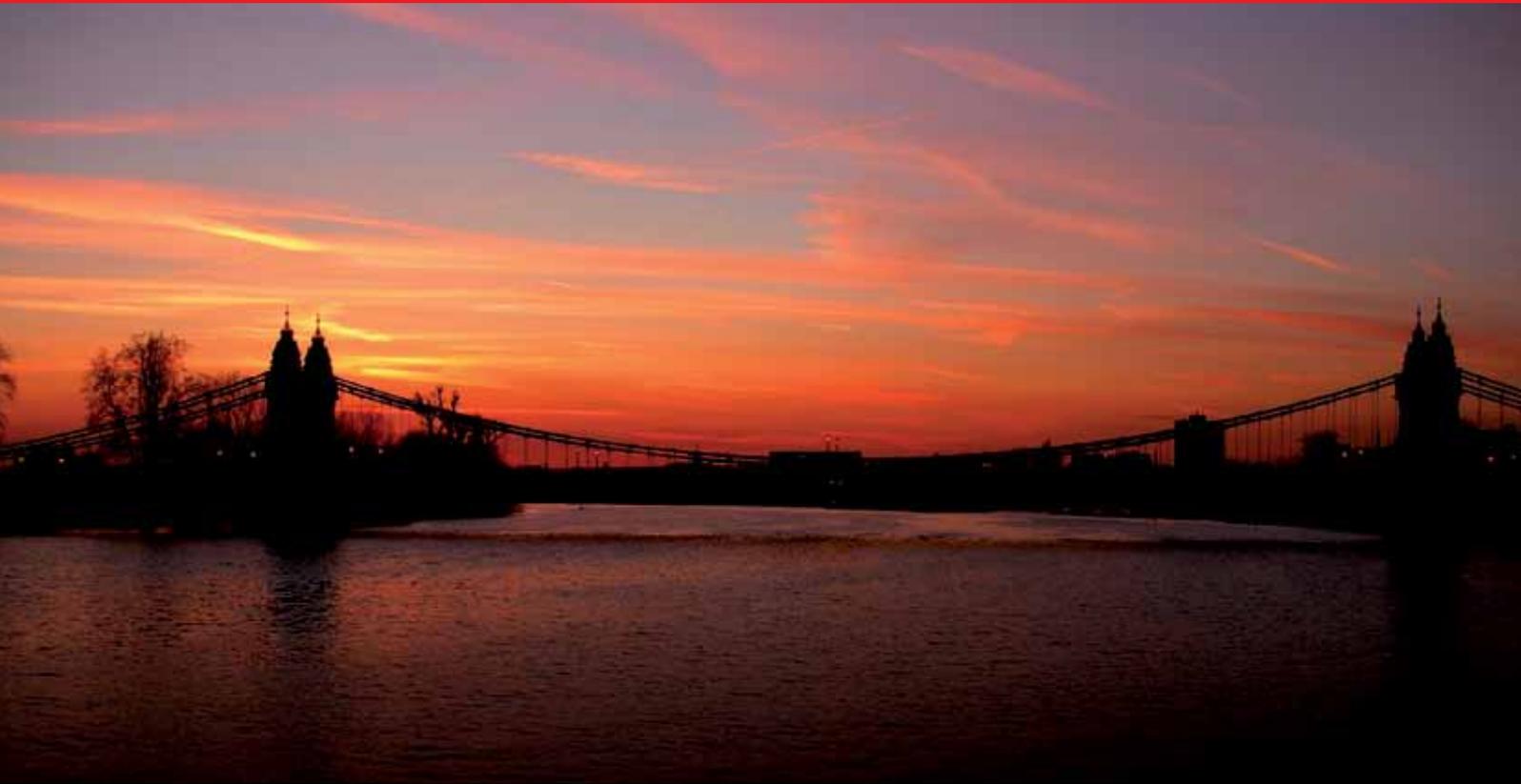




UK BUSINESS CONFIDENCE MONITOR

Q3 2012



WELCOME



The fall in confidence in this quarter's *ICAEW/Grant Thornton Business Confidence Monitor* is disappointing. Companies need to face up to the fact that we could be in a period of prolonged low growth and that the current economic environment may be the norm for some time. That's not to say we shouldn't continue to do what we can to boost confidence and stimulate the economy. New infrastructure is desperately needed to compete with economies in the East. Closer to home, more housing, especially social housing, is also required in almost all parts of the UK.

Given the austerity measures in place such government investment would be difficult, but budgets could be ring-fenced and further efficiency savings made across the board. In the short term at least, the funds this would release might just bring the growth and confidence that businesses and the UK economy need.

A handwritten signature in black ink that reads "Michael Izza". The signature is fluid and cursive.

Michael D M Izza
Chief Executive
ICAEW



Any optimism there was within UK business has dissipated and confidence has fallen back sharply. Growth globally has slowed and despite the continued efforts of the ECB and European leaders, there has been no let-up of the eurozone crisis and little to suggest there will be anytime soon. Businesses have revised down their expectations for turnover and profit growth as they continue to 'wait and see', still choosing to sit on their cash reserves rather than invest for growth.

One of the more positive notes is the expectation for increased levels of exports which is back up to pre-recession levels. Inward investment and overseas expansion will be core to growing the UK economy and as such we applaud any government initiative that seeks to promote UK business on the international stage.

A handwritten signature in black ink that reads "Scott Barnes". The signature is bold and cursive.

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 deteriorated in the third quarter of 2012. The Confidence Index now stands at +1.1, down from +12.0 in Q2 2012.

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 show quarter-on-quarter growth of just 0.1% in Q3 2012, confirming its continuing weakness.

KEY ISSUES EMERGING THIS QUARTER

- A sharp fall in confidence suggests that the UK economy in 2012 will continue to underwhelm.
- In line with the fall in the Confidence Index, businesses have revised down their expectations of future turnover and profit growth.
- Despite a slight slowdown this quarter, expected export growth over the next 12 months is still broadly at pre financial crisis levels, meaning an export-led recovery remains a possibility for the UK in the medium term.
- Business investment intentions remain very modest, with firms expecting capital investments to increase by just 1.0% over the next 12 months.

The Bank of England recently expanded its programme of quantitative easing by a further £50bn to £375bn. The Bank Rate also remains on hold at its historic low of 0.5%. We don't expect a rise in the Bank Rate until 2016, given slow growth is likely to persist as austerity bites and the eurozone economy continues to flounder.

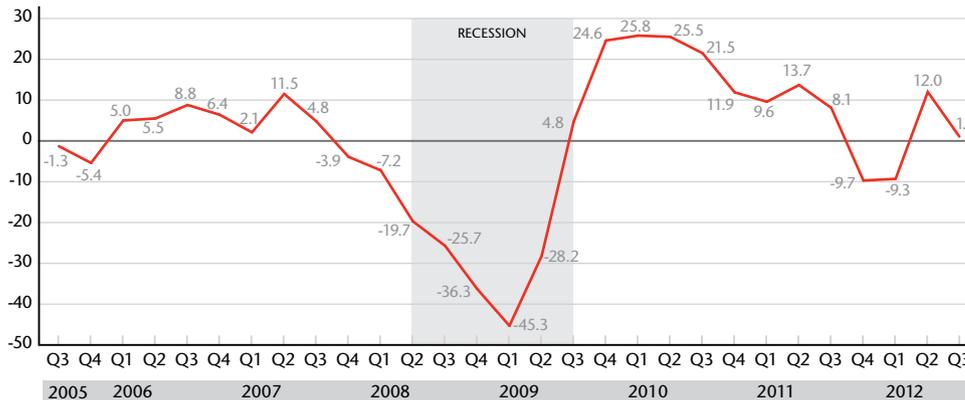
Our view is that, even with incredibly low interest rates, inflation is unlikely to be a problem for the UK over the next four years – weak demand for goods and services should curb price rises. Indeed, we think inflation will undershoot the Bank of England's target of 2.0% next year, and BCM supports this: reported growth in selling prices among businesses this quarter has fallen to its lowest level since Q1 2011. Ultimately, falling inflation means that the Bank of England has little reason to raise interest rates any time soon.



Douglas McWilliams
Chief Executive, Cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q3 2012

FIG. 1 TREND OF UK BUSINESS CONFIDENCE

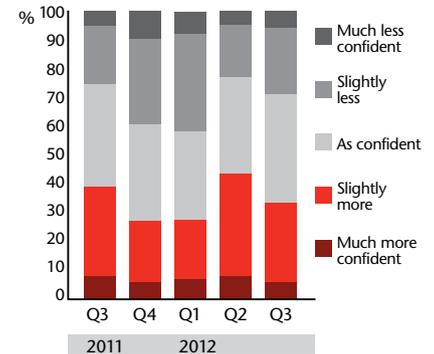


The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence has fallen back this quarter from the more optimistic mood in Q2 2012. The Confidence Index remains just in positive territory at +1.1, down from +12.0 the previous quarter.

CONFIDENCE INDEX FALLS BACK AS OUTLOOK WORSENS

The latest findings from BCM show confidence decreased sharply in Q3 2012, after a temporary boost to optimism in Q2, possibly injected by the Jubilee celebrations, wore off. The Confidence Index fell from 12.0 in Q2 2012 to 1.1 this quarter, highlighting the current fitful nature of growth in the UK economy. However, the Index continues to stand in marginally positive territory rather than returning to the negative readings of the end of 2011 and beginning of this year.

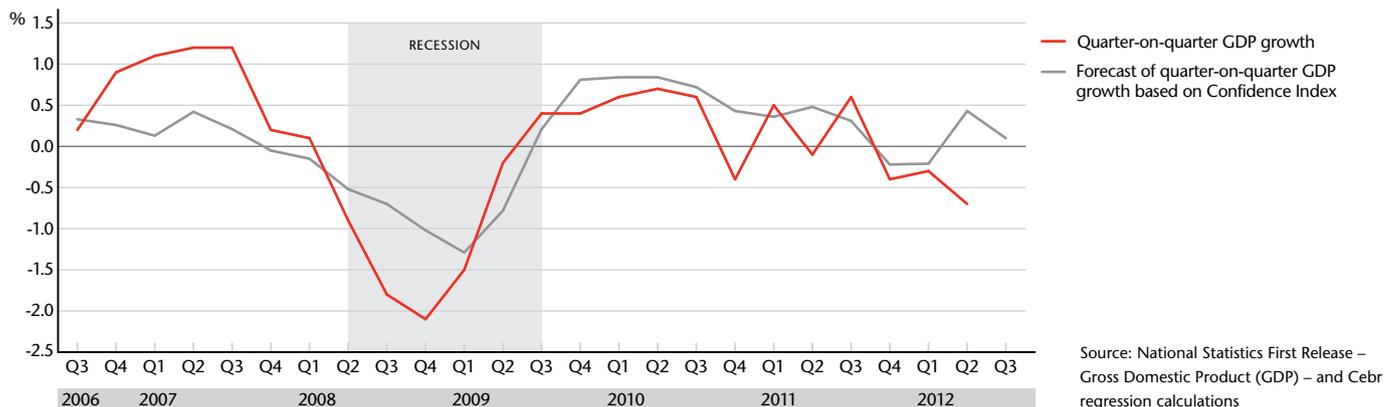
FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES



This quarter, a third of firms (33%) are more confident about their economic prospects for the coming year compared with the previous 12 months, noticeably down from 44% last quarter as businesses shift to being less optimistic.

In addition, the proportion of businesses who believe their prospects are worse for the coming year is up from 22% in Q2 2012 to almost three in ten businesses (29%) this quarter.

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



The economy shrank in the second quarter of 2012 for the third consecutive period, taking the UK deeper into recession. Preliminary estimates from the Office for National Statistics (ONS) show the economy contracted at a quarter-on-quarter rate of 0.7% in Q2 2012. Compared with a year ago, output in the economy is down by 0.8%.

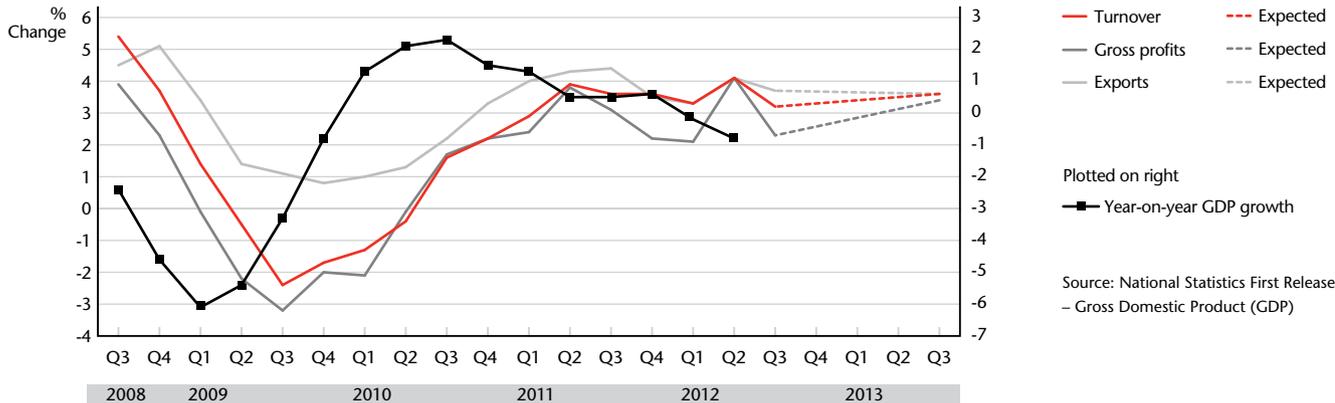
BCM POINTS TO MARGINAL GROWTH AHEAD

The 0.7% quarter-on-quarter contraction in the UK economy in Q2 followed a 0.3% decline in the previous quarter and a decrease of 0.4% in the final quarter of 2011. Sector data from the ONS show output shrinking across the economy; construction output fell by a substantial 5.2% in the quarter, while manufacturing activity declined by 1.4% and the service sector saw a marginal fall of 0.1%. With this third consecutive quarter of decline, output in the UK economy is now some 4.5% below its pre financial crisis peak.

The Q3 2012 Confidence Index points to a continuation of fragile growth conditions in the third quarter of 2012, indicating that the UK economy will see only a marginal expansion later this year. Bank of England governor Sir Mervyn King has indicated that the UK may not have even reached the halfway mark of the current financial crisis yet, and the latest BCM findings suggest improvement in the economic environment remains elusive.

BUSINESS FINANCIAL PERFORMANCE

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



In line with falling confidence, key indicators show business performance slipping back in the 12 months to Q3 2012. Turnover and gross profits have grown by 3.2% and 2.3% respectively, both down from 4.1% for the 12 months to Q2 as economic conditions remain tough. Expectations for growth over the coming 12 months have also weakened.

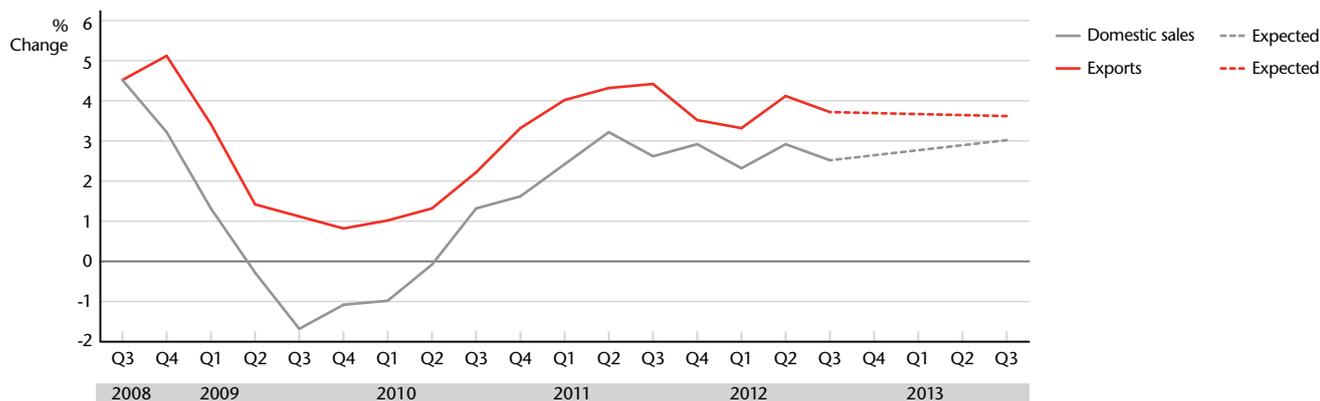
EXPORT GROWTH HOLDS STEADY

This quarter, businesses report exports growing year on year by 3.7%, only marginally down from annual growth of 4.1% reported in Q2 2012. Despite global trade growth slowing to levels seen in the approach to the 2008-09 recession, UK exports have been holding up relatively well, with reported export growth remaining comparable with typical levels seen before the financial crisis.

Businesses also expect exports to hold firm over the coming 12 months, and anticipate export growth of

3.6%. There is further evidence of the UK broadening its export base away from the traditional markets of Europe to higher-growth emerging markets. The share of goods exports to non-EU countries rose significantly above the 50.0% mark in May for the first time since comparable records began in 1998. At a time when the eurozone is embroiled in a period of weak economic growth and sovereign debt crisis, shifting focus away from this market could help provide resilience for UK exporters.

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



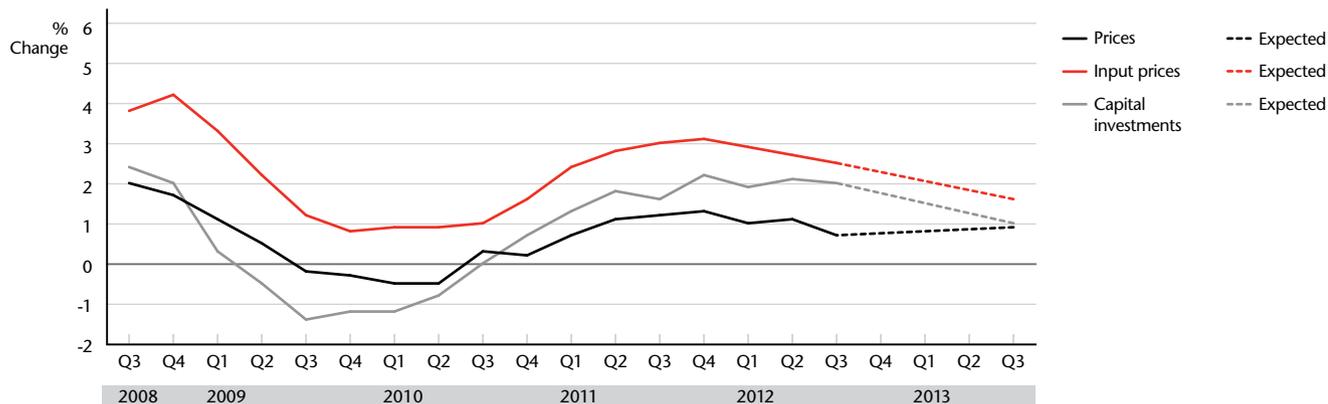
On the back of falling confidence and a weak UK economic environment, business expectations for domestic sales growth have weakened. The more optimistic mood last quarter proved temporary as economic uncertainty has increased: growth of 3.0% is now anticipated for the next year. This is down from a forecast of 4.0% recorded in Q2 and in line with expectations in Q1.

DOMESTIC SALES GROWTH SLIDES BACK

Businesses this quarter report annual domestic sales growth of 2.5%, marginally down from a year-on-year expansion of 2.9% reported last quarter and well below pre financial crisis growth rates. Conditions in the domestic market remain subdued, as consumers' ability to spend is held back by low confidence and a weak labour market. Elevated unemployment is contributing to low average earnings growth by constraining wage-bargaining power, while weak economic activity is holding back performance-related bonuses.

The increase in domestic sales over the past year remains well below annual export growth, highlighting the fragile economic climate in the UK. Businesses expect the trend of low sales growth at home coupled with higher export growth to continue. This suggests that any economic growth this year is likely to be export-led rather than relying on spending by businesses, government or consumers in the UK.

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



Capital investment growth is anticipated to slow in the coming 12 months. Businesses report capital investment rising by 2.0% over the past year, broadly unchanged from growth rates seen over the previous three quarters, but this is expected to slow to 1.0% growth over the coming year.

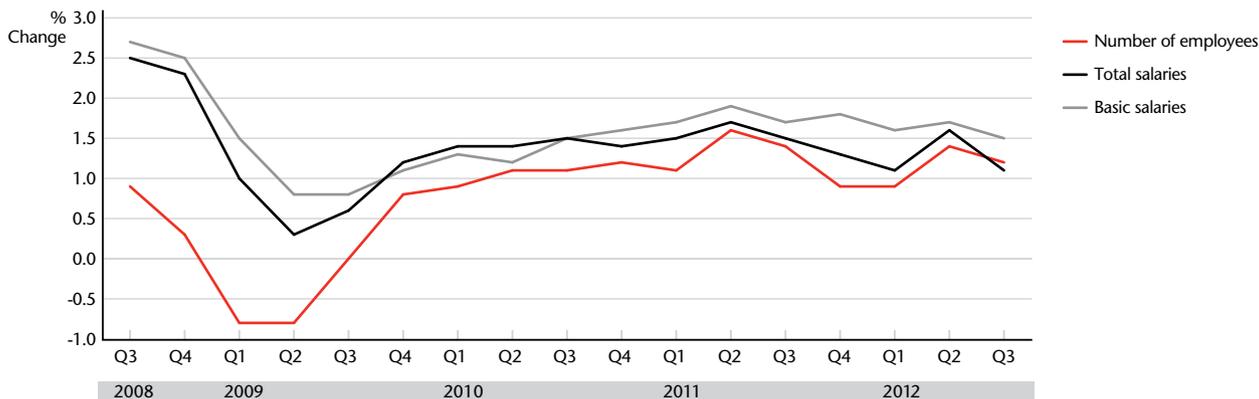
INPUT PRICE INFLATION TO SLOW

This quarter, businesses report a further slowdown for input price inflation with prices growing over the year by 2.5%, easing pressure on bottom lines. This follows a general downward trend from Q4 2011 when input costs rose by 3.1% year on year. Businesses expect input price growth to slow further to 1.6% over the coming 12 months, the lowest annual rate of growth expected since Q4 2010. This reflects the sharp downward trend in the price of Brent crude oil between March and June feeding through into the cost of inputs.

Capital investment growth held steady this quarter, rising over the year by 2.0%. Annual investment

growth has remained broadly unchanged since the final quarter of last year but stands below levels seen before the financial crisis, reflecting ongoing business nervousness. Businesses anticipate investment growth will fall back further over the coming 12 months to 1.0% as the economic outlook remains uncertain. These latest BCM findings suggest that the Office for Budget Responsibility's (OBR) business investment growth forecast of 6.4% for 2013 may be unrealistic.

FIG. 7 AVERAGE EXPECTED % CHANGE OVER 12 MONTHS FROM ...



Expected pay growth remains very weak. This quarter, businesses expect average total salaries to increase over the coming 12 months by 1.1%. This is the lowest salary expectation since Q3 2009, when the UK had just come out of recession.

JOB CREATION IS EXPECTED, BUT AT LOW LEVELS

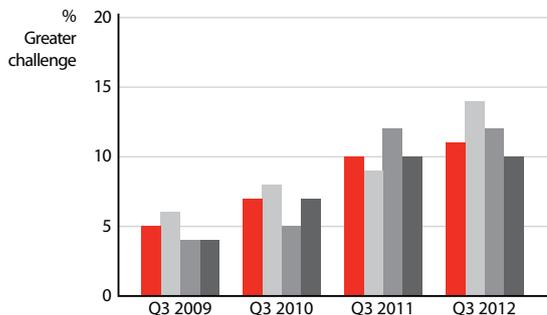
In line with ongoing weak business confidence, private sector firms continue to expect only small increases to their headcount. They expect employee numbers to grow by 1.2% on average over the coming year. With further public sector job cuts planned throughout this government, and the private sector remaining cautious in job creation, employment conditions are likely to remain fragile. However, flexibility in the labour market may have stopped the level of unemployment from rising further, as firms take on more part-time workers. While the number

of full-time employees remains significantly below the pre-crisis peak, part-time employment has risen steadily.

With high joblessness, earnings growth is held back as employees lose wage-bargaining power. Firms expect average total salaries to increase by 1.1% and basic salaries by 1.5% over the next 12 months. This suggests that earnings growth will lag the rate of inflation for the coming year, keeping the squeeze on consumer spending power and acting as a brake on economic recovery in the UK.

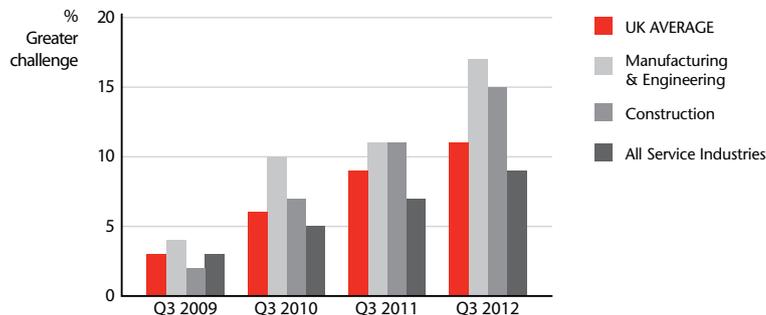
FACTORS AFFECTING BUSINESS PERFORMANCE

FIG. 8 AVAILABILITY OF MANAGEMENT SKILLS – CHANGE V. 12 MONTHS AGO



This quarter, just over one in ten businesses (11%) report availability of management skills to be a greater challenge than 12 months ago, up from just 5% in Q3 2009. The proportion of firms reporting availability of non-management skills to be a greater challenge has also risen compared to 2009. This suggests that, while firms may be thinking about hiring, they may also be finding that recruits with the right skills are in short supply.

FIG. 9 AVAILABILITY OF NON-MANAGEMENT SKILLS – CHANGE V. 12 MONTHS AGO



SKILL SHORTAGE FOR MANUFACTURERS MORE OF A CONCERN

This quarter, 14% of businesses in the manufacturing sector report availability of management skills to be a greater challenge than a year ago. This proportion has been following a general upward trend since 2009, and is currently higher than any service sector.

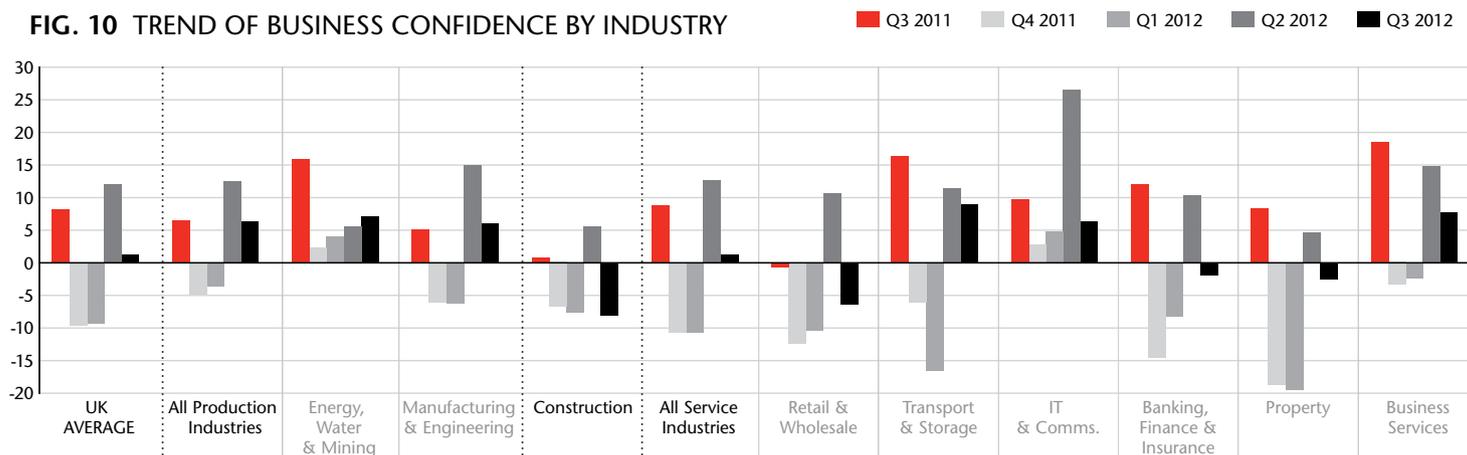
A similar picture is emerging for the availability of non-management skills, with 17% of manufacturers reporting this to be a greater challenge than a year ago. By comparison, availability of skills – particularly non-management

skills – appears less of an issue for the service sector.

This shortage of employees with the right skills for manufacturers suggests a strengthening of the labour market within the industry, and could point to manufacturers playing a leading role in driving UK growth. However, the proportion of firms finding availability of skilled staff a challenge remains below levels typically seen before the crisis, indicating there is still some way to go for economic recovery.

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence has fallen back among construction firms and is now lower than in any other sector. After improved optimism in Q2, the Confidence Index for the industry has decreased to -8.1, broadly in line with the start of the year and end of 2011 as growth conditions remain fragile. Official statistics suggest that construction output fell by 5.2% in the second quarter of 2012.

CONFIDENCE OF FINANCE AND PROPERTY FIRMS FALLS BACK

This quarter, confidence declined across every UK sector except Energy, Water & Mining, taking the Confidence Index back into negative territory in some industries. This latest movement reverses much of the strengthening of optimism seen in Q2, as a temporarily stronger outlook has given way to more uncertain prospects.

Confidence is low in the Banking, Finance & Insurance sector in particular, dropping back to -2.0 from the previous reading of 10.2. Financial

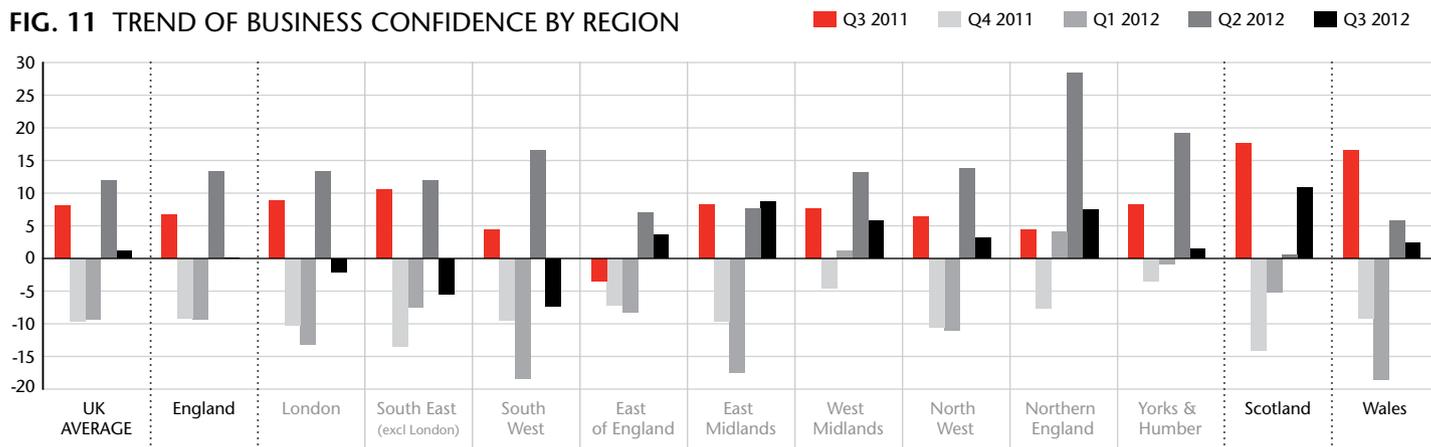
services are particularly exposed to the sovereign debt crisis in some eurozone countries, with levels of activity in the sector remaining at historically low levels.

At the same time, confidence among firms in the Property sector dropped back to -2.5 from 4.5 in Q2 2012. With the monthly number of mortgage applications remaining at low levels and average house prices falling back, economic activity in the sector is subdued.

CONFIDENCE DOWN IN ALL SECTORS EXCEPT ENERGY • ACTIVITY SUBDUED IN FINANCE AND PROPERTY SECTORS

TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 11 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence has declined across the UK this quarter, apart from in the East Midlands and Scotland. The Confidence Index is highest in Scotland where it stands at 10.8 and lowest in the South West where it has fallen this quarter to -7.3.

CONFIDENCE CLIMBS IN SCOTLAND

Confidence among Scottish firms is higher this quarter than in any other part of the UK, as the Confidence Index climbed to 10.8. This continues an upward trend which began at the end of 2011, and optimism in Scotland now stands at its highest level since Q3 2011. Official statistics from the Scottish Government suggest that the economy has performed better than the nation as a whole, contracting by less than the UK overall at the end of 2011 and beginning of 2012.

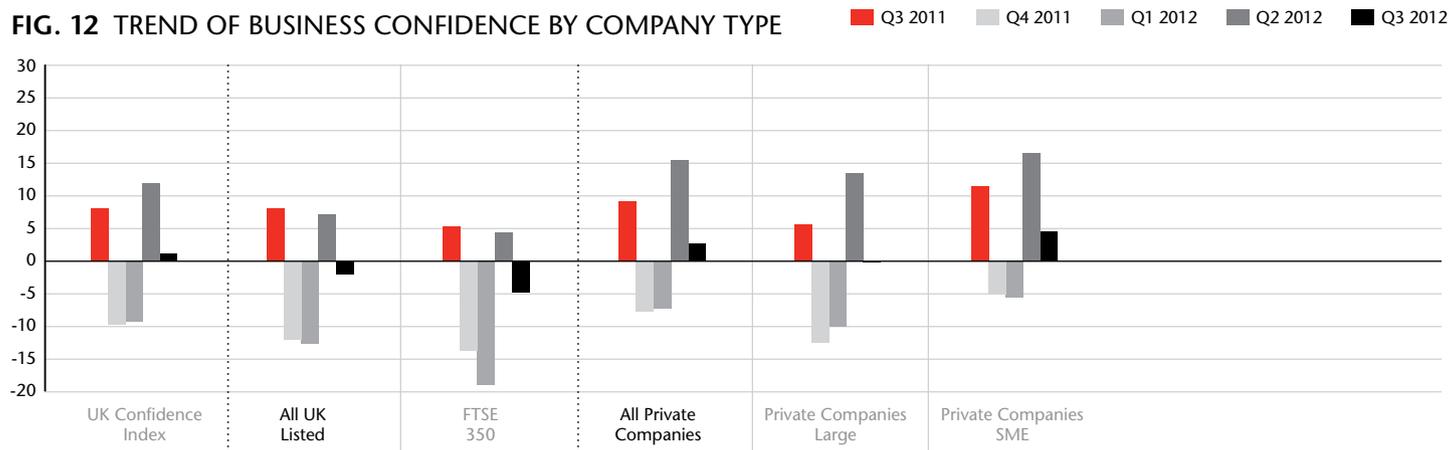
While the outlook for most other parts of the UK worsened this quarter following a strengthening in Q2, the Confidence Index remains above that seen at the end of 2011 and the start of this year in many regions.

This quarter, the southern regions of England have the lowest confidence levels in the UK. London's relatively high dependence on the financial services sector is likely to be weighing on the outlook for the region, as the eurozone sovereign debt crisis depresses levels of activity in the sector.

UPWARD TREND FOR CONFIDENCE IN SCOTLAND CONTINUES • CONFIDENCE LOWEST IN LONDON AND SOUTH

TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 12 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



Optimism among listed companies remains lower than for privately-owned firms, although the gap between the two has narrowed since last quarter. The Confidence Index for all listed firms stands at -2.0 this quarter, with confidence among FTSE 350 businesses continuing to be marginally lower at -4.8.

SMEs REMAIN MORE CONFIDENT THAN LARGER BUSINESSES

This quarter, the outlook of large private companies dipped back into negative territory, with a Confidence Index reading of -0.1. This is down from a reading of 13.5 in the previous quarter as optimism was temporarily boosted, but remains above levels seen in Q4 2011 and Q1 2012.

Confidence among small and medium-sized firms (SMEs) has held up better than among large firms, with the Confidence Index for SMEs remaining positive this quarter. This may reflect the more international nature of larger

companies and greater exposure to worldwide economic pressures weighing down on their business prospects.

Despite dividend payments at record highs in the first half of 2012, confidence among UK listed companies fell back noticeably this quarter, suggesting that strong performance is unlikely to continue.

OUTLOOK OF LARGE FIRMS DIPS BACK TO NEGATIVE TERRITORY • CONFIDENCE HOLDS UP BETTER AMONG SMEs

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 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 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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