

ICAEW



UK BUSINESS CONFIDENCE MONITOR REPORT

Q2 2010



WELCOME



Stabilisation is the key theme from this quarter's BCM. There has been a broadening of recovery in more sectors, regions and sizes of business as UK companies take small – but cautious – steps to recovery.

The data show that companies are operating within their means and planning to work with the resources they have, rather than taking on new risks. Against a backdrop of political uncertainty and the recent General Election campaign, it suggests that economic recovery is continuing but at a sluggish pace.

Businesses cannot allow themselves to be complacent and must remain cautious about the outlook. Inevitable public sector cuts, potential fallout from the Greek fiscal crisis and imported inflation linked to sterling depreciation could destabilise the economic recovery. Until their impact on business prospects becomes clearer, UK plc must continue to manage risk, cut costs and avoid exposure to potential threats outside its control. This will act as a drag on growth.

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.

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 business confidence stabilising after the record level seen last quarter. The continued strength of confidence is a sign that the recovery is becoming more broad-based, although significant challenges lie ahead.

The UK economy has avoided a double-dip recession so far, with growth in the final quarter of 2009 upwardly revised to 0.4% and 0.2% growth recorded in the first quarter of 2010. In the Budget, the Treasury announced it was expecting growth in the range 1.0-1.5% in 2010. An improvement on the slow start to the year will be needed to achieve this, but expansion of around 1.2% this year seems entirely plausible. This will not, however, be enough to stop unemployment rising further.

KEY ISSUES EMERGING THIS QUARTER

- Business outlook continues to improve, although growth expectations remain below pre credit crunch levels. The strengthening view is supported by good prospects for exports as the weak pound provides a fillip.
- Businesses are still cautious. Expected growth in capital investment and staff numbers is low. Three in five businesses are still operating below capacity.
- Business expectations for wage and price growth remain anchored.
- Re-stocking is providing a short-term boost to economic activity; this effect will diminish later in 2010.

The UK recovery is continuing, but challenges loom large – namely the possibility of contagion spreading through the eurozone following the IMF bailout of Greece and the need to deal with the UK's own fiscal mess. Cutting back the £163bn budget deficit will be a major drag on growth, whatever combination of spending cuts and tax rises the new government chooses.

Further sterling depreciation could cause above-target inflation to persist. But with most businesses operating below capacity and growth in prices and wages forecast to stay low, we think that the Bank of England should resist interest rate hikes this year rather than risk stalling the still-developing recovery – as long as the new government can convince financial markets of its determination to reduce the budget deficit and sterling does not fall out of bed.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q2 2010

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



The latest ICAEW *UK Business Confidence Monitor (BCM)* shows the recovery continued in Q2 2010, with confidence stable from last quarter. This stabilisation in the Confidence Index comes after four successive quarterly rises. As in Q1 2010, business confidence regarding economic prospects over the next 12 months stands dramatically higher than the same quarter a year earlier as the UK has so far avoided a double-dip recession.

BUSINESS CONFIDENCE STABILISES

The latest findings from BCM show the Confidence Index at 25.5 in Q2 2010, practically unchanged from the record high of 25.8 in Q1 2010. This brought an end to a run of four successive rises in the Confidence Index. Business confidence has been remarkably stable over the last nine months, as the recession ended and the recovery continued to develop. In Q2 2010, just short of six in ten businesses (58%) are more confident about economic prospects facing their organisation over the next

FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES



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

12 months compared to the previous 12 months. This compares to just under one in five (19%) during the same quarter a year earlier.

Of the businesses that are more confident, the majority are still only slightly more confident about economic prospects. The share of all businesses feeling much more confident stands at 12% in Q2 2010. This is the highest proportion since BCM began and a reflection of just how poor the business outlook got last year.

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



The latest BCM Confidence Index points to continued growth in Q2 2010 following confirmation that the UK economy continued to expand in Q1 2010, albeit more slowly than in the final quarter of 2009. Upwardly revised estimates from the Office for National Statistics (ONS) show the economy recorded 0.4% growth in Q4 2009 while the preliminary estimate for Q1 2010 indicates growth at 0.2% quarter-on-quarter.

UK ECONOMY CONTINUES STEADY RECOVERY

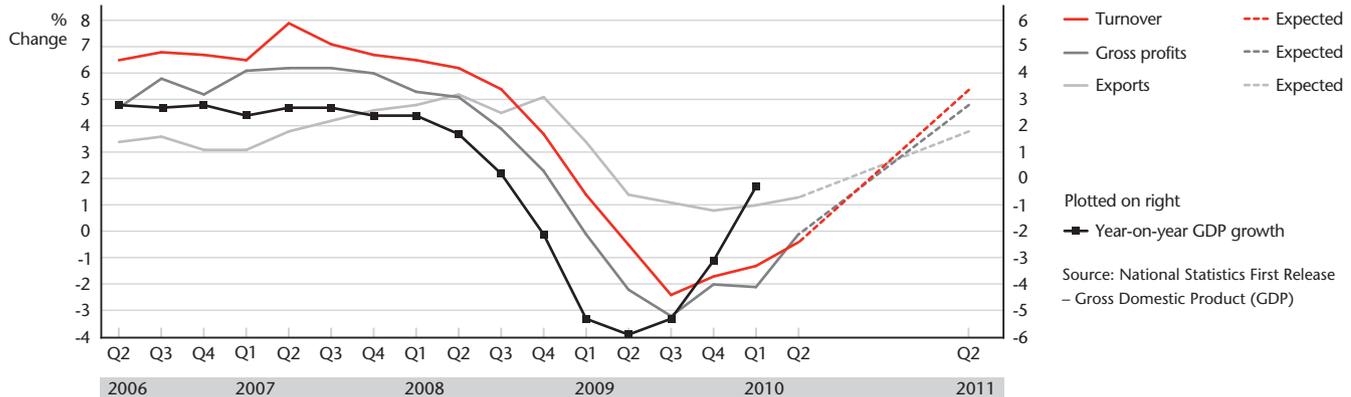
As the BCM had suggested might happen, the ONS revised its estimate of growth for Q4 2009 upward. There may also be a slight upward revision to Q1 2010 growth, although weaker performance is not surprising given the VAT reversal and poor weather.

Stabilisation in the Confidence Index implies growth will continue in Q2 2010. Other indicators point to continued improvement in the UK economy: growth in exports and industrial production picked up in February, while the Society of Motoring Manufacturers and Traders reports car production up by 90% in March compared with a year earlier.

The labour market continued to show signs of stabilisation as claimant count unemployment declined again in March, while growth in average earnings picked up to the strongest level since December 2008 – up 2.2% over the three months to February compared to a year earlier, although still below pre-recession norms. However, the wider International Labour Organisation (ILO) measure of unemployment surpassed 2.5m for the first time since 1994 and job creation remained weak, with vacancies falling from January to February.

BUSINESS FINANCIAL PERFORMANCE

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



This quarter firms report the smallest twelve-month declines in turnover and gross profits since Q1 2009 and the strongest growth expectations since Q1 2008. The latest BCM shows that businesses' results are improving and that firms expect continued strengthening of the economy to translate into stronger business growth. However, expectations for improvement in key performance indicators are still below pre credit crunch levels other than for exports, where sterling depreciation should provide a boost.

FIRMS REVISE GROWTH EXPECTATIONS UP

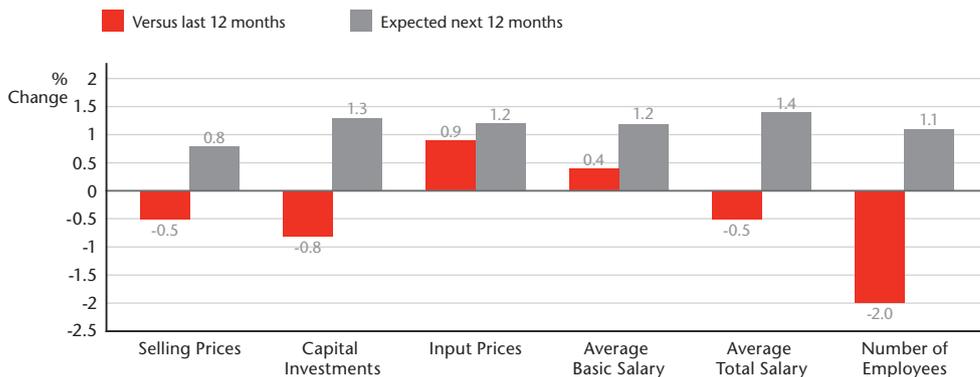
Consistent with the UK's exit from recession, the Q2 2010 BCM shows that the rate of decline in turnover slowed to 0.4% over the last 12 months, compared to a 1.3% decrease in Q1. The pace of decline has eased in each of the last three quarters following the low point seen in Q3 2009. Firms expect turnover to grow by 5.4% over the next 12 months as the economy strengthens – the most positive outlook in over two years.

Similarly, gross profits were broadly flat over the last 12 months, an

improvement from the 2.1% decline reported in Q1. This is by no means a robust performance; however, a rise of 4.8% is forecast for the coming 12 months, the strongest outlook since Q1 2008 but still behind typical pre credit crunch growth rates.

For the fifth successive quarter exports have held up while both turnover and profits have contracted. Businesses expect exports to grow by 3.8% over the next year; this is in line with pre-recession levels as firms build on improved competitiveness due to sterling depreciation.

FIG. 5 Q2 2010 – AVERAGE % CHANGE IN...



Although businesses expect improved financial performance, they are still cautious about increasing investment and taking on new staff. Expected growth in both capital investment and headcount remains below pre-recession norms. Price and wage growth expectations are also relatively low, and three in five businesses are operating below capacity.

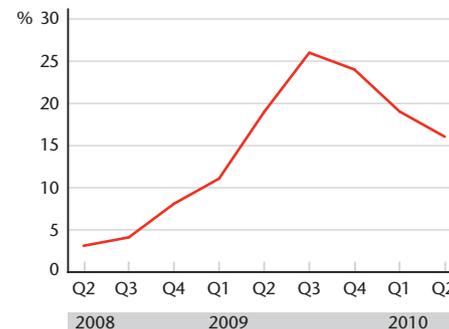
INVENTORY CYCLE PROVIDING SHORT-TERM GROWTH BOOST

The steep de-stocking that accompanied the deepest recession since quarterly records began and exaggerated the decline in economic activity is now being reversed as firms re-stock to meet growing demand. This quarter the share of businesses reporting stock levels of raw materials below normal declined for the third quarter in succession to 16%, although this is still higher than before the recession.

Although business performance has improved, firms report a 0.8% decline in capital investment and 2.0% reduction in headcount over the last 12 months. Moreover, businesses are

FIG. 6 STOCK LEVELS – RAW MATERIALS AND COMPONENTS

BELOW NORMAL, Manufacturing, Construction, and Transport sectors



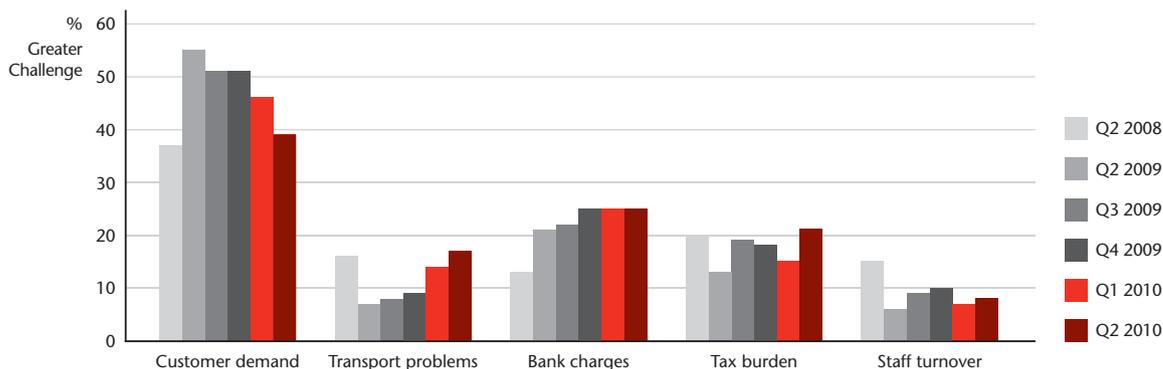
still too cautious about the recovery to increase investment or employment substantially, with only modest growth expected over the coming year.

Despite the annual rate of consumer price inflation reaching 3.4% in March, prices remain relatively anchored. Selling prices are expected to rise by 0.8% over the next year which is substantially below pre-recession norms. In addition, labour market slack is keeping wage costs down. Hence, domestically generated inflationary pressures are of relatively limited concern; imported inflation is the key risk.

BUSINESSES REMAIN CAUTIOUS • PRICE AND WAGE GROWTH LOW • IMPORTED INFLATION KEY RISK

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

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



There are further signs of a strengthening market as the share of businesses reporting the level of customer demand to be a greater challenge to their performance has fallen for a second quarter. Transport problems rose up the agenda for businesses in Q2 2010 due to the disruption caused by bad weather earlier in the year. Staff turnover remains of low concern to businesses, showing that plenty of labour market slack remains as UK unemployment rose to 8%.

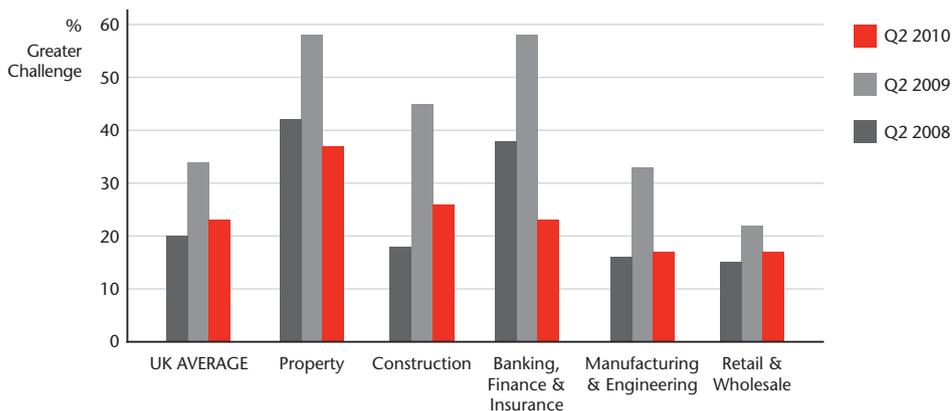
CUSTOMER DEMAND IMPROVES BUT LABOUR MARKET STILL WEAK

In Q2 2010 less than two in five (39%) businesses report customer demand to be a greater challenge to business performance than a year ago, down from 46% in Q1 2010 and the second successive quarterly decline.

While the labour market has shown signs of stabilisation with the rate of new job losses easing, job creation is still relatively weak. This is reflected in just 8% of businesses identifying staff turnover as a greater challenge to business performance than a year ago, substantially below levels seen before the recession.

With the reversal of the temporary reduction in VAT rate in January, a larger proportion of businesses report the tax burden to be a greater challenge to performance than a year ago – 21% compared with 13% in Q2 2009. The proportion of businesses reporting transport problems as a greater challenge is still elevated this quarter as memories of the very severe weather in Q1 2010 remain strong. Seasonally adjusted ONS data show automotive fuel sales down 15% in the three months to March, linked to poor weather and higher petrol prices.

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



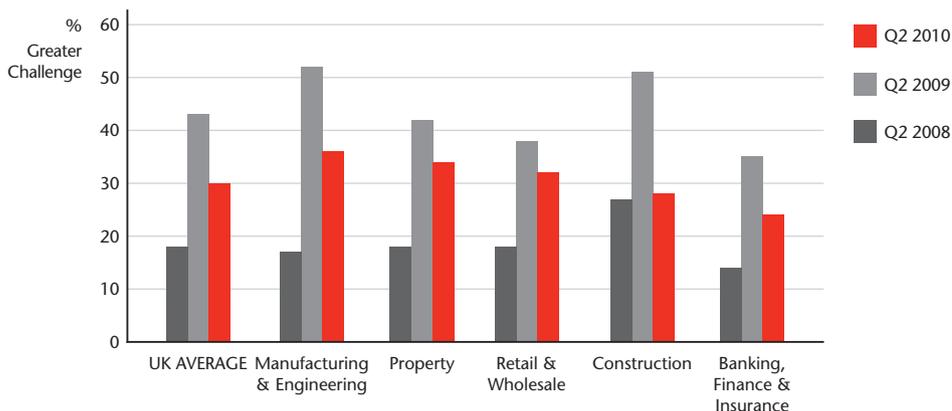
ISSUES WITH ACCESS TO CAPITAL AND LATE PAYMENTS CONTINUE TO SUBSIDE

BCM shows there has been a decline in the share of businesses reporting access to capital as a greater challenge to business performance since Q3 2009, but our findings suggest that the overall level of concern among businesses in relation to sourcing finance remains above levels seen prior to Q2 2008 when the credit crunch hit.

Restricted access to capital has been felt disproportionately in the Property sector, and currently 37% report it as a greater challenge to business performance than a year ago. This is an improvement from nearly six in ten property firms reporting this trend a year earlier, though also still above levels recorded prior to Q2 2008.

Late payment from customers rose to prominence through the recession as demand weakened and cash flow became critical. Here also BCM shows steady improvement over the last 12 months. Three in ten businesses now report late payment from customers as a greater challenge to business performance than a year ago – an improvement compared to a year ago, though still worse than in Q2 2008.

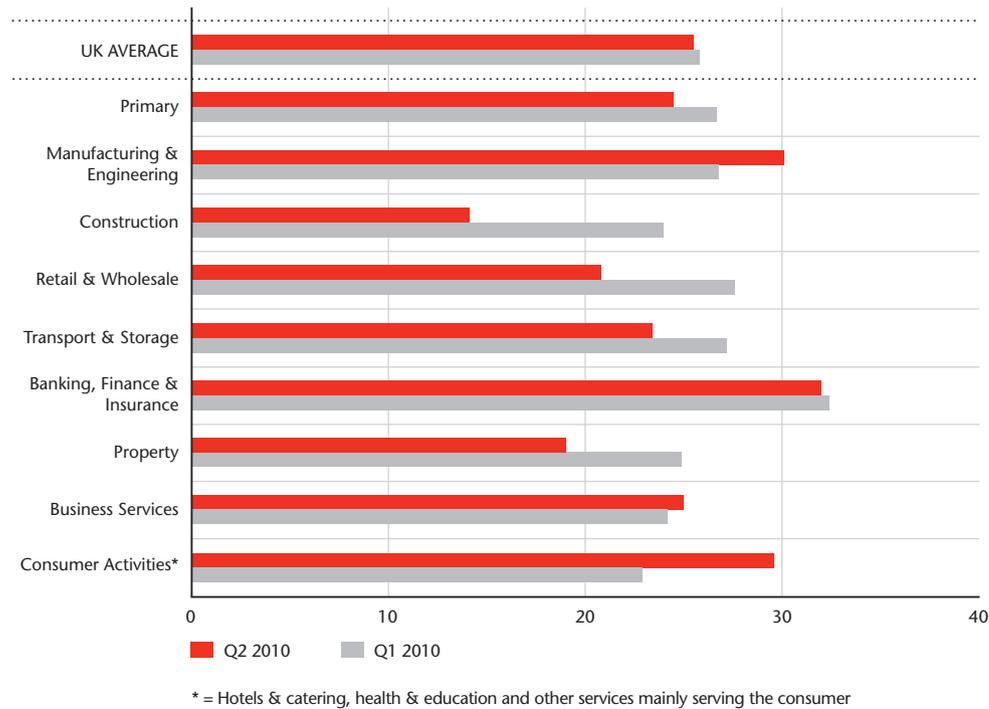
FIG. 9 LATE PAYMENTS FROM CUSTOMERS – CHANGE VERSUS 12 MONTHS AGO



ACCESS TO CAPITAL OF DIMINISHING CONCERN TO BUSINESSES • LEVEL OF LATE PAYMENTS ALSO IMPROVING

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



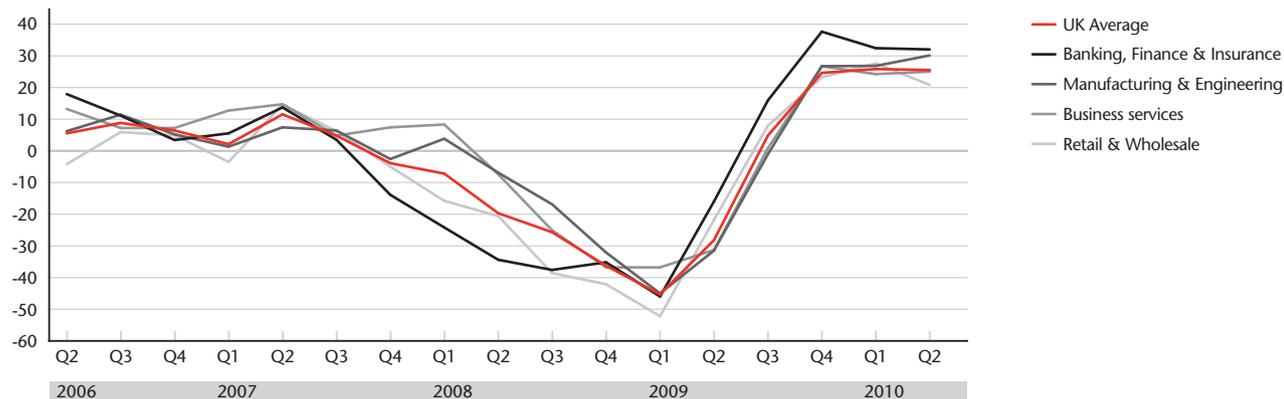
The Q2 2010 BCM provides signs that the UK economic recovery is becoming more broad-based, with business confidence remaining high across most sectors. Across the UK as a whole, we saw a strong positive trend in confidence from Q2 2009 up to the start of this year. While overall UK confidence has stabilised this quarter, for some of the more important industry sectors the positive trend has continued. Construction and Retail & Wholesale are two important exceptions to this.

CONSTRUCTION CONFIDENCE DIPS AGAIN

Following signs of improvement in the Q1 2010 BCM, confidence in the Construction sector has dipped this quarter. This comes as official data suggest the sector may slip back into recession – a second successive quarter of decline in Construction sector output was recorded in the last quarter. Businesses in the sector are being hit by the still patchy lending recovery and the prospect of lower orders from the public sector, as cuts loom large in the next administration.

Confidence among both Property and Business Services firms stands in line with the UK average. The housing market stuttered in early 2010 with mortgage approvals falling back. At the same time, commercial property has shown signs of recovery. The improvement of confidence in the Business Services sector is a sign of the economic recovery becoming more broad-based as higher economic activity sees an increase in business-to-business demand.

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence in the Banking, Finance & Insurance sector remains above the UK average as the large US investment banks posted robust growth and UK banks followed suit.

The Manufacturing & Engineering sector is also above the UK average confidence level, having strengthened considerably over the last year as sterling depreciation boosted competitiveness. Confidence in the Retail & Wholesale sector has fallen back this quarter as consumer spending weakened and the 17.5% VAT rate was reinstated.

MANUFACTURING SECTOR BOOSTED WHILE RETAILERS FALL BACK

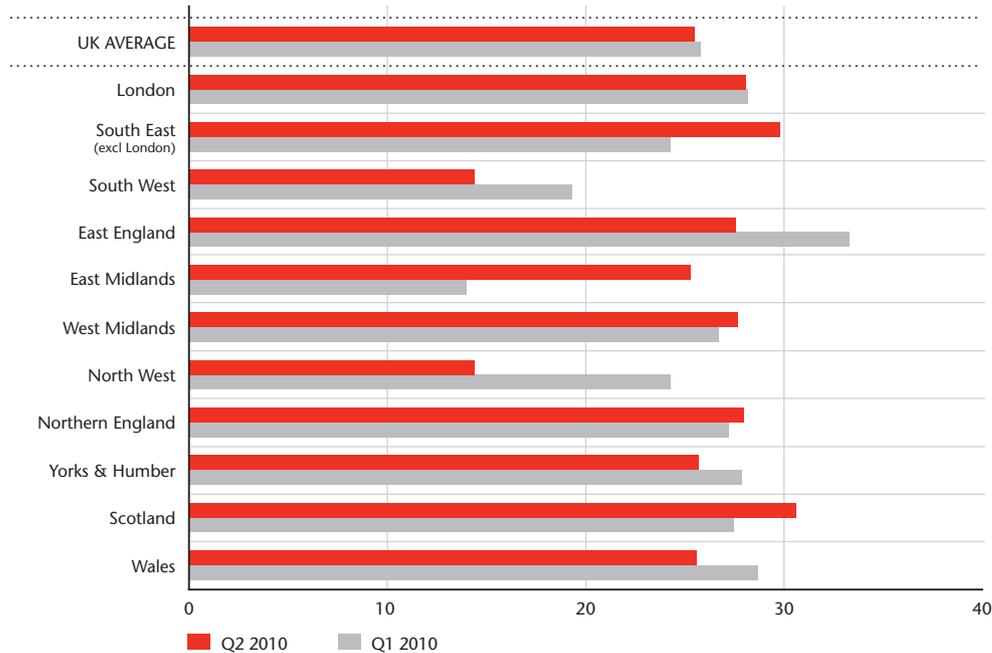
Confidence in the Manufacturing & Engineering sector has risen this quarter to stand 61.6 points higher than at this time last year. Official data show a significant improvement in performance recently in Manufacturing as re-stocking bolstered demand. The ONS reports year-on-year output growth at 1.5% in February – the highest in two years. The roughly 25% depreciation in sterling since 2007 has helped improve the UK's competitiveness – official trade data also showed stronger growth in exports in February.

The Retail & Wholesale sector saw a drop in confidence in Q2 2010 as consumer spending was hit by severe weather at the start of the year, the VAT rate cut reversal, and weak growth in real disposable incomes. The VAT hike and imported inflation from rebounding oil prices, combined with further sterling depreciation, contributed to the annual rate of inflation reaching 3.4% in March. With average earnings growth still relatively weak, real disposable incomes have been squeezed. According to official figures, retail sales declined by 1.7% over the three months to March compared to the previous three months.

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



Business confidence across all regions is significantly stronger than at this time last year. Compared to last quarter, the Confidence Index is unchanged in real terms in all regions; however, it is the longer-term trend which is more telling. Scotland, the South East and London are now the most confident parts of the UK, while business confidence is at its weakest in the North West and South West. As in Q1 2010, however, the difference between most and least confident regions is smaller than was typical through 2008-2009.

LONDON AND SOUTH EAST SHOWING STRENGTH

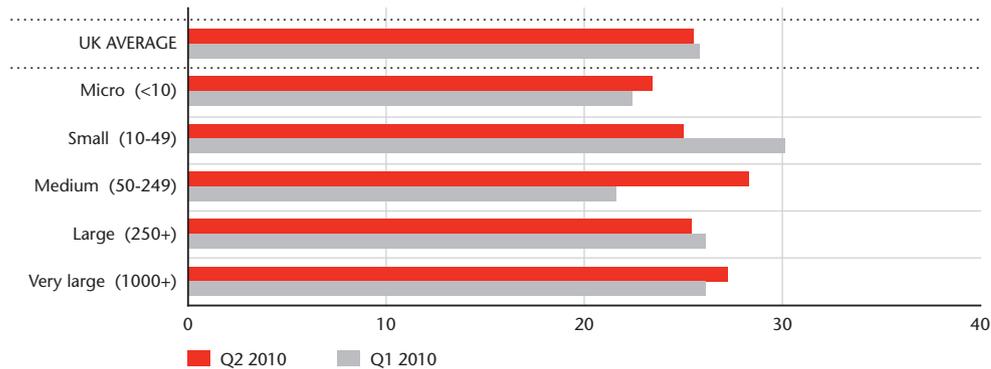
Business confidence in the capital held steady in Q2 2010 while confidence in the South East recorded a marginal 5.5 point gain, as the two largest regional economies within the UK continued to show a return to strength. Over the last year London has recorded the second largest gain in confidence across the regions. Confidence in the East of England also stands above the UK average for the fourth successive quarter.

Scotland records the highest Confidence Index this quarter. In five of the six quarters before this, Scotland was ranked top, or second highest as business confidence was hit less than elsewhere in the UK through the recession.

The North West and South West of England are the least confident regions in the UK this quarter. There is now an 11.1 point gap between the Confidence Index in these two regions and the UK as a whole, though both regions are significantly more confident than in Q2 2009.

TRENDS IN BUSINESS CONFIDENCE SIZE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY SIZE



This quarter the variation in business confidence across different sizes of business is limited. The difference between the most and least confident size segment is less than five points – a further sign that the economic recovery is becoming more broad-based. The largest businesses have seen the greatest gains in confidence over the last year, having fallen into deepest negative territory for confidence during the recession.

CONFIDENCE GAP NARROWS BETWEEN BUSINESS SIZE SEGMENTS

In Q2 2010, business confidence stands far above the same quarter a year earlier for all sizes of business, with no real change for any size segment since last quarter.

As the recession has run its course, businesses of different sizes have followed a similar trend for confidence, with all hitting the lowest point in Q1 2009 and recovering steadily since then. Larger firms

recorded more strongly negative scores in Q1 last year than SMEs, and have consequently seen bigger gains in confidence over the past year.

The difference in confidence between the most and least confident business-size segment is well below that seen in any quarter through 2008-2009, evidencing the broad-based recovery now in train.

ALL SIZES OF FIRM MORE POSITIVE THAN IN 2009 • ECONOMIC RECOVERY BECOMING MORE BROAD-BASED

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 27 January–23 April 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.



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Because of us, people can do business with confidence.

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