



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

UK BUSINESS CONFIDENCE MONITOR REPORT

Q4 2009



WELCOME



The latest *ICAEW UK Business Confidence Monitor* (BCM) sees our Confidence Index firmly in positive territory following three consecutive quarters of improvement. The view from our members, which echoes what I hear as I travel around the country, is that the UK economy is in better shape than this time last year.

Although we are still on track for a return to economic growth, the recovery is very fragile and will take time. Tightening of fiscal policy, the return of the 17.5% VAT rate, continued difficulties accessing finance and consumers on a budget at Christmas are all potential threats to this recovery.

Since its introduction in 2003, BCM has provided a regular snapshot of the state of the economy, informed by senior business professionals advising and 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.

We cannot overemphasise enough the fragility of the recovery. November's Queen's Speech and the *Pre-Budget Report* are effectively the starting gun for next year's general election. Policy makers need to be careful that the measures they announce support the recovery rather than unintentionally threaten it.

Please visit www.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
The Institute of Chartered Accountants in England and Wales

ECONOMIST'S VIEW



The latest *ICAEW UK Business Confidence Monitor* (BCM) shows confidence continued to rise for a third consecutive quarter. The record high in the Confidence Index is partly explained by businesses' comparing their confidence to a period of economic turmoil which included the Lehman collapse and the steepest half-year decline in economic activity since records began. Nonetheless, the clear majority of businesses are now confident that the recovery is in train.

This improvement in confidence implies the UK economy is on the path back to growth. However, this encouraging trend is set against the backdrop of a disappointing Q3 first estimate for economic growth from the Office for National Statistics (ONS). This indicated the economy shrank for the sixth quarter in a row, making this the longest recession on record.

KEY ISSUES EMERGING THIS QUARTER

- Firms are forecasting reasonable growth in profit, turnover and sales over the coming year, though from a lowered base. All three contracted in the year to date.
- There are signs that the inventory cycle has started to turn, with a slight decline in the proportion of firms in the Manufacturing, Construction and Transport sectors reporting stock levels below normal.
- The outlook in the Banking, Finance & Insurance sector has continued to improve as banks rebuild balance sheets after the financial crisis. However, for the wider business community access to capital remains an issue, with one in three firms still reporting that the challenge of securing finance is worse than a year ago.

We have been consistently cautious about the strength of the recovery as unemployment rises and consumers look to pay off debt. Moreover, the area that keeps deteriorating even as others show signs of improvement is the UK's public finances.

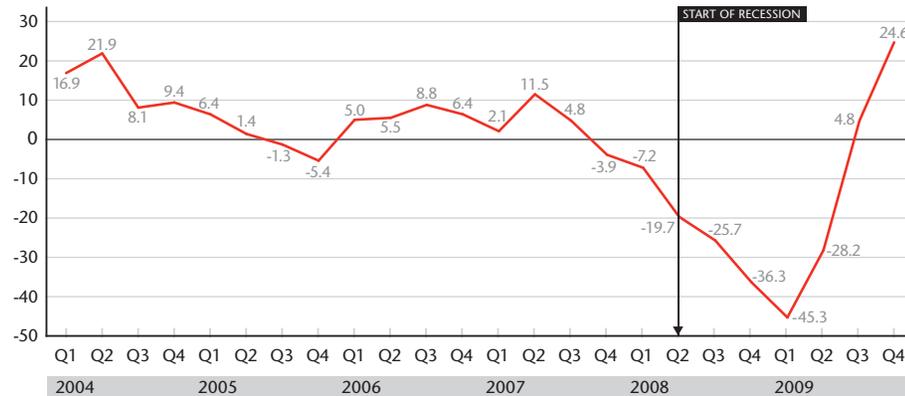
With record peacetime borrowing projected in the next two fiscal years, the next parliament is likely to see considerable fiscal consolidation – a combination of tax rises and public spending cuts – which will act as a drag on economic growth in 2010 and beyond. As such, we expect interest rates to remain low as the Bank of England does all it can to help the UK economy return to health.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q4 2009

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



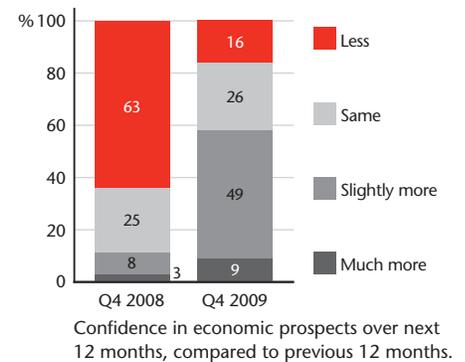
The latest ICAEW *UK Business Confidence Monitor (BCM)* sees the third successive improvement in confidence.

The Confidence Index has moved to its highest-ever reading following an all-time low in Q1 2009. This rise in confidence perhaps represents an overriding sense of relief that firms have survived the turbulence of the last two years.

ECONOMY ON PATH TO RECOVERY

The latest findings from BCM show the Confidence Index at a record high of 24.6, up from 4.8 last quarter. Confidence has now improved for three consecutive quarters, reflecting some improvement in the UK economy. Almost six in ten businesses are now more confident about the economic prospects facing their organisation over the next 12 months compared to the last 12 months. This is up from just over one in ten in the Q4 2008 BCM.

FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES

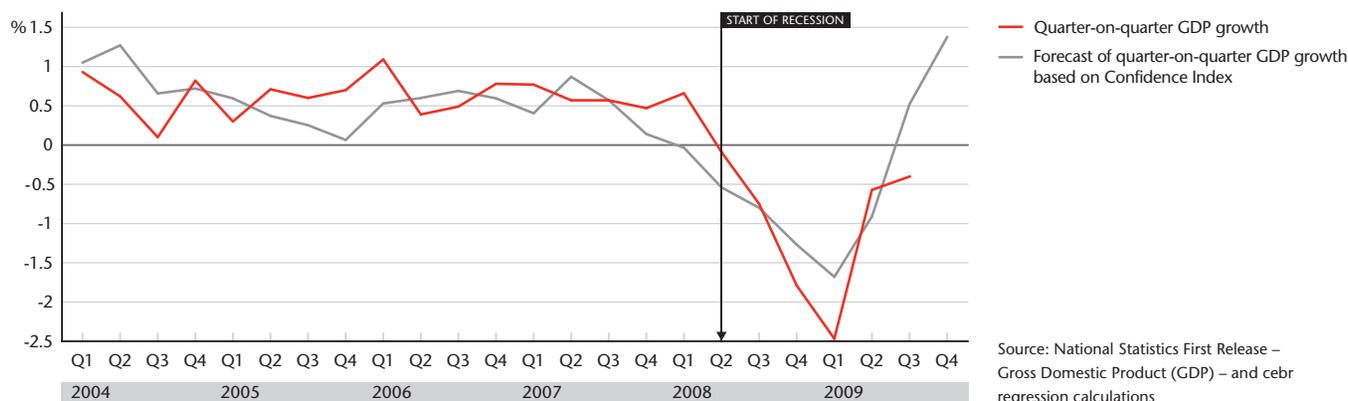


The Confidence Index tracks senior business professionals' perceptions of the outlook for the coming year relative to the previous 12 months. This point of comparison encompassed the most severe parts of the recession, with the economy declining by 5.2% over the latest year to date for which data are available. Hence caution is required when interpreting this improvement in confidence.

Moreover, the vast majority of those who are more confident about the economic prospects facing their organisations report they are slightly rather than much more confident.

HIGHEST EVER CONFIDENCE INDEX • FIRMS RELIEVED THEY SURVIVED TURBULENCE OF LAST TWO YEARS

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



The latest BCM Confidence Index indicates the UK economy is on track to return to economic growth. The economy has declined by 5.9% from peak to trough in this recession. The ONS first estimate of Q3 2009 showing GDP had contracted further was disappointing, especially in the global context where the US, Germany, France and Japan have all pulled out of recession, and China and India have bounced back remarkably well.

MORE SIGNS OF IMPROVEMENT FOR UK ECONOMY

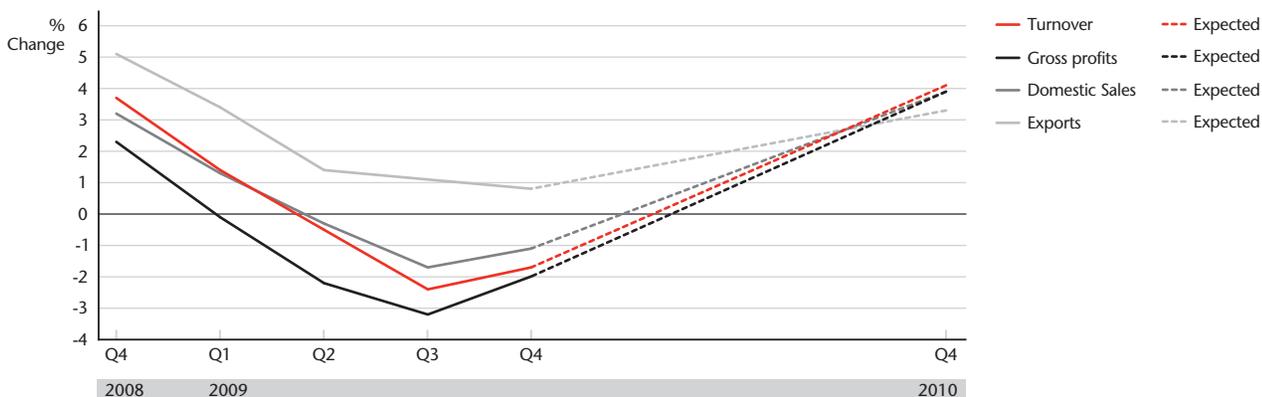
Despite the first estimate of GDP growth, a variety of indicators have shown improvement in recent months. According to the Chartered Institute of Purchasing and Supply's Purchasing Managers' Indices, the service sector has recorded growth in each of the six months to October, while the manufacturing index jumped to its highest since November 2007. The latest official data on industrial output shows production rose by 1.5% in September, although this follows particularly poor downwardly revised figures for August.

The UK economy is undoubtedly in better shape than this time last year, and the strong improvement in confidence shows the relief businesses feel to have kept their heads above water.

Economic recovery remains fragile, however. Bank lending is structurally below pre-recession levels. The latest Bank of England data show that net lending to the private sector fell in five of the six months up to September. Moreover, unemployment continues to rise, the fiscal stimulus will soon be withdrawn as the VAT cut is reversed, and fiscal policy is likely to tighten in the years ahead.

BUSINESS FINANCIAL PERFORMANCE

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



Firms still report declines in gross profits, turnover and sales over the last 12 months. However, the reported rates of decline have eased and businesses expect a reasonable rate of growth to return over the next year. Exports have held up over the last year, supported by improved UK competitiveness due to the 25% depreciation in sterling compared to pre-recession levels.

FIRMS EXPECT GROWTH TO RETURN TO BOTTOM LINE

With UK year-on-year economic output down 5.2% in Q3 2009, it is not surprising that the firms surveyed by BCM report declines in turnover, sales and profits over the last 12 months. However, the pace of reported contraction has eased. Firms reported a 3.2% decline in gross profits over the 12 months to Q3 2009 but the reported rate of decline improved to -2.0% in Q4 2009.

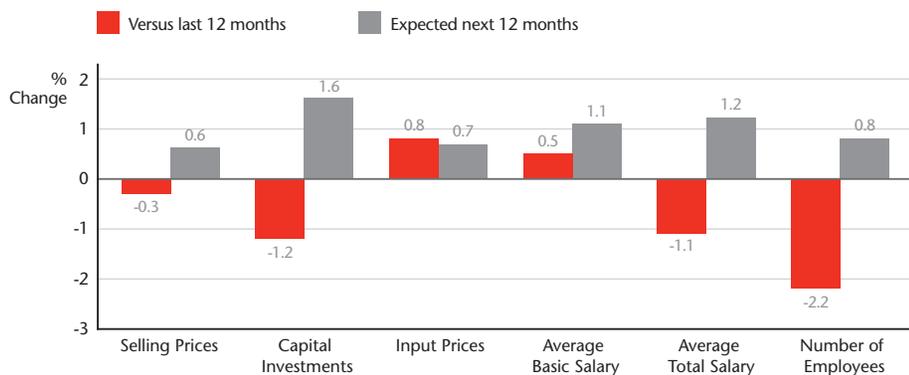
Firms expect gross profits to grow by 3.9% over the coming 12 months – the strongest growth forecast since Q2 2008, when the UK economy entered recession.

In line with this, firms expect domestic sales to grow by 3.9% over the next 12 months, a rate of growth also close to Q2 2008 levels.

With sterling still some 25% down from pre-recession levels, firms report positive export growth over the last 12 months – at 0.8% – while many other indicators are in negative territory. Exports are expected to grow by 3.3% over the coming 12 months, the strongest outlook in a year as export markets have started to recover and the weak pound offers a helping hand.

RATES OF DECLINE EASE FOR TURNOVER, PROFITS, SALES • WEAKER STERLING HAS SUPPORTED EXPORTS

FIG. 5 Q4 2009 – AVERAGE % CHANGE IN...



This quarter firms show some increased willingness to invest.

Over the next 12 months capital investments are forecast to increase by the greatest proportion since Q1 2008, albeit from a very low base. Official data for Q2 2009 show that business investment declined by 19% from the pre-recession peak. A modest pick-up in expected salary payments is also forecast by firms for the coming year, but expected pay growth is relatively weak as there is still considerable slack in the labour market.

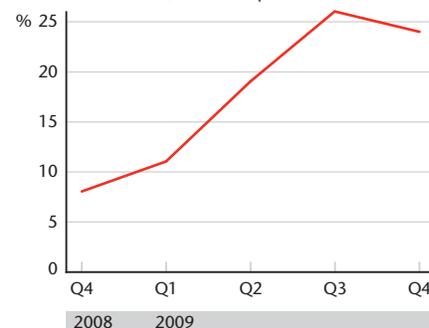
STOCK LEVELS STABILISE AS INVENTORY CYCLE STARTS TO TURN

This quarter's BCM suggests the inventory cycle is starting to turn. The share of businesses in the Manufacturing, Construction and Transport sectors reporting stocks of raw materials below normal levels has stabilised. With inventory levels low following months of de-stocking, there will be a boost to overall economic activity as firms now replenish stocks.

Firms report a 2.2% drop in the number of employees over the last 12 months, a slightly smaller contraction than recorded in Q3 (-2.9%). Firms now expect to grow their workforce over the next year

FIG. 6 STOCK LEVELS. RAW MATERIALS AND COMPONENTS

BELOW NORMAL, Manufacturing, Construction, and Transport sectors

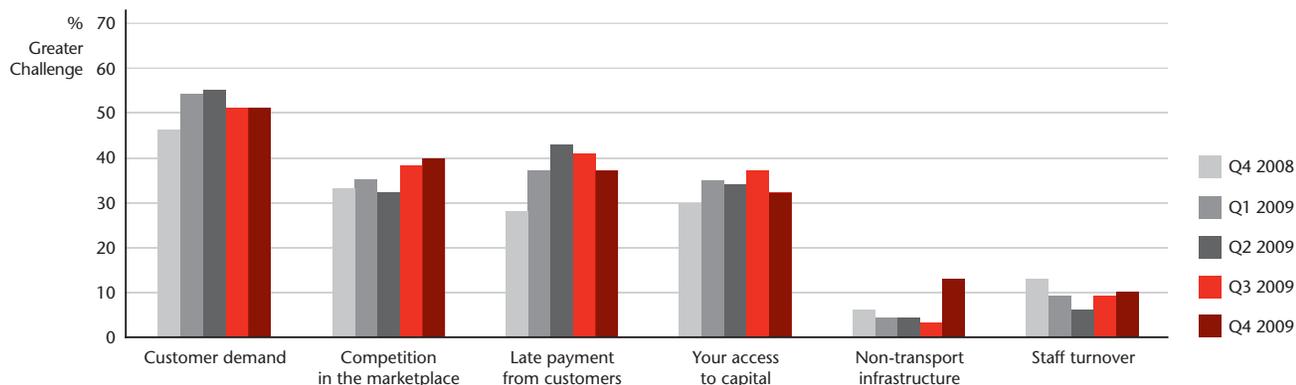


although, at 0.8%, forecast growth is below typical pre-recession levels. In addition, forecasts for pay growth remain historically weak, with the average basic salary expected to grow by 1.1% over the next 12 months, around two percentage points below pre-recession norms.

There are few signs of looming inflationary pressures. As well as modest wage growth expectations, input price growth is expected to be relatively subdued at 0.7%. With demand still fragile, firms expect to raise selling prices by just 0.6% over the coming year.

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

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



Non-transport infrastructure problems have moved up the agenda for firms in the Q4 2009 *UK Business Confidence Monitor*.

This coincides with the protracted Royal Mail unofficial – and now official – industrial action and shows that businesses are concerned about the disruption this is causing. Customer demand is also reported as a greater challenge by one in two firms, a situation which has persisted throughout 2009, while pressure from competitors remains consistent.

ACCESS TO CAPITAL AND LATE PAYMENTS STILL CAUSE CONCERN

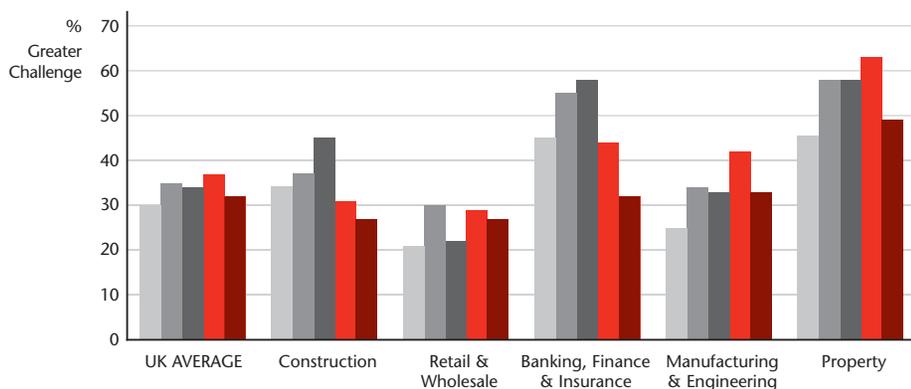
Access to capital is still a major concern for businesses, with one third (32%) of firms reporting it to be a greater challenge to business performance than 12 months ago. This is down from the peak seen last quarter, but remains above the level recorded in the same period last year. Moreover, the enduring impact of the credit crunch is evident over the longer term: at the end of 2007 just 12% of businesses reported this trend.

As the recession has taken hold, cash flow has become more important than ever. The proportion of firms

reporting that late payment from customers is a greater challenge to performance than a year ago peaked at 43% in Q2 of this year. This quarter, concerns over late payments have eased a little, although they remain elevated, with 37% reporting late payments as a greater challenge.

In line with the slack labour market, the proportion of firms reporting staff turnover as a greater challenge to performance than a year ago remains low at 10%. In the final quarter of 2007 nearly one in four firms (23%) reported this trend.

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



PROPERTY FIRMS MOST LIKELY TO FEEL IMPACT OF TIGHT LENDING

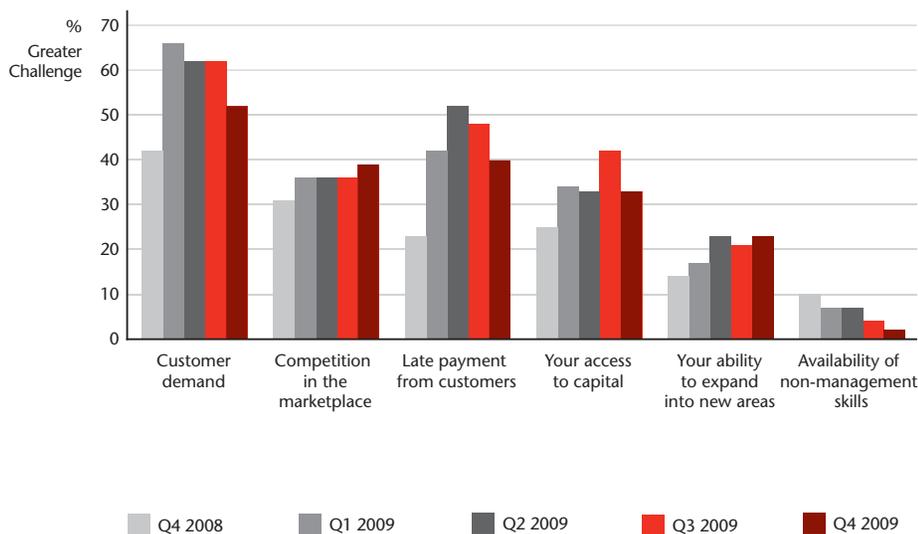
This quarter, BCM results show that firms in the property sector continue to be more likely than those in other sectors to report access to capital as a greater challenge to business performance than a year ago. However, the situation appears to have improved somewhat from last quarter. On the commercial side, much reduced property values mean limited security for borrowing, while for those involved with domestic property, success is linked to the flow of mortgage lending, which is still at much reduced levels.

For the Manufacturing sector, access to capital remains of less concern than weak customer demand and late payments, although both of these challenges have abated somewhat this quarter.

A trend of strengthening competition also seems to be emerging in this sector – understandable with manufacturing output down by 15% from peak to trough in this recession.

On the positive side, the Manufacturing sector is benefiting from the slack labour market through a ready supply of skilled labour.

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

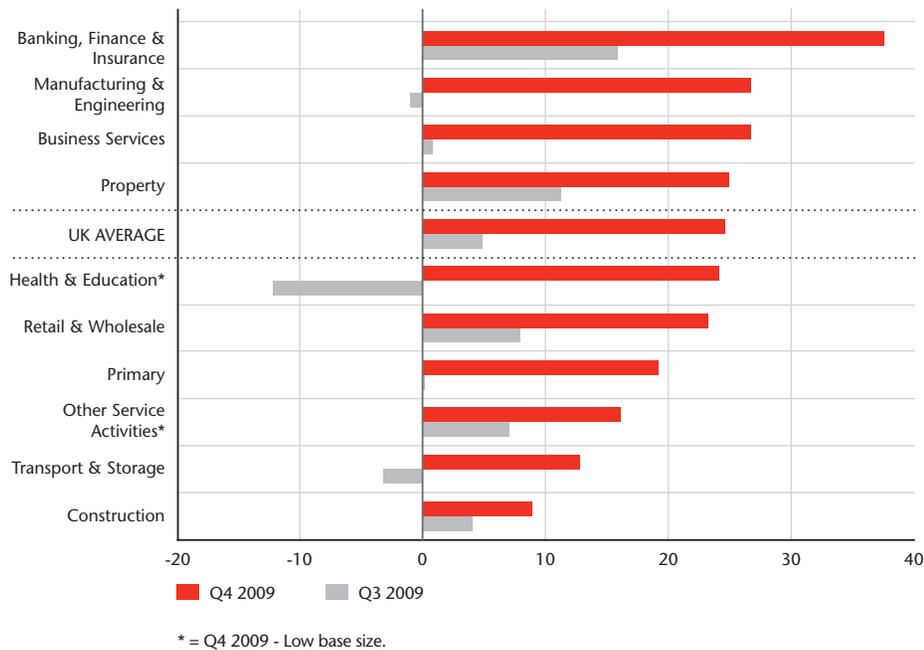


WEAK ACCESS TO CAPITAL IMPACTS PROPERTY SECTOR MOST • MANUFACTURING OUTPUT DOWN 15%

TRENDS IN BUSINESS CONFIDENCE

INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence strengthened across all sectors for the second consecutive quarter. The Banking, Finance & Insurance sector is considerably more confident than the rest of the economy. The official first estimate of economic output in Q3 2009 shows that the service sector contracted by 3.8% year-on-year compared with a 10.4% annual decline in industrial output; the service sector has been less severely affected by the recession. The Construction sector is the least confident in Q4 2009.

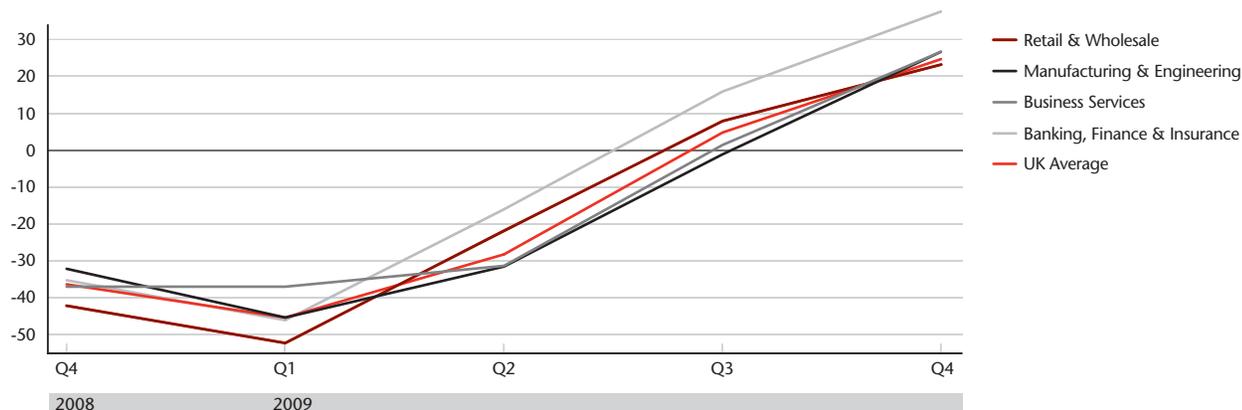
BANKING, FINANCE & INSURANCE SECTOR CONFIDENCE SOARS

This quarter BCM shows the third consecutive significant improvement in confidence for the Banking, Finance & Insurance sector. The sector's Confidence Index has risen by 21.7 points, following a record 31.9 point jump in Q3 2009. The Banking, Finance & Insurance Confidence Index is now 72.8 points higher than a year ago – the largest year-on-year rise in confidence recorded for any sector. Firms in the sector expect gross profits to rise by 4.8% over the next year, a sign that businesses are rebuilding their balance sheets.

Confidence in the Property and Business Services sectors has also strengthened, reflecting relief that service sector business prospects appear to be improving after a period of contraction which has proved manageable.

The Construction sector remains in the doldrums compared to other sectors, with confidence 15.7 points below the UK average. The ONS estimated a 13.0% year-on-year decline in construction output in Q3 2009.

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence in the Business Services and Manufacturing & Engineering sectors moved above the UK average this quarter, both having been below average in Q3 2009. Official data show that the manufacturing sector grew in the months of June and July before suffering a steep drop in August and a return to growth in September. Overall, there are signs of stabilisation as the inventory cycle turns but the recovery remains fragile.

CAUTIOUS OUTLOOK FOR CONSUMER

The Retail & Wholesale sector recorded its third consecutive improvement in confidence in this quarter, although the rate of improvement has slowed compared to the last two quarters. August and September retail sales data showed weakness, and there may also be some trepidation regarding the return to the 17.5% rate for VAT.

Consumer spending has been boosted by the VAT reduction and Bank of England rate cuts. However, as unemployment continues to rise and earnings growth remains weak, a more cautious consumer may emerge. Indeed, the latest national

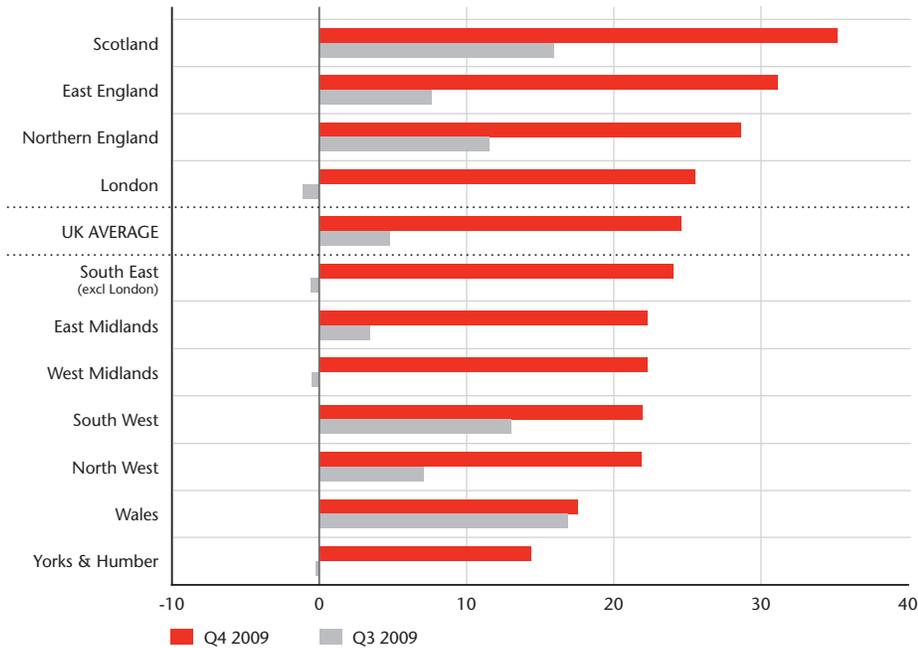
accounts show that the household saving ratio jumped from 3.9% in Q1 2009 to 5.6% in Q2.

The Business Services sector shows a record 26 point increase in confidence this quarter to stand just above the UK average. This sector accounts for around 11% of the UK economy. According to the ONS, apart from government activity, Business Services and Finance experienced the smallest decline in output in the third quarter, while the latest labour market statistics show a minor increase in job vacancies over the three months to September in these sectors.

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



In Q4 2009 business confidence has risen in all regions for the third consecutive quarter. London and the South East record the largest gains in confidence. Scotland and the East of England are the most confident regions while Yorkshire & Humber and Wales are least confident. Wales records the smallest gain in confidence this quarter which may reflect the worsening condition of the Welsh labour market, where unemployment rose by 1.6% over the three months to August – by far the largest increase in regional unemployment across the UK.

CONFIDENCE IMPROVES MOST STRONGLY IN LONDON AND SOUTH EAST

This quarter the largest rises in the Confidence Index were in London and the South East. Both of these regions recorded a negative Confidence Index in the previous quarter. These two regions combined account for over a third of UK economic output, so this strong increase in business confidence is particularly encouraging at this time.

The least confident region is Yorkshire & Humber, with a Confidence Index over 10 points below the UK average. According to the latest labour market statistics, Yorkshire & Humber has suffered the largest proportional decline in employment in England – with a 2.6% year-on-year decline over the three months to August.

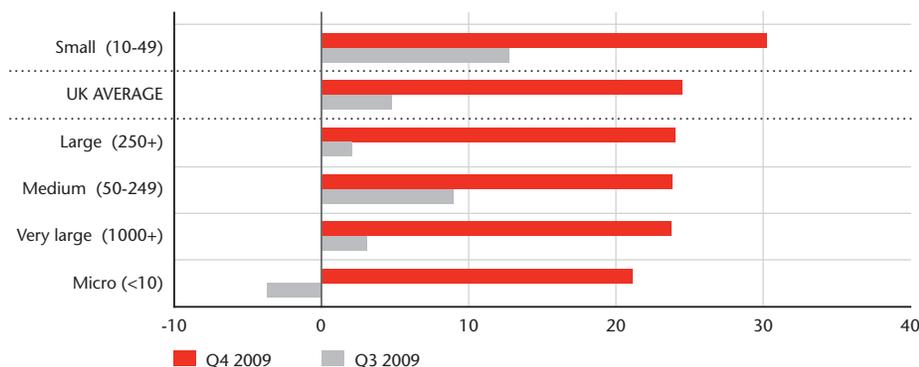
Scotland is more confident than the regions of England and Wales, with a Confidence Index score of 35.2. After being the second least confident region in both Q2 and Q3 2008, Scotland bounced back to be first or second most confident in each of five quarters to date.

POSITIVE CONFIDENCE TREND CONTINUES ACROSS UK • LARGEST GAINS IN LONDON AND SOUTH EAST

TRENDS IN BUSINESS CONFIDENCE

SIZE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY SIZE



In Q4 2009, confidence improved among all sizes of business for the third consecutive quarter.

The Confidence Index is now in positive territory for all sizes of firm.

TREND REFLECTS A BROAD-BASED IMPROVEMENT IN CONFIDENCE

In Q4 2009 confidence has again risen across all sizes of business. All sizes of business are, on balance, more confident about the economic prospects facing their organisation over the next 12 months compared with the previous 12 months. Furthermore, the spread between the most and least confident firms by size has narrowed this quarter, reflecting a broad-based improvement in confidence.

Confidence among micro firms (those with fewer than 10 employees), is now positive. In Q3 2009 micro firms were the only segment in negative territory. The Confidence Index for this segment improved by 24.9 points this quarter.

As in Q3 2009, businesses with between 10 and 49 employees have the most positive outlook for the next 12 months.

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 5 August–26 October 2009, 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

cebr

centre for economics and business research ltd is an independent consultancy with a reputation for sound business advice based on thorough and insightful research. Since 1992, cebr has been at the forefront of business and public interest research. They provide analysis, forecasts and strategic advice to major UK and multinational companies, financial institutions, government departments and agencies and trade bodies.

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.

ABOUT US

As a world-class professional accountancy body, The Institute of Chartered Accountants in England and Wales (ICAEW) provides leadership and practical support to over 132,000 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.

FURTHER INFORMATION

For more results and historical reports, please visit

www.icaew.com/bcm

For further information or data tables, please contact:

Ruth Betts

Strategic Research

ICAEW

E ruth.betts@icaew.com

For further information about the organisations involved please visit

www.icaew.com

www.cebr.com

The Institute of Chartered Accountants in England and Wales

Chartered Accountants' Hall PO Box 433

Moorgate Place London EC2P 2BJ UK

www.icaew.com