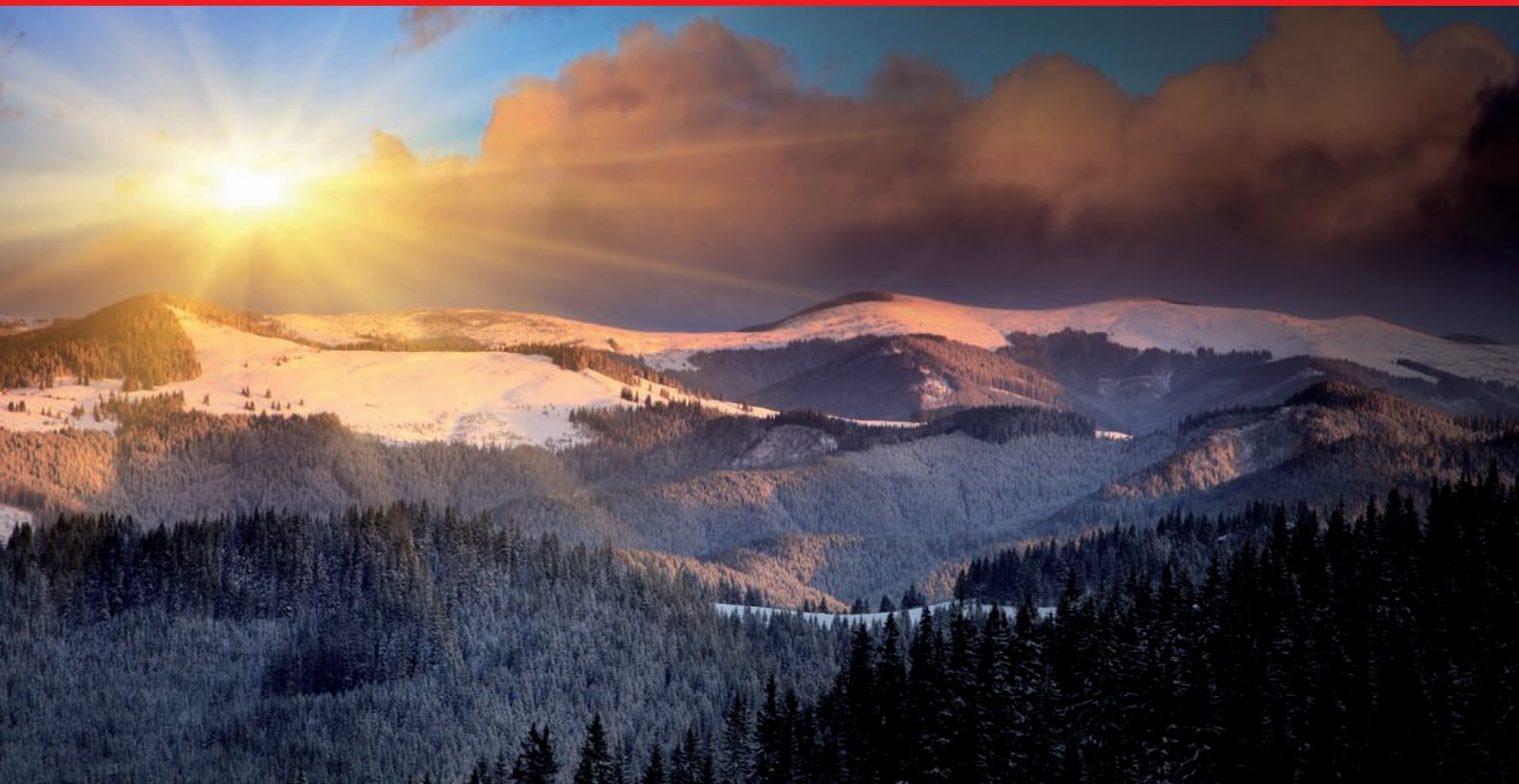




**Grant Thornton**  
An instinct for growth™

# UK BUSINESS CONFIDENCE MONITOR

## Q1 2013



# WELCOME



The rise in business confidence this quarter is good news for the economy. The recent high profile retail collapses and poor weather have not given the economy the best start to the New Year. So while the latest *ICAEW/Grant Thornton Business Confidence Monitor* shows that companies are more optimistic for 2013, we should not be complacent.

To maintain that confidence we need economic growth. Such a task will not be easy or quick, but it is possible. As I travel around the country, I speak to young people who want to start their careers and make their way in the world. I speak to many businesses that are doing well. They are profitable and increasing their market share. We need to focus on these people and give them the support and encouragement to grow their businesses and take on new employees. This in turn will drive investment and secure a stronger economic recovery.

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

Michael D M Izza  
Chief Executive  
ICAEW



With confidence improving, I would hope to see a return to businesses unlocking the potential in their balance sheets, releasing meaningful investment which is key to sustained growth. Their focus on export growth is also good news for the economy. As I have said before, cross-border trade will be instrumental to recovery. Businesses do, however, need to be diligent and should seek to rebalance their export markets to fast-growing emerging economies where there is a demand for their products and services.

All the indications from this quarter's *ICAEW/Grant Thornton Business Confidence Monitor* are that we should avoid a triple-dip recession and that we are moving in the right direction. It is, however, important to echo others in reminding both business and government that there is no time for sitting back, and the hard work and innovation needs to continue to ensure we maintain positive economic momentum.

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 improved significantly in the first quarter of 2013 and now stands at +12.8, up from +4.2 in Q4 2012.

The Confidence Index is a leading indicator for growth, and this quarter's reading suggests that the economy will expand by 0.4% in Q1 2013, following the 0.3% contraction in output recorded in Q4 2012. This would mean that the UK avoids a triple-dip recession, with growth resuming this quarter.

## KEY ISSUES EMERGING THIS QUARTER

- A significant rise in confidence this quarter, pointing towards a return to economic growth in Q1 2013.
- Business expectations of future turnover and profit growth have improved slightly, though remain below levels typically seen before the financial crisis.
- Export growth is expected to pick up over the coming year, offering hope of a trade-led recovery in 2013.
- Business investment intentions remain very modest, and below the Office for Budget Responsibility's (OBR) forecast for 2013.

Preliminary estimates from the Office for National Statistics (ONS) point to a contraction in the UK economy in Q4 2012, highlighting the ongoing fragility of the economy. However, output was depressed by distorting effects from the oil and gas sector, where an extended shutdown for maintenance constrained output by more than usual, suggesting a near negligible contraction in underlying output.

This quarter's BCM provides reason for cautious optimism in 2013 – or at least the expectation that the economy will perform better than 2012 when zero growth was recorded overall. In particular, an export-led recovery could start to emerge, particularly if businesses are successful in rebalancing their export markets to high-growth emerging economies. BCM also suggests that private sector employment should grow further this year, helping to absorb further public sector job cuts.

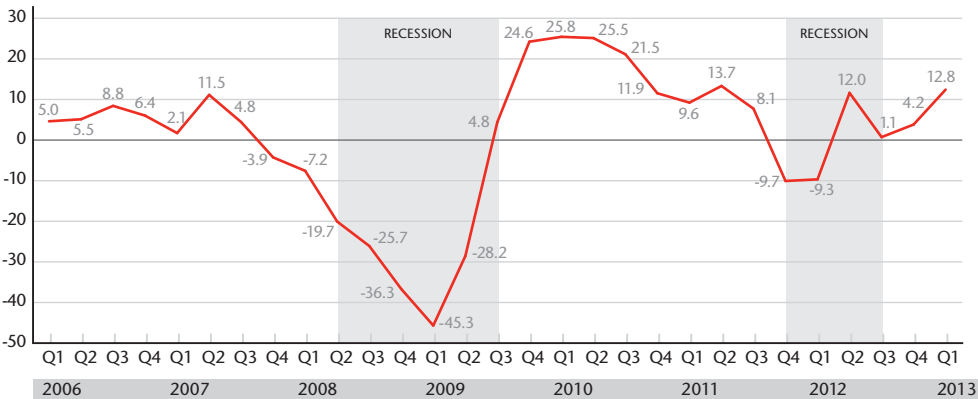
On the downside, January's snow could bear down on economic output. Looking further ahead, restraint in the up-rating of benefits payments, and further real income erosions due to weak wage settlements, will hold back consumer spending growth in 2013. So the UK is far from out of the woods, and more monetary stimulus – quantitative easing – could be required before the year is out.



Douglas McWilliams  
Chief Executive, Cebr  
ICAEW Economic Partner

# BUSINESS CONFIDENCE IN Q1 2013

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



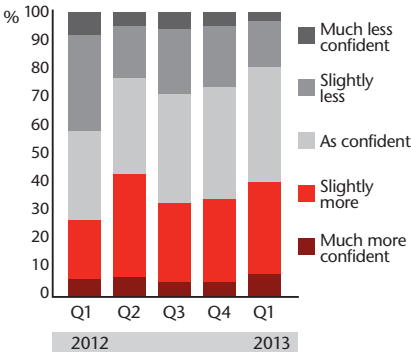
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows a continuing positive trend in the business environment. The Confidence Index now stands at +12.8, significantly higher than the +4.2 registered in Q4 2012. Compared with this time last year the Confidence Index is up more than 20 points, from -9.3 in Q1 2012.

## CONFIDENCE INDEX CONTINUES TO RISE

The latest findings from BCM show business confidence moving further into positive territory in Q1 2013 as the Confidence Index now stands at +12.8, its highest point since Q2 2011. The Index has remained above zero for a full year now, suggesting that business conditions are stronger at the start of this year than at the same point in 2012.

This quarter, 40% of businesses are more confident about their economic prospects over the coming 12 months compared to the previous 12 months. This share of companies is up from just 26% in the same quarter a year ago. At the same time, the proportion

FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES



CONFIDENCE INCREASES SIGNIFICANTLY IN Q1 2013 • FOUR CONSECUTIVE QUARTERS OF POSITIVE READINGS

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



The UK economy fell back into contraction in the final quarter of 2012, as output continued on its zigzag path. Preliminary estimates from the ONS show the economy shrinking at a quarter-on-quarter rate of 0.3% in Q4 2012, meaning the UK economy registered zero growth overall for 2012.

### BCM SUGGESTS UK WILL AVOID TRIPLE-DIP RECESSION

The return to negative growth in Q4 2012 highlights the fragile nature of the UK economy, with manufacturing output falling back over the period and service sector activity unchanged. However, part of the quarter's poor performance was due to temporary distorting factors: the largest oil field in the North Sea saw a longer than usual shutdown period for maintenance in the final three months of the year, and excluding the oil and gas sector GDP fell by a less severe 0.1%.

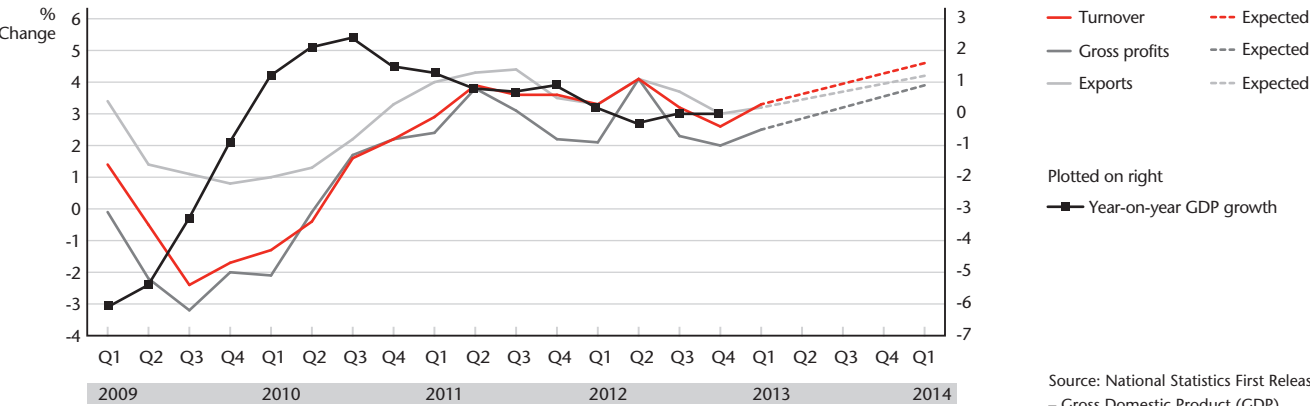
While the Q4 growth figures raise the possibility of the UK entering a triple-dip recession, the latest BCM

findings suggest that the economy will expand in Q1 2013 by 0.4%, avoiding a continued contraction. Although this growth rate remains below the average before the financial crisis, it compares favourably to a contraction of 0.2% this time last year and would return the UK economy to positive year-on-year growth.

MODEST GROWTH PREDICTED FOR Q1 2013 • THE UK ECONOMY IS FORECAST TO AVOID A RETURN TO RECESSION

# BUSINESS FINANCIAL PERFORMANCE

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



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

This quarter, businesses report modest but continued annual growth in turnover and profits. Over the past 12 months turnover rose by 3.3% and gross profits by 2.5%. These rates are both below typical levels from before the financial crisis, but in line with rising business confidence companies expect a stronger performance ahead: turnover and profits are expected to rise by 4.6% and 3.9% respectively over the next 12 months.

## EXPORTS EXPECTED TO HELP DRIVE RECOVERY

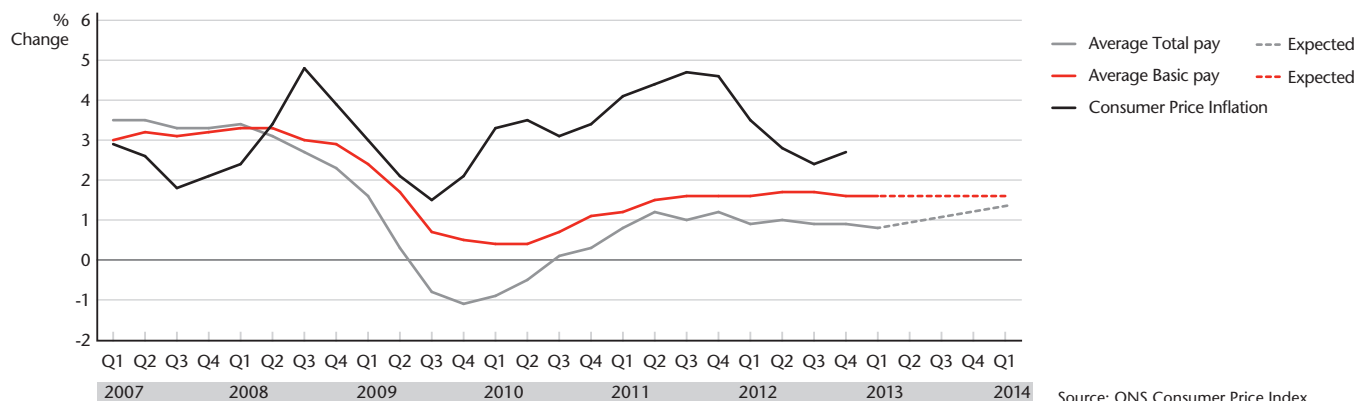
Despite persistently low levels of international trade volume growth in 2012, reflecting a slowdown in the world economy, UK businesses continue to show encouraging export performance. This quarter export growth of 3.2% is reported, largely unchanged from the same period a year ago.

The past 12 months have seen the UK changing its export focus, with a shift away from the uncertain eurozone and towards markets with stronger growth prospects. As a result, goods exports to outside the EU made up half of total UK exports in 2012. This is the highest share since at least 1998

when comparable records began, and up from 46.8% in 2011.

The world economy is expected to pick up slightly in 2013, with the IMF predicting global growth of 3.5% across the year as a whole compared to 3.2% for 2012. In line with this upturn and strengthening business confidence, UK companies expect faster export growth of 4.2% over the coming 12 months, helping to drive increases in turnover and profits.

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



Source: ONS Consumer Price Index

**As price rises continue to outpace wage growth, workers face further erosion in real income.** UK businesses report increasing average basic salaries by 1.6% over the past 12 months, while average total salaries (ie, including bonuses) increased by 0.8%. With the latest ONS data showing inflation at 2.6% in Q4 2012, this implies that in real terms wages are continuing to decline.

## WEAK ECONOMY HOLDING BACK WAGE GROWTH

The UK labour market strengthened in 2012, with unemployment falling from 8.3% at the start of the year to 7.7% by the three months to November. This quarter, businesses report increasing employee numbers by 1.0% over the past year, the fastest headcount growth since Q4 2011.

Despite increases in employment, the current weakness in the UK economy is holding back salary growth. This situation is unlikely to change in 2013: businesses expect to increase their average basic salaries by 1.7% over the next 12 months, but with consumer price inflation expected to run at 2.5% in 2013 it is likely that workers will face

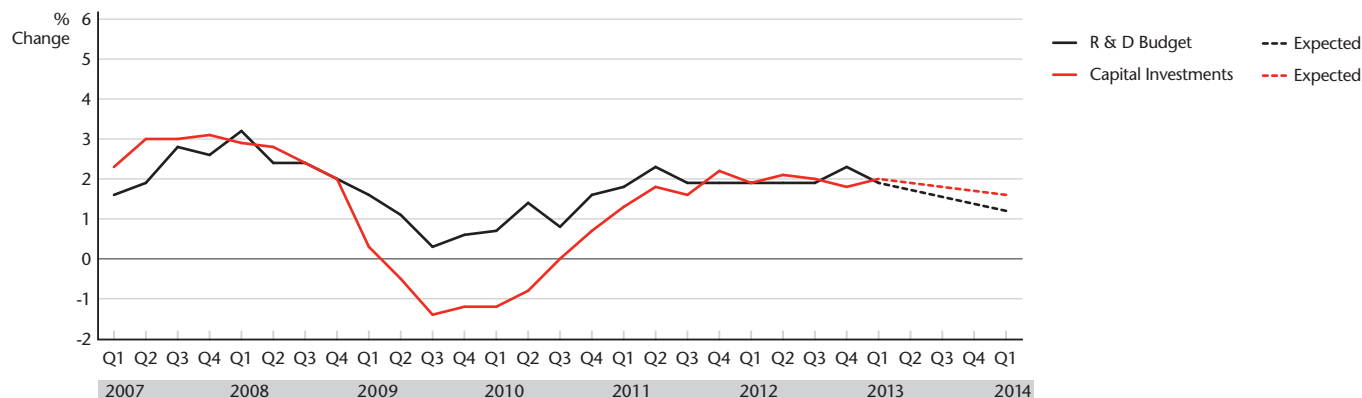
a further year of real wage erosion in the 'new normal' economic environment.

In addition to falling real wages, real household income growth is likely to be further constrained by the 1% cap on benefits up-rating from April 2013. This is estimated by the Institute for Fiscal Studies to affect up to 9.5m working and workless households below retirement age. As a result, consumer spending growth is likely to be held back this year.

**INFLATION LIKELY TO CONTINUE TO OUTPACE WAGE GROWTH, LEADING TO FURTHER EROSION OF REAL INCOMES**



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



**Despite rising business confidence, companies remain cautious about investing.**

Capital investment growth of 2.0% over the past year is reported, compared to a level of around 3% which was typical before the financial crisis. At the same time, research and development budgets rose by just 1.9% over the past year, and growth in investment in R&D is expected to remain modest at just 1.2% in 2013.

### CAPITAL INVESTMENT SPENDING EXPECTED TO SLOW

This quarter, businesses expect capital investment spending to increase over the coming 12 months by 1.6%, compared to 2.0% growth seen over the past year. Business investment is an important driver of the economy and, as such, continued private sector apprehension is likely to constrain UK growth prospects.

In a bid to boost growth, an increase in the Annual Investment Allowance from £25,000 to £250,000 was announced in the 2012 Autumn Statement, to come into effect from the start of 2013. This tax incentive for investing in plant and machinery is designed to increase

capital spending, but the latest BCM data suggest that despite improving business sentiment, the announcement has had only a limited effect on investment intentions so far.

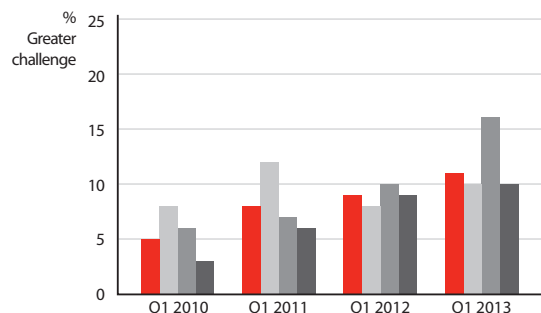
The latest OBR forecasts predict that UK business investment will increase by 4.9% in 2013. Although this forecast was revised down from a previous projection of 6.4% growth in 2013, the latest BCM findings suggest that even the revised forecast will prove difficult to achieve in current conditions.

**BUSINESSES EXPECT ONLY MODEST CAPITAL INVESTMENT AND R&D SPENDING GROWTH IN THE COMING YEAR**



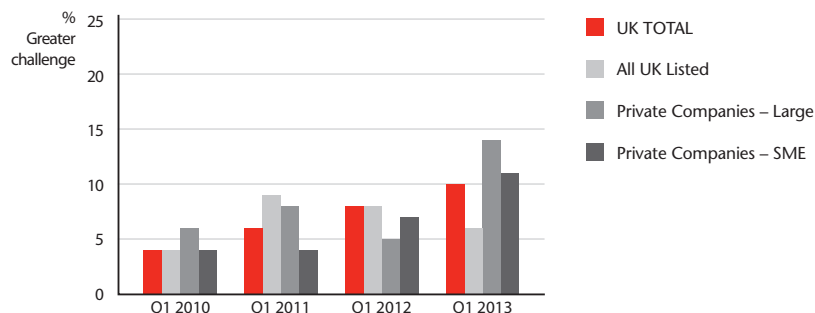
# FACTORS AFFECTING BUSINESS PERFORMANCE

**FIG. 7 AVAILABILITY OF MANAGEMENT SKILLS – CHANGE V. 12 MONTHS AGO**



This quarter, one in ten companies (11%) report that the availability of management skills is a greater challenge than 12 months ago, up from 5% in Q1 2010. Shortages are becoming more pronounced, with both management and non-management skills being perceived as more challenging to source by an increasing number of businesses.

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



## SHORTAGE OF MANAGERS A CONCERN FOR BUSINESSES

There are signs that the UK may not have enough managers to lead the recovery, with a growing number of businesses finding the availability of management skills to be a greater challenge compared with a year ago.

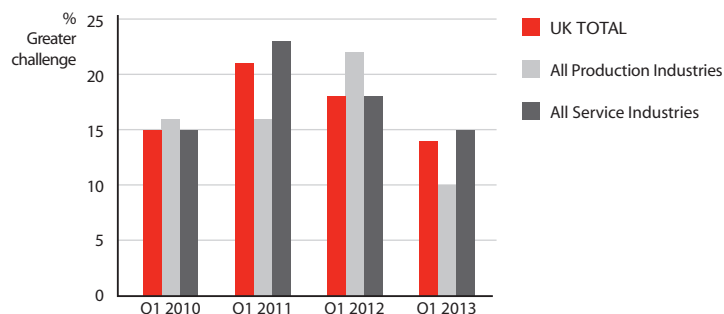
This is particularly the case for private businesses compared with listed companies. The share of private businesses reporting the availability of management skills to be a greater challenge has tripled since Q1 2010; over the same period, listed companies' perceptions have remained steadier.

The availability of non-management skills is also becoming a greater challenge for a rising share of businesses. A tenth of companies (10%) report this as more of a concern now than a year ago, compared to 8% in the same quarter a year ago and 4% in Q1 2010.

These latest BCM findings reflect the recent strengthening of the labour market: the level of advertised vacancies has been rising since mid-2012 to reach its highest since the end of 2008. With more job openings available, it is becoming harder for each business to source skilled labour.

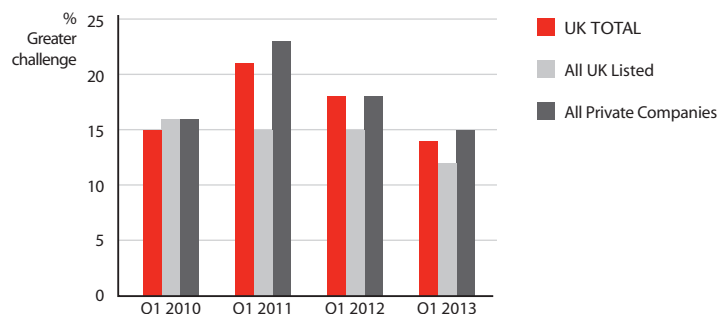
SKILLS SHORTAGES COULD START TO AFFECT COMPANIES' ABILITY TO DELIVER ECONOMIC GROWTH

**FIG. 9 TAX BURDEN – CHANGE V. 12 MONTHS AGO**



There are continuing signs that UK businesses are benefiting from recent changes to the UK tax system, including reductions in the corporation tax rate. The effect is most noticeable in the production sector, although it is also seen among service sector businesses which make up roughly three quarters of the economy.

**FIG. 10 TAX BURDEN – CHANGE V. 12 MONTHS AGO**



## BUSINESSES ACKNOWLEDGE CHANGES TO TAX REGIME

14% of UK businesses report that their tax burden is a greater challenge now than it was a year ago. This proportion is down from 18% in the same quarter in 2012 and from a high of 25% in Q3 2011. During this time there has been a reduction in the main rate of corporation tax of two percentage points, to 24%, with a further one point reduction planned for April 2013.

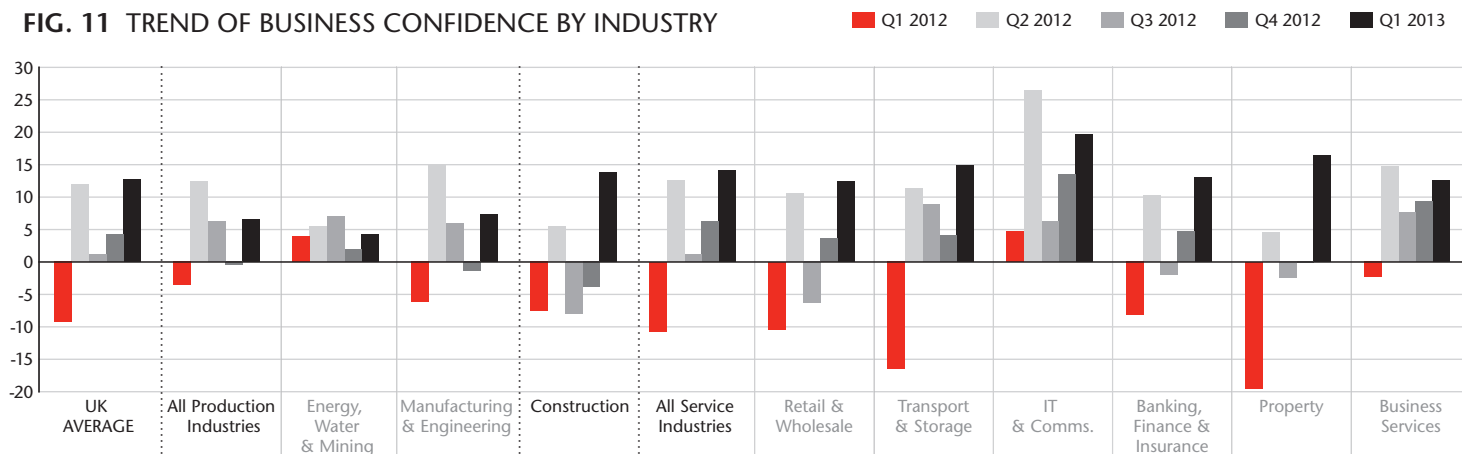
The benefits of changes in the tax system are particularly being felt by privately-owned UK companies. The proportion of these reporting their tax burden as a greater concern than the previous year stands at 15% this

quarter, from 18% in the same quarter in 2012 and almost one in four businesses (23%) in Q1 2011. Over the same period there has been little variation in the share of publicly-listed companies reporting this issue as more of a challenge, suggesting they may be less likely to benefit from changes.

CHALLENGE OF TAX BURDEN EASES • GREATEST IMPROVEMENT HAS BEEN AMONG PRIVATE BUSINESSES

# TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



The increase in business confidence this quarter was broad based, with substantial increases in optimism across the different sectors of the economy. Companies in both the Business Services and IT & Communications sectors continue to show confidence on an upward trend, but this quarter there is now positive sentiment across the economy.

## CONFIDENCE IMPROVES ACROSS THE ECONOMY

This quarter, confidence returned to positive territory in every sector, with strong increases in both services and production. The construction sector saw a marked increase in business confidence with a reading of +13.8, up from -3.9 in Q4 2012. These findings come as the latest estimate of GDP for Q4 2012 showed that the construction sector expanded quarter on quarter by 0.3%, the largest quarterly increase since Q2 2011 and the first quarterly increase since Q1 2012.

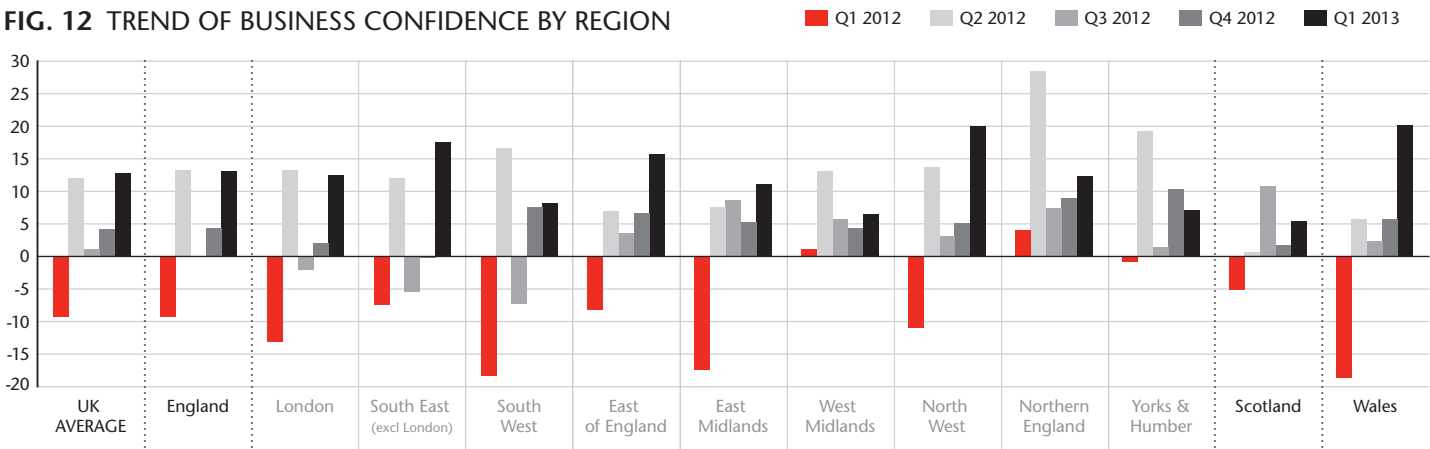
Confidence in the service industries, which comprise roughly three quarters of the UK economy,

continues on an upward trend, reaching a reading of +14.2 this quarter. Within services, optimism among Business Services companies and IT & Communications businesses climbed further to reach +12.6 and +19.7 respectively. These confidence levels from service sector businesses suggest that stronger growth will be recorded across 2013 than the zero quarter-on-quarter output growth seen in the sector in Q4 2012.

CONFIDENCE INCREASES FOR PRODUCTION AND SERVICES THIS QUARTER • ALL SECTORS IN POSITIVE TERRITORY

# TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence stands in positive territory across the UK, with notable increases in many regions. There are substantial rises in London and the South East, while confidence in most other areas has now been positive for a full year.

## CONFIDENCE STRENGTHENS ACROSS MUCH OF THE UK

This quarter confidence continues to rise in Northern England, increasing for the second consecutive quarter to reach +12.3. Rising confidence levels in the region reflect conditions in the local labour market, with the latest data for September to November showing the unemployment rate falling back by 2.1 percentage points year on year.

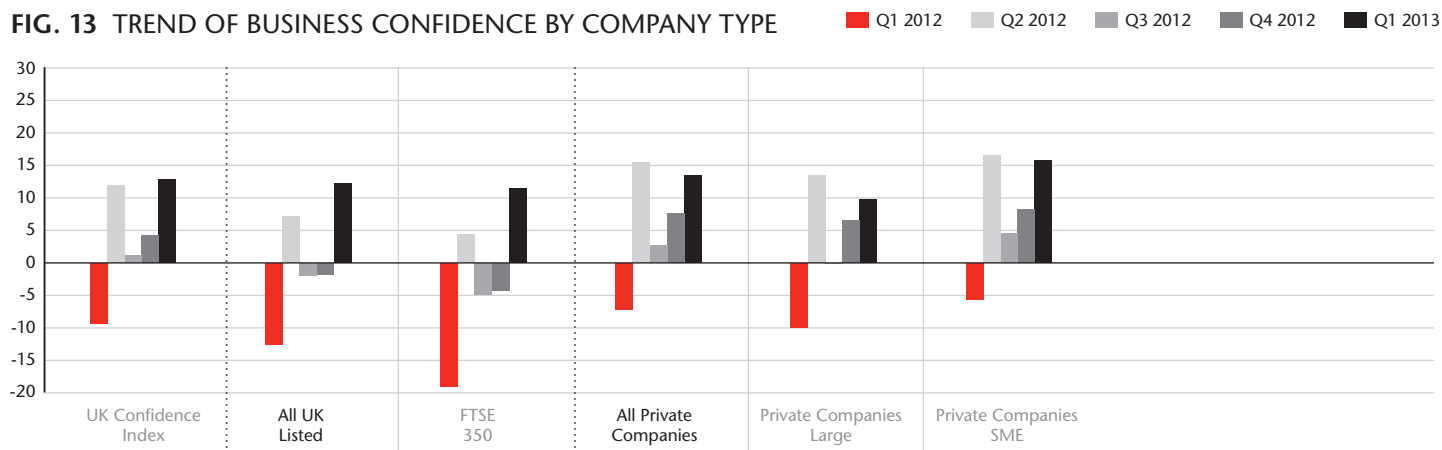
There are large increases in the Confidence Index for London and the South East this quarter, with readings of +12.5 and +17.5 respectively. These regions are the most global-facing, together making up a quarter of the UK's total goods exports, and have

some of the fastest export growth expectations in the UK. Stronger expected global growth and a settling down of the eurozone crisis for now are likely to be disproportionately affecting these UK regions and helping to boost confidence.

CONFIDENCE POSITIVE IN ALL REGIONS OF THE UK • SENTIMENT IMPROVED IN MANY AREAS THIS QUARTER

# TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



**A strong upward trend in confidence among small and medium-sized privately owned companies (SMEs) continues this quarter.** The Confidence Index for these businesses reached +15.8 in Q1 2013, the second consecutive quarter of improvement and substantially higher than the reading of -5.6 recorded in the same quarter a year ago.

## CONFIDENCE REBOUNDS AMONG LISTED COMPANIES

The Confidence Index for FTSE 350 companies climbed to +11.5 this quarter, the highest reading since Q1 2011 and well up from -19.0 recorded in the same quarter a year ago. These companies are typically more exposed to global trends and, as such, this latest rise in confidence may reflect the fact that the world economic outlook is stronger now than at the start of 2012.

Meanwhile, the Confidence Index for all privately-owned companies continues to climb, reaching a level of +13.5 this quarter. Confidence among these businesses has been on a general upward trend now since

the final quarter of 2011, though it is SMEs rather than larger private firms which are driving the trend.

Strong confidence among SMEs is particularly important for the UK economy: these businesses employ more than half the workers in the private sector, account for just under half of private sector turnover and, as such, are a key engine for growth in the UK economy.

CONFIDENCE UP IN BOTH LISTED AND PRIVATE COMPANIES • FTSE CONFIDENCE RETURNS TO POSITIVE TERRITORY

# 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](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

### Cebr

Centre for economics and business research Ltd is an independent consultancy with a reputation for sound business advice based on thorough and insightful research. Since 1992, Cebr has been at the forefront of business and public interest research. They provide analysis, forecasts and strategic advice to major UK and multinational companies, financial institutions, government departments and agencies and trade bodies. For further information about Cebr please visit [www.cebr.com](https://www.cebr.com)

### 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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