



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS

IN ENGLAND AND WALES

UK BUSINESS CONFIDENCE MONITOR REPORT

Q3 2009



WELCOME



The latest *ICAEW UK Business Confidence Monitor* (BCM) sees confidence in positive territory for the first time in two years. Having implemented robust business strategies in response to unprecedented global economic conditions, businesses now forecast growth in profit, turnover and sales during the year ahead.

While this is encouraging, we should not lose sight of the reality that we are still in a very tough environment for business. The large proportion of firms challenged by limited access to finance persists and – as revealed in our recent *SME Access to Finance* research – there is a clear need for the lending institutions to be more transparent and consistent with their small business customers.

Since its introduction in 2003, BCM has provided a regular snapshot of the state of the economy, informed by senior business professionals advising and running all types of businesses across the UK. It is one of the largest and most comprehensive quarterly reviews of UK business confidence.

BCM findings are shared with a range of policy-makers at a national and regional level, and are used by the business community, academics and researchers, providing a robust tool on which government and regional authorities can base decisions for developing policy. Leaders of UK businesses also find BCM useful as a credible predictor of economic change.

Although positive growth in the autumn seems more likely, there are concerns about the strength of the recovery. Salaries are expected to remain squeezed and with no planned recruitment there is still an air of nervousness among UK businesses. The signs are that the next twelve months are very much about building for the 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

ECONOMIST'S VIEW



The latest *ICAEW UK Business Confidence Monitor* (BCM) shows confidence is positive following seven consecutive quarters in negative territory. Having correctly pointed to an easing in the pace of contraction last quarter, the Confidence Index now suggests that the UK economy could return to modest positive growth this quarter.

The Bank of England has moved further with its quantitative easing programme as inflationary risks remain minimal and stimulating recovery is paramount. August's Monetary Policy Committee meeting caught the markets by surprise in expanding the Bank's planned asset purchases from £125bn to £175bn. The jury is out on whether 'QE' is working: however, my feeling is that it has helped confidence by showing that the Bank has more tools at its disposal after interest rates reached a floor at 0.5% in March – the level they are likely to stay at until at least mid 2010.

KEY ISSUES EMERGING THIS QUARTER:

- Firms are forecasting growth in profit, turnover and sales over the coming year; indeed, 13 out of 14 financial performance indicators are expected to rise in the year ahead where the majority are reported to have contracted in the year to date.
- Inventory levels have reduced further. More than a quarter of firms in the Manufacturing, Construction and Transport sectors report stock levels below normal, suggesting growth could be round the corner as the inventory cycle turns.
- Confidence in the Banking, Finance & Insurance sector improved markedly for the second quarter. However, despite quantitative easing and improvements in credit markets, more than one in three firms still report access to capital as a greater challenge than a year ago.

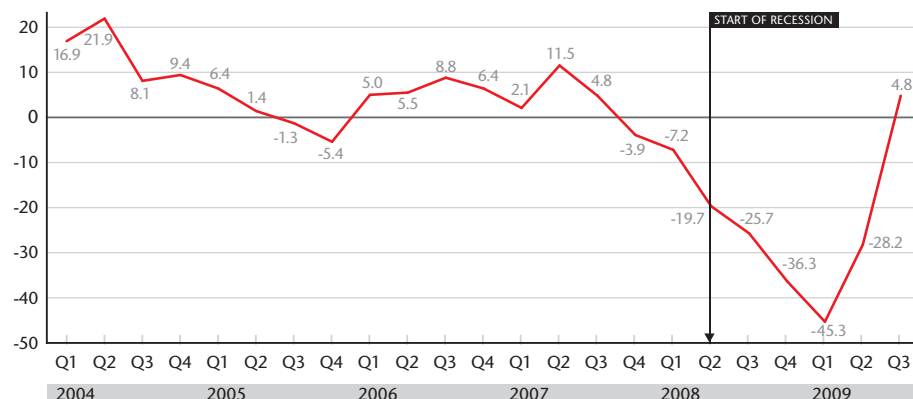
Despite compelling signs of the recession nearing an end, I remain doubtful over the strength of recovery. The UK economy is still swamped with debt, earnings growth is weak and unemployment is rising, so the outlook for households is cautious. The real elephant in the room is the state of the UK public finances. Major spending cuts – and possibly tax hikes – will be needed in the next parliament to bring government finances back to health, which is likely to put the brakes on the recovery.



Douglas McWilliams
Chief Executive, cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q3 2009

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



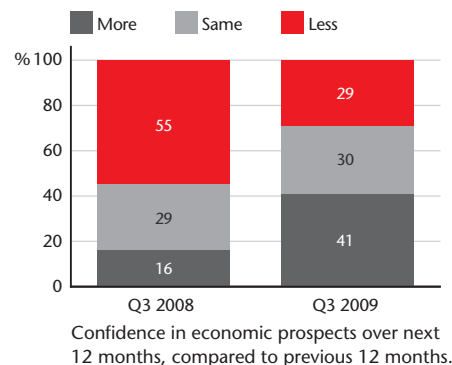
The latest ICAEW *UK Business Confidence Monitor (BCM)* shows a significant improvement in confidence. The Confidence Index has moved into positive territory for the first time since Q3 2007 when the credit crunch was in its infancy. The UK economy has contracted by 5.7% during the current recession but BCM indicates that positive growth could return this quarter.

CONFIDENCE INDEX MOVES INTO POSITIVE TERRITORY

The latest findings from BCM show the Confidence Index standing at 4.8, up from -28.2 last quarter. The Confidence Index has risen for two consecutive quarters and is at its highest level since Q3 2007. This quarter's change is the largest quarterly improvement seen since BCM began.

This improving picture fits with a number of other indicators on the UK economy. The closely watched index of production showed output rose by 0.5% month-on-month in June, the second increase in three months and the largest increase since October 2007. In addition,

FIG. 2 CONFIDENCE INDEX – DETAILED RESPONSES



the service sector Purchasing Managers' Index has shown expansion in three consecutive months to July.

Four in ten senior business professionals interviewed in BCM (41%) are more confident about economic prospects facing their organisation over the next twelve months compared with the previous twelve months, the largest proportion expressing this sentiment since Q2 2007. However, only 6% feel **much** more confident, so while economic recovery is in train, caution remains over its strength.

CONFIDENCE POSITIVE AFTER SEVEN NEGATIVE QUARTERS • OUTPUT UP 0.5% • CAUTION REMAINS

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



The latest BCM Confidence Index indicates the UK economy will return to growth in the third quarter of 2009. In line with BCM forecasts the economy contracted 0.8% during Q2, a considerably slower pace than was seen in Q1 when a contraction of 2.4% was recorded. The signs are that the combined force of financial sector interventions, steep cuts in the Bank Rate by the Bank of England, fiscal policy and quantitative easing are helping the economy to emerge from recession.

POLICY INTERVENTIONS HELP TO TURN THE TIDE

The credit crunch has shown further signs of easing in recent months as banks returned to profitability, while spreads on inter-bank lending fell to their lowest level in eighteen months and lending volumes edged up. Mortgage approvals have risen from a low of 27,400 in November 2008 to 47,600 in June 2009.

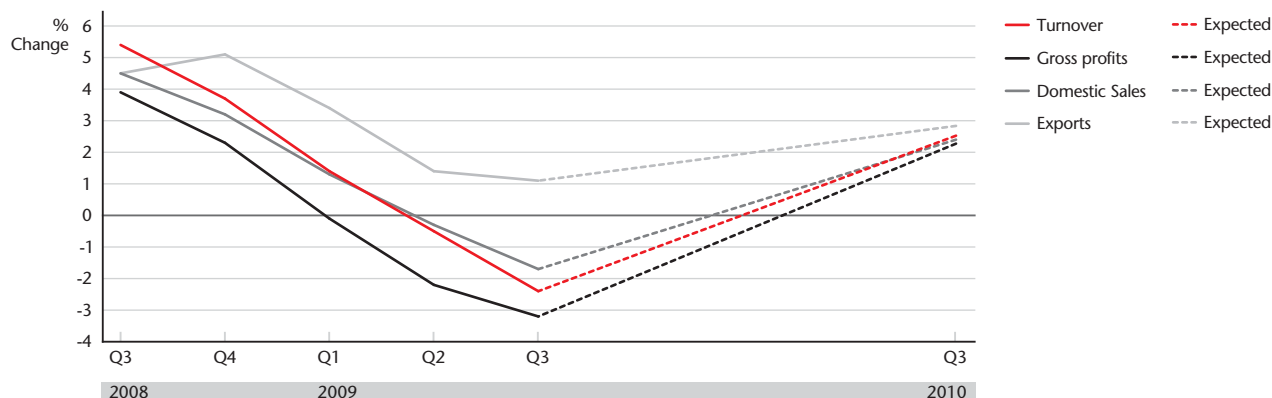
However, growth in bank lending has been steady at best. Issues with heightened stringency on the part of lenders and inconsistency in the way smaller firms are treated were highlighted particularly in the ICAEW *SME Access to Finance* research released last month: views

on access to capital expressed here ranged from 'fairly difficult' to bank lending having 'come to a standstill'.

On balance, the economy appears to be emerging from recession. The Q2 2009 BCM forecast the pace of contraction in the economy was easing as the Confidence Index increased for the first time since Q2 2007. The boost in business confidence recorded this quarter implies that the economy could grow by as much as 0.5% in the third quarter of 2009, which would be the first expansion since Q1 2008.

BUSINESS FINANCIAL PERFORMANCE

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



Firms report steep declines in gross profits, turnover and sales over the last 12 months. However, expectations are for growth over the year ahead; strengthening business confidence provides evidence that business professionals feel the economic situation has turned a corner. Export growth remained in positive territory over the last year and is expected to pick up over the next 12 months as sterling depreciation boosts UK plc's competitiveness.

FIRMS EXPECT PICK-UP IN TURNOVER AND PROFIT GROWTH AFTER DRASTIC YEAR

With UK year-on-year economic output down 5.6% in Q2 2009, it is no surprise that firms report steep falls in turnover, sales and profits over the last 12 months. Turnover is reported to have fallen by 2.4%, the steepest drop ever recorded by BCM. While firms have scrutinised costs where they can, profit margins have been hit even harder with a 3.2% decline in gross profits over the 12 months to date.

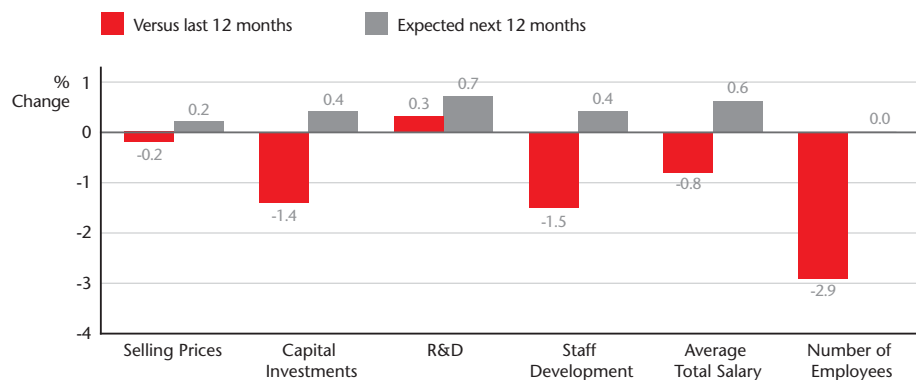
Poor financial performance has come on the back of a 1.7% reported drop in domestic sales and 0.2% fall in prices as demand fell

steeply. However, firms have been boosted by the resilience of export growth, with exports increasing by 1.1% over the last year. Sterling has rallied since the spring. This, combined with stabilising demand in export markets, is expected to drive export growth of 2.8% over the next 12 months. Domestic sales are also expected to rise and firms expect selling prices to stabilise.

Firms expect turnover to grow by 2.5% over the next 12 months – the most positive outlook seen in a year – while gross profits are expected to increase by 2.3%.

PROFITS, TURNOVER, SALES CONTRACT SHARPLY BUT GROWTH EXPECTED • EXPORTS REMAIN POSITIVE

FIG. 5 Q3 2009 – AVERAGE % CHANGE IN



Firms have been forced to assess their cost base carefully over the last year. Labour costs have been squeezed through job cuts and pay restraint, while investment in discretionary areas has shrunk. Firms expect to keep a tight rein on costs in the coming 12 months, but forecast increased spending in areas important for advancing the recovery, notably research and development.

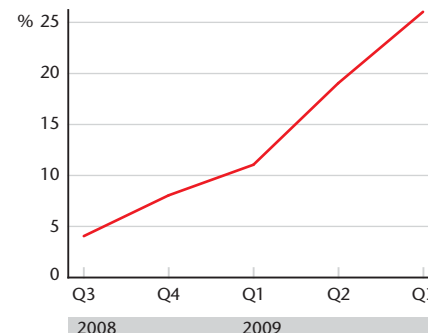
FIRMS KEEP WATCHFUL EYE ON COSTS AND STOCKS

As demand evaporated in the recession, firms had to act quickly to cut their cost base. Capital investment fell by 1.4% over the year to Q3 2009 while staff development budgets were cut by 1.5%. Labour costs have also been cut significantly: firms report a 2.9% contraction in the number of employees over the last year.

Firms expect headcount to be unchanged over the year ahead. However, flat labour demand will not prevent unemployment rising further. Notably in this recession, wage growth has taken a considerable amount of the strain: firms report that average total salary

FIG. 6 STOCK LEVELS. RAW MATERIALS AND COMPONENTS

BELOW NORMAL, Manufacturing, Construction, and Transport sectors

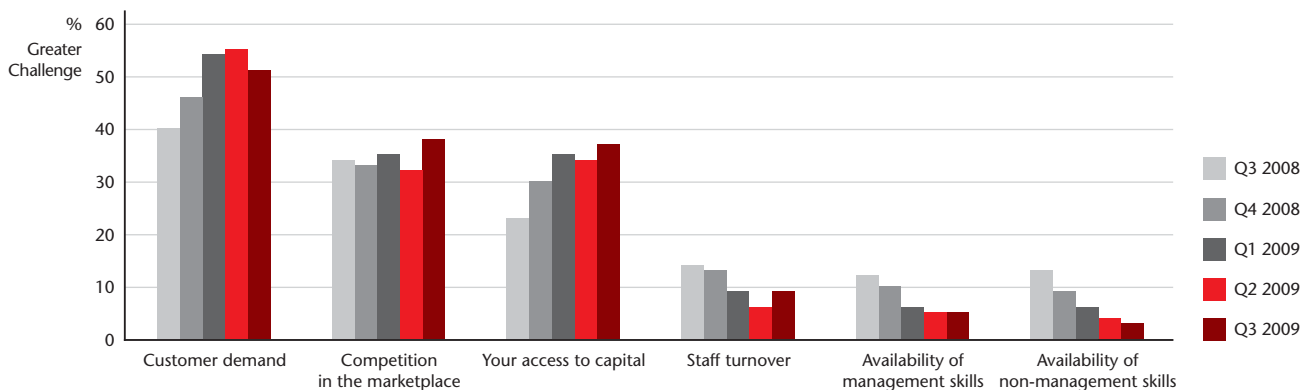


declined by 0.8% over the 12 months to Q3 2009 and expect negligible growth over the coming year.

Firms continue to manage stock levels closely. One quarter (26%) of firms in the Manufacturing, Construction and Transport sectors report stocks of raw materials are below normal levels, suggesting inventories have been significantly reduced. Across the economy firms ran down £10 billion worth of stocks from October to March. There is a limit on how low stock levels can go, however, so the inventory cycle will contribute to growth in the second half of 2009.

FACTORS AFFECTING BUSINESS FINANCIAL PERFORMANCE

FIG. 7 IMPACT ON ORGANISATION'S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (UK AVERAGE)



Access to finance remains a major concern for businesses. More than one in three firms report access to capital as a greater challenge to business performance than 12 months ago, continuing the long-term worsening trend. With economic activity running some 5.7% below peak, customer demand remains a challenge for half of businesses, and competition may be starting to pick up.

ACCESS TO CAPITAL STILL CRUCIAL WHILE COMPETITION STRENGTHENS

Access to capital shows no sign of ceasing to be a cause of concern for businesses. While credit markets are showing signs of improvement and banks are in much better shape, the supply of capital remains constrained and is at a premium.

The proportion of firms reporting access to capital as a greater challenge to business performance than 12 months ago is up more than 50% on the same quarter last year. Despite some improvement in level of mortgage approvals, the property sector is particularly badly hit.

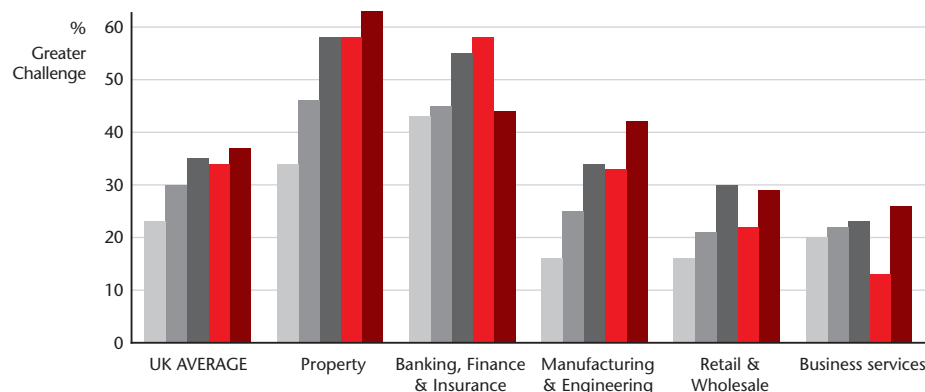
Levels of concern over customer demand have eased slightly as the

precipitous drop in economic activity has slowed. However, it appears competition for demand which exists is hotting up, with 38% of firms reporting competition in the marketplace to be a greater challenge to business performance than a year ago, up from 32% in Q2.

The labour market remains slack. Unemployment has risen by 780,000 over the year to May. Consequently staff turnover and the availability of management and non-management skills remain relatively low on the agenda of firms' concerns.

ACCESS TO CAPITAL TIGHT • PROPERTY SECTOR PARTICULARLY HIT • LABOUR STILL SLACK

FIG. 8 ACCESS TO CAPITAL – CHANGE VERSUS 12 MONTHS AGO



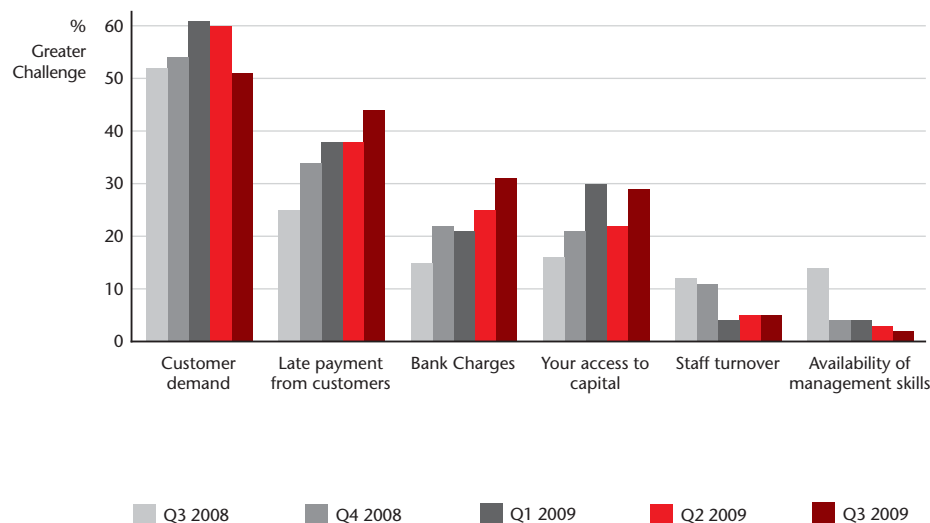
CUSTOMER DEMAND IMPROVES FOR RETAIL & WHOLESALE SECTOR

Average household budgets have been boosted by reduced mortgage interest payments due to cuts in interest rates, and consumer confidence is edging up. Reflecting these trends, customer demand has become less of a challenge for Retail & Wholesale firms in Q3 2009.

This is in line with official figures suggesting retail sales have been remarkably strong for a recession: sales volumes grew by 0.7% over the quarter to June. However, risks do lie ahead for the sector as consumer spending is hit by rising unemployment, weak income growth, increased precautionary saving and possible tax rises.

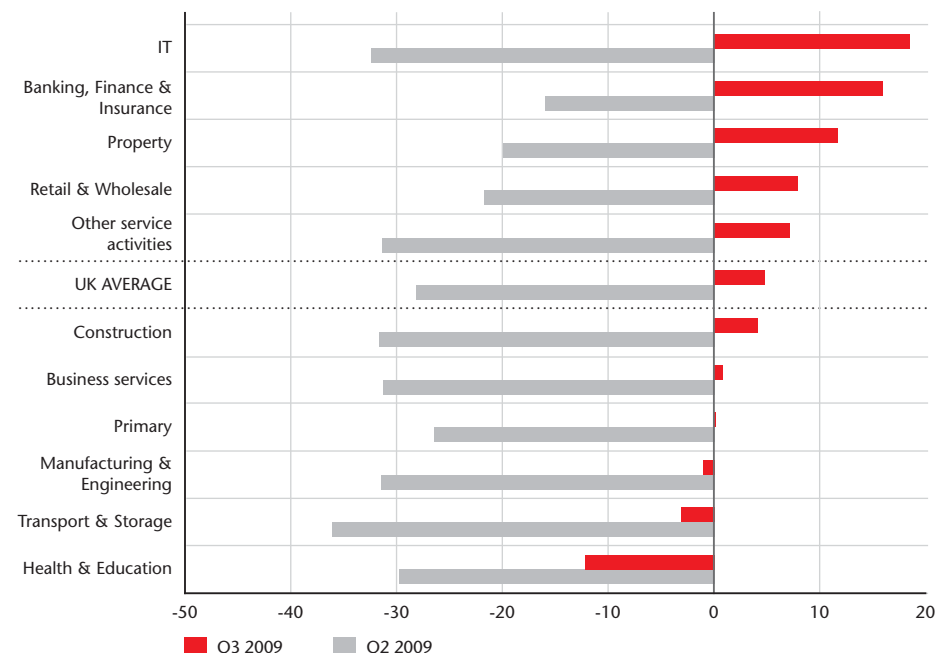
The current recession also means cash flow and bank charges remain heightened concerns for the Retail & Wholesale sector. The share of firms reporting late payment from customers as a greater challenge to business performance than 12 months ago is up 19 percentage points year-on-year, while more than three in ten firms in this sector report bank charges as a greater challenge to business performance than a year ago.

FIG. 9 IMPACT ON ORGANISATION'S PERFORMANCE – CHANGE VERSUS 12 MONTHS AGO (RETAIL & WHOLESALE)



TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 10 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence strengthened across all sectors in Q3 2009.

The most confident sectors now are IT, Banking, Finance & Insurance and Property, suggesting it will be service industries which will lead the way out of recession. This fits with latest official data which showed the pace of contraction eased in the service sector first, and the Purchasing Managers' Indices showing the service sector saw positive growth for three consecutive months to July.

FINANCIAL SERVICES A WORLD AWAY FROM AUTUMN BANKING CRISIS

The Q3 2009 BCM shows another marked improvement in confidence in the Banking, Finance & Insurance sector. The sector's Confidence Index rose by a record 31.9 points, following a 30 point increase in Q2 as firms implemented strategies in response to the financial crisis.

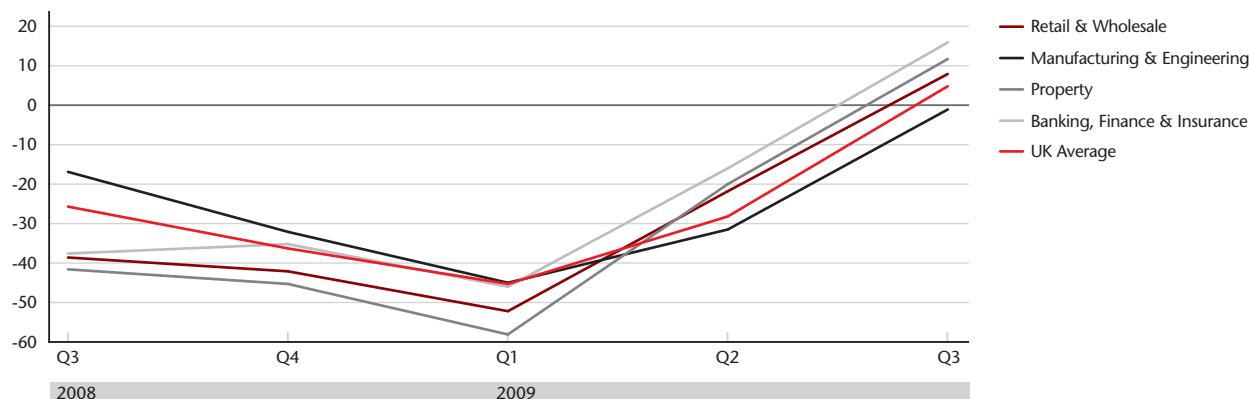
The sector is now the second most confident, in stark contrast to a year ago when confidence in the sector stood almost 12 points below the national average.

A significant gain is also recorded in the IT sector. IT firms are the most confident of all and saw the greatest improvement in confidence in the quarter with the Confidence Index reaching 18.5 – the highest since Q4 2007.

The least confident sector is Health & Education, with a Confidence Index of -12.2. This sector had previously been less affected by precipitous drops in economic activity. However, the talk of public spending cuts in the next parliament is likely to be creating anxiety among Health & Education firms.

CONFIDENCE UP FOR ALL SECTORS • SERVICE INDUSTRIES LEADING THE WAY OUT OF RECESSION

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Confidence in the Retail & Wholesale and Property sectors improved strongly this quarter as improved household balance sheets and a pick-up in housing market activity and mortgage lending strengthened consumer sentiment. Caution remains, however, as unemployment continues to rise, household debt persists at high levels, and lending is expanding only gradually.

STRONG RETAIL SALES AS CONSUMER CONFIDENCE IMPROVES

Confidence in the Retail & Wholesale sector stands at its highest level since Q2 2007 having risen by 60.1 points over the last two quarters. Retailers benefited from strong sales in June, with the highest year-on-year growth since December as consumer confidence improved; the GfK Consumer Confidence Index stood at -16.0 in July, the highest reading since May 2008.

Confidence in the Property sector strengthened for the second quarter in succession as housing market activity increased and house prices showed tentative signs of growth.

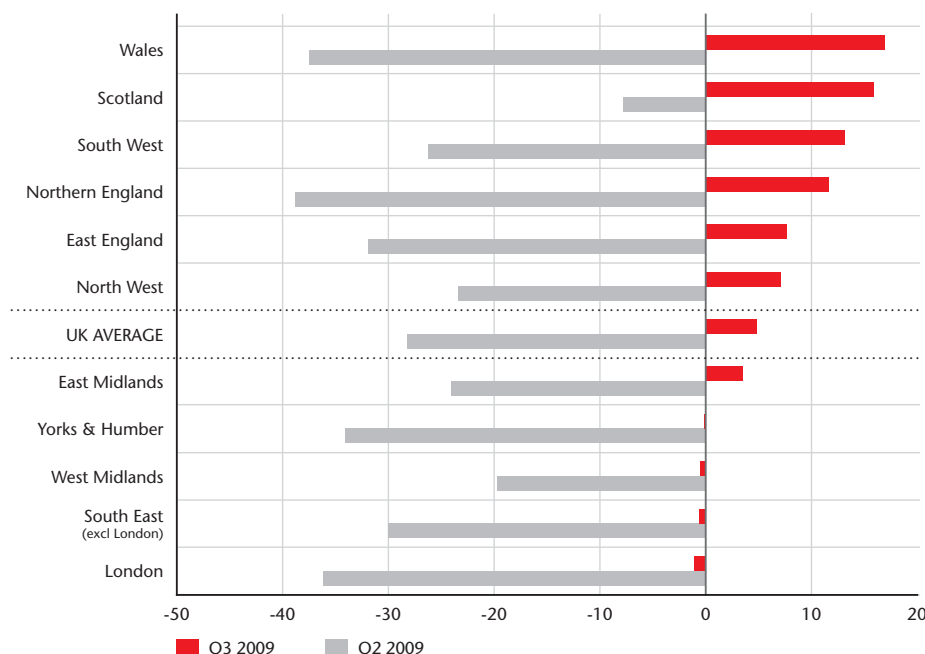
Nationwide house prices have increased in four out of the last five months, while the July Royal Institute of Chartered Surveyors survey shows that new buyer enquiries have now increased for nine consecutive months.

The Manufacturing & Engineering sector Confidence Index improved by 30.4 points, the largest quarterly rise on record, to take confidence to its highest since Q1 2008. However, confidence in the sector remains in negative territory reflecting caution over the strength of recovery in the real economy.

TRENDS IN BUSINESS CONFIDENCE

REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



This quarter business confidence rose in all regions for the second consecutive quarter, with record quarter-on-quarter rises seen in all but three regions. Wales and Scotland are now the most confident regions, while London, the South East and the West Midlands are least confident with Confidence Indices still in negative territory.

CONFIDENCE REBOUNDS STRONGLY IN ALL REGIONS

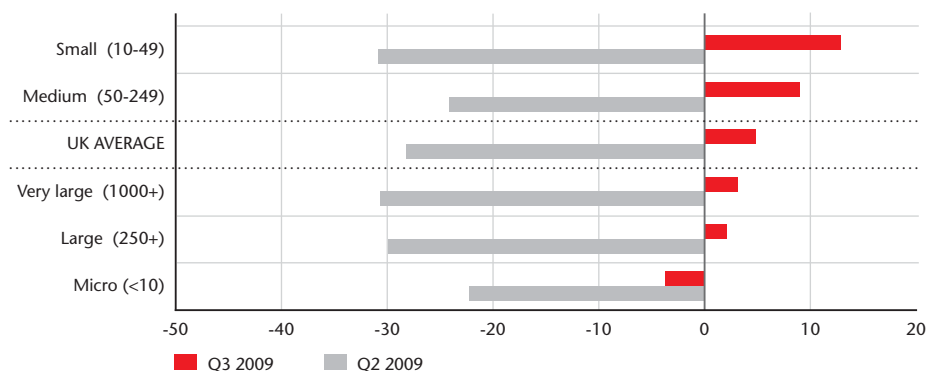
Wales is now the most confident part of the UK, with a Confidence Index of 16.9 in Q3 2009, the highest since Q1 2007. Wales is the only part of the UK where unemployment declined over the quarter to June compared with the previous quarter: in July the Welsh Assembly's ProAct scheme, which offers subsidised training places to firms faced with making redundancies, was reported to have saved 4,487 jobs at 76 companies.

In England, the largest rise in confidence across the regions was seen in Northern England, where the Confidence Index rose by 50.3 points. Positive news from major employers Corus and Nissan, among other factors, has boosted optimism here. Confidence in the South West and East England rose by close to 40 points. In the South West, good prospects for the tourism industry, as sterling remains relatively low, have improved the regional economic outlook.

CONFIDENCE UP IN ALL REGIONS • LONDON REMAINS DOWNBEAT • CONFIDENCE HIGHEST IN WALES

TRENDS IN BUSINESS CONFIDENCE SIZE

FIG. 13 TREND OF BUSINESS CONFIDENCE BY COMPANY SIZE



Confidence improved for all sizes of business in Q3 2009.

The Confidence Index is in positive territory for all but the smallest firms. Micro firms (those with fewer than 10 employees) are, on balance, less confident about their economic prospects for the next 12 months with a Confidence Index of -3.7.

CONFIDENCE UP FOR ALL SIZES OF BUSINESS

In Q3 2009 confidence rose across all sizes of business for the second consecutive quarter. All but the very smallest businesses are now, on balance, more confident about economic prospects facing their organisation over the next 12 months compared with the previous 12 months.

Medium- (those with between 50 and 249 employees) and small- (those with 10 to 49 employees) sized businesses were the most confident in the Q3 2009 BCM. Large firms (those with more than

250 employees) record a significant increase in their Confidence Index this quarter but remain less confident than the average UK firm as caution over the strength of recovery persists.

ALL SIZES OF FIRM SEE CONFIDENCE RISE • ONLY SMALLEST FIRMS REMAIN IN NEGATIVE TERRITORY

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) and Kudos Research.

During the period 13 May – 3 August 2009, 1000 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.

Data has been weighted to ensure the profile of the survey sample accurately represents the UK economy (by value) for company size (no. of employees), regional location and industry sector.

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

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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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Because of us, people can do business with confidence.

FURTHER INFORMATION

For more results and historical reports, please visit

www.icaew.com/bcm

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