



UK BUSINESS CONFIDENCE MONITOR

Q2 2011



WELCOME



The last six months have seen the UK economy effectively stagnate. As this quarter's *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows, we're now beginning to see signs that growth is restarting. Confidence is increasing and certainty is returning to the UK economy. Businesses are more optimistic about the future and this is reflected in their forecasts for turnover and profit growth. We are seeing business concerns starting to ease as future prospects brighten.

Government needs to do all it can to stimulate growth in the short term without jeopardising the UK's medium to long-term economic prospects. The Budget in March saw welcome reforms in the tax and regulatory burdens faced by business. However, it's clear more still needs to be done to make the UK one of the best places to start, finance and grow a business.

Michael D M Izza
Chief Executive
ICAEW



The latest BCM paints a mixed picture for UK business. Businesses have reported growth in turnover, profits and exports with expectations remaining on an upward trend. If those figures can be sustained over the year, the business environment would be healthier than it appears; however, with the impact of public sector cuts and European and global difficulties still to work their way through the system, common sense dictates we adopt a more cautious view.

We should welcome the positive signs in the economic indicators for small and medium sized businesses as this, rather than FTSE market, is the sector of the economy where employment will grow if conditions are right.

Privately owned companies welcomed the Government's reductions in corporation tax; they are looking to the Bank of England to keep interest rates low for some time to create the semblance of stability in these turbulent times.

Scott Barnes
Chief Executive Officer
Grant Thornton

ECONOMIST'S VIEW



The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence picked up in Q2 2011, following four consecutive quarters of decline.

The preliminary estimate of quarterly economic growth in Q1 2011 indicates that the UK economy expanded by 0.5% quarter on quarter, avoiding a double-dip recession after the 0.5% decline in Q4 2010. This is in line with the 0.6% growth implied by the Q1 2011 BCM.

KEY ISSUES EMERGING THIS QUARTER

- The downward trend in the Confidence Index has reversed this quarter, but it is still 11.8 points lower than a year ago.
- Financial performance continues to improve. Turnover and profit growth are at their strongest since Q3 2008, while growth expectations are at their highest since before the recession.
- The Manufacturing & Engineering sector remains buoyant. However, strong growth in the sector is expected to slow over the coming year.
- Service sector confidence is flat, and is weaker than for the UK as a whole. The Retail & Wholesale sector is the least confident.
- There is some evidence of rising inflationary pressures. Firms expect stronger prices growth than forecast since Q3 2008, although salary growth expectations remain low.

Since Q3 last year the UK has faced the unpleasant combination of weak growth performance and high inflation. The economy was flat in the six months to the end of March while the annual rate of inflation averaged 4.2% in Q1 2011. As inflation soared to 4.4% in February it seemed possible the Bank of England would raise interest rates as early as May. However, inflation has fallen back and clear downside risks remain for continued economic growth.

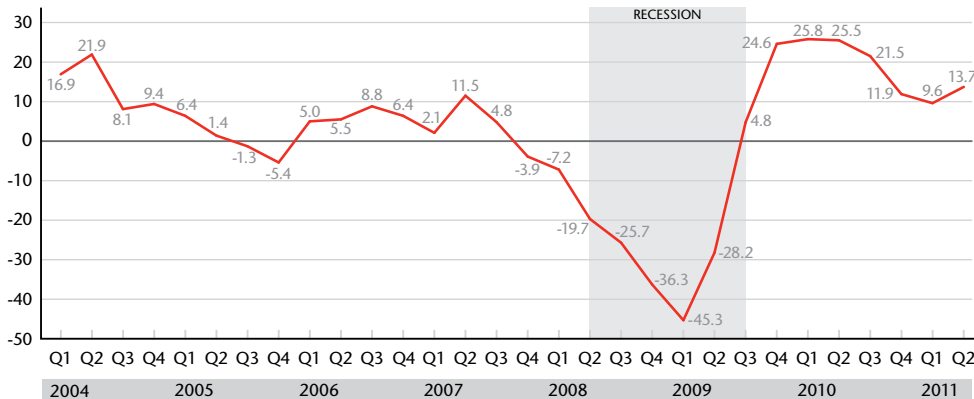
This quarter's BCM implies growth should continue in Q2 2011 and inflationary pressures are also likely to remain in the short term. However, wage growth is still low, and confidence in the service sector – which accounts for about 75% of the UK's economy – remains subdued. On balance, we see the weak growth outlook as the dominant concern; hence the likelihood of a Bank of England rate rise in the short term has diminished. Indeed, we would not be surprised to see rates remain on hold until 2012.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q2 2011

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



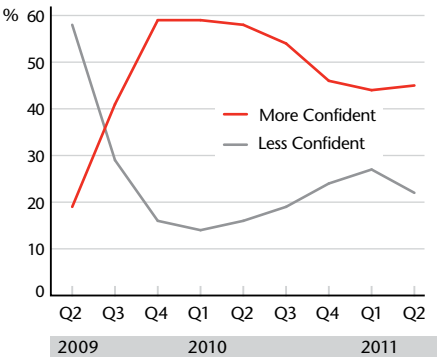
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence rose in Q2 2011. The Confidence Index has increased for the first time since Q1 2010, from 9.6 in Q1 2011 to 13.7 in Q2 2011. This is the highest level in three quarters and the strongest quarterly increase in confidence since Q4 2009. However, the overall trend in the Confidence Index over the last year has been downward following the post-recession bounce back.

CONFIDENCE INDEX RISES FOR FIRST TIME SINCE Q1 2010

The latest findings from BCM show the Q2 2011 Confidence Index has increased to 13.7, up by 4.1 points on the quarter but down 11.8 points on the year, reflecting the decline in confidence following the post-recession bounce back. The Q2 2011 increase breaks a trend of four consecutive decreases in the Confidence Index.

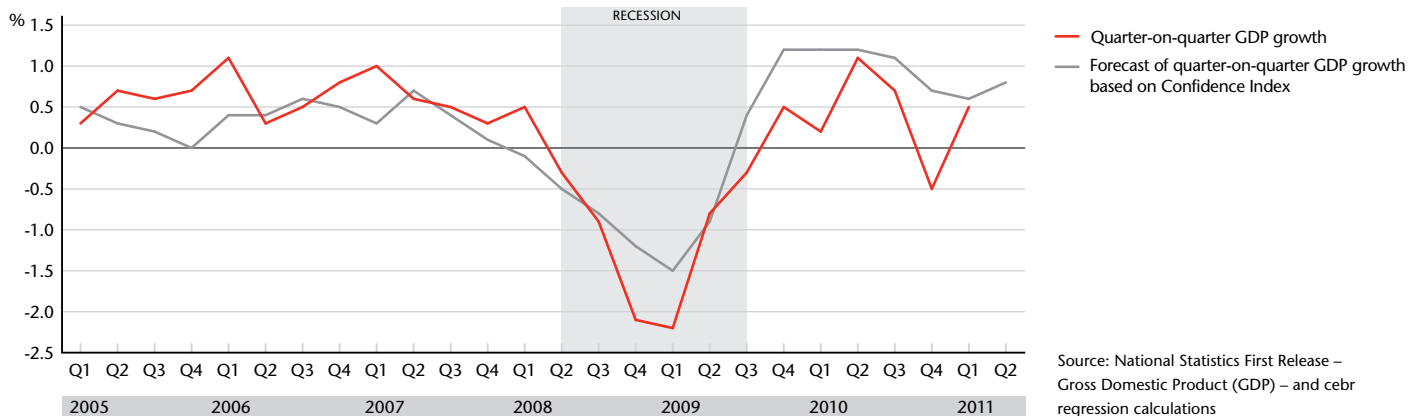
The overall share of businesses more confident about the coming 12 months is unchanged from last quarter, although it remains

FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES



13 percentage points lower than in Q2 2010. The share of businesses less confident about the coming 12 months has declined by five percentage points since last quarter, suggesting some easing in business concerns following a turbulent winter for the economy. The Confidence Index has now been at broadly similar levels for the last three quarters, following the sharp decline seen from 2007 to early 2009 and subsequent recovery as the economy returned to a more positive footing.

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



The UK economy returned to growth in Q1 2011, cancelling out the weather-induced decline in Q4 2010, so economic growth has been flat over the last six months. Preliminary estimates from the Office for National Statistics (ONS) show the economy grew by 0.5% quarter on quarter in Q1 2011, broadly in line with expectations; the Q1 2011 BCM had pointed to 0.6% growth. This quarter's Confidence Index score suggests growth will continue in Q2 2011.

CONFIDENCE INDEX SUGGESTS GROWTH WILL CONTINUE

In April the ONS published its first estimate of Gross Domestic Product (GDP) for Q1 2011, showing a quarter-on-quarter expansion of 0.5% which was broadly in line with expectations. However, this is still below long-run trend growth of around 0.7%. Also, taking Q4 2010 and Q1 2011 together, the economy failed to expand at all following four successive quarters of growth since the recession ended in Q4 2009.

Following the 6.4% peak to trough decline in output through the recession, which took the economy back to the lowest level of output

since Q2 2005, the growth seen in Q1 2011 leaves the economy around where it was in Q2 2006. Hence, there is still a long way for the recovery to go. The latest Confidence Index points to further positive quarterly growth in Q2 2011: around 0.8% quarter on quarter. If realised, this would be the strongest growth since Q2 2010. However, as BCM is a measure of **private sector** confidence this may not take into account the full effect of public sector spending cuts – which get under way in earnest this year – on the headline rate of growth.

BUSINESS FINANCIAL PERFORMANCE

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



Business financial performance improved further in Q2 2011, with turnover and profit growth picking up. The latest BCM financial performance indicators show the strongest year-to-date performance since Q3 2008. Turnover and profit growth expectations are at their strongest since Q1 2008 – the final quarter before the recession began. Growth in exports has shown signs of losing some momentum, although expectations remain upbeat.

FINANCIAL PERFORMANCE STRENGTHENS

Businesses continue to strengthen their financial position with annual turnover growth at 3.9%, its highest level since Q3 2008 and the largest quarterly improvement since Q3 2010. This stronger revenue performance is also feeding through to the bottom line, with reported gross profits up by 3.8% over the last 12 months compared to 2.4% annual growth in profits reported last quarter – the strongest performance since Q3 2008.

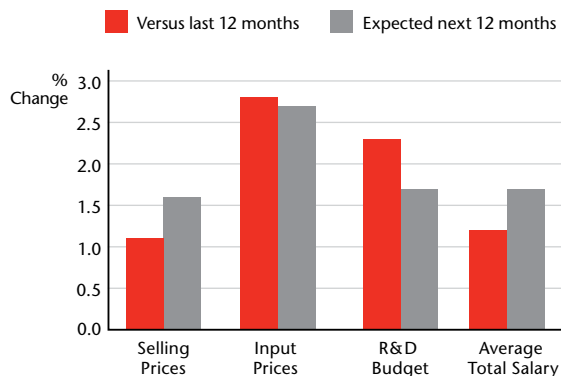
Encouragingly, businesses expect financial performance to strengthen further. Turnover is forecast to expand

by 5.7% over the next year, the strongest expected rate of annual growth recorded by BCM since Q1 2008. Similarly, gross profits are projected to rise by 5.1% over the next year, the highest expected growth since Q1 2008.

Exports grew by 4.3% in the 12 months to Q2 2011. Although this is the highest growth rate for exports since Q4 2008, when compared to the increases in the rate of growth seen over the last three quarters, expansion in exports now seems to be levelling off.

STRONG YEAR-TO-DATE FINANCIAL PERFORMANCE • FIRMS EXPECT GROWTH TO STRENGTHEN FURTHER

FIG. 5 Q2 2011 – AVERAGE % CHANGE IN...



BCM shows inflationary pressures building. The rate at which businesses expect to increase selling prices over the coming 12 months is now in line with levels recorded by BCM before the recession. This reflects global factors driving input costs. With the price of Brent crude as high as \$125 a barrel in March and April, businesses report an average 2.8% increase in input prices over the last 12 months, the highest level reported since Q1 2009.

FIG. 6 EXPECTED AVERAGE % CHANGE IN CAPITAL INVESTMENTS Next 12 months

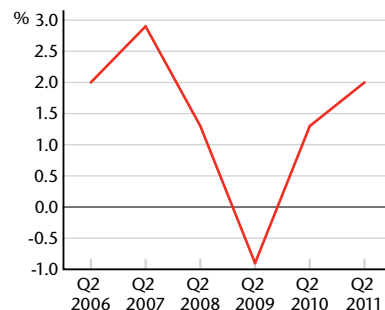
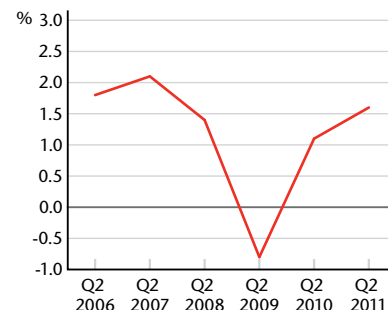


FIG. 7 EXPECTED AVERAGE % CHANGE IN EMPLOYEE NUMBERS Next 12 months



PRIVATE SECTOR EMPLOYMENT GROWTH EXPECTED

In a positive sign that the private sector recovery has gained some traction, businesses report a 0.9% increase in employment over the last 12 months. While still modest compared to pre-recession norms, this is the strongest annual rate of employment expansion recorded by BCM since Q3 2008, and job creation is expected to strengthen further over the coming 12 months.

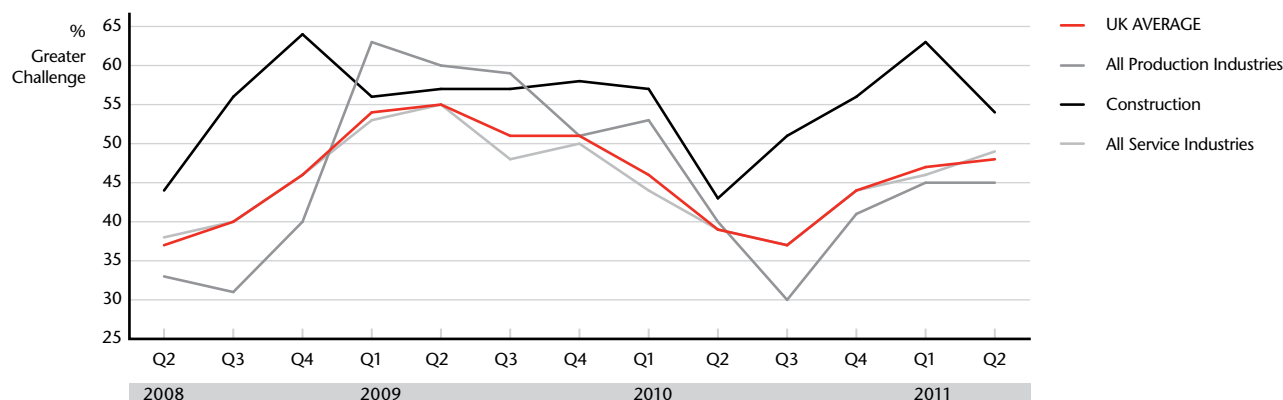
Although the BCM implies labour market conditions are improving, to date pay growth has been contained well below typical pre-recession levels.

Firms also forecast only modest growth in average total salaries over the coming 12 months. With annual inflation on the consumer price index at 4.2% in Q1 2011, many employees are facing declines in income in real terms.

With wage growth pressures limited, firms appear to be more confident to invest. At 1.8% on average, capital investment growth over the last 12 months is at its strongest since Q4 2008, and firms forecast growth of 2.0% in capital investment over the year ahead.

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 8 CUSTOMER DEMAND – CHANGE VERSUS 12 MONTHS AGO



Although financial performance has improved, customer demand remains a key concern for many businesses. While the proportion of businesses reporting customer demand as a greater challenge to business performance is lower than during the recession, it has risen over the last year and remains at an elevated level.

CUSTOMER DEMAND IS STILL A DOMINANT CONCERN

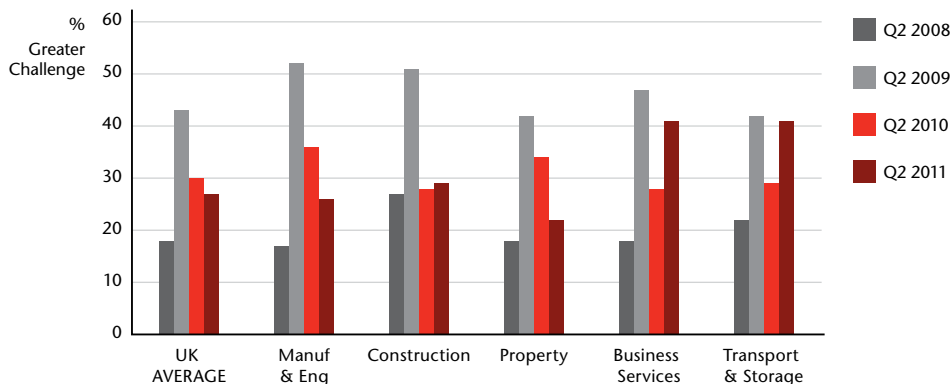
The proportion of businesses reporting customer demand to be a greater challenge to business performance than 12 months ago has been edging up since Q3 2010. The share reporting this trend has risen from 39% in Q2 2010 to nearly half (48%) this quarter.

The share of businesses reporting customer demand to be a greater challenge to business performance is inversely correlated with GDP growth. Therefore, the rise in share of businesses citing customer demand as a greater challenge implies that over the last year the growth outlook

has weakened, and the business environment is increasingly demanding.

The pattern is fairly consistent across sectors. This quarter, businesses in the Construction sector are more likely to report customer demand to be a greater challenge to business performance than is the case for other sectors. However, this variation has moderated since last quarter, potentially signalling an improvement in expected workload for construction firms, who have been under considerable pressure in recent months.

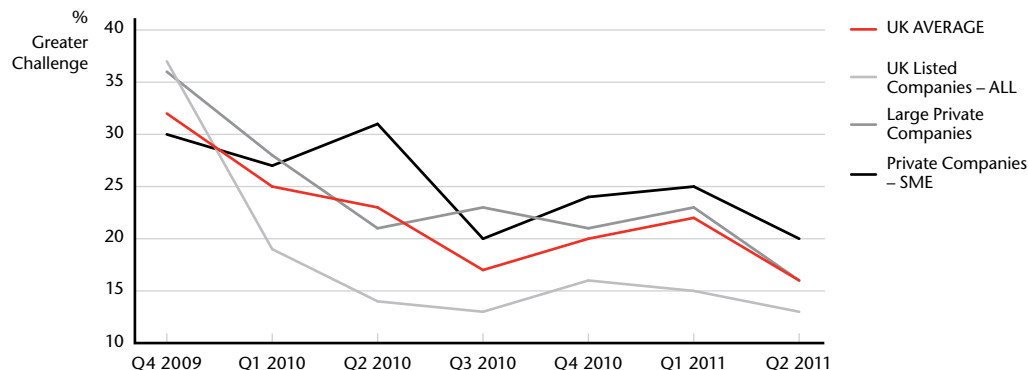
FIG. 9 LATE PAYMENTS BY CUSTOMERS – CHANGE VERSUS 12 MONTHS AGO



LATE PAYMENTS STILL A CONCERN

The share of businesses reporting late payments from customers to be a greater challenge to business performance than 12 months ago is down from the level recorded a year ago, but remains higher than was typical before the recession. This quarter some 27% of businesses report this trend compared to 18% in Q2 2008. This suggests businesses still need to manage cash very carefully. The picture also varies by sector, with two key sectors which mainly serve other businesses – Business Services and Transport & Storage – more likely than average to report late payment as a greater challenge.

FIG. 10 ACCESS TO CAPITAL – CHANGE VERSUS 12 MONTHS AGO



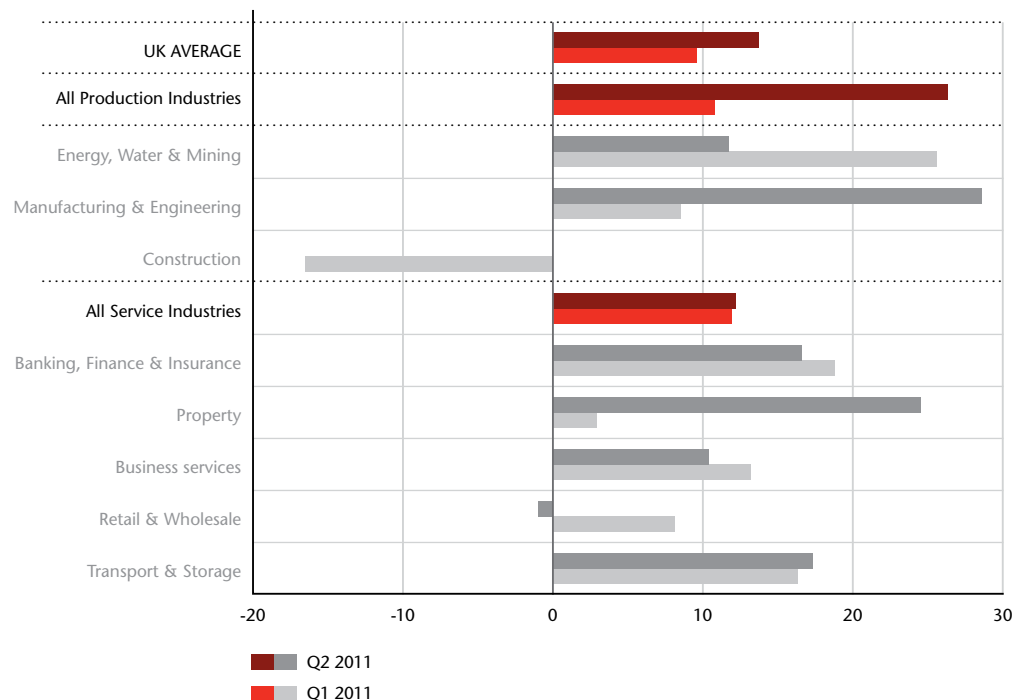
Access to capital emerged as a key issue for businesses as the credit crunch took effect. The latest BCM implies cautious optimism, with just 16% of businesses reporting access to capital as a greater challenge to business performance than a year ago, down from 23% in Q2 2010. Access to finance is still more likely to be an issue for SMEs than for larger firms.

CONCERN OVER LATE PAYMENT PERSISTS • ACCESS TO CAPITAL STILL MORE LIKELY TO BE AN ISSUE FOR SMEs

TRENDS IN BUSINESS CONFIDENCE

INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence among Manufacturing & Engineering firms has recovered this quarter: although less buoyant than some sectors in Q1 2011, it has been the most confident sector in three of the last five quarters. Business confidence remains variable across the Service sectors. The Retail & Wholesale sector's Confidence Index has slipped into negative territory while confidence among Transport & Storage sector firms is relatively strong, and the Property sector has rebounded sharply.

MANUFACTURING SECTOR BUOYANT

The Manufacturing & Engineering sector is the most confident sector in Q2 2011 with a Confidence Index score of 28.6. Confidence in the sector is now close to the level recorded a year ago when it stood at 30.1.

Manufacturing & Engineering firms report turnover growth of 6.3% over the last 12 months, stronger than any other sector and well ahead of the UK average of 3.9%. Data from the ONS show the sector recorded 1.1% quarterly growth in Q1 2011.

In BCM, manufacturers also report robust growth in exports over the last 12 months at 6.3%, compared with 4.3% across the whole economy. However, some signs of caution are emerging for the sector, with firms expecting export growth to slow to 5.6% over the coming 12 months, while in all quarters back to Q2 2009 they expected the rate of exports growth to increase. This quarter, early Purchasing Managers' Index (PMI) data have also pointed to some weakening in manufacturing output growth.

MANUFACTURING SECTOR CONFIDENCE RECOVERS • CONFIDENCE STILL VARIABLE ACROSS SERVICE SECTOR

FIG. 12 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence across the Production Industries overall has recovered this quarter and is now in line with the level recorded a year ago. The Construction sector remains weak with the Confidence Index at 0.0, an improvement on Q1 but down from 14.1 a year ago. For the Service Industries overall confidence this quarter is weaker than for the Production Industries. It has also remained flat since Q4 2010 and is down more than 13 points year on year.

RETAIL SECTOR SLUMPS AND CONSTRUCTION IN RECESSION

The Retail & Wholesale sector records a Confidence Index of -1.0, down nine points from last quarter and nearly 22 points down compared to a year ago. The sector is under pressure from squeezed consumers facing real income declines as the cost of living rises at almost double the pace of earnings growth.

Confidence among Construction sector firms also remains very low, with a Confidence Index of 0.0. The latest data from the ONS show an estimated 4.7% quarter-on-quarter decline in Construction sector output in Q1 2011 after a 2.3% drop in Q4

2010. This means that the sector is technically in recession. However, ONS construction estimates can be subject to revision and the quarterly contractions are likely to have been weather-affected. Overall, weak trends in official data combined with fragile confidence would suggest serious concerns ahead for the sector.

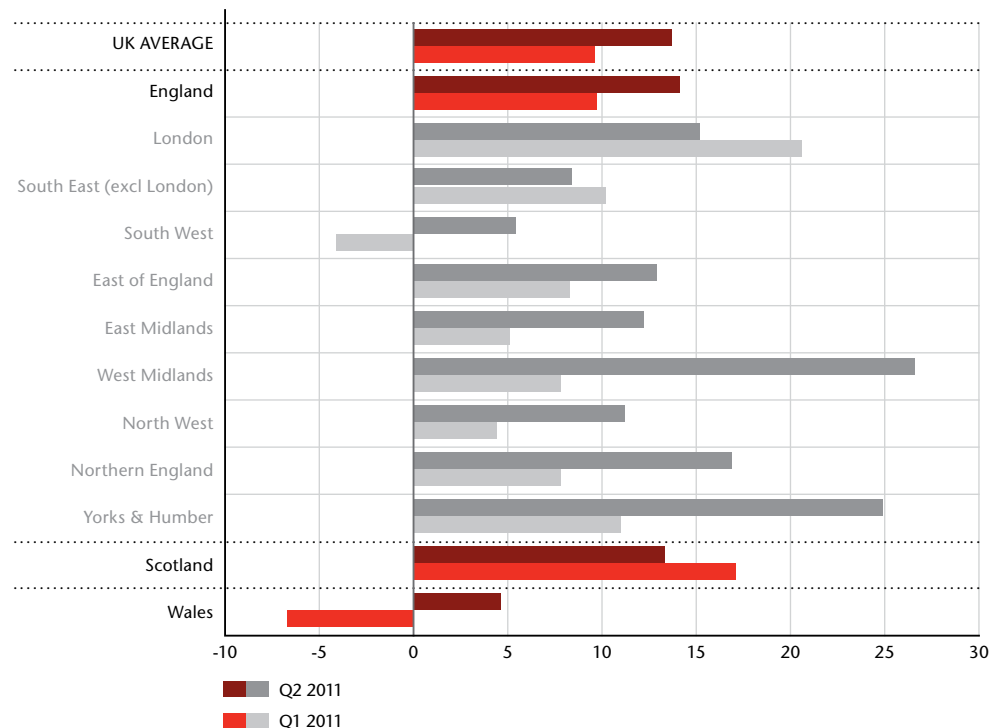
The Property sector has bounced back in Q2 2011 suggesting the housing market could be set for some improvement after a disappointing start to the year. The Nationwide index showed a 1.3% year-on-year fall in house prices in April.

RETAIL & WHOLESALE CONFIDENCE NOW NEGATIVE • CONSTRUCTION FIRMS' CONFIDENCE REMAINS LOW

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 13 TREND OF BUSINESS CONFIDENCE BY REGION



This quarter confidence has strengthened in England, moved out of negative territory in Wales but continued to weaken in Scotland. Business sentiment strengthened in all English regions with the exception of London and the South East – the two largest regional economies. BCM records particular improvements in confidence among firms in the West Midlands and Yorkshire & Humber, while businesses in Wales and the South West are least confident for the second successive quarter.

CONFIDENCE BOUNCES BACK IN WEST MIDLANDS AND YORKSHIRE

Business confidence has strengthened this quarter in the West Midlands and Yorkshire & Humber. In both regions the share of businesses more confident about the coming 12 months has increased while fewer are neutral or less confident. Manufacturing is particularly important to both regional economies, so the relatively buoyant manufacturing sector could be underpinning the general business outlook.

Confidence in Scotland, having been above the UK average for 10 successive quarters, weakened further this quarter to move in line with the UK as whole. This suggests that business conditions in Scotland are starting to move in line with those prevailing across the rest of the UK.

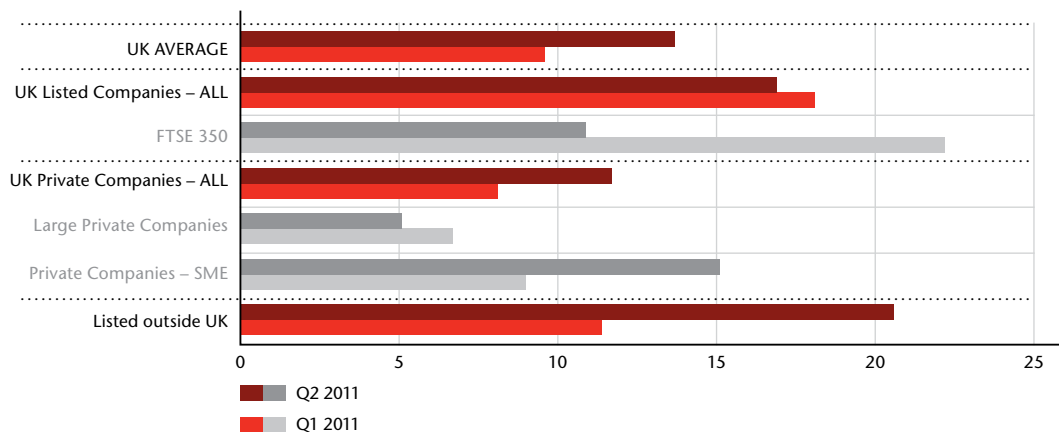
Confidence in London has weakened marginally and will be significantly below the level recorded in Q1 2011 if this trend continues. Given London's more internationalised services sector, weakening confidence is likely to reflect a general concern about the strength of the global economy, amid ongoing unrest in the Middle East and North Africa, and lacklustre growth in the developed world.

CONFIDENCE WEAKENING IN LONDON AND SCOTLAND • OUTLOOK IMPROVES IN MIDLANDS AND NORTH

TRENDS IN BUSINESS CONFIDENCE

TYPE

FIG. 14 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



The gap in confidence between listed and private companies has narrowed this quarter. Confidence among listed companies remains higher than among private companies. Larger private sector firms remain less confident than average this quarter. Companies listed outside the UK are much more confident this quarter than companies listed in the UK.

CONFIDENCE RISES AMONG SMALL AND MEDIUM-SIZED FIRMS

Confidence among UK private companies has lagged behind that of listed companies for over a year. However, the gap closed to 5.2 points this quarter having been around 10 points in Q1 2011 and Q4 2010.

The Confidence Index for private firms stands at 11.7 this quarter, the highest level recorded since Q3 2010. The improvement from Q1 2011 has been driven by small and medium-sized firms. Confidence among large private companies is now significantly lower than the UK average.

Notably, there has been a divergence in the confidence of firms listed in the UK and those listed abroad: FTSE 350 firms suffered a steep 11.4 decline in their Confidence Index this quarter, while firms listed outside the UK saw confidence rise by 9.2 points.

GAP BETWEEN LISTED AND PRIVATE FIRMS NARROWS • THOSE LISTED OUTSIDE UK MOST CONFIDENT

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 1000 telephone interviews conducted 1 February – 21 April 2011, with ICAEW members working in industry and commerce. These probed 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. Data are weighted to represents the UK economy by value.

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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ICAEW

Chartered Accountants' Hall
Moorgate Place London
EC2R 6EA UK

T +44 (0)20 7920 3505
E bcm@icaew.com
icaew.com/bcm