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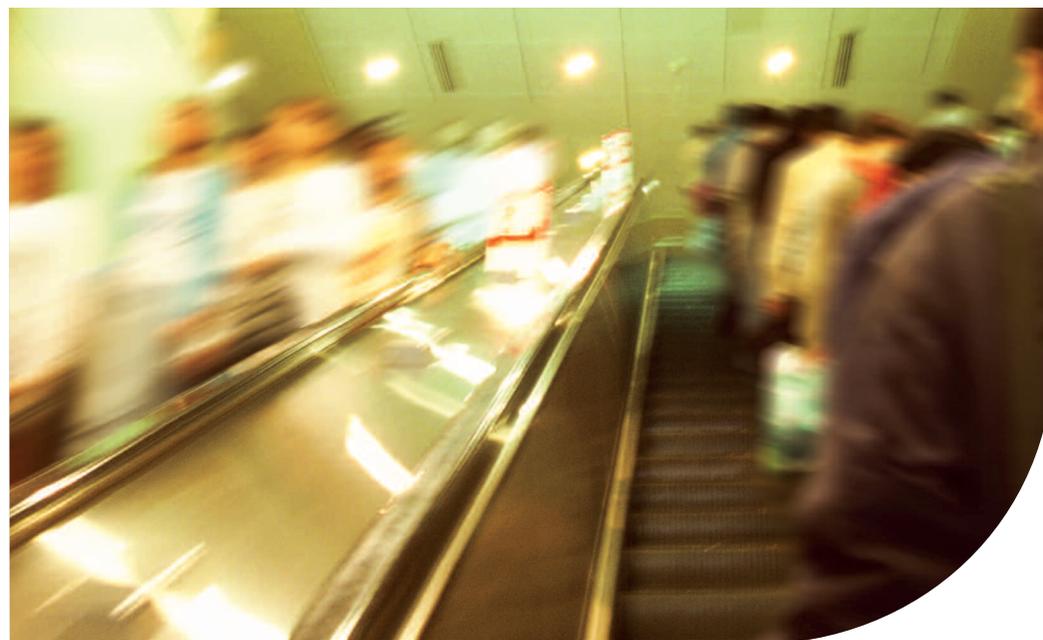
Q2 2008 UK BUSINESS CONFIDENCE MONITOR

National Summary Report

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The slowdown in the economy is no longer just an issue in the City of London. As this quarter's **ICAEW UK Business Confidence Monitor** (BCM) shows, the slowdown has spread to all sectors, to businesses of all sizes, and across all regions of the UK.

In times of financial challenge, cash flow management is critical. If there is a conflict between making profit and generating or saving cash, go for the cash alternative. Loss-making businesses can survive, but businesses that run out of cash will not.

BCM provides a snapshot of the state of the economy, informed by senior business professionals advising and running businesses of all sizes and across every economic sector in the UK. It is one of the largest and most comprehensive quarterly reviews of UK business confidence.

Despite yet another fall in business confidence this quarter, those working in business may take comfort that our detailed economic analysis, while predicting challenging times ahead, continues to suggest the UK economy will escape a recession.

Please visit www.icaew.com/bcm for further analysis and detail about BCM.

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

Q2 2008 KEY POINTS

- Business confidence declines for a fourth consecutive quarter to reach lowest level since the survey began.
- Companies facing the most challenging economic environment since this *Monitor* began and, in all probability, since the early 1990s. However, UK recession remains unlikely.
- Growth in turnover, profits and exports all expected to moderate while access to capital continues to tighten.
- Impact of credit crunch feeding through to all areas of the UK economy. It is no longer just the Financial Services sector in London experiencing real concern, rather findings point to a tough year for businesses of all sizes, in all sectors and regions.
- Property sector painting the bleakest picture for the year ahead driven by increasingly negative indicators in the housing market.
- Consumer confidence also likely to be knocked by falling house prices, increasing repossessions and rising unemployment presenting further challenge to consumer-focused sectors.
- Banking, Finance & Insurance sector remains wary despite Bank of England's special liquidity scheme and rights issues.

FOREWORD

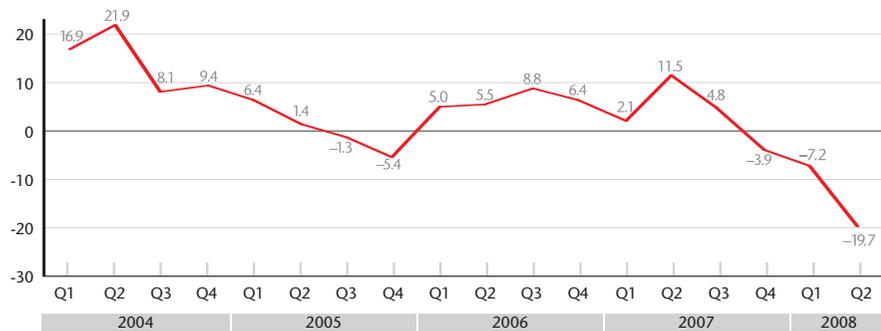
JOHN WARD, CEBR – ECONOMIC ADVISER TO THE ICAEW



UK BUSINESS CONFIDENCE HITS NEW ALL-TIME LOW

The UK slowdown is gathering pace in the second quarter of 2008. Following the turmoil in the financial markets since August 2007 and, with a US economic slowdown well in train, UK plc is feeling the impact of difficult global economic conditions. The impact of the credit crunch is feeding through from the housing market and the Financial sector to all areas of the UK economy. The key finding from the latest ICAEW *Business Confidence Monitor* is that the consumer and housing slowdown is set to create, at the very least, the most challenging business environment since the survey began and, in all probability, as far back as the early 1990s.

Fig. 1 BCM Confidence Index trend



Source: ICAEW UK Business Confidence Monitor

While the gap between the underlying rate of economic growth suggested by our survey and the current official measure (annual GDP growth) remains relatively large, the movement in the Confidence Index correctly predicted the slowdown in UK economic activity in the first quarter of 2008. Business confidence has fallen back significantly since the second quarter of 2007 and, while the decline in real GDP growth is unlikely to be as dramatic, the Confidence Index points to a tough year for businesses. The Confidence Index is negative for businesses of all sizes. It is also negative in every sector and across all regions. This is a marked change from Q1 when the outlook for confidence was more variable across these dimensions, and when there was a sense that the Financial Services sector in London was likely to be most adversely affected.

HOUSING AND CONSUMER SLOWDOWNS IN TRAIN

The slowdown in the UK housing market has become more pronounced of late. In April house prices fell by 1.1% over the year, the first year-on-year decrease since 1996. Month-on-month

falls have been seen for the last six months. New mortgage approvals fell by a huge 44% in March from a year before to record the lowest number of mortgage approvals since Bank of England records began in 1993. The housing market is set to continue to slow, with uncertainty as to the extent of falls in house prices. In this context, it is no surprise to see the Property sector painting the bleakest picture for the year ahead.

As house prices start to fall, consumer confidence will also be knocked. Increasing numbers of homeowners are now facing repossession orders, as evidenced by Ministry of Justice figures, with forecasts that actual repossessions could increase by between 25% and 50%. These problems will be exacerbated by evidence that the labour market is showing signs of bottoming out: February saw the first rise in the claimant count following 16 consecutive months of falling unemployment.

Given this, it is surprising that retail sales were strong in the first two months of 2008, rising by 6% year-on-year. However, figures for March were noticeably weaker and, looking forward through 2008, Confidence Index scores below -20 show that the Hotels & Catering and Retail & Wholesale sectors are bracing themselves for a challenging consumer slowdown.

The Financial sector remains cautious and uncertain following the credit crunch taking scalps on both sides of the Atlantic with the collapses of Northern Rock and, more recently, Bear Stearns. With the announcement of the Bank of England's £50bn special liquidity scheme, and rights issues helping large financial institutions to shore up their balance sheets, some light may be beginning to show at the end of the tunnel for this sector. However, the Banking, Finance & Insurance sector remains wary and is the second most pessimistic sector for the year ahead.

NEGATIVE INDICATORS POINT TO SLOWEST GROWTH SINCE EARLY 1990s

Despite record lows for the Confidence Index and obvious concern at the extent of the financial shock, a UK recession – two quarters of output contracting – remains unlikely. The historic relationship between the Confidence Index and per annum GDP growth suggests growth in the economy of 1.4% in the second quarter of 2008 which would be the lowest since the early 1990s, although the rate predicted by the Confidence Index is on the low side of current estimates.

While the slowdown in the housing market and weakening consumer spending will provide major challenges to the UK economy in 2008, too many comparisons with the early 1990s are dangerous. Interest rates, inflation and unemployment are all much lower now than then. Further to this, the three Bank of England rate cuts seen since December will be followed by further cuts throughout the year as cooling demand takes the pressure off inflation. As and when the current problems in the financial markets are overcome and these reductions are passed through to consumers, further relief will be felt by UK households.

Overall, 2008 looks set to be one of the toughest years seen in recent times for both UK businesses and consumers. With the housing market now in decline and confidence hitting record lows, there are significant worries over the depth of the slowdown. While I believe that some have been guilty of overstating the magnitude of the likely downturn, we can expect economic growth to be well below trend both this year and next.

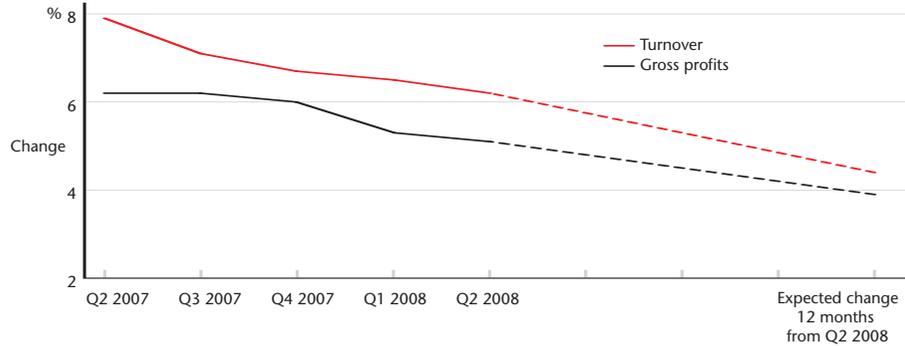
John Ward, cebr
Economic adviser to the ICAEW

MAIN FINDINGS

BUSINESS FINANCIAL PERFORMANCE

Senior business professionals expect a downturn in turnover growth with profits growth also forecast to moderate.

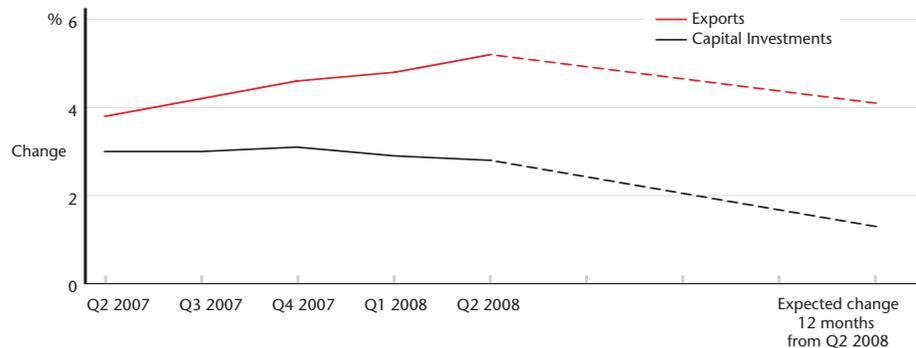
Fig. 2 Change over 12 months to...



The impact of the credit crunch is clear as senior business professionals expect just 1.3% growth in capital investment over the next 12 months. This compares with 2.8% over the previous year and reflects the difficulties across the economy in accessing (debt) capital. In addition, more and more firms report that access to capital is now presenting a greater challenge to business performance than was the case a year ago.

Following a steadily increasing trend in exports growth since the end of 2006, culminating in an increase of 5.2% in the 12 months to Q2 2008, the rate of export growth is expected to moderate to 4.1% over the next 12 months, reflecting weakening global growth prospects. However, despite this expected decline, export growth above 4% is relatively strong, reflecting increased UK competitiveness stemming from the largest depreciation of sterling since the ERM crisis in 1992.

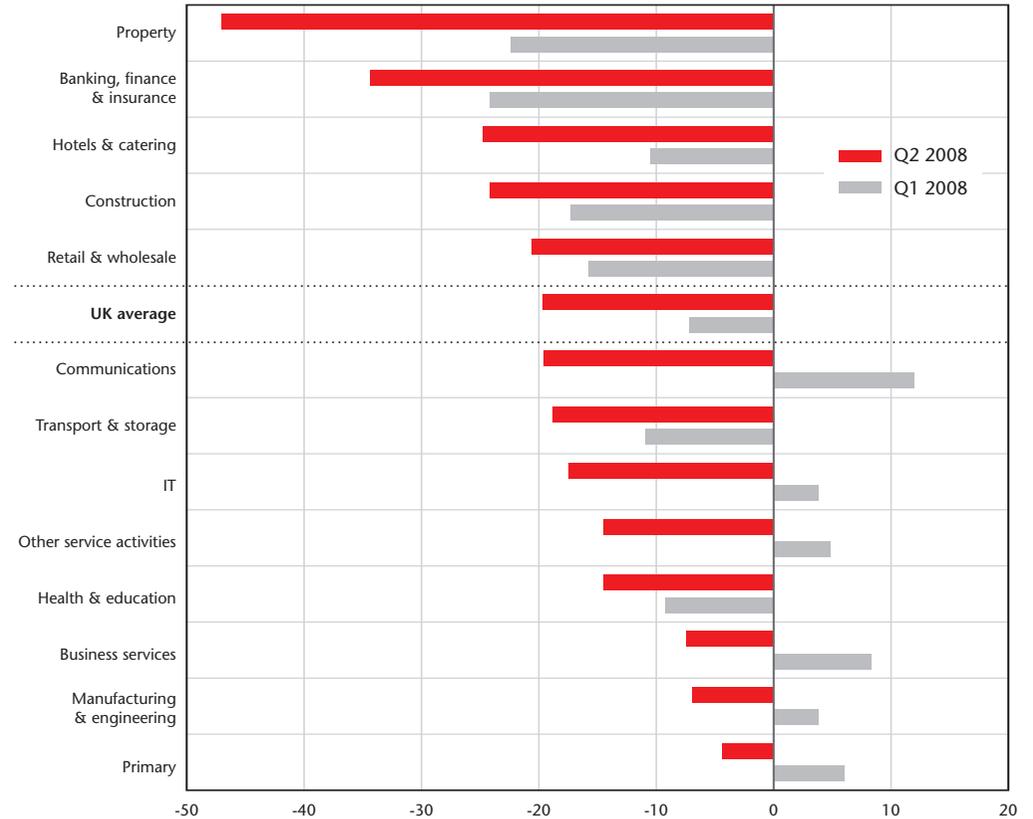
Fig. 3 Change over 12 months to...



TRENDS BY INDUSTRY

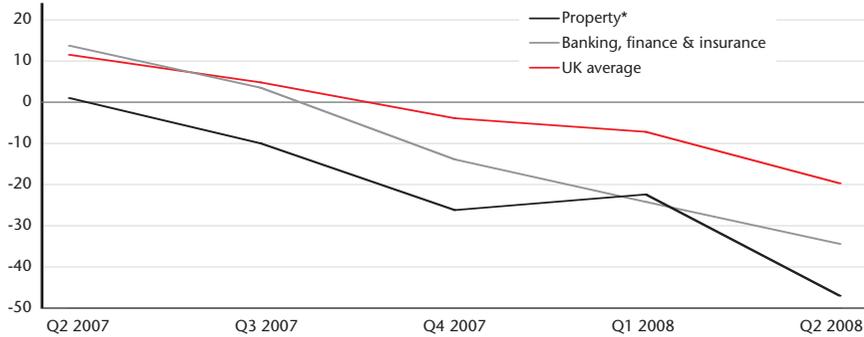
The Property sector records the lowest confidence score in this quarter's *Business Confidence Monitor*, falling to -47.0. Prospects in the Property sector have deteriorated significantly as the UK housing market has slowed considerably.

Fig. 4 BCM Confidence Index trend



Confidence in the Banking, Finance & Insurance sector also remains brittle as the effects of the credit crunch continue to be borne out, with continuing uncertainty and difficulties in the interbank markets. Uncertainty still remains over the extent of subprime-linked write-downs. However, the Bank of England's special liquidity scheme and the shoring up of large banks' balance sheets with new rights issues from major players in this sector may point to some light at the end of the tunnel.

Fig. 5 BCM Confidence Index trend



* Property low base in Q2 2007

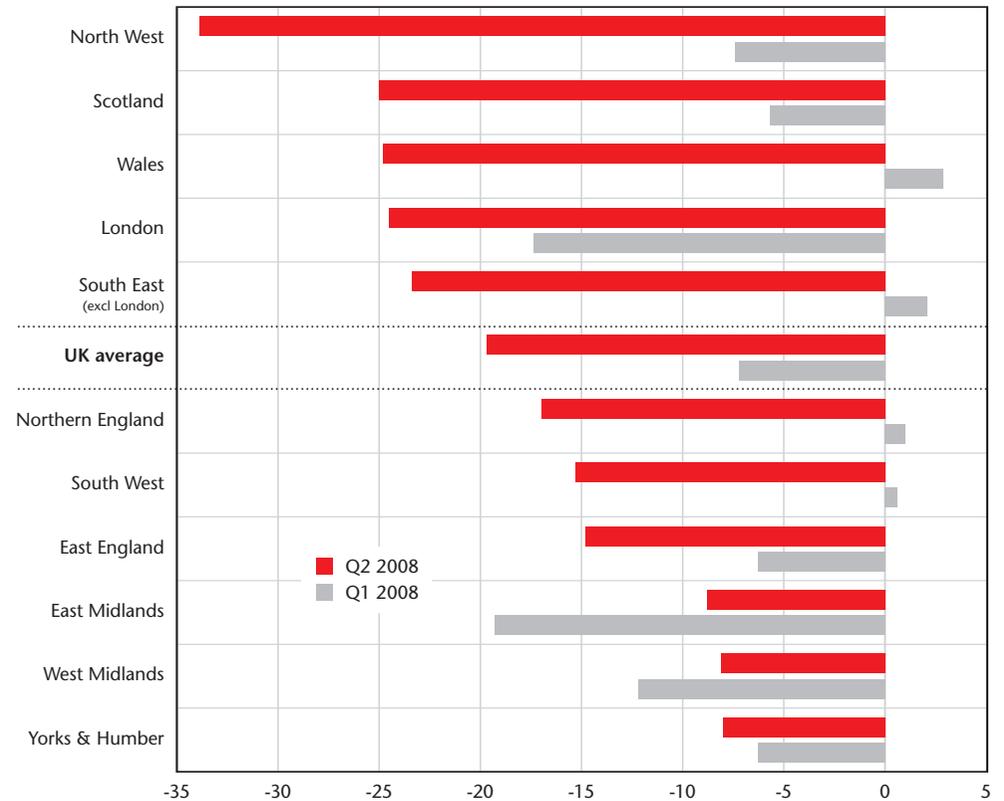
Falls in confidence were recorded across all of the sectors, with no sector now net positive in outlook. Four further sectors appear to have been particularly affected by the prospect of a significant slowdown in UK consumer spending in 2008: the Hotels & Catering, Retail & Wholesale, Communications and IT sectors.

Only three sectors record confidence indices above -10. The outlooks for the Business Services, Manufacturing & Engineering and Primary sectors are the least pessimistic, though still on balance negative.

TRENDS ACROSS UK REGIONS

The average firm in every region of the UK is now pessimistic about the outlook for 2008. Seven of the eleven regions record their lowest ever Confidence Index score since the beginning of 2004. Optimism in London has declined, resulting in a Confidence Index score of -24.5. With confidence in the Property and the Banking, Finance & Insurance sectors both particularly low in the second quarter of 2008, prospects in the capital have weakened considerably.

Fig. 6 BCM Confidence Index trend



In five regions the Confidence Index stands below -20, reflecting challenging business conditions up and down the UK. The most negative region is the North West, where the Confidence Index fell sharply to -33.9.

While no regions are optimistic, two are more upbeat now than in the first quarter of 2008. In the West Midlands, confidence has rebounded somewhat. This region has, however, been among the three most negative for the last two quarters.

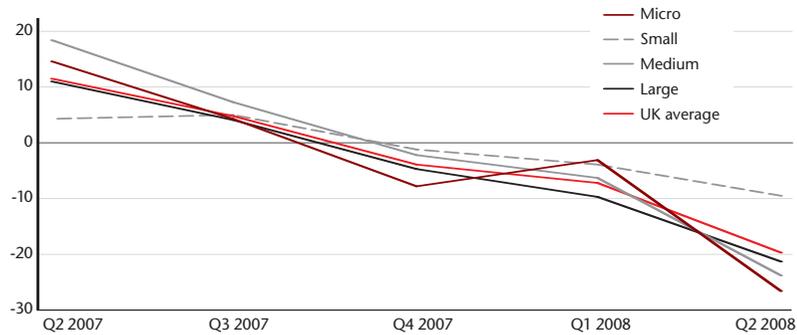
Confidence has also improved in the East Midlands, which was previously the least confident region in the UK, although the long term trend in both East and West Midlands remains down.

TRENDS BY SIZE OF BUSINESS

The key development this quarter is that the significantly weaker prospects for the UK economy now appear to be impacting on all sizes of business.

Micro firms (those employing fewer than 10 people) are the most pessimistic about their business prospects, while the weakening global outlook has seen confidence for Medium (those with 50–249 employees) and Large (250 or more employees) businesses fall every quarter since Q2 2007.

Fig. 7 BCM Confidence Index trend



TECHNICAL INFORMATION

This research was conducted by the Institute of Chartered Accountants in England & Wales (ICAEW) with assistance from centre for economic and business research (cebr).

During the period 29 January to 25 April 2008, 984 ICAEW members working in industry 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.

Further technical details and the full question set available upon request.