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Economic Intelligence Wales

Economic Intelligence Wales

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Contents

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The ONS has advised on the production of this report but is not responsible for the views or statistics presented and has not validated the content.

Summary

This is the fifth Economic Intelligence Wales Annual report. The report provides a review of economic data relevant to SME development in Wales and a summary of the investment activities of the Development Bank of Wales during the fourth quarter of the financial year 2022/23, and throughout the year.

UK economic conditions continue to be challenging. Dominating headlines in mid-June was the **Bank of England decision to raise interest rates again by 0.5 of the percentage point to 5% which they have risen again to 5.25% in August.** This has severe impacts upon households, consumer demand and will reverberate through to finance costs for small firms.

Internationally, there are fears that recessions will be the result of chasing inflation rates down. Stock markets in the US, UK and Eurozone reacted negatively to the rounds of interest rate increases and are factoring in concerns that economic growth could slow right down this year.

Economic conditions facing small enterprises.

In their Global Economic Prospects (June 2023), the World Bank warned of the "precarious state" of the global economy with a strong tightening of monetary policy. They forecast that **global economic growth is expected to have fallen from 3.1% in 2022 to 2.1% in 2023.** In more advanced economies growth is projected to decline from 2.6% in 2022 to just 0.7% in 2023.

The OECD Economic Outlook (June 2023) projected global growth of 2.7% in 2023 with an increase to 2.9% in 2024. **For the UK, the OECD forecast 0.3% growth in 2023, improving to 1.0% in 2024.**

According to the ONS, twelve-month CPI in the UK fell from 8.7% in May 2023 to 7.9% in June. The annual inflation rate of producer output (factory gate) prices fell by 2.6 percentage points from 2.7% in May 2023 to 0.1% in June 2023.

The **UK economy grew by 0.1% in 2023 Q1.** In the previous quarter, 2022 Q4, growth had also been estimated at 0.1%.

Following a 0.2% fall in 2022 Q4, **UK business investment in 2023 Q1 rose by 0.7% to its highest level since the pandemic but remains 1.4% below 2019 Q4 levels.** The growth in business investment was primarily attributed to positive contributions from ICT equipment and other machinery and equipment, and intellectual property products.

The highest UK regional unemployment rates in the three-months to May 2023 were in Wales (5%), West Midlands (5%), and London (4.9%), The comparative UK rate was 4%. Wales experienced the largest increase in the unemployment rate compared with the same period last year (an increase of 1.2 percentage points). However, **there was a slight fall in the unemployment-related benefit claimant count in Wales during the year to June 2023 to 3.3%** of the working age population (compared to 3.7 in the UK).

In the period March to May 2023, the number of UK job vacancies was 1,051,000, decreasing 79,000 from the previous quarter. There was a rise in the number of payroll employees in the UK in May 2023 to 30m, an increase of 1.6% over the figure for May 2022. **In Wales the number of payroll employees grew by 1.5% to 1.3m in the year to May 2023.**

In Wales, the redundancy rate for the three-month period to May 2023, was 3.3 per 1,000 employees (a decrease from 3.6 in the three months to April 2023). The comparative UK figure for the three months to May 2023 was also 3.3 per 1,000 employees.

Summary

The nominal value of Welsh exports increased by 25.6% to £20.9 billion over the year to March 2023.

In their Spring UK Economic Outlook, published in May 2023, the National Institute of Economic and Social Research (NIESR) noted that they expected "sluggish growth" for UK GDP in 2023 of 0.3%, and forecast UK GDP growth of 0.6% in 2024, rising to 1.1% in 2025.

The demand and supply of SME finance.

The UK FSB small business confidence index saw some recovery after declines in the three quarters leading up to 2023 Q1. Confidence moved from -45.8 in 2022 Q4 to -2.8 in 2023 Q1. Despite remaining in negative territory, the 43-point increase is the third largest quarterly improvement on record. The net balance of small businesses reporting an increase in operating costs reached an all-time high of 88.7%.

In **Wales there were 2,875 business births and 3,620 business deaths during 2023 Q1.** There has been a widening of the gap between business births and deaths in recent quarters.

For the smallest enterprises there is stronger likelihood that a reduction in business income caused by cost inflation is linked to an inability to pass cost increases onto larger customers. **There is also the spectre that self-employed households might experience higher levels of material deprivation compared to households made up of employees,** and with research suggesting increased self-employment might have led to an increase of in-work poverty.

The number of registered company insolvencies in England and Wales increased to 2,552 in May 2023, which is the **highest level for the past four years.** County Court judgements were up 15% to 264,000 in 2023Q1 when compared with 2022 Q1. These judgements partially predict future insolvencies, which are of particular concern, particularly when set alongside the recent interest rate increases.

The BVA BDRC SME Finance Monitor for April 2023 revealed that an estimated 29% of all responding UK SMEs (excluding starts) reported growth in the past 12 months. This compares to a figure of 26% of responding SMEs in Wales during 2022Q4. Some 44% of UK SMEs reported that increasing costs had had a significant impact on their business in the last three months. In 2022 Q4, 40% of responding **Welsh SMEs reported that costs had significantly increased in recent months,** this compares to 51% of SMEs in Wales reported a significant increase in costs in 2022 Q2.

The April 2023 SME Finance Monitor revealed that 41% of UK SMEs were using external financial in the past three months, which indicates some recovery compared to the figure of 34% in 2022 Q4. **In 2022 Q4 28% of SMEs in Wales were using external finance.**

The ONS Business Impacts and Conditions Survey (BICS) revealed that **15.5% of businesses reported increased turnover in May 2023,** which is slightly lower than previous months. An estimated 23% of businesses reported that sales were lower in May 2023 compared with April.

The Bank of England Credit Conditions 2023 Q1 Survey showed lenders reporting that the overall supply of credit to businesses remained unchanged for businesses of all sizes. **The demand for business lending decreased for businesses of all sizes.**

The Bank of England Agents' Summary of business conditions (2023 Q2) indicated that both investment intentions and demand for credit continued to be subdued. The Bank of England reported that the demand for working capital remained high.

Summary

Average interest rates on SME loans have increased for 19 consecutive months, from 2.65% in October 2021 to 6.8% in April 2023 as the base rates have increased. Dominating headlines in mid-June was **the Bank of England decision to raise the base rate of interest again by 0.5 of a percentage point to 5%.**

The British Business Bank Small Business Equity Tracker reported UK equity finance decreased by 11% to £16.7bn in 2022. Wales saw an increase in announced number of equity deals but a 10% decrease in investment value in 2022.

The Bureau van Dijk FAME database of Companies House data **revealed that 5.2% of Welsh SMEs were estimated to be in the highest risk credit rating category in June 2023, up from around 4.8% in June 2022.**

Development Bank of Wales.

In 2022/23 the Development Bank of Wales completed **516 investments,** with a total value of just over **£124m.** These investments were associated with almost **3,500 new and safeguarded jobs.**

Over 61% of investments by value in 2022/23 were accounted for by loans and equity, with the remaining 39% linked to property development investments. In total, 18% of the value invested in 2022/23 related to equity investments at nearly £23m following a strong performance in the second half of the year. Around 42% of the total value of investments were made to firms located in south east Wales during 2022/23, with firms in mid and south west Wales, and those in north Wales receiving approximately 34% and 24% of investment value respectively.

The cumulative number of investments made by the Development Bank in its first five years to the end of 2022/23 was over 3,642, with the value of investments at over £610m. This includes its Covid-19 Wales Business Loan Scheme delivered during the pandemic.

The Annual report includes an analysis of the estimated GVA associated with employment supported by £75.8m of Development Bank debt and equity finance through the year. This analysis excludes its property development investments. This revealed that Welsh GVA associated with 1,358 (gross) new jobs linked to £75.8m of Development Bank debt and equity activity in 2022/2023 was £64.9m. Similarly, the Welsh GVA associated with the 2,076 (gross) jobs safeguarded is £135.7m.

Together the total of direct jobs created and safeguarded by debt and equity investments in 2022/23 is estimated to be connected to £200.6m of GVA in gross terms and **£120.5m of GVA in net terms once account is taken of assumed deadweight, displacement, substitution and multiplier effects.** This equates to an estimated **net increase in Welsh GVA of around £35,100** for each job created or safeguarded by debt and equity investments.

Introduction

This is the fifth Economic Intelligence Wales Annual report. The report provides a review of economic data relevant to SME development in Wales and a summary of the investment activities of the Development Bank of Wales during the fourth quarter of the financial year 2022/23, and an analysis of the Bank's performance in terms of jobs created and safeguarded by investment activity. The report includes commentary on the global and local economic context and conditions affecting the supply and demand for finance in Wales.

Sections 2-4 of this report provide the macroeconomic context within which Welsh SMEs operate and then examines factors relating to the demand for, and supply and cost of, SME finance. Section 5 summarises the activities of the Development Bank of Wales while section 6 analyses the economic impact of the investments made by the Development Bank during the 2022/23 financial year. The final section provides some overall conclusions to the report.

This report is largely based on publicly available data (generally reported in calendar years) together with a special analysis of data provided by the Development Bank of Wales (mostly reported in financial years). Due to differences in reporting periods, there will be some slight temporal mismatch of data within this report.

In the period covered by this report, Economic Intelligence Wales implemented its expansion plans. New academic partners, Bangor Business School and the Enterprise Research Centre, joined the research collaboration. These new members will produce reports and develop further insights into the real-time issues affecting the Welsh economy.

- Bangor Business School has an international reputation in banking and finance and is recognised as a Chartered Banker Institute 'Centre of Excellence'. It is also currently ranked highest of all UK universities for research in the field of Banking.
- The Enterprise Research Centre (ERC) is the UK's leading centre of excellence for research into the growth, innovation and productivity of small and medium-sized enterprises (SMEs), with a particular focus on drivers of SME growth, innovation and performance. Its research helps shape the policies and practices which enable SMEs to thrive.

Since the last Annual report in September 2022, Economic Intelligence Wales has published the following reports:

- Quarterly report, November 2022
- Covid-19 Welsh Government financial interventions: An analysis of administrative and beneficiary survey data, January 2023
- Quarterly report, February 2023
- Quarterly report, May 2023

Over the coming year, Economic Intelligence Wales will be publishing reports on the following topics:

- evaluating the impacts of Welsh Government Covid-19 financial interventions for businesses,
- R&D-intensive businesses and economic growth in Wales,
- assessing the availability of early-stage equity in Wales,
- net zero carbon policies and SME initiatives towards decarbonisation.

Global, UK and regional economic prospects 2

- The tightening of monetary policy to restrict inflation in major economies is constraining the global economy. The World Bank global growth forecast of 2.3% in 2023 is still below the average growth rate in the two decades before the pandemic of 3.1%.
- Rapid policy responses seemingly curbed recent instability in the global financial system and prevented further damage to banks – although sensitivity to interest rate expectations remains.
- First quarterly estimated data of GDP indicated that the UK economy grew by 0.1% in 2023 Q1, the same rate as in the previous quarter, 2022 Q4.
- The highest UK regional unemployment rates in the three-months to May 2023 were in Wales (5%), West Midlands (5%), and London (4.9%), The comparative UK rate was 4%.

UK economic conditions continue to be tough, and little has changed since the last Quarterly report, published in May 2023. Dominating headlines in mid-June was the Bank of England decision to raise the base rate of interest again by 0.5 of a percentage point to 5% which they have risen again to 5.25% in August. It is unlikely that this will be the last interest rate rise this year.[1] This has severe impacts upon households, consumer demand and will reverberate through to finance costs for small firms. Such is the gravity of the latest rise that the UK Treasury has quickly brokered a deal with the main UK mortgage lenders for a 12-month delay before houses are repossessed following payment defaults.

Meanwhile inflation rates in the UK economy had been stubbornly resisting attempts by policymakers and the Bank of England to bring them under control. It has been estimated that private sector earnings grew by around 7.6% over the last year, but with inflation at above that rate, although falling from 8.7% in May to 7.9% in June. Inflation in many cases is still outstripping earnings and with this prompting a continuation of the wave of strikes. Indeed, such are the pressures that Church of England clergy placed a formal pay claim for first time in their history. As a result of the fall in inflation in June, expectations for peak interest rates have eased, with these no longer anticipated to exceed 6% by early 2024.

Internationally, there are mounting fears that recessions will be the result of chasing inflation rates down. Stock markets in the US, UK and Eurozone have reacted negatively to recent rounds of interest rate increases and are factoring in concerns that economic growth could slow right down this year. While in most major economies inflation rates have fallen since the autumn, rates remain high. The UK rate of inflation (excluding food and energy) is running ahead of the Eurozone CPI (Consumer Prices Index) and the US PCE (personal consumption expenditure index). The Eurozone also seems to be seeing some slowdown in manufacturing activity according to PMI data.[2]

[1] https://www.theguardian.com/business/2023/jul/19/uk-inflation-interest-rates-bank-of-england
[2] See https://www.pmi.spglobal.com/Public/Home/PressRelease/6a9a73ef2b4d449eb8a8d9b827cb2070

International economic prospects also continue to be affected by the continued warfare in Ukraine and sustained pressure of US-China relations.

In their Global Economic Prospects published in June 2023, the World Bank warned of the "precarious state" of the global economy with a strong tightening of monetary policy to restrict inflation.[3] During early 2023, the sharp rise in interest rates resulted in many banks facing sizeable unrealized losses, followed, at some of these banks in the United States and Europe, by depositor flight and instability. Although rapid policy response seemingly curbed this, financial markets were seen as highly sensitive to expectations of future interest rates of major central banks. The report also noted that, since their peak in 2022, energy prices have fallen due to diminished global growth prospects and a warm northern winter. This reduced consumption of natural gas and electricity. Moreover, some major Eurozone economies have decreased their dependency on Russian gas and have sought more gas imports from the US. The World Bank projected that inflation would decline slowly as demand falls and commodity prices ease, provided longer-term inflation expectations remain anchored.

Taking these factors into consideration, the World Bank forecast that global economic growth is expected to have fallen from 3.1% in 2022 to 2.1% in 2023. In emerging markets and developing economies (EMDE), economic growth is projected to increase from 3.7% in 2022 to 4.0% in 2023, which is 0.6 of a percentage point above their January 2023 projections. In more advanced economies growth is projected to decline from 2.6% in 2022 to just 0.7% in 2023, which is 0.2 of a percentage point above their January projections.

The OECD Economic Outlook[4] published in June 2023, noted that despite global GDP growth slowing markedly throughout 2022, several factors may have reduced economic risks. These included a reduction in energy prices and headline inflation; the easing of supply bottlenecks; China's economy re-opening after the pandemic; strong employment; and relatively resilient household finances. However, the report also noted that the recovery was likely to be modest due to concerns such as persistent core inflation, and relatively high debt levels. The OECD projected global growth of 2.7% in 2023 with an increase to 2.9% in 2024. For the United States it projected growth of 1.6% in 2023, falling to 1.0% in 2024; growth in the Euro area of 0.9% in 2023, rising to 1.5% in 2024; and in the UK, 0.3% growth in 2023, improving to 1.0% in 2024.

The World Economic Situation and Prospects, Mid-Year Update, published in June 2023 by the United Nations[5], heralded the ending of a decade of loose monetary policy where low interest rates and quantitative easing stimulated excessive leverage in the financial sector. The report noted that this had been replaced by high interest rates and quantitative tightening, which presented challenges, particularly for developing countries. The UN projected global economic growth to slow from 3.1 per cent in 2022 to 2.3 per cent in 2023. They highlighted that this growth rate is below the average growth rate achieved in two decades before the pandemic (3.1%).

[3] https://openknowledge.worldbank.org/server/api/core/bitstreams/6e892b75-2594-4901-a036-46d0dec1e753/content
[4] https://www.oecd-ilibrary.org/economics/oecd-economic-outlook/volume-2023/issue-1_ce188438-en
[5] https://www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-as-of-mid-2023/

UK inflationary pressures remain but there are signs they are easing

Data from the ONS indicates that annual input and output producer price inflation fell in June 2023. Both these index values peaked in June 2022, and have since fallen sharply. Producer output (factory gate) prices fell by 2.6 percentage points from 2.7% in the year to May 2023, to close to zero in the year to June 2023, representing the lowest annual rate since December 2020[6]. This was mainly attributed to the downward contribution to the annual output inflation rate in June 2023 from refined petroleum products, which had a negative contribution of 4.7 percentage points. The largest offsetting upward contributions to the annual output inflation rate in June 2023 came from food products (an annual 2.0 percentage point increase) and other outputs from manufacturing (1.5 percentage points).

According to the ONS, twelve-month CPI in the UK fell from 8.7% in May 2023 to 7.9% in June.[7] The rate in June 2023 was the lowest since March 2022, and contrasts with the recent peak of 11.1% in October 2022.

The Bank of England's Monetary Policy Summary for June[8] noted that CPI inflation in the UK is expected to fall significantly further during the course of the year, mainly due to energy price developments, while Services CPI inflation may remain largely unchanged in the near term. Services inflation is more linked to domestic drivers such as employment and wages rather than the impacts of imported energy and food, which have more influence over inflation's headline figure.

Evidence from developments in cost and price indicators earlier in the supply chain (such as sharp falls in annual producer output price inflation noted above) suggest core goods CPI inflation will decline later in 2023. Furthermore, the report notes that, in the coming months, food price inflation is projected to fall.

UK GDP growth estimates show that the economy expanded marginally in the quarter to 2023 Q1

First quarter estimated GDP data, published by the ONS in May 2023, indicated that the UK economy grew by 0.1% in 2023 Q1.[9] In the previous quarter, 2022 Q4, growth had also been estimated at 0.1%. The level of UK quarterly GDP in 2023 Q1 was 0.5% below the pre-Covid level (2019 Q4). By sector, output in services rose by an estimated 0.1% in 2023 Q1, following a 0.1% increase in 2022 Q4. The information and communication sub-sector (which grew by 1.2% in 2023 Q1), along with administrative and support service activities (increased by 1.3%), provided the largest positive contribution to growth, while there were output declines in education (0.7%), health (0.5%), public administration and defence (0.7%), and transport and storage (1.0%). These activities were where industrial action had occurred across

[6] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/latest
[7] https://www.bankofengland.co.uk/monetary-policy-summary-and-minutes/2023/june-2023
[8] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/januarytomarch2023
[9] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/businessinvestment/januarytomarch2023provisionalresults

the quarter. In 2023 Q1, production output rose by 0.1%, following no growth in the previous quarter. This increase was mainly driven by Manufacturing activity (increasing 0.5%) while electricity and gas supply experienced no growth. Construction sector output increased by 0.7% in 2023 Q1. This was mainly attributable to repair and maintenance (up 4.9%) but was partially offset by a decline of 1.9% in new work.

UK business investment increased in 2023 Q1

Following a 0.2% fall in 2022 Q4, UK business investment in 2023 Q1 rose by 0.7% according to figures published by the ONS.[10] The growth in business investment was primarily attributed to positive contributions from information and communication technology equipment and other machinery and equipment, and intellectual property products. In 2023 Q1, business investment was at its highest level since the pre-coronavirus (COVID-19) pandemic period 2019 Q4 but remains 1.4% below that level.

Job vacancies continue to fall in the UK

In the period March to May 2023, the number of UK job vacancies was 1,051,000, decreasing 79,000 from the previous quarter, December 2022 to February 2023.[11] In March to May 2023, total vacancies were down by 250,000 from the level of a year ago, although they remained 250,000 above their pre-pandemic January to March 2020 levels.

Early estimates from Pay as You Earn Real Time Information[12] show a rise in the number of payrolled employees in the UK for May 2023 to 30m, an increase of 460,000 employees (or 1.6%) over the figure for May 2022, and a rise of 1,016,000 (or 3.5%) since February 2020. Payrolled employment increased by 23,000 employees (0.1%) in May 2023 when compared with April 2023.

The increase in payrolled employees in the UK in the year to May 2023, was largest in the health and social work sector (an increase of 183,000 employees or 4.5%) and smallest in the wholesale and retail sector (a decrease of 43,000 or -1.0%). The wholesale and retail sector, construction and the administrative and support services category experienced a fall in payrolled employees between May 2022 and May 2023. The percentage increases in payrolled employees over the year were highest in arts, entertainment, and recreation (6.0% or 35,000 employees) and finance and insurance (4.9% or 51,000 employees).

In Wales the number of payrolled employees grew by 19,800 (or 1.5%) to 1.3m in the year to May 2023.[13] The UK regional data on payrolled

[10] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/businessinvestment/januarytomarch2023provisionalresults
[11] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/jobsandvacanciesintheuk/june2023
[12] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/earningsandemploymentfrompayasyouearnrealtimeinformationuk/june2023
[13] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/realtimeinformationstatisticsreferencetableseasonallyadjusted

employees by sector is updated less frequently, but the data to April 2023 shows that the percentage increase in payroll employees over the year in Wales was highest in finance and insurance (6.9% or 2,500 employees).[14]

Over the year to April 2023, there was an increase of nearly 7,500 (or 3.5%) payrolled employees in the health and social work sector in Wales, and 3,200 (or 1.7%) in education.

Wales has the joint highest unemployment rate in the UK in the three-month period to May 2023

The UK unemployment rate for the three-month period to May 2023 was an estimated 4%, an increase of 0.2 of a percentage point from the previous three-month period.[15] The highest UK regional unemployment rates in the three-months to May 2023 were in Wales (5%), West Midlands (also 5%), and London (4.9%), while the lowest rates were in Northern Ireland (2.5%), the Scotland (3.2%), and the South West (3.2%). Wales experienced the largest increase in the unemployment rate compared with the same period last year (an increase of 1.2 percentage points).

A decrease the unemployment-related benefit claimant count in Wales during the year to June 2023

During the year to June 2023, the UK unemployment-related benefit claimant count increased by almost 4,000 to 1.55m people.[16] In Wales, almost 62,000 people claimed unemployment-related benefits (equal to 3.3% of the working age population, compared with a figure of 3.7% for the UK) in June 2023[17], a decrease of 2,300 claimants from the year to June 2022.[18]

The Welsh unitary authority areas with the highest proportion of working age population claiming unemployment-related benefits, according to the data for June 2023, were Newport (4.5%), Blaenau Gwent (4.4%), Cardiff (3.8%), Torfaen (3.7%), Isle of Anglesey (3.7%), Swansea (3.6%), and Denbighshire (also 3.6%), and those with the lowest proportions were Powys (2.3%), Monmouthshire (also 2.3%), Ceredigion (2.4%), Gwynedd (2.8), Carmarthenshire (2.8%), and Bridgend (2.8%).

The UK redundancy rate for the three-month period to May 2023 remained the same as the previous three-month period at 3.3 per 1,000 employees according to the Labour Force Survey.[19] The UK redundancy rate saw a peak of 14.4 per 1,000 employees in the three months to November 2020, and a historic low of 1.8 per 1,000 employees in the three-month period to May 2022.

In Wales, the redundancy rate for the three-month period to May 2023, was also 3.3 per 1,000 employees, a decrease from 3.6 in the three-month period to April 2023.[20] The

[14] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/realtimeinformationstatisticsreferencetableseasonallyadjusted/current
[15] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/regionallabourmarket/july2023
[16] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/claimantcountbyunitaryandlocalauthorityexperimental
[17] Provisional data.
[18] https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/People-and-Work/Unemployment/Claimant-Count/claimantcount-by-welshlocalareas-variable-month
[19] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/redundancies/datasets/redundanciesbyindustryagesexandreemploymentratesred02
[20] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/redundancies/datasets/redundanciesbyindustryagesexandreemploymentratesred02

redundancy rate in Wales in the three-month period to May 2023 was higher than Yorkshire and the Humber (2.4 per 1,000 employees), Scotland (2.7 per 1,000 employees), London (2.9 per 1,000 employees) and the East of England (3.1 per 1,000 employees). This data should be treated with a degree of caution as it is based on relatively small sample sizes and has not been seasonally adjusted.

Economic inactivity decreases in the UK but remains above pre-pandemic levels

In the period March 2023 to May 2023, there was a 0.4 of a percentage point quarterly decrease in the UK economic inactivity rate to 20.8%. However, the ONS Labour Market Overview, UK: July 2023[21] noted that the economic inactivity rate was still above pre-pandemic levels. The decrease in economic inactivity in the latest three-month period was mainly driven by those inactive for 'other reasons[22], those looking after family or home, and those who are retired'. The economic inactivity rate in Wales fell by 0.6 of a percentage point on the quarter, to 24.2% in March to May 2023. However, Wales had the largest increase (0.8 of a percentage point) in the economic inactivity rate compared with the same period last year.[23] In the March to May 2023 period, the economic inactivity rate in Wales was the highest of all regions and devolved nations with the exception of Northern Ireland which had an economic inactivity rate of 26.1%.

Negative growth in GDP in Wales in 2022 Q3

The quarterly (experimental) GDP estimates indicate that Wales and Scotland experienced negative quarter-on-quarter growth in gross domestic product (GDP) of 2.0% and 0.3% respectively in 2022 Q3.[24] England and Northern Ireland experienced flat quarterly GDP growth at 0%. A degree of caution should be applied to these estimates as regional data can be volatile, and these data are still in the developmental phase and designated as Experimental Statistics by the ONS.

Figure 1 reveals the trend in Welsh production, construction, and market service output indices from 2020Q1 to 2022Q4. Output as a whole overall was higher than the pre-covid level. While both production and market service indices remained stable in 2022Q4 compared to 2022Q3, the construction index increased sharply during the second half of 2022. The Mineral Products Association suggested that recent increases in construction were driven by growth in infrastructure, private housing repair and maintenance, and industrial work.[25]

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21 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/uklabourmarket/july2023

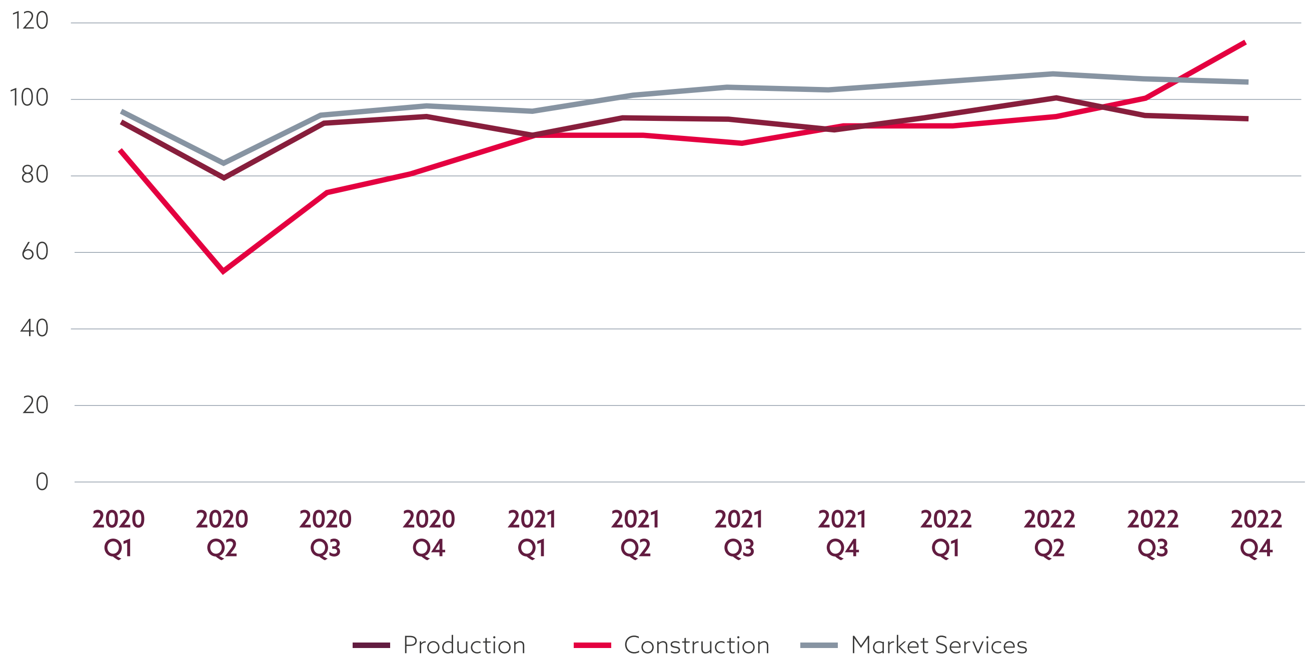
22 "Other reasons" for being economically inactive include people who are waiting for the results of a job application, have not yet started looking for work, do not need or want employment, have given an uncategorised reason for being economically inactive, or have not given a reason for being economically inactive.

23 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/regionallabourmarket/latest

24 https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpukregionsandcountries/julytoseptember2022

25 https://www.mineralproducts.org/MPA/media/root/Documents/2023/Regional_overview_of_construction_and_mineral_products_markets_in_GB_Spring_2023.pdf

Figure 1.
Welsh output indices: trend 2020Q1 – 2022Q4 (2019=100)



Source: Stats Wales, [Welsh Indices of Production and Construction (2019=100) by section and year] and [Index of Market Services (2019=100) by year and area]

The value of exports from Wales increased in the year to 2023 Q1

The ONS note that a degree of caution should also be applied when interpreting data on trade. Data are typically published in current or nominal prices which means they have not been adjusted to remove the effects of inflation. For the period to 2023 Q1 the trade in goods data for the UK regions show that there had been an increase in the value of exports for all UK countries in the year to March 2023 compared with the previous twelve months.[26] In Wales the value of exports increased by 25.6% to £20.9 billion over the year to March 2023 (compared with an increase of 21.6% in Scotland, 17.6% in England, and 17.9% in Northern Ireland).

The value of Welsh exports had relatively high growth in several sectors over the year to March 2023.[27] Mineral fuels total exports increased to £4.6bn in the year to 2023 Q1, from £2.8bn in the previous twelve months, an increase of 60.2%. Machinery and Transport exports increased to £8.0bn in the year to March 2023, from £6.6bn in the previous twelve months, an increase of 21.6%. The total exporter count in Wales in 2023

[26] https://www.uktradeinfo.com/trade-data/regional/2023/uk-regional-trade-in-goods-statistics-first-quarter-2023
[27] https://www.gov.uk/government/statistical-data-sets/uk-regional-trade-in-goods-statistics-first-quarter-2023-accompanying-tables

Q1 was 3,165 representing a fall of 1.2% from the figure in 2022 Q1 (using the Whole Number Method[28]). This compares to a drop of 0.7% for the UK as a whole in the same time periods.[29] Trade volume data published by HM Revenue & Customs for the year 2022 showed that a net mass of 11.1 billion kilograms were exported from Wales, an increase of 15.4% from the year 2021.[30]

The value of imports also grew in all UK countries in the year to March 2023 compared with the previous twelve months[31]. In Wales the value of imports increased by 30.2% to £23.9 billion over this period (compared to increases of 26.8% in Scotland, 20.0% in England, and 17.0% in Northern Ireland). The total importer count in Wales in 2023 Q1 was 8,623 an increase of 6.5% from the figure in 2022 Q1. In the UK as a whole the total importer count decreased by 2.0% over the same period.[32] Trade volume data published by HM Revenue & Customs for the year 2022 showed that a net mass of 23.7 billion kilograms were imported into Wales, an increase of 2.2% from the year 2021.[33]

UK economy forecasts

A comparison of independent forecasts received between the 1st and the 14th of July 2023 was published in the July 2023 HM Treasury Forecasts for the UK Economy.[34] The average forecast for UK GDP growth in 2023 was 0.2%, a downgrade of 0.1% projected in the June 2023 publication. The average forecast for GDP growth for 2024 has fallen compared with the forecast made in the previous month, to 0.7% (compared with 1% in the June forecast).

In their Spring UK Economic Outlook published in May 2023, the National Institute of Economic and Social Research (NIESR) noted that they expected "sluggish growth" for UK GDP in 2023 of 0.3%, with the on-going cost-of-living crisis, as well as the possibility of rising unemployment,[35] and forecast UK GDP growth of 0.6% in 2024, rising to 1.1% in 2025. The NIESR Spring Economic Outlook highlighted that severe structural challenges continued to exist in Wales in terms of poor productivity, and that the region faced a relatively high level of inactivity. Strong supply side policies were suggested to improve participation and productivity in high value activities.

[28] "Whole number method": A business counts as 1 in each region they have employees.
[29] https://www.gov.uk/government/statistical-data-sets/uk-regional-trade-in-goods-statistics-first-quarter-2023-accompanying-tables
[30] https://www.uktradeinfo.com/trade-data/rts-custom-table/
[31] https://www.uktradeinfo.com/trade-data/regional/2023/uk-regional-trade-in-goods-statistics-first-quarter-2023
[32] https://www.gov.uk/government/statistical-data-sets/uk-regional-trade-in-goods-statistics-first-quarter-2023-accompanying-tables
[33] https://www.uktradeinfo.com/trade-data/rts-custom-table/
[34] https://www.gov.uk/government/statistics/forecasts-for-the-uk-economy-july-2023
[35] https://www.niesr.ac.uk/wp-content/uploads/2023/05/Spring-2023-UK-Economic-Outlook.pdf

- UK small business confidence recovered in 2023 Q1.
- The gap between business deaths and births in Wales reached a high in 2023 Q1.
- Pressures expected to remain on Welsh SMEs through this year in line with anticipated interest rate increases.

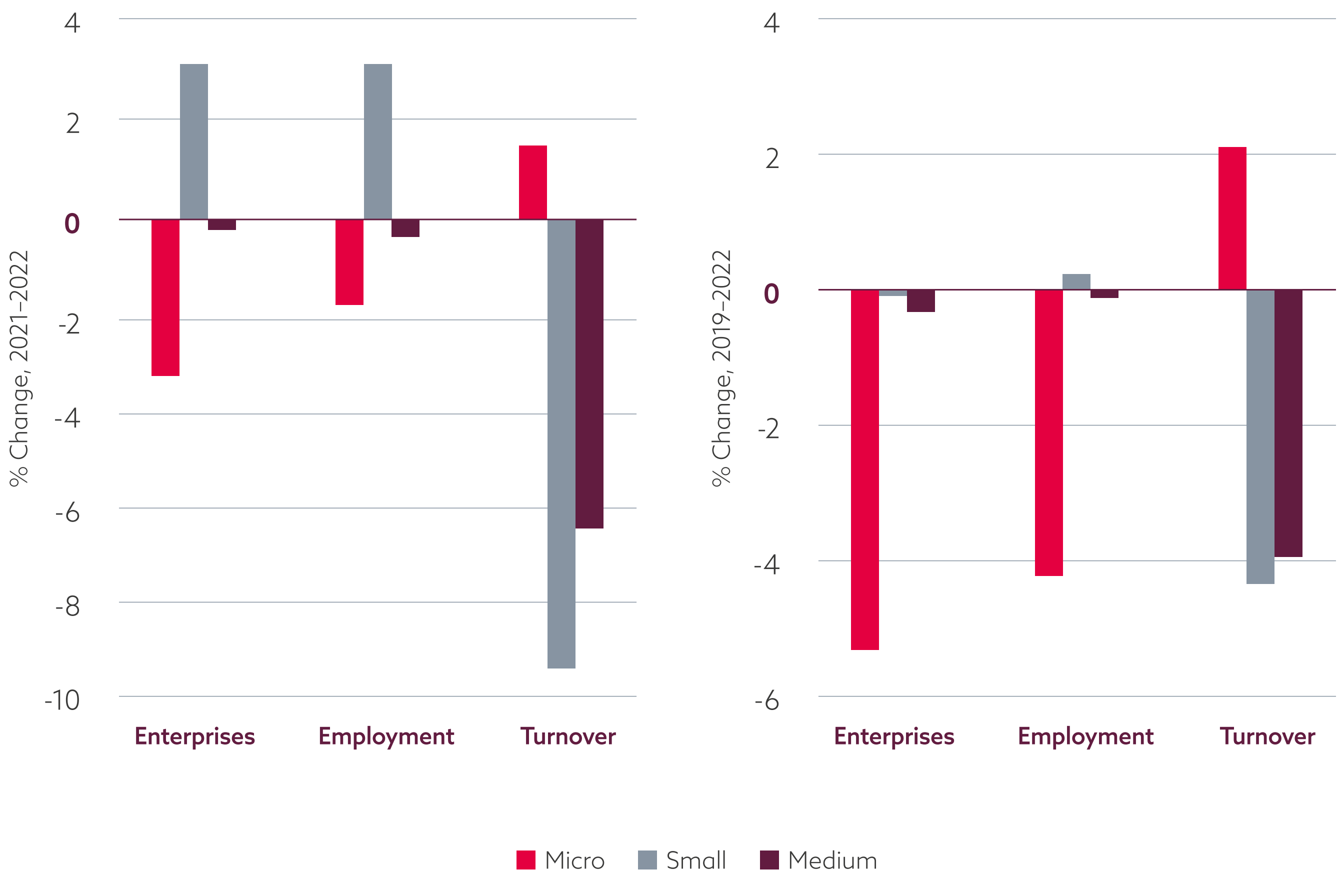
Welsh small firms increased in count and employment in 2022

The Size Analysis of Active Business in Wales reported that an estimated 252,100 active SMEs (0-249 employees) in Wales employed around 719,800 employees in 2022. Wholesale, retail, transport, hotel, food & communication was the largest SME sector in Wales in terms of both employment (392,500) and enterprises (63,300), accounting for almost 25% of active SMEs and just over 31% of SME employment in Wales.

Figure 2 shows the percentage change in enterprise count, employment, and turnover by size band in 2022 compared with 2021 and 2019, respectively. The small firm size band was the only group that experienced an increase in employment and business count (both up by 3.1%) between 2021 and 2022[36]. However, the turnover of small firms declined by over 9% during this period, with medium-sized firm turnover also declining by almost 7%. Compared to pre-pandemic levels (2019), there has been a decrease in enterprise count across all size bands of SMEs, particularly for micro businesses. However, the turnover of micro firms increased by just over 2% during the 2019-2022 period. Small and medium-sized businesses had less significant changes in enterprise count and employment compared with micro businesses in the 2019-2022 period but experienced declines in turnover.

[36] https://statswales.gov.wales/Catalogue/Business-Economy-and-Labour-Market/Businesses/Business-Structure/Headline-Data/enterprises-by-sizeband-area-year

Figure 2.
Percentage change in enterprise count, employment, and turnover by size band (2021-2022 & 2019-2022)



Source: Size Analysis of Active Business, 2022

The Gender Index revealed that there were 22,900 active female-led companies in Wales in 2023.[37] The proportion of female-lead companies in Wales increased marginally over the year (by 0.2%) to 16.7% in 2023. Some 12.1% of high turnover growth firms in Wales in 2023 were female-led, which is the highest rate across all UK regions. The numbers of female-led companies in Wales who have secured external finance, increased by around 1,500 to 5,665 during 2023.

The Global Entrepreneurship Monitor (GEM) UK report 2022/23[38] showed that the rate of total early-stage entrepreneurial activity (TEA) in the UK was 11% in 2022. The TEA rates varied across the home countries: England (11.5%), Wales (7.8%), Scotland (8.8%) and Northern Ireland (8.7%). The report showed that Wales had the lowest entrepreneurial intention rate (15.7%) among all UK home nations, however some 5.6% of respondents in Wales were established business owners, higher than the rates in Scotland (5.4) and Northern Ireland (5.0).

[37] https://www.thegenderindex.co.uk/images/Narratives/2023/Wales-2023.pdf
[38] https://www.gemconsortium.org/report/global-entrepreneurship-monitor-uk-report-202223

Small business confidence increased after three consecutive quarterly declines

The UK small business confidence index[39] showed some recovery after declines in the three quarters leading up to 2023 Q1. Confidence moved from -45.8 in 2022 Q4 to -2.8 in 2023 Q1. Despite remaining in negative territory, the 43-point increase is the third largest quarterly improvement on record. The recovery was partially driven by sustained falls in wholesale energy prices in 2023. All UK regions saw an increase in small business confidence in 2023 Q1. The confidence index became positive in four regions, Scotland, West Midlands, South East, and London.[40]

All major industries saw an improvement in small business confidence in 2023 Q1. While most industries still saw negative scores, confidence was in positive territory in construction and professional, scientific and technical businesses. Wholesale and retail trade saw the strongest increase in confidence in the quarter to 2023 Q1 of 58.1 points to -25.2.

The net balance of small businesses reporting increased revenue in 2023 Q1 stood at -7.1%, suggesting that more businesses saw a decrease in revenue than an increase. 2023 Q1 marked the fourth consecutive negative reading for this figure. In spite of the increase in confidence mentioned above it was the wholesale and retail trade sector that recorded the worst situation, with a net reading of -26.8%. Accommodation and food services saw the second-lowest net balance figure at -25.9%. Small businesses were more optimistic about future growth, with a net balance of 12.9% expecting revenue growth in 2023Q2.

The net balance of small businesses reporting an increase in operating costs reached an all-time high of 88.7%. Utilities remained the most-cited source of increasing cost (reported by 62.7% of respondents). Other major cost sources included labour cost, rent cost, and taxation, reported by 45.3%, 25.3%, and 22.8% of survey respondents, respectively.

An increase in both business births and deaths in Wales in 2023 Q1

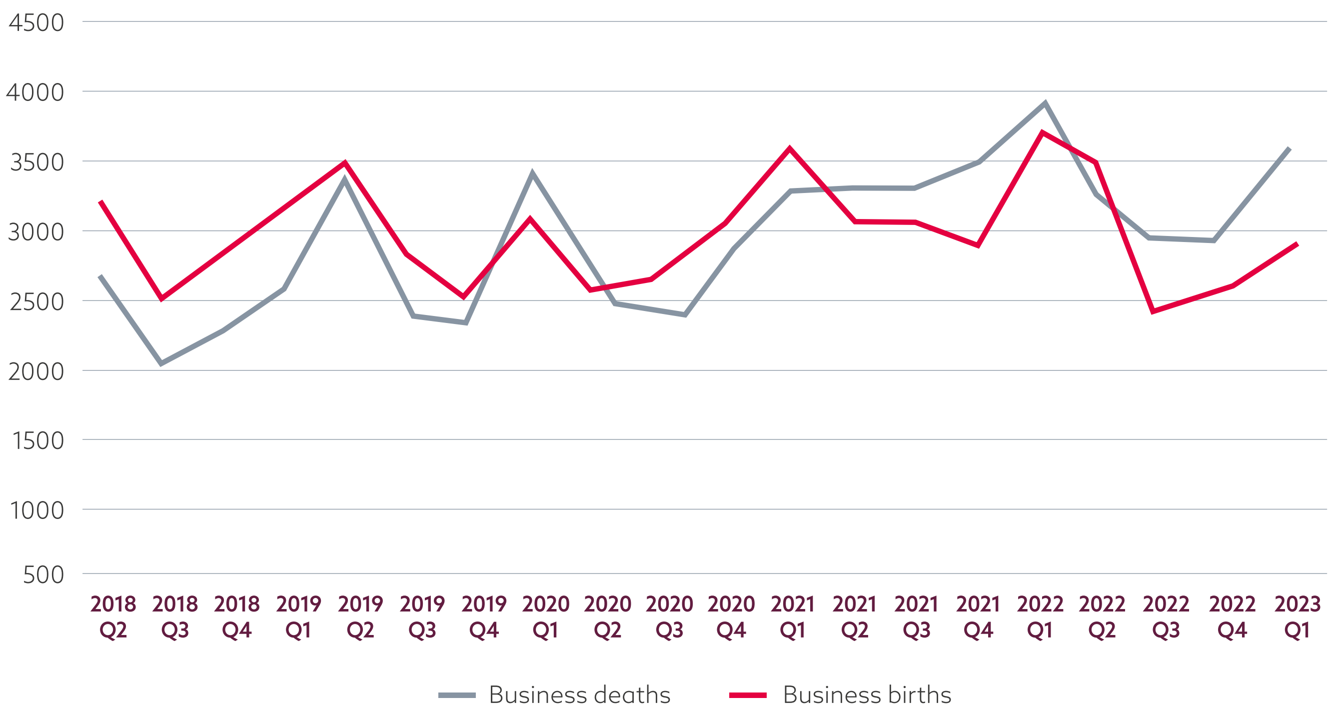
ONS[41] reports that both UK business births and deaths strongly increased in 2023 Q1. The number of business births increased from 69,950 to 79,090 and business deaths increased from 79,305 to 82,390. Figure 3 shows the trend of Welsh business births and deaths from 2018 Q2 to 2023 Q1. There were 2,875 business births and 3,620 deaths during 2023 Q1. Figure 3 reveals a widening of the gap between business births and deaths in recent quarters. Indeed, the gap between business births and deaths in the first quarter of 2023 is one of the largest on record in recent times.

[39] "The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting 'much improved' are given the weighting +2, slightly improved +1, approximately the same 0, slightly worse -1, and much worse -2; the Small Business Index is derived from the sum of these factors" (FSB, 2020).

[40] Analysis for Northern Ireland and Wales is excluded due to insufficient sample size in the survey. Furthermore, results for the East Midlands, East of England and North West should be interpreted with care due to low sample size.

[41] https://www.ons.gov.uk/businessindustryandtrade/business/activitysizeandlocation/datasets/businessdemographyquarterlyexperimentalstatisticsuk

Figure 3.
Quarterly business births and deaths in Wales 2018Q2-2023Q1



Source: ONS Business demography, quarterly experimental statistics, UK

Pressure on Wales' smallest businesses

There have been concerns raised about how the cost-of-living crisis might impact some of Wales' smallest businesses. A recent OECD survey reported that SMEs have reported decreases in production and/or commercial business because of the energy crisis[42]. In Wales' smallest firms the fate of the household is more closely linked to income of the business. In this respect it is important to recognise that Wales has close to 162,000 businesses with no employees and with the majority of these being unregistered for VAT and PAYE and turnover of less that £31,500. For the smallest enterprises there is stronger likelihood that a reduction in business income caused by cost inflation is linked to an inability to pass cost increases onto larger customers. There is also the spectre that self-employed households might experience higher levels of material deprivation compared to households made up of employees, and with research suggesting increased self-employment might have led to an increase of in-work poverty. Henley (2019)[43] suggests that: "At the lower end of the earnings distribution where risk of material deprivation is higher, self-employed households are exposed to greater risk of poverty because of greater reliance on the earnings of a sole, probably precarious, worker." In this respect

[42] https://25159535.fs1.hubspotusercontent-eu1.net/hubfs/25159535/website/documents/pdf/SMEs/2022-12-FIN%20Business%20at%20OECD%20SME%20Survey%20-%20Energy%20crisis%20impact%20for%20SMEs.pdf

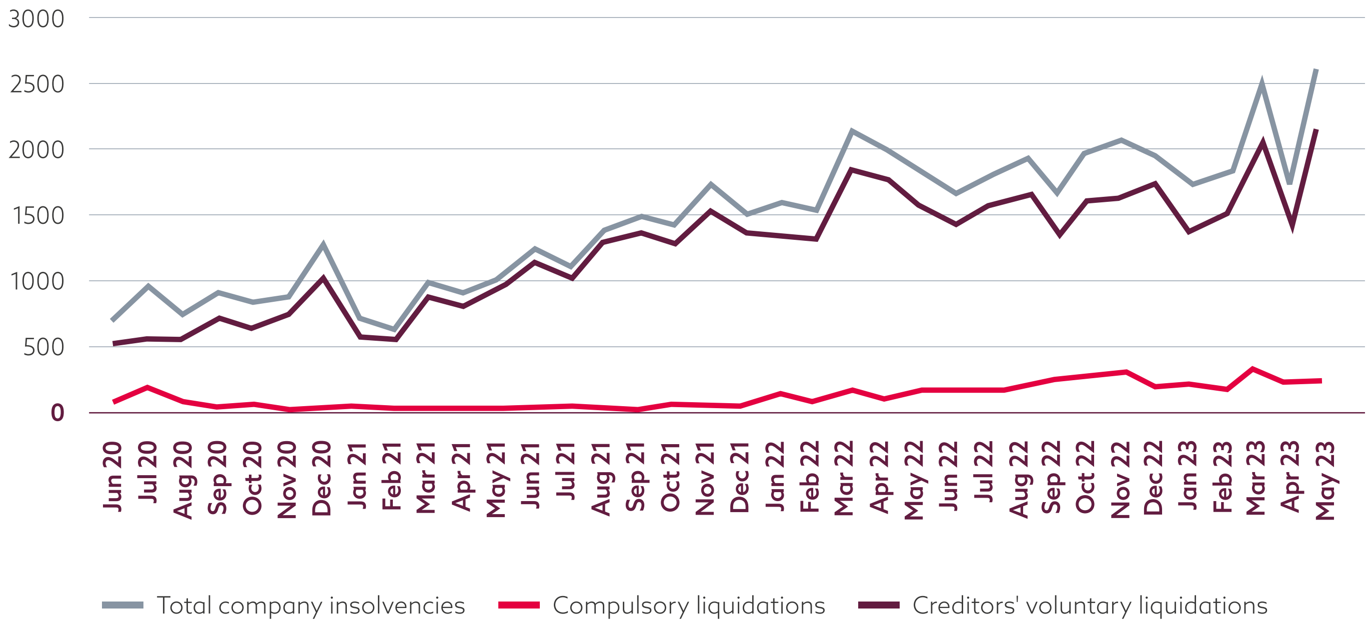
[43] See Henley (2019) https://journals.sagepub.com/doi/full/10.1177/09500170221092640

the LSE-CEP Survey of Self Employed[44] reporting in February 2023 suggested that the cost-of-living crisis was hitting the smallest businesses particularly hard, and with energy prices a particular cause. This report revealed increases in the proportion of the self-employed earning less than £1,000 per month and falling proportions earning between £1,000 and £3,000.

Trends in business insolvencies

Figure 4 reveals monthly variation in registered company insolvencies in England and Wales.[45] The number of insolvencies increased to 2,552 in May 2023, which is the highest level for the past four years. The second-highest record during the same period is 2,473 in March 2023. The majority of insolvencies were driven by creditors' voluntary liquidation. By contrast, only 189 out of 2,552 insolvencies were compulsory liquidations in May 2023.

Figure 4.
Monthly registered company insolvencies in England and Wales



Source: [ONS Monthly Insolvency Statistics]

The insolvency data is in line with the statistics of County Court judgments for debt, which partially predict future insolvencies. These statistics are of particular concern, particularly when set alongside the recent interest rate increases.

Compared to 2022 Q1, County Court judgements were up 15% to 264,000 in 2023Q1,[46] with 91% of these being default judgements. Meanwhile, County Court claims increased by 8% to 443,000, the highest volume since 2020 Q1.

[44] See https://cep.lse.ac.uk/_NEW/publications/abstract.asp?index=9873
[45] https://www.gov.uk/government/collections/monthly-insolvency-statistics
[46] https://www.gov.uk/government/statistics/civil-justice-statistics-quarterly-january-to-march-2023/civil-justice-statistics-quarterly-january-to-march-2023#:~:text=There%20were%20443%2C000%20County%20Court,the%20same%20quarter%20in%202022.

SME Finance Monitor

The BVA BDRC SME Finance Monitor for April 2023[47] revealed that an estimated 29% of all SMEs (excluding starts) reported growth in the past 12 months, ranging from 26% in the case of businesses with 0 employees to 49% with 10-49 employees. The percentage of medium-sized firm (with 50-249 employees) that reported growth had increased for 4 consecutive quarters. Some 43% of SMEs reported a growth aspiration in April 2023. This figure was led by larger UK SMEs with 100-249 employees. Some 44% of SMEs reported that increasing costs had had a significant impact on their business in the last three months. The increasing costs were a more severe issue for international-facing SMEs where 53% reported a significant impact.

The SME Finance Monitor survey data for Wales is available up until 2022 Q4. This survey showed that the proportion of SMEs that made a net profit in the last 12 months reached a low of 37% in 2021 Q2, and this has since gradually recovered. In 2022 Q4 this proportion was 56% but was still lower than the pre-pandemic level (of 75% in 2019 Q4). In 2022 Q4 an estimated 26% of all responding SMEs in Wales reported growth in the past 12 months, and some 40% of SMEs reported that costs had significantly increased in recent months, this compares to 51% of SMEs reporting increased costs in 2022 Q2.

1 in 5 businesses expect sales increases in July

The ONS Business Impacts and Conditions Survey (BICS) for the period 30 May to 11 June 2023 (Wave 84)[48] revealed that 15.5% of businesses reported increased turnover in May 2023, which is slightly lower than previous months. An estimated 23% of businesses reported that sales were lower in May 2023 compared with April. An estimated 19% of businesses expected sales to increase in July 2023. Cost inflation was still affecting businesses in the June survey with 30% of businesses reporting a price increase of goods or services in May 2023 compared to April. Interestingly however there is some evidence here of pressures reducing as the similar figure was around 48% in September 2022.

The survey also revealed evidence of a tight labour market with 27% of businesses with 10 or more employees revealing that they had experienced difficulties recruiting in May 2023.

The various surveys reviewed in this section of the report reveal something of a mixed picture in terms of the impacts of inflation and expectations of future growth. It is likely that business confidence in the first half may have been bolstered by the expectation that inflationary pressure was gradually being taken out of the economy. However, recent news in terms of interest rate increases suggests there is still a long way to go to bring inflation back to 2% and then that confidence might suffer in the second half if there are fears of a recession.

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[47] https://www.bva-bdrc.com/wp-content/uploads/2023/06/SME-Monthly-charts-Apr-23.pdf
[48] https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessinsightsandimpactontheukeconomy

- Investment intention and demand for credit were subdued in 2023Q2.
- Default rates on SME lending increased in 2023 Q1 and were expected to grow in Q2.
- Equity investment decreased in 2023 Q1.
- Interest rates move steadily upwards increasing to 5% in June and 5.25% in August as the Bank of England seeks to control inflationary pressure.

The supply and demand of credit to SMEs in 2023Q1

The Bank of England Credit Conditions 2023 Q1 Survey[49] reported on both the supply of and demand for credit for the three months to end-February 2022 (Q1), and with these compared to the period between September and November 2022 (Q4). The survey also reported expected changes in credit conditions in the next quarter. Lenders reported that the overall supply of credit to businesses remained unchanged for businesses of all sizes. The credit supply to businesses was expected to be unchanged in 2023 Q2. Meanwhile, the demand for business lending decreased for businesses of all sizes and was expected to be unchanged in Q2.

Lenders also reported that spreads on corporate lending to small businesses were unchanged but had widened for large businesses and slightly narrowed for medium-sized businesses in Q1. Default rates for lending to small and medium-sized businesses increased in Q1 and were expected to increase further in Q2. By contrast, the default rate on loans to large firms was unchanged in Q1 and expected to be unchanged in Q2.

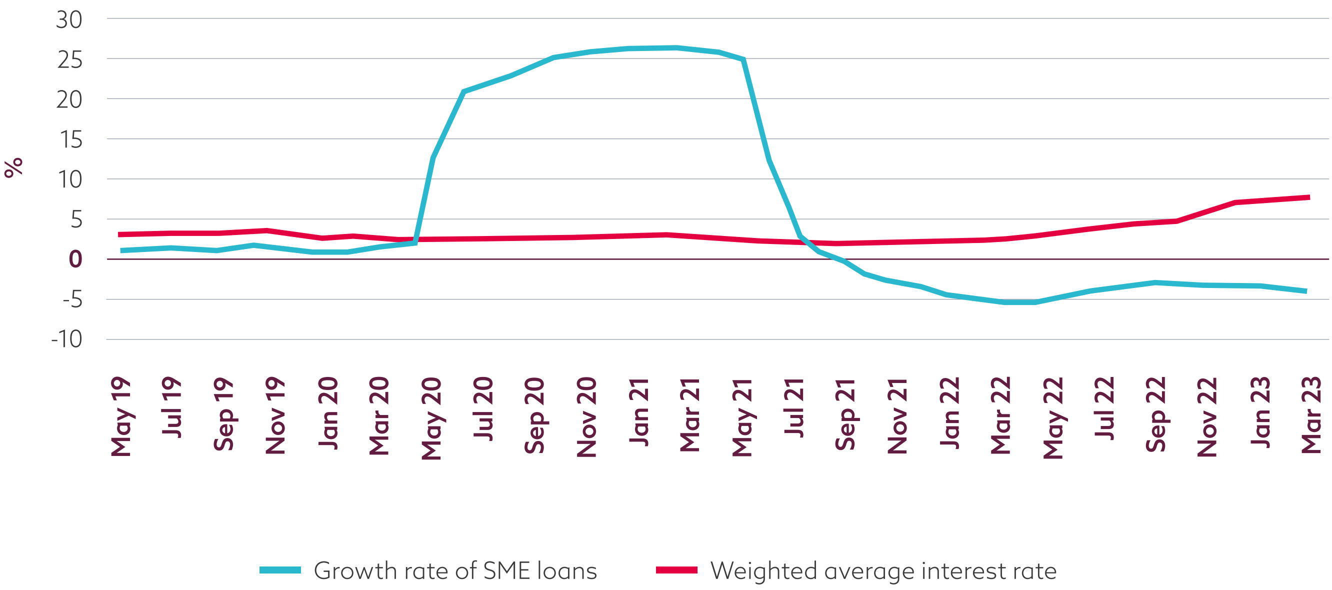
The Bank of England Agents' Summary of business conditions (2023 Q2)[50] indicated that both investment intentions and demand for credit continued to be subdued. The constrained investment outlook was caused by higher investment costs, uncertainty about the economy, and decreasing investment returns. For instance, some forecasts suggest that the UK economy is under recessionary pressures. Banks become more cautious in their lending practices and borrowing costs have increased with the rising interest rate. Banks then retrench their lending to business to manage risks. Credit demand across investment, property development, and mergers and acquisitions was particularly subdued, but the Bank of England reported that the demand for working capital remained high. The summary of business conditions reported that there was no evidence that the US banking crisis had affected UK corporate funding.

[49] https://www.bankofengland.co.uk/credit-conditions-survey/2023/2023-q1#:~:text=Lenders%20expected%20availability%20to%20decrease,in%20Q2%20(Chart%202)
[50] https://www.bankofengland.co.uk/agents-summary/2023/2023-q2#:~:text=Vacancies%20have%20continued%20to%20fall,May%202023%20Monetary%20Policy%20report

Increasing interest rates

Figure 5 shows the monthly growth rate of SME loans and the interest rate on SME loans based on Bank of England data. The growth rate of SME loans[51] had remained negative since September 2021 but had experienced a slight growth since April 2022. Specifically, the growth rate decreased from -3.7% in January 2023 to -4.2% in April 2023. Average interest rates on SME loans have increased for 19 consecutive months, from 2.65% in October 2021 to 6.8% in April 2023.[52] The Bank of England further raised the Bank Rate to 5% in June 2023 to combat inflation which they have risen again to 5.25% in August.

Figure 5.
Growth rate of SME loans and interest rates on SME loans



Source: Bank of England

[51] This is the monthly 12-month growth rate of monetary financial institutions' sterling and all foreign currency loans to small and medium sized enterprises (in percent) seasonally adjusted. Bank of England series RPMZO8M.

[52] Monthly average of UK resident banks' sterling weighted average interest rate - other loans, floating rate linked to Bank Rate (<3mth reset) to small and medium sized enterprises (in percent) not seasonally adjusted. Bank of England series CFMZ6HQ.

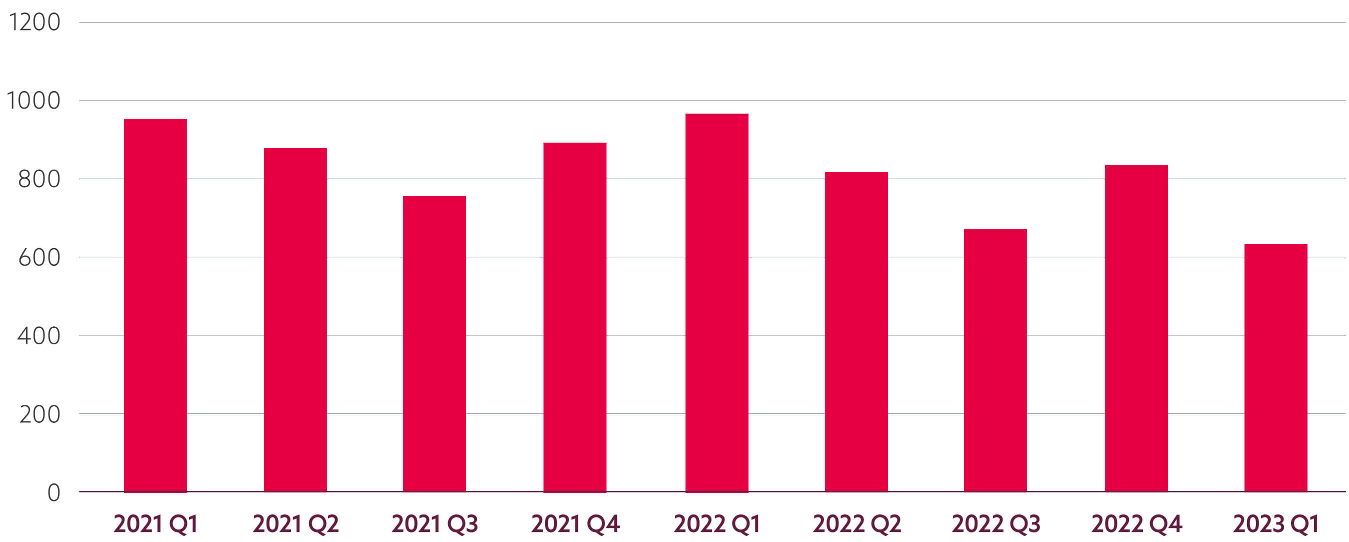
A decrease in UK equity investment in 2022

The British Business Bank Small Business Equity Tracker[53] reports the trends in equity finance for small businesses in the UK. UK equity finance was reported to have decreased by 11% to £16.7bn in 2022, but investment activity varied significantly through the year. Companies received a record level of investment over the first half year, with company valuations rising sharply, particularly in the tech sector. However, the concerns about over-valuation and rising inflation and interest rates resulted in a 47% decline in the second half year. The overall downturn continued into 2023 Q1, during which £2.2bn was invested in UK SMEs, 28% lower than in 2022 Q1.

Wales was one of the three regions (along with the South West and Yorkshire & Humber) that experienced an increase in the announced number of equity deals in 2022. Wales saw a 19% increase in deals to 70 in 2022, the highest annual growth rate among all regions. However, due to the decrease in average deal size, Wales experienced a 10% decrease in investment value to £82m in 2022. The decrease of deal size was mainly caused by a sharp decrease in the deal size of growth stage investments.

The Crunchbase dataset[54] reveals both equity and debt investment in the UK. Figure 6 depicts the trends of equity investment in the UK between 2021 Q1 and 2023 Q1. In line with the Small Business Equity Tracker, Crunchbase data shows an overall downward trend of quarterly investments in the UK. In 2023 Q1 there were 623 announced equity investment deals, which was 35.3% lower than 2021 Q1.

Figure 6.
Number of financial investments in the UK according to Crunchbase



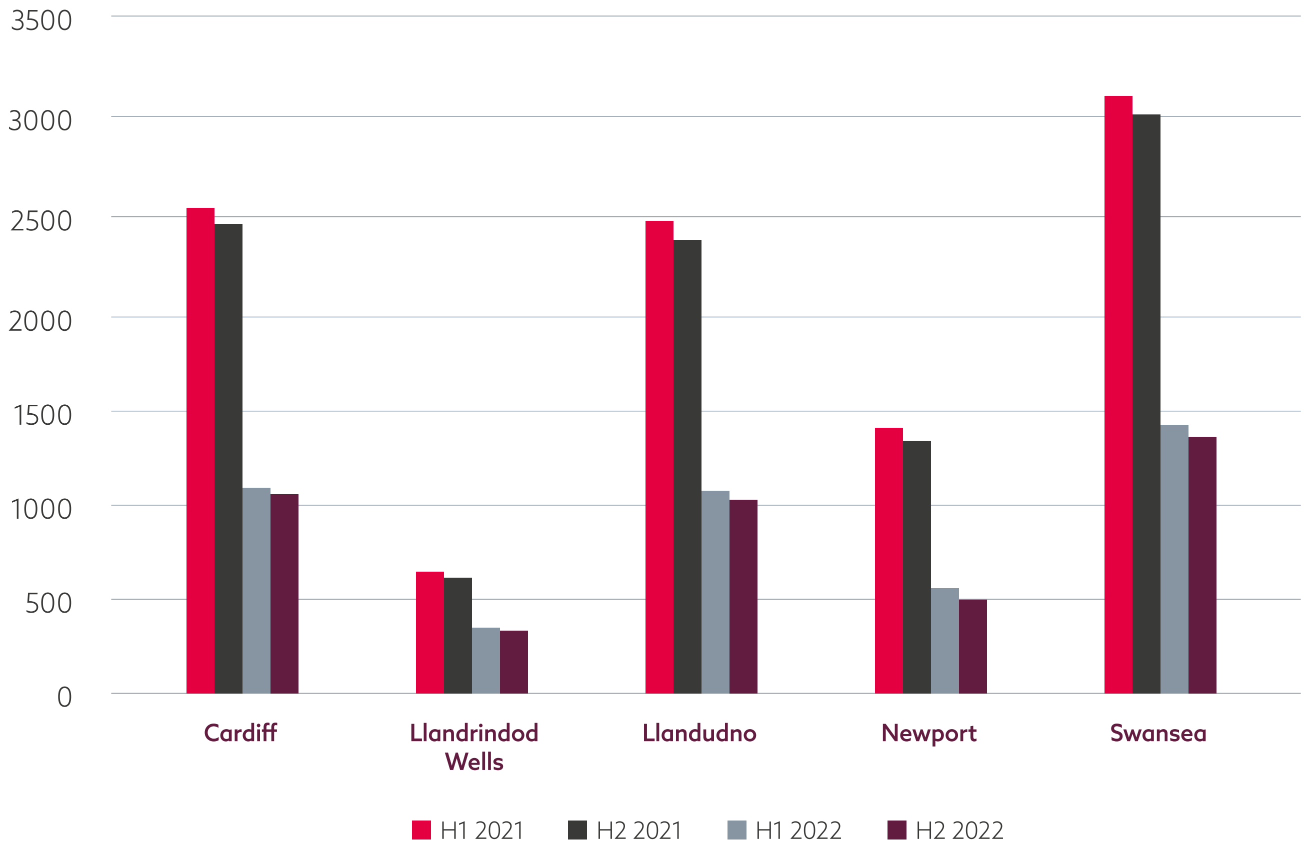
Source: Crunchbase.

[53] https://www.british-business-bank.co.uk/wp-content/uploads/2023/06/J0250_BBB_SBET_2023_AW3.pdf
[54] https://www.crunchbase.com/home

A fall in SME lending in Wales in 2022

Figure 7 shows estimates of lending to SMEs by the main Wales postcode areas from 2021H1 to 2022H2. After a plummet of SME lending (including loans and overdrafts) in 2022H1, there was a slight decrease across all regions in Wales in 2022H2. Swansea received the most SME lending during this period, followed by Cardiff and Llandudno. All regions saw a sharp decline in SME lending in 2022. The lending volumes were less than half of the value in 2021 in all regions.

Figure 7.
SME lending by Welsh postcode area (£m)



Source: UK Finance Postcode Lending Data: SMEs

The proportion of UK SMEs using external finance increased in early 2023

The SME Finance Monitor for April 2023[55] revealed that 41% of responding UK SMEs were using external financial in the past three months, which indicates some recovery compared to the figure of 34% in 2022 Q4. The increase in businesses using external finance has been seen across all size bands. In particular, 67% of small firms (with 10-49 employees) were using external finance, which is higher than the pre-pandemic level. The percentage of permanent non-borrowers (i.e. SMEs that decline to use external finance) also decreased in early 2023, from 51% in 2022 Q4 to 47% in April 2023. Some 36% of UK SMEs had injected personal funds in April 2023, which is higher than the figure in 2022 Q4 (32%).

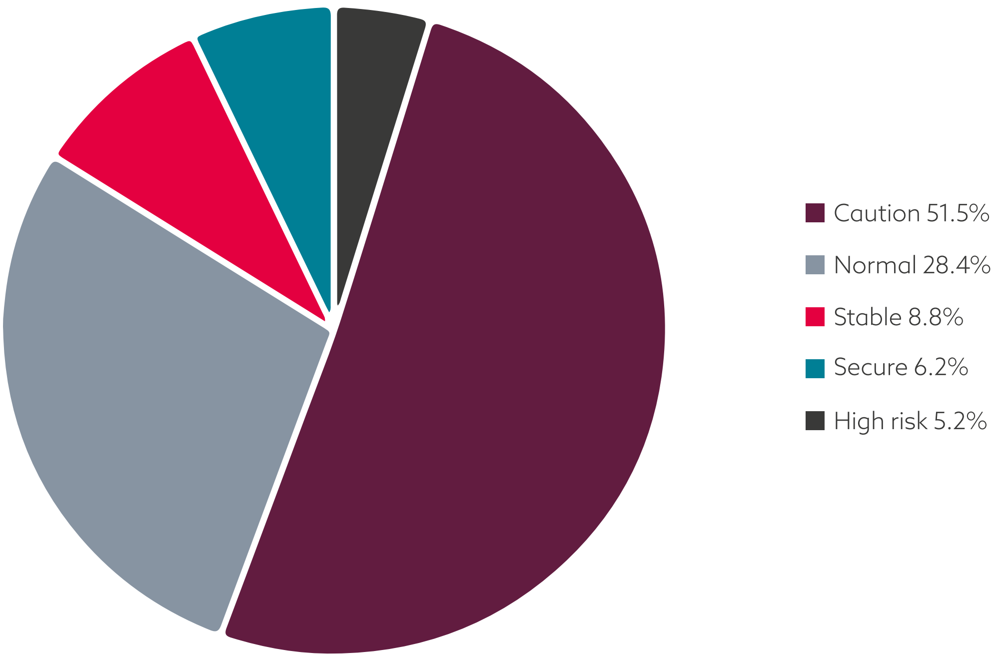
The proportion of SMEs in Wales using external finance increased from 49% in 2019 Q1 to 63% in 2021 Q4. In line with trend observed in Figure 7, this proportion decreased during 2022, to 28% by 2022 Q4. In 2022 Q4 62% of responding SMEs in Wales used finance for working capital, with 54% using finance to trade through difficulties, and 44% of SMEs in Wales responding to the survey using finance for new plant and machinery.

A slight increase in the proportion of Welsh SMEs in the highest risk credit category

The Bureau van Dijk FAME database of Companies House data was searched in June 2023 to seek evidence of the proportion of Welsh SMEs that fell into different credit risk categories. The June 2023 search yielded 89,255 SMEs with a known credit rating. It is important to recognise that this source may not identify Wales' smallest firms. Figure 8 reveals that of this total 5.2% were estimated to be in the Highest risk credit rating category up from around 4.8% in June 2022. The Caution category embraced some 46,000 SMEs or 51.5% of the total, again up from 50.9% in June 2022. These proportions are quite slow to change and with updates to credit rating coming at different intervals according to when new data is uploaded on the FAME database. However, the rise in businesses in the High risk category is of interest with an expectation of some increase in business defaults during 2023.

[55] https://www.bva-bdrc.com/wp-content/uploads/2023/06/SME-Monthly-charts-Apr-23.pdf

Figure 8.
Percentages of Welsh SMEs in June 2023 in different credit risk categories



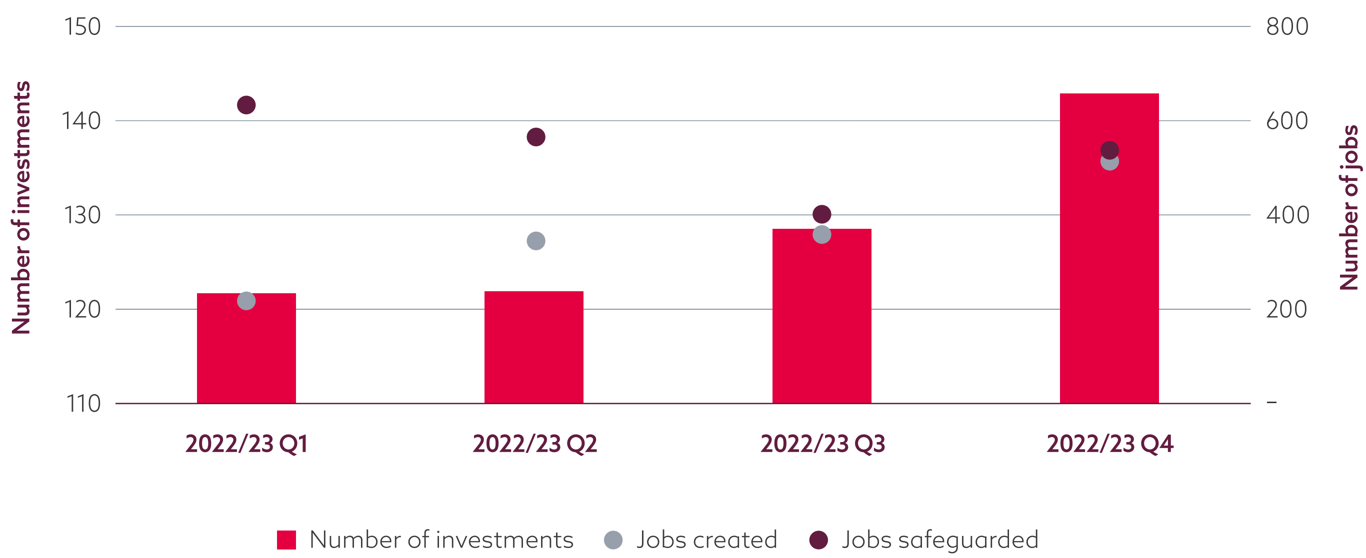
Source: FAME Database

- In 2022/23 the Development Bank of Wales completed 516 investments, with a total value of just over £124m. These investments were associated with almost 3,500 new and safeguarded jobs.
- Over 61% of investments by value in 2022/23 were accounted for by loans and equity, with the remaining 39% linked to property development investments. In total, 18% of the value invested in 2022/23 related to equity investments at nearly £23m following a strong performance in the second half of the year.
- Around 42% of the total value of investments were made to firms located in south east Wales during 2022/23, with firms in mid and south west Wales, and those in north Wales receiving approximately 34% and 24% of investment funds respectively.
- The cumulative number of investments made by the Development Bank in the five years to the end of 2022/23 was over 3,642, with the value of investments at over £610m.

An increase in the number of investment transactions made by the Development Bank during 2022/23

In the final quarter of the 2022/23 financial year, the Development Bank of Wales made over 144 investments, which created and safeguarded over 1,000 jobs. This was quite a sharp increase in the number of investments compared with the previous quarters. This investment pattern is similar to that reported in previous Economic Intelligence Wales Annual reports, where investments have peaked in the final quarter. The exception is the 2020/21 financial year, when a significant number of investments were made under the Covid-19 Wales Business Loan Scheme during the first quarter of the year. During the 2022/23 financial year a total of 516 investments were made, creating or safeguarding almost 3,500 jobs.

Figure 9.
Investment transactions and jobs created and safeguarded during 2022/23

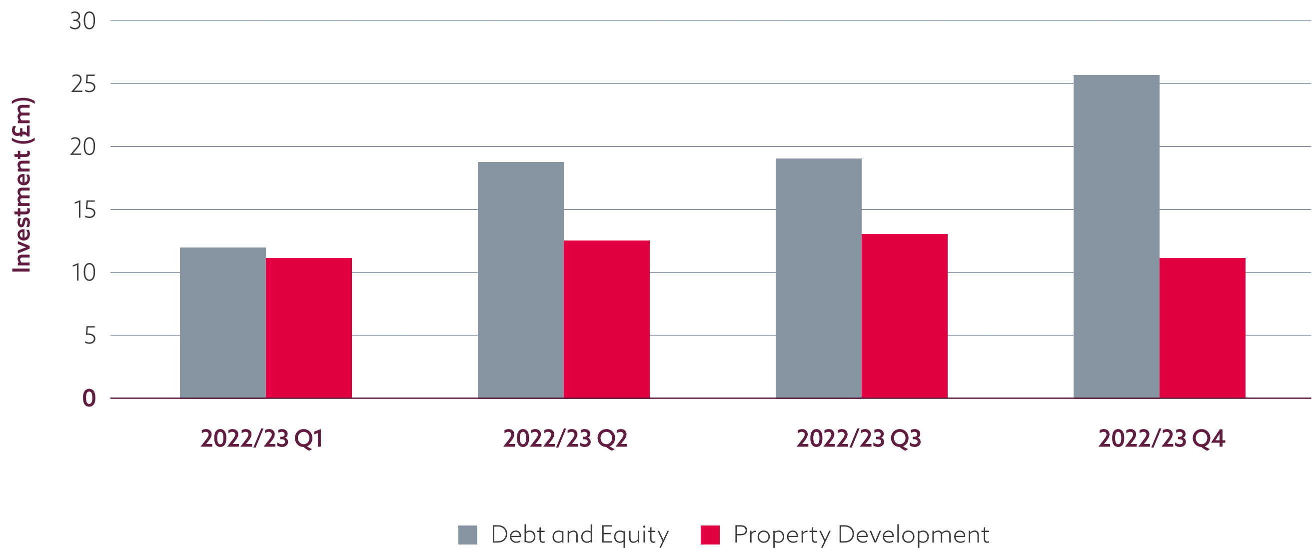


The total value of investments made during 2022/23 was just over £124m

The total value of investments has also risen during the final quarter of the 2022/23 financial year. New loan debt and equity investment was £26m in 2022/23 Q4, with equity investments accounting for almost £7m of this value. Figure 10 shows that there was a strong performance in debt and equity investment values in 2022/23 Q4. This was driven by equity investment in the second half of the financial year, and particularly in Q3 (£10.6m).

The total value of debt and equity investments during 2022/23 was £75.8m, with equity investment made during the financial year of nearly £23m, almost double the value in the previous financial year. The value of property development investments during 2022/23 totalled £48.4m.

Figure 10.
New Investment by investment type, £m, 2022/23 Q1-Q4



In total, almost 1,360 new jobs were created by the 494 debt and equity investments made in 2022/23, with a further almost 2,080 jobs safeguarded (Figure 11). On average, each £1m of Development Bank debt and equity funding deployed in 2022/23, created or safeguarded around 45 (gross) jobs.[56] The total of 22 property development investments made by the Development Bank of Wales in 2022/23 created or safeguarded almost 50 jobs.

[56] Further analysis is provided in section 6 of this report.

Figure 11.
Investment transactions and jobs created and safeguarded during 2022/23

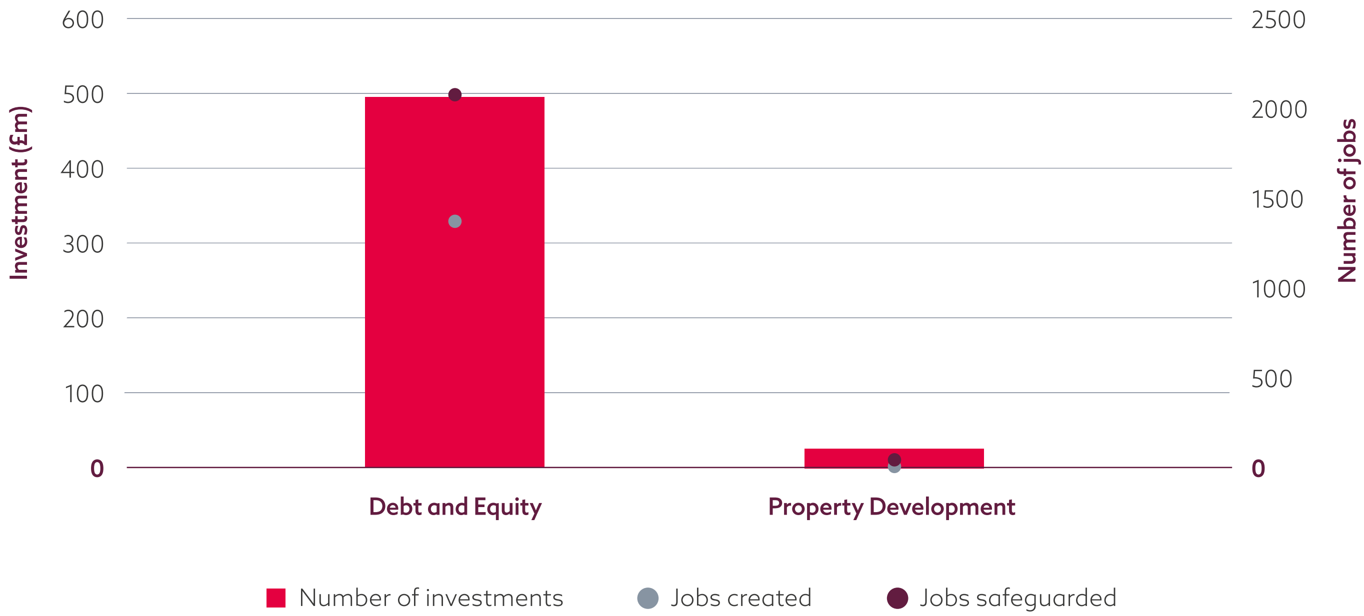


Figure 12 shows that businesses in south east Wales received around 42% of total investment funds during 2022/23, with firms located in mid and south west Wales receiving almost 34% of funds, and businesses in north Wales accounting for 24% of investment funds. The south east Wales region has the largest concentration of businesses in Wales, accounting for around 46% of the business population. The value of Development Bank investments in 2022/23 per SME in south east Wales was almost £450.

The north, and mid and south west Wales regions both received slightly above their business population share of Development Bank investments in 2022/23. The value of Development Bank investment per SME in north Wales, and mid and south east Wales, was around £530 in 2022/23. Almost 88% of total equity investments made, by value during 2022/23, were to businesses in south east Wales, with businesses in mid and south west Wales securing the largest share of loan funding.

Figure 12.
Investment by location during 2022/23

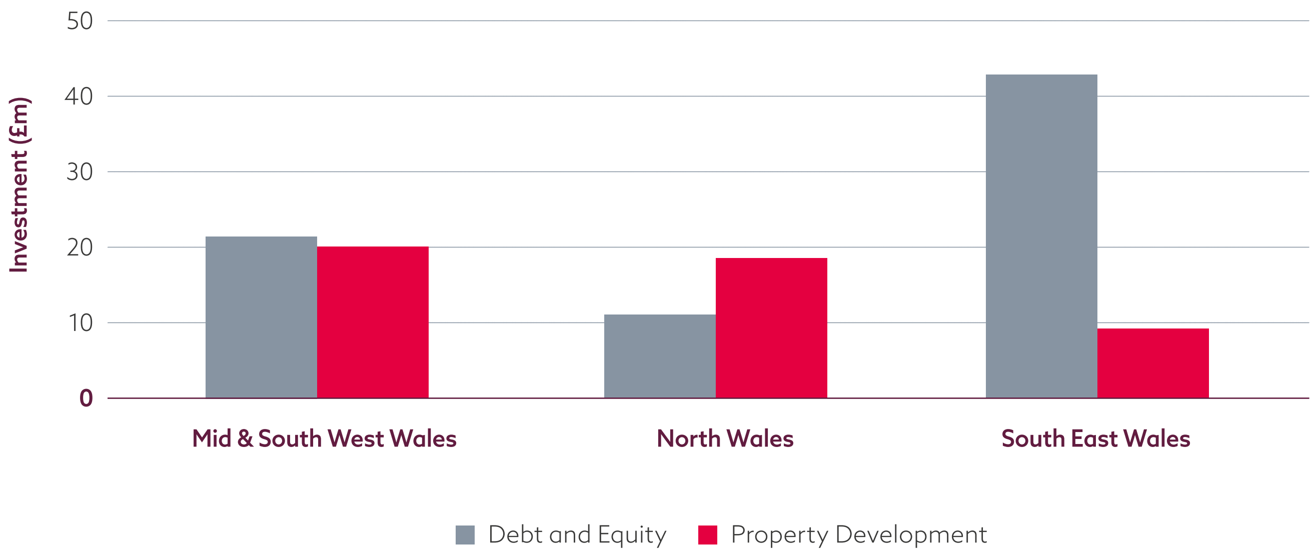
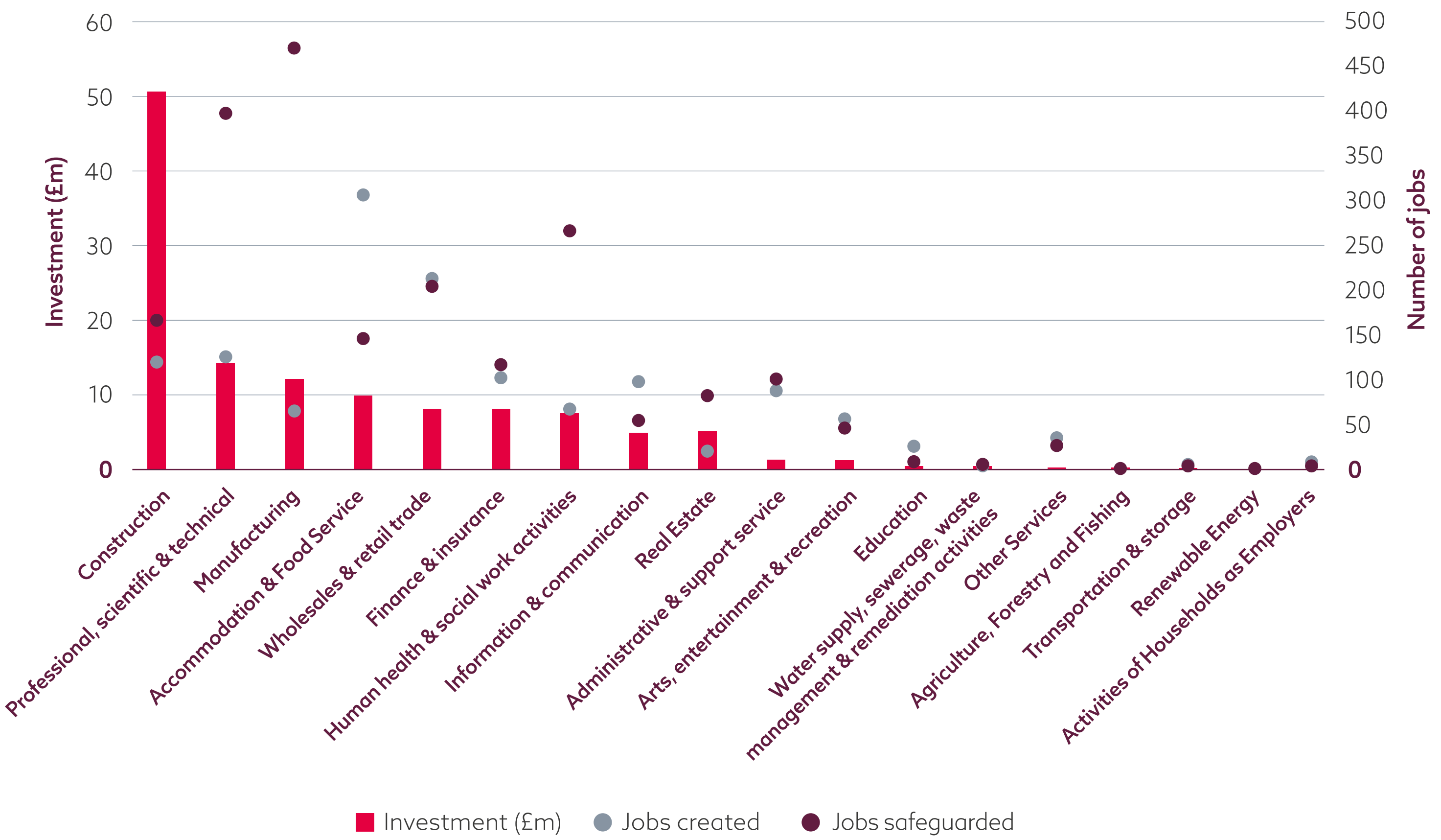


Figure 13 shows that most investment in 2022/23 has been received by firms in the construction sector (just over £50m), whilst businesses supported by the Development Bank in the manufacturing sector are linked to the highest number of safeguarded jobs (almost 470 jobs), but with supported firms in the accommodation and food services food sector creating the most jobs (just over 300 jobs).

Figure 13.
Investment value and jobs by sector during 2022/23



The cumulative value of investments for the five-year period to the end of 2022/23 was over £610m

The cumulative number of the Development Bank of Wales investments during the last five years reached 3,640 by the end of the 2022/23 financial year. These investments have created over 5,460 jobs and safeguarded over 25,130 jobs. Businesses in the construction sector received the highest share (almost 40%) of investment funds during the five-year period. The manufacturing sector received around 11% of investment funds but created or safeguarded the highest number of jobs (almost 5,000 jobs).

Signs of recovery in the value of co-investment since the Covid-19 pandemic

Figures 14 and 15 provide some historical context to the Development Bank's lending activities. Figure 14 tracks the nominal value of investments made by the Development Bank, and the associated co-investment (private sector leverage) during the last five years. While 2020/21 includes investment amounts attributable to the Covid-19 Wales Business Loan Scheme, the value of investments in 2022/23 shows an increase from the pre-pandemic period. The value of co-investment related to debt and equity activity declined during 2019/20 due to a small number of investments recording high values of co-investment in 2018/19. This decline continued in 2020/21 due to changes in lending supply during the pandemic but recovered slightly during the 2021/22 financial year. During 2022/23 total co-investment reached almost £115m, with £103m of this attributable to debt and equity investments. Over the five-year period shown in Figure 14, co-investments have totalled over £440m.

Figure 14.
Investment and co-investment, £m, 2018/19 – 2022/23

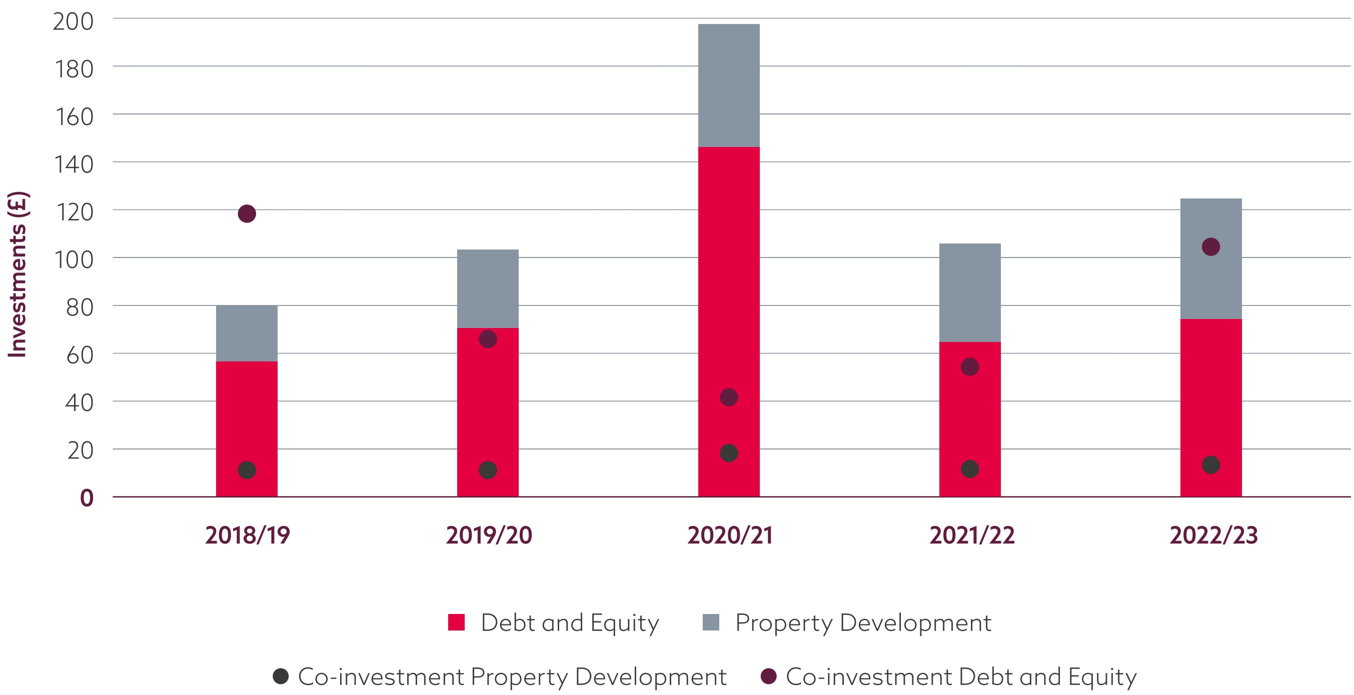
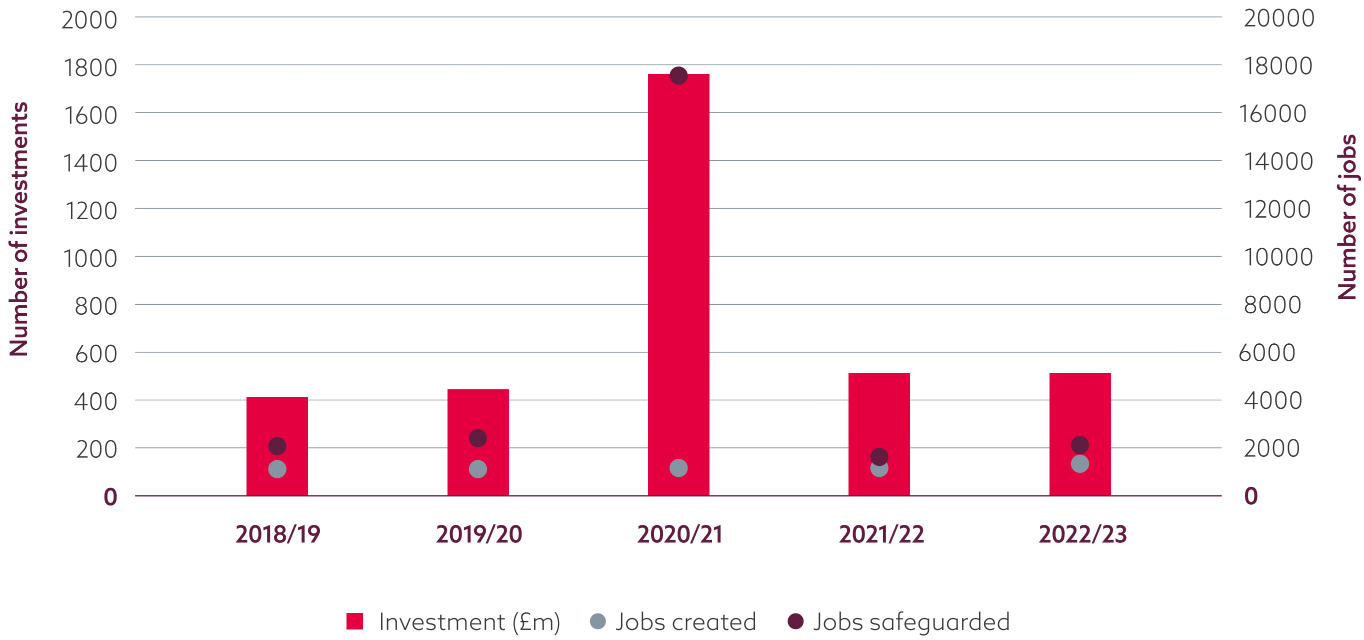


Figure 15 further illustrates the scale of the lending during 2020/21 financial year, with over 1,700 investments completed, and more than 18,300 jobs supported (mostly safeguarded) due to the Covid-19 Wales Business Loan Scheme. The number of investments made in the most recent two financial years exceeds those in the two years prior to the pandemic, although with a slight decline in the number of investments in 2022/23. The number of jobs created and safeguarded in 2022/23 is above those in the previous year, and also the pre-pandemic period.

Figure 15.
Number of investment transactions and jobs created and safeguarded, 2018/19 – 2022/23



The economic impact of the Development Bank's investments 2022/23

This section provides estimates of the gross value-added (GVA) supported by Development Bank of Wales activity. A summary of the estimation methodology is provided in Appendix 1.

The estimation of GVA impacts in this report is limited to debt and equity investments, where jobs are key performance indicators (KPIs). This means that some funds (relating specifically to property/construction)[57] are excluded from the analysis as no, or very limited employment is directly linked to the investments. **Therefore, the investment value of relevant funds, excluding the property related funds, analysed in this section of the report is £75.8m, linked directly with 3,434 (gross) new and safeguarded jobs.** These figures are higher those presented in the 2021/22 Annual report, where relevant funds were less than £70m and gross new and safeguarded jobs were 2,610.

The methodology involved various stages in the analysis to estimate net impacts (adjusting gross outcomes to take account of assumed deadweight, displacement, substitution and multiplier effects).

The results of this analysis are summarised below (and see Figure 16):

- Welsh GVA associated with the 1,358 (gross) new jobs estimated to be created in 2022/2023 is £64.9m.
- Once allowance is made for deadweight, displacement, substitution and multiplier effects etc the level of GVA supported in Wales connected to this job creation is estimated to be £37.6m.
- Similarly, the Welsh GVA associated with the 2,076 (gross) jobs safeguarded is £135.7m.
- Again, once allowance is made for deadweight, displacement, substitution and multiplier effects etc the level of GVA supported in Wales connected to these safeguarded jobs is estimated to be £82.8m.
- Together the total of direct jobs created and safeguarded in 2022/23 is estimated to be connected to £200.6m of GVA in gross terms and **£120.5m of GVA in net terms once account is taken of deadweight, displacement, substitution and multiplier effects.**[58] This compares with an estimated £85.8m GVA in net terms supported in the previous financial year.
- This equates to an estimated **net increase in Welsh GVA of around £35,100** for each job created or safeguarded in 2022/23. The equivalent estimate for 2021/22 was £32,860 per job.

The results obtained are determined by the varying amounts of jobs created or safeguarded by sector, and the estimates of GVA per job in each of these sectors, which will also vary. For example, jobs created or safeguarded in the accommodation or food and beverage services sectors are, on average,[59] connected to lower levels of estimated GVA per job, than those in information and financial services. Furthermore, whilst the assumed deadweight, displacement and substitution adjustments used in the analysis do not vary by sector, the multiplier impacts will be sector specific.[60] Here the accommodation and food services GVA multipliers are higher than those for information and financial services.

As noted above, the GVA impacts for 2022/23 exceed those for the financial year 2021/22. This is partly explained by the higher relevant funding and direct jobs created and safeguarded

[57] The funds excluded from this analysis are Property Fund II, Self Build Wales, Stalled Sites and the Commercial Property Fund. Together these investments had a value of almost £48.4m in 2022/23.

[58] For context, estimated total Welsh GVA in 2021 was £69.5bn. See https://www.gov.wales/regional-gross-domestic-product-and-gross-value-added-1998-2021

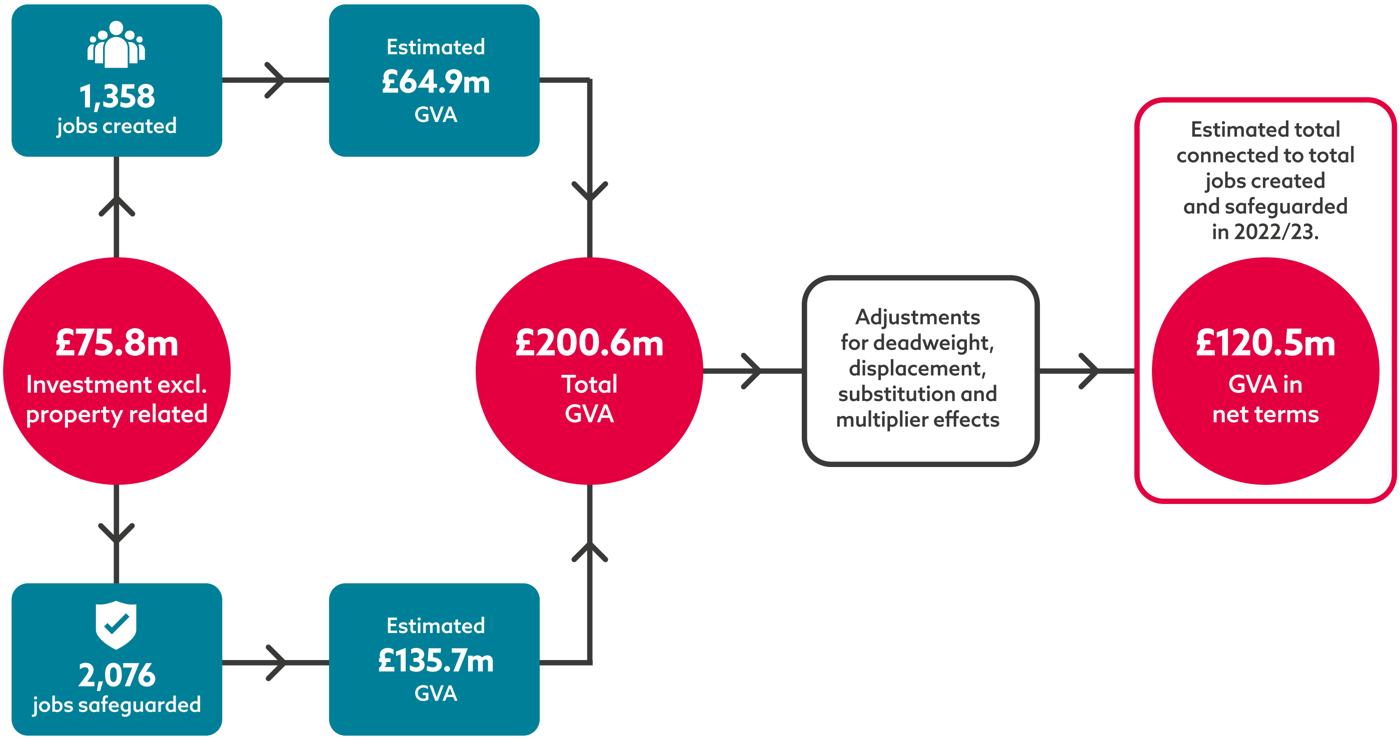
[59] Using average GVA per job by sector for Wales, see Appendix 1.

[60] Using average multipliers by sector for Wales, see Appendix 1.

in 2022/23. In addition, there is some variation in the GVA per job estimates per year, and variation in the distribution of jobs supported and safeguarded by Development Bank of Wales activities. Some of the sectoral GVA per job estimates used in this report have increased, and others decreased compared with the estimates used for the 2021/22 Annual report. However, on average there was an increase in the average GVA per job estimates for Wales as a whole between the two periods.

These results are estimates and are based on a number of assumptions. Also, these results are likely to be conservative, due to the exclusion of some funds that are not aimed at job creation/safeguarding. Furthermore, in the application of the deadweight factors etc to derive net outcomes, no consideration is given to the fact that the vast majority of funds are repaid to the Development Bank. This type of 'gross to net' calculation is usually undertaken in relation to grant payments. Finally, the Development Bank's investment activities are also linked with varying levels of co-investment/private sector leverage. The impacts relating to co-investment are not considered in this analysis.

Figure 16.
Welsh GVA effects of Development Bank of Wales non-property investment in 2022/23



Conclusions

One of the features of this Annual report has been interpreting mixed messages in the various figures reviewed. At one level there appears to have been some improvement in business confidence in the first quarter of 2023, but with different surveys still picking up on business concerns about inflationary pressure. These concerns are still dominating even after falling energy prices during 2023, and some easing of inflationary pressure in June. Moreover, labour markets in both the UK as a whole and Wales still appear relatively strong in terms of employment, and numbers of vacancies. While increases in the unemployment rate in Wales are a cause for concern, the data showing a decline in the unemployment-related claimant count provides some positive news.

This leaves the major question during the remaining months of 2023 of how far interest rate hikes will serve to slow down underlying inflation but then also cut into UK consumer confidence and with the inevitable consequences for economic growth. The major forecasting groups at UK and international levels are already predicting slower growth for 2023.

In terms of small firms, the evidence reviewed in this report points to a rise in the number of business deaths, and a rise in the number of business insolvencies, and with this latter expected to worsen during the year. There was also evidence presented of an increase in Welsh SMEs in the highest risk credit rating in June 2023. This links to the findings from surveys of a more subdued market for finance and with this also not helped by the rise in interest rates in June.

All in all, the evidence points to SMEs in Wales facing challenging economic conditions for the remainder of 2023.

In the current economic conditions, the activities of the Development Bank of Wales, which supports Welsh jobs and GVA, provides important impacts for the regional economy. The report reveals an estimated £200m of Welsh (net) GVA being connected to the employment created and safeguarded by Development Bank activity in 2022/23. There is every indication that this is a conservative estimate of the contribution of these activities to the economy.

Appendix 1:
GVA estimation methodology

This section provides a summary of the methodology used to estimate the gross value-added (GVA) supported by Development Bank of Wales activity (see section 6). To provide the estimates the Development Bank provided information relating to new and safeguarded employment connected to projects where investment finance has been provided (see section 5).

The estimates provided for this report follow the same methodology and assumptions as applied in the 2021/22 Annual report; these are repeated below for reference. Data provided by the Development Bank, as well as estimates of average GVA/employment (see below) have been updated to the latest available.

As well as information on new and safeguarded employment, there are a number of other fields provided in the data sets from the Development Bank, including the industry in which employment has been supported (in terms of Standard Industrial Classification, SIC 2007). Using this data, it was possible to gain an estimate of the GVA connected to each of the jobs created and safeguarded by industry, and the extent to which these might be connected to the support of activity indirectly in other parts of the regional economy.

Average GVA/employment data was collected from the Office for National Statistics (ONS) using GVA current price estimates for 2021 and information from the Business Register and Employment Survey.[61]

There are some considerations with this approach. GVA estimates are based on average GVA per employment, and it is assumed that the firms in which jobs are created and safeguarded share the characteristics of the industry average. This might be a more reasonable assumption for selected services as opposed to manufacturing sectors. As such the GVA figures connected to employment should be taken as indicative and used only as a guide to effects.

The Development Bank data on employment provides an indicator of the gross outcomes associated with Development Bank activity. However, it should be noted that not all investments will result in jobs being created and safeguarded, and not all jobs created are recorded during the relevant period, thus excluding them from in-year and any future-years analysis. In relation to the former point, the analysis in this section of the report is limited to the funds where jobs are key performance indicators (KPIs). This means that some funds (relating specifically to property/construction)[62] are excluded from the analysis as no, or very limited employment is directly linked to the investments. The approach is then conservative in the estimation of impact, as the activities supported by these investments may support GVA within Wales, but it will not be captured by this methodology.

Furthermore, it is useful to understand the net outcomes associated with the investments. In moving from gross to net outcomes it is necessary to derive assumptions on deadweight, displacement, leakage, substitution and multiplier effects associated with interventions.[63]

This report does not discuss these issues in detail; however, an outline is provided below:

- Deadweight relates to the extent to which any employment outcomes might have occurred in the absence of the Development Bank support i.e., firms might have created or safeguarded employment in the absence of the loan or equity finance.
- Displacement relates to the fact that firms assisted by the Development Bank may

[61] For GVA see Regional gross value added (balanced) by industry: all ITL regions - Office for National Statistics

[62] The funds excluded from this analysis are Property Fund 2, Self Build Wales, Stalled Sites and the Commercial Property Fund. Together these investments had a value of almost £48.4m in 2022/23.

[63] Note: Additionality in this context should be understood as follows. Gross impacts – deadweight factor – displacement factor- leakage factor – substitution factor + multiplier effects = an estimate of net impacts.

gain an advantage over unassisted firms, perhaps succeeding in the market and reducing activity levels in their competitors.

- Leakage refers to the fact that the positive employment outcomes reported by the Development Bank may occur outside of Wales.
- Substitution relates to the issue that the loan or equity support provided could work to create opportunities for some employees at the expense of others. For example, a programme may encourage a firm to take on new employees with higher skill levels, while those with lower skills are made redundant.
- Finally, employment outcomes could be connected to multiplier effects. New or safeguarded jobs are expected to be linked to gross value added directly. However, as businesses purchase inputs to support their economic activities this will includes purchases in the local economy supporting gross value-added creation in other local enterprises. Moreover, new and safeguarded jobs will enable employees to purchase goods and services in the local economy, and this also supports gross value-added creation elsewhere in the regional economy.

For this report deadweight, displacement, substitution and leakage factors have been derived from a review of prior evaluations in both Wales and the wider UK, with this including previous meta-analysis of additionality from a wide range of programmes.[64]

These are summarised as follows:

- Deadweight. Assumed at 46% i.e., 46% of employment outcomes occur regardless of support offered by the Development Bank to businesses.
- Displacement. Assumed at 30% i.e., the extent to which economic opportunities in competitors are affected.
- Leakage. 0% and with Development Bank outcomes reported being wholly within Wales.
- Substitution. Assumed at 4%. Expected to be limited but some of the loan and equity support offered by the Development Bank to support innovation might work to create opportunities for some skilled workers while displacing opportunities for others.

Multiplier effects associated with activity supported are estimated using the framework of the Wales Input-Output tables for 2019. It must be stressed that the process of moving from gross to net impacts is heavily assumption-led. Ideally estimates of deadweight and displacement are best estimated through extensive primary research with beneficiaries, but this is not currently possible within the framework of this project.

[64] See for example, BIS OCCASIONAL PAPER NO. 1, Research to improve the assessment of additionality October 2009 see: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/191512/Research_to_improve_the_assessment_of_additionality.pdf and Department for Business, Enterprise & Regulatory Reform Impact of RDA spending – National report – Volume 1 – Main Report March 2009 https://webarchive.nationalarchives.gov.uk/20090609050004/http:/www.berr.gov.uk/files/file50735.pdf

Appendix 2:
Selected frequently updated resources

Some figures reported in the Quarterly and Annual reports change quite rapidly. For the reader, this appendix provides web links to the statistics that are frequently updated such that updates can be gained prior to the next Quarterly report.

UK GDP updates:
https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/latest

UK labour market analysis:
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes

UK regional labour market data:
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/nationallabourmarketsummarybyregions01

Dirnad Economi Cymru
Economic Intelligence Wales

bancdatblygu.cymru
developmentbank.wales