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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.

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Executive summary

- There has been rising pessimism on global economic growth prospects in the first half of 2022 due to the war in Ukraine and growing concerns over food and energy costs. Forecasting groups have downgraded estimates of global growth for 2022 and 2023.
- The Small Business Confidence Index in Wales improved in the quarter to 2022Q1, back into positive territory.
- The UK and Wales recorded relatively high increases in business deaths in the year to 2022Q1.
- The UK default rate on loans to small businesses grew in 2022Q2.
- In 2021/22 the Development Bank of Wales completed 519 investments, with a total value of £109m. These investments were associated with around 2,630 new and safeguarded jobs.
- Since its launch in October 2017, the cumulative number of investments made by the Development Bank in the period to the end of 2021/22 was 3,304, with the value of investments at almost £530m.
- The direct/gross jobs created and safeguarded by selected Development Bank investments in 2021/22 are estimated to be connected to £143.8m of GVA. Once account is taken of deadweight, displacement, substitution and multiplier effects, the impact is estimated at £85.8m of GVA. This is a net additional impact associated with the jobs supported by selected investments made by the Development Bank.

Levels of economic uncertainty have been rising during the first half of 2022. This is a result of inflationary and supply chain pressures which have been further exacerbated by the war in Ukraine. The war continues to have wide-ranging impacts on the global economy. **Economic forecasting groups have been downgrading forecasts since the start of 2022.**

In the first quarter of 2022, UK GDP is estimated to have grown by 0.8%. UK GDP fell by 0.3% in April 2022.

Following growth of 1% in 2021Q4, UK business investment fell by 0.5% in 2022Q1. In 2022Q1, UK business investment was 9.1% below the pre-Covid-19 level in 2019Q4.

Between March and May 2022, the number of UK vacancies reached a record high of 1.3m, increasing by 20,000 from the previous quarter. The total number of workforce jobs in the UK increased to an estimated 35.6 million in March 2022. However, **the number of UK self-employment jobs remains 600,000 below December 2019 levels.**

The UK unemployment rate for the three-month period to April 2022 was estimated at 3.8%. In the same period, the unemployment rate in Wales was estimated at 3.5%.

The average of independent forecasts (received between 1-13 June 2022) for UK GDP growth in 2022 was 3.6%, with growth of 0.9% expected in 2023. **In early May, the Bank of England's forecasts for UK GDP growth in 2023 were revised downwards from 1.25% to -0.25%.**

In their Spring UK Economic Outlook, published in May 2022, NIESR cut its UK GDP growth forecast for 2022 to 3.5% from 4.8%, and downgraded its 2023 forecast to 0.8% from 1.3%. NIESR forecasted that Welsh GVA has exceeded pre-pandemic levels and is projected to grow faster than the UK average.

Executive summary

The small business confidence index for the UK and Wales both increased in 2022Q1. This upturn in confidence is surprising, given the economic context. It will be interesting to chart this indicator into the latter part of 2022.

Wales recorded a small increase in business births in the year to 2022Q1. Following the trend seen in the UK figures for closures, **business deaths in Wales increased from 4,075 in 2021Q1 to 4,610 in 2022Q1.**

Welsh SME confidence increases in 2022Q1

The confidence index in Wales increased into positive territory in 2022Q1, up 45.5 points from 2021Q4, to +14. Only London (+43) and the East Midlands (+17) scored higher on the confidence index in 2022Q1.

The ONS Business Impacts and Conditions Survey (BICS) for the period 30 May 2022 to 12 June 2022 reported that the main concern for businesses in July 2022 was inflation of good and services prices, this being noted by 32.4% of UK enterprises and 35.2% in Wales. Energy prices and supply chain disruption were also frequently noted as concerns.

The Bank of England Credit Conditions Survey revealed that the default rate on loans to small businesses had changed from +3.4 in 2022Q1 to an expected +25 in 2022Q2. Moreover, future demand for credit card lending from small businesses, and demand for unsecured lending also saw strong positive balances in 2022Q2 (i.e., +22.4, and +19.8) respectively. One conclusion here is that **tougher business conditions following from rising inflation is starting to hit the working capital position of smaller firms and is pushing them towards higher levels of demand for external funds.**

The Small Business Equity Tracker 2022 from the British Business Bank has revealed that £18.1bn was invested into high growth potential small businesses in 2021, with equity investment up 88% from 2020. The Equity Tracker revealed a total of 2,616 UK deals in 2021 up from 2,244 in 2020. **In Wales 60 deals were announced in 2021, which was down 22% on 2020. However, the equity investment value in Wales in 2021 was £83m, which was up 44% on 2020.**

Credit risk associated with Welsh SMEs is one factor that determines whether banks will lend to firms. In June 2022, **close to 56% of Welsh SMEs had a relatively higher risk of failure, with 4.8% being in the highest risk category.**

During the 2021/22 financial year the Development Bank of Wales completed investments to the value of £109m, which supported almost 2,630 new and safeguarded jobs. By the end of the 2021/22 financial year, a cumulative total approaching £530m has been invested by the Development Bank since its launch in October 2017.

The direct jobs created or safeguarded in 2021/22 by selected investments are estimated to be connected to £143.8m of GVA in gross terms and **£85.8m of GVA in net terms, once account is taken of deadweight, displacement, substitution and multiplier effects.**

Introduction

This is the fourth Economic Intelligence Wales Annual report. The report provides a summary of the investment activities of the Development Bank of Wales during the financial year 2021/22, and a commentary on the global and local economic context and conditions affecting the supply and demand for finance in Wales.

This report is published at a time of continued high economic uncertainty. The UK and other world economies are experiencing significant inflationary pressures, and the war in Ukraine is continuing to impact supply chains, resource availability and costs. Geopolitical tensions have also worsened considerably during the past year. For businesses, cost pressures and labour shortages prevail in many parts of the economy, while UK households are increasingly impacted by the cost-of-living crisis, with the prospects of further increases in energy costs in the Autumn. In relation to the UK (and global) economy, there are limited signs of optimism, with political uncertainty in the UK unlikely to be improving optimism.

Sections 2-4 of this report provide the UK and Welsh macroeconomic context within which Welsh SMEs operate. The report then examines factors relating to the demand for, and supply and cost of, small and medium-sized enterprise (SME) finance.

These sections have the objectives of understanding:

- Macro-economic factors shaping the demand for SME finance in Wales.
- Trends in SME growth, start-ups, and business survival prospects in Wales.
- The supply of finance to SMEs in Wales.
- The amounts and types of lending/investment into SMEs in Wales.

Section 5 summarises the activities of the Development Bank of Wales in the context of factors affecting the demand and supply of finance to SMEs in Wales.

This section examines:

- The use of Development Bank funds in financing Welsh SMEs, and what types of enterprises and industries are being supported.
- The geographical distribution of SME investment around Wales.

Section 6 provides some analysis of the economic impact of the investments made by the Development Bank during the 2021/22 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. Economic data relating to forecasts and impacts of the crisis in Ukraine on the global and local economy are changing quickly. Establishing a timely economic picture of impacts across the Welsh SME landscape is therefore challenging.

Global, UK and regional economic prospects 2

- Pessimism on global economic growth prospects increased during the first half of 2022 due to the war in Ukraine and growing concerns over food and energy costs. Forecasting groups have downgraded estimates of global growth for 2022 and 2023.
- UK GDP is estimated to have increased by 0.8% in 2022 Q1. The level of quarterly GDP in 2022 Q1 was 0.7% above the pre-Covid-19 level (2019 Q4). However, UK GDP fell by 0.3% in April 2022, following a decline of 0.1% in March 2022.
- A further tightening in labour market conditions has continued across the UK. Vacancies are at high levels. Wales had one of the lowest unemployment rates in the UK in the three months to April 2022 (3.5%, compared to 3.8% for the UK).

Global economic prospects are very uncertain in first half of 2022

Since the development of the Ukraine crisis in February 2022, inflationary pressures have increased and with spiralling energy prices. Adding to global problems have been major lockdowns across the main Chinese economic centres caused by the ongoing Covid-19 pandemic there. In their June 2022 Global Economic Prospects, the World Bank claimed that the global economy suffered more global and regional risks in the first half of 2022 than was expected in their January 2022 publication.[1] These risks included elevated inflation, rising energy prices, less favourable financial conditions, and supply chain disruptions, as well as the emerging impacts of the "zero-Covid-19" policy in China.

According to the World Bank, global economic growth is expected to fall from 5.7% in 2021 to 2.9% in 2022. In more advanced economies, growth is projected to slump from 5.1% in 2021 to 2.6% in 2022, which is 1.2 percentage points below their January projections. In emerging markets and developing economies (EMDE), economic growth is projected to fall from 6.6% in 2021 to 3.4% in 2022. The World Bank also considers tightening US monetary policy, the energy import crisis in Europe, and continuous lockdowns in China as major new threats to the global economy.

In addition, The Economist analysed the recent 0.75 percentage point increase in the Federal Reserve benchmark interest rate and claimed that contractionary monetary policy in the US might cause further financial burdens and slower economic growth in EMDEs.[2] Higher interest rates in the US are also expected to impact the UK through exchange rate changes with the US dollar strengthening against sterling. In China, the forecast of economic growth in 2022 was reduced from 5.1% to 4.3% due to stricter Covid-19 lockdowns.

[1] https://www.worldbank.org/en/news/press-release/2022/06/07/stagflation-risk-rises-amid-sharp-slowdown-in-growth-energy-markets
[2] https://www.economist.com/finance-and-economics/2022/06/15/eight-days-that-shook-the-markets

The ongoing Ukraine war will cause further chain reactions in the global economy

There are several consequences that the invasion of Ukraine has provoked: higher living costs, weaker global demand, and growing uncertainty in global markets[3]. The OECD interim Economic Outlook[4], published in June 2022, also stressed the effects of the war in Ukraine, and highlighted the possibility of an economic recession.

In World Economic Situation and Prospects published in June 2022 by the United Nations[5], the war in Ukraine was considered as one of the major factors that will impact the global economic recovery in 2022. The UN estimate of global economic growth is only 3.1% in both 2022 and 2023, lower than the 4.0% and 3.5% UN forecasts made in January.

The National Institute for Economic and Social Research (NIESR) in March 2022[6] argued that the effect of the war will lead to global GDP being reduced by over 1% at the end of 2022 and estimates of global GDP growth in 2022 and 2023 were downgraded to 3.3% and 3.2% respectively.

The European Central Bank (ECB) reported 0.3% GDP growth for the Euro Area economy in the final quarter of 2021 and lowered estimates of GDP growth in 2022Q1. According to data from Eurostat, the Euro Area witnessed an 8.1% inflation rate in May 2022, increasing from 7.4% in April 2022[7].

UK GDP grew in 2022 Q1

In the first quarter of 2022, UK GDP is estimated to have grown by 0.8%. The level of quarterly GDP in 2022Q1 was 0.7% above the pre-Covid-19 level (2019 Q4)[8]. However, UK GDP fell by 0.3% in April 2022, following another decline of 0.1 % in March[9]. The service sector was the main contributor to April's shrinking economic growth, with a fall in output of 0.3%. There were also output declines in the production and construction sectors in April 2022. This was the first time that all main sectors made negative contributions to a monthly GDP estimate since January 2021. The Bank of England estimated that UK GDP will fall in 2022Q2 due to reduced households' real incomes[10].

[3] https://thedocs.worldbank.org/en/doc/5d903e848db1d1b83e0ec8f744e55570-0350012021/related/Implications-of-the-War-in-Ukraine-for-the-Global-Economy.pdf
[4] https://www.oecd-ilibrary.org/sites/62d0ca31-en/index.html?itemId=/content/publication/62d0ca31-en
[5] https://www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-june-2022-briefing-no-161/
[6] https://www.niesr.ac.uk/publications/walking-line?type=global-economic-outlook
[7] https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Inflation_in_the_euro_area
[8] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/januarytomarch2022
[9] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/april2022
[10] https://www.bankofengland.co.uk/monetary-policy-report/2022/may-2022

UK business investment shrank in 2022 Q1

Following growth of 1% in 2021Q4, UK business investment fell by 0.5% in 2022 Q1[11]. In the first quarter investment in information, and communications technology (ICT) equipment, intellectual property products (IPP) and other machinery and equipment grew, while transport equipment and other buildings and structures saw falls in business investment. In 2022Q1, UK business investment was 9.1% below the pre-Covid-19 level in 2019 Q4. The Bank of England confirmed that business investment remained weak in 2022 Q1 due to supply chain disruption and recent geopolitical risks. However, the estimate of long-term UK business investment remains positive, albeit much less optimistic than expected in February 2022.

New record high in the number of job vacancies in UK reached amid a tightening labour market

Between March and May 2022, the number of UK vacancies reached a record high of 1.3m, increasing by 20,000 from the previous quarter[12]. Even though the quarterly growth rate of vacancies decreased to 1.6% from 5.6% in the previous quarter, the number of job vacancies is steadily increasing. The ratio of vacancies to every 100 employee jobs hit a record high of 4.3 during March-May 2022.

The total number of workforce jobs in the UK increased to an estimated 35.6 million in March 2022. There has been an increase in the number of workforce jobs in every three-month period since December 2020. Between December 2019 and March 2022, the number of employee jobs (not including the self-employed) has increased by 521,000, reaching a record high of 31.3 million. However, the number of self-employment jobs remains 600,000 below December 2019 levels.

Early estimates from Pay as You Earn Real Time information indicate that the number of payrolled employees was 29.6 million in May 2022, a 3.9% increase compared with the same period in 2021[13 14]. This was also a moderate increase of 0.3% (90,000 people) compared to the previous month. The accommodation and food service activities sector witnessed the largest increase in the number of payrolled employees between May 2021 and May 2022 (a rise of 289,000 employees), while the construction sector witnessed the smallest increase (a rise of 2,000 employees). Comparing May 2022 with May 2021, percentage increases in payrolled employees ranged from 0.2% in the construction sector to 19.2% in arts and entertainment.

[11] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/businessinvestment/januarytomarch2022provisionalresults
[12] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/jobsandvacanciesintheuk/june2022
[13] See https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/earningsandemploymentfrompayasyouearnrealtimeinformationuk/june2022
[14] The early estimates are more likely to be subject to later revisions.

Wales sees further growth in payrolled employment

In Wales the number of payrolled employees grew by almost 15,000 between March and May 2022 to approximately 1.3 million, a higher growth rate compared with the last period (January to March 2022)[15].

By April 2022, the number of payrolled employees in Wales in almost all sectors was higher than pre-pandemic levels. For example, in arts, entertainment and recreation the number of payrolled employees was 10% above that in May 2020.

UK unemployment rate fell below pre-pandemic levels

The UK unemployment rate for the three-month period to April 2022 was estimated at 3.8%, 0.2 percentage points lower than previous three-month period, and 0.1 percentage points below the pre-Covid-19 level[16]. The highest UK regional unemployment rates in the three months to April 2022 were in the North East (5.4%), London (4.8%), and Yorkshire and the Humber (4.6%), whilst the lowest rates were in Northern Ireland (2.6%), East Midlands (2.7%), and South East (3.1%)[17]. In the same period, the unemployment rate in Wales was estimated at 3.5%.

The UK redundancy rate[18] recorded a historic low in the three-month period to April 2022. According to the Labour Force Survey, the UK redundancy rate declined to 2.0 per 1,000 employees in the three-month period to April, falling from 2.5 in the three month period to end March[19]. The UK redundancy rate saw a peak of 14.1 per 1,000 employees in the three months to November 2020.

In Wales, figures were only available for the three-month period to March 2022. There was a decrease in the redundancy rate in this period (2.9 per 1,000 employees), following another decrease in the previous three-month period to February 2022 (3.3). The redundancy rate in Wales in the three-month period to March 2022 was higher than Scotland (2.7), Northern Ireland (1.5), and England (2.5). However, this data has not been seasonally adjusted, and is based on small sample sizes, so should be used with caution.

[16] See footnote 13
[17] https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/regionallabourmarket/latest
[18] The redundancy rate is the ratio of the redundancy level for the given quarter to the number of employees in the previous quarter, multiplied by 1,000.
[19] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/redundancies

A decrease in the number of unemployment benefit claimants in May 2022

The UK unemployment-related benefit claimant count in the year to May 2022 was 1.61m people[20]. In Wales, 66,275 people claimed unemployment-related benefits (equal to 3.4% of the working age population, compared with 3.8% for the UK) in May 2022. The Welsh areas with the highest proportion of working age population claiming unemployment-related benefits were Newport (5.0%), Blaenau Gwent (4.3%), Merthyr Tydfil (3.9%) and Torfaen (3.9%), and those with the lowest proportions were Monmouthshire (2.3%), Powys (2.4%) and Ceredigion (2.6%). The proportion of the working age population claiming unemployment-related benefits in May 2022 continued to decline in almost all sub regions of Wales.

Continuing economic pressures in the UK despite stronger labour markets during 2022

In the Bank of England's Monthly Decision Maker Panel Survey (May 2022)[21], respondents were surveyed about major sources of uncertainty and for the first time about their expectations for CPI inflation. Compared with their last version in March 2022, uncertainty related to the war in Ukraine, Covid-19, and Brexit had a modest decline, while inflation became the major source of uncertainty. On average, they estimated that CPI inflation in May 2022 would rise to 7.6% and might be higher in coming months, while in fact the real CPI inflation in May 2022 reached 9.1%, much higher than expected[22].

The Bank analysed the current high UK inflation and claimed that the invasion of Ukraine, higher costs of agricultural commodities, higher wages offered to applicants due to a tightening labour market, and businesses charging more for their products were key contributors[23]. The Bank also hinted that more monetary and interest rate adjustments might be required to slow down the pace of inflation. In this respect, Forbes researchers have argued that the lockdowns in China might lead to more threats to inflation in developed countries such as the US due to supply chain disruptions[24].

[20] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/claimantcountbyunitaryandlocalauthorityexperimental
[21] https://www.bankofengland.co.uk/agents-summary/2022/2022-q2/latest-results-from-the-decision-maker-panel-survey-2022-q2
[22] https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/may2022
[23] https://www.bankofengland.co.uk/knowledgebank/will-inflation-in-the-uk-keep-rising
[24] https://www.forbes.com/sites/jonathanponciano/2022/05/20/china-covid-lockdowns-threaten-to-fuel-us-inflation-as-economic-pessimism-grows/

GDP in Wales decreased in 2021 Q3

Quarterly (experimental) GDP estimates show that all the UK devolved administrations experienced positive quarterly GDP growth in 2021Q3, except Wales. The Welsh economy recorded quarterly GDP change at -0.3%, compared with 0.9% in Scotland, 0.6% in England and 1.4% in Northern Ireland[25]. In Wales, the industry with the largest growth in 2021Q2 was accommodation and food service activities, while the industry with the largest decline in 2021Q3 was mining and quarrying.

UK and Welsh economy forecasts

The April HM Treasury forecast publication contained a comparison of independent forecasts received between 1-13 June 2022.[26] The average forecast for UK GDP growth in 2022 was 3.6%, with growth of 0.9% expected in 2023. The average forecasts have been downgraded compared with forecasts made in previous periods. The average of the independent forecasts for 2022 is above the Economist Intelligence Unit forecast (June 15) of 3.2% GDP growth in 2022.[27] The IMF's latest projection of UK GDP growth was 3.7% in 2022 and 1.2% in 2023. In early May, the Bank of England's forecasts for UK GDP growth in 2023 were also revised downwards from 1.25% to -0.25%.

In their Spring UK Economic Outlook, published in May 2022, NIESR cut its UK GDP growth forecast for 2022 to 3.5% from 4.8%, and downgraded its 2023 forecast to 0.8% from 1.3%[28]. They were also concerned about possible fiscal tightening and its impact on economic recovery in UK, rising risks of stagflation due to the war in Ukraine, and higher living costs. In this publication the NIESR forecast is that GVA in Wales has exceeded pre-pandemic levels and is expected to grow slightly faster than the UK average. They estimated that GVA in Wales relative to levels in 2019 Q4 would be 4.5% higher by 2022 Q4 and 5.5% higher by 2023 Q4. NIESR comment that employment growth in Wales has outperformed the UK average, but that there are concerns around inactivity rates, with productivity levels still lagging behind the UK average.

[25] https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpukregionsandcountries/julytoseptember2021
[26] https://www.gov.uk/government/statistics/forecasts-for-the-uk-economy-june-2022
[27] The Economist, June 15th 2022 edition. Economic and financial indicators.
[28] https://www.niesr.ac.uk/publications/sailing-treacherous-seas?type=uk-economic-outlook

- The Small Business Confidence Index in Wales improved in 2022Q1 and went back into positive territory.
- Welsh SME confidence was joint third highest of the UK regions in 2022Q1.
- The UK and Wales recorded relatively high increases in business deaths in the year to 2022Q1.

Small business confidence increases

After the relatively sharp fall in small business confidence shown in the 2021Q4 UK Small Business Index[29] to -8.5, the 2022 Q1 confidence reading showed an increase of 23.8 points to +15.3 as Government restrictions put in place to combat the Omicron COVID-19 variant were eased. However, this confidence score for 2022Q1 was below the comparative figure from the same quarter in 2021, where the index stood at +27[30].

UK Small Business Confidence Index increases in all sectors in 2022 Q1

The Accommodation and food services confidence index saw the largest quarterly improvement from -33 in 2021Q4 to +16.5 in 2022Q1. Despite improving by 2.9 points, the score for manufacturing stayed negative (-9.1) for the second consecutive quarter in 2022Q1. Similarly, the retail and wholesale sector confidence score in 2022Q1 improved to -8.2 from -40.3.

The Federation of Small Businesses reported that confidence in an economic recovery has been damaged by price pressures. An all-time series high of 86.7% of UK businesses surveyed in 2022Q1 indicated that costs had increased over the past three months compared to the previous year. Previously existing cost pressures, due to COVID-19 related disruption in global supply chains, have been exacerbated by increasing commodity prices arising from geopolitical events, notably the conflict in Ukraine. In 2022Q1 small businesses in the UK were most likely to name fuel (60.1%) and utility prices (58.0%) as a key driver of cost increases.

There are a number of economic challenges emerging that are likely to negatively impact on economic confidence in the near term, including the cost-of-living crisis as domestic price pressures increase, and inflation at a level not seen for 40 years.

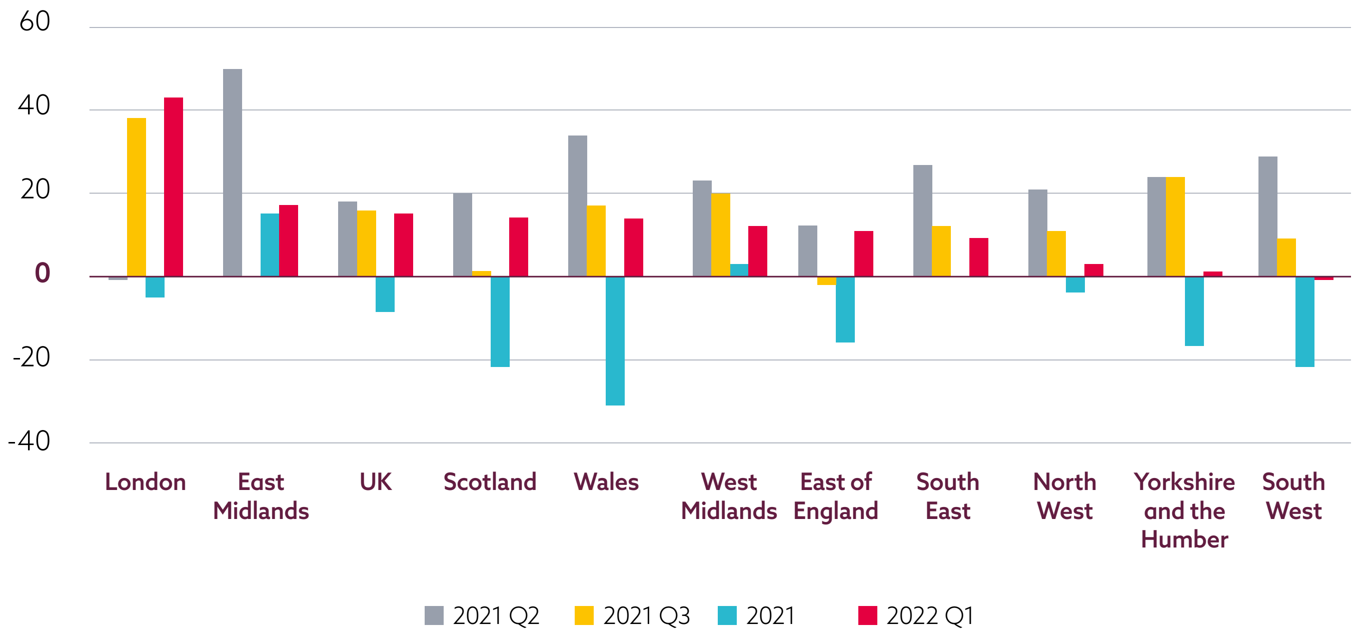
[29] "The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' 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).

[30] FSB (2021). FSB voice of small business index, Quarter 1 2022. Available at: https://www.fsb.org.uk/static/b584ae33-10cc-40e7-a7cba637371decf3/FSB-Small-Business-Index-Q1-2022.pdf

Welsh SME confidence in 2022Q1 rebounds into the positive

The Federation of Small Businesses reported that SME confidence in Wales increased into positive territory in 2022Q1, up 45.5 points from 2021Q4 to +14. Figure 1 shows that only the regions of London (+43) and East Midlands (+17) scored higher on the confidence index in 2022Q1, with Scotland equal (at +14).

Figure 1.
Small Business Index, UK regions, 2021Q2-2022Q1



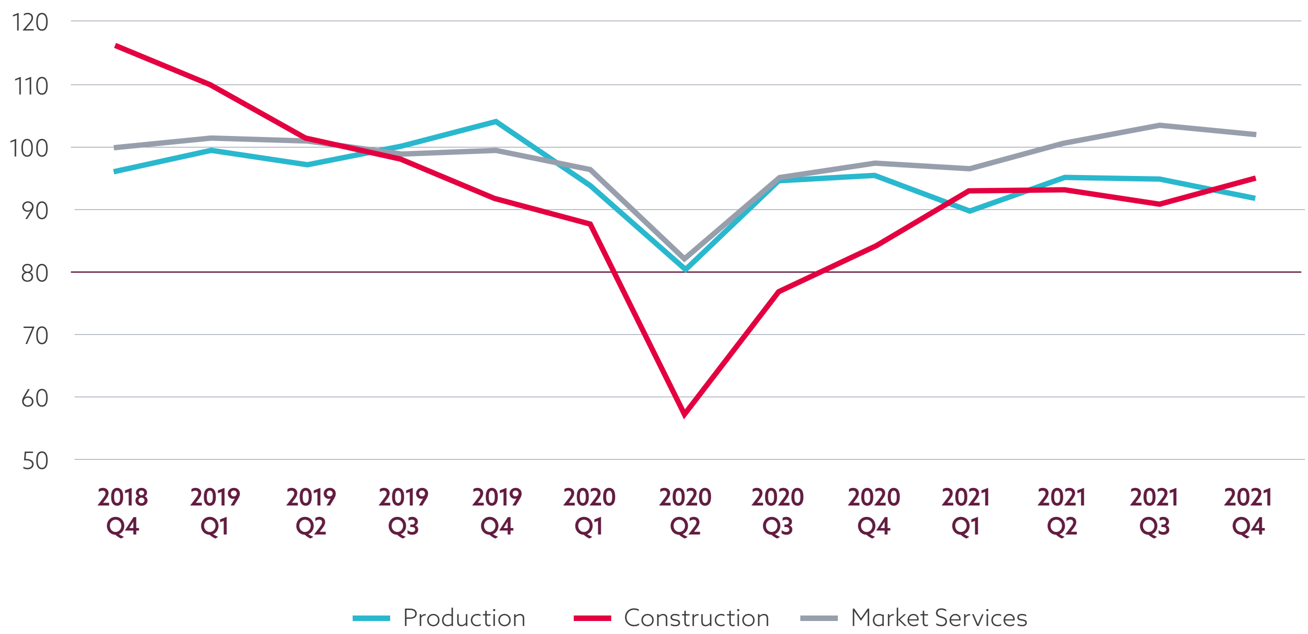
Source: FSB Voice of Small Business Index 2022 Q1

Generally positive output growth across Welsh economic activity sectors, particularly in production, and market services in 2021

Figures from StatsWales reveal that construction output recovered in 2021Q4, while output in production and market services decreased. Figure 2 illustrates the quarterly movement in Welsh indices of output in production, construction, and market services from 2018Q4 to 2021Q4. The index of production, which had remained fairly static between 2021Q2 and 2021Q3 (at 94.9 and 94.7 respectively) fell to 91.8 in 2021Q4.

The index of market services decreased from 103.3 in 2021Q3 to 101.9 in 2021Q4. With forced stoppages made in large construction projects during lockdown in the first half 2020, the construction index has since made a robust recovery. The construction index reached a value of 94.8 in 2021Q4, up from 90.6 in 2021Q3.

Figure 2.
Welsh output indices: trends 2018 Q4 – 2021 Q4 (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]

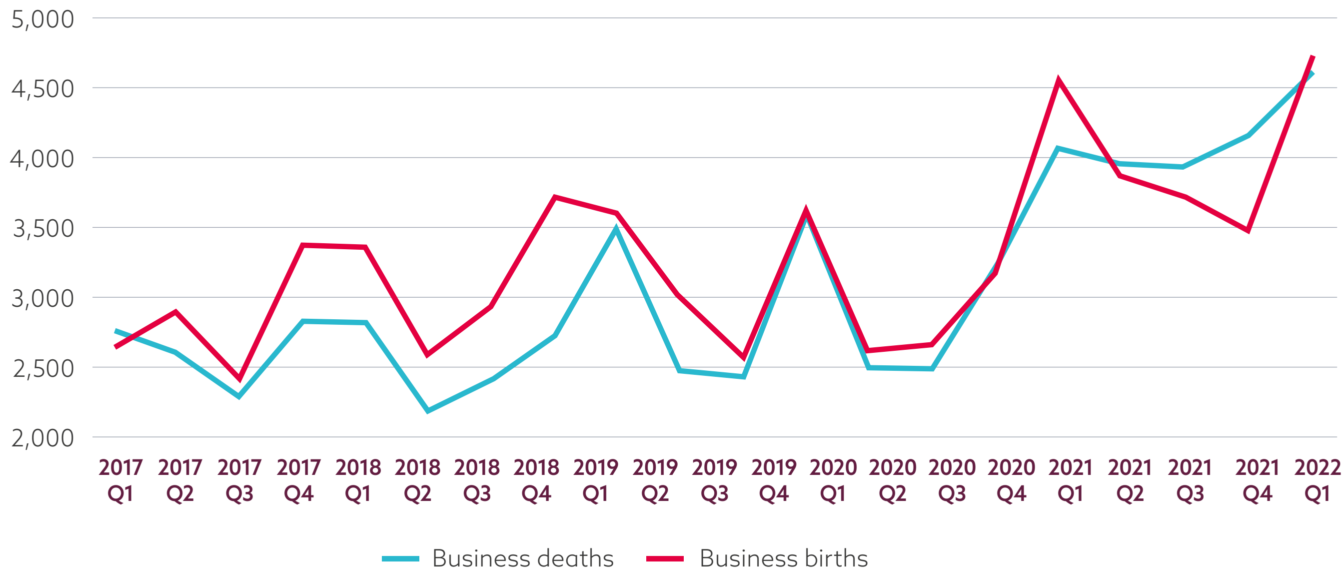
Increase in both business births and deaths in Wales in the year to 2022Q1

UK business births remained largely unchanged in the year to 2022 Q1, decreasing 0.3% to 136,390 in figures provided by ONS[31]. The number of business deaths in the UK rose by a relatively sharp 23.5% from 111,145 in 2021Q1 to 137,210 in 2022Q1.

The number of UK business closures in 2022Q1 was 41.5% higher than the average of business closures in the first quarter of the calendar years from 2018 to 2021. The increase in business deaths in the year to 2022Q1 was duplicated in all UK regions. The picture for business births was more varied over this same time period. The sectors with the greatest annual proportional increase in business deaths in 2022Q1 were transportation/storage, health and social care, and wholesale. This may in part be attributable to the fact that there were a relatively high number of births in these sectors at the start of the pandemic – so there has been a reversal of the pandemic effect in 2022Q1.

Wales recorded an increase in business births in the year to 2022Q1. Business births in Wales rose by 3.3% in the year to 2022Q1, increasing from 4,565 in 2021Q1 to 4,715 in 2022Q1. Following the trend seen in the UK figures for closures, business deaths in Wales increased from 4,075 in 2021Q1 to 4,610 in 2022Q1, rising by 13.1% (following the 29% increase in business closures seen from 2020 Q4 to 2021 Q4). The number of Welsh business closures in 2022Q1 was 39.7% higher than the average of business closures in the first quarter of the calendar years from 2018 to 2021. Figure 3 illustrates the similarity between the number of business deaths (4,610) and business births (4,715) in 2022Q1 and highlights the volatility of this data set since 2017.

Figure 3.
Quarterly business births and deaths in Wales



Source: Business demography, quarterly experimental statistics, UK

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

The BVA BDRC SME Finance Monitor focusing on the three-month rolling analysis to the end of April 2022[32] indicated that the proportion of UK SMEs (excluding start-ups) reporting growth in the last year increased to 25% in 2021Q4 from 18% in 2021Q3 and had remained stable since (with 24% of UK SMEs in the 3 months to April 2022 reporting growth in the last year). It was noted, however, that these proportions were still below pre-pandemic levels, with the corresponding figure for UK SMEs surveyed in the whole of 2019 at 37%.

According to the BVA BDRC SME Finance Monitor, 41% of SMEs questioned in the three months to April 2022 had seen business decline in the previous year, marking an improvement from 2021Q1 where the equivalent figure was 65%. In 2020, around 19% of SMEs reported a decline in the previous year. The percentage of SMEs surveyed in the three months to April 2022 that had plans to grow in the coming months remained unchanged compared to 2021Q4 (at 44%). For 2019 as a whole, 52% of SMEs expected to grow.

The ONS Business Impacts and Conditions Survey[33] (BICS) for the period 30 May 2022 to 12 June 2022 (Wave 58) revealed that the proportion of all UK businesses reporting they had exported in the last twelve months (10.4%) had increased slightly since the start of 2022 (the equivalent figure being 10.3% in the period 27 December 2021 to 9 January 2022, Wave 47). For SMEs the percentages reporting in Wave 58 that they had exported in the last 12 months were: 0 to 9 employees 9.4%; 10 to 49 employees 16.5%; 50 to 99 employees 28.8%; and 100 to 249 employees 34.3%. When these export enterprises were asked to compare the amount of exports in May 2022 with the same calendar month in 2021, they were most likely to report "exporting stayed the same" (45%) or "exported less" (29.2%) rather than they had "exported more" (15.2%).

EU commission vice-president, Maroš Šefčovič, stated in June 2022 that trade in goods and services in 2021 from the UK to the EU was severely down compared to 2019 levels with new border controls being introduced[34]. The effects of Brexit on trade in practical terms were seen in more paperwork and checks. However, there was some better news for Welsh exports. Trade data for the 2021 calendar year showed Welsh food and drink exports hit a record high of £641m[35]. This was £89m higher than the comparative figure in 2020 and represented a 16.1% increase, the largest percentage increase out of the four UK devolved nations. Food and drink exports from Wales to the EU increased by £51m between 2020 and 2021 to £465m. How far these increases will be sustainable will need to be carefully monitored over the next year.

The BICS report for the period 30 May 2022 to 12 June 2022 also reported that the main concern for businesses in July 2022 was inflation of good and services prices, this being noted by 32.4% of UK enterprises and 35.2% of enterprises in Wales. Energy prices and supply chain disruption were also frequently noted as concerns.

[32] https://www.bva-bdrc.com/wp-content/uploads/2022/06/SME-Monthly-charts-Apr-22-FINAL.pdf
[33] https://www.ons.gov.uk/economy/economicoutputandproductivity/output/datasets/businessinsightsandimpactontheukeconomy
[34] https://www.ft.com/content/c1821751-731a-49c3-b563-ca0241107b27
[35] https://gov.wales/welsh-food-and-drink-exports-hit-record-high

- UK default rate on loans to small businesses grew in 2022Q2.
- UK Finance postcode lending data shows for year ending 2021Q3 total SME lending was estimated at £20.4bn, up around 15% for the year.
- In 2021, 60 equity deals were announced in Wales with an investment value of £83m; this value was up 44% on 2020.
- The significant impact of inflationary pressure on firms is beginning to show through strongly in the SME Finance Monitor. In the three months to April 2022, 29% of respondents cited the current economic climate as a major obstacle to running a business over the next year.

Little change in business credit availability

The first quarter of 2022 saw very little change in the overall availability of credit to all business sizes according to the Bank of England Credit Conditions Survey[36]. Lenders responding to the survey were requested to consider changes in the three months to the end of February 2022 (Q1 for this Bank of England Survey) in comparison to the period September and November 2021 (Q4). This earlier period was considered in Economic Intelligence Wales' June quarterly report[37]. The same lenders were also asked to consider changes expected in the following period March to May 2022 (Q2).

Lenders revealed that credit availability to business had changed very little in 2022 Q1 and was expected to remain unchanged during the 2022Q2 and with this conclusion holding irrespective of the size of the corporate borrower. However, there was some expectation that demand for funds from all business sizes would increase in 2022Q2 (but see below on growth rate of SME loans), and lenders also expected that spreads of lending to small and large firms would widen during 2022Q2. Key factors identified as contributing to any changes in credit availability through 2022Q2 were the changing economic outlook, pressures from capital markets and wholesale funding conditions.

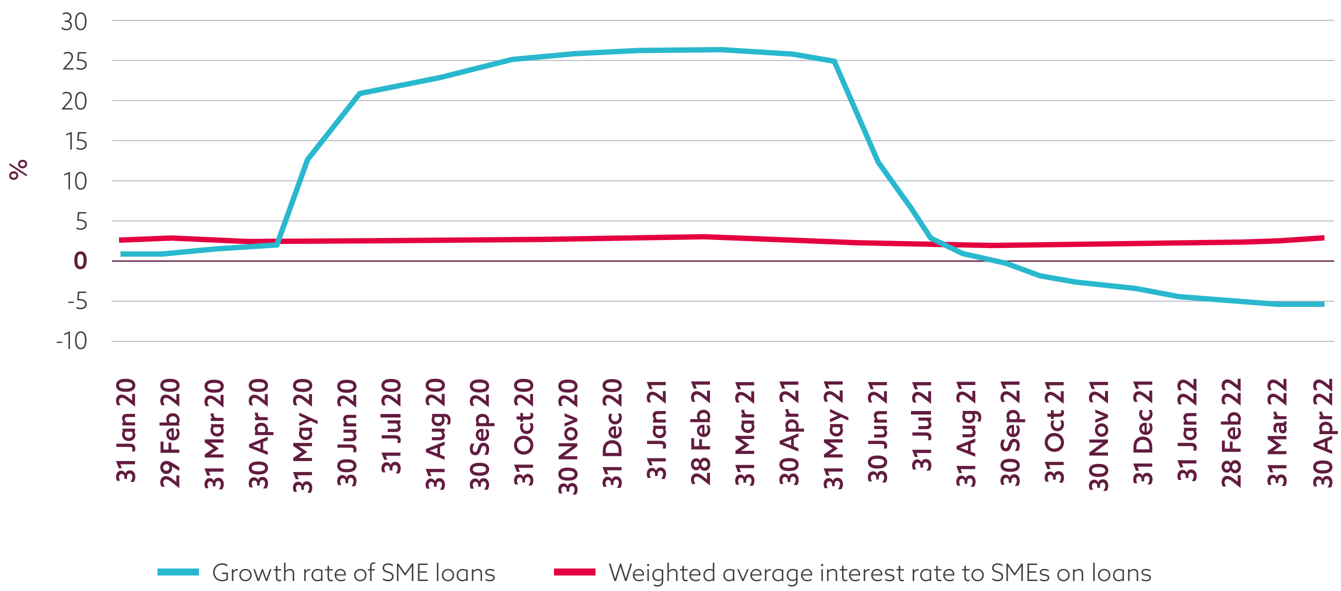
[36] Credit Conditions Survey - 2022 Q1 | Bank of England
[37] EIW Quarterly report Q3 2022 ENG V4.pdf (developmentbank.wales)

Some increase in business default rates

Despite lender on the availability and demand for funds, the Bank of England Credit Conditions Survey conducted 28 February to 18 March did reveal that the default rate on loans to small businesses had changed from +3.4 in the 3 months prior to the Survey to an expected +25 for the next three months after the Survey. In 2021Q1 the comparable figures were +13.5 and +24.7 respectively.[38] Moreover, future demand for credit card lending from small businesses, and demand for unsecured lending also saw strong positive balances for the 2022 Q2 (i.e., +22.4, and +19.8) respectively. Tougher business conditions following from rising inflation is starting to hit the working capital position of smaller firms and is pushing them towards higher levels of demand for external funds.

Figure 4 reveals Bank of England data in respect of the monthly growth rate of SME loans[39]. This was still in negative territory in April 2022 at -5.3%. In comparison, the same monthly growth rate of SME loans in April 2021 was 25.4%. The monthly growth rate on SME loans has been in negative territory since September 2021 after reaching a high of 26.3% in the month to February 2021. Figure 4 reveals that Covid-19 and subsequent mitigations such as the UK Government/British Business Bank initiatives to increase the supply of funding to businesses, had a huge bearing on the magnitude of the positive numbers from May 2020 onwards through to May 2021.

Figure 4.
Growth rate of SME loans and interest rates on SME loans



Source: Bank of England

[38] In the Bank of England Credit Conditions Survey, in order to calculate aggregate results, each lender is assigned a score based on their response. Lenders who report that credit conditions have changed 'a lot' are assigned twice the score of those who report that conditions have changed 'a little'. These scores are then weighted by lenders' market shares. The results are analysed by calculating 'net percentage balances' — the difference between the weighted balance of lenders reporting that, for example, demand was higher/lower or terms and conditions were tighter/looser. The net percentage balances are scaled to lie between ±100. Positive balances indicate that lenders, on balance, reported/expected demand/credit availability/defaults to be higher than over the previous/current three-month period, or that the terms and conditions on which credit was provided became cheaper or looser respectively.

[39] 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

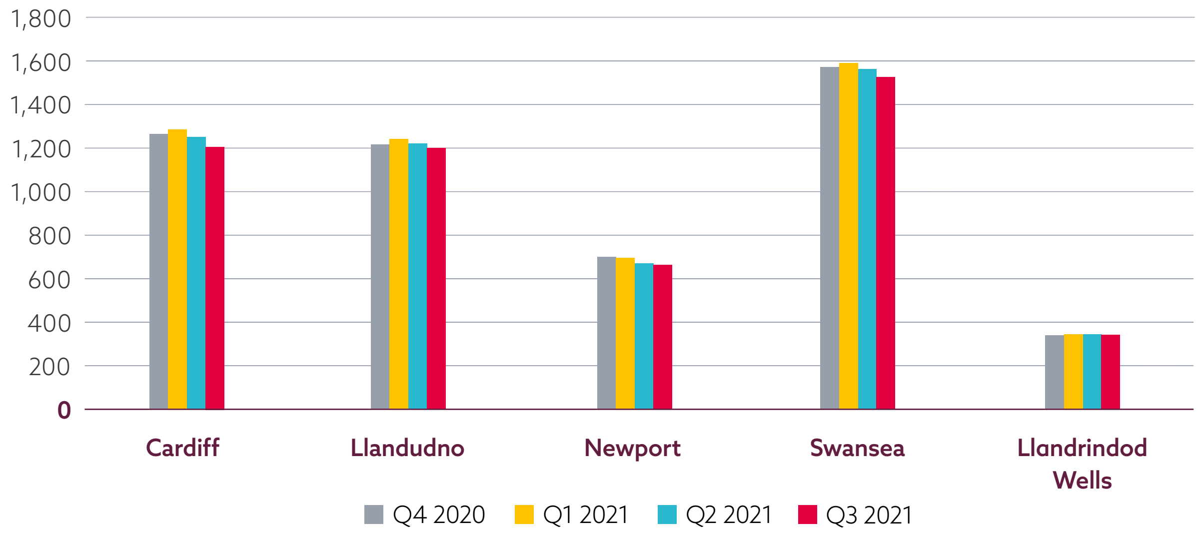
Figure 4 also reveals an increase from 3.15% to 3.25% between March and April 2022 in the weighted average interest rate to SMEs on loans as a slightly upward trend since September 2021[40]. The Bank of England increased interest rates by 0.25 percentage points to 1.25% during June 2022, with some expectation that interest rates will increase further this year as the Bank seeks to make progress towards long term inflation rate targets of around 2%.

Slight downward trend in SME lending

For GB as a whole, 2021Q3 saw total lending to SMEs reach £120.3bn (Q2 £124.4bn)[41]. GB lending in the year to 2021Q3 was £499.1bn, up from £412.5bn for the same quarters in the previous year (an increase of close to 21%). For Wales, changes in the level of SME lending have not been so pronounced. For the year ending 2021Q3, total SME lending was estimated at £20.4bn, up around 15% on the same figures for the year ending 2020Q3.

In Wales there has been a slight fall in lending for each of the three quarters ending 2021Q3. For example, total lending was £5.2bn in 2021Q1 falling to £5.0bn in 2021Q3. Figure 5 reveals estimates of lending by the main Wales postcode areas for the four quarters ending 2021Q3. This reveals change quarter on quarter and with the share of lending in each postcode area changing little over the period. Swansea postcode areas accounted for around 31% of the lending to SMEs in the year to 2021Q3. The figure also reveals that each of the Welsh postcode areas, with the exception of Llandrindod Wells, saw slight falls in the level of lending over the three quarters to 2021Q3. It is important to note that the above analysis does not include lending to SMEs in Shrewsbury postcode areas in Wales.

Figure 5.
SME lending by Welsh postcode area (£bn year to 2021Q3)



Source: UK Finance Postcode Lending Data: SMEs
Note: Does not include analysis of Shrewsbury postcodes within Wales.

[40] 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.
[41] SME Lending within UK postcodes | UK Finance

Small Business Equity Tracker

The Small Business Equity Tracker 2022[42] from the British Business Bank has revealed that £18.1bn was invested into high growth potential small businesses in 2021, with equity investment up 88% from 2020. The Equity Tracker revealed a total of 2,616 UK deals in 2021, up from 2,244 in 2020. In Wales 2021 saw 60 deals announced which was down 22% on 2020. However, investment value in Wales in 2021 was £83m which was up 44% on 2020. The BVCA Report on Investment Activity (2021) published in July 2022 revealed that all UK private equity funds raised reached £16.7bn in 2021. The report revealed that Wales attracted an estimated 1.1% of all UK private equity and venture capital investments in the year. Some 92% of the total in Wales was directed towards SMEs, supporting a little over 2,500 employees.[43]

The fastest growth of investment in equity deals in the year to 2021 was in the North West (213%), Northern Ireland (240%) and South West (357%). In terms of average number of yearly deals between 2019 and 2021, Cardiff saw an annual average of 30 deals and average annual investment of £34m. Over the same period, the Bath and Bristol area saw an annual average of 53 deals and £222m of investment.

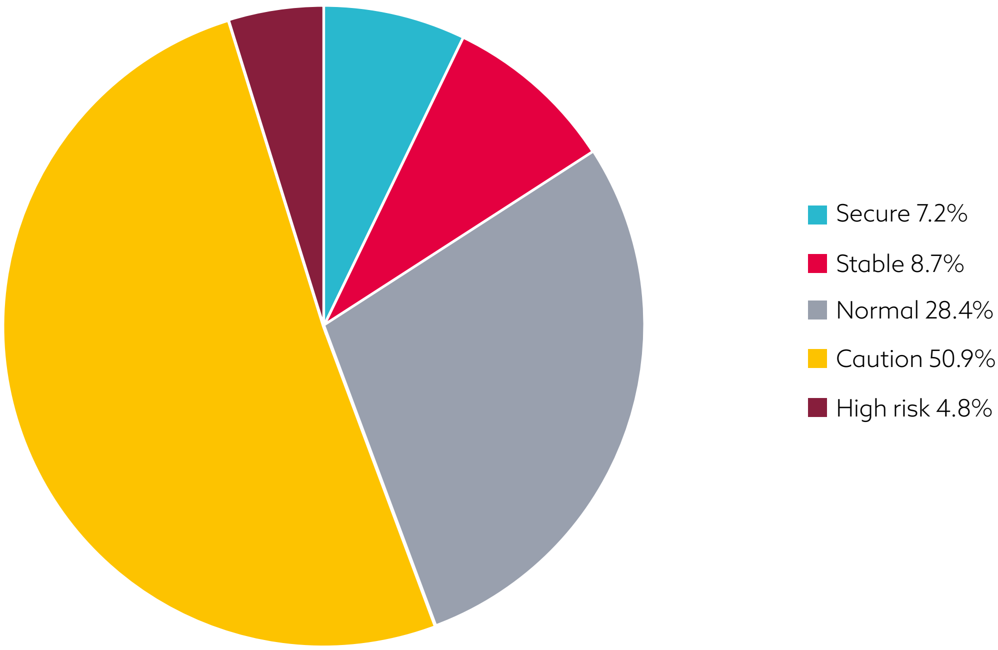
An estimated 56% of Welsh SMEs in higher risk categories

The credit risk associated with Welsh SMEs is one factor that determines whether banks will lend to firms. Our series of Economic Intelligence Wales quarterly reports seeks to maintain an estimate of the numbers of Welsh SMEs that fall into different broad credit risk categories. In June 2022 the Bureau van Dijk FAME database was analysed and credit score information was available for a total of 85,225 SME companies. Credit risk here is classified as either Secure, Stable, Normal, Caution or High credit risk. As a guide, the likelihood of a firm ranked as Secure failing within the next accounting period is around 1%, a company ranked as Normal has a likelihood of failure of around 5%, whereas a company ranked as High Risk could have a likelihood of failure of up to 20% in the next financial period.

Of the total of over 85,000 identified Welsh SMEs, just over 43,300 fell into the Caution category, and close to 4,100 were rated as High Risk. On this basis, close to 56% of Welsh SMEs have a relatively higher risk of failure (Caution and High Risk categories), and with 4.8% being in the highest risk category (see Figure 6). It is difficult with this data to compare one period with another. However, the most recent quarterly report by Economic Intelligence Wales[44] revealed that 53.5% of Welsh SMEs were in the Caution and High-Risk categories compared to 55.7% in June 2022. The previous Annual report revealed an estimated 53.7% of Welsh SMEs were in the Caution and High Risk categories.

[42] BBB Small Business Equity Tracker 2022 (british-business-bank.co.uk)
[43] BVCA (2022) see: https://www.bvca.co.uk/Portals/0/Documents/Research/Industry%20Activity/BVCA-RIA-2021.pdf
[44] EIW Quarterly report Q3 2022 ENG V4.pdf (developmentbank.wales)

Figure 6.
Estimated percentages of Welsh SMEs falling into different risk classifications



Source: FAME database

Changes in financial services activity in Wales

Many SMEs borrow funds from the main commercial clearing banks which have a whole UK coverage. However, in assessing the supply side of finance in Wales there is also some value in considering the amount of regional activity that is supported in various financial services. Prior research dating back over 20 years suggested that Wales is poorly represented in a number of financial and business services but with limited work undertaken since this time.[45] Here the focus is on employment in financial services and changes occurring between 2015 and 2020 (the latest year of data available). This employment analysis reveals something of the supply side to business and domestic lending in the region.

[45] Gripaios, P. and Munday, M. (2000) "Uneven development in UK financial services: The case of South West and Wales", Service Industries Journal, 20.1, pp. 153-180.

Welsh economy poorly represented in financial services

In 2015 Welsh employment in financial services was around 14,000 people according to the ONS Business Register and Employment Survey. This fell to 11,000 by 2020. By far the largest contributory factor was an estimated loss of 4,000 employments in Banks, with some positive gains in sectors such as credit granting by finance houses and other credit granting. Wales hosts just 2.4% of GB financial services employment, compared to around 4.5% of total GB employment. Compared to other parts of the UK this is a very low percentage.

Looking across the GB regions (see Figure 7) and comparing their share of GB financial services employment to their share of GB employment, London inevitably comes out strongly. In the London case, its share of GB employment is around 17%, but its share of financial services employment in close to 40% i.e., a simple location quotient of around 2.3 (40%/17%). For many other regions (North East, North West, Yorkshire and The Humber, West Midlands, South West and Scotland) this ratio is between 0.8 and 1.0 i.e. these regions have share of GB financial services employment close to their share of overall GB employment. However, for Wales this ratio falls to 0.5 (similar to East Midlands, but better than the case in East, 0.3).

Figure 7.

GB regions; Financial services employment as a percentage of total employment 2020

Source: Derived from ONS Business Register and Employment Survey, NOMIS

Figure 8.

Financial services employment: GB and Wales 2020

Financial Services sector	GB employment	Wales employment	% Share GB	% Share Wales
64110 : Central banking	5,000	-	1.1	0.0
64191 : Banks	331,000	7,000	71.0	63.6
64192 : Building societies	34,000	1,750	7.3	15.9
64205 : Financial services holding companies	450	10	0.1	0.1
64301 : Activities of investment trusts	5,000	5	1.1	0.0
64302 : Activities of unit trusts	700	-	0.2	0.0
64303 : Venture/development capital companies	1,500	-	0.3	0.0
64304 : Open-ended investment companies	2,250	50	0.5	0.5
64305 : Activities of property unit trusts	10	-	0.0	0.0
64306 : Activities of real estate investment trusts	1,000	5	0.2	0.0
64910 : Financial leasing	5,000	15	1.1	0.1
64921 : Credit granting: non-deposit finance houses	29,000	1,500	6.2	13.6
64922 : Activities of mortgage finance companies	3,500	25	0.8	0.2
64929 : Other credit granting	3,000	300	0.6	2.7
64991 : Security dealing on own account	11,000	15	2.4	0.1
64992 : Factoring	2,500	5	0.5	0.0
64999 : Other financial service activities	31,000	350	6.7	3.2
Total	**466,000**	**11,000**	**100.0**	**100.0**

Source: Derived from ONS Business Register and Employment Survey, NOMIS

For GB as a whole, banks made up an estimated 71% of financial services employment (Figure 8), while in Wales this figure drops to a little under 64%. However, compared to GB, a relatively high amount of Welsh financial services employment is accounted for by building societies (i.e., 16% in Wales compared to 7% for GB as a whole). Not surprisingly Figure 8 reveals that in some parts of financial services there is virtually no activity in terms of employment (for example, central banking and security dealing), and with activity in some sectors focused on London. However, of particular concern here are activity levels in sectors such as venture and development capital, with no employment reported in this survey, although with the activities of the Development Bank of Wales not included here but rather under public administration (i.e., Welsh Government).

Latest findings from the SME Finance Monitor reveal growing concerns on inflation

The SME Finance Monitor[46] findings for the 3-month period to the end of April 2022 revealed that 40% of SMEs were using external finance but with this increasing to 59% for those businesses employing 10-49 people. It is SMEs with elements of international business in their portfolios that were found to be much more likely to be using external finance. The Monitor also reveals little recent change in the proportion of survey respondents which were permanent non-borrowers. For the 3 months to April this stood at 44% and is little changed since 2021Q2.

The Monitor also reveals some reductions in the proportion of respondents injecting personal funds into their businesses. For example, in the year to April 2022 34% of respondents had injected personal funds, with this compared to a high of 40% in the year to end 2021Q2. The proportion of SMEs happy to use finance to grow their businesses stood at 31% in April, with this little changed since 2021Q4. 9% of SMEs reported that they would have a need for external funding over the next year.

The significant impact of inflationary pressure on firms is beginning to show through strongly in the SME Finance Monitor. In the three months to April 2022, 29% of respondents cited the current economic climate as a major obstacle to running a business over the next year. However, 44% of firms reported that increasing costs were having a significant impact upon them, and with this up from 34% for 2021Q4. The businesses most significantly impacted by cost inflation were agriculture, manufacturing and hotels and restaurants. In manufacturing, for example, 56% of firms reported they were being significantly impacted by increasing costs.

Early evaluation evidence of UK-wide Covid-19 financial interventions for businesses indicates that up to 34% of borrowers might have stopped trading in 2020 without the assistance of loan schemes. Economic Intelligence Wales is working closely with Welsh Government to examine the effectiveness of Covid-19 interventions to assist small firms in Wales. However, alongside this work there are a wider set of evaluations occurring of Covid-19 interventions throughout the UK. For example, in June the British Business Bank published its initial assessment of the Covid-19 loan guarantee schemes. This included an assessment of the Coronavirus Business Interruption Loan Scheme (CBILS), the Coronavirus Large Business Interruption Loan Scheme (CLBILS) and Bounce Back Loan Scheme (BBLS).

The first phase of the evaluation has revealed that the UK Government loan guarantee schemes are estimated to have safeguarded between 150,000 and 500,000 businesses and between 500,000 and 2.9m jobs. The analysis also suggests that between 10-34% of BBLS borrowers and 7-28% of CBILS/CLBILS borrowers might have stopped trading in 2020 without the assistance of the loan schemes. Although not directly comparable, the Economic Intelligence Wales survey[47] on beneficiaries of the Covid-19 Wales Business Loan Scheme revealed that over 50% of beneficiaries believed that all their employment was at risk at the time of their loan application. In similarity to analysis of Welsh Covid-19 financial interventions, the main uses to which funds were put was to safeguard working capital position, and with funds used in some cases to innovate in terms of digital technologies and improve business resilience.

[46] SME Finance Monitor 3 month rolling analysis to end April 2022. BVA BDRC BVA BDRC | SME Finance Monitor (bva-bdrc.com)
[47] EIW Bespoke Report 2022 Covid-19 intervention_ENGLISH-v4.pdf (developmentbank.wales)

Development Bank of Wales activity

5

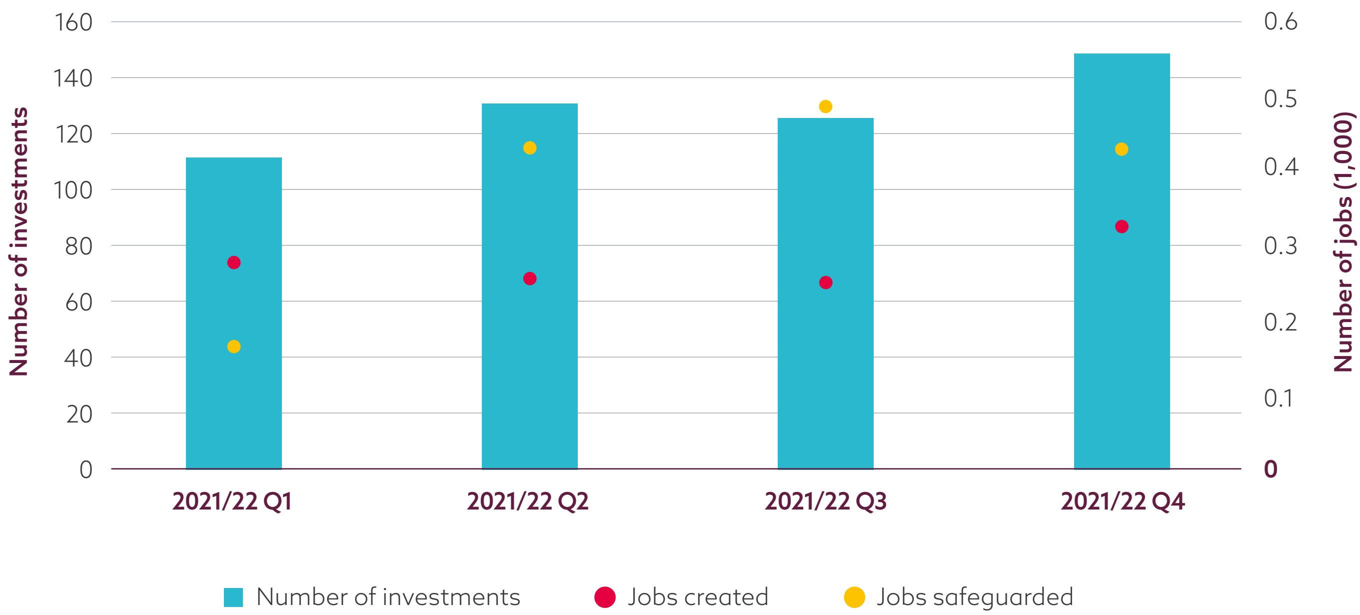
- In 2021/22 the Development Bank of Wales completed 519 investments, with a total value of £109m. These investments were associated with almost 2,630 new and safeguarded jobs.
- Nearly 43% of the total value of investments was made to firms located in South East Wales during 2021/22, with firms in north Wales and mid and south west Wales each receiving approximately 30% of investment funds.
- The cumulative number of investments made by the Development Bank in almost five years since its launch in October 2017 to the end of 2021/22 was over 3,300, with the value of investments at almost £530m.

A steady increase in the number of investment transactions made by the Development Bank during 2021/22

In the final quarter of the 2021/22 financial year, the Development Bank of Wales made over 149 investments, which created and safeguarded almost 760 jobs. Figure 9 shows that the number of investment transactions increased steadily during the financial year, from 111 investment in 2021/22 Q1. During the financial year, a total of 519 investments were made into [number TBC] unique businesses, creating or safeguarding almost 2,630 jobs.

Figure 9.

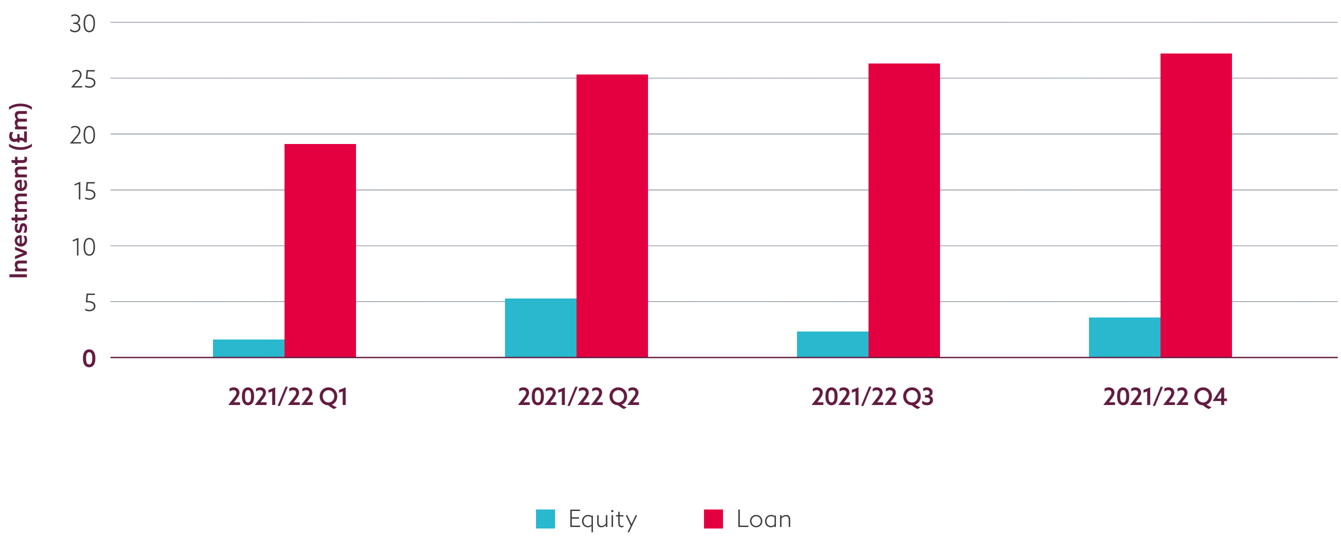
Investment transactions and jobs created and safeguarded, 2021/22



The total value of investments made during 2021/22 was just over £109m

The total value of investments has also risen during the final quarter of the 2021/22 financial year. New loan investment was £27m in 2021/22 Q4, whilst equity investments were £35m in the same period. Figure 10 shows that there was a stronger performance in equity investment in the second quarter of the financial year. The total value of equity investment made during the 2021/22 financial year was over £11.5m, with the value of loans totalling over £97.5m.

Figure 10.
New Investment by investment type, £m, 2021/22 Q1-Q4



Firms in south east Wales received around 43% of total investment funds during 2021/22, with firms located in mid and south west Wales, and in north Wales each receiving around 30% of investment funds (Figure 11).

Figure 11.
Investment by location during 2021/22

The cumulative value of investments to the end of 2021/22 was almost £530m

Previous Annual reports had included cumulative data relating to investments from 2001. However, as the Development Bank of Wales reaches the end of its first five years, the reported data has been changed to no longer include data from investments made by the Development Bank's predecessor, Finance Wales. Annual reports from this point forward will only report cumulative data relating to the Development Bank of Wales since its launch in October 2017.

The cumulative number of the Development Bank of Wales investments in the almost five years since its launch reached 3,304 by the end of the 2021/22 financial year, with nearly 94% of these being loans. These investments have created or safeguarded over 29,200 jobs.

Figure 12.
Cumulative number of investment transactions and jobs created and safeguarded to end of 2021/22

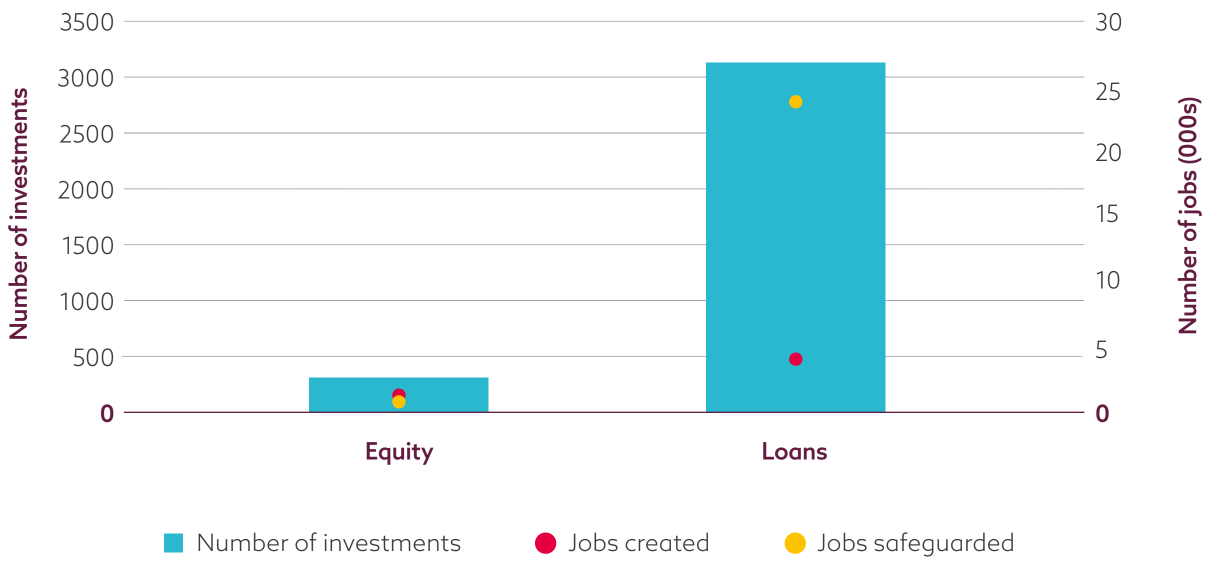
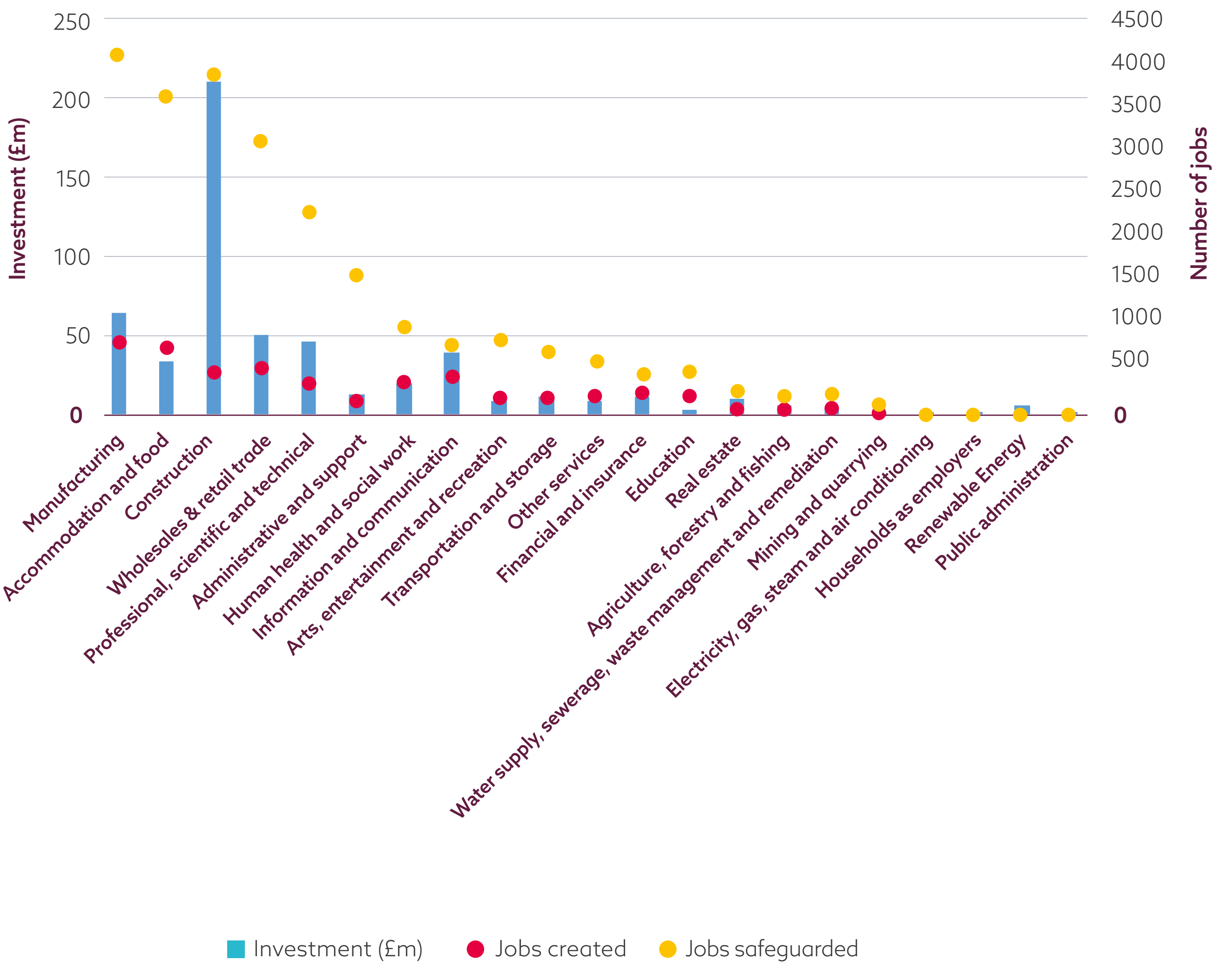


Figure 13 shows that most investment has been received by firms in the construction sector (just over £200m), and in the manufacturing sector (almost £61m) in the period to end of 2021/22. Firms supported by the Development Bank in the manufacturing sector are linked to the highest number of jobs created and safeguarded (almost 5,000), but with supported firms in the accommodation and food services food sector creating or safeguarding more than 4,300 jobs. This compares with almost 3,700 jobs in the wholesale and retail trade sector, and 4,200 jobs in supported firms supported in the construction sector.

Figure 13.

Cumulative investment value and jobs by sector 2017/18-2021/22



Some signs of recovery in the value of private sector leverage during 2021/22

Figures 14 and 15 provide some historical context to the Development Bank's investment activities. Figure 14 tracks the value of investments made by the Development Bank, and the associated and private sector leverage (PSL) since its launch. Figure 14 also identifies the investment amount attributable to the Covid-19 Wales Business Loan Scheme (CWBLS). This investment of ca. £92m is in addition to the 'business as usual' value of investment in the year. The value of investments shows an increase from the pre-pandemic period. The value of PSL declined during 2019/20 due to a small number of investments recording high values of PSL in 2018/19. This decline continued in 2020/21 due to changes in lending supply during the pandemic, but has recovered slightly during the 2021/22 financial year to just over £64m.

Figure 14.

Investment and PSL, £m, 2017/18 – 2021/22

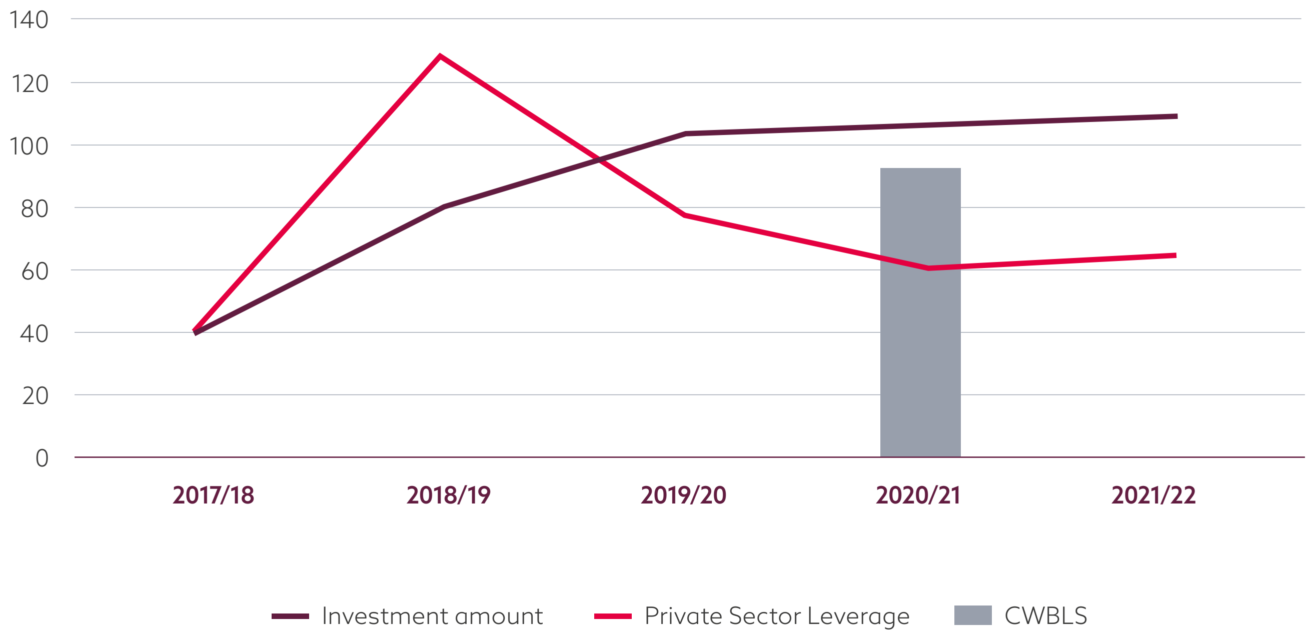
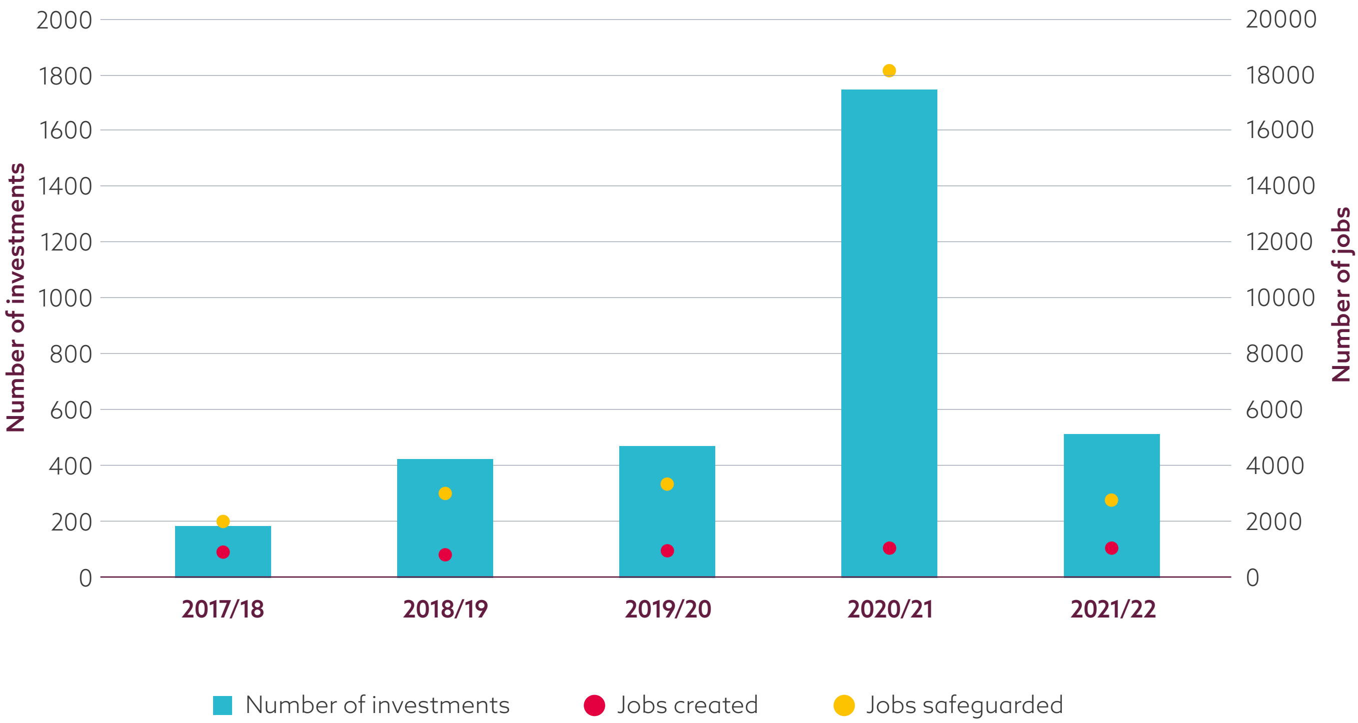


Figure 15 further illustrates the scale of the lending during the previous 2020/21 financial year, with over 1,700 investments completed, and more than 18,300 jobs supported (mostly safeguarded). The number of investments shows an increase compared with the pre-pandemic period, although with the number of jobs created or safeguarded being lower than the pre-pandemic period. Since its launch in October 2017, over 29,200 jobs have been created or safeguarded by the Development Bank.

Figure 15.

Number of investment transactions and jobs created and safeguarded, 2017/18 – 2021/22



The economic impact of the Development Bank's investments in 2021/22

In developing an estimate of the gross value-added (GVA) supported by Development Bank of Wales activity, information from the Development Bank is used that reveals estimates of employment connected to projects where investment finance has been provided (see section 5).

There are a number of other fields provided in the data sets including the industry in which employment has been supported (in terms of Standard Industrial Classification, SIC 2007). This allows the estimation of job creation and safeguarding linked to Development Bank activity by industry. Using this data, it was possible to gain an estimate of the GVA connected to each of the jobs created and safeguarded, 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 2019 and information from the Business Register and Employment Survey.[48]

There are some considerations to flag 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)[49] are excluded from the analysis as no, or very limited employment is directly linked to the investments. The approach here will then be conservative in the estimation of impact, as the activities supported by these property-related investments may support GVA within Wales, but it will not be captured by this methodology. **The investment value of 'relevant funds', excluding the property-related funds, analysed in this section of the report is £69.7m in 2021/22, linked directly with 2,610 (gross) new and safeguarded jobs.**

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.[50]

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

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

[49] 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 £40m in 2021/22.

[50] 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.

- **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, an investment may enable 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 include 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 the Annual 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.[51]

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% due to 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 derived through extensive primary research with beneficiaries, but this is not possible within the framework of this project.

The results of this analysis are summarised in Figure 16:

- Welsh GVA associated with the 1,121 (gross) new jobs estimated to be created in 2021/2022 is £60.6m.
- 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 £34.4m.
- Similarly, the Welsh GVA associated with the 1,489 (gross) jobs safeguarded is £83.2m.
- 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 £51.4m.

[51] 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

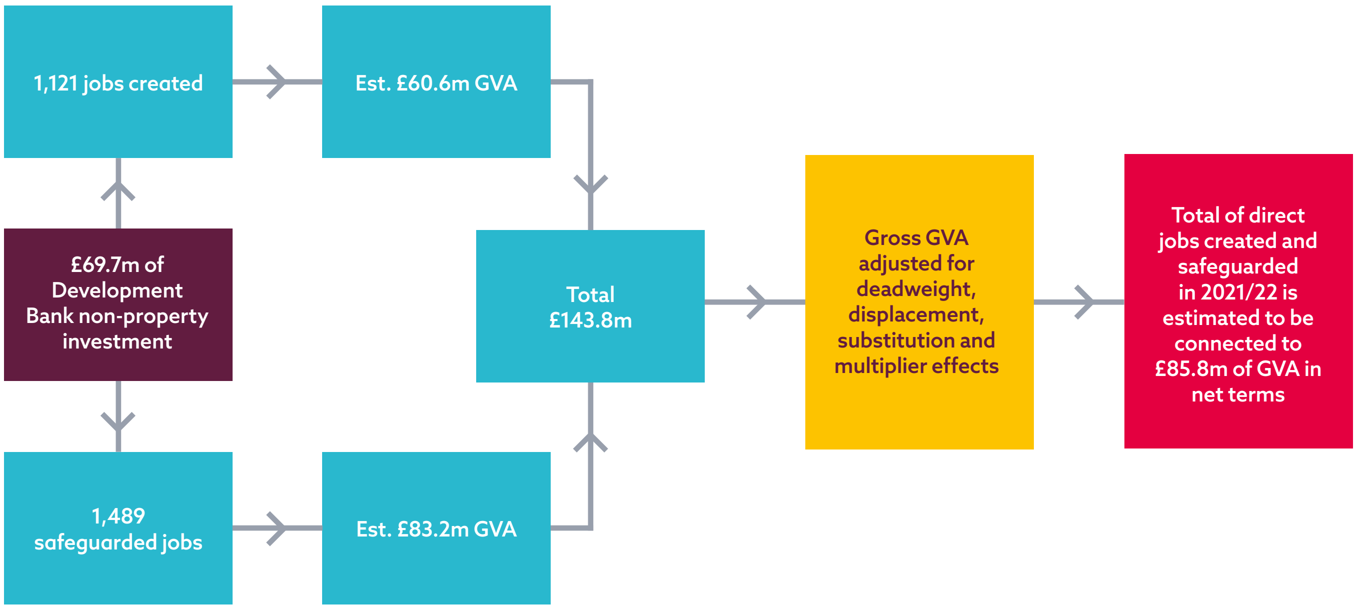
- Together the total of direct jobs created and safeguarded in 2021/22 is estimated to be connected to £143.8m of GVA in gross terms and **£85.8m of GVA in net terms once account is taken of deadweight, displacement, substitution and multiplier effects.**
- This equates to an estimated **net increase in Welsh GVA of around £32,860** for each job created or safeguarded.

As noted above, 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 investment activities are also linked with varying levels of private sector leverage. The impacts relating to private sector leverage are not considered in this analysis.

The estimates in this section cannot be compared to those in previous years which have focused more on gross estimates of impact with no account of deadweight, displacement and substitution effects (see Appendix 1 for further detail).

Figure 16.

Welsh GVA effects of Development Bank of Wales non-property investment in 2021/22



Conclusions

The past year has been characterised by high levels of uncertainty as a consequence of the pandemic, the emergence of new Covid-19 variants, global supply chain issues, and inflationary pressures. The outbreak of war in Ukraine has significantly added to the worsening global economic outlook. There are very few signs of optimism for the remainder of this year, with some prospect of a UK recession in the months ahead and into 2023. Further evidence of UK labour shortages has emerged in the aviation and airport sectors, which are expected to have knock-on effects on the tourism sector as a whole. There are also increasing rebound effects from uncertainty in the political environment around the UK Government, and with a loss of continuity in some key UK ministerial posts.

UK GDP recorded a growth of 0.8% in the first quarter of 2022, although there are expectations that 2022Q2 GDP growth will be negative largely due to falling real household incomes. Business investment fell during the first quarter of 2022, and this is also more than 9% below pre-pandemic levels.

Interestingly there was some upturn in business confidence in the first quarter of 2022, which may have partly related to the continued easing of the Covid-19 restrictions at the start of the year. The survey results on business confidence for the remainder of this year will be awaited with interest. Many business surveys are now reflecting businesses' concerns around inflationary pressures, with energy prices and supply chain disruptions also concerning businesses. These challenging business conditions are now likely to be increasing the demand for external sources of finance. Of some concern is the increase in the default rate on loans as reported in the Credit Conditions Survey. There is also the near certain prospect of increasing UK interest rates in response to the inflationary pressure in the economy.

For the months ahead, as well as the uncertainty on the scale and duration of the war in Ukraine, and the full extent of the global economic and social consequences, there is still a prospect of future Covid-19 variants of concern. In the UK, the summer months are offering some prospects of increasing business activity in some of the sectors hit hardest by the pandemic. However, these same sectors, including hospitality, and tourism, are also experiencing difficulties due to staff shortages that may limit their opportunities for growth. The worsening cost of living crisis will also impact demand in these and other sectors of the economy. It is expected that the cost-of-living crisis will become more acute in the final quarter of 2022 with energy prices stepping up again.

The Development Bank of Wales provided almost £110m of investment to firms in Wales during the 2021/22 financial year. Of this total, some £69.7m of funds were specifically linked to job outcomes, with these funds creating or safeguarding over 2,600 jobs. The net impacts of these specific investments are estimated to be an increase in Welsh GVA of around £32,860 for each job created or safeguarded. These impacts illustrate the importance of the Development Bank in supporting firms in Wales in the highly challenging business environment.

Appendix 1:

Economic impact estimation methodology

An overview of the methodology for the current and previous Economic Intelligence Wales Annual reports

The methodology used in previous Economic Intelligence Wales reports started with the estimation of gross jobs created and safeguarded by sector, which totalled 2,610 in 2021/22. GVA per job estimates by sector were then applied to these estimates to derive direct GVA linked to the new or safeguarded employment. In this methodology, the GVA per job estimates were weighted downwards to reflect an anticipated lower GVA per job for SMEs compared with large firms that tend to have higher productivity levels, influencing the average GVA per job estimate for each sector. This was expected to be a potential problem, particularly as the sectors previously used for the analysis were more aggregated. The weightings were derived using data on turnover per employee by firm size as an indicator of possible differences in GVA per employee.

In the new methodology, a finer level of disaggregation of data has been possible. This partially limits the issue of differences in GVA per employee by firm size through improved estimates of GVA per employee matching to more specific sectors, although noting this may still disguise differences in GVA per employee by firm size. There is further a possibility that GVA per employee in some supported firms may be above the sector average. The finer disaggregation of sectoral information in the new methodology has also enabled the use of more specific sector multipliers.

Once the gross estimates of GVA had been derived, multiplier effects by broad sector were used to estimate the total impacts.

For illustrative purposes, applying the previous methodology (see Figure 17) the 2,610 gross new and safeguarded jobs, would be connected to a total of £175.1m of GVA after multiplier effects, but excluding the deadweight, displacement and substitution effects as outlined in Section 6.

Figure 17.

Welsh GVA effects of Development Bank of Wales non-property investment in 2021/22 using previous economic impact methodology

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

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