



UK BUSINESS CONFIDENCE MONITOR

Q4 2013

WELCOME



This quarter's *ICAEW/Grant Thornton Business Confidence Monitor* shows that business confidence has now risen for five consecutive quarters. This represents the longest period of rising optimism since the survey started 10 years ago. It also means that the UK is set to be the fastest growing economy in the western world going into 2014.

That said, as the economy returns to pre-crisis levels external threats do still remain. The challenge now is for government not to be complacent but to ensure that we sustain the growth we've seen in the last 12 months. The recovery is certainly starting to gain momentum, and it's crucial that all of us – government, businesses and consumers – play our part in building on the solid foundations that have been laid.



Michael D M Izza
Chief Executive
ICAEW



Growth in business confidence is accelerating and this quarter's *ICAEW/Grant Thornton Business Confidence Monitor* shows that the UK economic recovery is well underway. UK growth is also predicted to outpace all other developed economies going into 2014, testament in part to the resilience and agility of UK business. Also encouraging is that key financial performance indicators such as reported turnover and profit have risen and are expected to improve further.

While still at lower levels than we would like to see, there are tentative signs that businesses are increasing the pace of their investment and export plans; both instrumental in achieving and maintaining solid UK economic growth.



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 increased again in Q4 2013 to +31.7, up from +24.0 in Q3 2013 to reach its highest level in the BCM's 10 year history. Confidence has now increased for five consecutive quarters, the longest period on record, suggesting resilience in the current recovery.

The Confidence Index is a leading indicator for growth, and this quarter's reading suggests that the economic recovery will continue to accelerate in Q4 to expand by 1.3%, following the 0.8% growth seen in Q3 2013. This suggests that growth over 2013 as a whole will comfortably outpace the Office for Budget Responsibility's (OBR's) March 2013 forecast of 0.6% growth for the year.

KEY ISSUES EMERGING THIS QUARTER

- Business confidence rose again in Q4 2013, suggesting that the economic recovery is continuing to gain momentum.
- Financial performance indicators such as turnover and profit growth have picked up and are expected to grow faster over the next 12 months.
- Signs are emerging that businesses are becoming more inclined to invest.
- However, more than half of businesses are still operating with spare capacity as economic output remains below the pre-crisis peak.
- Pay restraint remains the order of the day, with expected growth in employee earnings standing below current rates of consumer price inflation.

In Q3 2013, the UK economy expanded at a quarter-on-quarter rate of 0.8% according to the Office for National Statistics' first estimate of quarterly output. This is up from 0.4% and 0.7% in Q1 and Q2 2013 respectively. For a second consecutive quarter, the Production, Construction and Services sectors all expanded, suggesting that economic recovery is becoming more broad-based.

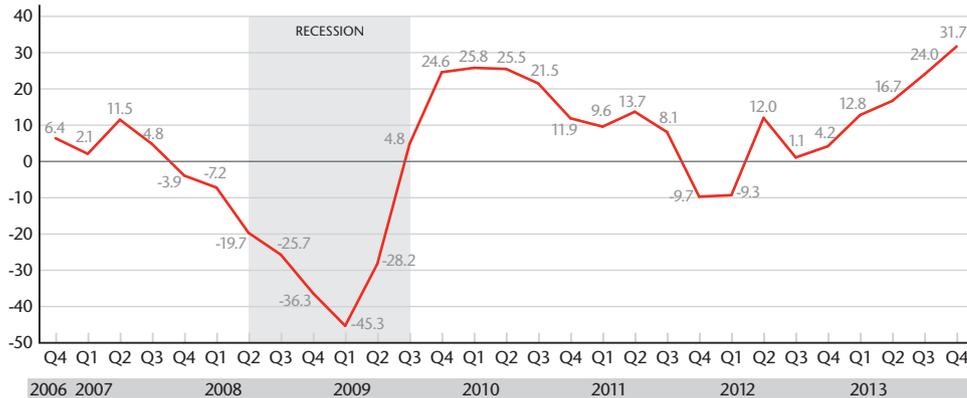
This quarter's BCM provides further encouraging signs for the UK's economic prospects over the next 12 months. Companies are now cautiously planning to increase their capital investment growth, and employment growth has picked up with further increases expected over the coming year. It is becoming increasingly likely that the UK unemployment rate will fall to 7.0% – the threshold at which the Bank of England will consider raising interest rates – before 2016. With economic growth picking up and businesses willing to hire, there may be a Bank Rate rise as early as 2015.



Douglas McWilliams
Chief Executive, Cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q4 2013

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



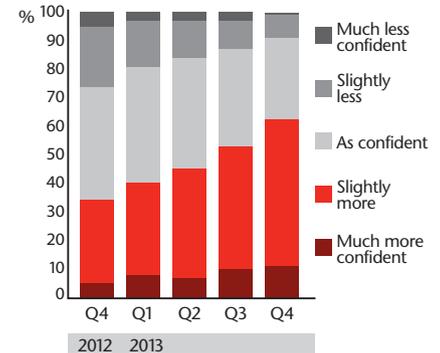
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence continuing to climb. The Confidence Index for Q4 2013 has increased to +31.7, up from +24.0 in Q3 2013 and taking confidence levels to their highest in the BCM's 10 year history.

CONFIDENCE RISES FOR OVER A YEAR TO REACH NEW HIGH

This quarter's BCM findings show UK business confidence rising for the fifth consecutive quarter, climbing significantly from +4.2 in Q4 2012 to +31.7 now. This is the longest period of sustained rising confidence recorded in the survey, and the Confidence Index now stands above the previous high of +25.8, registered in Q1 2010.

The recent trend of increasing confidence contrasts with that seen in 2009/10 when confidence increased sharply as the UK came out of the deep recession of 2008/09, only to fall back as growth figures remained

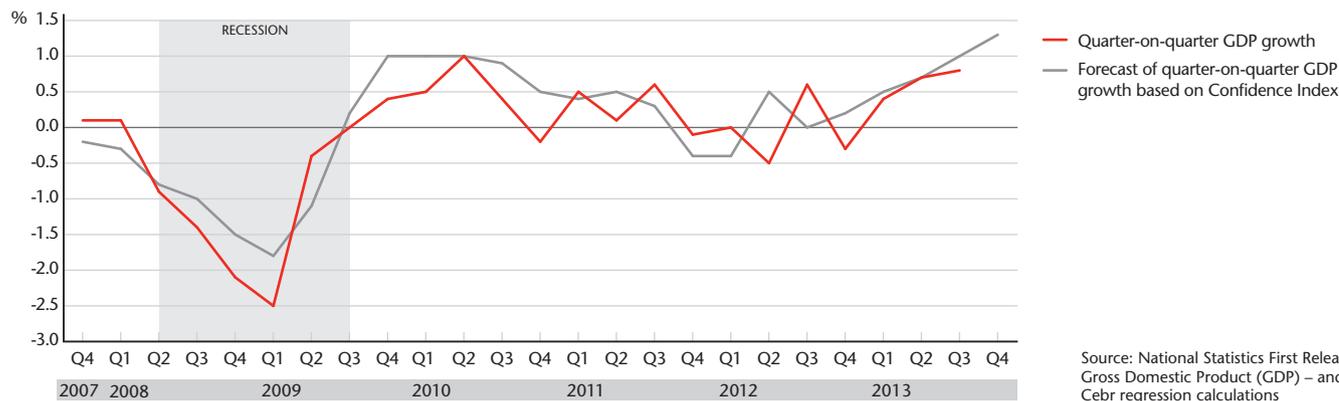
FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES



modest. The recent upward trend in confidence is steadier and more protracted, reflecting a sustained period through which the economic outlook has been strengthening.

This quarter, almost two thirds of businesses (63%) are more confident about their economic prospects over the coming 12 months than the previous year. This proportion has also risen for the past five quarters to reach a new high. At the same time, only 9% of businesses are less optimistic about the year ahead than the one just passed – down from 26% at the same time in 2012.

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



UK economic growth is accelerating through 2013. Initial estimates from the ONS showed the economy growing at a quarter-on-quarter rate of 0.8% in Q3 2013. Quarterly growth has only been faster than this once since the recession of 2008/09, in Q2 2010, and this is now the third consecutive quarter of acceleration, following a 0.3% contraction seen in the final quarter of 2012.

BCM POINTS TO STRENGTHENING GROWTH PERFORMANCE

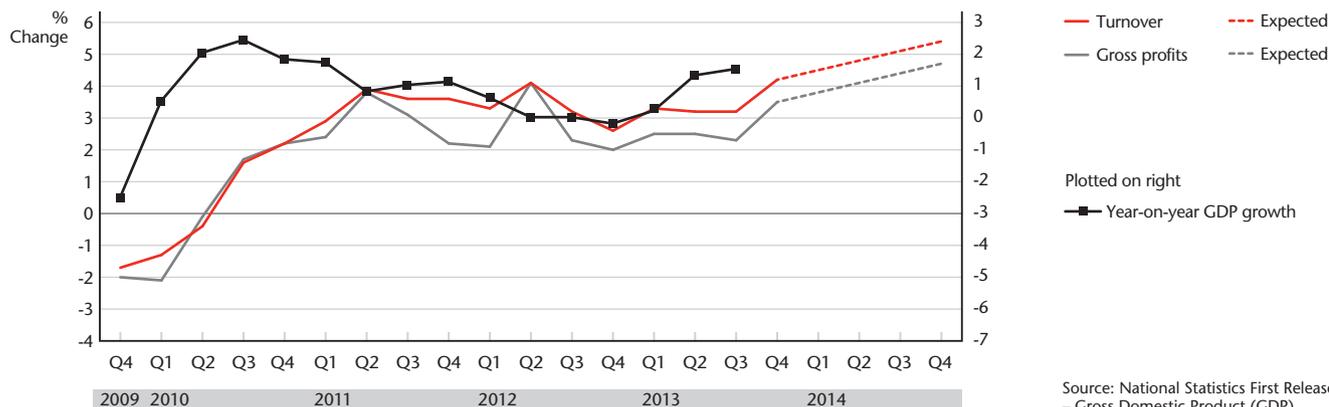
The latest Confidence Index results suggest that economic growth will accelerate again in Q4 2013, predicting a 1.3% increase in GDP over the quarter. If realised, this would be the fastest quarterly growth since 2007, before the financial crisis. With growth continuing to accelerate, the UK economy is set to exceed the OBR's March 2013 forecast of 0.6% growth for the year as a whole, illustrating the extent to which the outlook has improved over the year.

Data from other sources support the picture of a strengthening recovery.

ONS data show that output growth is coming from across the economy, with a quarter-on-quarter expansion in Agriculture, Production, Construction and Services in Q3 2013. Alongside this there is evidence that consumer confidence is also picking up. The YouGov/Cebr consumer confidence indicator shows optimism increasing for 10 consecutive months to October 2013, boosted by a strengthening housing market and perceived increases in job security.

BUSINESS FINANCIAL PERFORMANCE

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



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

The acceleration in the UK economy is feeding through into business financial performance. Key performance indicators are starting to pick up as companies report faster annual growth in turnover, gross profits and sales volumes this quarter.

FURTHER UPLIFT IN BUSINESS GROWTH EXPECTED AHEAD

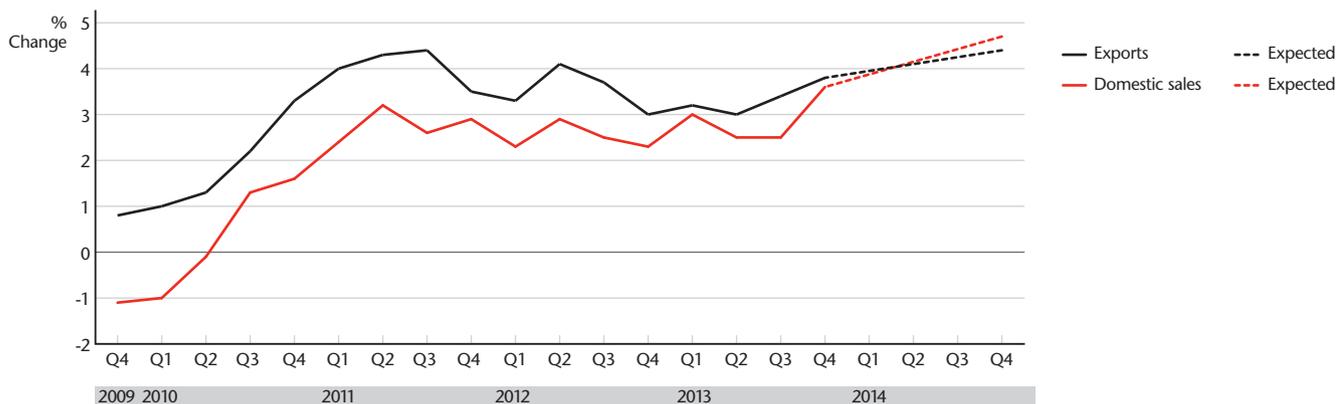
The latest figures for turnover and profit growth of 4.2% and 3.5% respectively are the highest seen in over a year as the business environment improves. In line with the continued increase in business confidence, companies anticipate a further uptick ahead, with growth of 5.4% and 4.7% expected respectively for turnover and gross profits over the next 12 months.

Small and medium-sized businesses anticipate the greatest increases in growth – turnover is expected to rise by 6.3% over the next 12 months, up from 4.4% in the past year.

In comparison, larger companies expect turnover growth to pick up to 4.6%, compared to 4.0% over the last 12 months.

A reduction in the rate of input price growth may help companies achieve their expectations for increased profitability over the year ahead. Businesses predict that input price growth will slow to 1.4% over the next 12 months, compared with the 1.8% increase reported over the past year. This is supported by forecasts from the IMF which suggest that prices for both crude oil and non-fuel commodities will fall back in 2014.

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



The latest uptick in turnover growth is being supported by rising demand both in the UK and from overseas. Growth in domestic sales and exports both increased this quarter, and higher growth for both is expected for the year ahead. These latest BCM results on exports give encouraging signs that the UK recovery is starting to come from more sustainable sources, rather than relying on consumer and government spending.

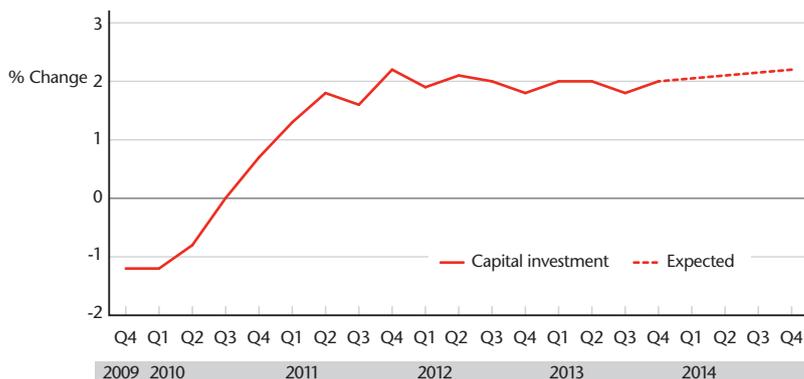
FURTHER UK AND OVERSEAS GROWTH EXPECTED AHEAD

Domestic sales growth rose to 3.6% over the last year – up from 2.5% the previous quarter – and has now reached the highest level since Q3 2008. Encouragingly, the trend looks set to continue with growth of 4.7% expected over the year ahead. These findings from BCM reflect the HM Treasury’s latest consensus forecasts which suggest that consumer spending will grow faster in 2014 than in 2013, bolstering domestic demand.

Export sales have also started to increase faster, rising by 3.8% over the year to Q4 2013, up from 3.4%

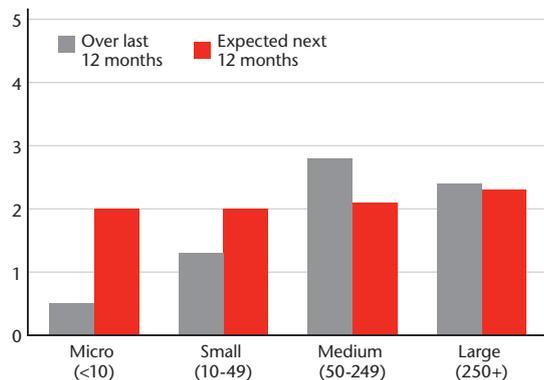
last quarter and expected to increase by 4.4% over the coming 12 months. This latest uptick in export performance is a tentative sign of sustainable growth returning to the UK – however, a prolonged continuation of this trend will be needed before the UK sees a robustly export-led recovery. In addition, there remain some risks to the outlook. Although the eurozone exited recession in 2013, growth in the single currency area is expected to be only marginal over 2014, while China is expected to see an economic slowdown.

FIG. 6 CAPITAL INVESTMENT – AVERAGE % CHANGE ...



There are signs emerging that businesses are becoming more willing to invest in capital. Investment growth of 2.2% is expected for the next 12 months, compared to 2.0% over the last year. This is the first time since Q3 2011 that expectations have outpaced current annual growth, in a further encouraging sign that the UK is starting to move towards a more sustainable recovery.

FIG. 7 CAPITAL INVESTMENT – AVERAGE % CHANGE ...



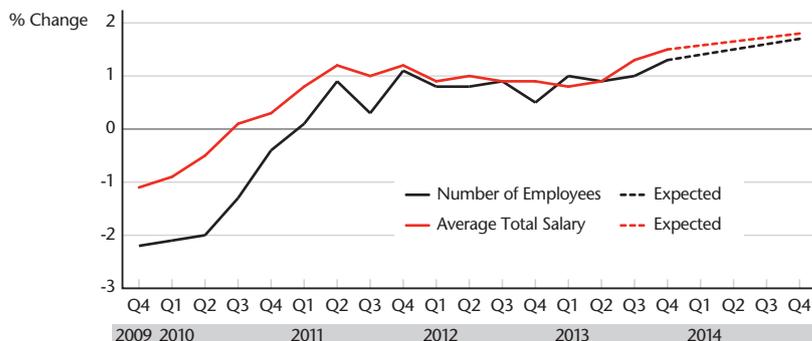
INVESTMENT GROWTH SET TO RISE AT SMALLER COMPANIES

Much of recent investment growth has come from medium-sized and larger companies, with a 2.4% year-on-year increase at large firms compared to just 0.5% growth at micro businesses. However, smaller companies have improved expectations for the year ahead. Both small and micro businesses anticipate investment growth of 2.0% over the next 12 months, possibly reflecting the effects of the re-focussing of the Bank of England's Funding for Lending scheme to bring better financing opportunities to smaller businesses.

Despite these positive signs, a risk to the investment outlook comes from

the level of spare capacity still in the economy, as more than half of UK businesses (55%) report running below capacity in Q4 2013. This is down from 62% in Q4 2012, but illustrates how UK economic activity remains behind its pre-crisis peak. It also suggests that some businesses may have room to grow, preferring to make greater use of their current resources before making further investment. In addition, even with the latest uptick in expectations, planned investment growth remains notably below the growth rates of around 3% seen before the financial crisis.

FIG. 8 AVERAGE % CHANGE OVER 12 MONTHS TO ...



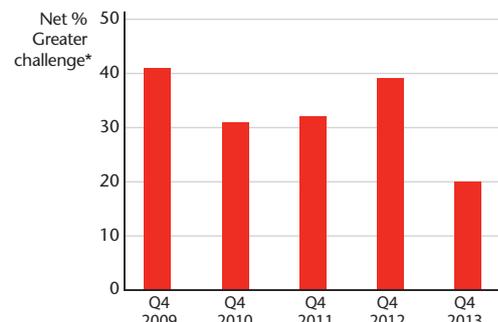
In line with rising confidence and improved financial performance, there are signs that businesses are taking on more staff and increasing salaries. Businesses report increasing staff numbers by 1.3% in the year to Q4 2013, with further increases predicted over the coming year. Total pay has increased by 1.5% over the past year on average – the fastest rate since Q4 2009 – but pay growth remains below consumer price inflation, meaning real incomes continue to be squeezed.

EMPLOYMENT GROWTH REACHES HIGHEST RATE SINCE 2008

The net share of businesses to report that customer demand is a greater challenge now than a year ago has fallen to 20%, down from 39% at the same time in 2012. In line with this, businesses report an increase in their rate of hiring with average headcounts growing by 1.3% over the last 12 months.

Companies expect growth in employee numbers to pick up further, predicting a 1.7% increase in headcounts in the year ahead. This faster UK private sector job creation will help bring unemployment back toward the 7.0% level at which the

FIG. 9 CUSTOMER DEMAND AS A GREATER CHALLENGE



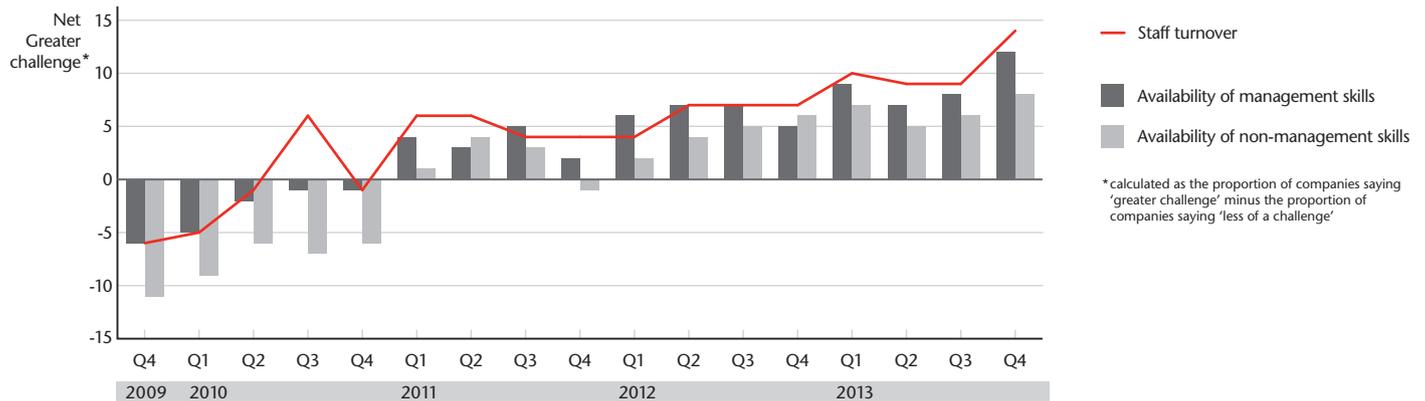
*calculated as the proportion of companies saying 'greater challenge' minus the proportion of companies saying 'less of a challenge'

Bank of England will consider raising interest rates.

The fastest growth in employee numbers is expected within the Business Services and IT & Communications sectors, with a 2.3% increase predicted for each over the next 12 months. The Banking, Finance and Insurance sector still expects to shed jobs with a 0.4% decrease in headcounts predicted; however, when compared with the 1.6% fall in employee numbers recorded in the sector over the last 12 months, there are tentative signs that job creation may return soon.

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 10 STAFF TURNOVER AND SKILLS AS A GREATER CHALLENGE



The strengthening UK labour market is starting to place pressure on businesses' staffing requirements. Staff turnover is a concern for an increasing proportion of companies as employment opportunities improve. Finding workers with management experience is becoming more of a challenge for a greater share of businesses, which could help boost pay growth for those with the right skills.

STAFFING ISSUES BECOMING A CHALLENGE FOR MORE BUSINESSES

This quarter, a net balance of 14% of UK businesses report that staff turnover is a greater challenge now than a year ago. This is the highest proportion since Q1 2008 and may indicate that the current economic growth is beginning to improve employment opportunities, making it easier for employees to change jobs.

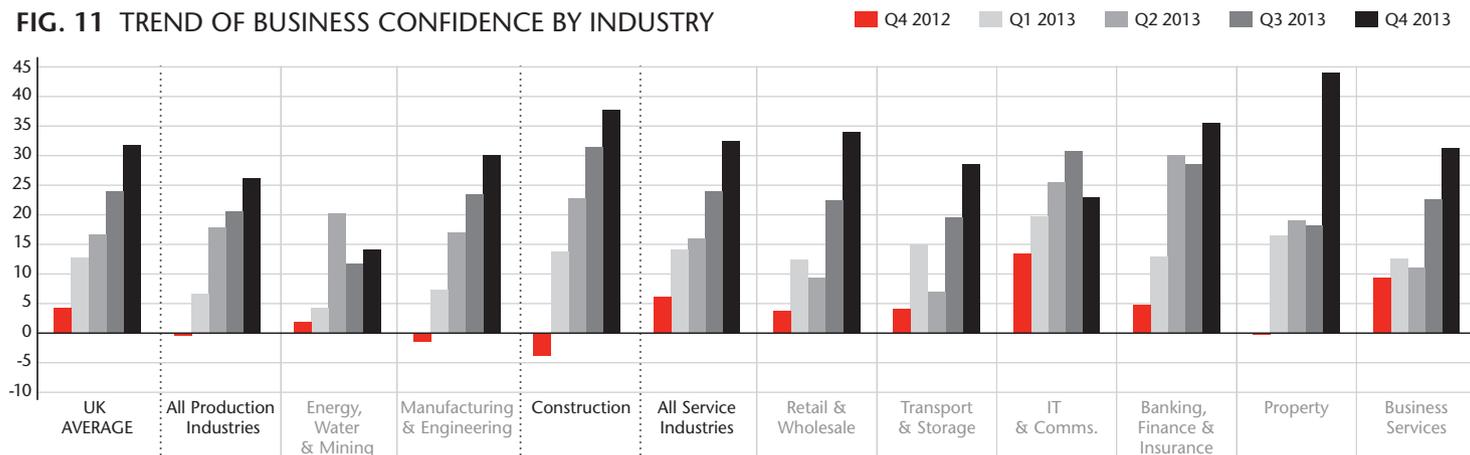
In addition, more businesses are now reporting that the availability of some skills is a greater challenge. This quarter, a net proportion of 12% of companies report that finding workers with the right management skills is more of a challenge than a year ago, up from a 5% at the same point in

2012. With management skills starting to become scarcer, those with the right experience could see an uptick in their pay growth starting to emerge.

Although these figures for both staff turnover and management skills availability remain below the levels seen before the financial crisis (as the overall unemployment rate is still relatively high), they do illustrate how reductions in labour market slack are starting to be made alongside economic recovery.

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



A strong upward trend in business confidence has been seen across all the major sectors of the UK economy over the past year. Confidence has stood in positive territory for all sectors of the economy for four consecutive quarters in a sign that the recovery is both broad-based and sustained.

RECOVERY CONTINUES ACROSS MAJOR INDUSTRY GROUPS

Confidence within the UK Construction sector has climbed to +37.8 this quarter, up from -3.9 at the same time a year ago. This has been accompanied by an upturn in real construction output growth: data from the ONS for Q3 2013 show year-on-year growth in sector output of 5.0%, compared to a 10.0% annual contraction in Q3 2012.

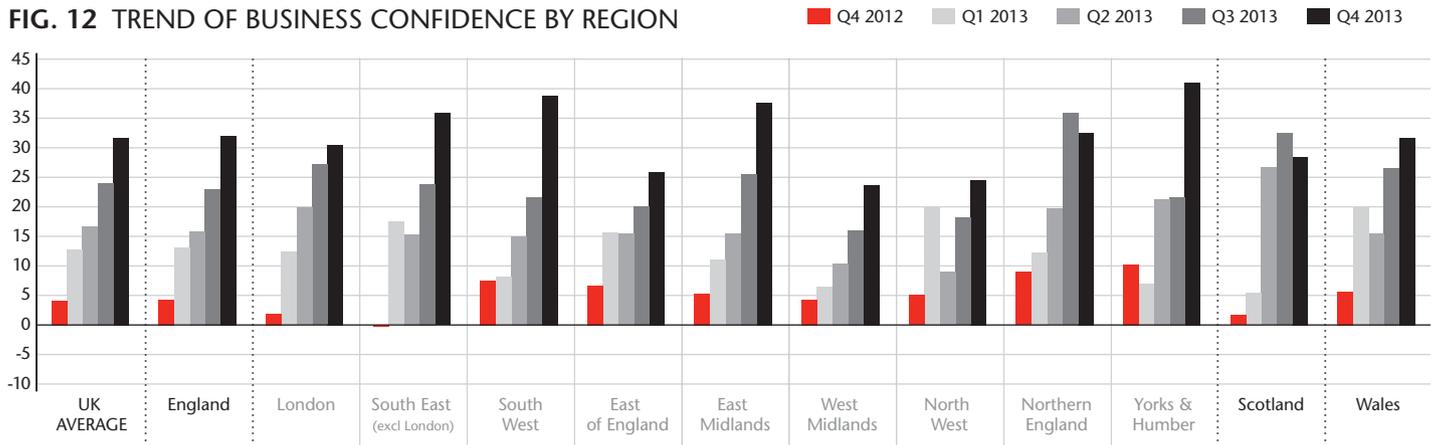
Confidence in the Production industries has also seen a marked increase over the past year, rising from -0.5 in Q4 2012 to stand at +26.1 this quarter, driven largely by the Manufacturing & Engineering sector. ONS data show that output in the

Manufacturing sector was broadly unchanged on a year ago in Q3 2013, a marked improvement from the 1.5% year-on-year decline seen in Q3 2012.

Within the overall Services sector, confidence in Banking, Finance & Insurance has been rising over the past year. Trading activity on the London Stock Exchange has recently been strengthening after a long period of decline, reflecting an improving outlook for the sector.

TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence has continued to strengthen across the regions and nations of the UK in Q4 2013. Only Scotland and Northern England saw the upward trend of business confidence level off this quarter, though even in these areas confidence remains relatively high.

CONFIDENCE RISES AGAIN ACROSS MUCH OF THE UK

Business confidence has now been in positive territory for a full year in every part of the UK, indicating that the private sector around the country is experiencing sustained economic recovery.

Confidence in London has shown a steady improvement over the past year, rising from +2.0 in Q4 2012 to +30.5 this quarter, boosted by rising confidence in the Banking, Finance & Insurance sector which makes up roughly a fifth of the capital's economy.

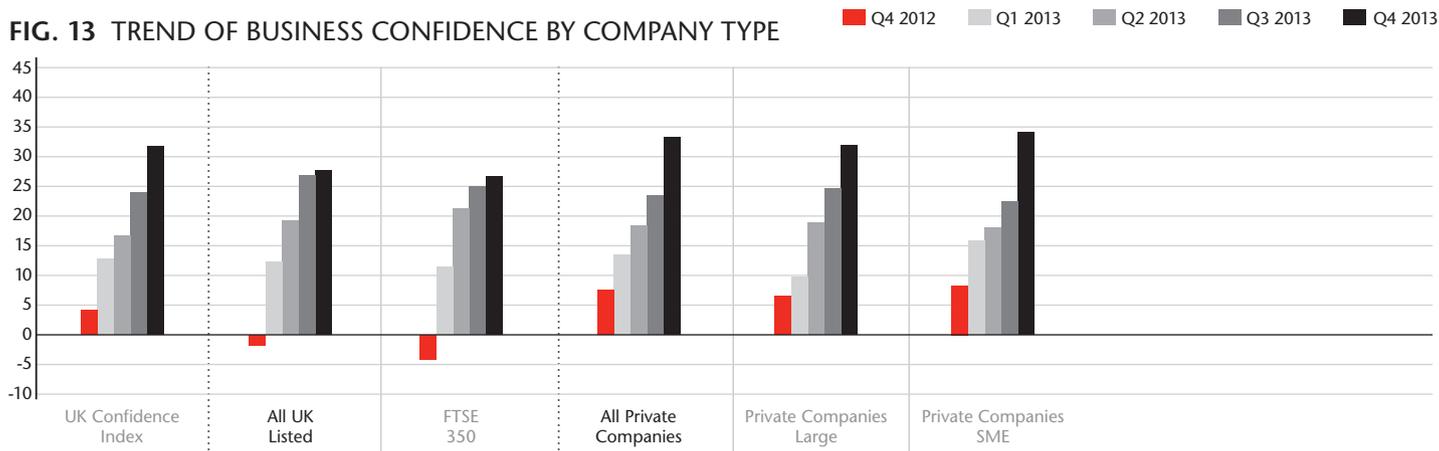
In contrast, confidence in Scotland and Northern England levelled off

this quarter, standing at +28.5 and +32.6 respectively in Q4. Despite this, confidence levels in both areas remain well up on Q4 2012 and close to the UK average.

Although up on last quarter, business confidence in the West Midlands remains the lowest of any region with an Index reading of +23.7. Employment prospects in the region have deteriorated recently, with unemployment jumping by 0.8 percentage points in June to August 2013 compared to the same period a year before.

TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



Confidence has now been in positive territory for all company types for a full year. The strongest increases this quarter were felt among SMEs and larger private companies, rather than listed businesses.

CONFIDENCE INCREASES LED BY PRIVATE COMPANIES

SMEs reported a Confidence Index of +34.1 in Q4 2013, a sharp rise from +22.5 in the previous quarter and the largest quarterly increase of any company type. Larger private companies also saw an increase in confidence, from +24.7 in Q3 2013 to +31.9 now.

In contrast, confidence among listed businesses has been slower to show gains this quarter, with FTSE 350 companies posting a rise from +25.0 in Q3 2013 to +26.7 now. Larger listed companies are often exposed to the global macroeconomic environment more than smaller businesses. Although the eurozone is

expected to return to growth in 2014, economic expansion is expected to be only marginal at best. In addition, the Chinese economy is expected to slow over the next 12 months – both factors that could be weighing on sentiment at listed global organisations.

However, confidence levels among listed companies remain positive, and there are signs that this is now translating into hiring intentions – average employment growth of 0.5% is expected over the next 12 months, compared to a 0.1% decline over the past year.

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 on 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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