Upbeat North East firms facing delicately balanced economy

An economist has warned North East businesses that just a slight increase in headwinds could plunge the UK into recession, despite upbeat forecasts.

Amid gloomy GDP data that showed the UK economy shrank by 0.5% in July, RSM economist Tom Pugh spoke to business leaders in Newcastle who showed optimism despite anticipating lacklustre growth – possibly only 0.1% per quarter – in the near future. Mr Pugh said the sluggish performance is because the impetus from rising real wages is offset by the drag from interest rates, a factor that increases as more people re-mortgage and pay down debt.

Amid easing, but still high inflation, the Bank of England is expected to hike the Bank Rate 23 basis points to 5.5% next week. And Mr Pugh told firms: "If we're not quite at the peak, we're not far off. But we don't really see interest rate cuts coming until the second half of next year."

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RSM's Q3 Middle Market Business Index showed an upswing in revenue, profits and confidence among middle market companies, with revenues of between £10m to £750m. The index was at its highest since the end of 2021, but that is against a "seesaw" balance between recovery in households' real incomes versus the weight of interest rate hikes over the past 18 months.

Mr Pugh told BusinessLive: "Talking about whether we're out of the woods yet, quite clearly the middle market is remaining resilient, at least. And certainly that's the message that was coming from people around the table. We’re not seeing signs of debt stress or anything like that. We were talking about inflation having fallen pretty sharply this year. It’ll bump up in next week’s figures but we should see some pretty chunky falls towards the end of the year and early next year.”

While wage growth has been viewed as a main driver of inflation – particularly from the Bank of England’s viewpoint – Mr Pugh suggested expectations that real wages would continue to rise over the next six to 12 months marked sight of the easing of the cost of living crisis. Discrepancy between industries and markets and their abilities to weather that inflationary time has produced mixed results with the North East having seen its share business collapses.

Mr Pugh explained: “You’re seeing quite a difference between industries. Those that have some pricing power, those able to pass on costs – and we’ve been in a high inflation environment so quite clearly firms are passing on costs – have actually been able to defend their margins quite well.”

He added: “There’s obviously a portion of firms who don’t have that pricing power who aren’t able to pass on costs – perhaps their market segment is in trouble or they’re serving the squeezed middle part of the market, they’re struggling. We’re seeing that volumes are very, very weak. If you’re a mid-market pizza chain, you’re not getting more customers through the door and if you’re unable to pass on price increases because competition in your market segment is intense, and you’ve had to build up a big stock of debt during the pandemic, that’s the real perfect storm and that’s the chunk of businesses we’re seeing going under now.”

The assessment comes as two separate regional snapshots show firms across different sectors remain confident, despite the mixed picture. North East manufacturers responding to a Make UK/BDO survey pointed to strong demand in the automotive and oil and gas sectors, spurred by the easing of chip shortages and improvements in supply chains from the Far East and new North Sea licences.

Similarly, the Entrepreneurs’ Forum Quarterly Members Pulse Survey showed 77% of respondents in August are optimistic about their business performance and 80% anticipating turnover growth in the next 12 months. A smaller proportion of firms (18%), reported that economic uncertainty is impacting their positivity for the year ahead, mainly due to increased costs.