



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS

IN ENGLAND AND WALES

Q4 2008

UK BUSINESS CONFIDENCE MONITOR

National Summary Report



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The findings of this quarter's ICAEW *UK Business Confidence Monitor* (BCM) clearly show that some businesses are suffering as the fall-out of the recent crisis in the global financial system spreads. While I don't think anybody is yet in a position to predict when normality will return, our data does offer glimmers of hope.

First, there are indications that the outlook in the financial services sector may be about to turn a corner, and second - as observed in Q3 2008 - businesses continue to take the right defensive actions to protect cash and bottom line; projected growth in discretionary spending remains low.

The Bank of England's decision to cut interest rates by 1.5% is a bold move to help the UK get through the recession which we all now believe is imminent. At this time, the focus must be on ensuring businesses survive in the short to medium term. I'd remind them they are not alone. If needed, they have access to professional advice and guidance to test options for any difficult business decisions. Looking to the future, the right choices now will ensure businesses are positioned to take advantage of the economic recovery when it comes.

Please visit www.icaew.com/bcm for further analysis and detail about BCM.

A handwritten signature in black ink that reads "Michael Izza". The signature is fluid and cursive, with the first name "Michael" and the last name "Izza" clearly distinguishable.

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

Q4 2008 KEY POINTS

- Business confidence declines for a sixth consecutive quarter to reach new record low as the UK economy contracts for the first time since 1992.
- There are tentative signs that confidence may have bottomed out in Banking, Finance & Insurance businesses after the announcement of the government's rescue package for the sector.
- Construction, Property, Wholesale & Retail, and Hotels & Catering sectors remain most pessimistic, with Business Services sector also below national average.
- Reported growth in turnover and profits continues to decline with expected profit growth at a record low.
- Expectations for lower input cost inflation due to the rapidly cooling global economy mean firms expect to contain output price rises.
- Evidence of a cooling labour market – UK firms expect negligible growth in head count next year, while staff turnover and availability of skills now considerably less of a challenge for many firms.
- Recent inflationary period likely to be short-lived while economic slowdown deepens; Bank of England's decision to cut rates so decisively in November should start to rebuild confidence.

FOREWORD

MARK PRAGNELL, cebr – ECONOMIC ADVISER TO THE ICAEW

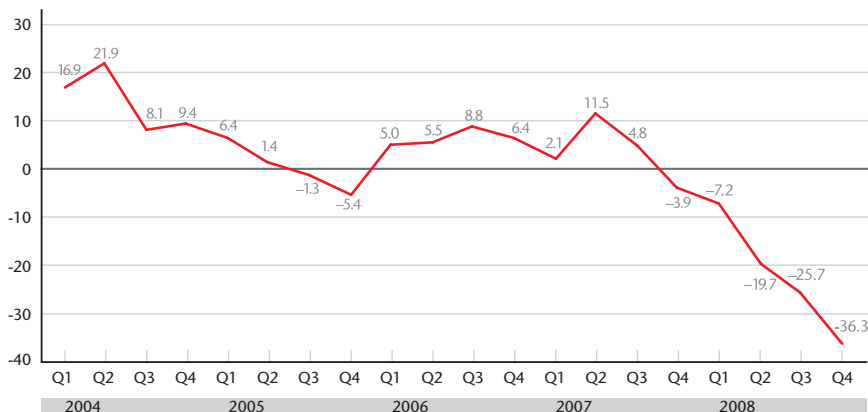


CONFIDENCE FALLS FURTHER AS BUSINESSES FEAR FINANCIAL CRISIS WILL BECOME ECONOMIC DRAMA

Since our last report three months ago, we have seen the credit crunch become one of the most momentous failures the global financial system has experienced. Now the attention is rightly turning to impacts on the so-called real economy as official data from both sides of the Atlantic show major economies contracting.

The latest findings from the ICAEW *UK Business Confidence Monitor* paint an increasingly bleak picture for businesses as the financial crisis looks set to become an economic drama. Confidence nationally has fallen to its lowest level since the survey began in 2003. The same is true for the vast majority of regions and sectors. The question is: how much further can confidence fall and how long until we see a recovery?

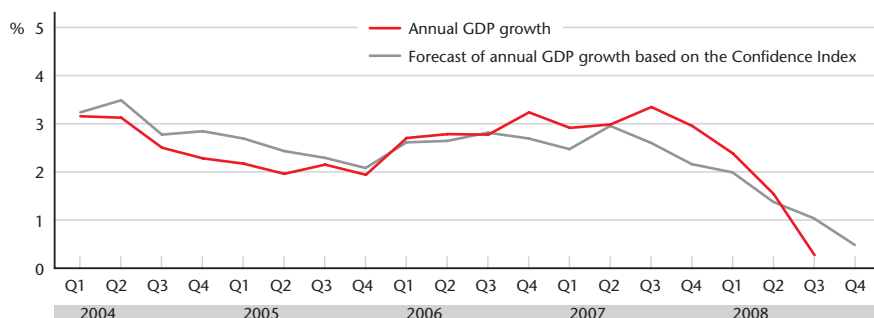
Fig. 1 Trend of UK Business Confidence



Source: ICAEW *UK Business Confidence Monitor*

The Confidence Index has been a solid guide to growth prospects in the UK economy. Preliminary figures from government statisticians suggest the UK economy shrank by 0.5% in the third quarter compared with the previous quarter; the largest quarterly contraction since late 1990. This brings year-on-year growth down to just 0.3%. The depth of this contraction was deeper than forecast by the *UK Business Confidence Monitor*, which suggests businesses have been surprised by the speed with which the economy has slowed, or – as has happened previously – that the preliminary official data may be subject to revision.

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

AFTER THE FINANCIAL CRISIS ...

Following the collapse, takeover and rescue of financial institutions across the globe, the credit crunch is now being compared by many to the Great Depression. I'd go further and suggest the intensely globalised nature of financial markets in the 21st century makes this crisis unprecedented. Around the time of the last *UK Business Confidence Monitor* report, we argued that government intervention was essential to get interbank, and ultimately mortgage, lending moving again. As the crisis intensified the British Government has reacted decisively. The recently announced three-pronged attack on the crisis – addressing liquidity concerns; recapitalising bank balance sheets; and guaranteeing interbank lending – is, in our view, appropriate and comprehensive, but is it too late?

DECISIVE ACTION BY BANK OF ENGLAND ON INTEREST RATES

The economy is now contracting and businesses are downbeat, although November's unprecedented 1.5% cut in base rate by the Monetary Policy Committee should begin to re-build business confidence. Having been sceptical for some time about the likely persistence of the inflationary episode which emerged earlier this year, it is now clear to me that inflationary pressures have not spread to the wider economy. Indeed, there is now a real and growing risk of deflation next year.

Although the official CPI measure hit 5.2% in September, average earnings grew by only 3.2% over the year to August. In addition, core inflation excluding energy and food remains contained at 2.2% and commodity prices have fallen dramatically as markets adjust to impending recession among the advanced economies. Notably, oil prices have dipped to \$60 a barrel, under half their peak of \$147 a barrel in July.

The emphasis is now shifting quite rightly from concerns over inflation to how deep and protracted the recession will be. Having instituted the biggest ever base rate cut since taking over operational responsibility for setting interest rates, the Bank of England should look to revive recession-hit businesses and consumers by reducing interest rates responsibly at the start of 2009.

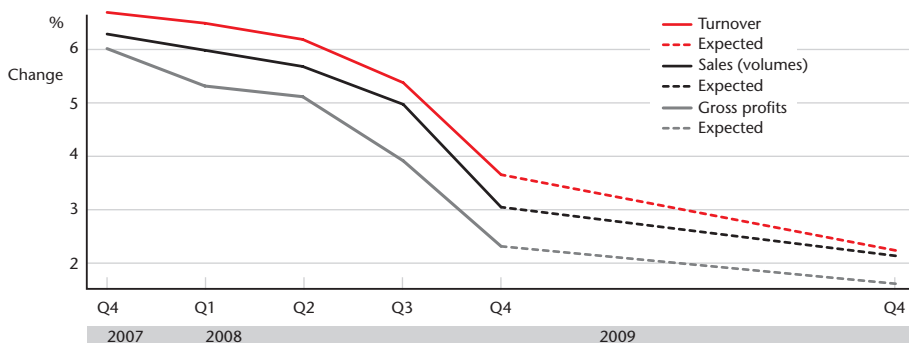
Mark Pragnell
Managing Director, cebr
Economic adviser to the ICAEW

MAIN FINDINGS

BUSINESS FINANCIAL PERFORMANCE

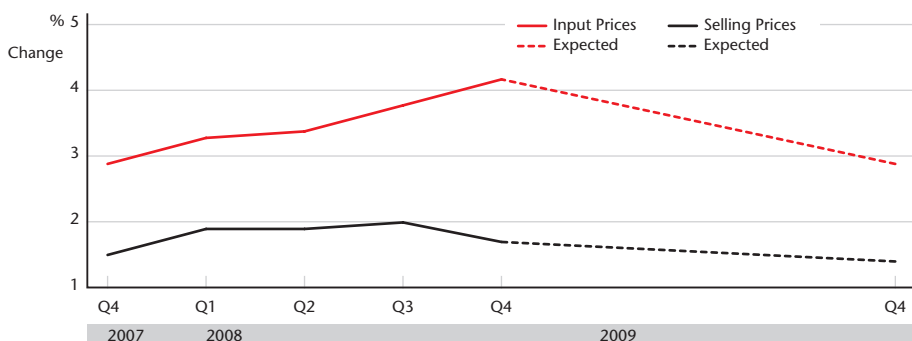
The challenging economic environment leads firms to expect turnover growth to weaken from a reported 3.7% over the last 12 months to just 2.3% over the next 12 months. This is expected to be driven in particular by slowing domestic sales growth. Profit growth is also expected to weaken. Having grown by 2.3% over the last year – the weakest performance since the *UK Business Confidence Monitor* began – profits are expected to grow by just 1.6% over the coming 12 months.

Fig. 3 Change over 12 months to...



After seeing profits squeezed by input price inflation over the last 12 months, the rate of input cost growth is expected to slow next year, a positive impact of the rapidly cooling global economy. This, combined with increased spare capacity in the UK, leads firms to expect their selling prices to be contained over the next year; inflationary pressures are dissipating, justifying the Bank of England's decision to cut rates so decisively in early November.

Fig. 4 Change over 12 months to...



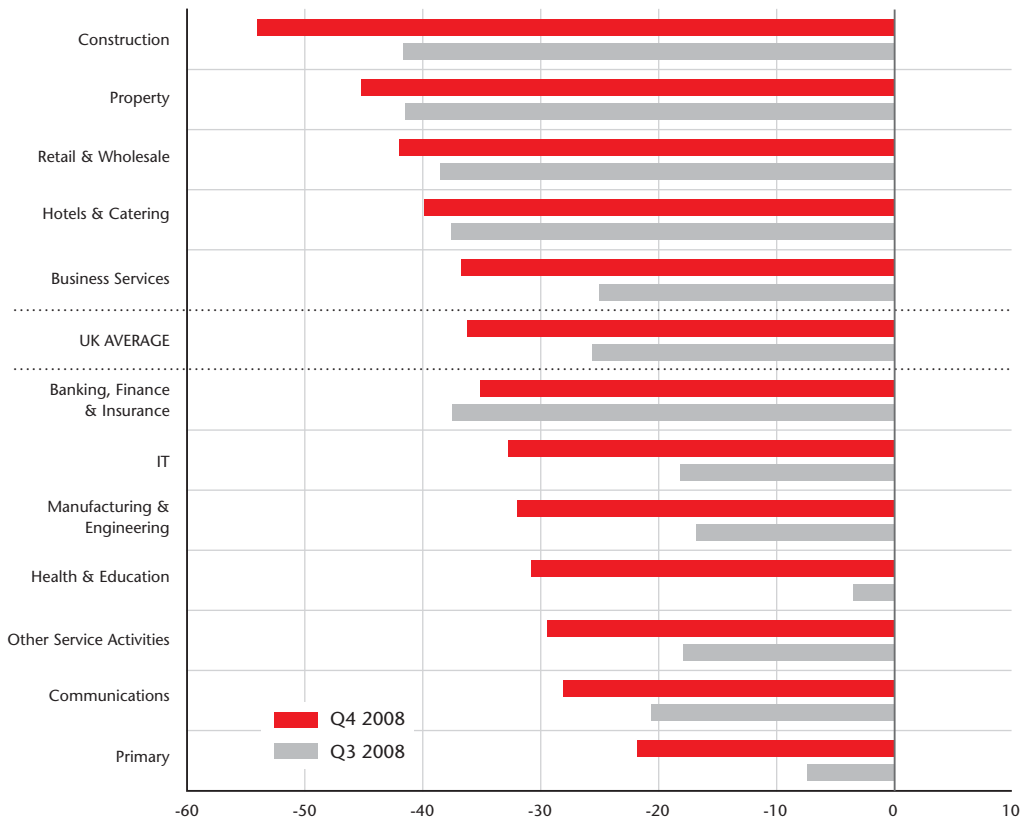
As borrowing remains constrained and the economic future uncertain, firms are displaying caution across the board, with staff numbers expected to be pretty much unchanged over the coming year and capital investment and R&D budgets also being hit.

TRENDS BY INDUSTRY

With a globally coordinated banking rescue in full swing, confidence in the Banking, Finance & Insurance sector may have begun to rebuild as the sector's Confidence Index improved very marginally this quarter. While confidence remains fragile, this movement may be a tentative sign that business professionals see a little light at the end of the financial crisis tunnel.

However, the sharp fall in confidence seen in Q3 for the Business Services sector has been followed by further decline as the impact of the economic slowdown on their clients' budgets feeds through.

Fig. 5 BCM Confidence Index Trend

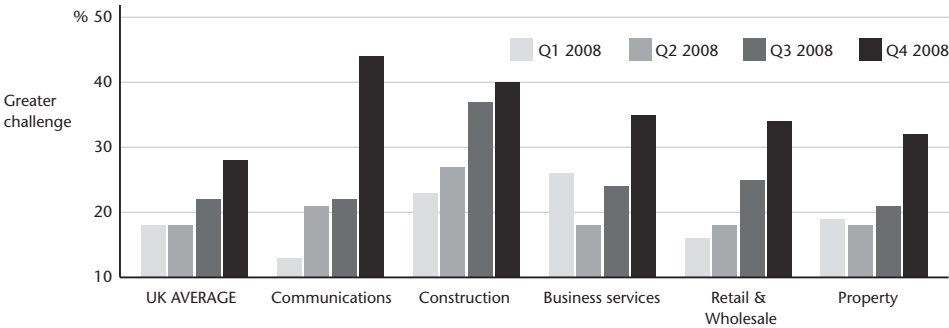


Across other sectors the economic crisis in the UK continues to take its toll. The Construction and Property sectors are again least confident. The Construction sector faces major challenges from the combined aspects of the property market downturn and difficulties accessing and restructuring finance. Property sector confidence has been at this low level since Q2. The volume of completed transactions in the housing market is currently below half that seen a year ago; confidence has perhaps not fallen further due to the more buoyant residential lettings market.

Firms in sectors heavily exposed to the fortunes of the consumer – Retail & Wholesale, Hotels & Catering - continue to record low confidence as they are increasingly aware that the recession will make trading conditions difficult. In Q2 2008, real consumption expenditure actually fell and is likely to have fallen further in Q3.

Confidence in the Primary sector fell sharply in Q4 as global commodity prices also fell, while low export demand is anticipated by Manufacturing firms, despite the weak pound suppressing confidence further.

Fig. 6 Late payments from customers – change versus 12 months ago



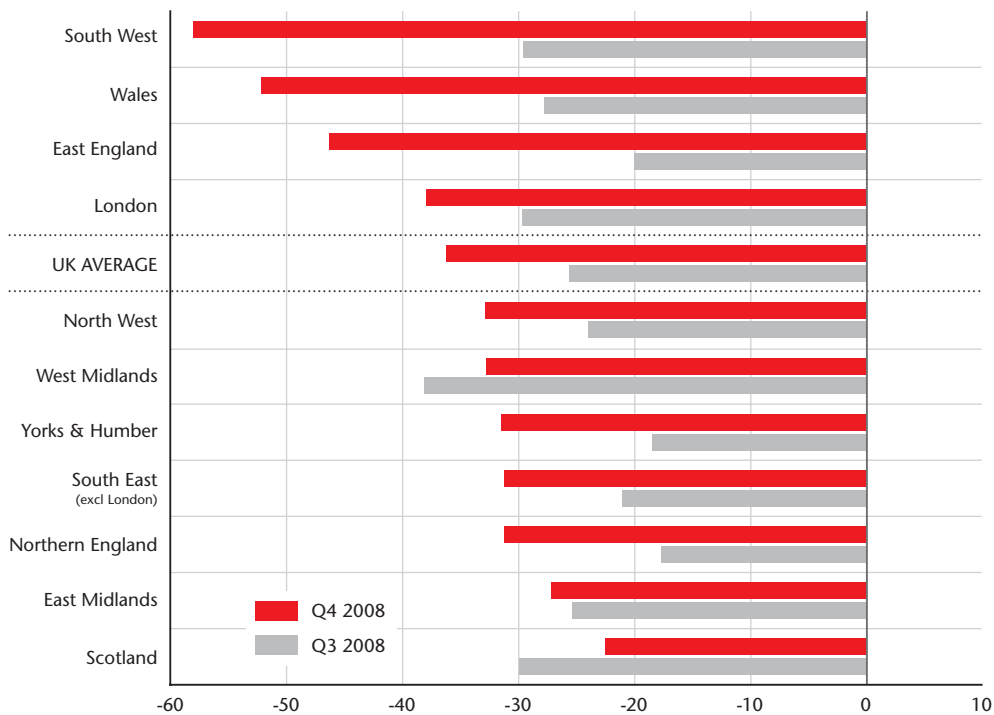
As access to credit remains constrained, late payment from customers is emerging as a major challenge for businesses. Almost one firm in three identifies this as a greater challenge to their success than 12 months ago with the Communications (comprising physical distribution and telecommunications), Construction, Business Services, Retail and Property sectors worst affected.

CONFIDENCE ACROSS UK REGIONS

Confidence has declined further in all but two regions across the UK. In eight of the eleven regions the Confidence Index stands at its lowest ever, and is below -20 in all regions. Confidence in London is now at a new all-time low. The South West, Wales and East England are the least confident regions.

House prices have fallen by more than the UK average in all these three regions. Latest Land Registry data shows that house prices are falling faster in Wales than in any other UK region, with prices 10.7% lower in September than a year earlier. The South West is heavily exposed to the leisure industry, so is likely to be suffering from the squeeze on consumer spending.

Fig. 7 Business Confidence by Region



Confidence improved slightly in Scotland and the West Midlands, but both these regions had already experienced sharp falls in confidence in previous quarters. In Scotland, the large financial services sector may have been boosted by news of the government bank rescue package reducing uncertainty over banks' futures.

CONFIDENCE BY SIZE OF BUSINESS

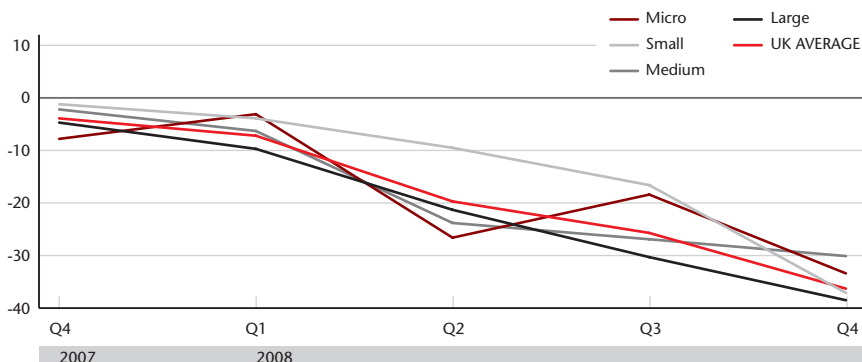
The fourth quarter sees a gloomy outlook across all sizes of UK businesses.

The largest firms – those with 250 or more employees – continue to be the least confident with a Confidence Index below the UK average at -38.5, a new record low. In addition, this quarter sees a sharp decline in the Confidence Index among small firms (10 – 49 employees), down by 20.5 points to marginally below the UK average.

The outlook for the smallest firms is increasingly challenging. Micro firms (less than 10 employees) also record a significant 15.0 point drop in Confidence Index in this quarter, reaching a new record low.

The largest firms are suffering as the prospect of a broad-based slowdown across the UK and global economies is becoming a reality, while the smallest firms face major challenges from crisis-stricken banks becoming ever more cautious with their lending.

Fig. 8 Trend of Business Confidence by Company Size



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).

During the period 30 July to 24 October 2008, 1001 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 was 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.

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 is applied to each response as shown below, and an average score calculated:

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

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 and the full question set available upon request.

DETAILED RESULTS AND FURTHER INFORMATION

For more detailed results and analyses, and further information on BCM please visit

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