

ICAEW



UK BUSINESS CONFIDENCE MONITOR REPORT

Q1 2010



WELCOME



Our first *ICAEW UK Business Confidence Monitor* (BCM) report of 2010 reveals that while business confidence has risen for the fourth quarter in succession, three out of five UK businesses are still running below capacity. This means businesses will be able to increase output and take advantage of the fragile economic recovery without taking on new staff. The spare capacity in the economy will also reduce long-term inflationary pressures, supporting the Bank of England's decision to keep monetary policy on hold.

For many business leaders, life continues to be tough. They face a number of challenges, not least nursing their businesses back to full capacity with fewer resources. Access to capital, while becoming easier, continues to be one of the more significant issues for those still struggling, or who want to take advantage of the opportunities that come with recovery.

Since its introduction in 2003, BCM has provided a regular snapshot of the state of the economy, informed by senior business professionals running all types of businesses across the UK. It is one of the largest and most comprehensive quarterly reviews of UK business confidence.

BCM findings are shared with a range of policy-makers at a national and regional level, and are used by the business community, academics and researchers, providing a robust tool on which government and regional authorities can base decisions for developing policy. Leaders of UK businesses also find BCM useful as a credible predictor of economic change.

This BCM is published in the run-up to the General Election campaign. There is no disguising the tough decisions that the incoming government will need to take. Ministers will have to balance maintaining steady economic growth with quickly tackling the public sector deficit. BCM will continue to be a good barometer of how businesses are reacting to the judgements they make.

Please visit icaew.com/bcm for further analysis and details 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
ICAEW

ECONOMIST'S VIEW



The latest *ICAEW UK Business Confidence Monitor* (BCM) shows that confidence across UK plc rose for the fourth successive quarter – a record high since the nadir of the recession a year ago.

The UK economy returned to growth in the final quarter of 2009, but the official figures imply a limp recovery. We suspect these figures could be revised up – certainly the BCM paints a more positive picture. After a 4.8% contraction in output in 2009 – the worst performance since records began – we expect growth to edge up in the first half of 2010 with annual expansion in the range 1.0-1.5%.

KEY ISSUES EMERGING THIS QUARTER

- Modest improvement in financial indicators: firms expect growth in profit, turnover and sales over the coming year after all three contracted over the year to date.
- Inflationary pressures remain muted. Businesses expect only modest growth in prices and wages over the next year, while three in five firms are operating below capacity.
- Export growth has remained positive and is expected to rise over the coming year.
- Access to capital has improved for the second quarter in succession, but still presents a greater challenge than 12 months ago for one out of every four businesses.

The UK is in recovery mode but the key factor on the horizon is the coming election. The public deficit continues to rise – it will be the largest as a share of GDP of any G20 nation this year. As illustrated by recent developments in Greece and countless other examples from economic history, failure to have a credible plan for dealing with the deficit would represent a serious risk.

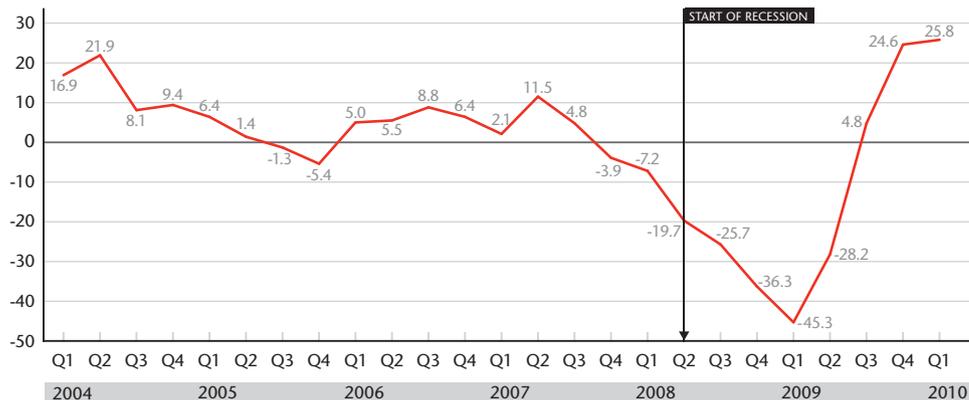
The key question in the current public discourse is the speed with which the deficit should be reduced. With the private sector recovery still emerging and fears of a double-dip recession, we expect the pain of public spending cuts to be immediate in the next parliament. Hence monetary policy is likely to be kept loose to accommodate this – our view remains that the Bank of England will keep interest rates on hold at 0.5% until 2011.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q1 2010

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



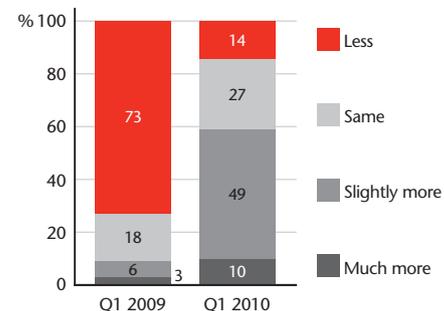
The latest ICAEW *UK Business Confidence Monitor (BCM)* marks the fourth successive improvement in confidence. The Confidence Index edged up slightly from Q4 2009 to reach a new record high. The contrast with a year earlier could not be starker – the Confidence Index was at a record low in Q1 2009. The rise in the index this quarter is the smallest of the four consecutive rises since the lowest point of the recession a year ago.

CONFIDENCE RISES AFTER TOUGHEST ECONOMIC YEAR SINCE 1930s

The latest findings from BCM show the Confidence Index has risen to a new record high of 25.8, up from 24.6 in Q4 2009. Confidence has now improved for four quarters in succession, the longest run of rises in the Confidence Index since BCM began.

As in Q4 2009, six in ten businesses (59%) are now more confident about economic prospects facing their organisation over the next 12 months compared to the previous 12 months. This compares with just one in ten in the corresponding quarter a year ago.

FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES



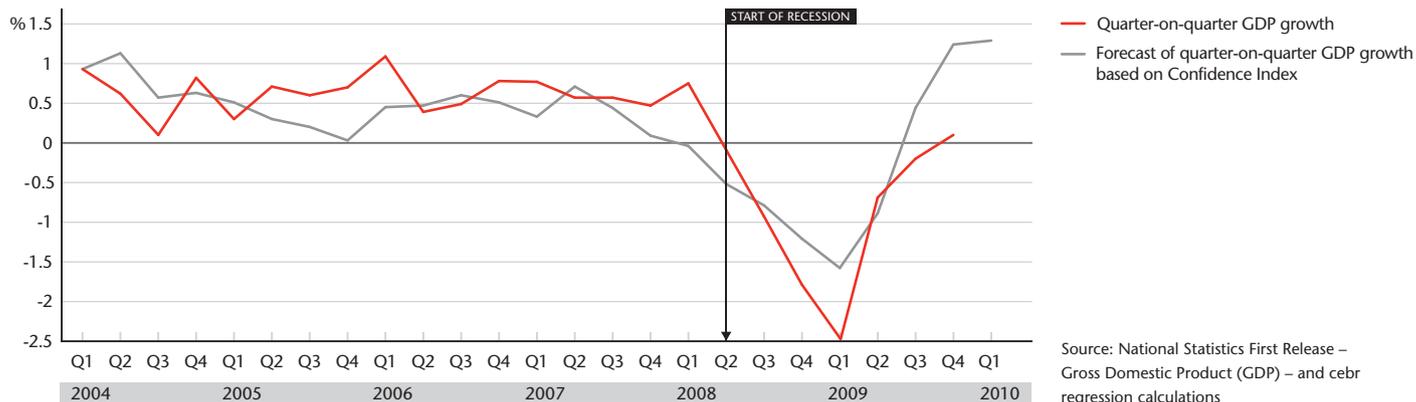
Confidence in economic prospects over next 12 months, compared to previous 12 months.

Most businesses are slightly more confident about economic prospects rather than much more confident. However, it is encouraging that now only 14% of businesses are less confident about economic prospects over the year ahead relative to the difficult last 12 months. This is the lowest proportion on record. Of this just 3% are much less confident: again, a record low.

So business confidence across the UK continues to rise, although the pace of improvement has eased.

Q1 2010 SEES FOURTH SUCCESSIVE QUARTERLY RISE IN CONFIDENCE • PACE OF IMPROVEMENT HAS EASED

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



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

The latest BCM Confidence Index implies that growth will continue in Q1 2010 after the Office for National Statistics (ONS) confirmed that the recession ended in Q4 2009. Following the longest recession since records began, the preliminary ONS estimate for growth in Q4 2009 was a meagre 0.1% quarter on quarter. The recession came to an end with a whimper according to these preliminary figures. Business confidence is far higher than a year ago and the economy should grow by at least 1% in 2010.

UK ECONOMY GROWING AGAIN

The official statisticians' confirmation of a return to growth in Q4 2009 was expected, but growth at 0.1% was weaker than City expectations of 0.4%. In contrast to this apparently limp Q4 recovery, BCM and a variety of other indicators nonetheless imply that performance was actually stronger.

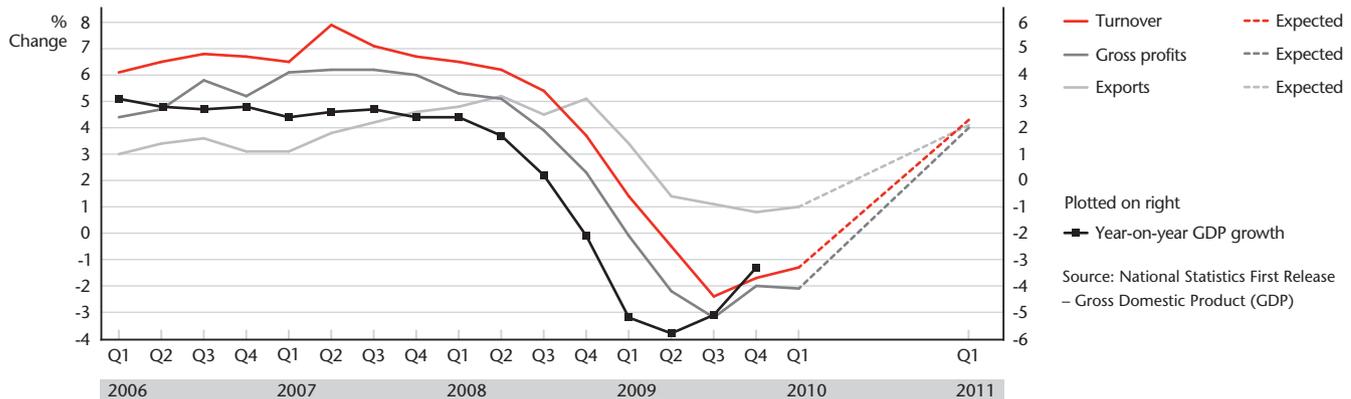
The Confidence Index has risen substantially, and the latest data suggest growth will edge up further in Q1 2010. On recent historic data, movement in the Confidence Index has correctly pointed to contractions in GDP in five of the six quarters of the recession. Many analysts foresee that the official figures could be revised up once all data become available.

It is also encouraging that the labour market has shown signs of stabilisation; in December claimant count unemployment fell by the largest number since April 2007, having also declined in November. In addition, the Chartered Institute of Purchasing & Supply Purchasing Managers' Indices show the service sector has recorded growth in each of the eight months to December, while the manufacturing index is at a two-year high.

RECESSION COMES TO AN END WITH A WHIMPER • SOME INDICATORS IMPLY RECOVERY MAY BE STRONGER

BUSINESS FINANCIAL PERFORMANCE

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



Firms still report year-to-date falls in gross profits and turnover, but exports have continued to grow over the last 12 months. The reported rate of decline in turnover continued to ease, but the 2% rate of contraction for gross profits has persisted. Firms expect growth to pick up over the next 12 months, with forecasts in line with Q4 2009 levels. Export growth has remained stronger than profit and turnover growth, as businesses have been helped by the weak pound.

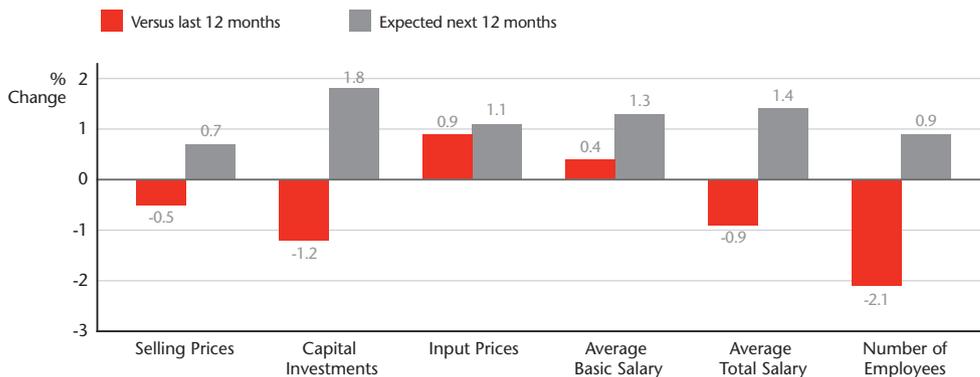
PROFITS STILL DECLINING BUT GROWTH EXPECTED TO RETURN

The year-on-year decline in UK economic output was 3.2% in Q4 2009, an improvement on the 5.1% drop in the previous quarter. In line with this, businesses report a moderation in the pace of decline of annual turnover growth: 1.3% over the 12 months to Q1 2010, the slowest decline since Q2 2009. Firms expect turnover to grow by 4.3% over the next year, below typical growth expectations of 5.0% since the survey began, but up from -0.3% in Q1 2009.

However, reported profit performance continues to weaken. Gross profits declined by 2.1% over the 12 months to date, but remain up from the worst performance on record seen in Q3 2009. Profits are expected to grow by 4.0% over the next 12 months – a far better picture than a year ago when a decline was forecast.

Export growth has been forecast throughout the recession. Firms report a marginal increase in export growth this quarter. Moreover, they forecast exports to grow by 4.1% over the next year, the strongest growth expectations since Q4 2008.

FIG. 5 Q1 2010 – AVERAGE % CHANGE IN...



Despite recent signs of recovery, three in five UK firms are running below capacity.

As the economy declined by around 6% from peak to trough in the deepest recession since quarterly records began, businesses cut back production in response to weakened demand. When the recession began, fewer than half of businesses were running below capacity. Current data demonstrate how far the UK economy has to go to get back to pre-recession levels of output.

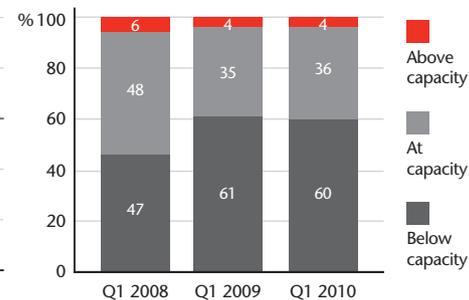
SURVEY IMPLIES PRICE PRESSURES STILL MUTED

Firms report a 0.5% drop in prices over the last year – the largest reported fall in selling prices in the history of the BCM. They expect prices to rise over the next year, but only modestly.

However, input price pressures are on the horizon as commodity prices have risen to reflect the global recovery: oil prices are roughly double what they were a year ago. Businesses report a 0.9% rise in input prices over the last year. Further, input prices are expected to rise by 1.1% in the coming 12 months, the highest forecast since Q1 2009.

FIG. 6 CAPACITY UTILISATION

Running at, above or below capacity

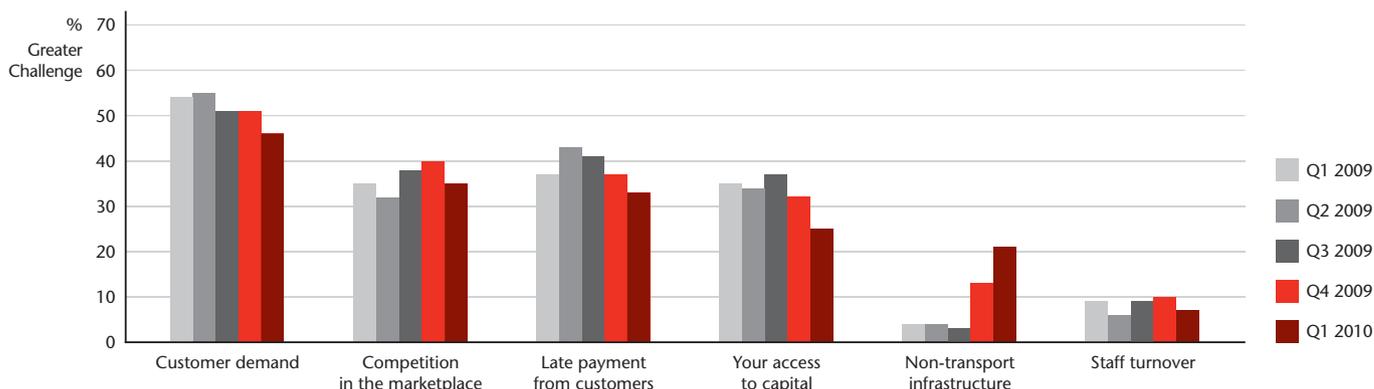


With unemployment at a 14-year high, there is limited pressure on employment costs. Average total salaries have declined by 0.9% over the last year compared with 1.6% annual growth a year earlier. Businesses do expect headcount to grow by 0.9% over the next year and average total salaries to rise by 1.4%. These are the highest growth expectations since Q3 2008 and Q4 2008 respectively, but they are still below typical pre-recession levels.

THREE IN FIVE FIRMS RUNNING BELOW CAPACITY • PRICES FELL LAST YEAR; ONLY MODEST GROWTH EXPECTED

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 7 IMPACT ON ORGANISATION'S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (UK AVERAGE)



This quarter there are tentative signs of an improvement in customer demand as the economy returned to growth. Access to capital also seems to be easing, although one in four businesses (25%) still report this as a greater challenge than 12 months ago. Non-transport infrastructure problems have moved up the agenda for firms recently. More than one in five businesses now report non-transport infrastructure problems as a greater challenge to business performance than a year ago, reflecting disruption to postal services due to Royal Mail industrial action up to the end of 2009.

CUSTOMER DEMAND IMPROVING

A positive trend emerging this quarter was a reduction in the share of businesses reporting customer demand as a greater challenge to performance than a year ago. After the economy returned to growth in Q4 2009, fewer than half of senior business professionals (46%) report customer demand as a greater challenge, down from 51% in Q4 2009 and the lowest level since Q1 2009.

A further sign of improvement is the continued downward trend in the share of businesses indicating potential cash flow problems. The proportion of

businesses reporting late payment from customers as a greater challenge to business performance than a year ago fell to 33%, 10 percentage points below the Q2 2009 peak, although still above typical pre-recession levels of less than 20%.

Non-transport infrastructure problems have become notably more of an issue for businesses over the last six months. In the corresponding quarter a year earlier, just 4% of firms reported this as a greater challenge to their organisation.

TENTATIVE SIGNS OF IMPROVEMENT IN CUSTOMER DEMAND • FEWER FIRMS REPORT ISSUES WITH LATE PAYMENT

FIG. 8 ACCESS TO CAPITAL – CHANGE VERSUS 12 MONTHS AGO

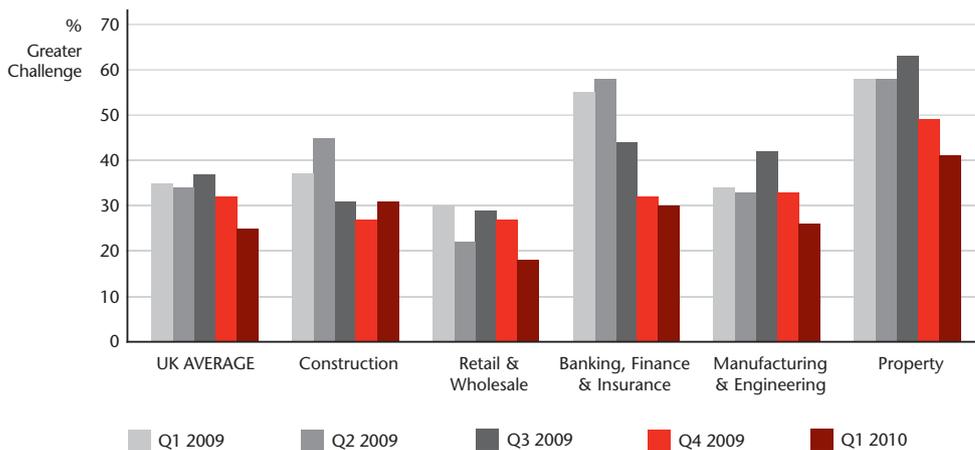
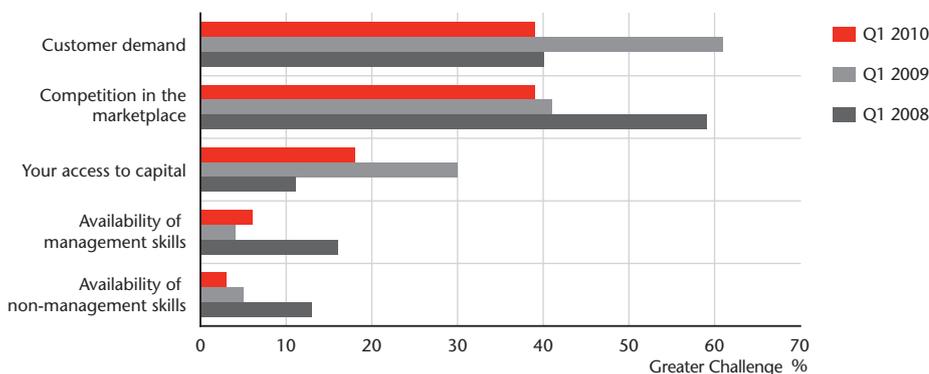


FIG. 9 IMPACT ON ORGANISATION'S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (RETAIL & WHOLESALE)



ACCESS TO CAPITAL IMPROVING STEADILY – FROM EXTREMELY CHALLENGING CONDITIONS

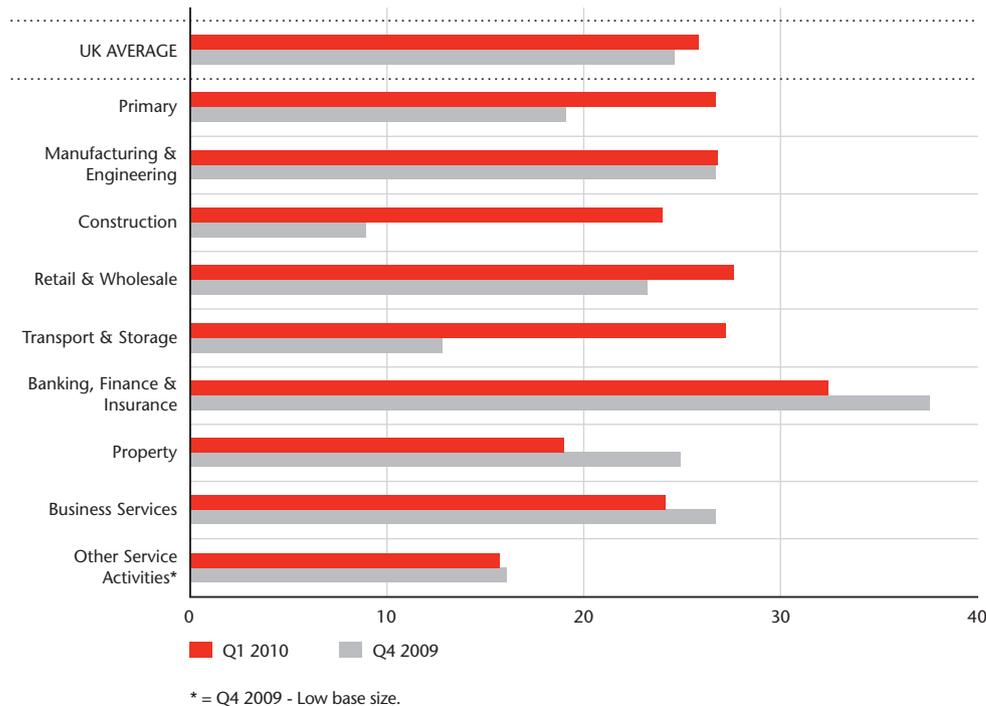
One in four firms (25%) report access to capital as a greater challenge to business performance than a year ago, a 10 percentage point improvement from Q1 2009. This fits with the latest Bank of England Credit Conditions Survey where lenders report improvements in corporate credit availability. However, lending flows remain constrained and the improvements in access to capital are relative to extremely impaired capital market conditions through 2008-09.

In the Retail & Wholesale sector, access to capital is less of a concern than levels of customer demand. Customer demand has improved significantly compared to Q1 2009 with fewer than two in five firms (39%) reporting it to be a greater challenge to performance than a year ago. ONS figures confirmed the consumer spending recession ended in Q3 2009 and many large retailers reported a decent Christmas performance. However, the official picture of retail performance is patchier. Moreover, 2010 is likely to see weak real disposable income growth, constraining consumer spending growth.

TRENDS IN BUSINESS CONFIDENCE

INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence fell back quarter on quarter in some sectors in Q1 2010 but has strengthened across the board over the last year. Despite a slight decline in Q1 2010, confidence in the Banking, Finance & Insurance sector remains strong. Firms in the Transport & Storage and Retail & Wholesale sectors are also positive. However, relatively freespending consumers and the VAT cut have supported retailers of late. Consumers are likely to come under strain from weak earnings growth in 2010 and official retail sales figures imply a mixed picture for retailers, despite strong performance by many large firms.

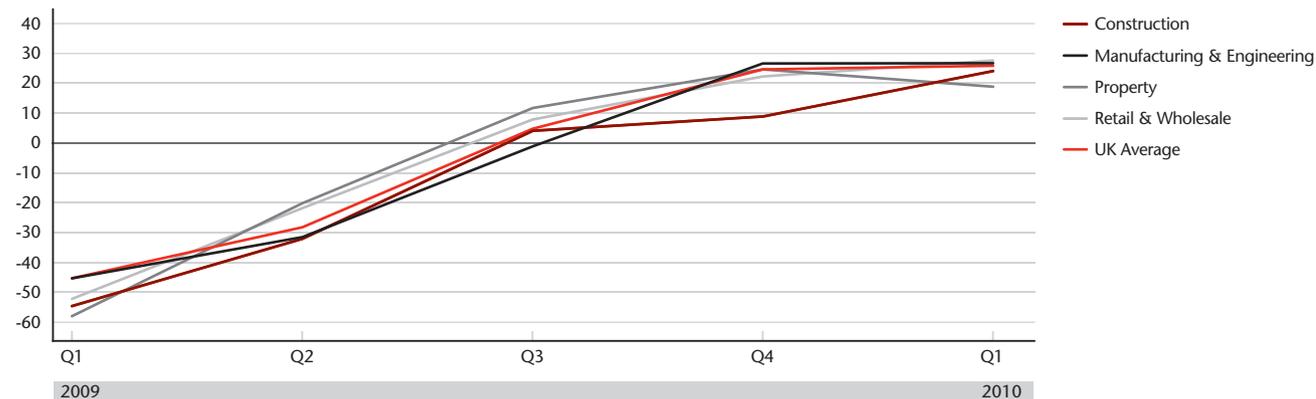
POSITIVE OUTLOOK FOR RETAIL, ALTHOUGH OFFICIAL PICTURE NOT CONSISTENT

Confidence in Retail & Wholesale rose for the fourth consecutive quarter and now stands just above the UK average. Data from the British Retail Consortium suggest robust growth in December retail sales with a 4.2% year-on-year rise, while most large UK retailers recorded impressive final quarter results ahead of the VAT cut reversal.

However, official retail sales figures were less impressive, implying a mixed picture in the sector. Consumer spending in 2010 is likely to come under strain due to weak earnings growth, further rises in precautionary saving and debt repayment.

In the Banking, Finance & Insurance sector confidence weakened slightly for the first time since Q1 2009 as the regulatory environment became more uncertain. However, record low interest rates and the Bank of England's quantitative easing scheme have seen most banks return to profitability: confidence has risen strongly after record lows at the height of the financial crisis.

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence in the Construction sector picked up as the light at the end of the tunnel came into view following a particularly severe downturn. The Construction sector posted the largest gain in confidence in Q1 2010, while Property sector confidence slipped back but still remained above the drastic lows seen a year earlier. Confidence in the Manufacturing & Engineering sector remained solid as growth returned.

CONSTRUCTION AND MANUFACTURING SECTORS BOOSTED AFTER TURBULENT 2009

The largest gain in business confidence this quarter was in the Construction sector – a 15.1 point jump to a Confidence Index of 24.0. The sector has had a tough recession – output fell by 10.5% in 2009 as a whole. However, latest ONS data suggest improvement as year-on-year growth in new orders in November 2009 was at its highest since April 2007.

Recovery in the housing market has surpassed expectations, boosted by a gradual pick-up in lending. In November mortgage approvals reached their highest level since March 2008, before falling back

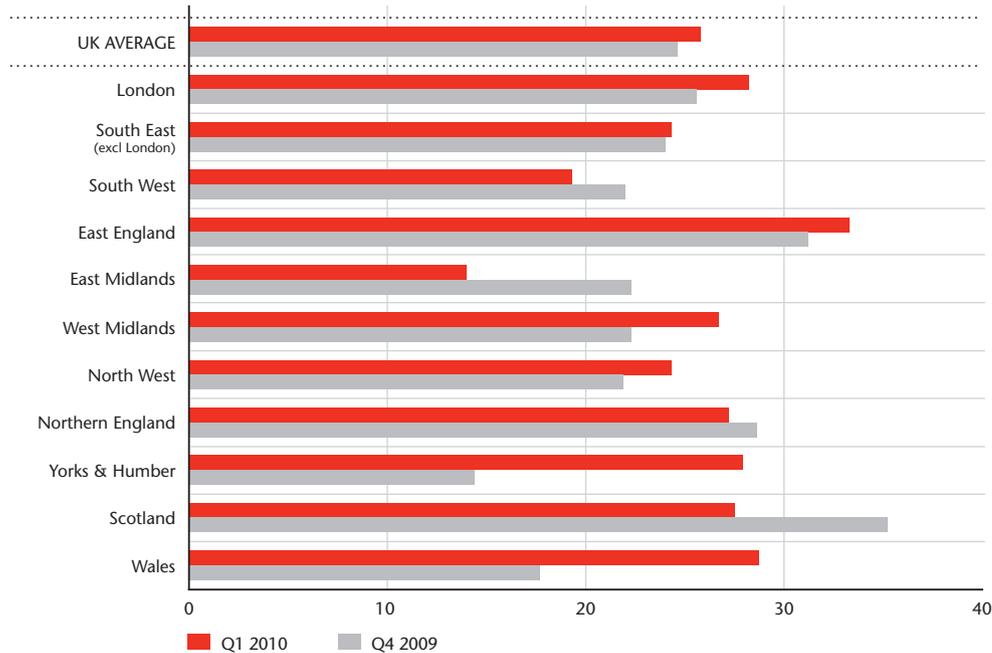
slightly in December. Although confidence in the Property sector has faltered in Q1 2010, over the last year the sector has bounced back more strongly than several others.

Confidence in the Manufacturing & Engineering sector remains at Q4 2009 levels and just above the UK average. There are signs of hope for the sector, including the support of the relatively weak pound. Manufacturing output declined by 10.8% in 2009 having fallen rapidly through the recession. However, growth returned in Q4 2009 with a 0.4% expansion.

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



In Q1 2010 the positive trend in business confidence continued in seven of the eleven UK regions, and every region is now significantly more confident than a year ago. The regions most confident about economic prospects in the year ahead are East of England, Wales and London. Compared to the same quarter last year, the largest increases in confidence were in the West Midlands and London, although Yorkshire & Humber improved most strongly from last quarter, continuing a positive trend which began in Q2 2009.

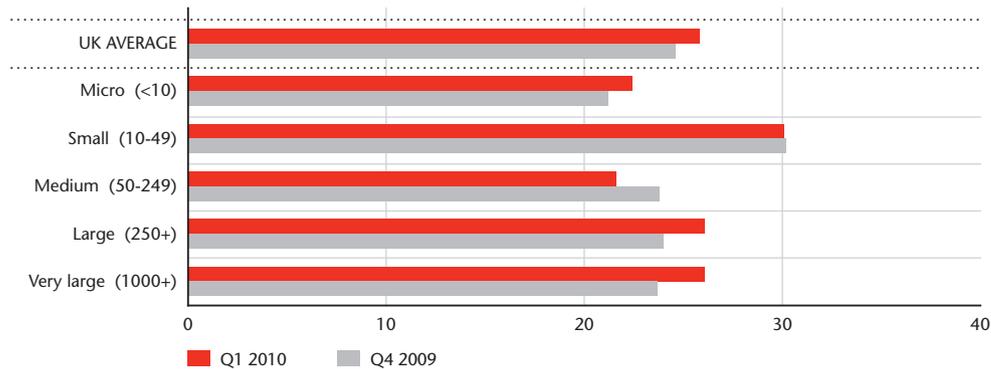
LONDON BOUNCING BACK

Business confidence in the capital improved again; London is now the third most confident of all UK regions. London's Confidence Index rose to 28.2 in Q1 2010, the second largest year-on-year regional gain; last year the region's Confidence Index was deep in negative territory at -52.5. The capital has recorded improvements in confidence in each of the last four quarters, boosted by the recovery in financial services and the positive effects for retailers of the weak pound attracting foreign shoppers.

The regional economy of London – along with the South East and East England – is less reliant than others on the public sector. These regions will be relatively immune to the expected cutbacks in public spending. As the expected fiscal retrenchment hits, it is in regions with the highest dependence on the public sector – the North, North West, Scotland and Wales – which are likely to suffer most. Hence a 'two-speed' recovery is likely which will further widen the divide between the north and south of the UK.

TRENDS IN BUSINESS CONFIDENCE SIZE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY SIZE



Q1 2010 sees little movement in confidence levels for different sizes of business.

The largest businesses record the greatest gain in confidence this quarter; with their Confidence Index now marginally above the UK average. Small firms remain most confident and medium-sized businesses least confident about prospects over the next 12 months, although all are relatively close to the UK average.

SMALLEST AND MEDIUM-SIZED FIRMS LESS CONFIDENT THAN UK AVERAGE

In Q1 2010, confidence for all sizes of business stands well above levels seen a year earlier when all were deep in negative territory. Confidence has changed only marginally within different sizes of business this quarter, with small businesses (between 10 and 49 employees) still the most confident about economic prospects over the next 12 months.

Medium-sized businesses (between 50 and 249 employees) are the least confident while the smallest, Micro businesses, are also marginally less confident than the UK average.

Firms with more than 1,000 employees record a 2.4 point gain in their Confidence Index this quarter, and are now well up from the record low level of -51.6 recorded this time last year.

ALL SIZES OF FIRM RELATIVELY OPTIMISTIC • LITTLE VARIATION, THOUGH SMALL FIRMS MOST POSITIVE

TECHNICAL INFORMATION

This research was conducted by The Institute of Chartered Accountants in England and Wales (ICAEW) with assistance from centre for economic and business research (cebr) and Kudos Research. During the period 28 October 2009–21 January 2010, 1000 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. Data has been weighted to ensure the profile of the survey sample accurately represents the UK economy (by value) for company size (no. of employees), regional location and industry sector.

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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Kudos Research

Interviewing and data analysis was undertaken by Kudos Research.

Kudos Research specialises in premium quality, custom-tailored UK and international data collection, as well as data analysis and research advisory services. Kudos Research interviews customers, stakeholders, business leaders and opinion formers across the globe, online and by telephone, as well as recruiting them for focus groups and depth interviews.



The ICAEW is a founder member of the Global Accounting Alliance, which represents around 775,000 of the world's leading professional accountants in over 165 countries around the globe, to promote quality services, share information and collaborate on important international issues.

As a world-class professional accountancy body, the ICAEW provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry to maintain the highest standards.

Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

Because of us, people can do business with confidence.

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