



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS

IN ENGLAND AND WALES

Q1 2009

UK BUSINESS CONFIDENCE MONITOR

National Summary Report



CONTENTS

Q1 2009 KEY POINTS	1
FOREWORD – MARK PRAGNELL, cebr	2
MAIN FINDINGS	4
BUSINESS FINANCIAL PERFORMANCE	4
CONFIDENCE BY INDUSTRY	5
CONFIDENCE ACROSS UK REGIONS	7
CONFIDENCE BY SIZE OF BUSINESS	8



In the last quarter of 2008 the economy experienced the steepest quarterly contraction in output since 1980. This is not the first time we have experienced recession; however, the globalised nature of business today combined with our recent reliance on the now fraught Financial Services sector as the driver of our economic prosperity gives previously unseen dimensions to the situation.

Surviving the downturn in business requires careful planning and strategic action. In January, the ICAEW published 'Eight Strategies for Surviving the Downturn' a guide to help businesses plan survival strategies and activities which could help them in facing the current economic challenges. It provides businesses with practical help and topics to discuss within their management teams as well as with their advisors.

The findings of this quarter's ICAEW *UK Business Confidence Monitor* show that many businesses see very difficult times ahead. We look at several financial performance indicators which give a real insight into how businesses are responding. From these, we can tell that businesses are making the tough decisions and taking the necessary actions in preparation for a long road to economic recovery.

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

A handwritten signature in black ink that reads "Michael Izza". The signature is fluid and cursive, with the first name "Michael" and the last name "Izza" clearly distinguishable.

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

Q1 2009 KEY POINTS

- Business confidence declines for a seventh consecutive quarter – again reaching uncharted negative territory – while the UK economy sees the largest contraction in a quarter since 1980.
- BCM records an expectation of job cuts among firms for the first time in the survey's history as official data shows that unemployment rose at its fastest pace since the early 1990s.
- Indeed, the forecast is for eight of the 14 financial performance indicators tracked by BCM to weaken over the next 12 months. This is a particularly telling indictment on quite how weak business confidence is at this time. To date the survey has always predicted at least marginal growth in all indicators.
- Deflation and a prolonged recession are the real risks. With consumer price inflation set to continue downward, possibly turning negative in the summer, the Bank's focus must be on limiting the chance of a prolonged period of deflation and economic stagnation.
- The UK is particularly exposed to the fallout of painfully slow global growth due to the hangover of consumer and business debt and the large share that the Financial Services sector contributes to prosperity.
- We must hope that the US Federal Reserve's 'unconventional' monetary policy measures and the euphoria surrounding the new US President will turn the US economy around by late 2009 – with the rest of the world in tow.

FOREWORD

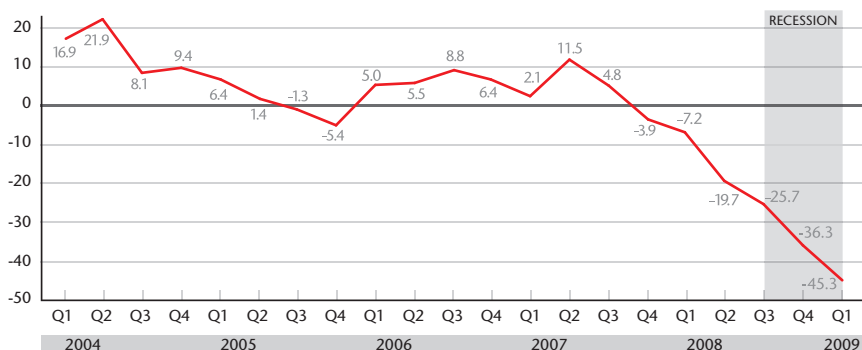
MARK PRAGNELL, cebr – ECONOMIC ADVISER TO THE ICAEW



CONFIDENCE PLUMMETS AGAIN AS RECESSION CONFIRMED

Since our last quarterly report, the UK's first technical recession since 1991 has been confirmed and the economy has experienced the steepest quarterly contraction in output since 1980. Few countries are now immune to the impact of global recession. The International Monetary Fund is forecasting the slowest global growth since World War II. The UK is particularly exposed due to the hangover of consumer and business debt and the large share that the Financial Services sector contributes to prosperity.

Fig. 1 Trend of UK Business Confidence



Source: ICAEW UK Business Confidence Monitor

The latest findings from the ICAEW *UK Business Confidence Monitor* show how tough conditions now are for businesses up and down the UK. In the first quarter of 2009 there has been another significant drop in the Confidence Index. Almost a third of UK businesses report that, compared to the last 12 months, they are **much** less confident about the economic prospects facing their organisation in the year ahead.

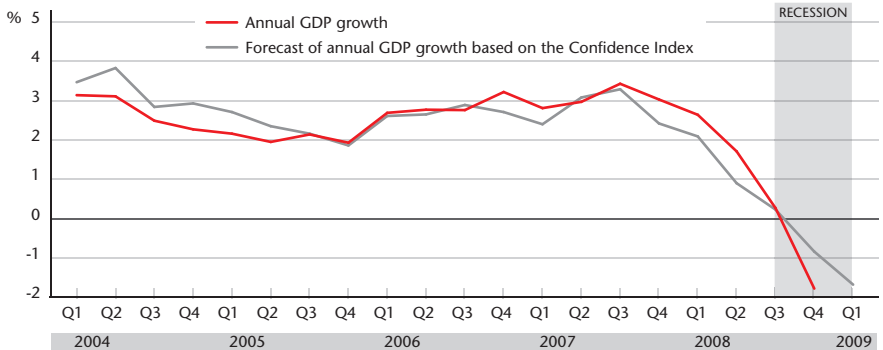
Unfortunately, increasingly difficult trading conditions are proving too much for many firms, with the rate of business failures and associated job losses rising appreciably in recent months. The Confidence Index has again proved its worth as a leading indicator of economic trends, and in coming quarters will reveal when the economy may begin to bottom out, and to recover.

BANK LENDING COLLAPSE THE KEY ISSUE

So why has the economy deteriorated so dramatically, and what implications does this have? The fundamental problem is that bank lending both to consumers and businesses has fallen considerably. Mortgage approvals were down 63% in the final quarter of 2008 compared to the same period a year earlier. Quarter-on-quarter net lending to non-financial corporations fell by £3.4bn in Q4 2008 while in the same period in 2007 it rose by £18.3bn.

As banks undergo major de-leveraging and attempt to repair their beleaguered balance sheets, new lending is at a premium. Given this, our forecast is for a 3% contraction of the UK economy in 2009 – the largest since post-war demilitarisation in 1946.

Fig. 2 Forecast of annual GDP growth based on ICAEW Confidence Index



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

DEFLATION AND A PROLONGED RECESSION ARE THE REAL RISKS

Demand in the economy is contracting and firms are shedding jobs as a result. Claimant-count unemployment rose by 213,000 in Q4 2008. Through 2009 we anticipate the rise in unemployment will be severe; the claimant count could almost double to reach 2.1m by the end of 2009. The latest *UK Business Confidence Monitor* data corroborates this, with firms reporting that they expect to cut their workforce over the coming year.

As we predicted, inflation is disappearing as fast as it arrived. Commodity prices have fallen significantly and domestic demand is contracting, causing discounting across the economy. Consumer price inflation will fall further, undershooting the Bank of England's target range in late spring and possibly turning negative in the summer. The one factor that could limit the extent of this fall is the depreciation of sterling, making imports more expensive. However, the Bank's focus must be on limiting the chance of a prolonged period of deflation and stagnation as happened in Japan in the 1990s. The base rate now stands at its lowest level since the Bank's foundation in 1694. We expect rates will soon be close to zero and will stay there through 2009 and probably most of 2010. But are record-low interest rates alone enough?

WHERE WILL RECOVERY COME FROM?

The US Federal Reserve is taking the lead on alternative monetary policy interventions; Governor Bernanke is engaging 'unconventional measures' in an attempt to ease the credit markets and get bank lending moving. Following this, in January UK policymakers announced details of an Asset Purchase Facility that will allow the Bank of England to purchase assets with the hope of ending credit market atrophy.

The worry is that there are systemic problems with the UK banking sector which the Government needs to address before an organic recovery can take place. I am sceptical whether the second recovery package announced in January can do enough to prevent a severe and prolonged recession. So can we look elsewhere? Can President Obama's stimulus package and Bernanke and Treasury Secretary Geithner's banking interventions drag the US, and with it the world, out of recession in late 2009?

Mark Pragnell

Managing Director, cebr

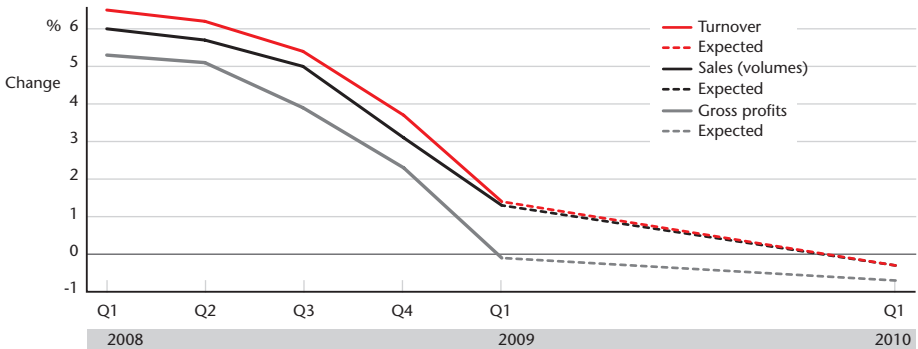
Economic adviser to the ICAEW

MAIN FINDINGS

BUSINESS FINANCIAL PERFORMANCE

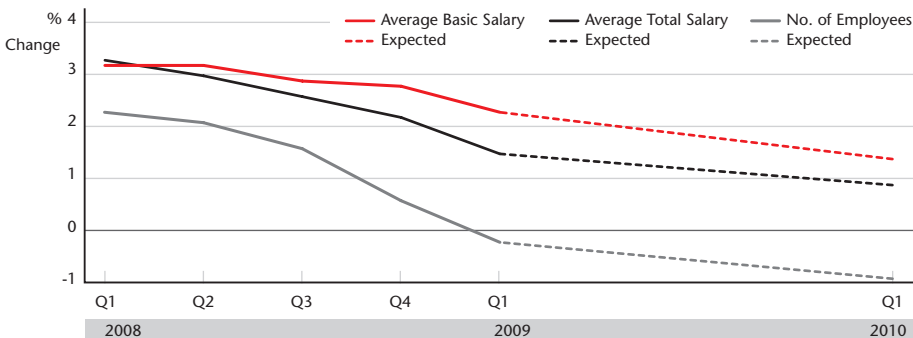
The significant deterioration in economic prospects is reflected across the financial performance indicators tracked in the *UK Business Confidence Monitor*. On average, turnover is expected to fall by 0.3% over the next 12 months following annual growth to date of just 1.4%. This is driven by declining sales volumes combined with minimal growth in selling prices as businesses compete for market share. Consequently there is pressure on profit margins, with a fall in gross profits already experienced and a larger contraction expected in the next 12 months.

Fig. 3 Change over 12 months to...



Tough market conditions are leading firms to take stringent action on costs. For the first time in the history of the *UK Business Confidence Monitor* a cut in workforce is expected over the next 12 months, while the looser labour market conditions mean wage inflation expectations for the coming year stand at the lowest level seen in BCM.

Fig. 4 Change over 12 months to...



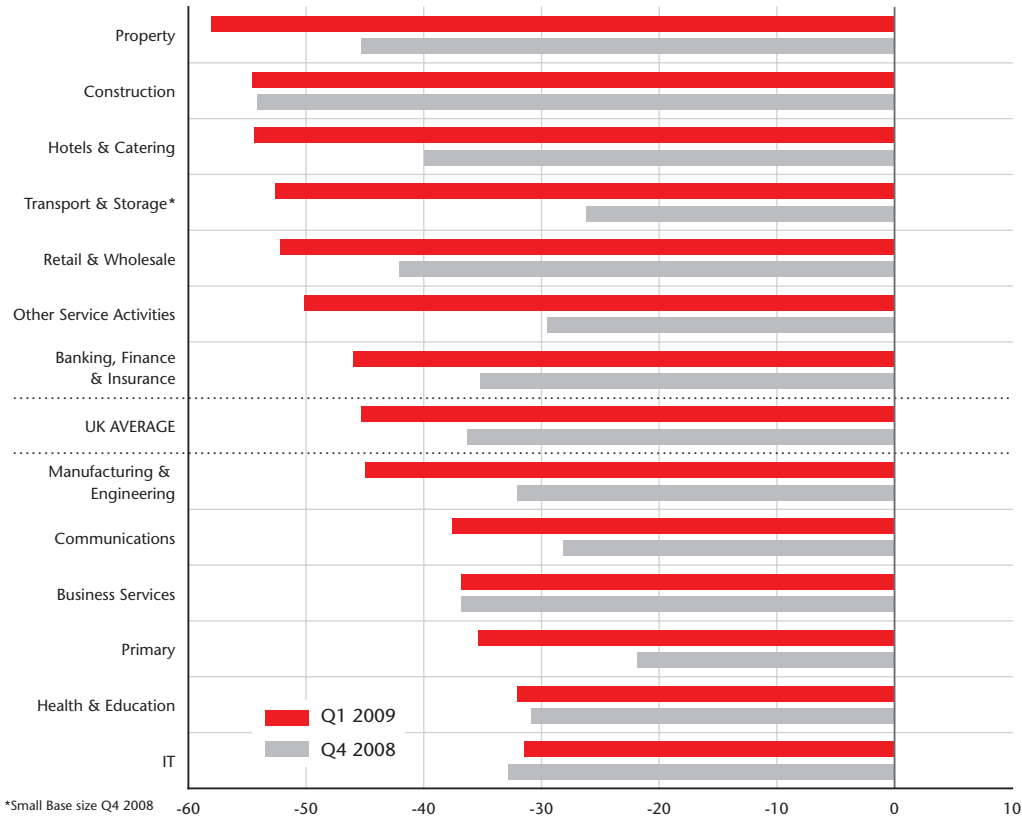
Firms are also cutting back on other areas of spending, such as capital investment – with a 1.2% contraction expected over the next 12 months following an expansion of just 0.3% over the last year – and research and development budgets, where a 0.4% contraction is expected over the coming year.

CONFIDENCE BY INDUSTRY

In the first quarter of 2009 the Confidence Index has reached record lows in almost all industry sectors.

Confidence in Manufacturing & Engineering also declined this quarter, bringing it in line with the UK average. According to official statistics, manufacturing sector quarterly output contracted by 3.9% from the third to final quarter of 2008 as orders dried up. Despite improved competitiveness from sterling's depreciation, the global economic slowdown limits potential for export growth.

Fig. 5 BCM Confidence Index Trend



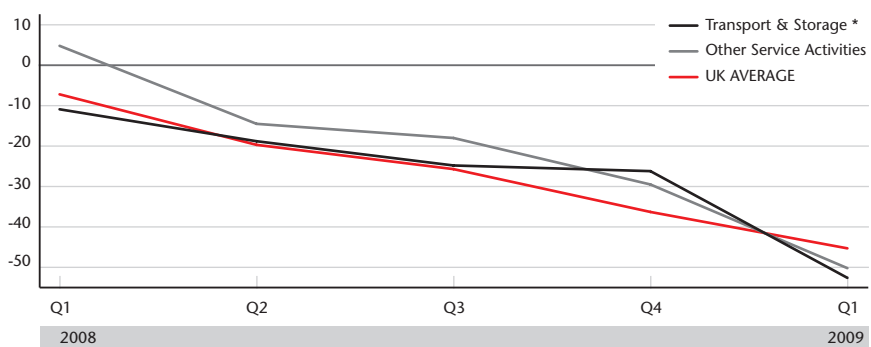
As access to credit is constrained and unemployment rises, consumers are becoming more cautious. As a consequence the outlook is tougher for the Hotels & Catering and Retail & Wholesale sectors which rely on consumer confidence.

As in the previous quarter, Property and Construction are the least confident sectors in Q1 2009, while the Banking, Finance & Insurance sector Confidence Index fell 10.7 points from its Q4 2008 position.

The steepest fall is in the Transport & Storage sector, where confidence has dropped by 26.4 points. This sector embraces passenger and freight transport and all related support services such as airports, terminals, car parks and travel agencies. The decline in confidence reflects how the recession is spreading across the economy, with the broad-based reduction in the level of economic activity pushing down confidence in a sector reliant on serving consumers and other businesses.

Similarly, the primarily consumer-focused Other Service Activities sector records a marked 20.7 point drop in confidence this quarter.

Fig. 6 Trend of business confidence by industry



*Small Base size Q4 2008

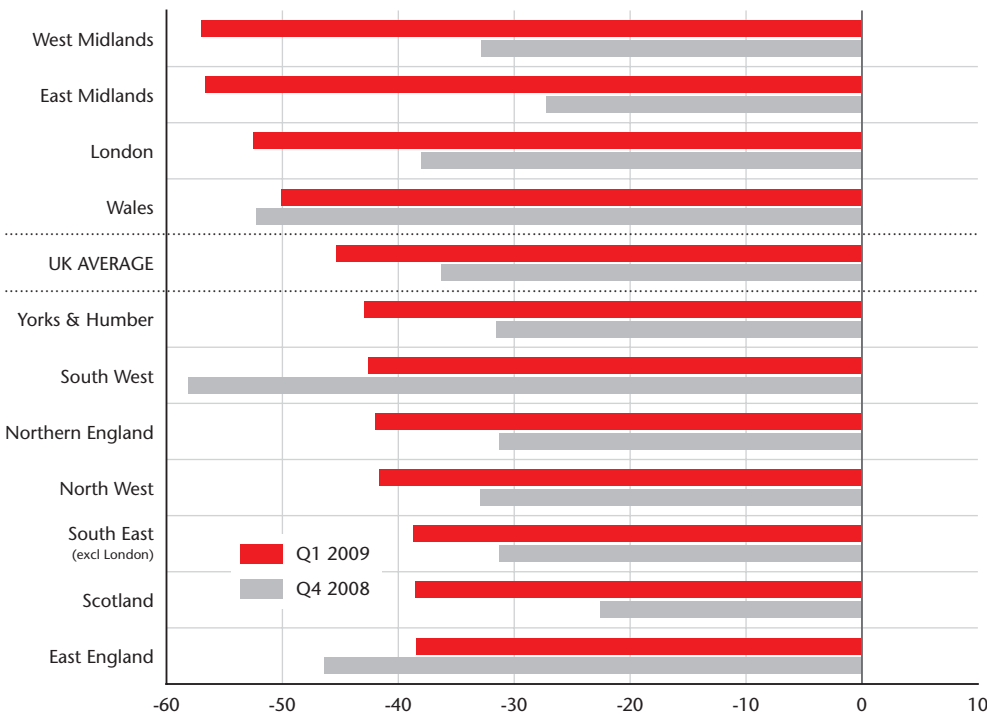
CONFIDENCE ACROSS UK REGIONS

Confidence has declined to record lows in all but three regions where particularly large falls were seen in Q4 2008: Wales, South West and the East of England. The Confidence Index fell most steeply in the East and West Midlands, with the West Midlands now the least confident UK region. Vehicle manufacturing and related industries are particularly important in these areas, so worries over the car industry are likely to have hit confidence hard in these regions.

Confidence in London is below the UK average for the fifth quarter in succession as business in the capital continues to be tainted by its heavy exposure to the financial crisis. Confidence fell significantly as City job losses mounted and leading Banking, Finance & Insurance sector employers came under immense strain.

Confidence weakened again in Scotland where financial services are also a significant part of the economy, although confidence among Scottish businesses still stands marginally above the UK average.

Fig. 7 Business Confidence by Region



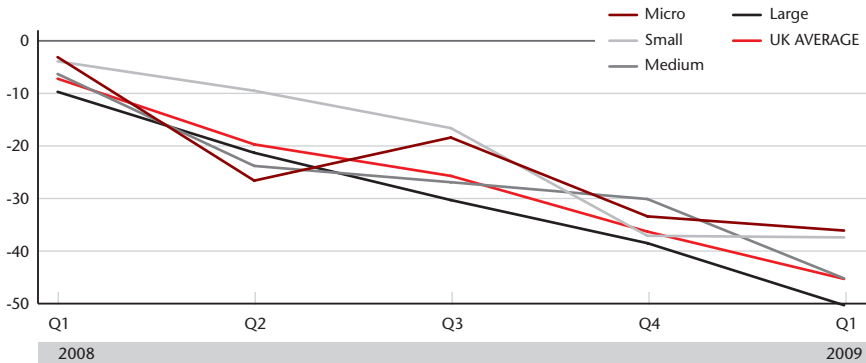
CONFIDENCE BY SIZE OF BUSINESS

Confidence is at an all-time low across all sizes of business. Medium and large businesses have seen the most marked weakening since Q4 2008. Large firms (with 250 or more employees) experienced an 11.8 point fall in their Confidence Index so remain the least confident size of business for the third consecutive quarter.

Medium-sized firms experienced the steepest fall in confidence in the first quarter of 2009: a 15.1 point fall in the Confidence Index.

Confidence of small (10–49 employees) and micro (fewer than nine employees) businesses remains close to Q4 2008 levels following the noticeable weakening in that quarter.

Fig. 8 Trend of Business Confidence by Company Size



TECHNICAL INFORMATION

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

During the period 29 October 2008 - 23 January 2009, 1001 ICAEW members active in business in the UK were interviewed by telephone. The interviews typically lasted 12–15 minutes and gathered opinions on past performance and future prospects for members' businesses, as well as investigating perceived changes in impact of factors such as availability of skills, government regulation and the tax regime. A copy of the full question set is available upon request.

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. Details of the weighting approach employed are included below.

Prior to June 2007 data for BCM was gathered via self completion methodologies, a mix of online and post.

The impact of design factors on data continuity was considered in detail before the decision to move to telephone data collection was made. Methodological testing indicated that the move to telephone would have limited impact on trends in the headline Confidence Index. The difference is not felt to invalidate comparison over time.

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 is applied to each response as shown below, and an average score calculated:

Variable	Score
Much more confident	+100
Slightly more confident	+50
As confident	0
Slightly less confident	-50
Much less confident	-100

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 and the full question set available upon request.

DETAILED RESULTS AND FURTHER INFORMATION

For more detailed results and analyses, and further information on BCM please visit

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