



# UK BUSINESS CONFIDENCE MONITOR

## Q3 2013



# WELCOME



Businesses are feeling at their most confident since Q2 2010, with that confidence yet again registering across all sectors and all regions. With confidence at such high levels, the economy is expected to grow by 1.0% this quarter, a figure we can afford to be confident in predicting having accurately forecast 0.3% and 0.6% growth in Q1 and Q2 of this year's other two BCM surveys. Businesses need to make the most of this environment to ensure that the recovery is consolidated, but currently decisions such as where to invest are being made on a short-term basis. To get a stronger commitment from companies, and to ensure a broad-based recovery has solid foundations, the government must continue to ensure the business environment remains conducive to growth.

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

Michael D M Izza  
Chief Executive  
ICAEW



From the discussions we have had with companies up and down the country, the results of the survey better reflect the better mood and the improvement in operating conditions they are experiencing. The business environment is steadying and we are pleased to see that employment expectations are improving, reinforcing the suggestion that the private sector remains willing to create jobs. And yet investment remains weak: government needs to maintain a stable environment where UK business can make longer term plans; and the economy can further benefit from the growing confidence we are seeing.

A handwritten signature in black ink that reads "Scott Barnes". The signature is written in a cursive style with a long horizontal stroke at the end.

Scott Barnes  
Chief Executive Officer  
Grant Thornton

# ECONOMIST'S VIEW



The latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) shows that business confidence continued to improve in the third quarter of 2013. The Confidence Index now stands at +24.0, the highest level since Q2 2010 and up from +16.7 in Q2 2013.

The Confidence Index is a leading indicator for growth, and this quarter's reading suggests that the economy will expand by 1.0% in Q3 2013, following the 0.6% growth seen in the second quarter of the year. Overall, BCM – which has correctly predicted economic developments in the first half of 2013 – suggests that this year the UK economy is set to grow at its fastest rate since 2010.

## KEY ISSUES EMERGING THIS QUARTER

- Business confidence increased again, suggesting that economic growth will accelerate in Q3 2013.
- Companies report continued growth in profits and turnover, and expect greater growth over the coming year.
- Businesses expect export growth to pick up over the next 12 months, despite a challenging global economic backdrop.
- Construction sector confidence stands at a record high, suggesting that the worst may be over for a sector hard hit by the economic downturn.

In Q2 2013, the UK economy expanded at a quarter-on-quarter rate of 0.6% according to the ONS's first estimate of growth in the quarter, building on growth of 0.3% in Q1 2013. Critically, growth in the economy was reasonably broad-based, with all four main industrial groups – Agriculture, Production, Construction and Services – expanding between Q1 2013 and Q2 2013.

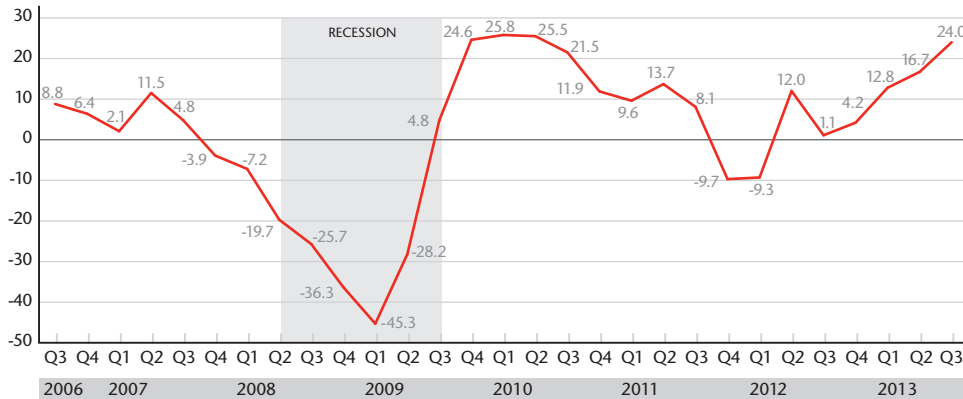
Overall the latest data are encouraging but a number of challenges remain in terms of delivering robust and sustainable growth in the UK. Recession across much of the eurozone and economic slowdown in China could limit the potential for an export-led recovery in the short-term. Further, despite an improving economy and higher confidence, intended capital spending growth remains weak, meaning that investment could play a limited role in driving growth over the coming year. Without investment and trade-led growth, the UK economy's medium to long-term growth prospects could be limited.



Douglas McWilliams  
Chief Executive, Cebr  
ICAEW Economic Partner

# BUSINESS CONFIDENCE IN Q3 2013

**FIG. 1 TREND OF UK BUSINESS CONFIDENCE**



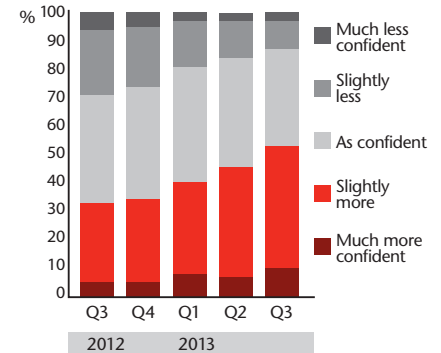
The latest ICAEW/Grant Thornton UK Business Confidence Monitor (BCM) shows business confidence at its highest level since Q2 2010. The Confidence Index for Q3 2013 stands at +24.0, up from +16.7 in Q2 2013.

## BUSINESS CONFIDENCE CONTINUES TO RISE

The latest findings from BCM show business confidence reaching its highest point since Q2 2010. The Confidence Index has now increased for four consecutive quarters, from +1.1 a year ago in Q3 2012 to +24.0 now. This suggests businesses have experienced a sustained period through which the economic outlook has been improving.

This quarter, over half of businesses (53%) are more confident about their economic prospects over the coming 12 months compared to the previous 12 months. This is sharply up from the 33% seen in the same quarter in 2012, and the highest share since

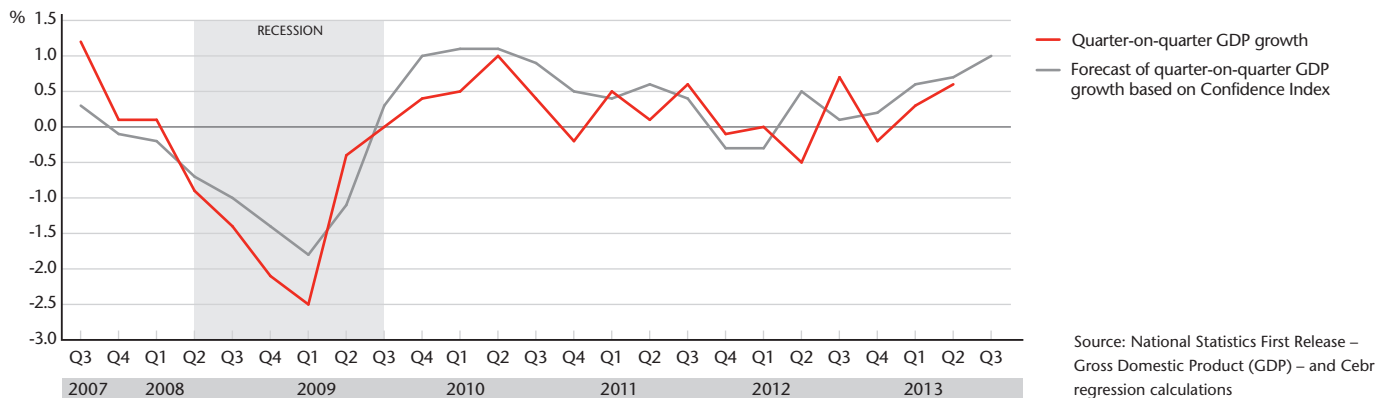
**FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES**



Q3 2010. At the same time, the share of businesses reporting they are less confident about their prospects stands at 13%, less than half the 29% seen in the same quarter a year ago.

CONFIDENCE INCREASES SIGNIFICANTLY IN Q3 2013 • CONFIDENCE NOW AT HIGHEST LEVEL SINCE Q2 2010

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



**UK economic growth accelerated in the second quarter of 2013.** Initial estimates from the ONS showed the economy growing at a quarter-on-quarter rate of 0.6% in Q2 2013, exactly as predicted in the last BCM report. Encouragingly, growth in the quarter was relatively broad-based with all of the major industry sectors expanding.

**BCM POINTS TO STRONGEST GROWTH PERFORMANCE SINCE 2010**

The latest Confidence Index suggests that the economy will expand at a quarter-on-quarter rate of 1.0% in Q3 2013. If realised, this would be the fastest quarterly growth since Q2 2010 and could point the way to the UK’s strongest annual growth performance since 2010, when the economy grew by 1.7%. If Q3 2013 growth is 1.0% – and provided there is no contraction in Q4 – the UK economy would grow by at least 1.3% over the year.

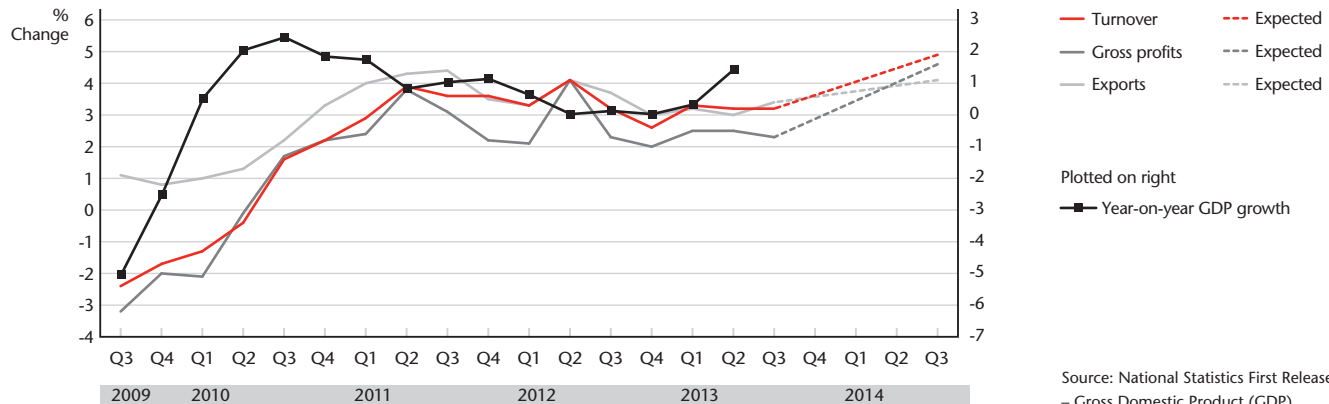
A range of other economic indicators also suggest that the UK economic recovery is gaining momentum: research agency GfK has released

consumer confidence data for July showing confidence rising to its highest level since April 2010, and there are signs that the housing market is recovering with Bank of England data showing a sharp rise in the number of mortgage approvals compared with a year ago. ONS data show that economic growth in Q2 2013 was relatively broad-based, with all major industry sectors – Agriculture, Production, Services and Construction – expanding in the quarter. Taken together this suggests that the economy is starting to stand on firmer ground.

**UK ECONOMIC GROWTH EXPECTED TO INCREASE • QUARTERLY GROWTH OF 1.0% FORECAST FOR Q3 2013**

# BUSINESS FINANCIAL PERFORMANCE

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



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

**Business financial performance has shown continued growth over the past three years –** this quarter, businesses report annual growth in turnover and gross profits of 3.2% and 2.3% respectively. Exports are reported to have risen by 3.4% over the same period, despite difficult global business conditions.

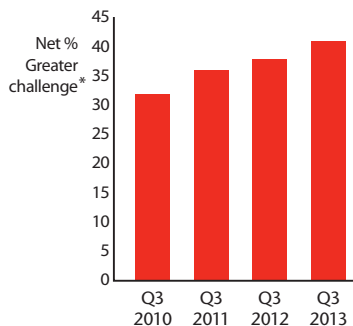
## EXPORT GROWTH EXPECTED TO PICK UP BUT RISKS REMAIN

The rate of growth in key performance indicators is expected to increase over the coming year: turnover and gross profits are predicted to rise by 4.9% and 4.6% respectively, while exports are expected to grow by 4.1%. If realised, these figures would represent considerable improvement in business performance. However, companies have been expecting increased growth for some quarters now, but continued challenging trading conditions have prevented these from being realised up to this point.

There are signs that some aspects of the global business environment may be improving: although much

of the eurozone remains in recession, the single currency area's economy is showing tentative signs of stabilising. The unemployment rate in Spain fell for the first time in two years in Q2 2013, and data from the European Commission showed consumer confidence rising in the eurozone in July 2013. However, clear risks to UK exports remain: in particular, there are concerns that economic slowdown in China will threaten growth prospects across the globe.

**FIG. 5 COMPETITION IN THE MARKETPLACE AS A GREATER CHALLENGE**



UK domestic demand growth is holding steady in Q3 2012, supported by sales growth among private companies. UK listed companies have consistently reported lower levels of growth than privately owned businesses, and the trend continues this quarter with UK listed companies reporting 2.0% annual growth in domestic sales compared with 2.9% growth from private businesses.

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

**FIG. 6 DOMESTIC SALES – AVERAGE % CHANGE OVER 12 MONTHS TO ...**



### DOMESTIC SALES GROWTH EXPECTED TO ACCELERATE

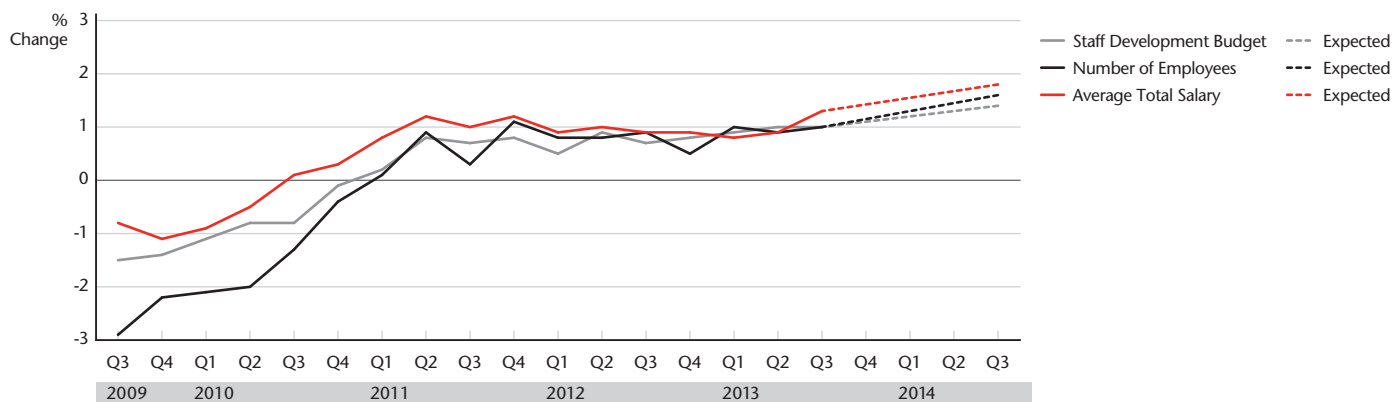
This quarter, businesses report that they expect domestic sales growth to accelerate over the coming year, with an average of 4.3% growth predicted overall. Domestic sales growth is expected to be strongest among private companies, which expect to see UK sales expand by 4.9% year on year, rising to 5.4% for private SMEs. In contrast, expected growth among UK listed companies is 3.4%.

Domestic demand over the coming year should be supported by rising consumer confidence as well as a recovery in the housing market. ONS data showed that UK house prices

increased by 2.9% in May 2013 compared with the same month a year ago. From BCM, the net share of businesses reporting customer demand to be a greater challenge now than a year ago has fallen to 28%, the lowest share since Q3 2010.

However, there are signs that competition in the marketplace has become more of an issue: the net share of businesses reporting market competition to be a greater challenge than a year ago stands at 41% in Q3 2013, up from 32% in the same quarter of 2010.

**FIG. 7 AVERAGE % CHANGE OVER 12 MONTHS TO ...**



**There are signs that businesses are investing in their employees.**

Companies report growth in headcounts, salaries and staff development budgets over the last 12 months, and expect further increases in all three indicators over the coming year. Although growth in staff development budgets is still relatively weak, it is encouraging that businesses are investing more in their employees, and that they expect to increase this over the next 12 months.

**SIGNS THAT PAY GROWTH IS PICKING UP**

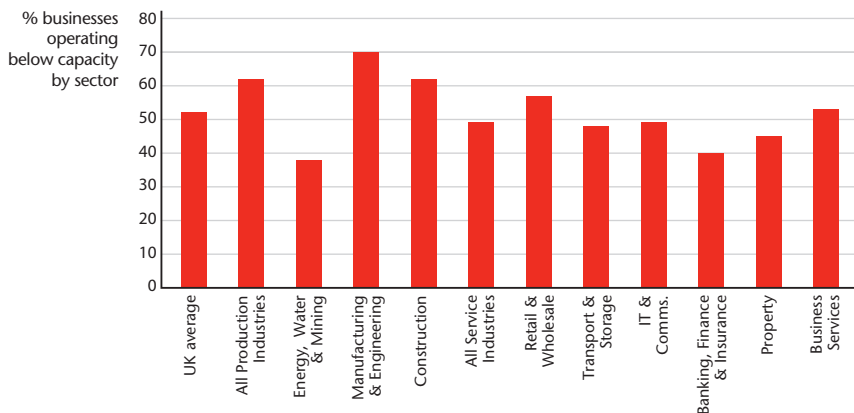
Unemployment has fallen faster than most economists expected since the start of 2012, with the UK unemployment rate declining from 8.2% in Q1 2012 to 7.8% in Q1 2013. Business Services sector companies played a significant role in job creation over the last year, expanding headcount by 1.7%. Looking forward, companies expect to increase employee numbers by 1.6% on average over the next 12 months. This should prevent UK unemployment rising while the public sector continues to shed jobs.

This quarter's BCM suggests that pay growth is starting to pick up. While

in Q3 2012 average total salaries were 0.9% higher than a year ago, this quarter annual growth of 1.3% is reported, and businesses expect wages to rise by 1.8% over the next 12 months. However, this is still well below inflation, which stood at 2.9% on the consumer price index (CPI) measure in June and is likely to remain above the Bank of England's central 2.0% target until at least the end of 2013. Employee spending power thus remains under pressure.

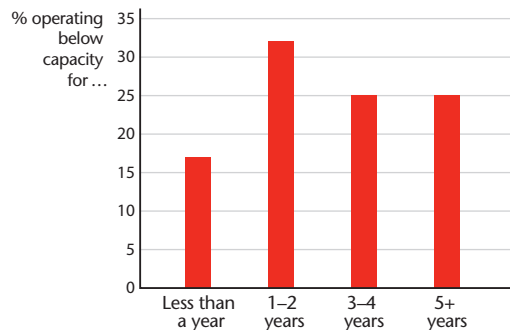


**FIG. 8 BUSINESSES OPERATING BELOW CAPACITY**



The proportion of businesses operating below capacity has fallen to its lowest level since Q2 2008. This quarter just over half (52%) of businesses report that they have spare capacity, down from 58% in Q2 2013. Of those businesses which are operating below capacity, around half (49%) have been doing so for up to two years, but a quarter (25%) report long-term underutilisation of resources, having been operating below capacity for at least five years.

**FIG. 9 TIME OPERATING BELOW CAPACITY**



Base: all businesses operating below capacity

### SHARE OF BUSINESSES OPERATING BELOW CAPACITY FALLS

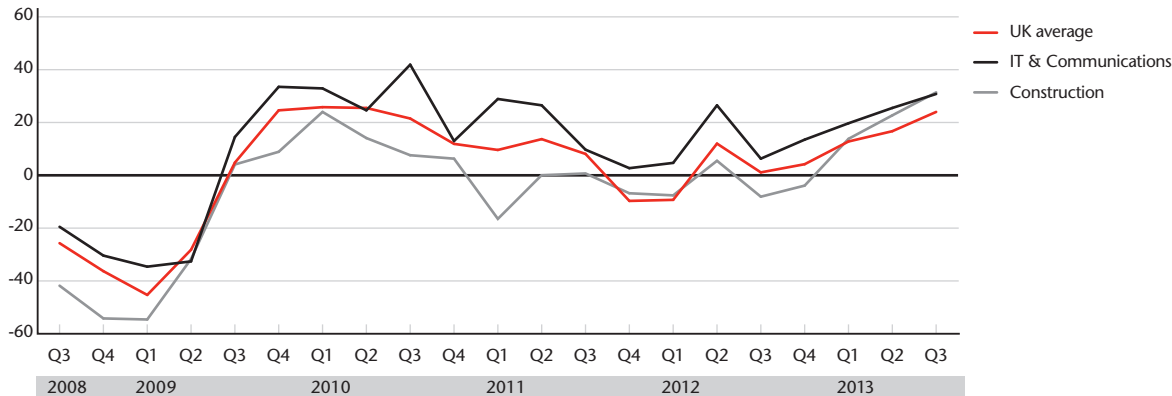
This quarter just over half (52%) of businesses report operating below capacity, down from 58% in Q2 2013 and the lowest share since Q2 2008. Although this fall is a further sign that economic conditions are improving, the share of businesses operating below capacity remains greater than before the financial crisis and, in Q2 2013, GDP in the UK was still 3.3% below its Q1 2008 peak level. The UK economy still has a long way to go to exceed its previous high-point in economic output.

The figures also point to different levels of capacity utilisation between industrial sectors: while around half

(52%) of businesses in the Services sector are operating at or above capacity, over three fifths (62%) of businesses in the Construction and Production sectors are operating below capacity, suggesting that significant slack in the non-Services part of the economy remains. This fits with ONS data which show that economic output in these sectors has fallen significantly since the financial crisis, while Services sector output has more-or-less recovered to where it was in 2008.

# SECTOR FOCUS

FIG. 10 TREND OF UK BUSINESS CONFIDENCE



This quarter, business confidence is highest among those in the Construction and IT & Communications sectors. The Confidence Index for these sectors stands at +31.4 and +30.8 respectively, notably higher than the +24.0 seen for the UK as a whole. While for IT & Communications confidence has been relatively high compared with other sectors over the last few years, in Construction it appears that a long period of hard economic times may be coming to an end.

## CONSTRUCTION LOOKS TO BE TURNING A CORNER

The UK Construction sector was hit hard by the financial crisis: in Q1 2013 Construction output was at its lowest level since Q1 2001. However, there are signs that the sector may be turning a corner. This quarter's BCM shows confidence within the Construction sector at a record high, and while businesses report gross profits to have fallen by 0.5% over the last 12 months, they expect 5.0% growth in profits over the coming year. Further, ONS data from Q2 2013 estimated that output in the Construction sector increased by 0.9% compared with the previous quarter. Government infrastructure

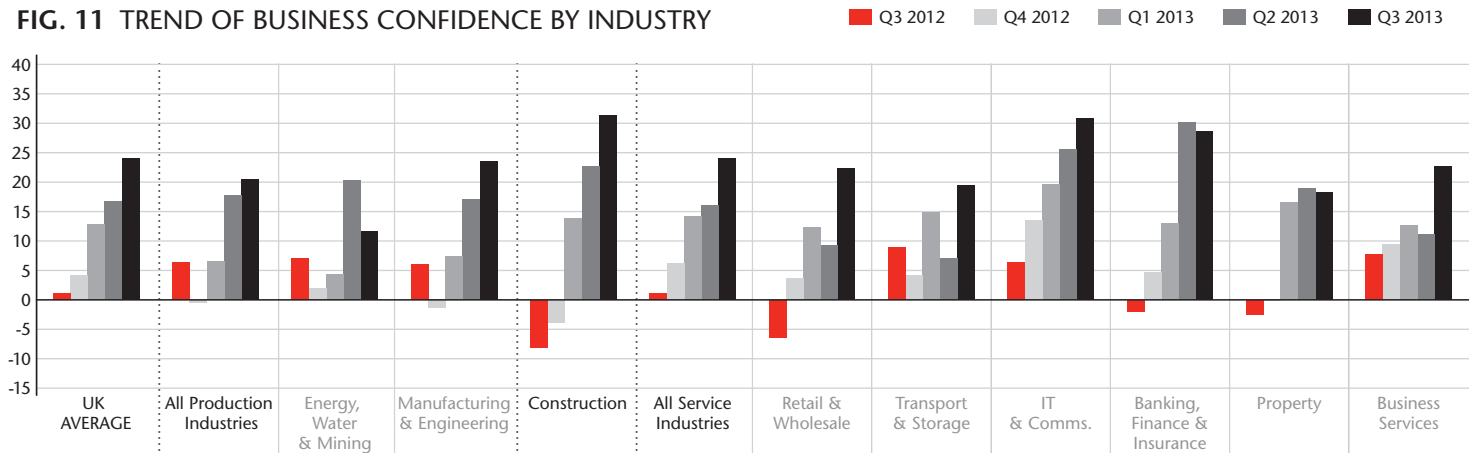
programmes, as well as policies such as Help to Buy aimed at boosting the housing market, should support the Construction sector.

The IT & Communications sector has consistently performed strongly in BCM and has done so again this quarter, suggesting that high-tech industries will help drive the UK economic recovery. This quarter, IT & Communications businesses report that gross profits have risen by 3.8% over the last 12 months, but much stronger growth (of 7.8%) is predicted over the coming year.

CONFIDENCE REACHES NEW HIGH IN CONSTRUCTION • STRONG PERFORMANCE CONTINUES IN IT & COMMS.

# TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 11 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



This quarter, confidence has held steady or risen across all industry sectors. Confidence has remained in positive territory for at least three quarters signalling broad-based optimism about the UK's economic prospects. In Retail & Wholesale and Business Services, confidence has increased significantly this quarter.

## POSITIVE CONFIDENCE FOR THIRD SUCCESSIVE QUARTER

Findings from this quarter show business confidence in positive territory in each of the broad industry sectors in BCM – Production, Construction and Services – for the third successive quarter; this suggests that the economic recovery is starting to extend in earnest beyond the Services sector.

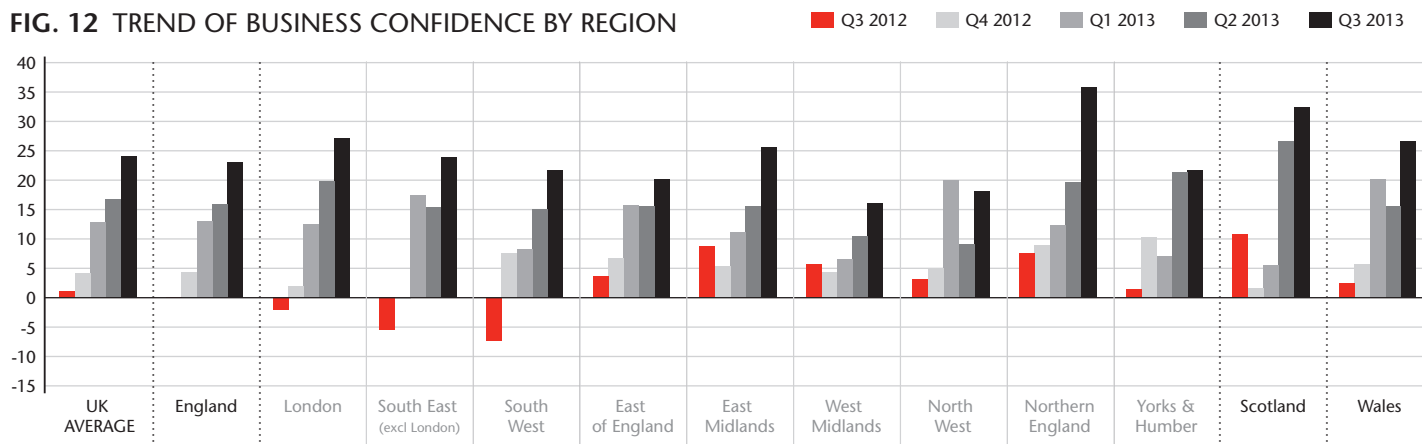
Recovery in non-Services sectors will play an important role in getting economic output back to the levels seen before the financial crisis. ONS data show that, in Q2 2013, output in the Production and Construction sectors was 12.5% and 15.3% respectively lower than in the same

quarter of 2008. Over the same period, output from the Services sector had broadly returned to the level seen in the same quarter of 2008, with output standing 0.2% higher in Q2 2013. In the March 2013 budget the Chancellor announced that capital investment plans would be increased by £3bn a year from 2015/16, which will provide a boost to the Construction sector in particular.

BUSINESS CONFIDENCE HAS STOOD IN POSITIVE TERRITORY FOR ALL INDUSTRY SECTORS THROUGHOUT 2013

# TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 12 TREND OF BUSINESS CONFIDENCE BY REGION



**Business confidence has continued to strengthen across the regions this quarter.** In all regions of the UK, confidence has remained in positive territory for three consecutive quarters, with an average Confidence Index reading in Q3 2013 of +24.0, up from +16.7 in Q2 2013. Confidence in Northern England has increased significantly this quarter to +35.9 from +19.7 in Q2 2013.

## CONFIDENCE REMAINS POSITIVE IN EVERY UK REGION

There have been steady increases in confidence in almost every UK region over the last few quarters, suggesting that the economic recovery is becoming more broad-based at a regional level. Encouragingly, confidence has increased in regions with a relatively high dependence on the public sector, such as Northern England, raising hopes that a private sector recovery will offset some of the negative impacts of government austerity on the economy over the coming years.

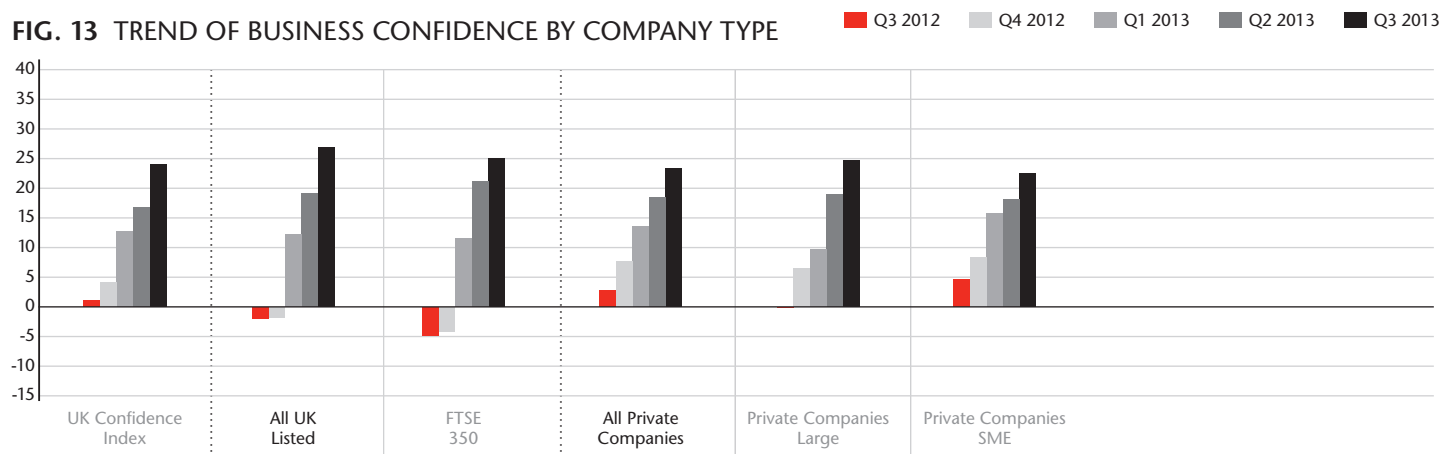
Although rising slightly, the Confidence Index for the West Midlands is the lowest of all the UK

regions in Q3 2013, at +16.1. Labour market data in the region has been relatively weak in recent months, with the unemployment rate rising according to ONS data. For the three months to May 2013, unemployment rose by 15,000 compared with the previous quarter, pushing the unemployment rate up from 9.1% to 9.8% – the second highest of the UK regions and much higher than the 7.8% seen for the UK as a whole.

CONFIDENCE POSITIVE IN ALL REGIONS • SIGNIFICANT INCREASE IN CONFIDENCE IN NORTHERN ENGLAND

# TRENDS IN BUSINESS CONFIDENCE TYPE

**FIG. 13** TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



Confidence is positive for all company types this quarter, as it has been since the start of 2013. The strongest rises in confidence since the end of 2012 have been seen among FTSE 350 listed companies, where confidence was in negative territory in the latter half of last year.

## CONFIDENCE TRENDS UP ACROSS ALL COMPANY TYPES

This quarter, confidence has continued to rise across all types of company. Rising confidence in FTSE 350 listed companies may reflect tentative signs that the economic situation in the eurozone is stabilising, providing better conditions for large listed firms with significant overseas operations. However, FTSE 350 companies still have lower expectations for future growth than privately owned businesses.

Confidence among SMEs stands at +22.5, up from +18.1 in the previous quarter. These figures tally with other findings from BCM which suggest

that conditions are improving for SMEs: for example, the share of SMEs reporting access to capital to be a greater challenge than 12 months ago stands at 13% this quarter, down from 23% in Q3 2012. Over the same period, the share of SMEs reporting banking charges to be a greater challenge has fallen from 18% to 14%.

CONFIDENCE STAYS IN POSITIVE TERRITORY FOR ALL COMPANY TYPES FOR THE THIRD SUCCESSIVE QUARTER

# 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](http://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

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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.



## Grant Thornton UK LLP

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