



UK BUSINESS CONFIDENCE MONITOR

Q3 2011



WELCOME



This quarter's BCM shows that confidence among business leaders continues to fall as they consider their prospects for the next twelve months. But perhaps of greater concern is the underlying message that is revealed in this quarter's report – a growing frustration at the lack of progress by the Government on making it easier to do business in the UK.

Businesses want to see more being done to tackle regulation and improve the competitiveness of the UK economy. They are yet to see any tangible improvement and are starting to lose faith. The Government needs to respond with increasing urgency. Delivering the 'Plan for Growth' is critical in making Britain more business-friendly and driving our economy forward.

A handwritten signature in black ink, reading "Michael Izza".

Michael D M Izza
Chief Executive
ICAEW



The increasingly difficult outlook for the global economy, particularly in Europe and the US over recent weeks, can only apply additional pressure to the faltering UK recovery. Businesses are predicting growth over the next 12 months, which is encouraging, but the fragility of our largest overseas markets makes an export-led recovery an increasingly questionable scenario. The Office of Budget Responsibility's prediction of 1.7% annual growth looks to be an almost unattainable target, and with little prospect of improvement is likely to be downgraded in the autumn.

So there is little surprise that confidence among the businesses surveyed has fallen to its lowest level in almost two years. However, the UK economy will grow this year, albeit weakly, and I believe we will avoid the double-dip recession. That may be little consolation today, but we have to look to longer-term recovery rather than quick fixes.

A handwritten signature in black ink, reading "Scott Barnes".

Scott Barnes
Chief Executive Officer
Grant Thornton

ECONOMIST'S VIEW



The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence has fallen to its lowest level since Q3 2009, when the UK was still in recession.

The Q2 2011 preliminary estimate of quarterly economic growth indicates that the UK economy expanded by 0.2% quarter on quarter, down from 0.5% growth in the first quarter of the year and reigniting concerns that the recovery may be slow and protracted. BCM points towards modest growth of around 0.5% in Q3 2011.

KEY ISSUES EMERGING THIS QUARTER

- The positive trend in turnover and profits growth which began in the middle of 2010 has faltered this quarter.
- Export growth remains robust, although expectations for future growth in exports have been revised downwards this quarter.
- Firms continue to report input prices growing more strongly than selling prices, implying an ongoing squeeze on profit margins. This may also be putting under threat hopes for private sector jobs growth. This quarter BCM sees the end of a seven-quarter upward trend in the reported rate of employment growth.
- Confidence is highest this quarter in some areas of the service economy, with the Manufacturing & Engineering sector relatively downbeat. This pattern could raise concerns over the UK's ability to rebalance growth away from being over-reliant on services.

The world economic outlook has generally deteriorated in recent weeks. The European sovereign debt crisis has escalated and spread beyond Greece, Ireland and Portugal to Italy and Spain. Alongside the US sovereign debt rating downgrade, equity markets suffered large declines in early August. Weak growth in the eurozone is a major risk for UK exports and the potential for net trade to drive growth. Export growth is essential at a time when neither government spending nor household consumption can be relied on to generate robust expansion.

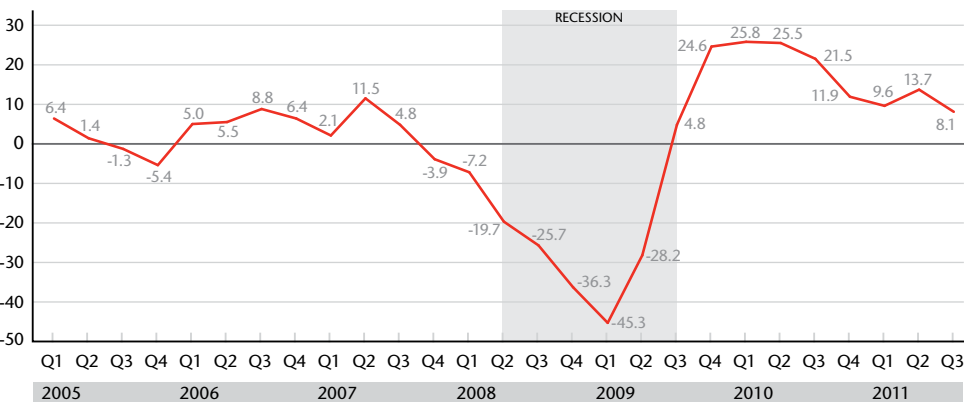
This quarter's BCM implies modest growth of 0.5% quarter on quarter in Q3 2011, suggesting the Office for Budget Responsibility (OBR) will almost certainly have to revise down its growth forecast of 1.7% for the current year in its autumn statement. With markets so volatile and UK growth so lacklustre, we think the Bank of England will keep interest rates on hold until Q2 2012 at the earliest.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q3 2011

FIG. 1 TREND OF UK BUSINESS CONFIDENCE

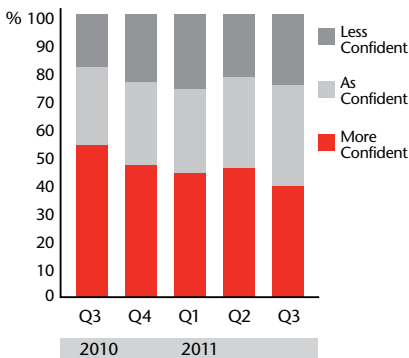


The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence has fallen in Q3 2011. The Confidence Index stands at 8.1 in Q3 2011, down from 13.7 in Q2 and the lowest level since Q3 2009 when the UK was still in recession. The Confidence Index has been on a downward trend since a post-recession bounce-back that started in late 2009 and peaked in the first half of 2010.

CONFIDENCE AT LOWEST LEVEL SINCE THE RECESSION

The latest findings from BCM show the Q3 2011 Confidence Index stands at 8.1, down by 5.6 points on the previous quarter and down 13.4 points on a year ago. The Confidence Index stands at its lowest level since Q3 2009, when economic output was still contracting. Though in part some fall in the Confidence Index is expected following the post-recession bounce-back, the most recent decline in the index is also likely to reflect fears about the strength of the global economy. In conjunction with lacklustre growth in the UK, the

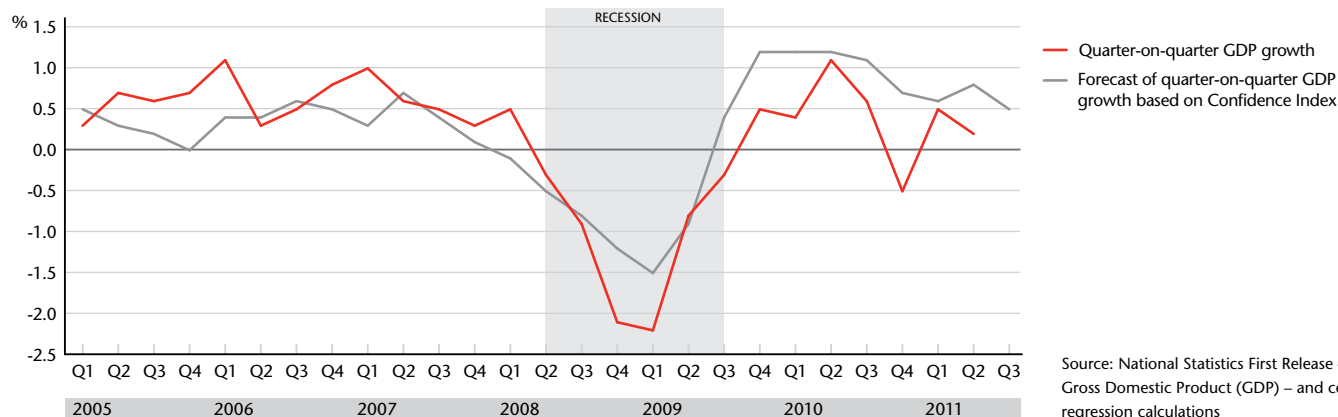
FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES



US recovery continues to disappoint while the eurozone remains embroiled in a major sovereign debt crisis.

The overall share of businesses more confident about the coming 12 months is down from last quarter, at 39% compared with 45%. This is the lowest share since Q2 2009. On a slightly encouraging note, the share of businesses less confident about the future has not increased sharply this quarter.

FIG. 3 FORECAST OF QUARTERLY GDP GROWTH BASED ON ICAEW CONFIDENCE INDEX



The UK economy saw a slowdown in growth in Q2 2011, underlining existing concerns that the economic recovery would be slow and protracted. Preliminary estimates from the Office for National Statistics (ONS) show the economy grew by just 0.2% quarter on quarter in Q2 2011, down from 0.5% growth in the first quarter of the year. Overall, this suggests the economy remains in a fragile state.

CONFIDENCE INDEX SUGGESTS GROWTH WILL REMAIN MODEST

The ONS believes that certain one-off factors may have contributed to the slowdown in growth seen in Q2 2011, namely the additional bank holiday for the royal wedding and the impact of the Japanese tsunami on global supply chains. Despite the impact of these temporary effects on the economy, there is a broad consensus that the weakness in growth is also a sign of a more fundamental economic malaise in the West arising from high inflation, attempts to reduce

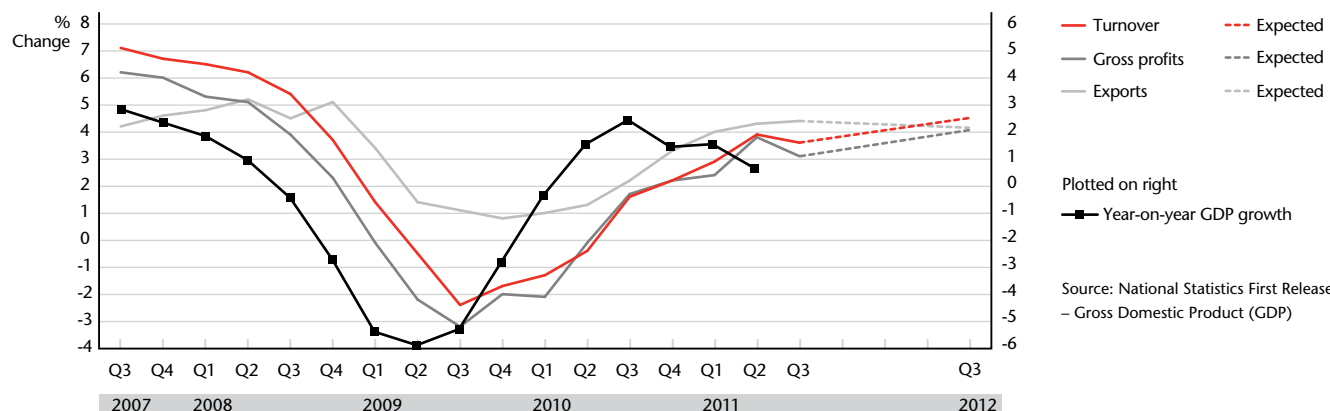
unsustainable government deficits and consumer debt.

The latest BCM Confidence Index points to positive quarterly growth in Q3 2011 of around 0.5% quarter on quarter. If this rate of growth is realised, the OBR's growth forecast of 1.7% for 2011 will almost certainly be missed, unless there is exceptional growth at the end of the year.

UK ECONOMIC GROWTH SLOWED IN Q2 2011 • BCM SUGGESTS OBR'S GROWTH FORECAST WILL BE MISSED

BUSINESS FINANCIAL PERFORMANCE

FIG. 4 AVERAGE % CHANGE OVER 12 MONTHS TO...



This quarter, the positive trend for growth in key business financial performance indicators which began at the end of 2009 has faltered. Average turnover growth in the 12 months to Q3 2011 stands at 3.6%, while average gross profit growth is reported at 3.1%. Firms have also revised downwards their expectations for turnover and profit growth over the next 12 months.

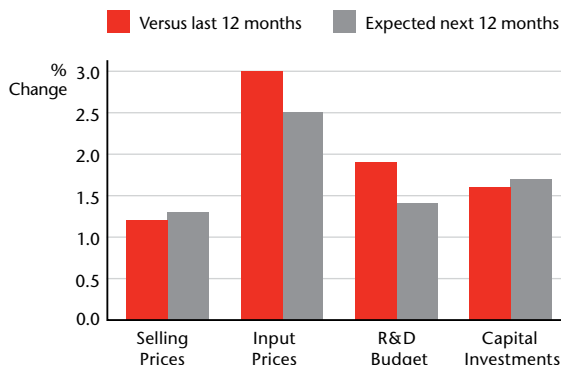
GROWTH TREND FALTERS BUT EXPORTS REMAIN ROBUST

Reported annual export growth remains broadly unchanged from last quarter, at 4.4%. The ongoing weakness of sterling against the euro and the dollar continues to make UK exports more price competitive. However, ongoing fragility in the economies of the UK's major trading partners – the US and the eurozone – poses a major threat to export growth. The escalation of the sovereign debt crisis on the Continent in recent weeks may be one reason for businesses revising their projections for export growth over the next 12 months from 4.8% last quarter to 4.2% this quarter.

Firms report domestic sales 2.6% up on a year ago, roughly half the rate of domestic sales growth seen before the recession. With household consumption and government spending accounting for some 88% of UK GDP in 2010, weak domestic demand is likely to be a major headwind to growth for some years to come. Rebalancing towards a more export-focused economy will take some time before it has a significant impact, leaving the UK vulnerable in the short term.

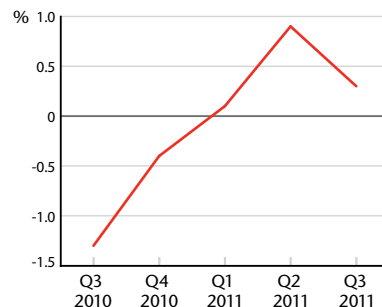
POSITIVE GROWTH TREND HAS FALTERED • ISSUES FOR UK'S TRADING PARTNERS THREATEN EXPORT GROWTH

FIG. 5 Q3 2011 – AVERAGE % CHANGE IN...



BCM shows firms still face significant cost pressures. Businesses report input prices are 3.0% higher this quarter than a year ago, the highest rate of growth since Q1 2009 and a continuation of the trend of rising input costs which began in Q3 2010. With firms reporting selling prices to have risen by only 1.2% over the last 12 months, profit margins remain under notable pressure. Capital investment growth remains subdued.

FIG. 6 AVERAGE % CHANGE IN EMPLOYEE NUMBERS Last 12 months

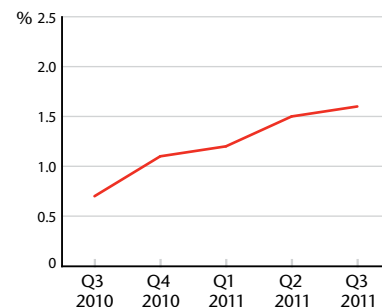


PRIVATE SECTOR EMPLOYMENT GROWTH SLOWS

This quarter, businesses report employee numbers to be just 0.3% higher than 12 months ago, a slowdown from 0.9% growth last quarter and ending seven consecutive quarters in which the growth rate of employment was on an upward trend. Firms are expecting an average 1.4% increase in staff headcount over the next 12 months, broadly unchanged from last quarter.

Private sector earnings growth remains modest, with businesses

FIG. 7 AVERAGE % CHANGE IN BASIC SALARIES Last 12 months

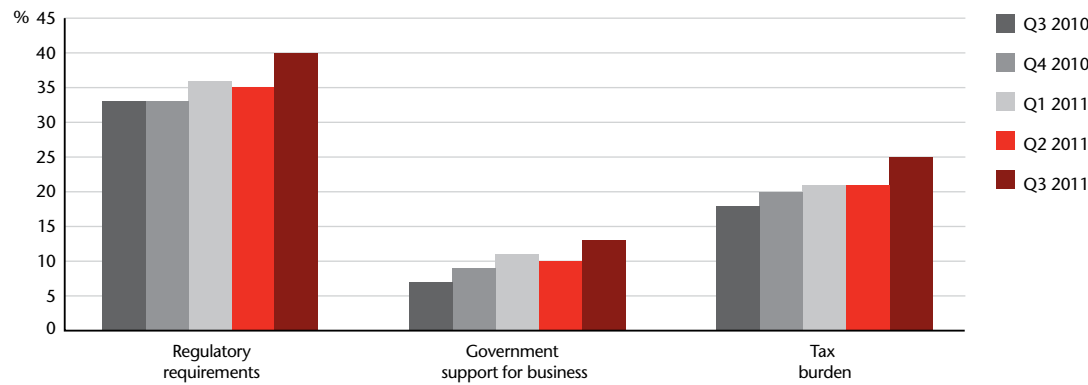


reporting staff basic pay on average 1.6% higher than a year ago, approximately half the rate of annual growth which was typical before the recession. With unemployment in the UK still elevated – over 55% higher than just before the recession – weaknesses in the labour market are likely to continue to constrain pay growth, as concerns about job security weaken employee wage bargaining power.

INPUT PRICE RISES AT HIGHEST RATE SINCE Q1 2009 • UPWARDS TREND FOR EMPLOYMENT GROWTH ENDS

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 8 IMPACT ON ORGANISATION’S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (UK AVERAGE)



The proportion of businesses reporting regulatory requirements to be a greater challenge has risen this quarter. Four in ten firms (40%) report regulatory requirements to be a greater challenge than 12 months ago, up from 33% in the same quarter last year and suggesting that many businesses believe more still needs to be done to cut red tape and bureaucracy.

LITTLE PROGRESS ON SUPPORT FOR PRIVATE SECTOR GROWTH

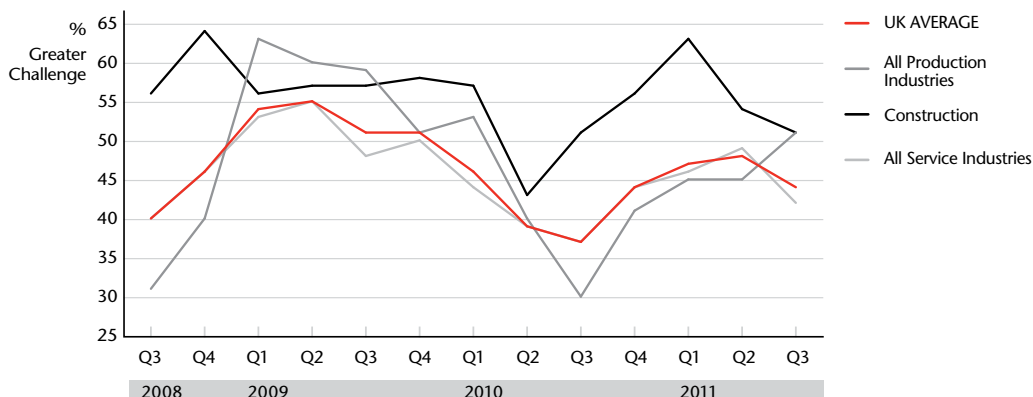
The proportions of businesses reporting government support for business and the tax burden to be greater challenges than 12 months ago have also increased rather than decreased since this time last year.

In part, the increasing proportion of firms reporting these factors to be a greater challenge reflects a return to the perennial issues that affect business growth. During the 2008-9 recession firms were more focused on issues such as access to capital and late payment by customers.

However, the fact that these indicators currently point to a

deteriorating business environment suggests that more still needs to be done to make the UK truly business-friendly. Despite numerous measures aimed at winning over businesses, such as the introduction of a ‘one in, one out’ rule for regulation and the reduction of the corporation tax rate from 28% to 26% in April, it looks as though the Government still has some way to go to convince entrepreneurs that Britain is open for business and delivering a genuine growth agenda.

FIG. 9 CUSTOMER DEMAND – CHANGE VERSUS 12 MONTHS AGO



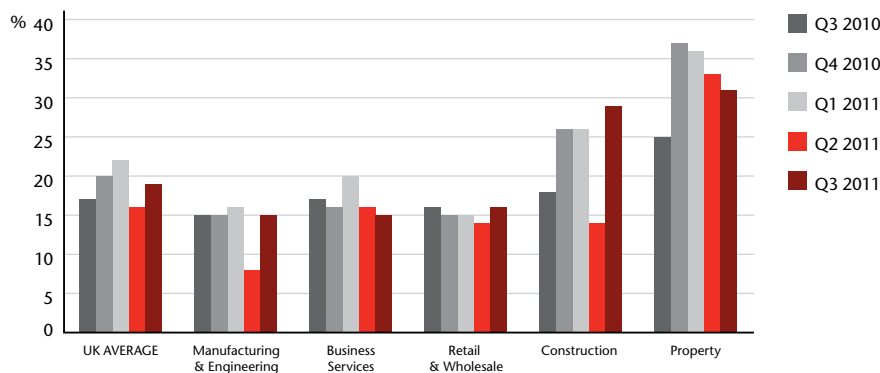
MARKET MORE CHALLENGING FOR PRODUCTION INDUSTRIES

This quarter, half of businesses in the Production Industries (51%) report customer demand to be a greater challenge than 12 months ago. The proportion of firms in the Production Industries reporting this trend has risen over the last year as demand conditions have toughened.

In the Service Industries, however, customer demand appears to be holding up better. This is in line with findings of the latest Markit/CIPS Services Purchasing Managers' Index (PMI). The Services PMI rose to 55.4 in July from 53.9 in June, signalling that activity in the UK's service sector expanded at its fastest rate for four months.

Concerns over access to capital are relatively limited compared to the levels seen during the recession. In Q3 2009 a peak of nearly four in ten firms (37%) reported it to be a greater challenge than 12 months earlier. Currently fewer than one in five firms (19%) report this trend, though there is considerable variation across sectors, with firms in Property and Construction most likely to report access to capital as a greater challenge.

FIG. 10 ACCESS TO CAPITAL – CHANGE VERSUS 12 MONTHS AGO

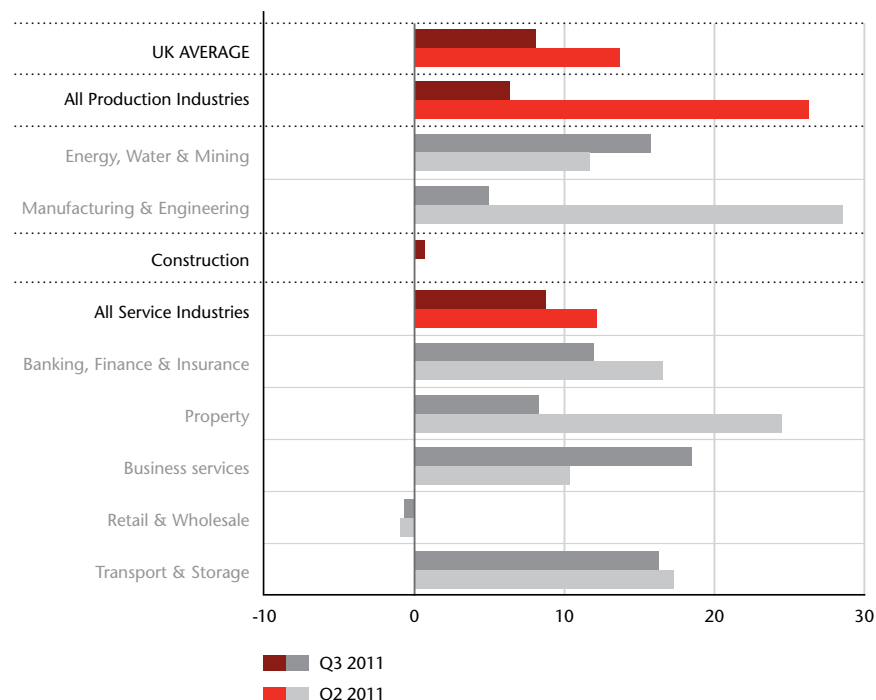


CUSTOMER DEMAND HOLDING UP FOR SERVICES • DEMAND GREATER CONCERN FOR PRODUCTION INDUSTRIES

TRENDS IN BUSINESS CONFIDENCE

INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence among Retail & Wholesale firms remains in negative territory. The Confidence Index for the sector stands at -0.7 this quarter, broadly unchanged from last quarter and likely to reflect the tough trading environment for retailers at present. Big brands such as Thorntons and Carpetright have announced shop closures, while the furniture store Habitat placed 30 of its stores into administration, and sold three London stores to Home Retail Group.

MANUFACTURING CONFIDENCE CONTINUES TO WEAKEN

The overall trend in confidence in the Manufacturing & Engineering sector has been down since the middle of last year. Concerns about UK export demand from the eurozone – currently struggling with sovereign debt issues – and the slowdown in global inventory restocking are two considerations which may be dampening any optimism. The Japanese tsunami earlier in the year has also had a disruptive and ongoing impact on global supply chains.

Across the different service sectors the pattern for confidence is mixed. In addition to the Retail sector being in negative territory, a negative trend in confidence among Banking Finance & Insurance firms continues this quarter. At the same time, the Transport & Storage sector has maintained above-average confidence levels across all three quarters of 2011, a surprising degree of resilience given weak confidence in the Manufacturing and Retail sectors where much of their business must derive.

RETAIL SECTOR CONFIDENCE REMAINS NEGATIVE • NEGATIVE TREND CONTINUES AMONG MANUFACTURERS

FIG. 12 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence in the Construction sector remains weak.

The Construction sector remains in the doldrums with the Confidence Index at 0.7, broadly unchanged from last quarter and 6.9 points lower than a year ago. Fragility in the housing market, in conjunction with reduced demand from falling government investment, continues to curb growth in the sector.

CONFIDENCE IN PRODUCTION INDUSTRIES CONTINUES DOWNWARD TREND

Confidence stands at a similar level among the Service and Production Industries this quarter, with Confidence Index scores of 8.8 and 6.4 respectively. Overall, the Production Industries Confidence Index has been on a downward trend since the middle of 2010 and official data show poor performance for the sector in the second quarter of this year. The latest ONS data show that output in Production Industries fell by a quarter-on-quarter rate of 1.4%

in Q2 2011, while output in Service Industries increased by 0.5%.

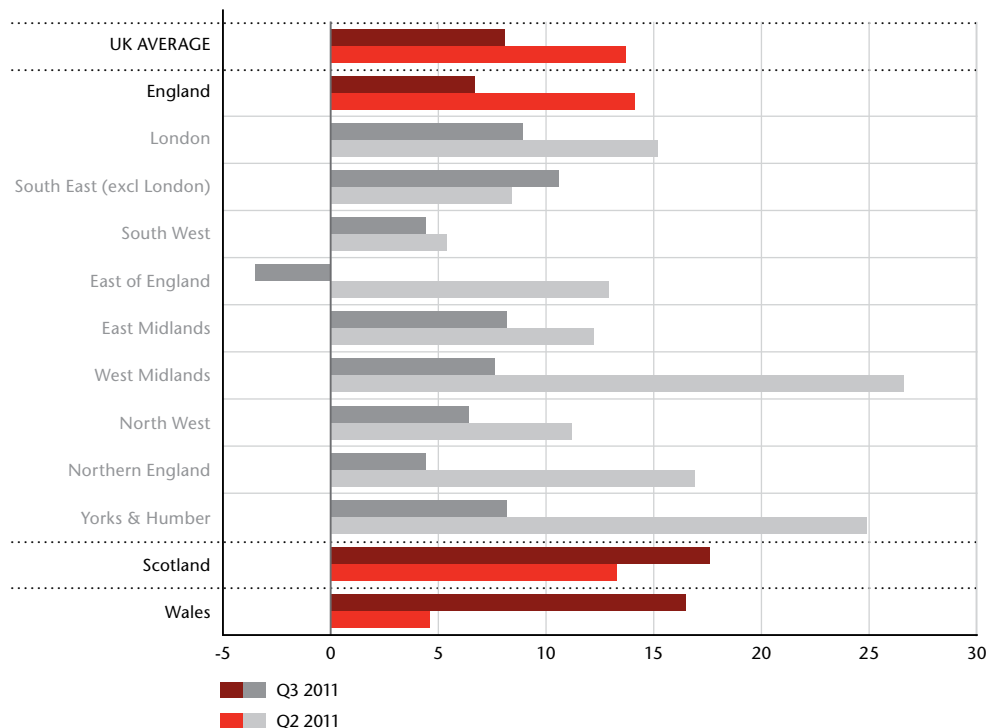
While it is too early to say whether or not this is part of an emerging trend, the fragility of the manufacturing sector at present, following a relatively strong 2010, is a concern. Questions remain over whether the UK will be successful in rebalancing its economy away from heavy reliance on the service sector towards manufacturing playing a greater role.

WEAK HOUSING MARKET AND FALLING GOVERNMENT INVESTMENT DEPRESS CONFIDENCE IN CONSTRUCTION

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 13 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence has held up well in the South East this quarter, and is stronger in London than in many other English regions. The Confidence Index stands at 10.6 in the South East and at 8.9 in London, compared with 6.7 for England as a whole. Overall, this is likely to reflect higher levels of household income and a relatively low dependence on the public sector compared with other parts of the country.

CONFIDENCE AHEAD IN SCOTLAND

This quarter, business confidence is strong in both Scotland and Wales, with Confidence Indices of 17.6 and 16.5 respectively. Confidence in Scotland has generally been higher than in England since the recession, possibly reflecting a public sector more insulated from UK austerity measures (so far, at least).

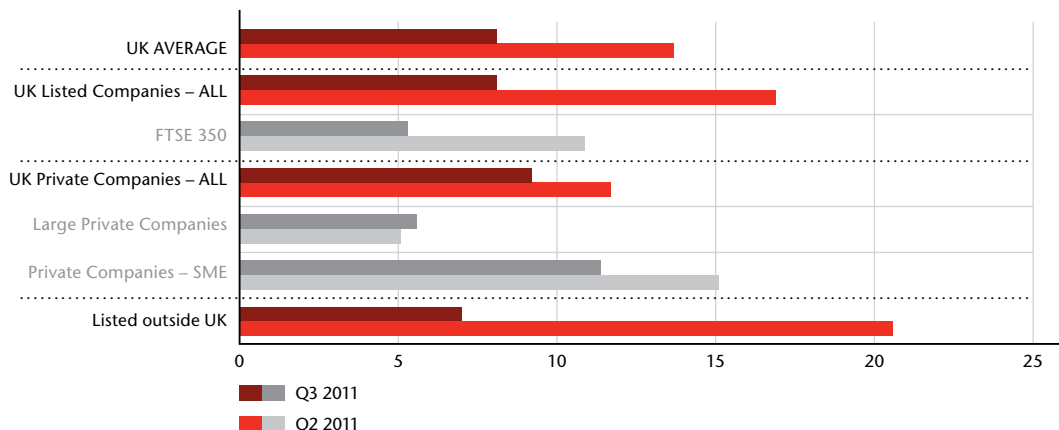
In Wales, confidence has been relatively weak since the final quarter of last year. Unemployment in Wales fell by 0.6 percentage points over the three months to May compared with the previous three months, better than the 0.3 percentage point fall seen in Scotland and the unchanged unemployment rate in England. However, with public sector employment accounting for over a quarter (26.1%) of total employment, it is unclear if this positive outlook in Wales will continue as government austerity measures start to bite in earnest in the months and years ahead.

OUTLOOK REMAINS MOST POSITIVE IN SCOTLAND • IN ENGLAND, LONDON AND SOUTH EAST MOST BUOYANT

TRENDS IN BUSINESS CONFIDENCE

TYPE

FIG. 14 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



Confidence similar for private and listed UK firms. Confidence among UK listed companies has weakened and is now broadly in line with that for UK private companies, breaking a trend in which listed companies' confidence has been consistently higher. Confidence among companies listed outside the UK has also weakened considerably this quarter, presumably reflecting concerns over the European sovereign debt crisis and continued weakness in the US economy.

CONFIDENCE REMAINS HIGHER AMONG SMEs

Private small and medium-sized firms (SMEs) remain more confident than large private firms this quarter. This is a trend which has been consistent since the UK's emergence from recession. In part, this may reflect the fact that smaller firms were more deeply affected during the downturn than larger ones, and are consequently more likely to be

optimistic about economic prospects compared with the recent past.

There is evidence that in some sectors smaller firms may be faring relatively well. The latest ONS retail sales data, for example, show annual value growth in retail sales (excluding automotive fuel) in June of 3.6% for small firms versus 3.2% for large businesses.

CONFIDENCE OF UK LISTED COMPANIES HAS WEAKENED • OUTLOOK OF FIRMS LISTED OVERSEAS ALSO DOWN

ABOUT BCM

BCM is one of the largest and most comprehensive quarterly reviews of UK business confidence and provides a regular snapshot of the economy, informed by senior business professionals running all types of businesses across the UK. It is shared with a range of national and regional policy-makers, the business community, academics and researchers. It is a credible predictor of GDP and economic change and supports policy decision-making.

The report is based on 1,002 telephone interviews conducted 3 May–29 July 2011, with ICAEW members working in industry and commerce. These probed opinions on past performance and future prospects for members’ businesses, and investigated perceived changes in impact of factors such as availability of skills, government regulation and the tax regime. Data are weighted to represent the UK economy by value.

BUSINESS CONFIDENCE INDEX METHODOLOGY

The Business Confidence Index is calculated from the responses to the following:

‘Overall, how would you describe your confidence in the economic prospects facing your business over the next 12 months, compared to the previous 12 months?’

A score was applied to each response as shown to the right, and an average score calculated.

Using this method, a Confidence Index of +100 would indicate that all survey respondents were much more confident about future prospects, while -100 would indicate that all survey respondents were much less confident about future prospects. Further technical details on the design of the survey are available upon request.

Variable	Score
Much more confident	+100
Slightly more confident	+50
As confident	0
Slightly less confident	-50
Much less confident	-100

ACKNOWLEDGMENTS

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