POLICY ADVICE FOR MINISTER

The impact of the increased Cost of Doing Business on the economy

An assessment by the Ulster University Economic Policy Centre (UUEPC)

FINAL

December 2022

Introduction

Section

Introduction

After an extended period of low or no inflation, costs have increased significantly, caused initially by supply and demand dislocations associated with the global policy response to COVID and then subsequently by the Russian invasion of Ukraine. These cost increases have created significant cost pressures on both households (referred to as the 'Cost of Living Crisis') and on businesses (the 'Cost of Doing Business Crisis').

In response, governments have intervened to protect both households and businesses from the worst impacts of the energy price rises. For some households and businesses these protections will be sufficient, but for others further support may be required. Given the funding constraints faced by many governments, it will be essential that any additional support will need to be targeted at those in greatest need.

This paper focuses on sub-sectors sectors within the private sector that have been most impacted by the increased 'Cost of Doing Business'. It is recognised Government can access accurate estimates of the impact higher costs are having in the public sector.

Introduction

Challenging funding environment

This paper does not make recommendations on specific sectors to support but can help inform that decision. However, **the current financial environment facing Northern Ireland departments is very challenging and it is recognised that funding may not be available to provide any support to business**. This is in stark contrast to the response the NI Executive were able to provide to local businesses in response to the pandemic.

Structure of this paper:

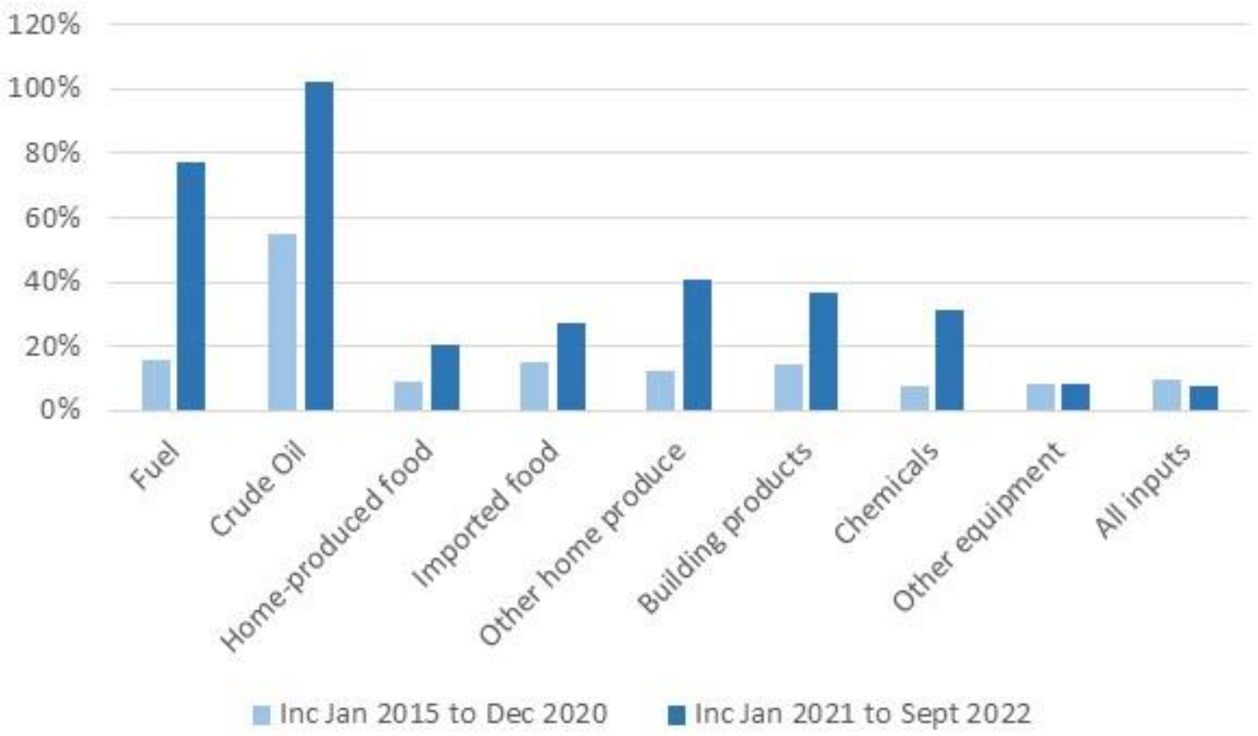
- Scale of cost increases;
- Impact of Cost of Doing Business pressures on individual sectors;
- Impact of Cost of Living pressures on households;
- Sector consultation summaries;
- Findings.

Section 2

Scale of cost increases

Input cost increases dominated by energy

Producer Prices increase, UK, from 2015 to 2020 and 2021 to 2022

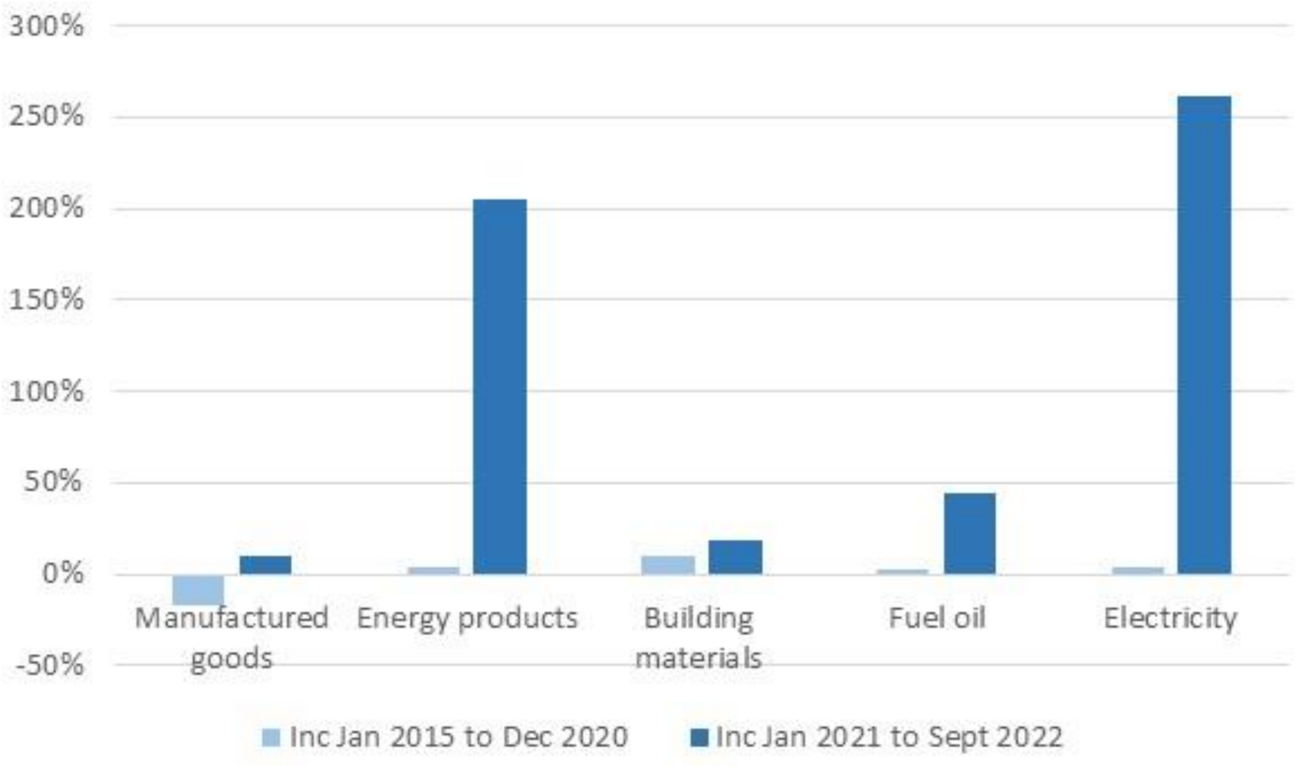


Source: ONS, PPI

- Many important producer input costs increased by more in the 21 months from Jan 2021 to Sept 2022 than in the previous 5 years (from Jan 2015 to Dec 2020).
- Fuel and crude oil prices experienced the largest increases, but a range of other inputs also increased significantly including:
  - Food – both home produced and imported;
  - Building products (official title Metals & Non-Metallic Minerals); and
  - Chemicals.
- Food prices are increasingly determined on international markets and building products and chemicals tend to be linked to energy prices.
- These cost inputs have increased significantly more than the average increase in ‘All Inputs’.

Input cost increases similar in RoI

Wholesale Price Increases, RoI, 2015 - Sep. 2022

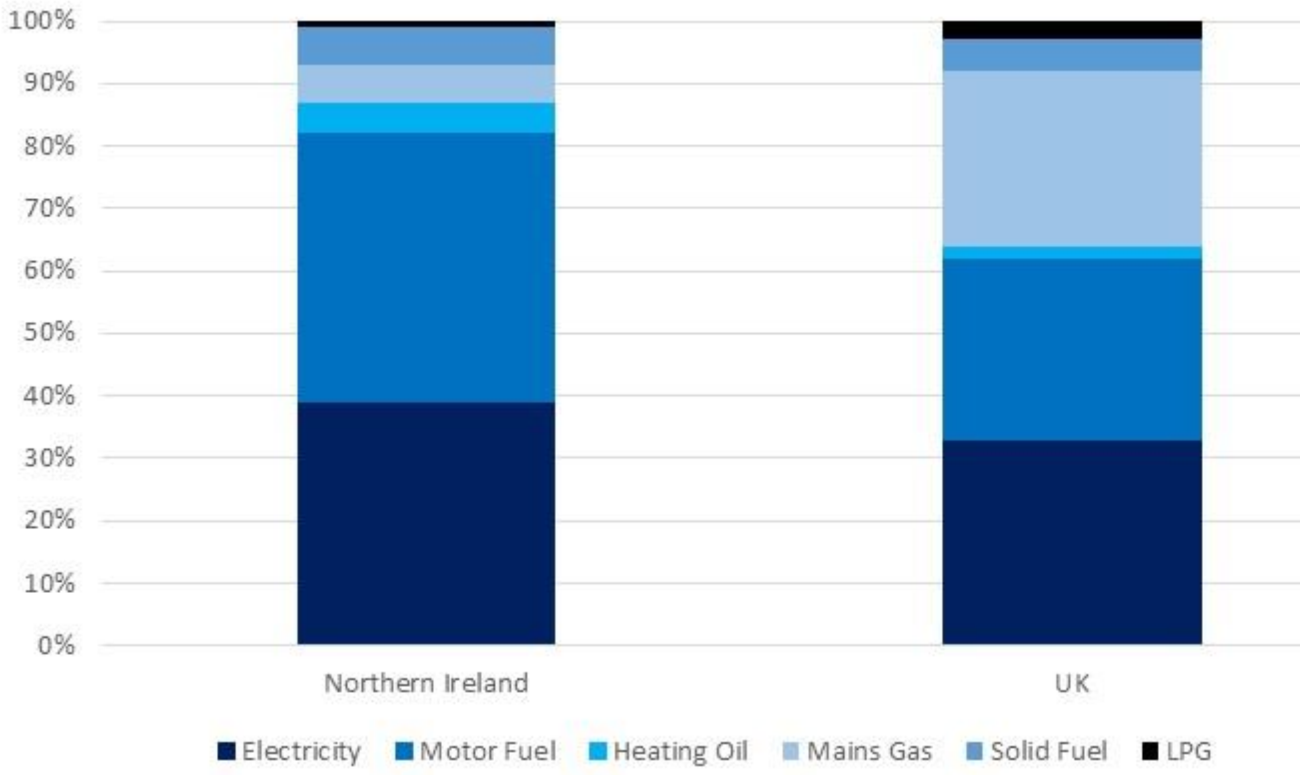


Source: CSO, Wholesale Price Index

- A similar trend exists in the Republic of Ireland, reflecting global pricing for many of these goods, where wholesale prices for Energy Products have moved sharply since January 2021.
- Higher Energy Products prices have been driven primarily by Electricity, but Fuel Oil has also increased significantly.
- Building Materials have increased by 19% since January 2021, twice the increase in the 5 year period from 2015 to 2020.
- Manufactured Goods prices fell by 18% between 2015 and 2020 but increased by 9% since Jan 2021.

Energy mix differences between NI and UK

Business energy mix, by share of purchases, NI and UK, 2018

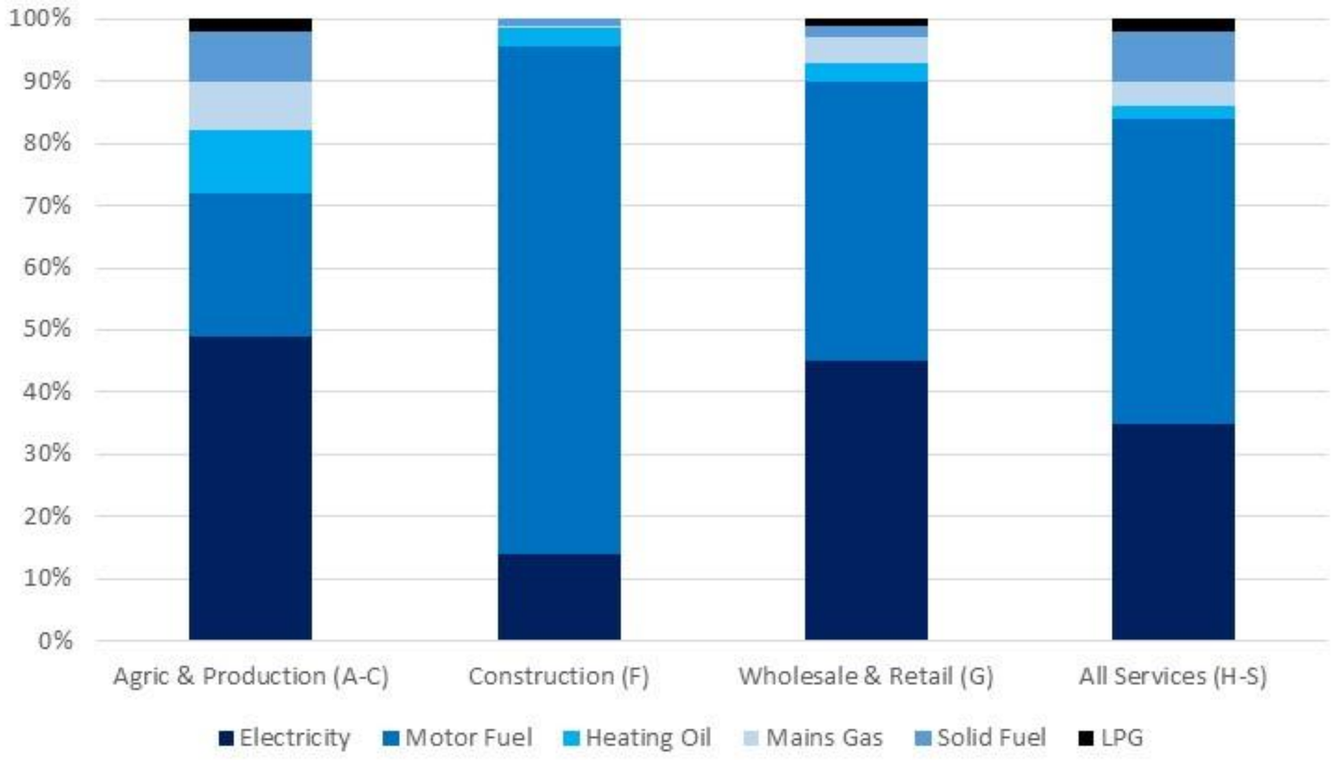


Source: ABI

- NI is marginally more reliant on electricity than UK as a whole (39% vs 33% of total energy usage) but is significantly more reliant on motor fuel which represents the single largest component of energy spend (43% in NI compared to 29% across the UK).
- In contrast, the UK is much more reliant on Mains (or Natural) Gas, which represents 28% of the total energy mix, compared to just 6% in NI.

Energy mix usage across NI sectors

Sectoral energy mix, by share of purchases, NI, 2018

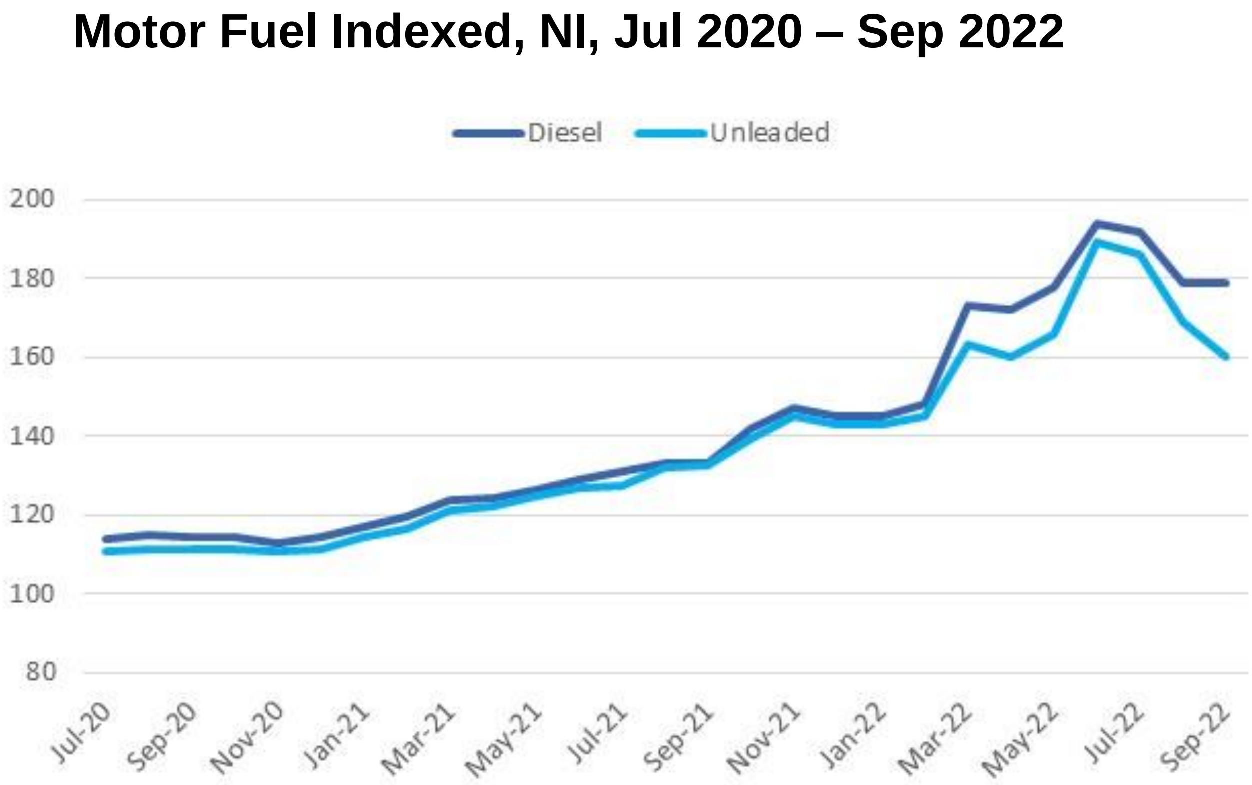


Source: ABI

The energy mix differs significantly across sectors:

- Agriculture and Production (Manufacturing) sectors have a heavy electricity usage (49% of total energy usage) followed by motor fuel (23%).
- Construction in contrast is very heavy reliant on motor fuel (81% of total energy usage) to operate machinery.
- Retail – more of a balance between electricity (in stores) and motor fuel (supply/ distribution).

Motor Fuel costs up significantly

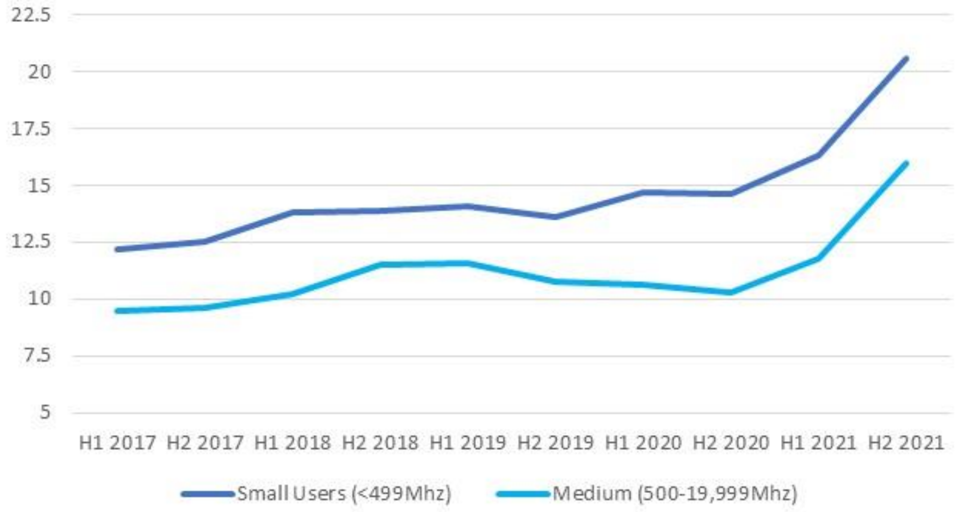


Source: Statista

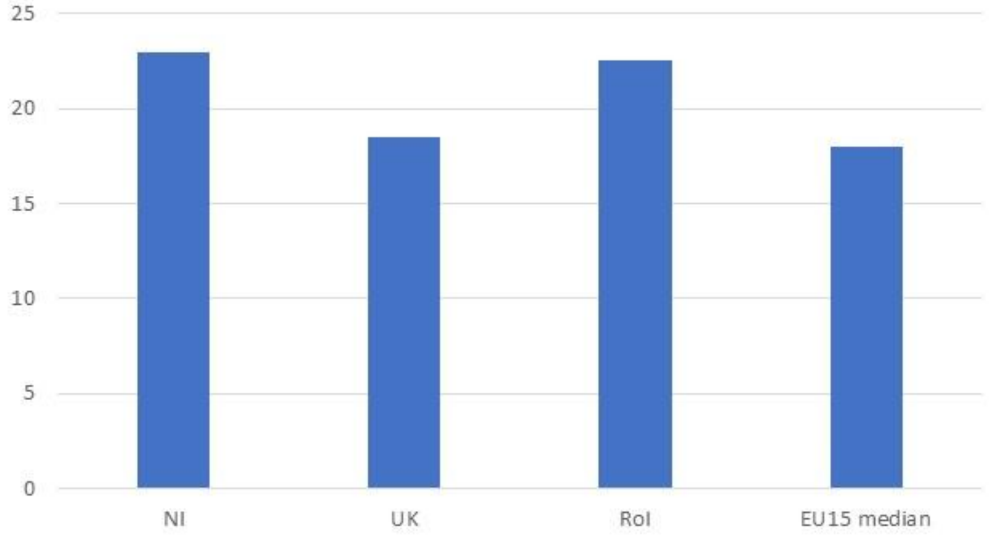
- Motor fuel represents the single largest component of the energy mix for all NI businesses (43% of total energy used) and is therefore a critical business cost component.
- Motor fuel prices started to rise in January 2021, then accelerated in February 2022 and peaking in June 2022.
- Although the price has declined in recent months (particularly unleaded) they are still at elevated levels and uncertainty remains over the future direction of prices.
- However, this reduction should be one of several factors the Bank of England considers when making future interest rate decisions.

Electricity costs also up significantly

Electricity tariffs (p/Kwh), NI, Small and Medium sized users, 2017-2021



Electricity tariffs (p/Kwh), Very small users (<200 MHz), H2 2021



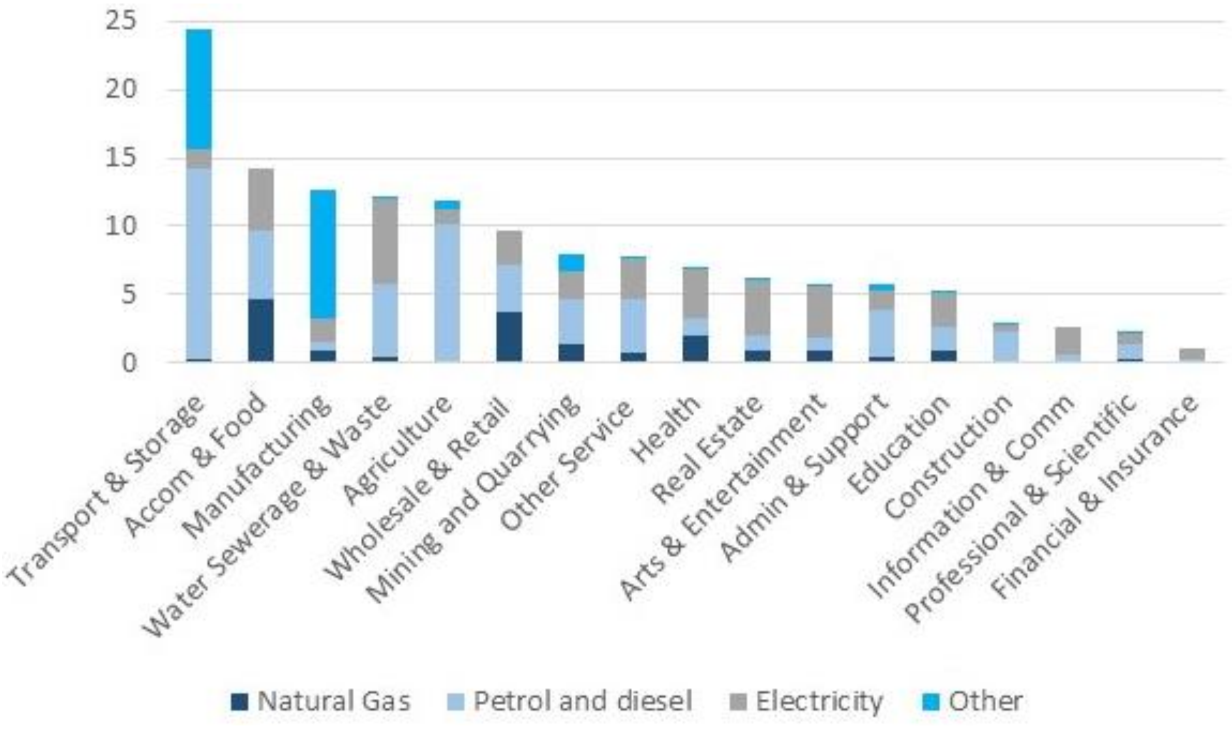
- Electricity represents the second largest component of the energy mix for NI businesses (39% of total energy used) and is therefore also important to overall business costs.
- Electricity costs (pence per Kilowatt hour) remained stable until early 2021 before rising by 40% of Small users and 55% for Medium users.
- The tariff for very small users is comparable with RoI but higher than UK and many EU averages.
- The Energy market monitoring reports for 2022 will not be published by the regulator until 2023, however, average domestic tariffs have increased by c.60% (before price supports).

Impact of Cost of Doing Business pressures on individual sectors

Section 3

Energy intensity across sectors

Energy Purchases as % of Total Purchases (Energy Intensity), by energy type and sector, GB 2019

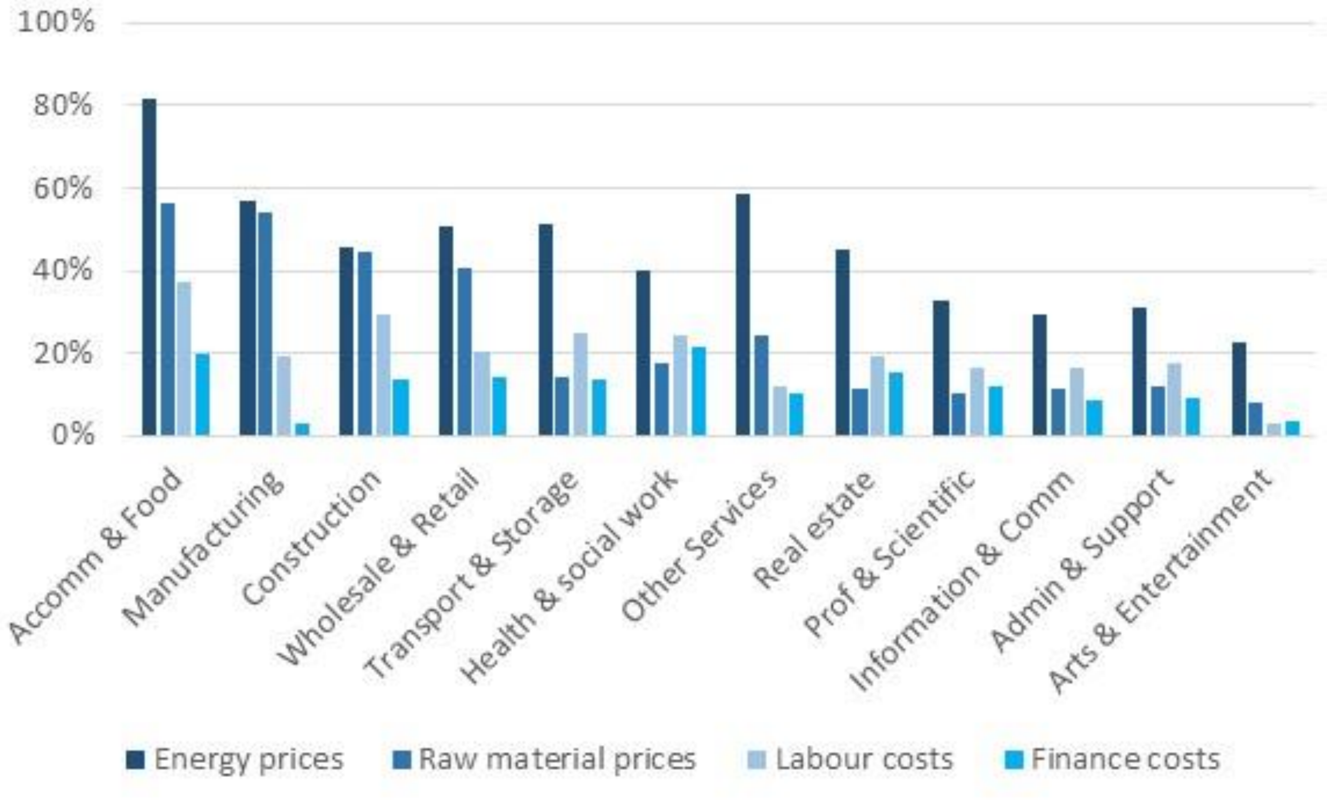


Source: ONS Business Energy Spending: Experimental Measures

- Energy intensity across sectors is recognised as being stable over long time periods and the most energy intensive sectors would be most vulnerable to significant increases in energy costs.
- The most energy intensive sectors are: Transport & Storage; Accommodation & Food; Manufacturing; Water, Sewerage & Waste; Agriculture; and Retail.
- Both Transport & Storage and Manufacturing are heavily dependent on ‘Other’ fuels which includes: kerosene, liquefied petroleum gas (LPG), coal and coke, and other refined petroleum products.
- The Electricity, Gas and Air Conditioning sub-sector has been excluded from this analysis although energy represents over half of all purchases.

Energy costs driving higher prices

Factors causing businesses to raise prices, UK, Sep 2022

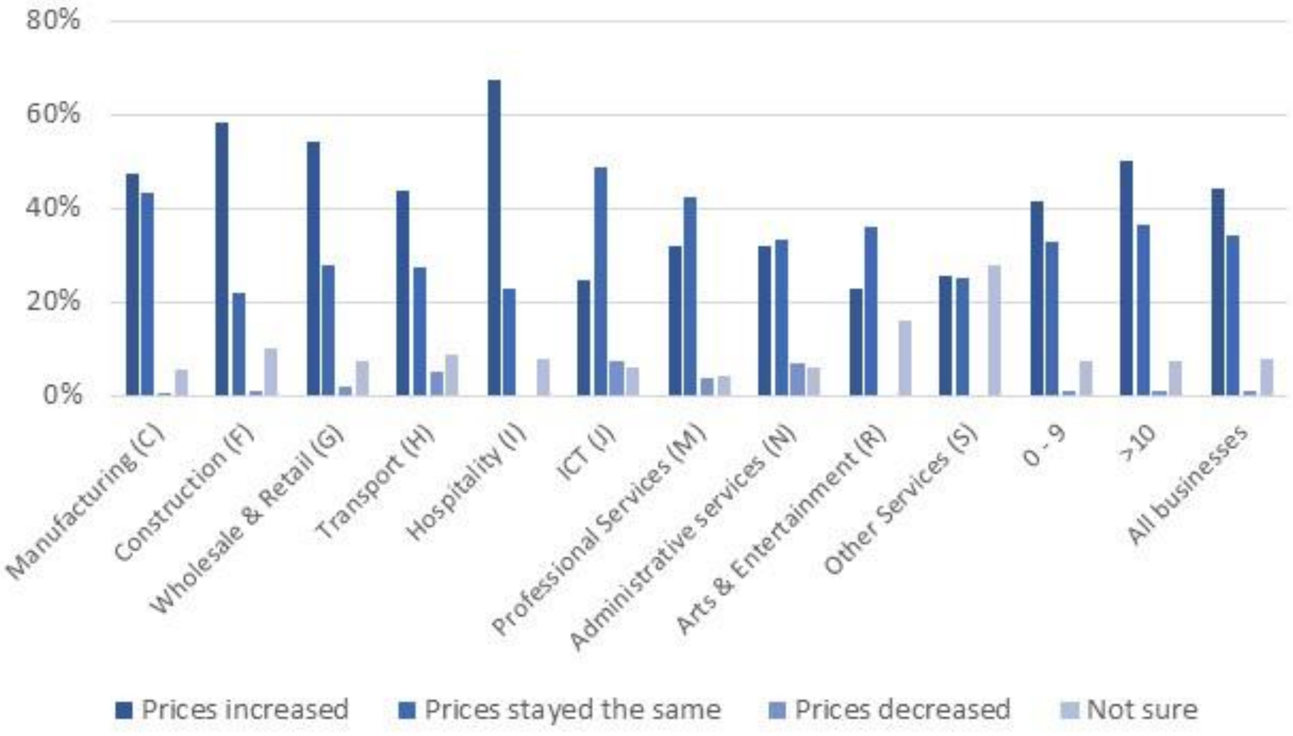


Source: BICS Wave 65, September 2022

- Energy costs, followed by input/ raw materials costs and labour costs are the key factors causing firms to increase their prices.
- The following sectors are most impacted:
  - Accommodation and Food – with 80% of businesses in the sector raising prices due to energy costs; 57% due to input prices (mostly likely food); and 37% due to increased labour costs;
  - Manufacturing, Construction and Retail sectors also highly affected by energy and raw material prices and to a lesser extent (but still significant) labour costs; and
  - Transport sector particularly impacted by energy costs.
- Finance costs are also cited as an issue, particularly in Accommodation reflecting a higher interest rates and a higher risk profile attributed by the banks to the sector.

Input cost increases vary across sectors

Change in Input Prices, Aug 2022 compared to previous month, UK by sector

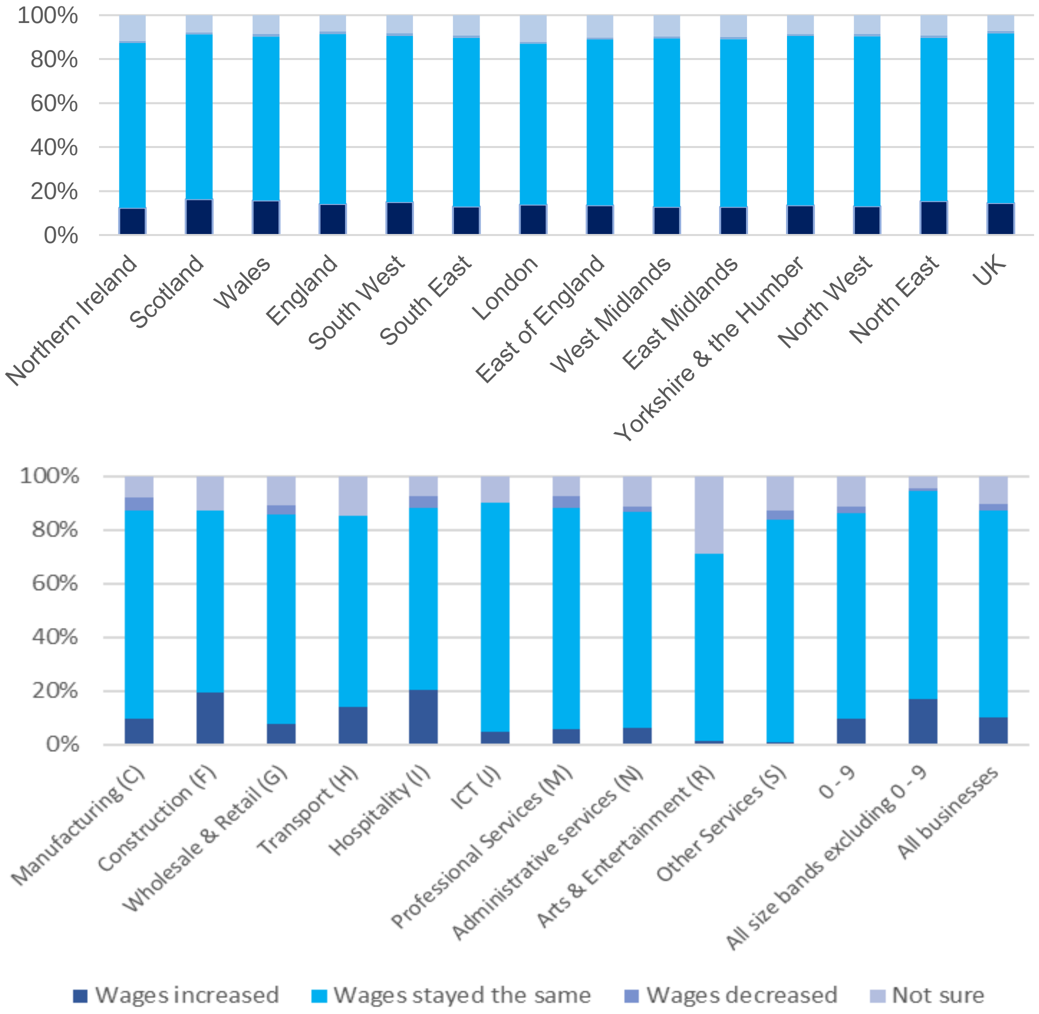


Source: ONS BICS wave 65, September 2022
Note: Agriculture not captured in this survey

- In August 2022, 44% of firms reported an increase in prices paid for inputs on the *previous month* (prices typically increase once or twice a year). This was most prevalent in:
  - Hospitality (67% of firms);
  - Construction (58%);
  - Wholesale & Retail (54%); and
  - Manufacturing (48%).
- This supports other qualitative evidence that indicates businesses are facing monthly increases in costs, which creates significant financial uncertainty, makes planning very difficult and discourages business investment.
- Looking at the data over a longer time series, Hospitality and Construction have consistently reported the highest numbers of firms experiencing cost increases.

Employment cost increases vary across sectors

Hourly Wages Aug 2022 compared to previous month, by region and sector

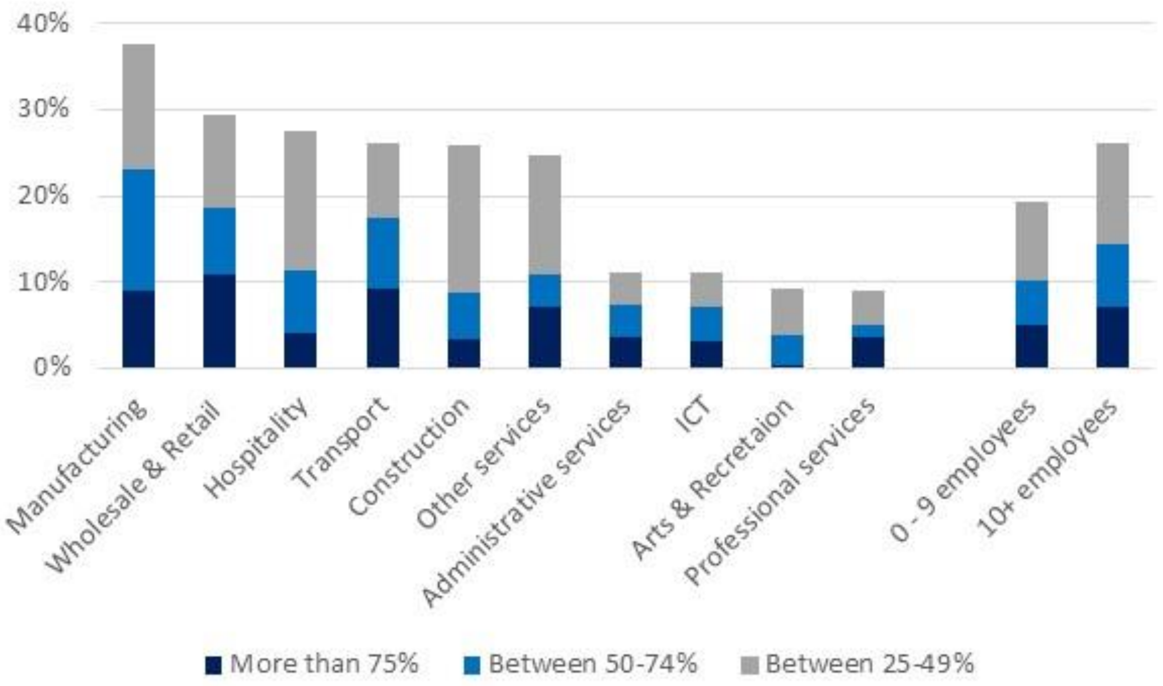


Source: ONS BICS wave 65, September 2022

- The proportion of businesses increasing wages remains high across the UK. On average 15% increased wages in August (not a common month for wage increases). Lower in NI at 12% of businesses.
- Sectors most likely to have experienced an increase in wages on the month are Hospitality (20% of firms), Construction (19%) and Transport (14%).
- Fewer micro businesses (< 9 employees) increased wages in August compared to other businesses.

Higher cost being passed through to customers

Extent to which higher costs are passed through to prices, UK, by sector and size, Sept 2022

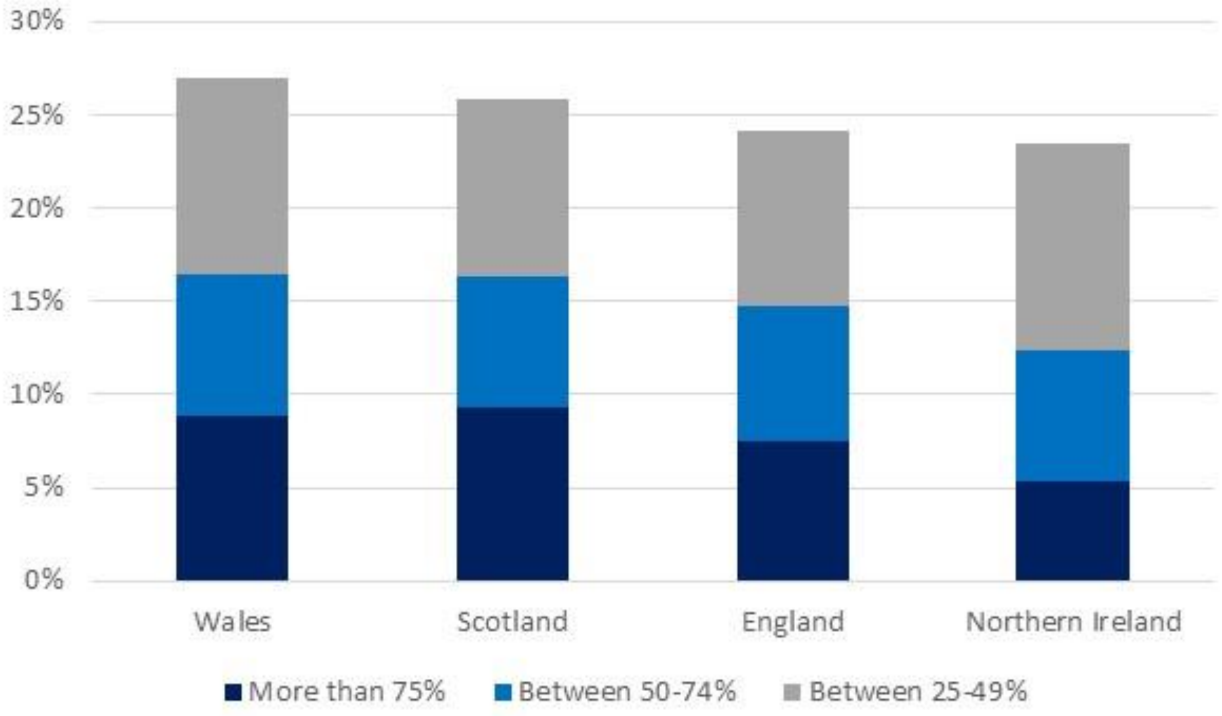


Source: BICS Wave 66, October 2022

- The sectors experiencing the largest cost increases are the same sectors most likely to pass on cost increases to their downstream supply chain/ customers.
- Sectors passing on at least 25% of their cost increases are: Manufacturing, Retail, Hospitality, Transport and Construction.
- However, this varies across sectors and in stark contrast over 60% of firms in Professional Services and ICT have not passed through any higher costs.
- Micro firms (employing less than 10 workers are also less likely to pass on a greater proportion of cost increases.

Higher costs being passed through to customers

Extent to which higher costs have been passed through to prices, UK nations, Sept 2022



Source: BICS Wave 66, October 2022

- The trend of firms increasingly passing on cost increases to their customers is broadly similar across the UK.
- Fewer NI businesses have passed on more than 25% of their cost increases relative to other nations – 23% in NI compared to 24% in England, 26% in Scotland and 27% in Wales; and
- Rising selling prices is also confirmed in PMI data.

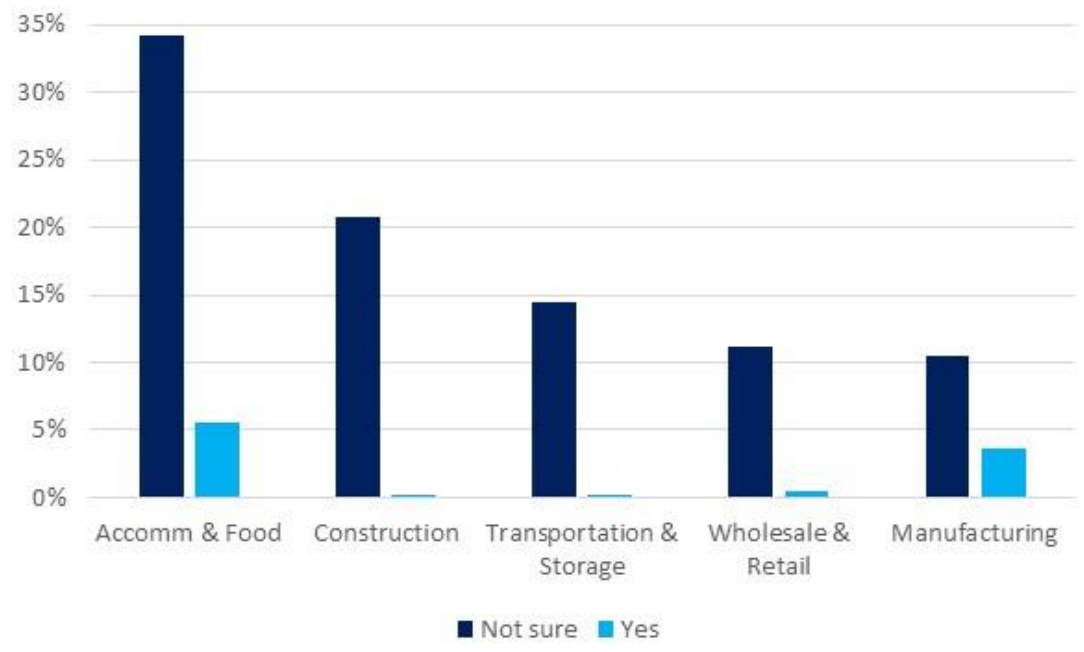
Sector Summary

The same sectors tend to rank highest in each of the three categories identified.

Most energy intensive sectors	Sectors most impacted by higher input costs	Sectors passing higher input costs through to prices
Transport	Hospitality	Manufacturing
Accommodation & Food (Hospitality)	Construction	Retail
Manufacturing	Retail	Hospitality
Agriculture	Manufacturing	Transport
Retail	Transport	Construction

Potential for redundancies in most impacted sectors

Expectations to make redundancies in next 3 months, UK, selected sectors, Sept 2022



Source: BICS Wave 65, September 2022

- High levels of uncertainty over redundancies in sectors most impacted by cost increases – reasons are not provided but increased costs likely a contributory factor.

- These survey results provide a basis to develop a scenario to quantify the potential scale of the employment impact linked to the current economic challenges. If the following (unevidenced) assumptions applied:
  - 50% of firms 'not sure' plus all who have indicated 'yes' follow through and make redundancies; and
  - 20% of workforce in those firms are made redundant.

  Then the following job losses could materialise:

Accommodation & Food	2,550
Construction	1,150
Transport & Storage	520
Wholesale & Retail	1,680
Manufacturing	1,670
TOTAL	**7,570**

- **This is a scenario NOT a forecast.**

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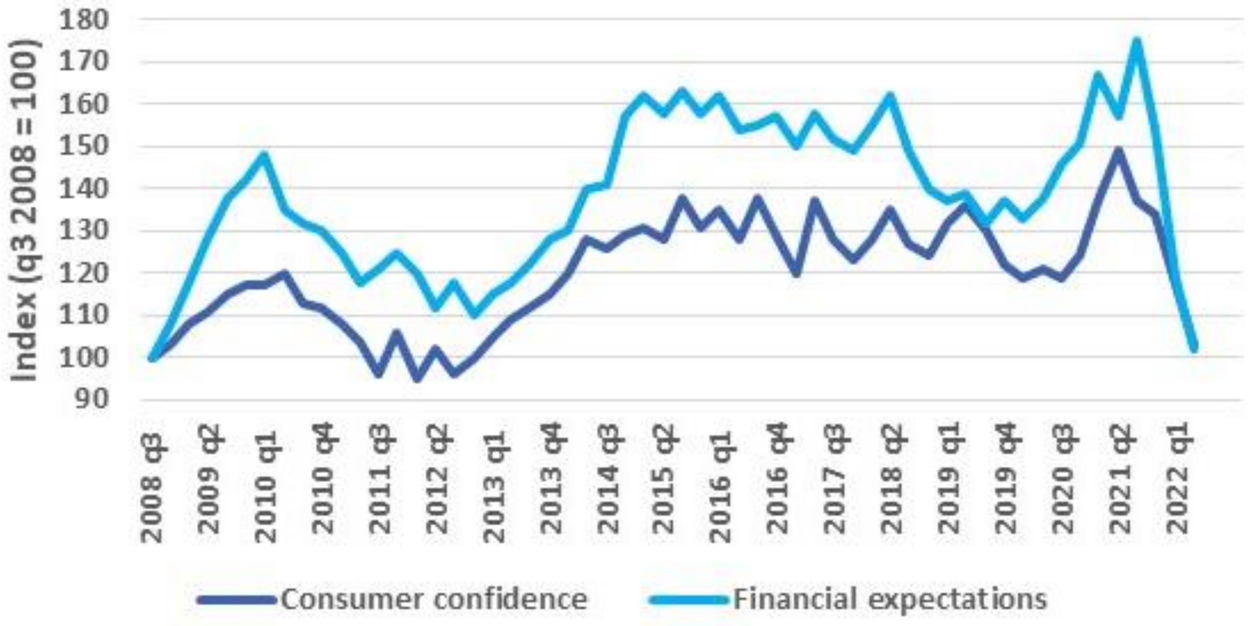
Section 4

Impact of Cost of Living pressures on households

Consumer confidence is falling sharply

Consumer confidence and personal financial expectations for year ahead, NI, Q3 2008 – Q2 2022

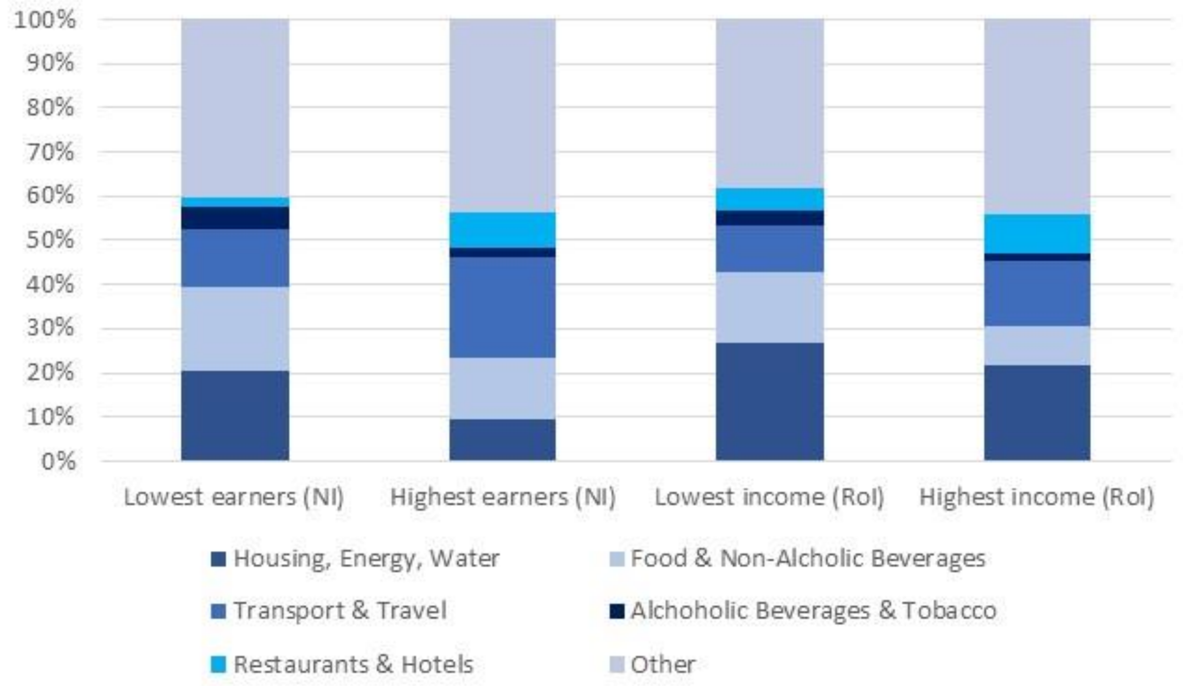


Source: Danske Bank quarterly survey

- Consumer confidence recovered strongly after the lows of the pandemic and individuals' expectations for their personal finances were also strong until Q3 2021.
- Since then, both consumer confidence and financial expectations for the year ahead have fallen sharply and are approaching lows last experienced following the financial crisis in 2008.
- These sentiments reflect a rising interest rate environment globally and economic forecasts from the Bank of England (and others) about the increased likelihood of an economic slowdown in late 2022 and into 2023.

Lower income households spend proportionally more on essentials

Spending on basic categories by highest and lowest earners, NI & RoI, 2022

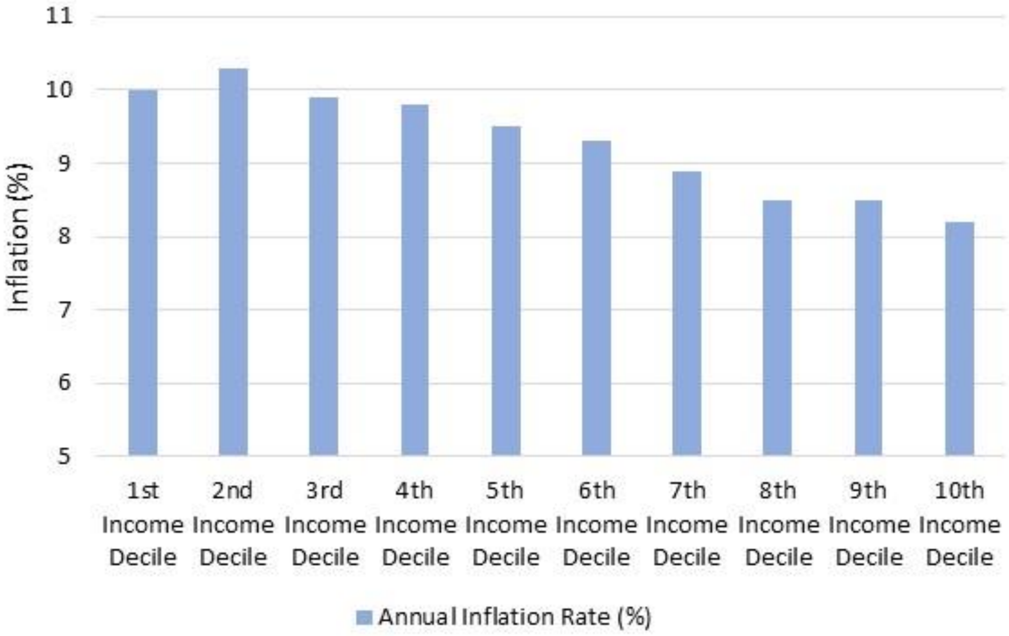


Source: CCNI and CSO

- Household spending patterns are determined by level of income. In NI lower income households spend proportionally twice as much on housing, energy and water as higher income households (20% of total spending compared to 9%). They also spend proportionally more on Food & non-alcoholic beverages.
- In contrast, higher income households spend proportionally more on transport & travel and restaurants & hotels.
- Similar trends in RoI although proportionally more is spent on Housing for all income groups.
- 'Other' refers to household goods, communications, clothing and recreation and represents almost half of all spending.

Inflation has a bigger impact on lower income households

Estimated inflation by household income deciles, RoI, June 2022

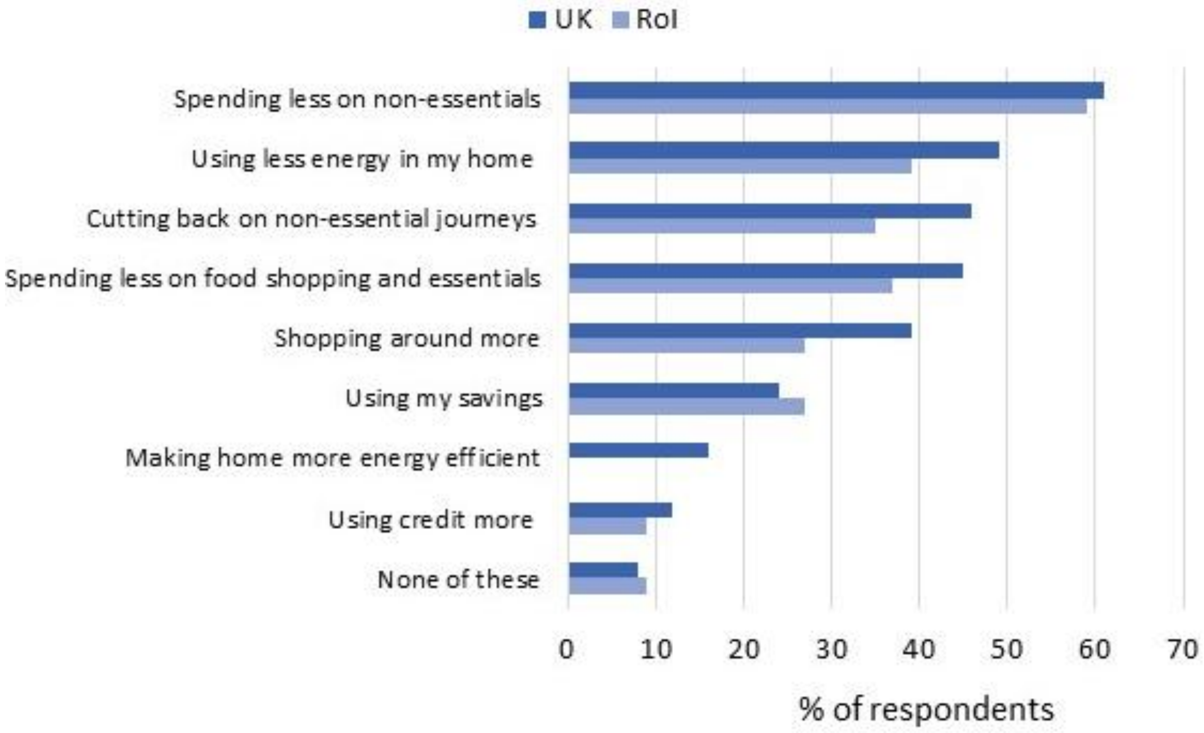


Source: CSO

- Given spending patterns vary by household income, the impact of inflation does not fall evenly across those groups.
- The current elevated levels of inflation are being driven primarily by energy and food prices (although all prices are now rising) and given lower income households spend a greater proportion of their income on these items, they will be more impacted.
- Analysis by the CSO estimated that in June (when the official inflation rate in Ireland was 9.1%) the effective rate for those on lower incomes was over 10%, but for those on the highest incomes, inflation was lower at 8.2%.
- With inflation increasing since June 2022, those inequalities are likely to have increased.

Households are spending less and reducing energy usage

Actions households are taking due to cost of living pressures, UK and RoI, June-July 2022



Source: RoI – KBC Consumer Sentiment report, June 2022; UK - ONS, Opinions and Lifestyle Survey, July 2022

- Households are responding to the squeeze on incomes by spending less on both non-essentials (61% in UK; 59% in RoI) and for some (45% in UK; 37% in RoI) essential items.
- The increase in energy prices is also causing a reduction in demand with households now using less energy.
- Also of concern, a significant minority of people are either using savings or additional credit to make ends meet.
- Only a small minority (less than 10% of people in both the UK and RoI) are not taking any actions to reduce their costs.

NI discretionary income lowest in the UK

Weekly discretionary income, by region and quarter

Source: CEBR, ASDA Income Tracker

Total Income

Less

Taxes

Less

Essential Spending

Equals

Discretionary Income

NI discretionary income fell the most in the UK

Year-on-year change in weekly discretionary income, by region and quarter

- NI has highest share of employees earning below the NLW (28% cf 23% in UK).
- NI spends more on high inflation categories:
    - Food 14.5% cf. 12% in UK
    - Energy 6% cf. 4.2% in UK
    - Motor fuel 6% cf. 3.5% in UK
- Reducing levels of discretionary income creates a particular challenge for sectors such as: retail (particularly non-food), hospitality and leisure.

Source: CEBR, ASDA Income Tracker

Sector consultation summaries

Section 5

Cross-sectoral

Cost impacts

Costs increasing across the board. NICCI survey results show:

- Salary/ Employment costs – 45% of firms offering 5%+ up from 22% 12 months earlier;
- Energy – 25% of firms experienced 50% increase in last quarter; 10% experienced 100% increase in last quarter;
- EU Exit/ NI Protocol – 50% of firms incurred additional costs but difficult to isolate with other costs also increasing;
- 81% of Manufacturing firms and 70% of Service firms expect to increase prices in next 3 months.

FSB survey suggests:

- 50% of firms are experiencing 40%-60% increase in total costs.
- 33% “ “ “ 20%-40% “ “ “
- 10% “ “ “ 60%-80% “ “ “

Firms are reducing their costs through number of ways:

- Reducing their electricity usage
- Reducing opening hours

Approx 2/3rds of firms are increasing their prices (source: FSB) but this is not sustainable beyond the short term.

Financial impacts

- Cashflow becoming an increasing issue and firms borrowing to manage cashflow rather than invest.
- Significant reduction in confidence in future profitability – because: costs up; demand down; and political uncertainty locally and nationally.
- Access to credit is an increasing issue alongside increased financing costs.

Cross-sectoral

Staffing impacts

- Businesses are still actively recruiting and experiencing challenges finding applicants with the right skills
  - Specifically identified in Childcare with some businesses having to close
- Difficult for smaller firms to access some skills programmes – e.g. Assured Skills programme works well for larger companies. There is a need for an aggregator for SMEs.
- Limited redundancies but concerns a “tipping point” is being reached.
- A Review of MAC Shortage Occupation List for NI is currently on hold. This needs addressed.

Demand

- Domestic and export orders are down. NICCI survey: 3 in 5 businesses reporting a slowdown in demand.
- FSB survey: more businesses expecting to contract than expand:
  - Approx. 33% anticipate expansion e.g. in ICT
  - Approx. 40% anticipate contraction e.g. in Retail

Supply

- COVID supply chain issues largely resolved, key issue now is cost of inputs, logistics and depreciation of £Sterling.
- Businesses increasingly undertaking more due diligence on suppliers (from a financial and sustainability perspective).
- NI Protocol remains an issue for some businesses.

Cross-sectoral

Outlook

- Majority of businesses still “trading well” but:
  - Slowdown in demand is reported.
  - Reduced business confidence/ sentiment leading to reduced business investment.
  - Concerns we have reached a “Tipping Point”.

Policy considerations

- Planning reform required to release private investment in renewable energy.
- Assured skills programme variant for SMEs – aggregator required.
- Migration Advisory Committee (MAC) – need a revised Shortage Occupation List for NI.
- Rates relief was of significant benefit during COVID and could provide significant relief in the current cost crisis.
- Late payment – FSB research: 250k of 1.7m invoices were paid late (i.e. after 30 days). To assist cashflow government should be paying all invoices within the statutory period.
- Support for childcare – releases spending for households and increases supply of labour. There is a need to reduce the time for employee checks and address the inequality issue with England and Scotland.
- Develop a dashboard to help businesses reduce their energy usage.

Construction

Cost impacts

The construction sector has been impacted by **significant cost increases** since January 2021:

- Building materials – increased by 30% (Construction Material Price Index Jan-21: 116.5; Aug-22: 159.5) and represent approx. one third of total costs.
  - Driven by several factors – initially COVID related supply constraints followed by COVID catch-up demand globally and then energy costs raising the cost of manufacturing building materials products.
- Energy – in addition to the global cost increases, the issue was exacerbated by the loss of the Red Diesel rebate in April 2022, increasing costs by approx. 40%. The sector has no alternative source of power.

Ability to **pass costs through to customer** depends on nature of contract:

- Instances where companies are ‘walking away’ from contract awards because they can no longer stand over the quoted price;
- Fixed price long-term contracts are a high risk for the sector given volatility in the price of building materials.

Financial impacts

- Firms serving the NI market more impacted than businesses serving the GB and RoI markets – the local pipeline is smaller and more intermittent.
  - The NI Block Grant 2022/23 capital budget is approx. £1.8bn, broadly equivalent to levels in 2007/08.
- No immediate signs of bankruptcies but firms very cautious about taking on new contracts, because of pricing concerns:
  - Different from 2008 recession where priority was to ‘win the next contract’.
  - More likely to bid and undertake short–term projects but multi-year projects are much higher risk.

Construction

Staffing impacts

- Employment structure of the sector has changed since 2007/08, when building contractors had large direct workforces and then following the recession there were significant redundancies. Now the sector is dominated by self-employed tradesmen working for contractors. As a result, as the number of construction projects falls, there will be less redundancies but still significant impact across the sector.
- Staff and skills shortages still being experienced and difficult for local companies competing for labour with GB and RoI operators – CEF Survey: 68% of respondents still anticipate increased demand for skills.
- Older age profile of the sector is a major medium to longer term issue.

Demand impacts

- Public sector
  - Pipeline is limited and intermittent and the budget tends to be concentrated on NI Water and the Housing Executive.
  - Work has been done to improve contracts and include inflation clauses.
- Private sector:
  - Activity in recent years on student accommodation and hotels, but this now slowing.
  - Retail – facing challenges pre-COVID and these challenges have been exacerbated.
  - Office – some larger projects nearing completion but no speculative building moving forward and Working from Home trends causing uncertainty for firms and landlords.

Construction

Supply impacts

- COVID related supply chain issues now resolved.
- Cost of materials is the key issue and taking much longer to normalise than expected.

Outlook

- Economic slowdown anticipated, not optimistic about the short to medium term future and expect costs to remain at elevated levels.
- Local firms adopting a “batten down the hatches” approach and consolidate their businesses.
- CEF survey: 62% expect reduced opportunities in the public sector and 70% reduced private sector opportunities.
- Public sector work is not profitable and private sector profitability is reducing.

Policies

- Government has provided support through the Procurement Advisory Note (PAN) which provides some cost relief through the materials cost index. This is estimated to provide support equivalent to approx. 25% of the materials cost increase.

Manufacturing

Cost impacts

Manufacturing NI Survey: at least 95% of respondents experiencing increased costs in each of these areas:

- Energy – increased by 200%+. Some firms initially protected by fixed price contracts but these are ending
  - Contracts typically agreed annually and renewed in either 1 April or 1 Oct so problems are only emerging for some.
  - Energy firms stopped offering fixed price contracts due to market uncertainty for approx. 6 months but started again in Sept 2022 and are approx. 200% higher.
- Labour – increased by 5%-10%.
- Raw materials – this varies significantly across sub-sectors, but typically costs would have increased once/ twice per annum, now cost increases are much more frequently.

Customers becoming increasingly resistant to accepting cost increases since Q2 2022.

Firms are attempting to mitigate cost increases by taking a range of measures:

- Reduce the number of production shifts (but keeping the same total hours worked).
- Reduce the number of product lines and changing production timelines to reduce storage costs.
- Some firms starting to consider redundancies as a potential cost reduction measure, but not implemented as yet.

Financial impacts

- Profitability is significantly impacted but not experiencing bankruptcies **yet**.
- The latest roll-over on energy contracts may see a further deterioration in financial conditions.

Manufacturing

Staffing impacts

- Availability of staff remains a critical issue for businesses in the sector – MNI Survey:
  - 85% of firms surveyed indicated they were experiencing labour supply issues;
  - 58% exploring investment in automation technology to mitigate labour shortages.
- Staff indicating a preference for reduced numbers of shifts but same hours (i.e. 4 x 12 hour shifts rather than 5 x 9.5)
- Redundancies being considered by some firms but not currently widespread.

Demand impacts

- No reductions in demand currently being experienced BUT lead times had been elongated during COVID and backlogs are now being reduced. So **the shortening of the order book may be masking a reduction in demand**.

Supply impacts

- Global supply chain issues largely resolved and although container transports costs significantly down from peak levels, they remain above pre-pandemic levels.
- Still some issues in the supply of steel, grains and oils (partially linked to Russia/ Ukraine).

Outlook

- Outlook remains positive – MNI Survey: 47% anticipate growth; 19% anticipate weakness.

Retail

Cost impacts

- Biggest cost increases experienced in Energy and Food:
  - Particular issue for food retailers, given the cost of refrigeration/ freezers and limited ability to mitigate that cost;
  - Some businesses reporting energy costs increasing by 50% in a month.
- Food is generally a low margin business and therefore costs have to be passed on to customers however, ability of customer to sustain increased prices is uncertain.
- General increase in cost of all goods and supply chains have become more expensive (partially a NI Protocol issue, but also wider global factors).
- Reduced opening hours to mitigate cost increases is not a factor at present but could be in 2023.

Financial impacts

- Profitability significantly impacted but only very limited numbers of closures reported.
- Given the importance of the Christmas season, a poor season could see more closures next year.

Staffing impacts

- Accessing new staff and retaining existing staff remains a challenge for the sector.
- Not clear where the staff are going to or the reasons for issues faced.

Retail

Supply and Demand

Supply

- COVID supply chain issues now resolved, but some issues reported around the increased cost of the NI Protocol

Demand

- Major concerns around the impact of a recession:
    - Non-food retailers already reporting sales 15% to 30% lower.
    - Cost of Living and higher interest rates reducing spending on the High Street.
- Higher costs driving customers to purchase lower cost items.

Policy consideration

- Address uncertainty around energy support post-March 2023 and concerns in advance of the Rates Reval publication.
- Measures to address lower footfall in urban centres.
- Calls for a rates holiday for the sector (or 50% reduction) as many retailers have not recovered from the pandemic and concerns about Councils significantly increasing rates bills.
- Rates repayment plans for those in distress and update the rates hardship fund legislation.

Outlook

- Significant concerns over economic outlook – discretionary income squeezed by higher costs and rising interest rates will have a major impact on the High Street. If slowdown persists then significant closures is likely.

Hospitality

Cost impact

Main cost increases:

- Energy – for those moving off fixed price contracts, price increases of 50% to 100% very common (in exceptional cases up to 300% higher).
- Food – increases by approx. 30%.
- Staff – increases by approx. 20%.
- Finance – banks started to consider the hospitality sector as higher risk and therefore financing costs have increased.

Cost increases are being mitigated in a number of ways:

- Businesses only open 4 – 5 days per week, this manages costs but significantly impacts the local tourism product.
- Changes to menus – removing more expensive items from menus.

Significant concerns that prices charged to customers have reached a ceiling and limited scope for further increases as Cost of Living hits customers’ pockets.

Financial impact

Significant impact to finances – gross profit is much lower:

- Revenues are up 10%-20% on 2019 levels but profits down by 50%-60% while businesses still repairing the damage of pro-longed lockdowns.
- Businesses now planning for two scenarios – breakeven; and how much cost can I absorb.
- Cost uncertainty impacts financial planning.
- Heavy reliance on Christmas to fund a quiet Q1 2023.

Hospitality

Staffing impact

- Access to staff and skills remains a major issue – even businesses with a replacement only recruitment policy are struggling to fill vacancies
- Employers have vacancies across all positions – but quality and quantity of applications has fallen.
- The Migration Advisory Committee (MAC) Shortage Occupation List needs to reflect the needs of the Hospitality sector.

Supply and demand

Supply:

- Beverages – two main suppliers in the industry and they have held prices steady but large (20%) increases expected in early 2023.
- Food – suppliers are substituting products to limit cost/ price increases. Also experiencing shortages in some products as production runs are changed to manage costs (and reduce stocks).

Demand:

- Discretionary income has fallen significantly in NI, which is the lowest of all UK regions (ASDA Income Tracker).
- People spending less or working to fixed budgets.
- Early/ mid-week footfall is lower.
- Number of take-aways is also falling – as people change eating/ cooking habits to save money.

Hospitality

Outlook

- Challenging time ahead – sector has been in survival mode since COVID and has been faced with a series of problems
  - Surviving an extended lockdown → staff shortages when reopened → energy and food price increases → customer cost of living crisis.
- Businesses are not investing for growth or to improve their offering.
- This recession is different (worse) than 2008 – costs are increasing, interest rates are going up and customer incomes are being squeezed.

Policy considerations

- Tourism infrastructure – several policy measures are needed to promote the growth of the sector and develop a 7-day tourism eco-system:
  - Sunday morning trading;
  - Supply of staff/ skills by recognising the needs of the sector on the MAC Shortage Occ List;
  - Increased investment in public transport.
- Rates for beverage businesses is based on turnover BUT:
  - Turnover is up and profitability is down;
  - Penalised for investing in and growing the tourism product.
- Review the need for regular renewal of entertainment licenses – costly, time consuming and bureaucratic.

Leisure

Cost Impacts

- Energy costs up 100% - historically equivalent to 15% of total costs now 30%. Higher energy costs in winter is more expensive because greater need to heat large premises.
- Labour costs up 10%.
- All other input costs (food, beverages, consumables) also significantly higher and typically rising on a monthly basis.
- Given nature of industry, tend to be small businesses in large premises – which impacts both rates and energy bills.
- Cost pass-through “Tipping Point” – prices have been raised but increasing reluctance from customers to accept further increases.

Financial Impact

- Revenues are down 15%-20% in Sept-22 compared to Sept-21, at a time when costs have increased.
- Slowdown has become more apparent in the last 3 months.
- Sector still recovering from the impact of extended lockdowns.
- Rising interest rates impacting the cost of debt finance.

Staffing Impact

- Access to skilled/ experienced staff still a major issue – tight labour market is bidding up wages.
- Recruitment challenges have improved since the period immediately after lifting of restrictions but are still more difficult than pre-pandemic.

Leisure

Supply and Demand

Supply

- Supply chain issues resolved but the key issue is costs.

Demand

- Income down 15%-20% on the year and driven by:
  - Significant drop in discretionary spend – household costs rising faster than incomes;
  - Consumer confidence is falling.

Outlook

- Significant concerns looking forward and recognising economic conditions are volatile which adds to uncertainty.
- Different from 2008 and could have a bigger impact on the sector because customers face rising cost of living and interest rates and businesses facing increased costs and finance charges.

Policy considerations

- Energy price support is essential.
- VAT was a significant benefit during pandemic because revenue had fallen and when revenue increased the VAT rate was restored. However, revenue is falling again for the leisure sector.
- Rates relief is very important for the sector – ‘small businesses, big premises’.

Food Service Supply Chain

Cost Impacts

- Energy costs up significantly:
  - Typically increased by 200%-300% before the price cap applied and 75%-100% after the price cap applied – lack of clarity on the extent to which the cap will apply and what happens after March 2023.
  - Energy cos. offering new contracts again but not extending additional credit (even though costs up significantly).
- Food costs up 15%-20% with a “take it or leave it” approach from producers/ processors.
- Labour costs up 8%-10%.
- Inbound freight costs up 15%.
- Several cost mitigation measures taken:
  - Changing shift patterns to increase night-time working when energy is cheaper – also charging batteries at night.
  - Reducing the number of deliveries to customers (e.g. from 3 to 2 per week) but maintaining volumes.
  - Desire to move to renewables but very bureaucratic process (in particular planning).
- Very narrow margin business so cost increases must be passed on to customers (i.e. the Hospitality sector).

Financial Impact

- Revenues holding steady but costs increasing so profits being squeezed – narrow margin business.
- Bad debt is a big concern in the customer base (i.e. Hospitality businesses) in 2023.
- Issues around meeting public sector contracts – historically public sector contracts made little/ no money but was subsidised by private sector contracts. However, public sector work now zero profit/ loss making and margin largely eliminated on private sector contracts.

Food Service Supply Chain

Staffing Impacts

- Access to staff remains an issue, in particular:
  - Operations staff – warehousing, transport, logistics (no commercial driving tests over COVID period);
  - Problems most acute immediately after lifting of restrictions but still elevated from pre-COVID.
- Employers offering other incentives to staff to help with Cost of Living such as increased food discounts/ free meals.
- Wage inflation remains in a tight labour market.

Supply and demand

Supply

- COVID related supply chain issues are solved but some producers/ processors are now rationalising their product lines to manage costs.
- NI Protocol has resulted in a 50%+ reduction in the number of suppliers in some areas.

Demand

- Demand has held up reasonably well and should continue through to the Christmas period, but expectation is that Q1 2023 will be very challenging.
- Some customers have discussed or are planning to close their businesses in Jan/ Feb 2023. This has never happened before.

Food Service Supply Chain

Outlook

- Significant concern for Q1 2023 period, given reliance of hospitality sector on discretionary spend (which is falling).
- Volatility in costs and uncertainty around issues such as energy price supports makes planning very difficult.
- Financial concerns around potential levels of bad debt.

Policy considerations

- Improve processes (incl. planning) to facilitate investment in renewable energy generation such as wind and solar.
- Greater flexibility in public sector contracts to reflect cost increases.
- Rates relief and increased flexibility around repayment plans for those in financial stress.
- Greater clarity around energy support.
- Support given to Food Services sector in England via their Local Authorities because they didn’t receive support during COVID:
  - In Northern Ireland this was linked to challenges identifying/ defining the sector through the rating system.

Voluntary & Community Sector (NICVA survey)

Cost impacts

Cost concerns

- 80% - concerned about cost of fuel and energy. 54% of orgs in sector spending more than 10% of income on energy.
- 52% - “ “ “ increase in wages.
- 46% - “ “ “ increase in expenses.
- 43% - “ “ “ increase in food and/ or other goods.

Mitigations to reduce costs:

- Reducing levels of service delivery.
- 43% - sourcing new donors.
- Collaborating to share costs.

Financial impacts

- 42% - concerned about decrease in charitable donations.
- 60% - using financial reserves to make ends meet.
- Attempting to broaden the revenue base.

Staffing impacts

- Organisations very concerned about the impact of the crisis on staff welfare, because having to make very difficult decisions on who to help with reduced available funding.
- Small numbers making some redundancies.

Section 6

Findings

Findings

- There has been a general increase in costs across the board and this is having an impact across all parts of the economy. However, the largest cost increases reported by consultees and supported by the quantitative analysis of data are in the following areas:
  - **Energy**;
  - **Food**; and
  - **Labour**.
- **Raw materials/ inputs** more generally have also increased and more recently firms are facing higher **finance costs**. This reflects rising interest rates as well as a perceived increased risk in some sectors (e.g. hospitality) associated with deteriorating economic conditions.
- Firms in general have weathered the storm thus far, in terms of avoiding both large scale redundancies and business closures. This has been achieved through a range cost management measures and increasing prices. However, there is a strong sense from many consultees that **the economy has reached a "tipping point"** where there is very limited scope for further cost management measures and customers are unable to bear further cost increases. Although the labour market remains tight, this suggests the number of redundancies could start to increase (possibly in the new year) if economic conditions do not improve.

Sectors most impacted and policy considerations

The research suggests **the following sectors have been most impacted** (in alphabetical order):

- Accommodation & Food (including Food Service Supply chain);
- Agriculture;
- Construction;
- Manufacturing;
- Retail & Wholesale; and
- Transport & Storage.

Analysis of the UK-wide Business Impacts and Conditions Survey (BICS) identified firms expectations of making redundancies. A scenario based on (unevidenced) assumptions estimates up to 7,570 jobs could be lost.

Accommodation & Food	2,550
Construction	1,150
Transport & Storage	520
Wholesale & Retail	1,680
Manufacturing	1,670

- Agriculture was not included in the survey
- **This is a scenario NOT a forecast.**

Sectors most impacted and policy considerations

The consultations identified several **potential policy interventions** to support businesses and economic recovery (only some of which are devolved):

- Staff
  - Updated MAC Shortage Occupation List for NI;
  - Amend the Assured Skills Programme to allow SME access possibly through facilitating an aggregator;
  - Supporting childcare could increase the supply of labour from those groups with caring responsibilities.
- Energy
  - Reform planning processes to facilitate greater levels of private investment in renewable energy generation.
- Non-domestic rates
  - Rates relief provided important support to many sectors during COVID and could do so again (50% if 100% is not affordable). However, rates relief is not of significant benefit to all sectors (such as construction).
  - More flexible rates repayment plans for firms in short term financial distress.

Policy considerations contd.

- Other support/ measures
  - Address uncertainty around energy price support beyond March 2023.
  - Prompt payment of invoices – to support cashflow, public sector organisations should be paying all invoices within the statutory period.
  - More flexible public sector contracts to reflect volatility in input costs.
  - Measure to increase footfall in urban areas.
  - Develop a 7-day tourism eco-system – Sunday morning trading; increase supply of staff/ skills; invest in public transport; review need for regular renewal of entertainment licenses.

END