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# UK Business Confidence Monitor

## Q3 2015

BUSINESS WITH CONFIDENCE

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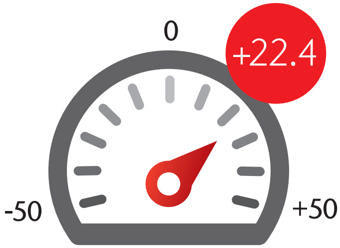
Q3 2015

## Overall confidence




boosted

## Turnover growth

stable

## Export growth

challenges remain

## ▶ Key points

Business confidence boosted by post-election bounce, although remains lower than a year before.

Turnover and profit growth is stable and expected to stay so, helping to shore up confidence levels.

Export growth is picking up and businesses are optimistic about future sales, although challenges remain.

## ▶ Implications

It is encouraging to see an uptick in confidence, no doubt attributed to a clear-cut election result which has reduced uncertainty. Spare capacity has reached its lowest level since 2008, which should provide a small boost to productivity, however any further improvement down the line will be hampered by the indication of weaker investment and the increase in skills shortages.

Overall, while business performance as reflected by sales and profit improvement stays strong, there remains a sense of uncertainty and caution as evidenced by the cash piles companies continue to accumulate. This is not surprising, given current events in Greece and geopolitical risks in other parts of the world. Domestic demand is buoyant and the first real increase in wages for several years will underpin this in 2015, but a lack of growth in exports is still a concern. Low to zero inflation could improve company profitability but it may also constrain price increases, and in sectors such as oil & gas it has adversely impacted investment.

## Capital investment

no plan for increase

## Average salary growth

holds up

## Availability of non-management skills

growing problem

## ▸ Key points

Capital investment plans continue to be cut back, a trend that may impact on productivity increases further down the line.

Wage growth stays on hold at 2%, despite zero inflation weakening employees' wage-bargaining power. Households are seeing significant gains to real spending power as a result.

Skills shortages and staff turnover are a growing problem for more companies and may start to weigh on the growth outlook ahead.

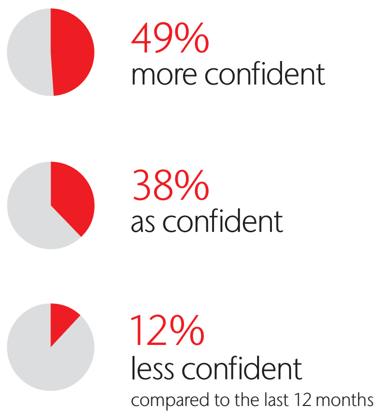
## ▸ Implications

Looking a little further ahead, the Bank of England seems to be signalling an interest rate increase, perhaps even later this year. While this is not likely to be large it will be something that many young businesses have never experienced, and could have a disproportionate effect on business confidence. The next BCM should indicate whether this has impacted on business confidence.

The living wage, apprentice levy and dividend tax changes announced in the Budget far outweigh the benefits from a corporation tax cut. So while confidence remains high with a boost from the election result, the future is uncertain and as a whole businesses are likely to continue to be cautious, prudent and accumulate cash.

# Business confidence in Q3 2015

Fig. 1 Trend of UK business confidence


## Confidence edging up as economy looks stable

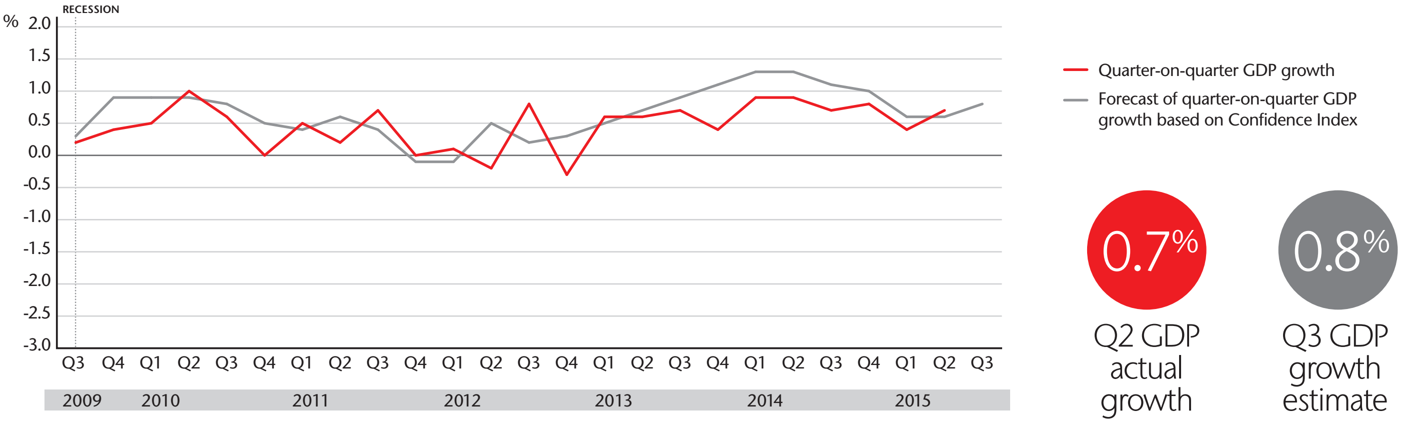
### Key highlights

**The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) showed optimism starting to rise again in Q3 2015, although it remains down on the same point a year before. The Confidence Index now stands at +22.4, up from the readings of between +16 and +17 in the first half of the year.**

This quarter's increase in the confidence reading marked the first pick-up in optimism since Q1 2014. Within the headline result, roughly half (49%) of businesses expect more favourable conditions in the next 12 months, up from 45% last quarter. At the other end of the scale, fewer businesses are less confident about the next 12 months – the proportion now stands at 12% compared to Q2's 18%.

One factor that is likely to be helping boost confidence this quarter is the end of the uncertainty caused by the general election. The rapid formation of a majority government means that businesses now have a clearer idea of how the political landscape will look over the next five years, reducing some of the unpredictability. However, with a Conservative majority, a referendum on Britain's membership of the EU is near certain – a factor that may start to create more unease as the potential date draws closer.

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




## Consumer spending continues to drive UK economy

### Key highlights

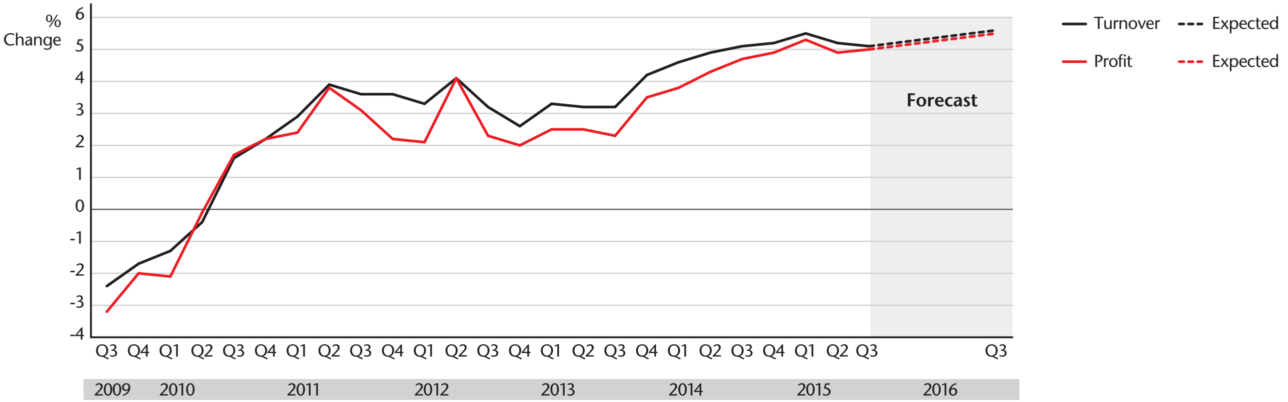
**The first estimate of UK GDP growth for Q2 2015 showed a return towards the pace of expansion seen throughout much of 2014. Output was 0.7% higher than in Q1 2015, up from the growth of just 0.4% seen last quarter, supported by faster rises in the Services sector and the mining & quarrying industry.**

With inflation currently standing around the zero mark, consumers are seeing significant gains to their real incomes and discretionary spending power at the moment. As such, the Office for Budget Responsibility (OBR) expects total consumer spending growth to accelerate to 3.0% during 2015, up from 2.5% last year. This is in contrast with forecasts for the other components of GDP: growth in government spending and business investment is projected to slow this year, with net trade continuing to make a negative contribution.

However, inflation is expected to pick up again later in the year, eroding the pace of growth in household real incomes and acting as a brake on consumer spending. Increases in the Bank of England's base rate in late 2016 or early 2017 will also weigh on the finances of mortgage holders. These factors come alongside a strong pound and weak eurozone economy holding back export growth, as well as deeper government spending cuts planned for next year. As such, GDP growth in 2016 is likely to slow to some extent from the performance this year.

# Business financial performance

Fig. 3 Turnover and profit – average % change




## Business performance continues to hold firm

### Key highlights

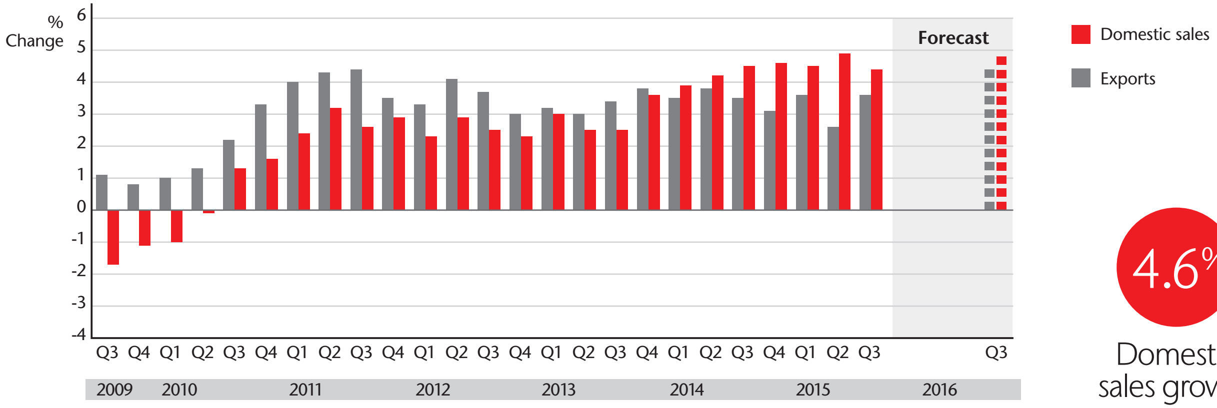
**Private sector turnover and profit growth stood broadly unchanged this quarter, with both increasing over the past year by around 5%. Growth has fluctuated only marginally around this level since Q3 2014, highlighting the relatively stable trading conditions that may be helping to support business confidence.**

Reflecting the fairly steady business conditions in recent quarters, the share of firms reporting that levels of customer demand are a greater challenge now than a year ago stands relatively low, at just one in three businesses (34%). This is well down from over 50% during 2009, and averages of around 40% before the financial crisis.

With trading conditions remaining buoyant, the number of business failures has fallen back to its lowest level since the end of 2007. According to figures from the Insolvency Service, there were just over 4,300 insolvencies on the latest data for Q1 2015, down from a peak of over 7,000 in the depths of the recession.

In addition, despite the economic pressures previously outlined that are likely to emerge into 2016, businesses are optimistic about their performance, projecting profit and turnover growth to continue at over 5% during the next 12 months.

Fig. 4 Domestic sales and exports – average % change




4.6% Domestic sales growth

3.6% Export sales growth

## Export growth up despite slowing world trade

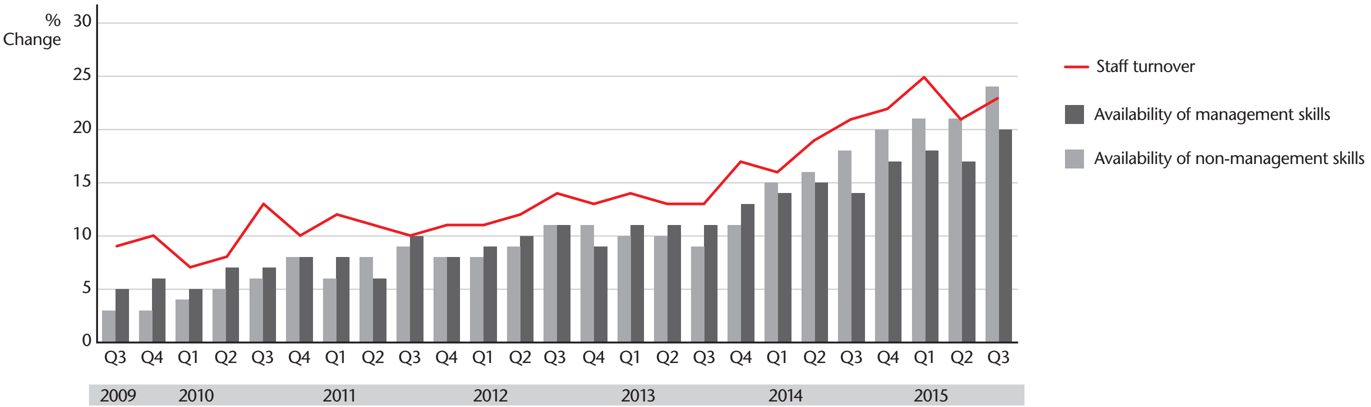
### Key highlights

**This quarter, firms report export growth of 3.6% over the past year. Although this is up from a weaker increase in Q2, the latest pace of growth is roughly in line with that seen earlier in 2015 and at the same point a year ago. In addition, businesses are buoyant for export growth over the next 12 months, projecting a rise of 4.4%.**

This relatively robust performance reported by UK businesses comes at a time when world trade growth is falling back: figures from the Netherlands Bureau for Economic Analysis show that global trade volumes declined month on month in May, and remained only marginally up on the same point a year before. OBR forecasts suggest that GDP growth in the eurozone and across the globe as a whole will accelerate in 2016, a trend that may boost export sales further in the UK. However, there is significant risk attached to this projection, with a Greek exit from the eurozone remaining one factor that could significantly disrupt economic expansion.

Domestic demand, meanwhile, has provided firms with stability in recent quarters, with domestic sales rising by 4.6% over the past year – a figure that hasn't changed notably since early 2014. This trend is projected to continue over the next 12 months, supported in large part by consumer spending, and in turn likely to help boost business confidence.

Fig. 5 Staff turnover and availability of skills as a greater challenge




## Skills shortages exceed pre-crisis levels

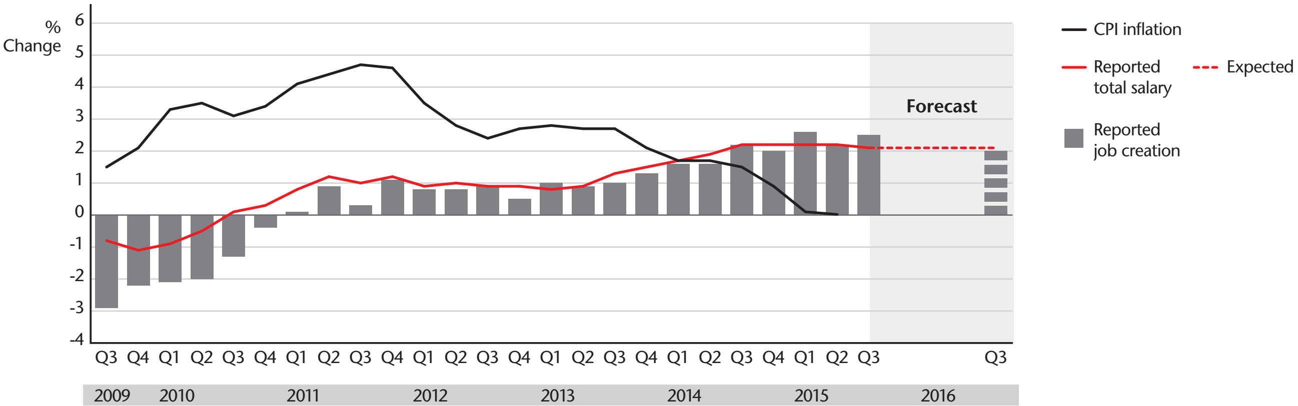
### Key highlights

**This quarter, nearly one in four businesses (24%) report that the availability of non-management skills is more of a challenge than a year ago. This is the highest proportion since comparable data began at the end of 2007 and, as such, suggests that skills shortages are now more acute than before the financial crisis.**

As well as non-management skills, the availability of management skills is a rising challenge for 20% of businesses this quarter, up from 17% at the same point a year before. In addition, staff turnover appears to be a concern for more companies than 12 months ago, suggesting employees may be switching roles between firms more often than before – a sign of a buoyant jobs market.

Perhaps in response to rising skills shortages, businesses have accelerated growth in their staff development budgets to between 1.5% and 2% in recent quarters, up from around 1% in 2013 and in line with increases seen before 2008. This effort may go some way to reducing the negative impact that a skills gap would have on UK growth – however, it may not be sufficient. Long-term unemployment (over 12 months) remains much higher than before the financial crisis, which may well be leading to significant skills atrophy. If businesses wish to continue increasing headcounts, additional staff development may be needed to re-train workers that have been unemployed for a long time.

Fig. 6 Employment, salary and consumer price growth (CPI) – average % change




## Wage growth holds up despite 'no-flation'

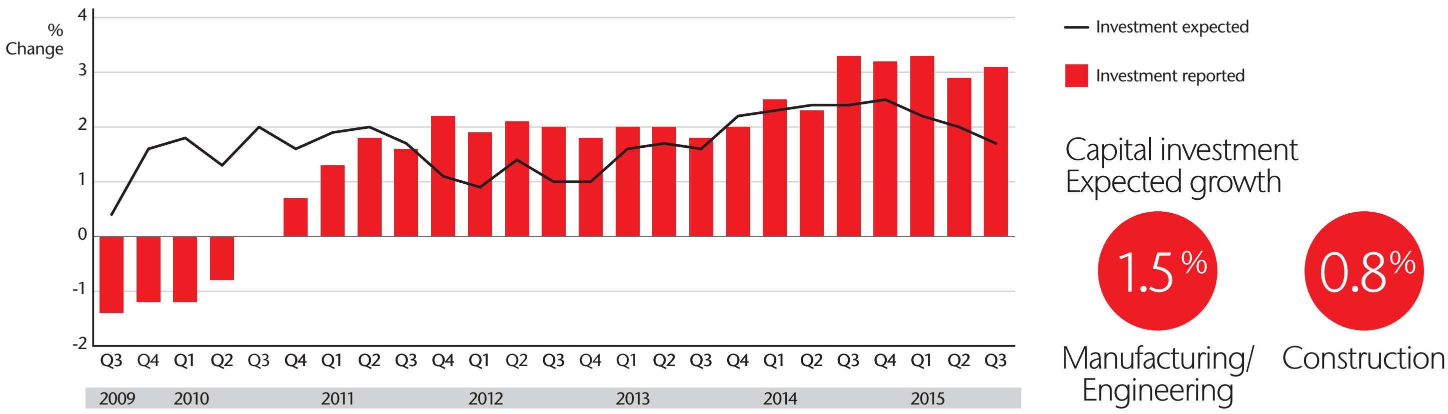
### Key highlights

**Businesses continue to report increasing wages year on year by just over 2%, and expect to see the same pace of growth over the next 12 months. This stable pay growth comes despite consumer price inflation dropping to zero, thus reducing both employee wage-bargaining power and the pressure on the growth of inflation-linked salaries, and it may be driven by the intensifying skills shortages.**

With inflation at zero, the latest 2.1% year-on-year rise in nominal salaries is passed through entirely into increased household real incomes. This factor is likely to help support growth in consumer spending and economic output across much of 2015. However, as the effects of last year's sharp drop in the price of oil dissipate, inflation is projected to start rising towards the end of the year. This will erode real wage growth and weigh down on spending power.

Employment growth, meanwhile, is expected to slow in the year ahead to 2%, down from the 2.5% headcount increase seen over the past 12 months. The unemployment rate is likely to reach pre-financial crisis levels in 2015, reducing the pool of available workers. However, there are still a significant number of workers employed only part time since they can't find a full-time job. This share is projected to fall by the end of the year, as businesses increase hours – a trend that may boost productivity.

Fig. 7 Investment – average % change




## Businesses continue to cut back investment plans

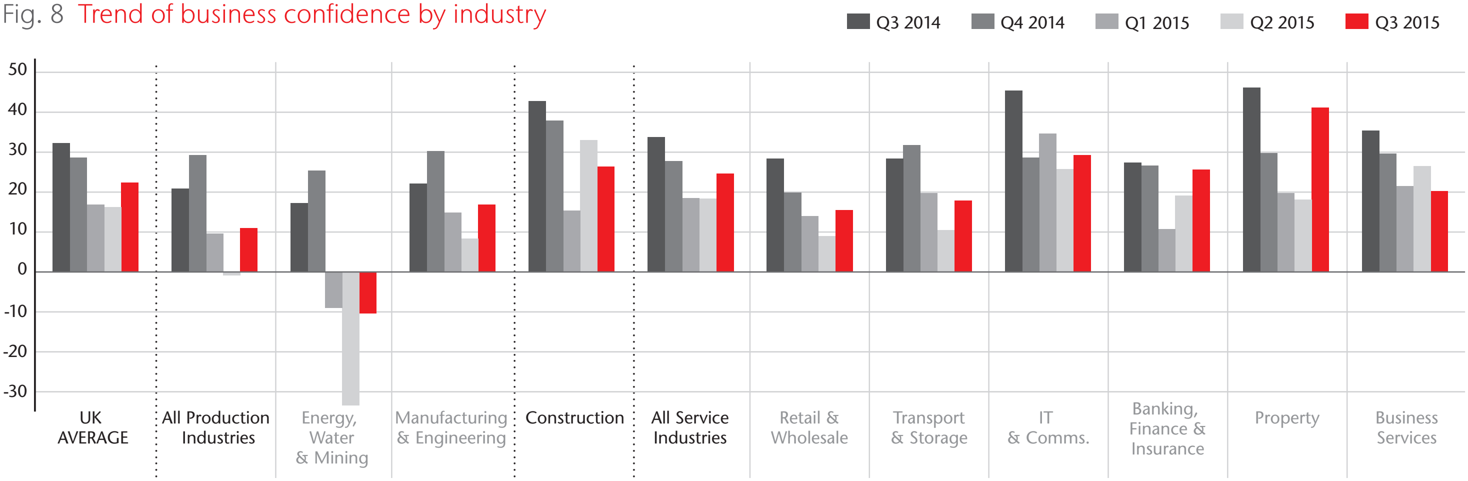
### Key highlights

**Although annual capital investment growth remains elevated this quarter, businesses are reducing their plans for growth over the next 12 months. This quarter, firms report year-on-year capital spending growth of 3.1%, but expect to increase expenditure by just 1.7% over the 12 months ahead. This trend is seen across most sectors of the economy, although particularly so in construction, manufacturing and logistics.**

Reduced business investment plans are concerning for UK economic prospects, as it means that sources of growth will be less diversified over the year ahead, with more of the onus being on the consumer sector to drive expansion.

These latest expectations come alongside the finding that spare capacity has fallen back to levels not seen since early 2008, when the recession had only just begun. This would typically be a sign of improving economic health, suggesting that productivity levels are rising and that greater investment may be needed ahead. The fact that investment intentions are actually on the way down may point to the continued uncertainty that still lies in the medium-term outlook, such as the prospect of the UK's exit from the eurozone. This is discouraging as, without continued business investment, it will be harder for productivity to rise over the longer term, limiting the extent to which GDP per person can rise, and hence the extent to which living standards can increase.

Fig. 8 Trend of business confidence by industry




## Banking, Finance & Insurance sector sees confidence strengthening

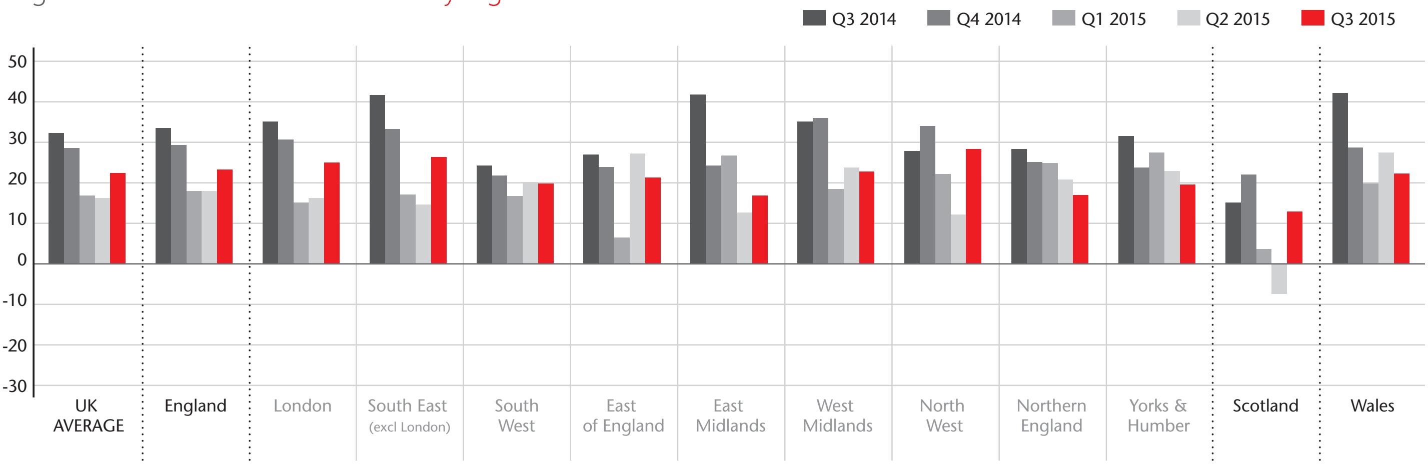
### Key highlights

**The Banking, Finance and Insurance sector has now seen its confidence readings rise for two consecutive quarters, leaving the level roughly in line with Q3 2014. Optimism levels have also recovered to some extent this quarter in the Energy, Water & Mining sector, following the impact on confidence in Q1 and Q2 from the sharp decline in the price of oil, but remain well below a year before.**

The two consecutive quarters of rising confidence in the Banking, Finance & Insurance sector reflect positive data emerging from the Office for National Statistics. Output in financial services has now regained positive year-on-year growth, for the first prolonged time since 2009. In part this is fuelled by more buoyant merger and acquisition activity, with figures showing the number of overseas purchases by UK companies rising sharply in recent quarters. With business activity on the up, this quarter's BCM shows firms in this sector hiring new staff at an accelerated rate.

However, one part of the economy where confidence remains under pressure is in manufacturing, where the optimism index is one of the lowest in the UK and is down on a year ago. Sterling standing at its strongest against the euro since 2007 may be one factor weighing on confidence and projections for export sales. Manufacturers typically export a greater share of their output than the Service sector does, but they project export growth to fall back over the next year, in contrast to the UK overall.

Fig. 9 Trend of business confidence by region




## Northern powerhouse may be boosting confidence in North West

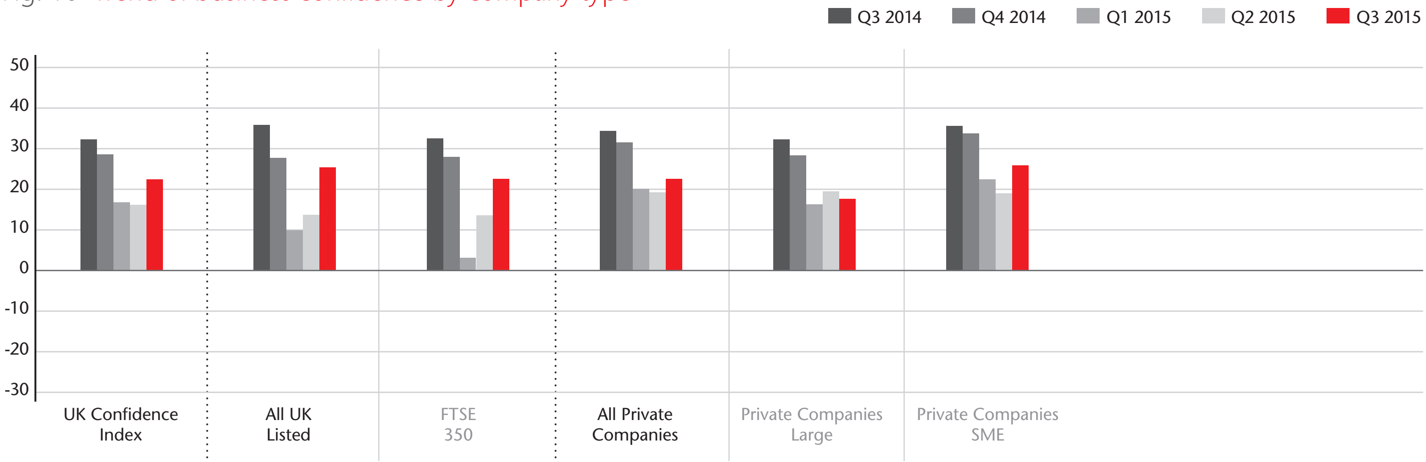
### Key highlights

**The Confidence Index for the South East and London picked up notably this quarter, boosted by stronger optimism in the Banking, Finance & Insurance and Property sectors. However, even in these regions, confidence levels remain below the highs seen at the same point a year ago. Optimism around much of the rest of the country remains more subdued, holding largely flat compared to the previous quarter.**

However, one other part of the UK where confidence levels are on the rise this quarter is the North West, with Greater Manchester acting as the focal point for the start of building the 'Northern powerhouse'. The prospect for greater devolution of government powers to the city and region may be helping to boost the confidence of local businesses. The North West has seen strong employment growth in Business Services since 2013, with the sector comprising 10% of all jobs now, up from 6% before the financial crisis. This is a sector that is likely to help drive UK economic growth over the medium term, and should help to continue boosting employment in the region.

Scotland also saw a recovery of confidence this quarter, with the headline index rising back into positive territory, as the oil companies of the Energy, Water & Mining sector became less pessimistic. Rising optimism levels in the Banking, Finance & Insurance sector are also likely to be playing a part, with the notable financial services sector of Edinburgh helping to boost the confidence reading.

Fig. 10 Trend of business confidence by company type




## Staff turnover becoming more of a challenge for listed firms

### Key highlights

**Confidence has been picking up noticeably over the past two quarters among the UK's listed firms, including those in the FTSE 350. The headline index for these firms is now well up on the near-zero seen at the start of the year as export growth has picked up and is expected to do so further. Optimism among private companies, meanwhile, has been steadier recently, perhaps reflecting a greater dependence on the stable domestic market.**

Staff turnover is now more of a challenge than a year ago for nearly three in ten listed companies (28%) – a share that has been gradually creeping up over the past few years, from just 12% in Q3 2011. By contrast, the proportion of privately-owned companies citing this as a growing challenge has remained relatively flat over the past three quarters, at the lower level of 20%.

With a tightening labour market, this trend among publicly-listed companies is likely to continue, and may start to spill over into private firms. Lower levels of unemployment and emerging skills shortages mean that many new hires at businesses will need to come from other companies, rather than the pool of jobless workers – a factor that may start to weigh on economic growth if the skills gap is not addressed by the private sector or government.

# 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 policymakers, 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 a continuous research programme of approximately 4,000 telephone interviews each year with ICAEW members working in industry and commerce. This probes opinions on past performance and future prospects for members' businesses, and investigates perceived changes in the impact of factors such as availability of skills, government regulation and the tax regime. Data are weighted to represent the UK economy by value.

For further technical details please see: BCM Technical Appendix at icaew.com/bcm

### 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 on 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.

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## UK Economic Forecast

Produced with Cebr, ICAEW's economic partner, this quarterly newsletter provides a forward-looking perspective on how the UK economy is going to develop over the next 12 months.

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These quarterly newsletters provide a unique perspective on the prospects for each region as a whole and for individual economies against the international economic background.

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