



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS

IN ENGLAND AND WALES

Q3 2008

UK BUSINESS CONFIDENCE MONITOR

National Summary Report



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This quarter's *ICAEW UK Business Confidence Monitor (BCM)* paints a stark picture of the challenging business environment that has emerged in the UK over the past year. This is now compounded by rising oil and commodity prices creating inflationary pressures and fall out from the continued downturn in the housing market.

As the economic slowdown continues there is a growing realism among UK businesses about the need to weather the current conditions with projected staff and capital investment both significantly down on this time last year.

While business confidence is low at present it is important to remember that our forecast remains one of low growth not contraction. We expect the slowdown to be at its worst towards the end of 2008 and into early 2009. However, we also expect inflation to start falling back from early 2009, allowing the Bank of England room to cut interest rates throughout 2009 so towards the end of next year economic activity will have started to pick up.

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 letters of the first and last names being capitalized and prominent.

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

Q3 2008 KEY POINTS

- Business confidence has declined for a fifth consecutive quarter to reach a new record low.
- Businesses face an increasingly challenging environment as the continued impact through the real economy of 2007's credit crunch is compounded by high oil and commodity prices creating inflationary pressures.
- Reported growth in turnover and profits has declined each quarter since the end of 2007. A further downturn in activity is predicted, though results suggest growth will remain positive, if painfully low, at around 1%.
- The Construction sector is now the least confident, closely followed by the Property sector, as the downturn in the UK housing market gathers pace.
- With the consumer outlook hit by the rising cost of living and concerns over falling property prices, the consumer-dependent Retail & Wholesale and Hotels & Catering sectors see large declines in business confidence.
- Evidence of a cooling labour market emerges. Growth in the number of employees is expected to halve, and firms expect salaries to rise by just 2.5% over the next year. While potentially representing a further threat to consumer confidence, on the upside this does imply that damaging wage-price inflationary spirals will be avoided.

FOREWORD

MARK PRAGNELL, cebr – ECONOMIC ADVISER TO THE ICAEW

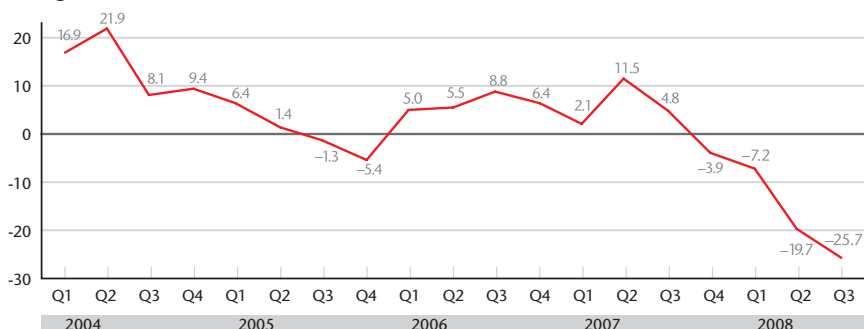


Mark Pragnell

UK BUSINESS CONFIDENCE HITS FURTHER RECORD LOW

The UK economy continued to slow in the third quarter of 2008. Latest findings from the ICAEW *Business Confidence Monitor* provide evidence of the continued impact of 2007's credit crunch through the real economy. What started a year ago with shockwaves through the financial sector spread in the first half of 2008 to all sectors of the economy, and has been compounded by rising oil and commodity prices creating inflationary pressures. UK plc must steer through these treacherous headwinds in the year ahead, though businesses are very apprehensive about their course, with the Confidence Index at a new record low of -25.7.

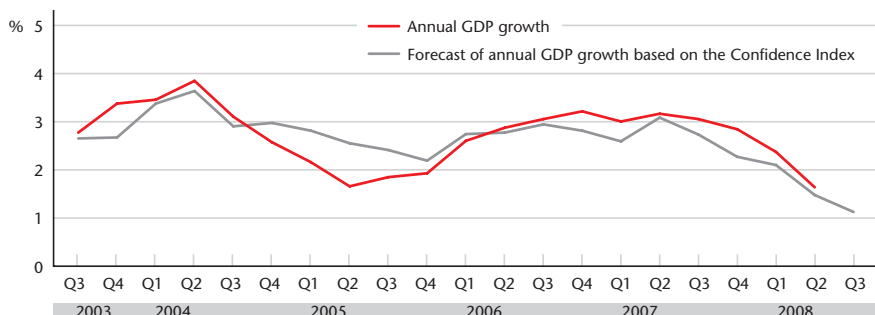
Fig. 1 Trend of UK Business Confidence



Source: ICAEW UK Business Confidence Monitor

The Confidence Index is a proven guide to growth prospects in the UK economy. In the second quarter of 2008, preliminary official figures indicate year-on-year growth slowed to 1.6%; the survey forecast was close to this with a growth estimate of 1.4%. A further downturn in activity is predicted in the third quarter of 2008, though results indicate growth will remain positive, if painfully low, at around 1%. This suggests a stark future for UK businesses as the challenging environment which has emerged since mid-2007 becomes particularly acute.

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

HOUSING MARKET SLOWDOWN GATHERS PACE WHILE INFLATION SPIKES

The downturn in the UK housing market has continued to gather pace in the second quarter of 2008. House prices are now showing the largest year-on-year falls since 1991 and mortgage approvals, at just 36,000 in June, are at their lowest level since the Bank of England started collecting data in 1993. The volume of housing transactions over the first five months of 2008 is 41% lower than the same period in 2007, leaving the Construction and Property sectors particularly pessimistic about the year ahead.

With households already downbeat given concerns over property prices and the weakening housing market, they have been hit by alarming levels of inflation over the second quarter of 2008. The latest data showed consumer price inflation rose to 4.4% in July – the highest level since 1992. This was driven by global price pressures, with record high prices for oil as well as many other commodities through May to July, caused by robust demand from emerging economies led by India and China. Encouragingly, as the global economy shows signs of cooling, these prices have recently started to moderate.

For the UK, the problem has been compounded by the largest depreciation in the value of sterling since the aftermath of Britain's withdrawal from the ERM in 1992. On a broad trade-weighted basket, sterling depreciated by 11.6% in July compared with a year earlier. The result is weaker purchasing power for the UK, making imports more expensive and holidays abroad less affordable, hence adding to the cost of living for consumers. The combination of property price worries and rising inflation is suppressing the consumer outlook considerably. Further to this, moderate earnings growth is adding to the squeeze on households' real disposable incomes.

NO BANK OF ENGLAND RATE CUTS AND WEAK CONFIDENCE POINT TO CONTRACTION

Bank of England Governor Mervyn King will, in all likelihood, be forced to write to the Chancellor of the Exchequer in the autumn as inflation pushes closer to 5% than 2%. The need to bring inflation back towards the 2% target rate suggests interest rates look set to remain on hold through 2008 despite the rapidly deteriorating economy. In addition, unemployment in July showed the largest one-month increase since the recession of 1992 and will continue to rise through the second half of 2008 as the economy slows.

Following 64 quarters of positive growth and the low levels of UK business confidence found in this quarter's BCM, combined with the restrictive monetary policy it seems the Bank will be unable to avoid, we are increasingly likely to see the first quarter of contraction of the UK economy in the second half of this year. Whether or not we actually experience a quarter of negative growth, we are likely to see the weakest year of growth since 1992, with the chances of a recession elevated by the extent of the slowdown in the housing market and the rise in inflation.

Our view, however, is that the UK may still just escape true recession – two quarters of falling output growth – but there are ever-increasing downside risks to this, as the latest *Business Confidence Monitor* shows.

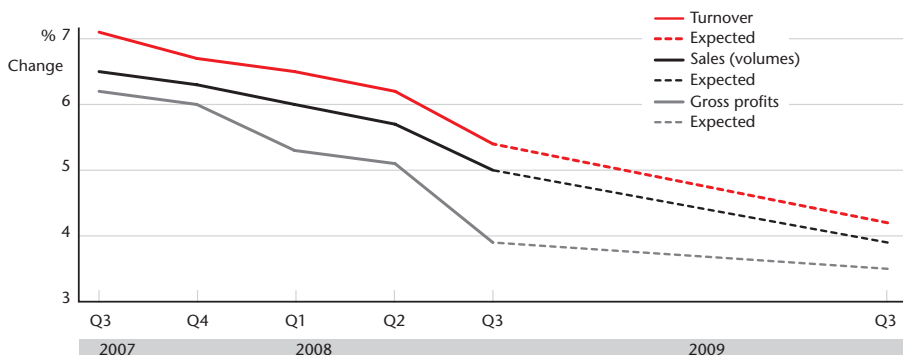
Mark Pragnell, cebr
Economic adviser to the ICAEW

MAIN FINDINGS

BUSINESS FINANCIAL PERFORMANCE

Senior business professionals expect turnover growth to weaken in the next 12 months recording the lowest expected rate of turnover growth since the survey began in 2003. Profits and sales growth are also forecast to moderate with sales volumes continuing a downward trend which began in Q2 2007.

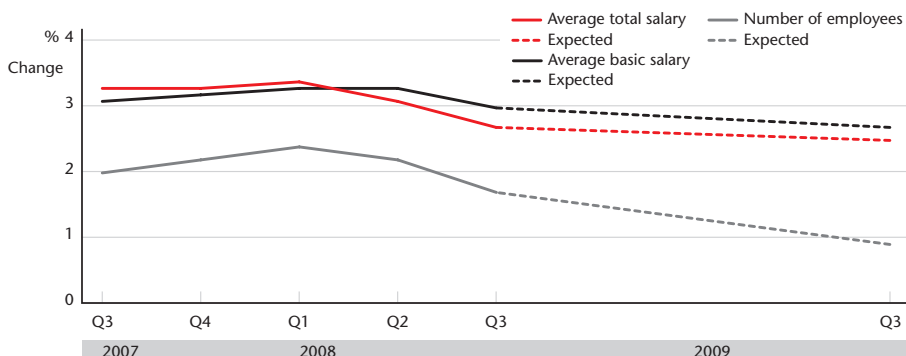
Fig. 3 Change over 12 months to...



Reported input prices rose by 3.8% over the last year, though are expected to grow by 3.5% over the coming 12 months in line with slowing global demand and evidence of falling commodity prices. Firms are taking steps to protect profits, with capital investment growth expected to moderate from 2.4% seen in the 12 months to date to 0.8% in the year ahead.

The labour market continues to cool, with firms expecting staff head count to increase by just 0.9% in the next 12 months, continuing a downward trend which started at the beginning of 2008. Some positive news for the Bank of England, though, is that average total salary growth is expected to moderate to 2.5% over the next year, reducing the prospect of wage-price inflationary spirals that could keep prices in the economy at an elevated level.

Fig. 4 Change over 12 months to...

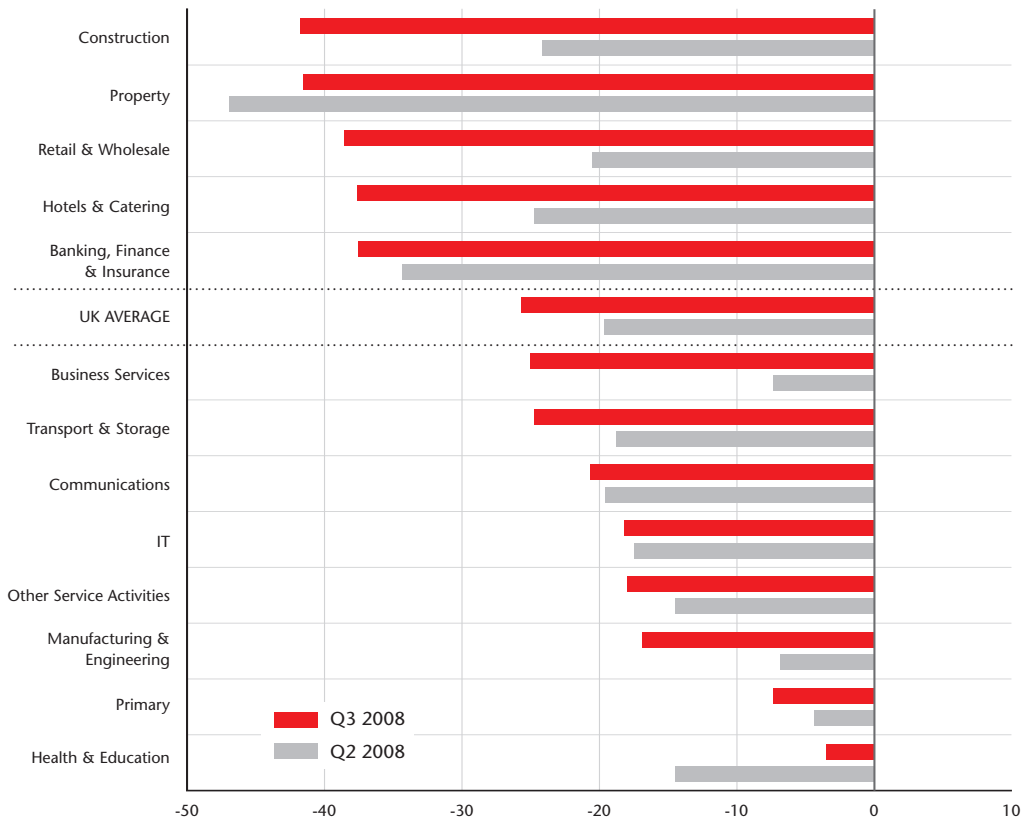


TRENDS BY INDUSTRY

Finance professionals in the Construction sector are most pessimistic this quarter recording the lowest ever Confidence Index score. Near-term prospects for the sector have been dealt a heavy blow by the slowdown in the UK property market.

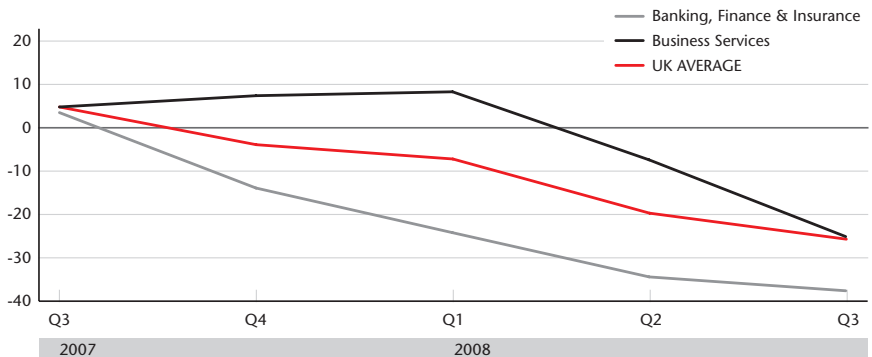
Retail & Wholesale and Hotels & Catering sectors saw significant falls in confidence as high inflation dented real disposable incomes and the weakening housing market depressed consumer confidence.

Fig. 5 BCM Confidence Index Trend



A sharp fall in confidence is also evident in Business Services. This sector remained optimistic relative to others when the effects of the credit crunch were first felt in the UK. The reality of the economic slowdown is now beginning to feed though, hitting areas such as recruitment and consultancy. Confidence in the Banking, Finance & Insurance sector also fell further.

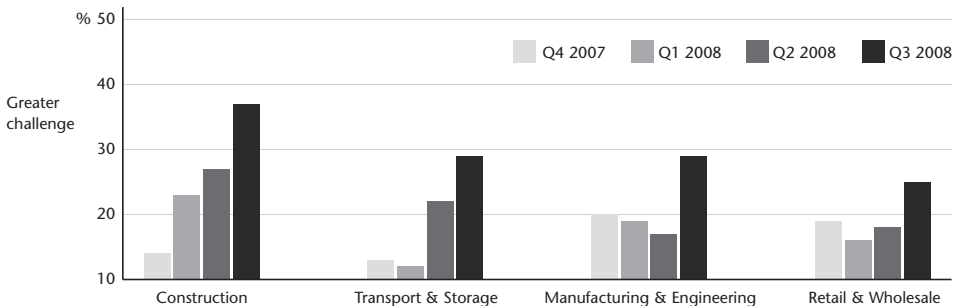
Fig. 6 Trend of Business Confidence by Industry



Recently Business and Financial Services have tended to drive UK economic growth. However, latest reported quarter-on-quarter growth for these sectors is at just 0.1% and they clearly expect further challenges in the quarters ahead.

This quarter sees a significant increase in the proportion of firms reporting late payment from customers as a greater challenge to performance. In the increasingly challenging business environment, careful cash flow management is essential for all firms. Those in the Construction sector are most likely to report deterioration in this area, followed by those in Transport & Storage and Manufacturing.

Fig. 7 Late payments from customers – change versus 12 months ago

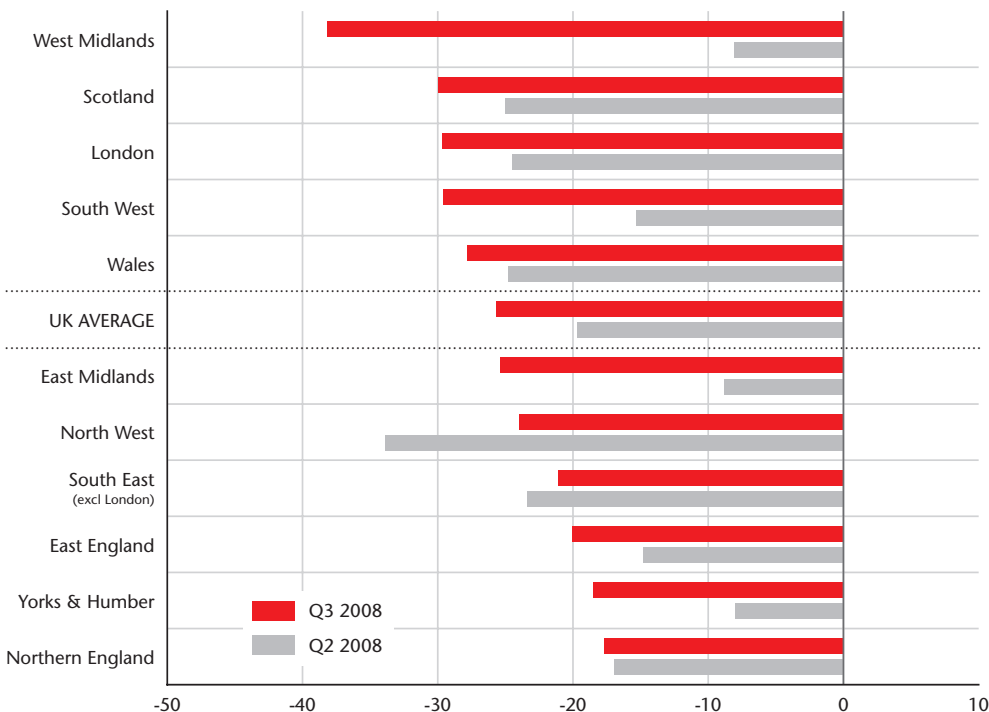


TRENDS ACROSS UK REGIONS

Confidence is well into negative territory in all regions of the UK in the third quarter. In all but 3 of the 11 regions the Confidence Index stands at its lowest ever. Only two regions, Northern England and Yorkshire & Humber, have a Confidence Index score above -20, although Yorkshire & Humber has seen a relatively large drop from a reasonably buoyant position of -8.0 last quarter.

In the third quarter, confidence has fallen most dramatically in the West and East Midlands regions. Manufacturing is an important sector in these areas, and input price inflation running at its highest level since the 1980s, combined with weakening domestic and external demand, is contributing to the sharp decline in confidence in manufacturing and these regions.

Fig. 8 Business Confidence by Region



Scotland, London and the South West are the next most pessimistic regions. Financial services figure strongly in all three regional economies, and the continued weakness for this sector is depressing regional confidence. In addition, the increasingly pessimistic Business Services and Property sectors are both highly significant in London.

TRENDS BY SIZE OF BUSINESS

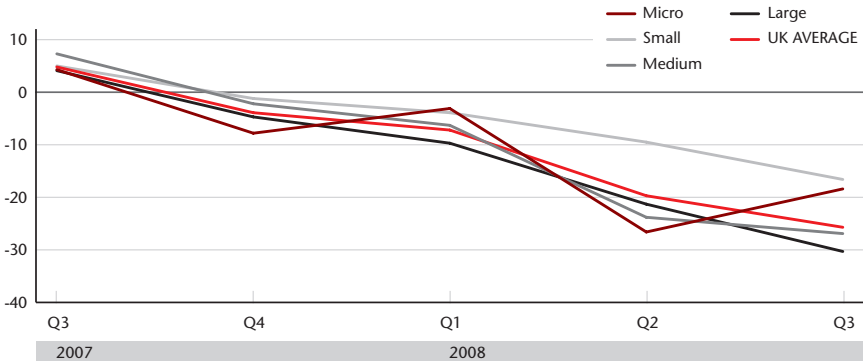
The economic downturn continues to affect businesses of all sizes across the UK.

In the third quarter of 2008 the largest firms have emerged as the gloomiest about prospects in the year ahead. Large businesses – those with more than 250 employees – saw their confidence decline by 8.9 points over the quarter to -30.3, the lowest level since the survey began in 2003. Confidence also fell to record lows among small (10-49 employees) and medium (50-249) sized firms in the third quarter.

Medium and large businesses have now seen their confidence decline for five consecutive quarters, and by 25 points since the end of 2007, as economic prospects weakened considerably through 2008.

Micro sized firms – those with up to nine employees – bounced back from their sharp drop in confidence in the previous quarter, but still remain pessimistic about the year ahead.

Fig. 9 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 24 April to 24 July 2008, 1025 ICAEW members active in business in the UK were interviewed by telephone. Questions covered past performance and future prospects for their businesses and 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 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 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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