



UK BUSINESS CONFIDENCE MONITOR

Q2 2012



WELCOME



The latest *ICAEW/Grant Thornton Business Confidence Monitor* shows an upturn in confidence among business professionals running all types of businesses across the UK. This is of course welcome news, despite the fact the UK is technically in recession. While the economic recovery will be fragile at least for the rest of this year, this rise in confidence shows that businesses believe the outlook appears a lot better than it did six months ago.

We mustn't squander the opportunity. Businesses are still not quite ready to start investing again in their future, so more needs to be done to encourage them to stop hoarding and start spending the cash surpluses they have built up over the last couple of years. In my view, this will be critical to helping return to sustained economic growth.

A handwritten signature in black ink that reads "Michael Izza".

Michael D M Izza
Chief Executive
ICAEW



Despite the increase in confidence this quarter, the financial performance indicators in the BCM are still not where we would like them to be. There are improvements to a variety of key business measures, but not to the same extent as we would like to see to facilitate a strong economic recovery. Turnover and profit growth have increased but we are still a long way behind pre-recession levels.

Businesses understandably continue to be cautious and realise that this will be the norm for some time to come. Consumer demand is expected to increase over the next year despite the squeeze on household incomes. However, until future plans for exporting and capital investment drastically improve, the uncertain outlook will remain.

A handwritten signature in black ink that reads "Scott Barnes".

Scott Barnes
Chief Executive Officer
Grant Thornton

ECONOMIST'S VIEW



The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence has improved notably in the second quarter of 2012. The Confidence Index now stands at +12.0, up from -9.3 in Q1 2012 and the highest level since Q2 2011.

The Confidence Index is a leading indicator for growth. It provided early warning signs of the impact of the financial crisis on the real economy in 2007/08, correctly predicted the end of the recession in 2009, and also predicted the UK's present return to recession. This quarter's Confidence Index suggests the economy will return to positive quarter-on-quarter growth of 0.6% in Q2 2012.

KEY ISSUES EMERGING THIS QUARTER

- The strong improvement in confidence this quarter, despite the double-dip recession, suggests the current recession is likely to be shallow and short-lived.
- Improvements in confidence are backed by improvement in firms' financial performance, though growth remains below pre-recession levels.
- Confidence is yet to translate into plans for increased capital investment, in itself a key driver of growth.
- Job creation in the private sector remains modest, but hiring is expected to pick up a little over the next 12 months.

However, the fragility of the underlying economic situation continues. Even if the economy returns to growth in Q2 2012, output remains some way below its pre-financial crisis peak, and the eurozone sovereign debt crisis threatens to escalate again, which could hit UK exports. With about a quarter of the economically active population in Spain unemployed and public discontent with austerity measures across a range of countries, a perfect storm of political events could trigger further market uncertainty.

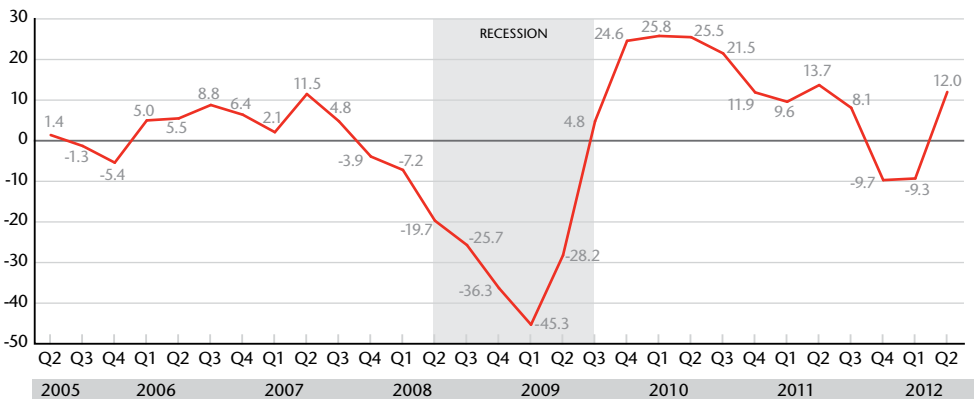
The current economic environment poses a significant challenge to policy makers in the UK. The scope for fiscal stimulus to prop up growth is highly limited, so the onus remains with the Bank of England to support the economy. The policy response is a likely continuation of interest rates at rock bottom levels – we don't expect the Bank Rate to rise until 2014 at the earliest. An expansion of the programme of quantitative easing (QE) is possible, though continued high inflation may limit the scope for more QE.



Douglas McWilliams
Chief Executive, Cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q2 2012

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



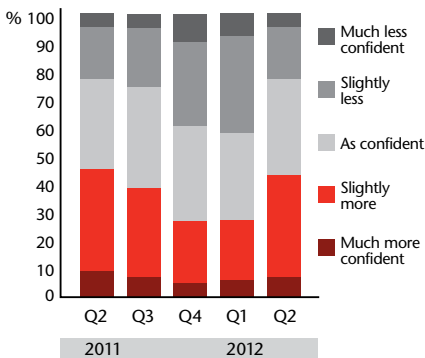
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence has recovered sharply this quarter, returning to positive territory. The Confidence Index stands at +12.0 in Q2 2012, up from -9.3 in Q1 2012.

CONFIDENCE RECOVERS AND RETURNS TO POSITIVE TERRITORY

The latest findings from BCM show the Confidence Index improved significantly in Q2 2012 compared to last quarter, increasing from -9.3 to +12.0. The Confidence Index currently stands at its highest level since Q2 2011.

This quarter, over two fifths (44%) of businesses are more confident in their economic prospects for the coming year compared with the last 12 months. This is notably up from

FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES

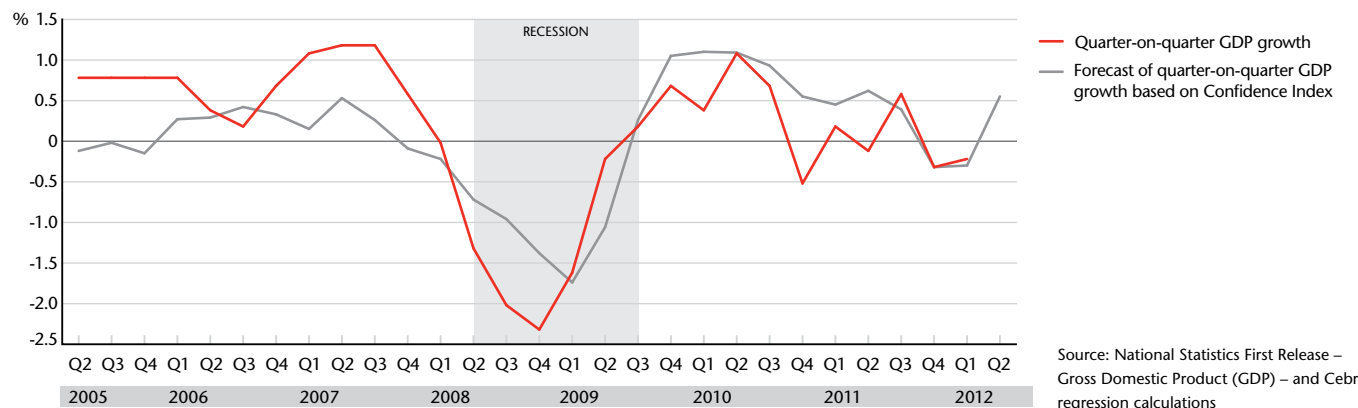


26% last quarter and the highest share since Q2 2011. The increase largely reflects a rise in the share of businesses 'slightly more' confident in economic prospects rather than a rise in the share of businesses 'much more' confident in prospects.

Over a fifth (22%) of businesses still believe that economic prospects for the coming year are worse than seen over the last 12 months, though this is down from 42% last quarter.

CONFIDENCE HIGHEST SINCE Q2 2011 • BUSINESSES 'SLIGHTLY MORE' CONFIDENT IN ECONOMIC PROSPECTS

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



The economy shrank in the first quarter of 2012, so the UK is now in the first double-dip recession since the 1970s. Preliminary estimates from the Office for National Statistics (ONS) show the economy contracted at a quarter-on-quarter rate of 0.2% in Q1 2012, in line with what was forecast in last quarter's BCM. Compared with a year ago, the economy has not grown at all.

BCM POINTS TO A RETURN TO POSITIVE GROWTH

The UK economy contracted at a quarter-on-quarter rate of 0.2% in Q1 2012, following a 0.3% contraction in Q4 2011. Two consecutive quarters of falling output mean the UK is now officially in a double-dip recession. ONS sector data for Q1 2012 show output in the production industries fell at a quarter-on-quarter rate of 0.4%. Output in the construction sector decreased by a sharp 3.0%, while in the services sector output was 0.1% higher compared with Q4 2011.

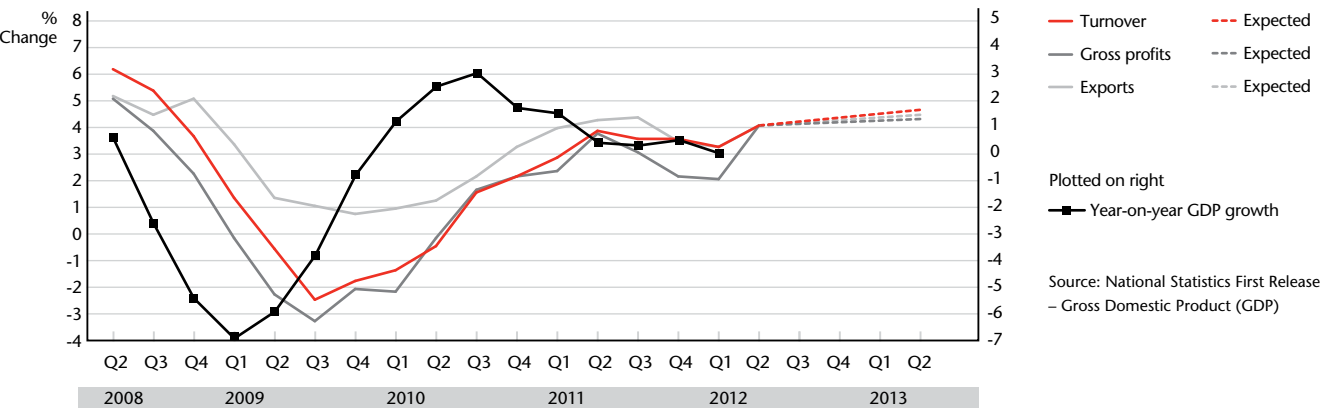
The Q2 2012 BCM Confidence Index points to a return to positive growth

of 0.6% in the second quarter of 2012, indicating that the current recession will be relatively shallow and short-lived. Bank of England governor Mervyn King has already indicated that the UK economy is likely to zig-zag this year, dipping in and out of growth. While rising business confidence should support economic growth this quarter, factors such as April's heavy rain and the Jubilee bank holiday may place downward pressure on economic output, leading to lower growth than the Confidence Index anticipates.

UK NOW OFFICIALLY IN DOUBLE-DIP RECESSION • ECONOMY EXPECTED TO DIP IN AND OUT OF GROWTH

BUSINESS FINANCIAL PERFORMANCE

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



Key indicators show business performance improving in the 12 months to Q2 2012, in line with the improvement seen in the Confidence Index this quarter. Gross profits and turnover have both grown by 4.1%, and expectations for growth over the next 12 months stand at 4.3% and 4.6% respectively.

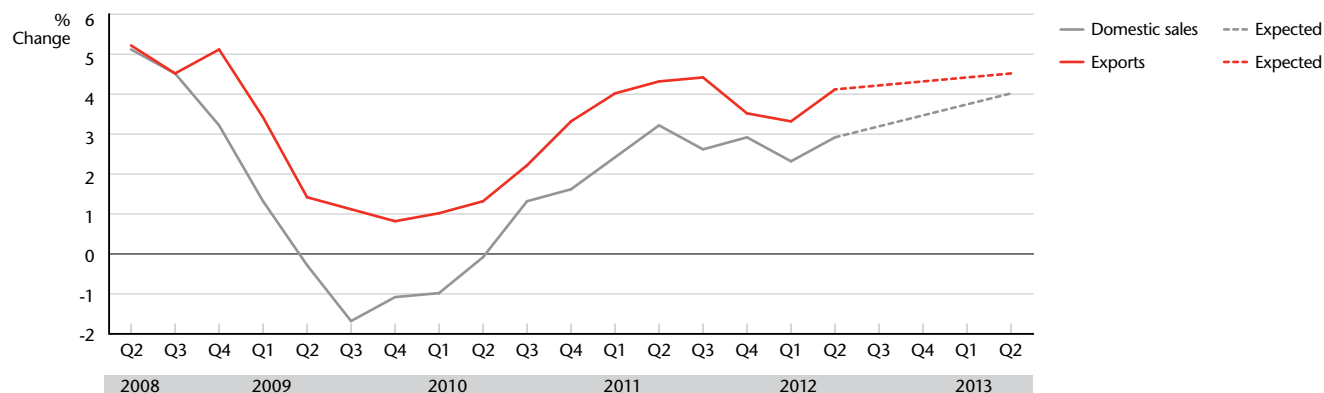
EXPORT GROWTH INCREASES

This quarter businesses report that exports are 4.1% higher than a year ago, up from 3.3% last quarter. Unlike many other financial performance indicators, reported export growth has returned to levels which are comparable with the pre-financial crisis period. This suggests that the ongoing weakness of sterling compared with before the recession of 2008/09 may be supporting demand for UK exports.

Despite the eurozone economy being in the grip of recession and embroiled in a severe sovereign debt crisis,

businesses expect exports to grow by 4.5% over the next 12 months, up from 3.9% last quarter. There are some tentative signs emerging that the UK is gradually rebalancing its exports away from Europe and towards faster-growing economies: while in 2001 non-EU exports accounted for 39% of total UK exports, by 2011 this had risen to 47%. Goods exports to China rose by over one fifth (22.2%) last year, though this is from a relatively low base. Exports to China accounted for just 3.1% of total UK exports in 2011.

FIG. 5 AVERAGE % CHANGE OVER 12 MONTHS TO ...



Despite the weak consumer environment, businesses have revised up their projections of domestic sales growth this quarter. They expect domestic sales to grow by 4.0% over the next 12 months, up from the 3.0% reported last quarter.

EXPORT GROWTH OUTSTRIPS DOMESTIC SALES GROWTH

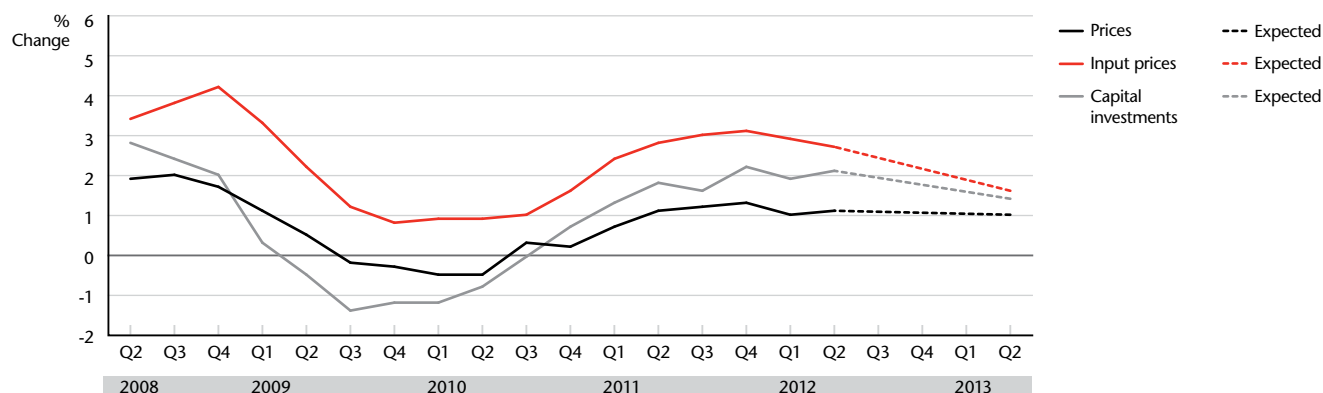
This quarter, businesses report domestic sales to be 2.9% higher than 12 months ago, up from the 2.3% reported last quarter but still significantly lower than the average growth of 4.5% seen in 2008. This suggests that the ongoing financial squeeze on UK households – as earnings growth trails behind inflation – is continuing to curtail domestic demand for goods and services. However, over the next 12 months businesses expect domestic sales to increase by a relatively robust 4.0%. The Office for Budget Responsibility (OBR) expects consumer price inflation to fall over the coming

quarters, which should help alleviate some of the downward pressure on consumer spending power seen recently, though this is likely to be partially offset by a fragile labour market and weak wage growth.

Ever since the third quarter of 2008, reported export growth among businesses has been higher than reported growth in domestic sales, suggesting that some rebalancing of the economy towards export-led growth may be taking place. Over the next 12 months, exports are also expected to grow faster than domestic sales, indicating that businesses expect this rebalancing to continue.

DOMESTIC DEMAND EXPECTED TO STRENGTHEN • EXPORTS FORECAST TO GROW FASTER THAN DOMESTIC SALES

FIG. 6 AVERAGE % CHANGE OVER 12 MONTHS TO ...



Reported selling price growth remains stable this quarter.

Businesses report that selling prices rose by 1.1% over the last 12 months, broadly unchanged from last quarter. Selling price growth remains elevated compared with most of 2009 and 2010.

CAPITAL INVESTMENT GROWTH EXPECTED TO SLOW

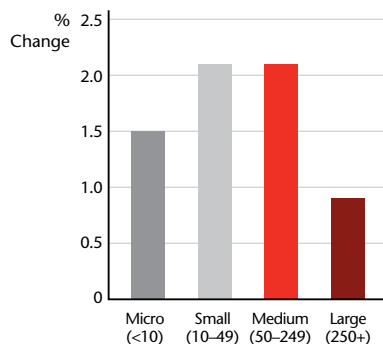
This quarter businesses report capital investment growing by 2.1% over the last 12 months, in line with the 1.9% reported in Q1 2012. However, capital investment growth is expected to slow, with expansion of just 1.4% expected over the next 12 months. In its March 2012 publication the OBR revised its business investment growth forecast for 2012 sharply, from 7.7% down to 0.7%.

Input price growth continued on a downward path this quarter, with firms reporting prices 2.7% higher

than 12 months ago, compared to 2.9% in Q1 2012 and 3.1% in Q4 2011. Nevertheless, reported input price growth remains above that seen through most of 2009 and 2010. Despite a slight decline in April, the price of Brent crude oil remains elevated and well above \$100 per barrel, placing ongoing cost pressures on many businesses. Businesses expect input price growth to continue slowing, anticipating that prices will rise by 1.6% over the next 12 months.

SELLING PRICE GROWTH ELEVATED BUT STABLE • INPUT PRICE GROWTH EXPECTED TO CONTINUE SLOWING

FIG. 7 AVERAGE EXPECTED % CHANGE IN EMPLOYEE NUMBERS



Headcount growth remains weak. This quarter, growth in average number of employees remains weak. Businesses report employee headcount to be on average 0.8% higher than 12 months ago. This is unchanged from last quarter and still significantly below typical pre-financial crisis levels, illustrating ongoing fragility in the private sector labour market.

FIG. 8 AVERAGE EXPECTED % CHANGE IN SALARIES



RATE OF RECRUITMENT EXPECTED TO PICK UP

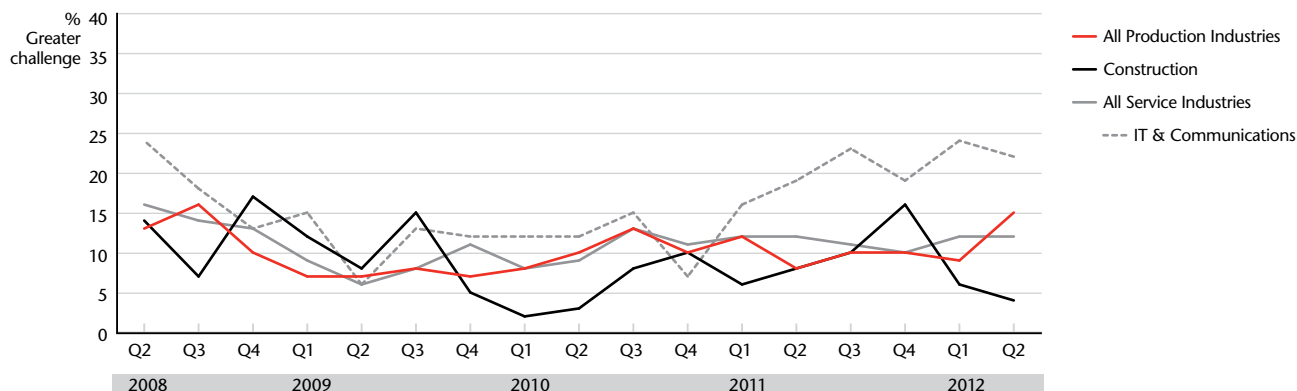
Although reported headcount growth remains weak, firms expect more rapid growth in employee numbers. Headcount is expected to increase by 1.4% on average over the next 12 months, with small and medium-sized firms expecting proportionately greater growth; both anticipate a 2.1% expansion in employee numbers on average over the next 12 months.

Firms report average total salaries to have grown by just 1.0% over the past 12 months. This compares with growth of more than 3.0%

typically seen before the financial crisis, and is also significantly below consumer price inflation, which stood at 3.5% in March. Over the next 12 months, total salaries are expected to increase by on average 1.6% – an improvement on current growth but likely to be significantly below inflation over this time period. Ultimately, this means that the squeeze on employee spending power is likely to persist throughout 2012, bearing down on overall economic growth.

FACTORS AFFECTING BUSINESS PERFORMANCE

FIG. 9 STAFF TURNOVER – CHANGE VERSUS 12 MONTHS AGO



This quarter, just over one in ten (12%) businesses report staff turnover to be a greater challenge than 12 months ago. Before the recession of 2008/09, this proportion stood at over 20%.

IT & COMMUNICATIONS FIRMS MAY FACE SKILLS SHORTAGES

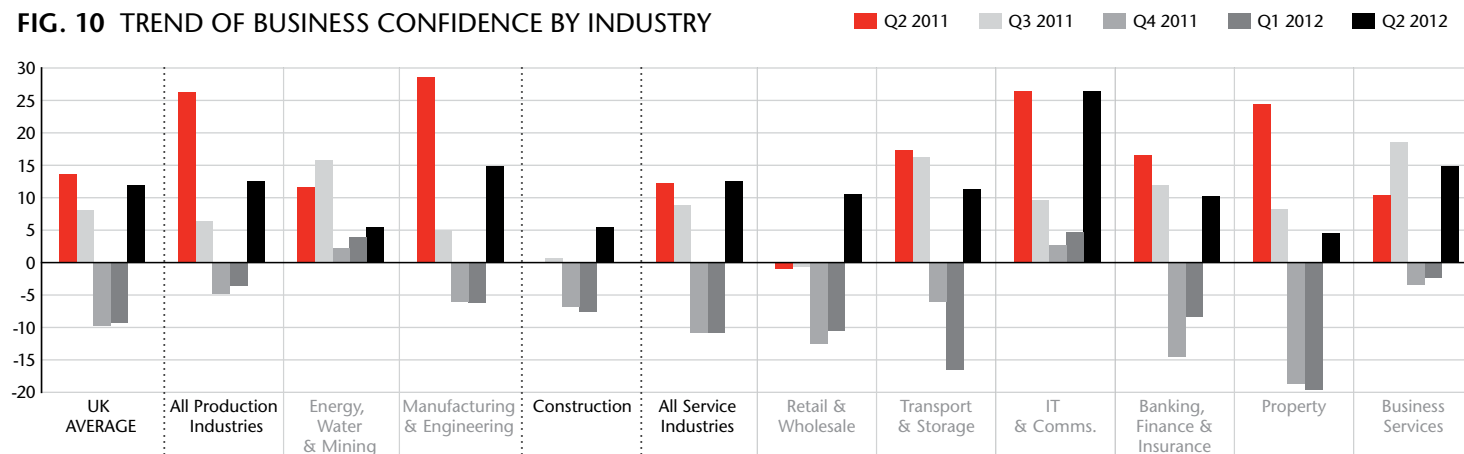
BCM suggests businesses in the IT & Communications sector may be struggling to retain staff with the necessary skills.

This quarter, just over one fifth (22%) of businesses in this sector report staff turnover to be a greater challenge than 12 months ago. This is higher than in other sectors of the economy and also sharply up from the 12% of firms in the sector reporting this trend two years ago.

Higher staff turnover points to a healthy labour market in the sector, where employees can move relatively easily from one company to another. Indeed, over the next 12 months, IT & Communications firms expect to increase headcount more than those in most other sectors – by on average 2.4%. They are also somewhat more likely than others to report availability of management skills to be a greater challenge than a year ago, which is also indicative of stronger hiring intentions in this sector.

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence remains strongest in the IT & Communications sector this quarter. The Confidence Index for the sector stands at 26.5 this quarter, compared to 12.0 for the UK as a whole. Confidence in IT & Communications has been stronger than in all other sectors for three consecutive quarters.

PROPERTY AND CONSTRUCTION CONFIDENCE WEAK

This quarter the Confidence Index is in positive territory across all sectors of the economy for the first time since the end of 2010. Last quarter the Confidence Index was in negative territory for every sector apart from Energy, Water & Mining and IT & Communications.

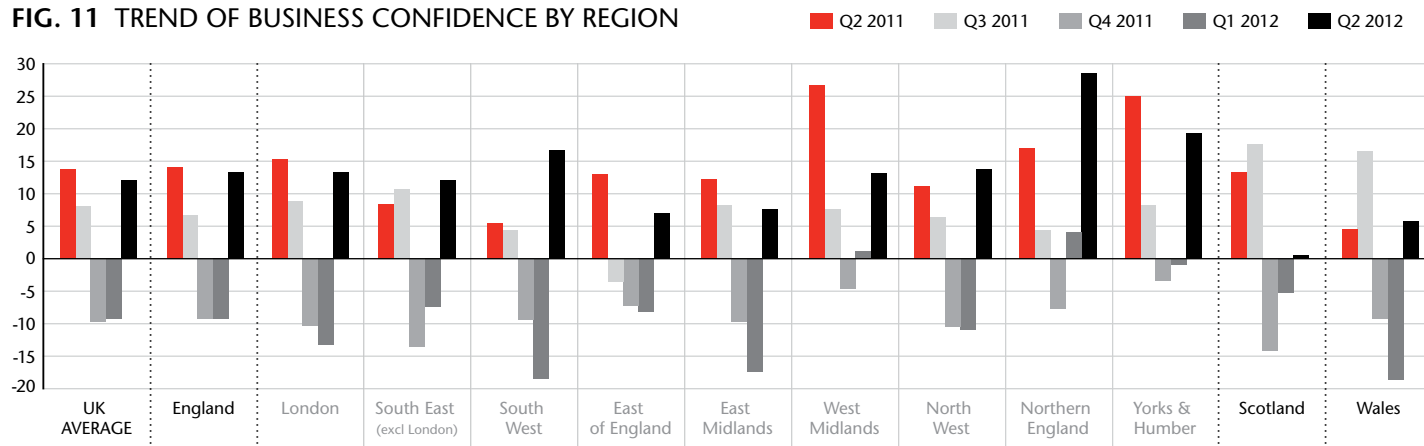
In both Construction and Property confidence is weak compared with other sectors, with the Confidence Index standing at 5.5 and 4.5

respectively. Ongoing fragility in the housing market is likely to be suppressing economic prospects in both sectors; monthly mortgage approvals for house purchases continue to stand at around half typical pre-financial crisis levels. Falling public sector demand is also likely to be suppressing confidence in the Construction sector – the OBR expects government investment to fall by 5.0% this year and by a further 3.6% in 2013.

CONFIDENCE POSITIVE IN ALL INDUSTRY SECTORS • IT AND COMMUNICATIONS FIRMS PARTICULARLY BUOYANT

TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 11 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence has recovered across all UK regions this quarter. The Confidence Index is highest in Northern England, where it stands at 28.4, and lowest in Scotland where it is only marginally positive at 0.6.

CONFIDENCE RETURNS TO POSITIVE TERRITORY IN ALL REGIONS

This quarter, the Confidence Index stands in positive territory across every UK region for the first time since Q2 2011. English businesses are more optimistic than those in Scotland, with the Confidence Index standing at 13.3 in England compared with 0.6 in Scotland.

Scotland is more dependent on the public sector than England, so the less positive outlook north of the border may reflect an expectation among Scottish firms that they will be hit by fall-out from fiscal austerity measures over the coming years. ONS data show that in Q4 2011

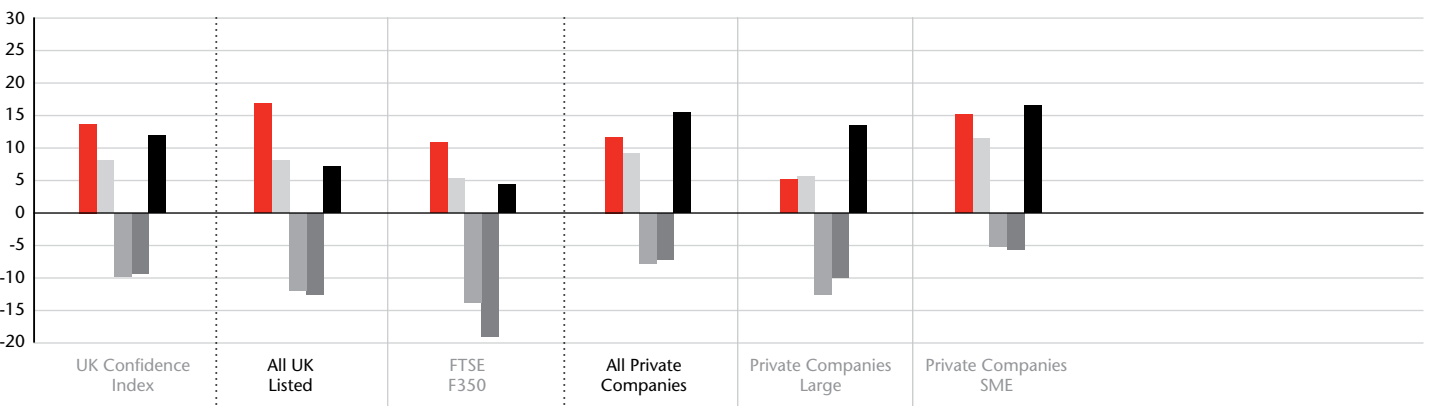
the public sector accounted for 23.8% of employment in Scotland – significantly higher than the 19.6% for England. The Scottish economy grew by 0.5% in 2011, slightly less than the 0.7% seen for the UK as a whole.

There is some variation in confidence across the regions of England and Wales, with the Confidence Index highest in Northern England. Since the beginning of 2011, Northern England has tended to be one of the more positive UK regions, despite its relatively high dependence on the public sector.

CONFIDENCE REMAINS HIGH AMONG NORTHERN ENGLAND FIRMS • OUTLOOK RELATIVELY WEAK IN SCOTLAND

TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 12 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



Confidence has improved among both listed and private companies this quarter. The Confidence Index for listed firms stands at 7.2, in contrast to private companies where it is 15.4.

LISTED COMPANY CONFIDENCE REMAINS WEAKER

Despite returning to positive territory, confidence among listed companies remains weaker than among private companies this quarter. This may reflect the fact that listed companies are more likely to operate overseas, meaning these firms may be affected by the ongoing economic malaise gripping the eurozone.

Small and medium-sized enterprises (SMEs) have tended to be more positive about their economic prospects than larger private firms since Q3 2010. This suggests they may have been – and remain – relatively shielded from the impact of global economic events.

LISTED COMPANIES' CONFIDENCE STILL LAGS PRIVATE FIRMS' • SMES POSITIVE ABOUT ECONOMIC PROSPECTS

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 policy-makers, 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 represents the UK economy by value.

For further technical details please see: BCM Technical Appendix at [icaew.com/bcm](https://www.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 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.

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