the environment SMEs were operating in during Q2 2015.

The period saw cost inflation for UK SMEs remain generally low, as global growth continues to slow and demand for commodities worldwide cools.

However, UK cost inflation rose to 0.8%, up from Q1 but well below the 2.7% high of Q2 and Q3 2011, and even further below the highs of near 5% before the financial crisis.

Significant reductions in the cost of physical goods such as textiles, foodstuffs, chemicals, hard commodities and some capital equipment means that SMEs in the manufacturing business continue to see overall price deflation. But, in the construction and business services sectors, costs are rising more quickly. This is largely due to wages, which make up a sizeable proportion of overall costs and continue to rise quickly.

Low or falling prices for physical commodities is likely to persist in the near future, as large economies such as China continue to slow. However, a tightening labour market at home is likely to push up wage growth, preventing SMEs from seeing overall cost deflation.

Interest rates for borrowing continue to stand at relatively low levels, and are falling back for the smallest firms, this is something I'm obviously pleased about as it has helped a lot of businesses get on their feet over the last seven years. This factor, alongside stable business conditions, is helping to keep the number of business insolvencies steady and close to pre-crisis levels.

However, the Bank of England is expected to start raising the base rate next year and so we have to start preparing for a return to 'normal'.

I hope you find this and the many other insights in this report useful and interesting.

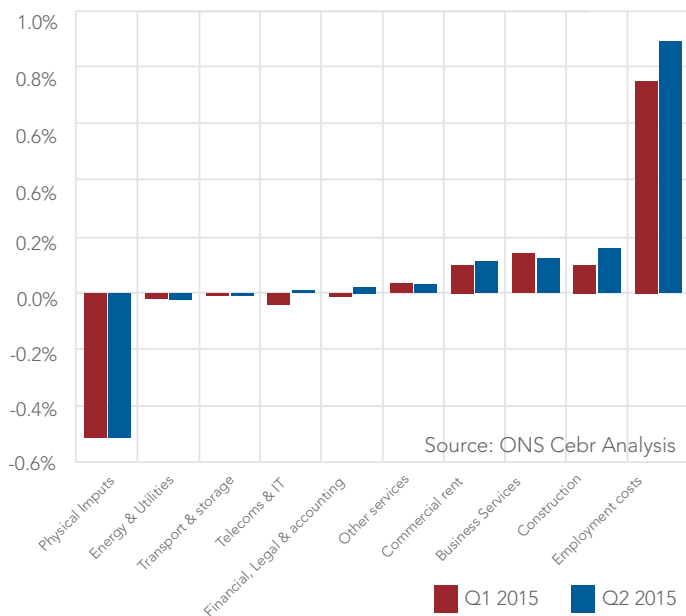
**Carl D'Ammassa**  
Group Managing Director – Business Finance



## SME cost inflation dips slightly, stuck at historic lows

- Annual cost inflation for UK SMEs rose to 0.8% in Q2 2015, up from 0.5% in Q1.
- Business service firms are seeing the fastest increase in costs, at 2.0% over the past year driven by a notable acceleration in pay.
- Employment costs make up over half of the costs for SMEs in the business services sector.
- Construction sector firms have seen a notable rise in cost inflation, to 1.7%, up from 0.7% in Q1 2015.
- Manufacturers are seeing their costs fall significantly year on year.

### ■ Percentage point contribution to headline annual SME cost inflation rate

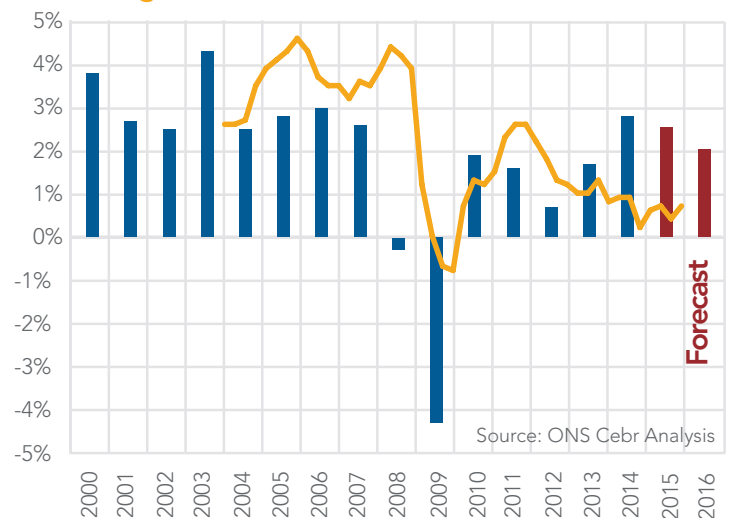


## Employment growth main driver of inflation uptick

- Employment costs are contributing 0.9% to overall SME cost inflation as unemployment fell to its lowest since before the financial crisis.

- Construction costs are the next largest contributor, although this is at just 0.2% of the total.
- Commercial rent is contributing an increasing amount to overall costs, rents rose over the past year by 3.2%, compared to annual inflation of just 1.4% at the same point a year ago.

### ■ UK annual GDP growth vs — Average SME annual cost inflation rate



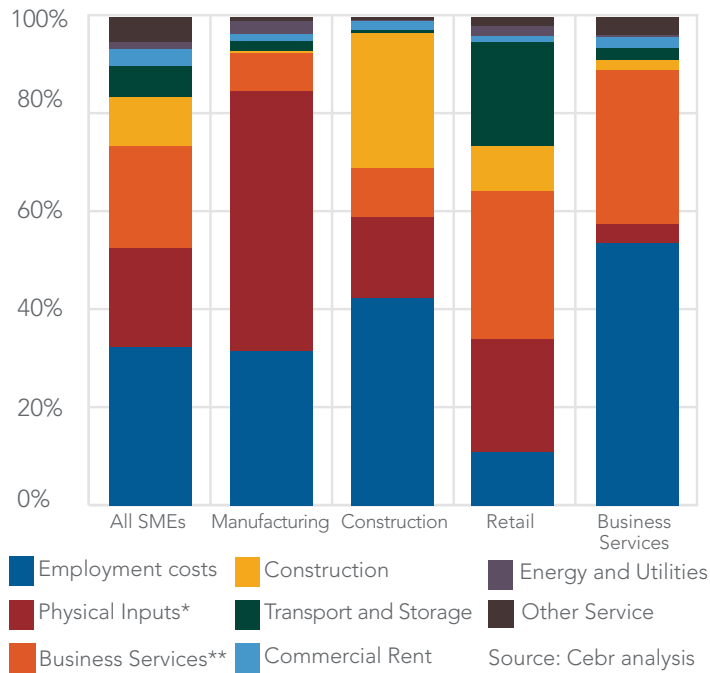
## Global pressures and rising inflation to constrain UK growth

- The UK economy has remained relatively buoyant in 2015 but in large part this is due to inflation standing essentially at zero.
- Workers are seeing the most significant gains to real incomes since 2007 and 2008 due to the lack of growth in the cost of living paired with wage growth.
- As a result, consumer spending growth has been rapid in 2015 – although not all retailers are benefitting, particularly given sharp price cuts in the grocery sector.
- Looking to 2016, inflation is likely to pick up again raising petrol and home energy prices, eroding some of the future gains to real income increases.

## Confidence amongst SMEs rises faster than amongst larger firms

- Confidence among UK businesses, as measured by the ICAEW/Grant Thornton Business Confidence Monitor, climbed notably in Q3 2015 across all firm sizes.
- However, SME confidence rose faster in the past quarter than at large companies (those with over 250 employees) and very large firms (with over 1000 workers).

### Breakdown of business costs, % of total, by SME type



\* including finance, legal & accounting, IT & telecoms

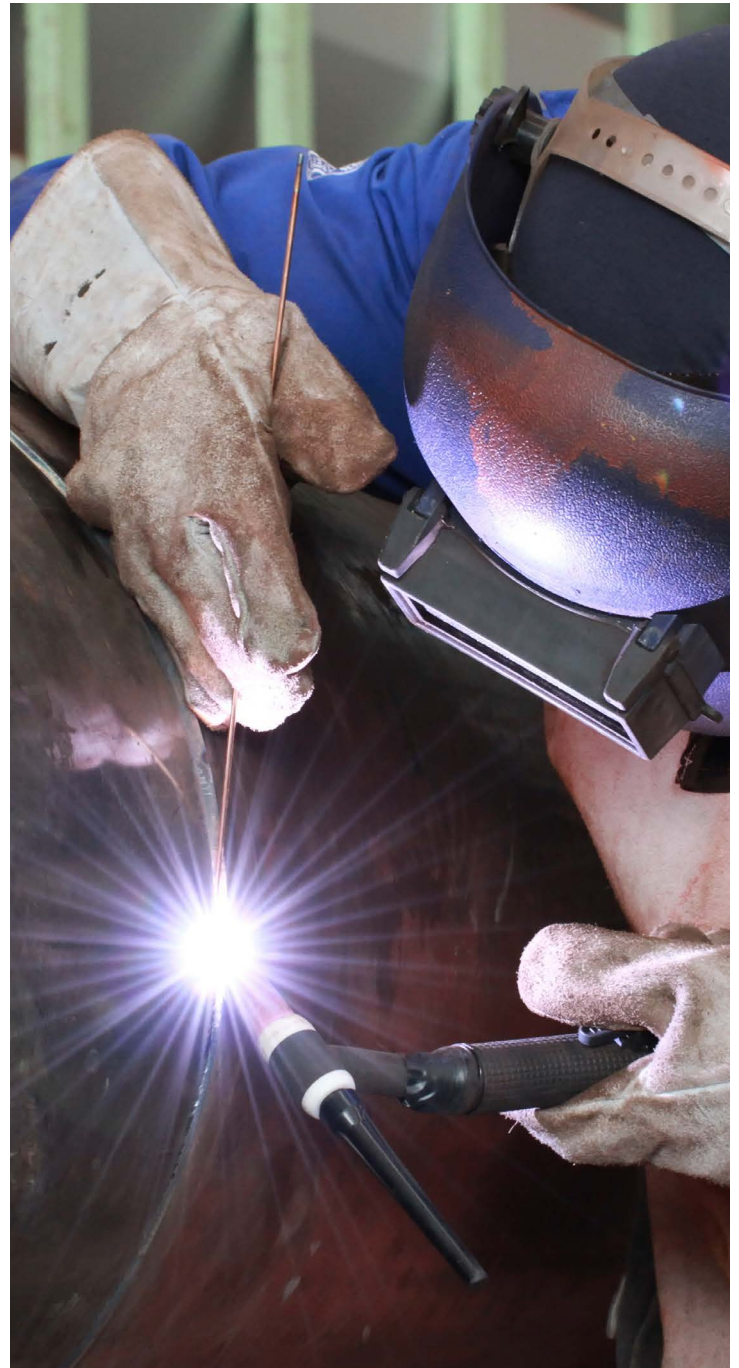
\*\* including raw materials such as those from agriculture, mining and forestry, as well as manufactured products such as steel, textiles, timber, chemicals and foodstuffs.

## SME insolvencies stabilise

- In Q2 2015, just under 3,500 businesses become insolvent and were liquidated, down from 3,750 at the same point a year before and 4,300 in Q2 2013.
- This latest movement highlights how the business climate has stabilised in recent quarters, helping small firms to avoid cashflow issues and remain solvent.

## Average lending rates fall further

- The UK's smallest firms have seen average lending interest rates falling to 4.3% in May from 4.6% at the same point a year earlier.
- Interest rates for medium-sized enterprises (annual turnover of £1m-£25m) have remained relatively static at 3.2%.



## Contact

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Methodological note:

The figures presented within this report are calculated from a range of data provided by the Office for National Statistics (ONS), including the Services Producer Price Indices (SPPi), Producer Price Indices (PPI), Institute of Chartered Accountants in England and Wales (ICAEW) / Grant Thornton Business Confidence Monitor, Bank of England Trends in Lending report and the UK Insolvency Service

# SME Outlook

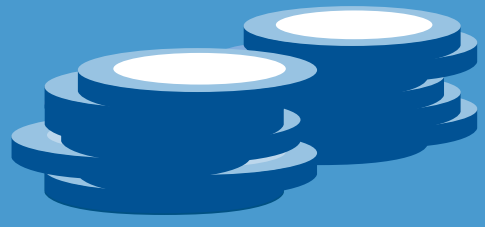
## Q2 2015

Aldermore's Q2 2015 SME Outlook paints a positive picture for SMEs as cost inflation remains low thanks to falling cost of physical inputs. However, wages are rising fast - great news for the jobs market and UK economy.



0.8%

SME cost inflation rose to **0.8%**



Workers are seeing the most significant gains to real incomes since **2007** and **2008**



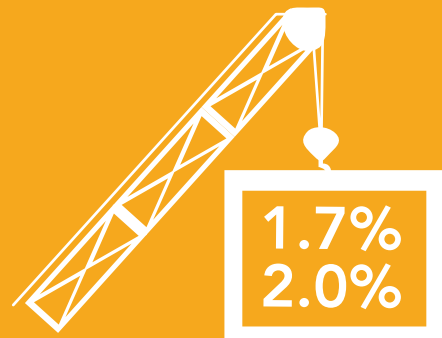
Inflation has accelerated across the board



**21%** of total costs are spent on business services



Fewer than **3,500** businesses become insolvent



Construction & business costs are rising more quickly, at **1.7%** & **2.0%**



4.3%

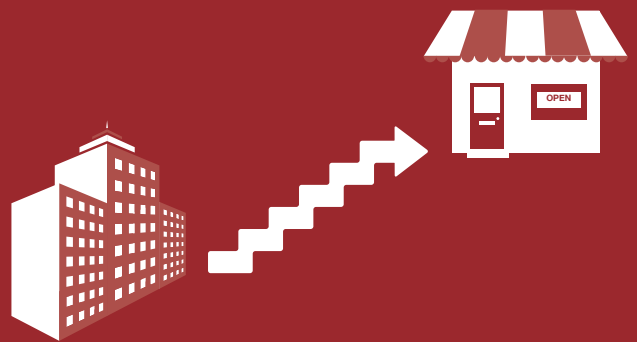
The UK's smallest firms have seen average lending interest rates falling to **4.3%** in May from **4.6%**



Rents rose over the past year by **3.2%**



Confidence climbed notably in **Q3 2015** across all firm sizes



SME confidence rose faster than at large companies

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### Sources

Office for National Statistics (ONS), including the Services Producer Price Indices (SPPI) and Producer Price Indices (PPI)  
ICAEW / Grant Thornton Business Confidence Monitor  
Bank of England Trends in Lending report  
UK Insolvency Service