



UK BUSINESS CONFIDENCE MONITOR

Q2 2013



WELCOME



The continuing rise in business confidence in this quarter's *ICAEW/Grant Thornton Business Confidence Monitor* shows that the UK economic recovery continues to strengthen. This is also supported by the underlying data within the report and will hopefully give businesses the signal they need to start upping their investment in the UK's economic future.

We still have some way to go before we return to pre-2007 levels of economic activity, and I'm sure there will be some setbacks along the way. The recovery is still susceptible to external events, but as we feel more secure about the UK's medium to long-term outlook, we should be better able to withstand them.



Michael D M Izza
Chief Executive
ICAEW



Our conversations with businesses across the UK reflect the reported improvement in confidence within all sectors, and we are hearing some really positive noises about current performance and their plans for growth – most are doing well. Risks beyond the control of business leaders clearly remain, but domestic demand is stable and export growth is expected to improve: these are key components for further economic improvements.

Disappointingly, reported plans for investment remain weak; however, there are clear signs that things are moving in the right direction and hopefully this wave of confidence should see businesses beginning to free up their cash reserves, a move that will add further strength to the economic recovery.



Scott Barnes
Chief Executive Officer
Grant Thornton

ECONOMIST'S VIEW



The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence continued to improve in the second quarter of 2013 and now stands at +16.7, up from +12.8 in Q1 2013.

The Confidence Index is a leading indicator for growth. Last quarter, the Index predicted that the UK economy would grow in Q1 2013 to avoid a triple-dip recession, and the first Office for National Statistics (ONS) estimates now show that the economy expanded quarter on quarter by 0.3%. This quarter's BCM suggests that the economy will grow by 0.6% in Q2 2013, indicating that the UK economic recovery may be gaining a stronger foothold.

KEY ISSUES EMERGING THIS QUARTER

- A continued increase in confidence suggesting that economic growth will rise in Q2 2013.
- Companies' expectations for profit growth increased further, though remain below typical pre financial crisis levels.
- Business investment intentions remain weak and are broadly in line with the latest Office for Budget Responsibility (OBR) forecast for 2013.
- Expected headcount growth remains modest and employee salary increases are extremely weak.

Initial ONS estimates for Q1 2013 show the economy expanding again, driven almost entirely by the services sector which grew at a quarter-on-quarter rate of 0.6%. The construction sector continued to constrain growth, seeing a contraction of 2.5% over the same time period. However, this quarter's BCM shows a sharp improvement in construction business confidence, suggesting that the worst may be over for the sector.

Downside risks to the UK economy still remain, in particular from the ongoing economic crisis in the eurozone. Gloomy news continues to emerge from the region and a further output contraction is likely in 2013. This will pose a significant challenge to UK exporters, threatening a potential trade-led recovery. In addition, despite continued growth in many key performance indicators in the BCM, data remain below pre-crisis levels.

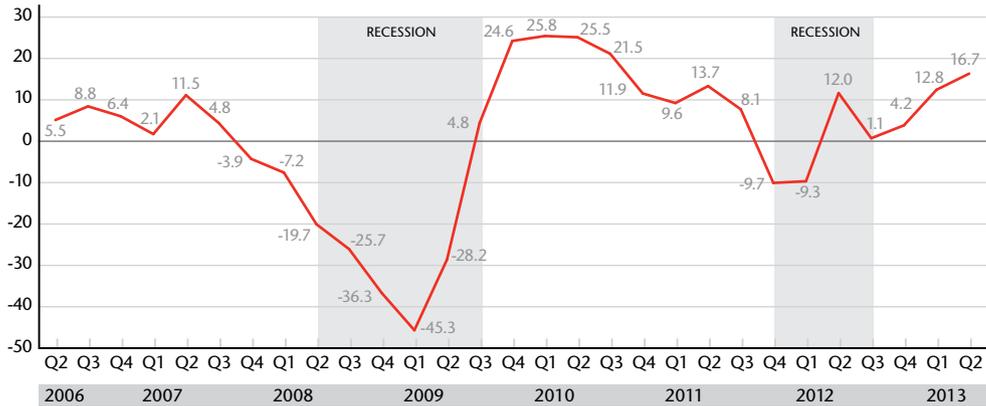
However, overall the latest economic statistics and BCM data suggest that the UK economy has not only beaten off concerns about a triple-dip recession, but economic recovery is starting to stand on more solid ground.



Douglas McWilliams
Chief Executive, Cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q2 2013

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



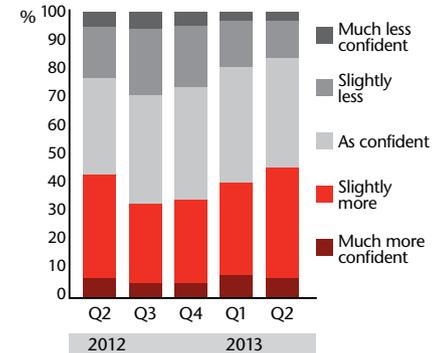
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows further signs of strengthening business conditions. The Confidence Index for Q2 2013 stands at +16.7, up from +12.8 in Q1 2013, and also higher than the same quarter a year ago when the figure was +12.0.

POSITIVE TREND IN BUSINESS CONFIDENCE CONTINUES

The latest findings from BCM show business confidence reaching its highest point since Q3 2010. This quarter sees the third consecutive year-on-year increase on the Index, following two full years of negative year-on-year movement, suggesting that businesses feel that conditions are notably stronger in 2013 than they were in 2012.

This quarter, almost half of businesses (46%) are more confident about their economic prospects over the coming 12 months compared to the previous 12 months. This is up from 40% last quarter and is the highest share since Q4 2010. At the same time, the share

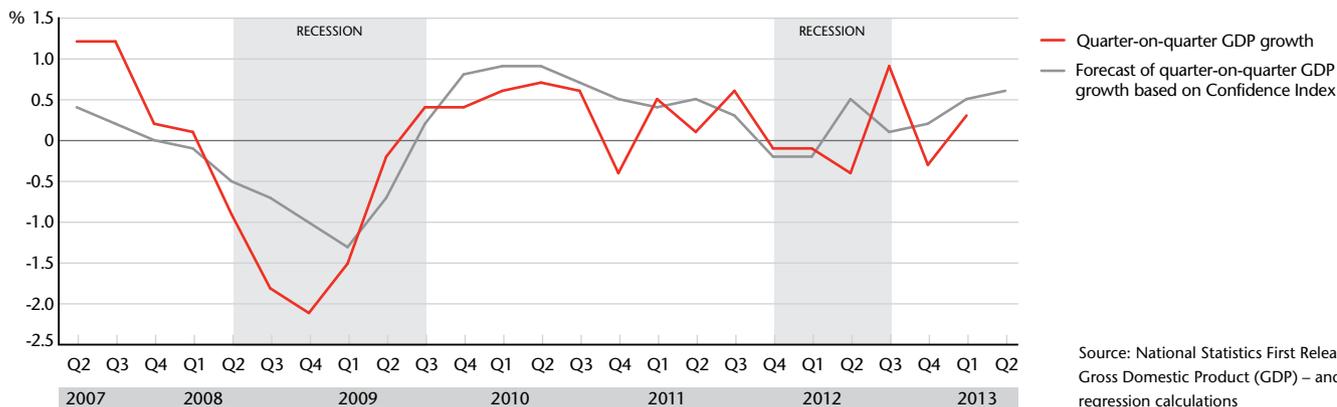
FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES



of businesses reporting they are less confident about their prospects has fallen back to its lowest in three years, at just 16%.

CONFIDENCE INCREASES SIGNIFICANTLY IN Q2 2013 • CONFIDENCE NOW AT HIGHEST LEVEL SINCE Q3 2010

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



Source: National Statistics First Release – Gross Domestic Product (GDP) – and Cebr regression calculations

The UK economy expanded in the first quarter of 2013, avoiding a fall into triple-dip recession. Initial estimates from the ONS show the economy growing at a quarter-on-quarter rate of 0.3% in Q1 2013, with the level of output standing some 0.6% above its reading at the same point a year earlier.

BCM INDICATES RISING UK GROWTH IN 2013

The latest Confidence Index suggests that the economy will expand by 0.6% in Q2 2013. If realised, this would help to put the year on a strong footing and take the level of output further back towards its pre financial crisis peak.

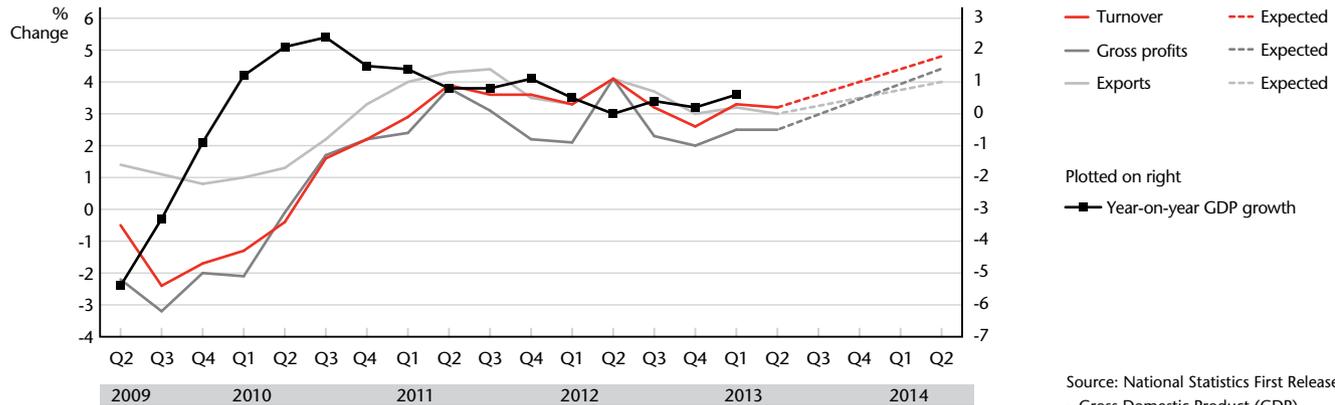
While the economy grew in Q1 2013, growth was not felt equally across all industries and there are continued risks to the recovery. Much of the growth came from the service sector, which accounts for around 75% of the economy and which experienced strong quarterly growth of 0.6%. In contrast, the manufacturing and construction sectors both contracted

in Q1 2013, with output falling by 0.3% and 2.5% respectively over the quarter. Recent quarters have seen increases in business confidence in both construction and manufacturing, which could indicate that the worst is over for these sectors and they will soon be able to contribute to overall UK growth.

AFTER AVOIDING A TRIPLE-DIP RECESSION IN Q1 2013, UK ECONOMY SET FOR 0.6% GROWTH IN Q2 2013

BUSINESS FINANCIAL PERFORMANCE

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



Source: National Statistics First Release
– Gross Domestic Product (GDP)

This quarter, businesses report steady growth in their key financial performance indicators, backing up the improvement in sentiment.

Over the past 12 months turnover rose by 3.2% and gross profits increased by 2.5% – both largely unchanged from annual growth in Q1 2013. At the same time, export sales increased year-on-year by 3.0% this quarter, holding up well despite slow global trade growth.

BUSINESSES EXPECT STRONGER GROWTH PERFORMANCE AHEAD

While it is encouraging that businesses continue to report growth in financial performance indicators, the rate of growth remains below the levels seen before the financial crisis, and further sustained growth will be needed to regain that momentum.

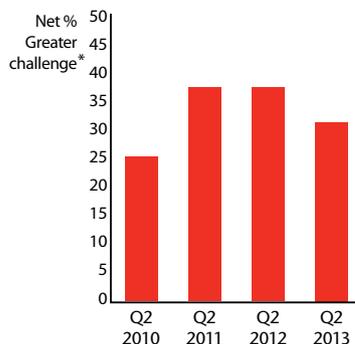
There are emerging signs that this may be achieved: in line with rising confidence levels, UK businesses are expecting stronger growth performance ahead. Turnover growth over the next 12 months is expected to increase to 4.8% and gross profits are predicted to rise by 4.4%, the strongest expectations for both since Q2 2011.

Exports are expected to expand over the same period by 4.0%. This is encouraging in light of persistently weak world trade volume growth and ongoing recession in the eurozone. However, much higher levels of export growth would still be needed to deliver George Osborne's vision of doubling exports by the end of the decade.

Despite steady growth in turnover and profits, there is still spare capacity in the economy. This quarter, 58% of businesses report operating at below capacity, broadly unchanged since the 2008-09 recession.

BUSINESSES REPORT CONTINUED TURNOVER AND PROFIT GROWTH • EXPORT GROWTH IS EXPECTED TO RISE

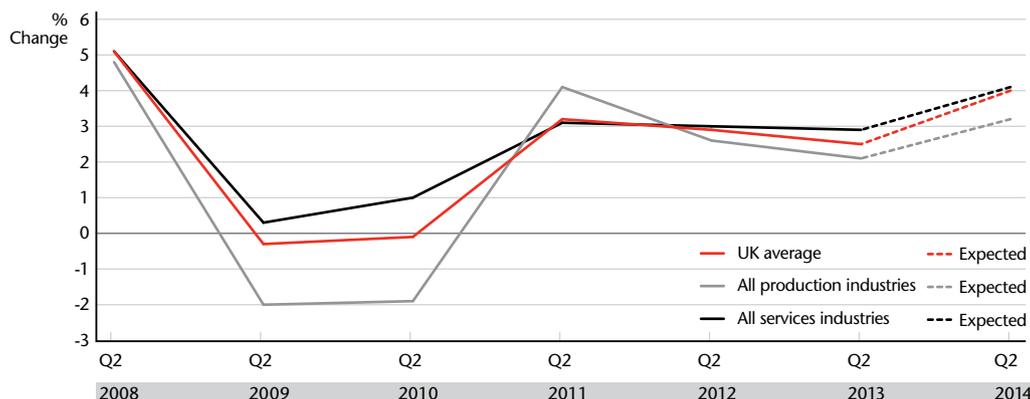
FIG. 5 CUSTOMER DEMAND AS A GREATER CHALLENGE



UK domestic demand levels are holding up relatively well in 2013, particularly in the service sector which this quarter reports annual domestic sales growth of 2.9%, broadly in line with figures seen in the same quarter in 2012 and 2011.

*calculated as the proportion of companies saying 'greater challenge', minus the proportion of companies saying 'less of a challenge'

FIG. 6 DOMESTIC SALES – AVERAGE % CHANGE OVER 12 MONTHS TO ...



BROAD-BASED UPTICK IN DOMESTIC SALES EXPECTED

The relatively robust domestic demand experienced by service sector companies contrasts with those in the production industries, where businesses have seen annual domestic sales growth slow to 2.1% this quarter, compared to 2.6% a year ago and 4.1% in Q2 2011.

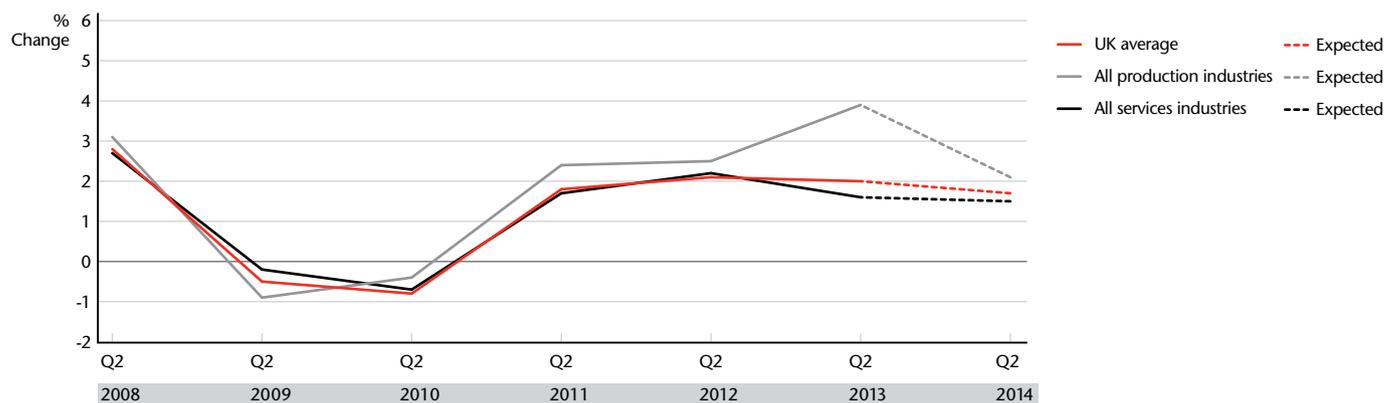
Businesses across the private sector are more optimistic about their domestic performance over the coming 12 months. Service sector businesses expect domestic sales to rise over the coming year by 4.1%, while those in production expect growth to increase to 3.2%.

Further evidence of a strengthening domestic economy comes as the net balance of all UK businesses reporting customer demand levels as a greater challenge to business performance has fallen to its lowest since 2010.

Despite these positive BCM findings, there are downside risks to the domestic outlook, as 2013 will see real household income growth constrained by a combination of low pay growth and elevated inflation. The OBR forecasts real household income growth of just 0.2% in 2013, down from 1.6% in 2012.

DOMESTIC DEMAND EXPECTED TO HOLD UP DESPITE CONTINUED HIGH INFLATION AND LOW PAY GROWTH

FIG. 7 CAPITAL INVESTMENT – AVERAGE % CHANGE OVER 12 MONTHS TO ...



Annual growth in capital investment has remained broadly stable across the UK for much of the past two years. Beneath the headline figure, this quarter production industries have shown faster annual growth than a year ago, while service sector companies have now slowed growth in their investment spending compared to Q2 2012.

SLOWER CAPITAL INVESTMENT GROWTH EXPECTED

This quarter, businesses increased their capital investment year on year by 2.0%, a broadly unchanged growth rate compared to last quarter and to a year ago. However, businesses expect growth to slow marginally over the coming 12 months to 1.7%, in a discouraging sign for UK growth prospects. The OBR revised down its forecasts for real business investment growth over 2013 from 4.9% in its December forecasts to 1.9% in the March outlook, taking the forecast broadly in line with the latest BCM findings.

Businesses in the production sector expect the greatest slowdown. These

companies expect investment growth to fall to 2.1% over the next 12 months, down from the 3.9% seen over the past year. This is despite the increase in the annual investment allowance to £250,000 a year from January 2013 from the previous limit of £25,000. Meanwhile, service sector businesses expect investment growth to remain broadly unchanged at 1.5%, compared to 1.6% over the past year.

BUSINESSES EXPECT CAPITAL INVESTMENT GROWTH TO SLOW, PARTICULARLY IN THE PRODUCTION SECTOR

FACTORS AFFECTING BUSINESS PERFORMANCE

FIG. 8 TAX BURDEN AS A GREATER CHALLENGE

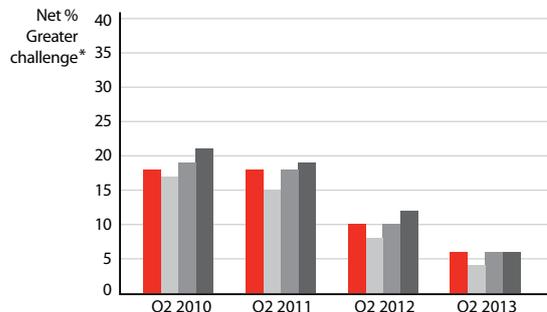
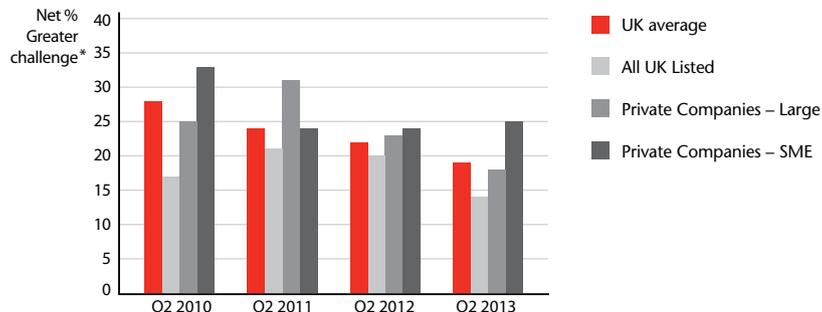


FIG. 9 LATE PAYMENT FROM CUSTOMERS AS A GREATER CHALLENGE



There is evidence this quarter that some of the financial pressures facing UK businesses are easing. The net share of companies viewing the tax burden as a greater challenge has fallen across the board, while a smaller net share of large companies are reporting that late payment from their customers is a greater challenge.

BUSINESS ENVIRONMENT SHOWS SIGNS OF STRENGTHENING

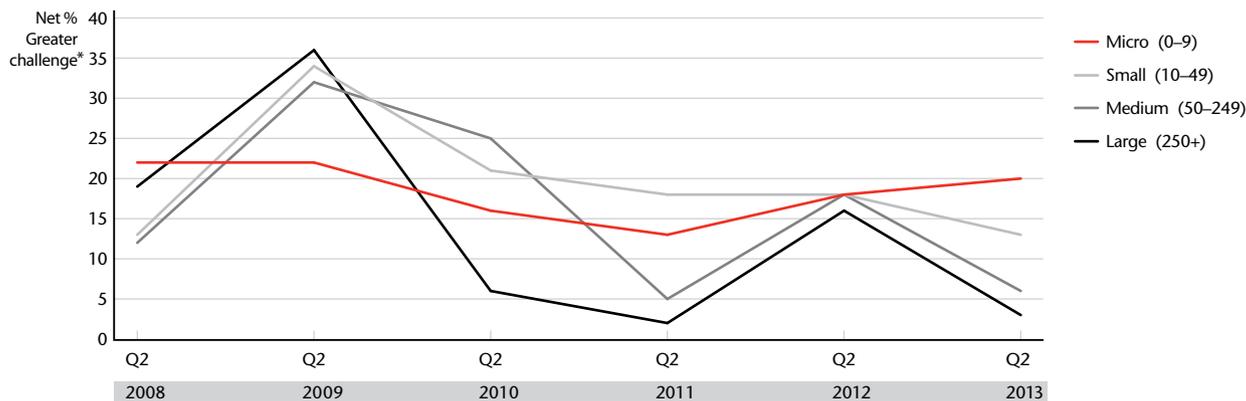
This quarter, a net balance of just 6% of businesses report that their tax burden is a greater challenge to organisational performance now than a year ago, down from 10% in Q2 2012 and from 18% in Q2 2011. These findings come alongside reductions in corporation tax since 2010 and the announcement in March of a reduction in Employer National Insurance Contributions by £2,000 a year for all companies, particularly helping small businesses.

to 19% this quarter, following a downward trend from a high of 49% in Q2 2009. However, there are concerns among SMEs as the net share finding late payment a challenge remains broadly unchanged over the past two years at 25%. A parliamentary inquiry into the effect of late payment on SMEs took place in April 2013, finding that businesses in all sectors are being hit, but particularly those in the construction sector.

In addition, the net balance of businesses reporting that late payment from customers is a greater challenge than a year ago has fallen

*calculated as the proportion of companies saying 'greater challenge', minus the proportion of companies saying 'less of a challenge'

FIG. 10 ACCESS TO CAPITAL AS A GREATER CHALLENGE



This quarter, access to capital funding is a greater operating challenge for a smaller net share of businesses. However, better access to capital is not being felt equally among all sizes of company, with the greatest improvements being felt by large organisations, while small businesses have seen little change.

ACCESS TO CAPITAL STILL A PROBLEM FOR SMALL BUSINESSES

Larger businesses are experiencing an easing of the challenge of access to capital. For those companies employing 250 or more workers, a net balance of just 3% report this factor as a greater challenge now than a year ago, down from 16% in Q2 2012. Likewise, for medium-sized businesses employing 50-249 staff the net balance has dropped to 6% this quarter from 18% a year ago.

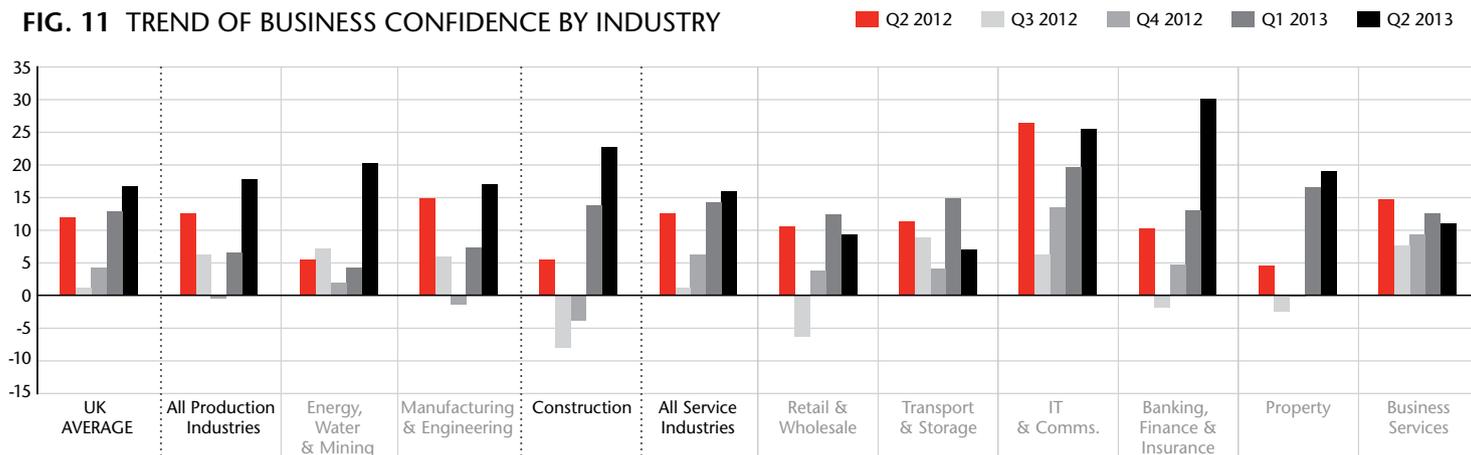
These findings come despite the introduction in August 2012 of the Funding for Lending scheme, designed to boost lending to small businesses and households. The latest figures from the Bank of England show that in the six months to February, lending to small businesses fell by 6.3% from the previous six months, compared to growth of 3.6% for large companies.

In comparison, a net balance of 13% of small companies and 20% of micro-businesses are finding access to capital a greater challenge now than a year ago. Indeed, for micro-businesses this share has risen from 13% in Q2 2011.

*calculated as the proportion of companies saying 'greater challenge', minus the proportion of companies saying 'less of a challenge'

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



This quarter sees a further increase in business confidence across the economy, with the Confidence Index rising in the Production sector, and in Banking, Finance and Insurance. Confidence in the Construction and Manufacturing sectors has been on a general upward trend over the past year, suggesting they may be able to turn around recent declines in output.

BROAD-BASED STRENGTHENING OF BUSINESS CONFIDENCE

Confidence stands in positive territory in every sector of the economy in Q2 2013 for the second consecutive quarter, making for a broad-based recovery. However, the change in confidence varies across the different sectors.

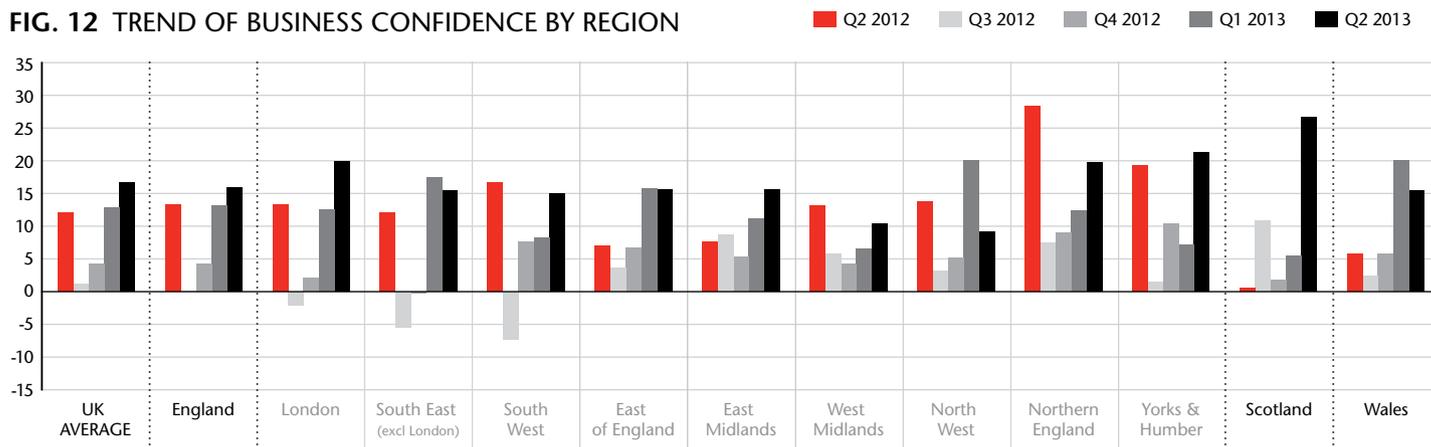
The Confidence Index for the Construction sector climbed to +22.7 this quarter, following a strong upward trend from a low of -8.1 in Q3 2012, and now stands at its highest since Q1 2010. These latest findings suggest that the worst contractions may be over, after output fell quarter on quarter by 2.5% in Q1 2013 and stood 5.9% below its level a year before.

In addition, both the Banking, Finance & Insurance and IT & Communications sectors saw continued strong performance. IT & Communications are expected to be a key driver of the UK economy in the coming years, and although the financial services sector is unlikely to grow as quickly as before the financial crisis, the recent uptick in confidence is an encouraging sign for a sector that employs almost 1.2m workers.

CONFIDENCE POSITIVE ACROSS THE ECONOMY • SIGNS THE PRODUCTION SECTOR MAY HAVE TURNED THE CORNER

TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence strengthened further across much of the UK this quarter, with optimism now standing in positive territory in every UK region for the second consecutive quarter. There are significant increases in the Confidence Index in Scotland and Yorkshire & Humber.

CONTINUED CONFIDENCE SEEN AROUND THE UK

London has seen a steady increase in business confidence in recent quarters which now stands at its highest since Q1 2011, boosted in part by strengthening optimism in the Banking, Finance and Insurance sector. Meanwhile, although the Confidence Index for the South East declined marginally this quarter it remains above its reading from the latter part of 2012. Business confidence in these regions is important for the UK outlook, as together they comprise more than a third of the total economy.

Confidence in Scotland has also risen recently, with a sharp increase in

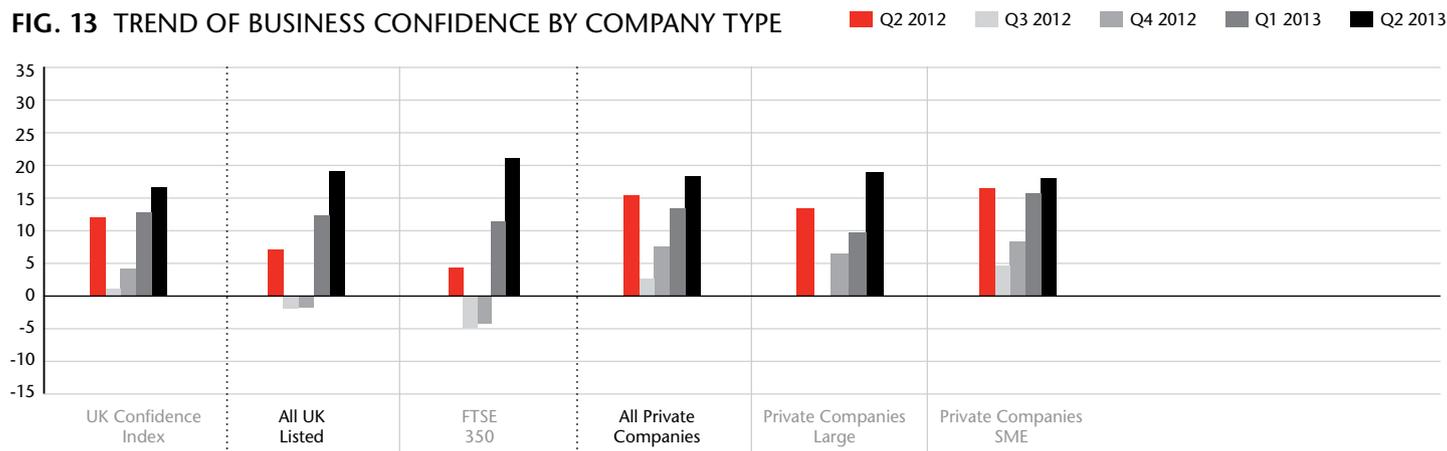
Q2 2013 taking the Confidence Index to its strongest reading since Q3 2010. The Scottish economy fared better in the final quarter of 2012 than the UK as a whole, with output levels increasing by 0.5% quarter on quarter against the UK's 0.3% contraction.

Wales saw a slight weakening in confidence in Q2 2013 compared to the previous quarter, although business optimism remains significantly higher than it was a year ago.

ALL REGIONS SHOW CONFIDENCE IN POSITIVE TERRITORY • SECOND CONSECUTIVE QUARTER OF POSITIVE READINGS

TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



This quarter saw a strong resurgence of business confidence among both FTSE 350 listed companies and large private companies, with the Confidence Index for both standing at its highest level since the second half of 2010. Confidence among these companies has now broadly caught up with that of SMEs, after lagging below over the past year.

CONFIDENCE REBOUNDS STRONGLY AT LARGE COMPANIES

The Confidence Index for UK FTSE 350 listed companies climbed to +21.2 this quarter, up from a previous reading of +11.5 and well above the level of +4.4 in Q2 2012. This resurgence comes as the value of the FTSE 350 market climbed to its highest ever level in March 2013 and has continued to stand at high levels since then, reflecting a strengthening in the outlook for these companies.

Large UK private companies also saw increases in confidence this quarter, with the Confidence Index standing at +18.9. This is the highest reading since Q3 2010, well up from +9.7

the previous quarter and +13.5 at the same time last year.

Confidence among SMEs now stands at +18.1, continuing the upward trend seen over recent quarters. A strong outlook among these businesses is important to the UK as a whole, as the SME sector makes up roughly half of all UK private sector employment.

CONFIDENCE POSITIVE ACROSS BUSINESS TYPES • FTSE AND LARGE PRIVATE COMPANIES BOTH SEE INCREASES

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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