



THE INSTITUTE  
OF CHARTERED  
ACCOUNTANTS  
IN ENGLAND AND WALES

# Q1 2008 UK BUSINESS CONFIDENCE MONITOR





In times of turmoil in financial markets the attitude of business can be a determining factor in coping with economic uncertainty. Although UK business confidence is low currently there are a number of practical things businesses can do, no matter what size they are, to help ensure they get through this period. I'd recommend, for example seeking to maximise cash flow, controlling working capital tightly and looking critically at capital expenditure. Steps such as these will ensure firms are geared up to take advantage of opportunities as the economic climate recovers.

The **ICAEW UK Business Confidence Monitor** (BCM) provides a snapshot of the state of the economy informed by senior finance professionals advising and running businesses of all sizes across every economic sector in the UK. It is one of the largest and most comprehensive quarterly reviews of UK business confidence.

We share BCM findings with a range of policy makers at a national and regional level. It is utilised by the business community, academics and researchers, and provides a robust tool from which government and regional authorities can base decisions for developing both business and economic policy.

Finance professionals also find the BCM findings useful as a credible predictor of economic change. Many use the report as a basis for making business decisions or to enhance dialogue with clients and economic stakeholders in their region.

Please visit [www.icaew.com/bcm](http://www.icaew.com/bcm) for further analysis and detail about BCM.

A handwritten signature in black ink that reads "Michael Izza". The signature is written in a cursive, flowing style.

Michael D M Izza  
Chief Executive  
The Institute of Chartered Accountants in England and Wales

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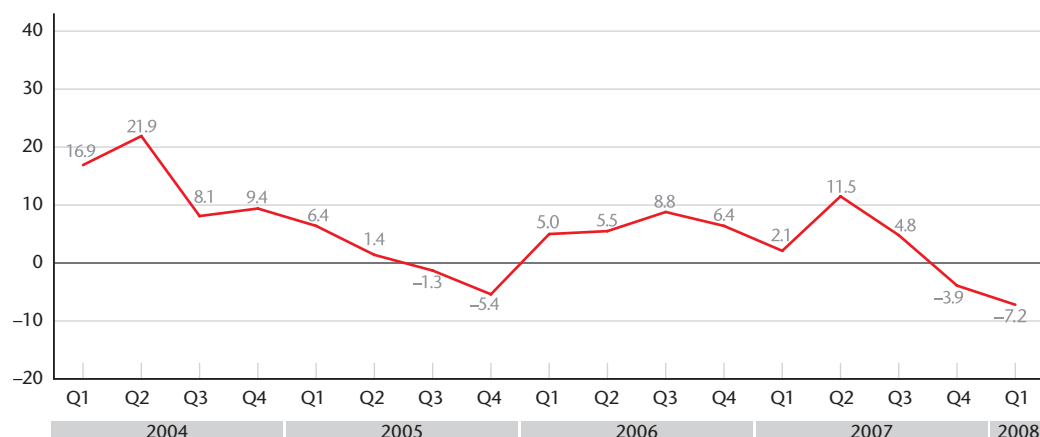
# FOREWORD

JONATHAN SAID, CEBR – ECONOMIC ADVISER TO THE ICAEW



Jonathan Said

**Fig. 1 BCM Confidence Index trend**



Source: ICAEW UK Business Confidence Monitor

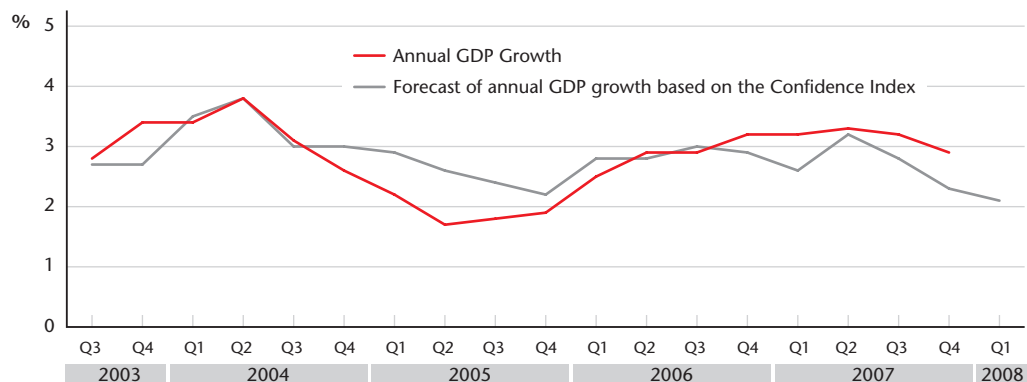
While the gap between the underlying rate of economic growth suggested by our survey and the official measure (Annual GDP Growth) remains relatively large, both measures are now in decline. However, we are seeing a more paced slowdown in the economy compared to the sharp slippage observed for business confidence, which perhaps simply reflects business reaction to the tone of recent media coverage.

## CITY AND PROPERTY MARKET CONTINUE TO LEAD DECLINE

Given the drivers of current downward pressure on confidence, it is of no surprise that the City of London and estate agents are leading pessimism in the economy.

Most financial sectors are now dealing with consequences of the US sub-prime mortgage situation which emerged in the second half of last year. Merger and acquisition and private equity deals continue to be hit by the lack of available finance, the equity markets have fallen 13% relative to the cyclical peak hit in late October, and investors are selling off corporate bonds in favour of gilts. In addition, bond insurers (monolines) are suffering from the defaults and from an inability to re-finance their obligations.

**Fig. 2 Forecast of annual GDP growth based on ICAEW Confidence Index**



Source: National Statistics First Release – Gross Domestic Product (GDP) – and cebr regression calculations

One positive for the financial services sector is that emerging markets continue to come to the rescue through sovereign funds – effectively providing City institutions with the credit they need – and by keeping commodity prices at record levels.

Year-on-year house price inflation slowed from a high of 11.6% last August to 5.3% in December, and the number of mortgage approvals fell 35% from the November 2006 peak. The housing market is set to continue to slow, with year-on-year inflation likely to turn negative this year.

Combined with the pessimistic Construction and Retail & Wholesale sectors – according to official statistics December retail sales saw the largest month-on-month real term fall since 2001 – it appears that UK plc is in for a bumpy ride.

### DESPITE NEGATIVE INDICATORS, TRUE RECESSION UNLIKELY

However, I am yet to be convinced that the economy faces a recession. The historic relationship between the Confidence Index and GDP growth suggests growth in the economy of 2.1% – still above the low of 1.7% seen in the trough of the 2005 cycle.

While I expect growth to slow below this level through 2008, a number of factors should mean that we do not see the two quarters of economic contraction which would constitute a technical recession.

The Bank of England is likely to cut interest rates substantially through the year. Although unlikely to react as fast as the Federal Reserve, pressure from the City will force the Bank to make cuts when the financial sector needs them, as occurred last December.

In addition, some sectors remain robust, namely Business Services and Communications. At least up to the Beijing Olympics, growth in emerging markets such as China, India, Brazil, Russia and Middle East will support export-driven sectors, and the wealth generated in these areas will lend a hand to the financial sector through the international transfer of funds.

Finally, although consumers are likely to face a tough year through 2008 on the back of tight personal finances, they will support their current level of expenditure by drawing from their savings. So while 2008 is set to prove a bumpy year for most businesses, the economy is likely to hold up with positive, if painfully low, levels of growth.

**ECONOMY LIKELY TO HOLD UP WITH POSITIVE, IF PAINFULLY LOW, LEVELS OF GROWTH**

**Jonathan Said, cebr**  
Economic adviser to the ICAEW

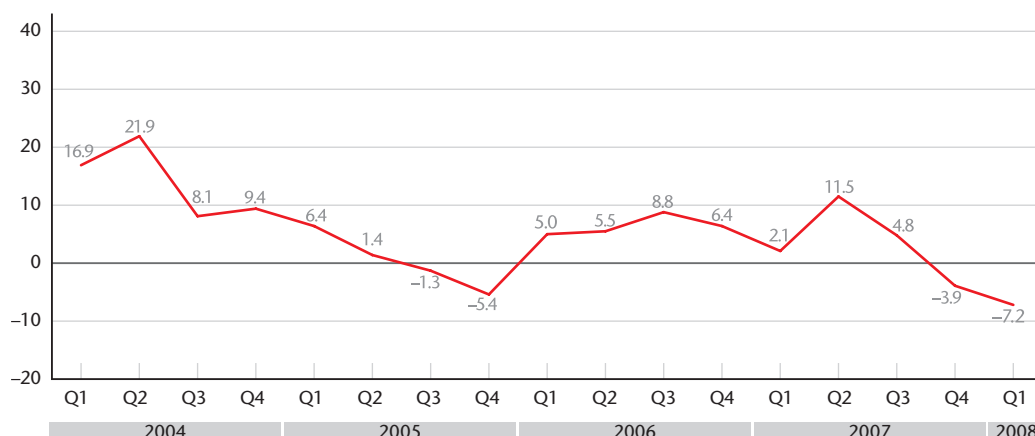
# 1 BUSINESS CONFIDENCE IN QUARTER 1 2008



Detail showing  
Q3 2007–Q1 2008

Fig. 1.1 BCM Confidence Index trend

The Q1 2008 ICAEW UK Business Confidence Monitor Index declined for a third consecutive quarter to the lowest level since the survey began. The Confidence Index slipped to -7.2 from -3.9 last quarter and a cyclical peak of +11.5 in Q2 2007. Finance professionals have become increasingly concerned about the impact on their business of a possible recession in the United States and of the financial market turmoil which has now persisted for six months.



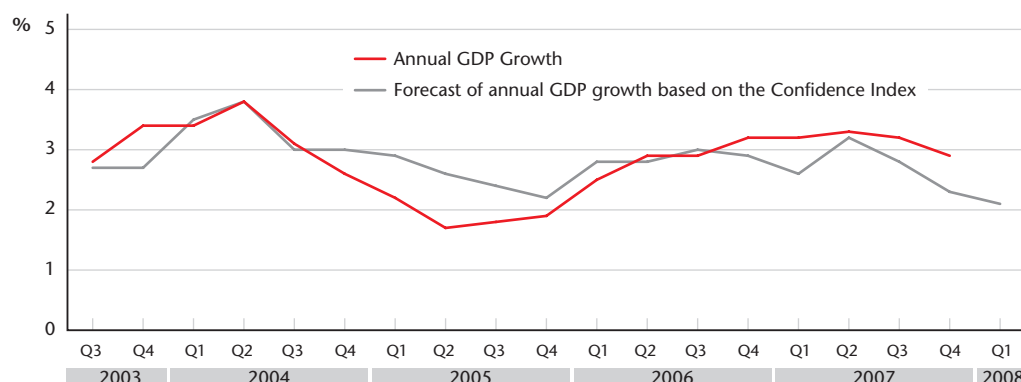
## CONFIDENCE MONITOR SUGGESTS ECONOMIC GROWTH DOWN TO 2.1%

In line with the Confidence Index, the UK economy has now started to slow. After expanding by 3.3% in the year to Q2 2007 and 3.2% in the year to Q3, the economy increased by 2.9% in the 12 months to Q4.

However, as with three months ago, there remains a relatively large gap between the Confidence Index and economic growth. According to the historic relationship between the two, the Q1 2008 Confidence Index score of -7.2 suggests GDP growth of 2.1% in the year to Q1 2008. The gap is due to the business mood being negatively affected by increased odds of a US recession and ongoing financial market turmoil, while at the same time the UK economy is slowing in a relatively paced manner, with the impacts of the housing market slowdown and tight credit taking a while to set in.

**UK BUSINESS  
CONFIDENCE AT  
LOWEST LEVEL  
SINCE BCM BEGAN**

**Fig. 1.2 Forecast of annual GDP growth based on ICAEW Confidence Index**



Source: National Statistics First Release – Gross Domestic Product (GDP) – and cebr regression calculations

The business outlook has worsened considerably, with the economy unlikely to expand much through 2008. Tight financial sector credit is liable to impact on a number of sectors, such as Manufacturing and Construction, while the housing slowdown and high inflation will limit the consumer's ability to spend.

However, continued emerging market growth and the expectation of further interest cuts by the Bank of England – following the cut in December – mean the economy is decelerating in a more orderly manner than might otherwise be expected.

## CITY OF LONDON AND ESTATE AGENTS LEADING PESSIMISM

### CITY AND PROPERTY MARKET CONTINUE TO LEAD DECLINE

As in Q4 2007, the Banking, Finance & Insurance and Property sectors are the least confident. The Index for the Finance sector slipped 10.3 points in the three months to Q1 2008 to settle at -24.2. This decline reflects the extent to which this sector is being affected by sub-prime write-downs and the resulting wider financial impacts. The Property sector also records a weak score this quarter at -22.4, although the index for this sector did rise 3.8 points in the past three months. Estate agents continue to detect a drop-off in housing market activity.

Other important sectors also saw a decline in confidence in the quarter. The outlook for the Construction sector fell to -17.3 – the lowest level since this survey began – as a number of projects were put on hold given credit constraints. Confidence in the Retail & Wholesale sector also slumped to -15.8 from -5.0 in Q4 2007. This comes on the back of poor Christmas sales and on the expectation of tight consumer spending through 2008. The sector's index is at the lowest level since Q3 2005. Health & Education, Hotels & Catering and Transport & Storage sectors also registered confidence near the -10.0 mark this quarter.

For the first time in a year and a half, the IT sector is not first for business confidence. Finance professionals in this sector have become concerned about the potential impact on

their business prospects of a significant US slowdown. Confidence retreated to +3.8 this quarter – again the lowest score since this survey began. On the positive side, confidence in the Business Services sector held up, rising marginally to +8.3 supported by strong exports to emerging markets.

### **CAPITAL INVESTMENT GROWTH TO TAKE A KNOCK**

As a result of the credit crunch, finance professionals expect capital spending growth to slow significantly over the next 12 months. Firms also expect to see relatively weak turnover and profit growth in 2008 when compared with expectations expressed over the past two years. However, the degree of decline in the financial outlook could prove stronger than expected by survey respondents, since they continue to expect input price inflation to retreat despite oil prices touching \$100 a barrel in January.

### **CONFIDENCE DECLINES IN MOST REGIONS**

The average firm in most of the UK's regions is pessimistic about its business outlook over the next year. Firms in the East Midlands, London, West Midlands and North West are the most concerned, though a number of regions that registered negative confidence three months ago have seen their index rebound this quarter to return to positive territory. These regions are the South East, South West, Wales and the North.

### **LARGE FIRMS MOST PESSIMISTIC**

When considering different firm sizes, businesses employing more than 250 employees are, on average, the most pessimistic about their outlook. Confidence among these large firms has declined to -9.7 from -4.7 last quarter. Within this category, those with more than 1000 employees are even more pessimistic, probably due to their increased exposure to the US and global economy. Medium sized firms are also relatively pessimistic, with a score of -6.3, while Micro sized firms (those employing fewer than ten people) are most positive, though their score remains in negative territory.



## 2 BUSINESS FINANCIAL PERFORMANCE

Finance professionals continue to expect a decline in turnover growth. At 6.3%, the expected rate of expansion over the next 12 months is relatively low when compared with growth rates actually seen over the past two years which ranged up to 7.9% and were consistently above 6.5%.

Profit growth is forecast to increase to 5.6% in the next 12 months from 5.3% seen over the previous year. Despite this modest upturn in expected profit growth, the predicted level of growth looks relatively weak when compared with performance through 2007, when profit growth was consistently at 6.0% or above.

### CHANGE OVER 12 MONTHS TO...

Fig. 2.1

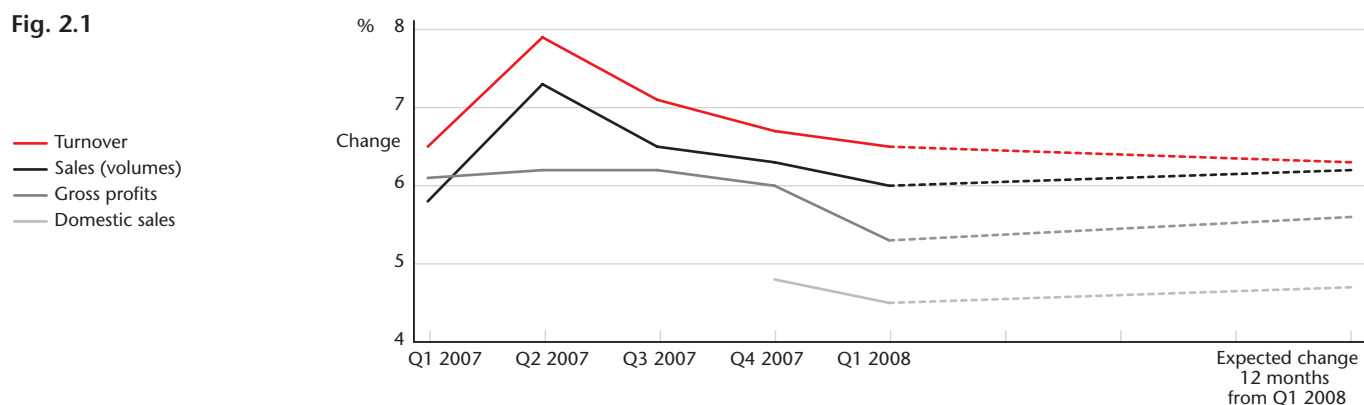


Fig. 2.2

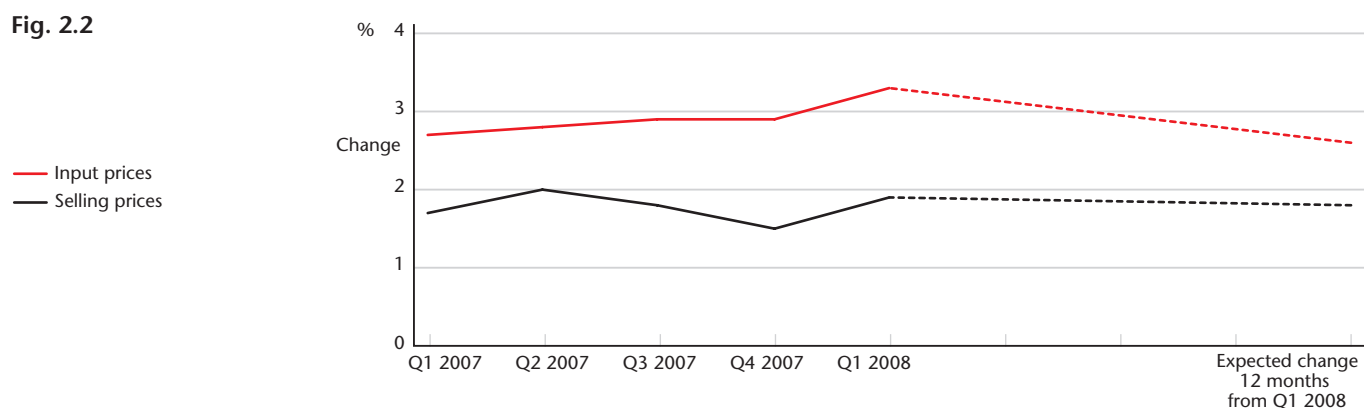


Fig. 2.3

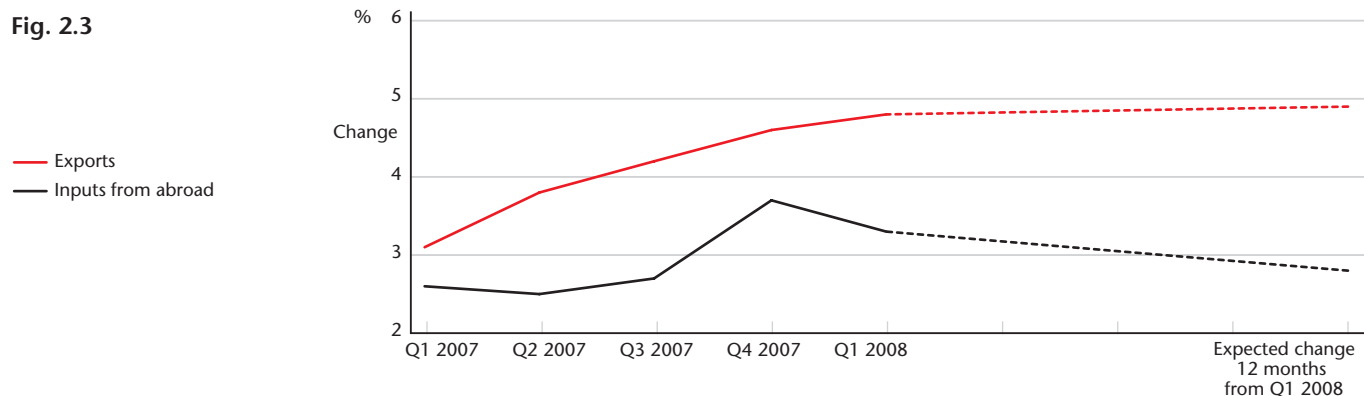
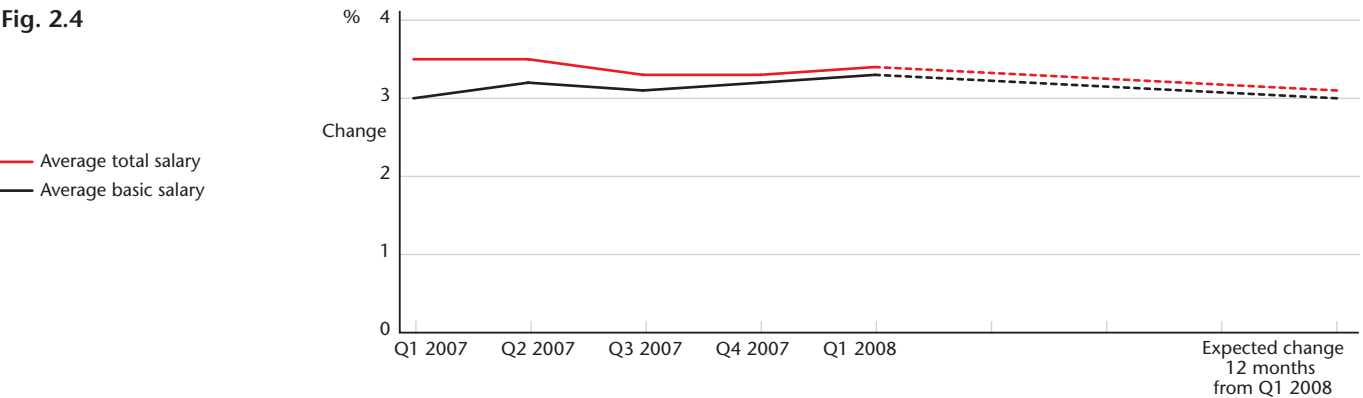


Fig. 2.4



CAPITAL SPENDING GROWTH EXPECTED TO SLOW

As a result of the credit crunch, capital spending growth is likely to slow significantly in the next 12 months to 2.2% from 2.9% seen in the year to date. In addition, job creation is also foreseen weakening.

Fig. 2.5

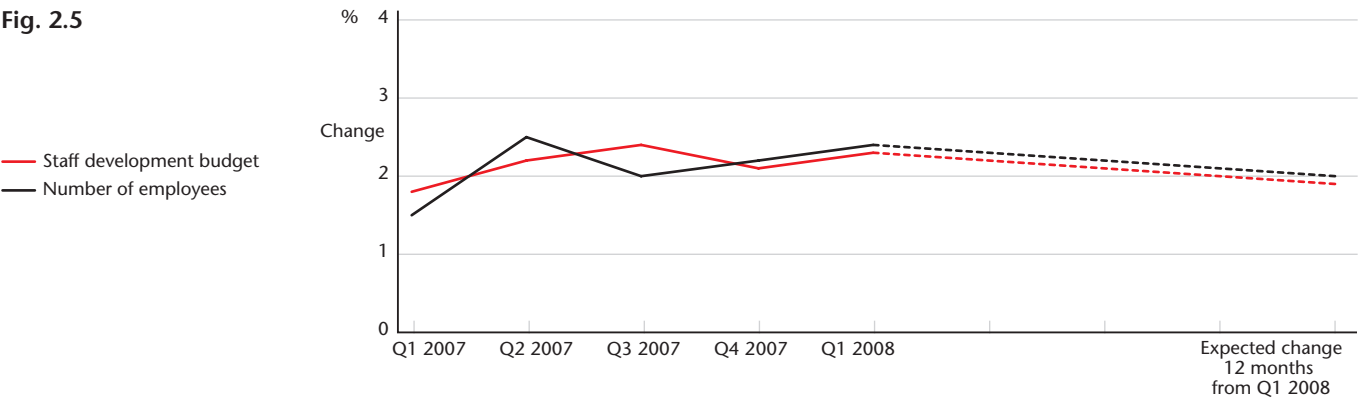
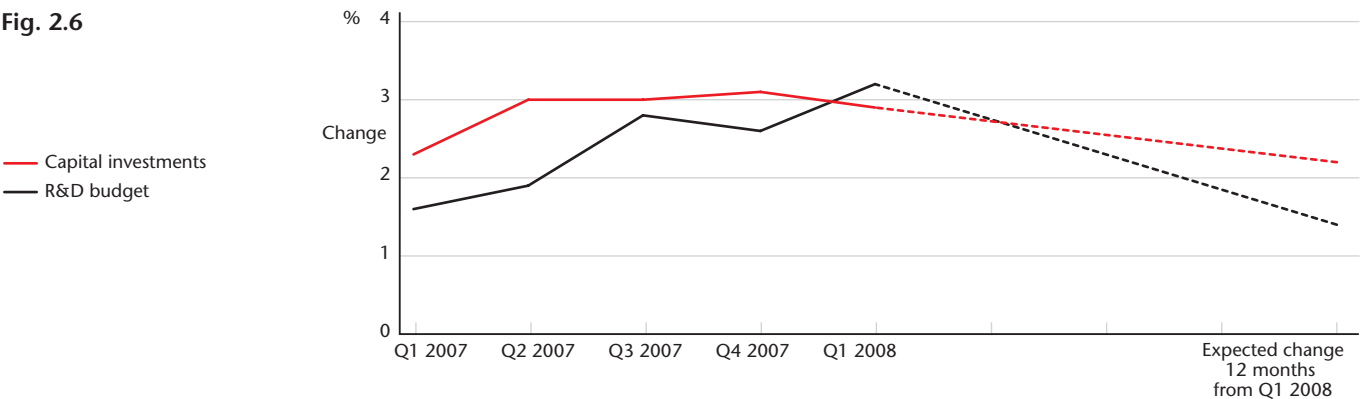


Fig. 2.6

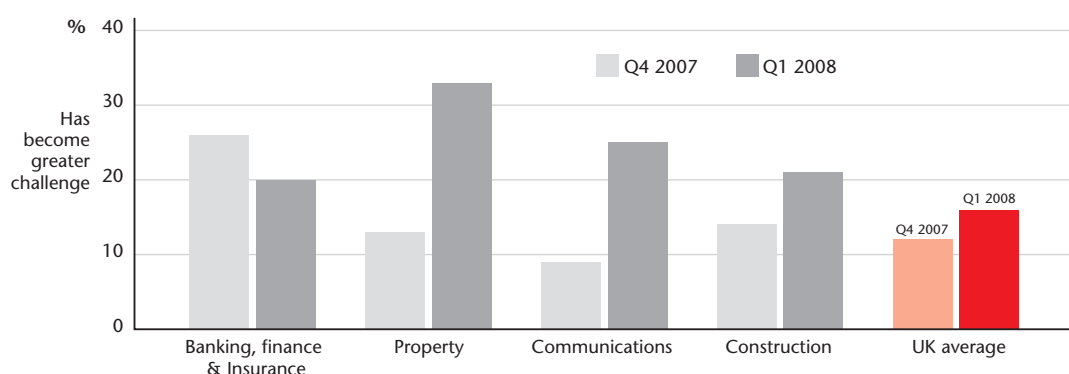


## 3 FACTORS AFFECTING BUSINESS PERFORMANCE

### ACCESS TO CAPITAL BEGINNING TO TIGHTEN

In line with the expected slowdown in capital spending growth, a greater proportion of firms report increased challenge in raising capital currently compared with 12 months ago. This is particularly the case for those in the Property, Communications and Construction sectors. For Banking, Finance & Insurance firms the situation regarding access to capital may have been mitigated somewhat compared to last quarter, though still one in five reports a deterioration in access to capital compared to 12 months ago.

Fig. 3.1 Access to capital over last 12 months

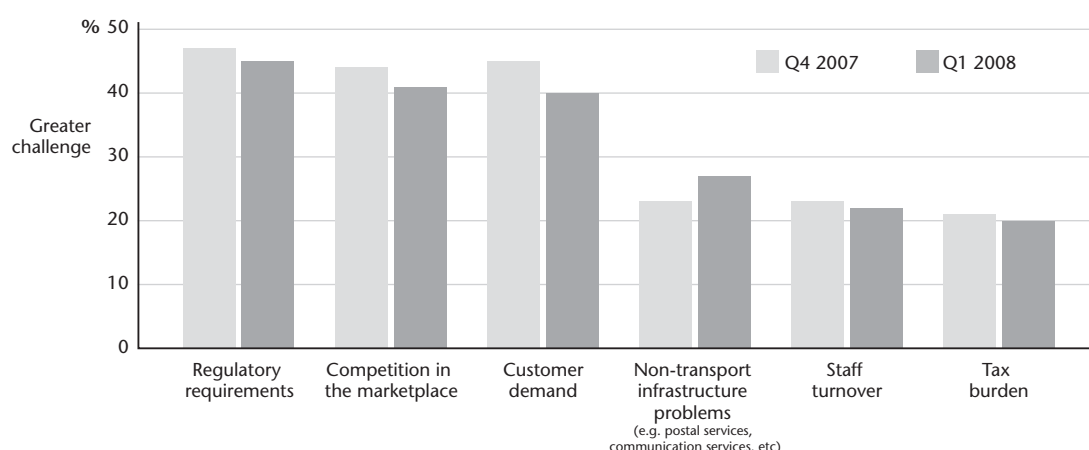


### REGULATION CONTINUES TO POSE GREATEST CHALLENGE TO PERFORMANCE

Despite this shift in access to capital, regulation continues to pose the greatest challenge to business performance, particularly for companies within Banking, Finance & Insurance. This, possibly reflects the introduction of MiFID, the EU legislation attempting to create a single wholesale financial market in the bloc. Overall close to half (45%) report that regulatory requirements have become a greater challenge for their businesses over the past 12 months with seven in ten (70%) in Banking, Finance & Insurance being of this view.

Other factors having a great impact on business performance are competition in the market place, customer demand, non-transport infrastructure problems (eg postal services, communication services), staff turnover (reflecting high levels of employment) and tax burden.

Fig. 3.2 Impact on organisation's performance over last 12 months



## 4 CONFIDENCE BY INDUSTRY

The Banking, Finance & Insurance and Property sectors continue to put the most downward pressure on the overall UK Confidence Index.

Confidence in the Banking, Finance & Insurance sector fell to -24.2 this quarter – the lowest since this survey began – from -13.9 last quarter and from +13.7 in Q2 2007, reflecting ongoing turmoil in financial markets. Banks are likely to remain uneasy for some time about providing credit, and concerns over exposure to a possible US recession will also continue to suppress confidence in this sector.

The decline in activity in the housing market has kept confidence in the Property sector low at -22.4, despite rising marginally from the -26.2 recorded three months ago.

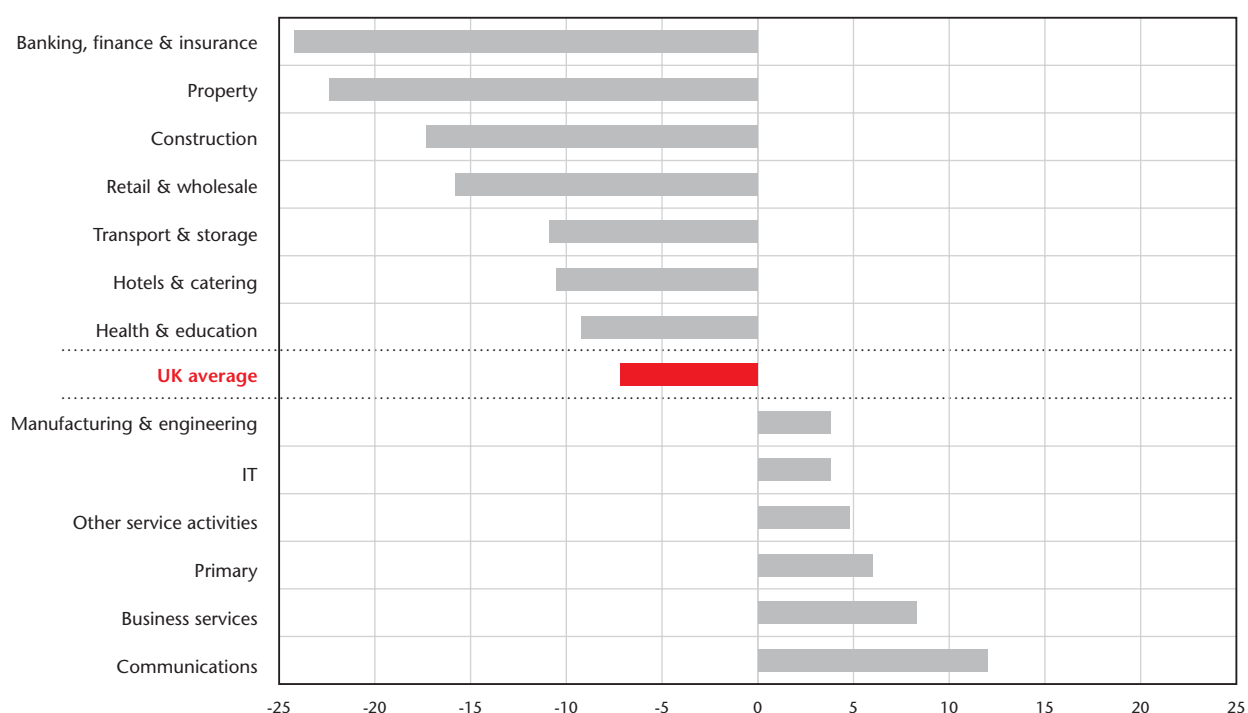
Other important sectors, such as Construction, Retail & Wholesale, Hotels & Catering and Transport & Storage, also recorded low confidence scores this quarter. Finance professionals in these sectors are concerned about potential impacts of a housing and consumer slowdown and inability to access appropriate levels and types of credit from the financial markets.

After recording the highest confidence of all sectors for six consecutive quarters, the IT sector saw its score plummet this quarter by 17.5 points. The sector now records a Confidence Index of +3.8. Despite the global boom of the internet the IT sector has, like most other sectors, become concerned that the US housing slump and possible recession could affect consumers thus reducing growth in sales of IT products.

Confidence rose in the Manufacturing & Engineering sector this quarter, suggesting that the large drop in confidence in Q4 2007 was a reaction to concerns before Christmas

**CONFIDENCE IN  
BANKING, FINANCE  
& INSURANCE  
SECTOR AT LOWEST  
LEVEL SINCE  
SURVEY BEGAN**

**Fig. 4.1 Business confidence by industry – Q1 2008**



## TREND OF BUSINESS CONFIDENCE BY INDUSTRY

which have now subsided. However, at +3.8 the sector's score remains below that recorded six months ago. The decline in the pound over the past three months is likely to have boosted the outlook for this sector, although with firms in this industry remaining reliant on accessing City finance, the 2008 outlook remains precarious.

One of the UK's most important sectors – Business Services – saw the recent positive trend for business confidence continue in the three months to Q1 2008. The sector continues to be supported by sales of services such as law, architecture and accountancy to emerging markets. In addition, given contract time lags, the sector has not yet been affected by the turmoil in the City of London.

Fig. 4.2

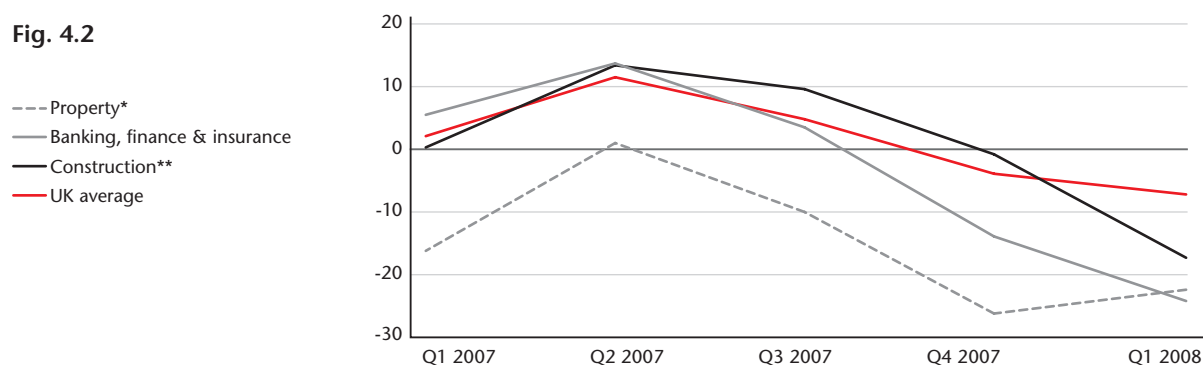


Fig. 4.3

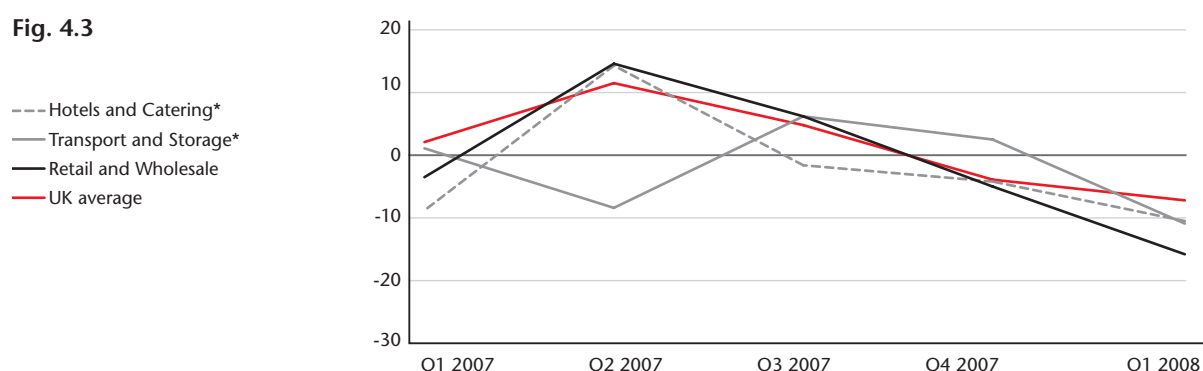
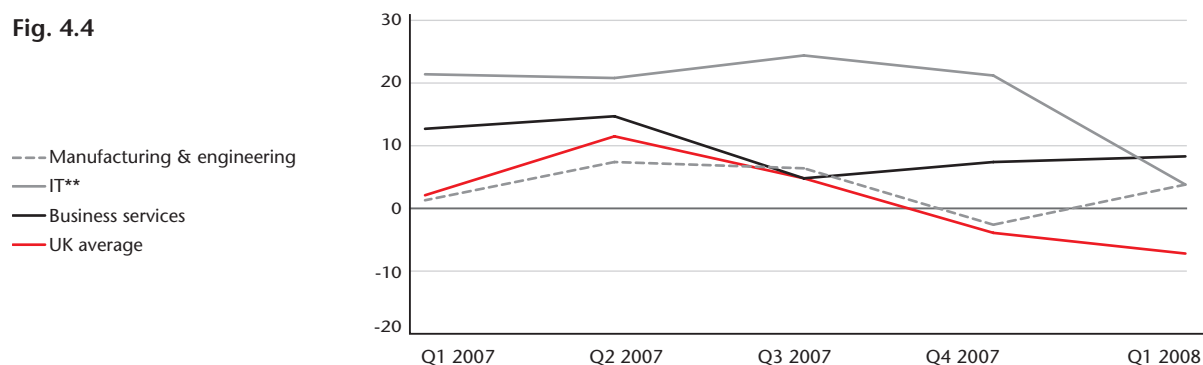


Fig. 4.4



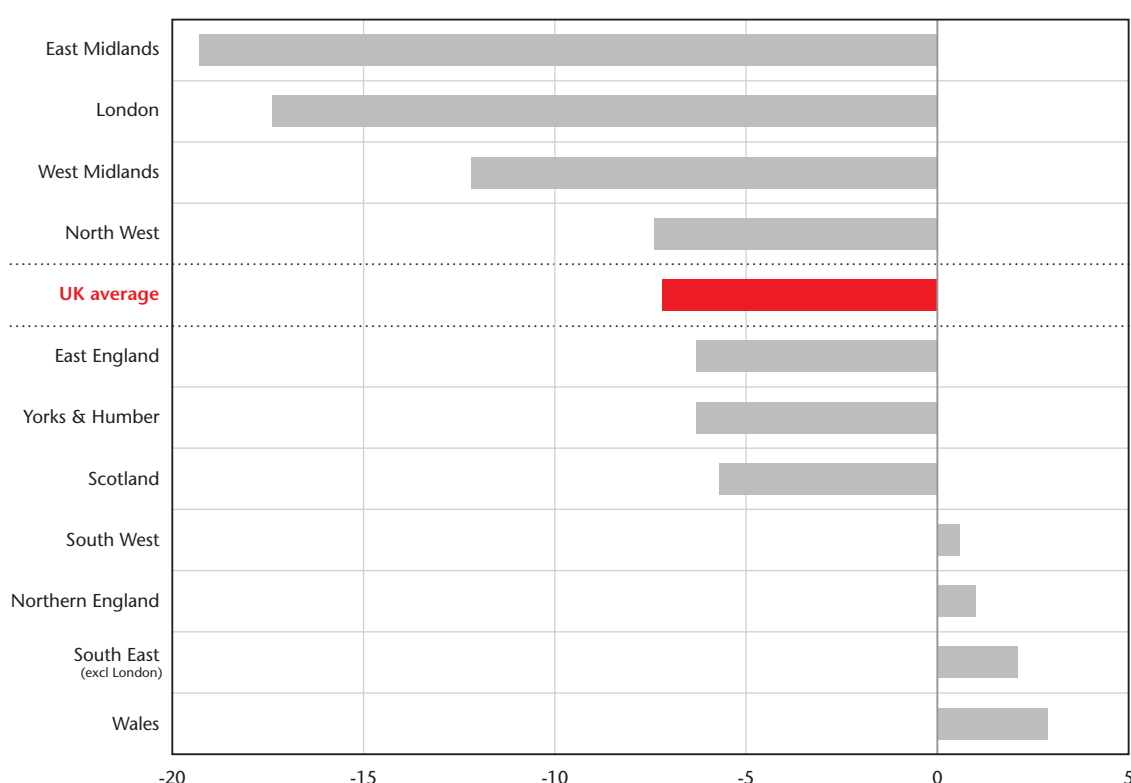
\* low base size in Q1 & Q2 2007

\*\* low base size in Q2 2007

## 5 CONFIDENCE ACROSS UK REGIONS

The average firm in most regions of the UK remains pessimistic about its outlook through 2008. Confidence in London has slipped to the lowest level since this survey began. The decline in confidence in the IT sector this quarter added to overall pessimism in the City of London and Canary Wharf on how current financial uncertainties will play out.

**Fig. 5.1**  
Business  
confidence  
by region  
Q1 2008



**IN CONTRAST TO NATIONAL TREND, SOUTH EAST, SOUTH WEST, NORTH AND WALES SEE POSITIVE CONFIDENCE**

The most negative region is the East Midlands where finance professionals record an index score of -19.3, down from -5.1 three months ago. The West Midlands region also registers a weak Confidence Index at -12.2. All but four other regions are also in the red.

However, in sharp contrast to the national trend, confidence has rebounded in some regions following a weak score three months ago. In the South East, confidence has risen to +2.1 from -9.5 in Q4 2007 on the back of a sustained positive outlook for Business Services and emerging markets. In the South West, confidence has risen to +0.6 from -8.6 supported by an improvement in the outlook for the Communications sector. Confidence has also improved in Wales and the Northern region, returning the index in these regions to the black.

TREND OF BUSINESS CONFIDENCE BY REGION

Fig. 5.2

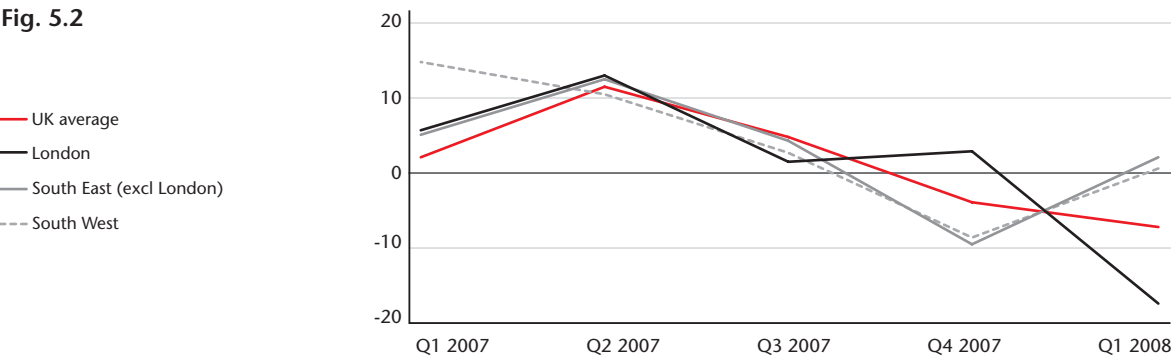


Fig. 5.3

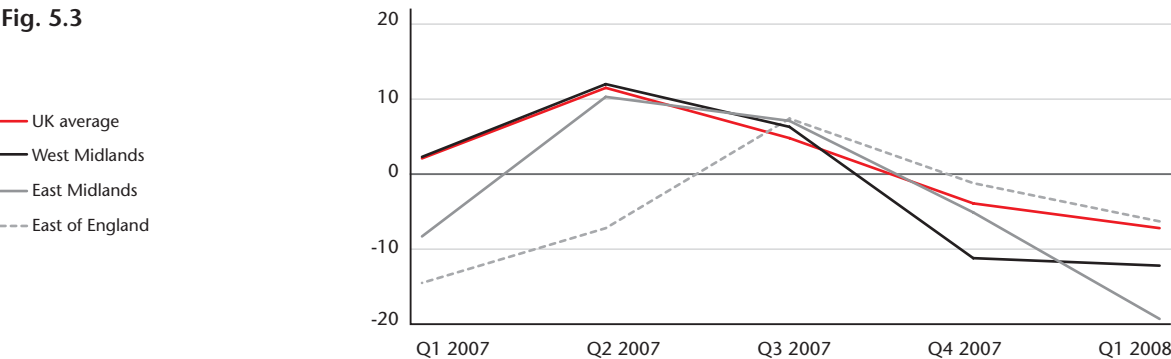


Fig. 5.4

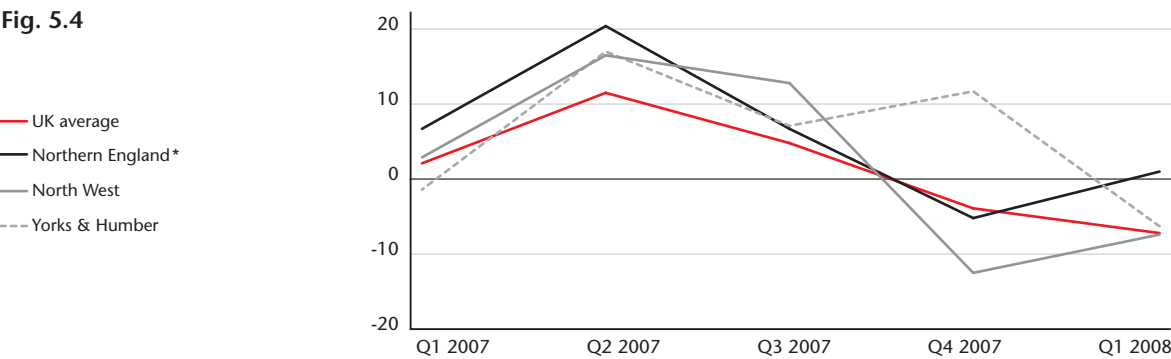


Fig. 5.5



\* low base size in Q1 2007

## 6 CONFIDENCE BY SIZE OF BUSINESS

**THE LARGER THE FIRM, THE DEEPER THE PESSIMISM FOR BUSINESS PROSPECTS**

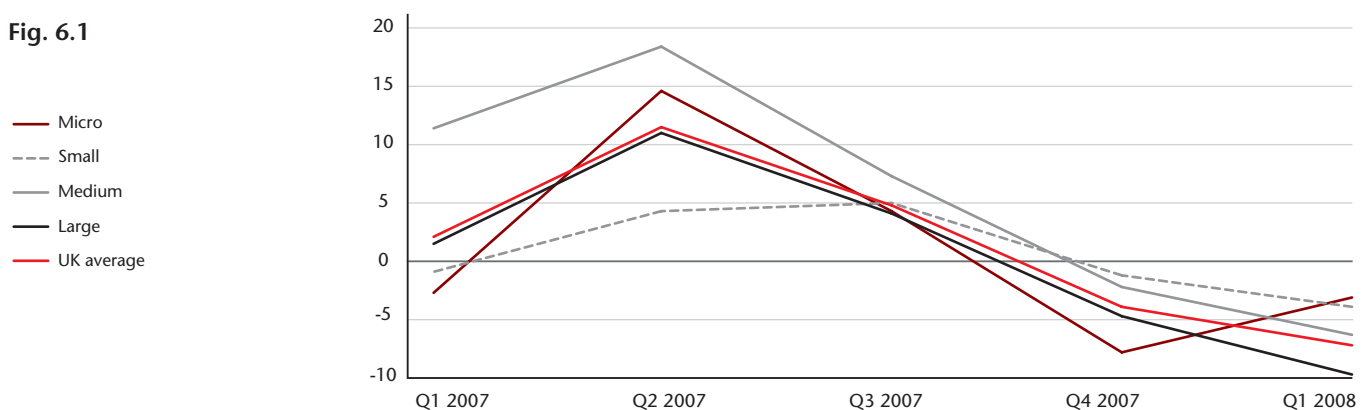
Firms employing more than 250 employees are the most pessimistic about their business prospects. These large companies register a Confidence Index of -9.7, continuing a downward trend which began in Q2 last year. This trend reflects increasing concerns on the health of the global economy while the odds of a US recession rise, and attempts by governments and central banks to slow Asian growth increase.

The global outlook typically impacts large firms more than smaller size businesses, as large firms are more likely to serve an international market. Within the large business category, firms employing more than 1,000 people are more pessimistic still, registering a Confidence Index score of -12.5.

All other business sizes register negative confidence.

### TREND OF BUSINESS CONFIDENCE BY COMPANY SIZE

Fig. 6.1





## APPENDIX: TECHNICAL INFORMATION

This research was conducted by the Institute of Chartered Accountants in England & Wales (ICAEW) with assistance from centre for economic and business research (cebr).

During the period 22 October 2007 to 8 January 2008, 1,036 ICAEW members active in business in the UK were interviewed by telephone. The interviews typically lasted 12–15 minutes and gathered opinions on past performance and future prospects for members' businesses, as well as investigating perceived changes in impact of factors such as availability of skills, Government regulation and the tax regime. A copy of the full question set is available upon request.

Data has been weighted to ensure the profile of the survey sample accurately represents the UK economy for company size (no. of employees), regional location and industry sector. Details of the weighting approach employed are included below.

Prior to June 2007 data for BCM was gathered via self completion methodologies, a mix of online and post.

The impact of design factors on data continuity were considered in detail before the decision to move to telephone data collection was made. Methodological testing indicated that the move to telephone would have limited impact on trends in the headline Confidence Index. The difference is not felt to invalidate comparison over time.

### FURTHER INFORMATION

For further information on the UK BCM please contact:

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### WEIGHTING APPROACH

Those who completed the survey (both current and historic data) were categorised by regional location, company size (no. of employees) and industry sector.

Rim weighting was applied to ensure the profile of the sample accurately represents the UK Economy. Weighting factors applied are detailed below. Target weights for sector and region were derived from Office of National Statistics published data on GVA (Gross Value Added) 2004. Weights for company size are based on turnover data for start 2005 published by the Small Business Analytical Unit of the Department for Business, Enterprise and Regulatory Reform.

	Sample number	Profile unweighted sample	Profile weighted sample
	Number	%	%
<b>REGION</b>	total ► 1036		
South East (excl London)	148	14	16
London	171	17	18
South West	91	9	8
Wales	56	5	4
West Midlands	83	8	8
East Midlands	73	7	7
East England	93	9	10
Yorks & Humber	66	6	8
North West	106	10	10
Northern	78	8	3
Scotland	70	7	8
Northern Ireland	1	0	0.1
<b>SIZE (EMPLOYEES)</b>	total ► 1036		
Micro & Small (up to 49)	265	26	31
Medium (50-249)	225	22	16
Large (250+)	546	53	53
<b>SECTOR</b>	total ► 1036		
Agriculture & fisheries, energy, water & mining	74	7	3
Manufacturing & engineering	131	13	14
Construction	75	7	6
Retail & wholesale	112	11	12
Hotels & catering	50	5	3
Transport & storage	72	7	5
Communications	47	5	3
IT	72	7	3
Banking, finance & insurance	113	11	8
Property & business services	133	13	22
Other service activities	76	7	5
Health and education	81	8	14

Weighted figures may not sum to 100% due to rounding

**COVERAGE OF REGIONAL ECONOMIC ACTIVITY**

Analysis shows the data which forms the basis of the BCM Business Confidence Index covers a significant proportion of UK economic activity both for the UK as a whole, and for the different UK regions. This assures that our data is accurately capturing the mood of UK business.

The table below shows our estimate of the proportion of economic activity which is represented by the businesses interviewed in BCM each quarter. (Further detail on the technical approach taken is available on request.)

Region	Coverage of economic activity (Gross Value Add)
	%
South East (excl London)	1.40
London	1.37
South West	1.64
Wales	2.53
West Midlands	1.57
East Midlands	1.70
East England	1.42
Yorks & Humber	1.57
North West	1.57
Northern	3.15
Scotland	1.31
<b>UK</b>	<b>1.32</b>

UK Business Confidence Monitor regional analysis is available on request. Please visit [www.icaew.com/bcm](http://www.icaew.com/bcm) or contact the relevant regional office detailed below for a full report.

**East England region**

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Fax 01223 257810  
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**Northern region**

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Newcastle upon Tyne  
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**South East region**

3000 Cathedral Hill  
Guildford, Surrey  
GU2 7YB  
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[www.icaew.com/southeast](http://www.icaew.com/southeast)

**West Midlands region**

West Midlands Office  
3 Brindleyplace  
Birmingham  
B1 2JB  
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Fax 0121 698 8618  
[www.icaew.com/westmidlands](http://www.icaew.com/westmidlands)

**East Midlands region**

Cumberland House  
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Nottingham  
NG1 6EE  
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Fax 0115 988 6226  
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**North West region**

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Cinnamon Brow  
Fearnhead, Warrington  
WA2 0XP  
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Fax 01925 661828  
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**South West region**

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Temple Quay  
Bristol  
BS1 6EA  
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Fax 0117 344 5046  
[www.icaew.com/southwest](http://www.icaew.com/southwest)

**Yorkshire and Humber region**

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1200 Century Way  
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LS15 8ZA  
Tel 0113 251 5669  
Fax 0113 251 5399  
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