



UK BUSINESS CONFIDENCE MONITOR

Q4 2012



WELCOME



Despite coming out of the second dip of the recession, the UK's economic recovery is not yet secure. This *ICAEW/Grant Thornton Business Confidence Monitor* highlights the fact that many businesses seem to be 'treading water' despite a higher-than-expected GDP figure for the third quarter of the year. Against a backdrop of continuing global economic uncertainty, not least in the eurozone, there are no signs yet of substantial growth for the economy over the next 12 months.

What else can therefore be done? Recent research suggests that businesses have an estimated £720bn of cash reserves. If £10bn of this were injected into the economy above and beyond current levels of spending, we would see business investment return to pre-crisis levels. That is why we have asked the Chancellor ahead of his Autumn Statement to look at new ways for the government to support growth and improve business confidence to invest.



Michael D M Izza
Chief Executive
ICAEW



According to third quarter GDP figures growth has returned to the UK economy, but the picture for business appears to have remained static. Business investment is showing no sign of picking up as tight credit conditions, muted global economic activity and continued problems in the eurozone hamper confidence.

Encouragingly we are seeing green shoots of confidence in regions beyond the South East, and recent studies have shown that the UK's medium-sized businesses are beating the market and reporting faster than average growth in turnover.

However, the pervading economic environment continues to act as a proving ground for companies as they adjust their fundamentals in order to compete. Clear effective governance, robust planning and attention to financial levers are all helping them to deal with the current environment, but more needs to be done to encourage UK businesses to use the cash on their balance sheets and begin to invest again.



Scott Barnes
Chief Executive Officer
Grant Thornton

ECONOMIST'S VIEW



In the latest *ICAEW/Grant Thornton UK Business Confidence Monitor* (BCM) the Confidence Index stands at +4.2, compared with +1.1 in Q3 2012. While this is not a statistically significant increase, there are signs that a positive trend in business confidence is beginning to emerge.

The Confidence Index is a leading indicator for growth and predicted the UK would re-enter recession at the end of last year. The UK economy grew by 1.0% in the third quarter of 2012 and the Confidence Index suggests quarter-on-quarter growth of 0.2% for Q4 2012. While Q3 performance looks strong at first glance, it was boosted by Olympic ticket sales. In addition, the loss of a working day due to an extra bank holiday constrained performance in Q2. This means underlying growth is much lower than the headline, so even with the predicted rise in the final quarter, zero output growth for the year as a whole is expected.

KEY ISSUES EMERGING THIS QUARTER

- An emerging trend for improved confidence, but the economy is still expected to show zero growth for 2012 as a whole.
- Business expectations of future turnover and profit growth remain stable and below their pre financial crisis averages.
- Reported export growth has slowed as the world economy cooled through 2012.
- Business investment intentions show no sign of picking up, meaning that an investment-led recovery is unlikely in the short term.

A wide range of headline economic indicators have been better than expected in recent weeks. Labour market data show employment at a record high, while retail sales growth remains relatively strong despite ongoing pressures on household finances.

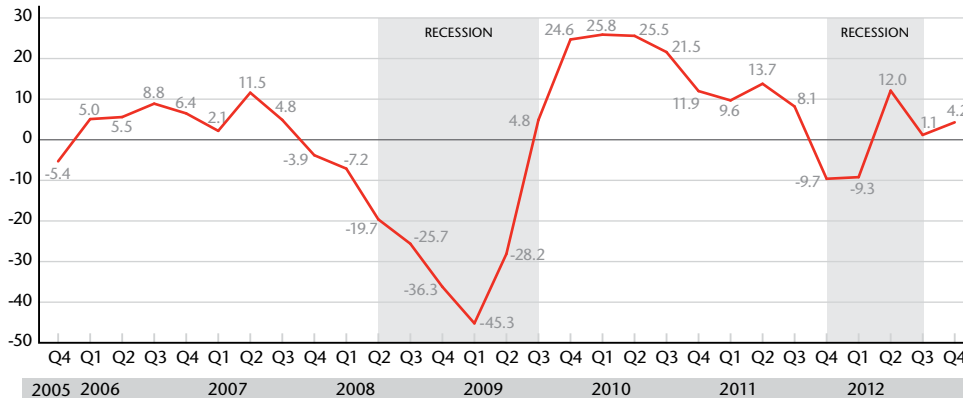
However, underlying signs of weakness in the economy remain. Much of the improvement in the labour market has been due to creation of part-time jobs and an increase in self employment. The number of full-time employees in the economy is nearly 700,000 lower than its peak level in April 2008. So the UK still has a significant underemployment problem. With economic fundamentals remaining weak, slower economic growth in the final quarter is expected once distortionary effects drop out. Given this outlook, there is no end yet in sight for the Bank of England's exceptionally loose monetary policy.



Douglas McWilliams
Chief Executive, Cebr
ICAEW Economic Partner

BUSINESS CONFIDENCE IN Q4 2012

FIG. 1 TREND OF UK BUSINESS CONFIDENCE



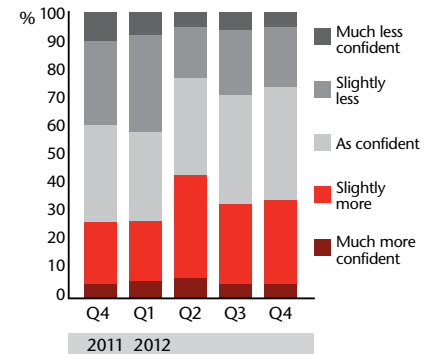
The latest *ICAEW/Grant Thornton UK Business Confidence Monitor (BCM)* shows signs of an upward trend in business confidence beginning to emerge. The Confidence Index stands at 4.2 in Q4 2012 compared to 1.1 in Q3, and is significantly higher than a year ago when the UK was re-entering recession.

UPWARD TREND EMERGING IN CONFIDENCE INDEX

In the latest findings from BCM, confidence stands in positive territory in Q4 2012, and there are signs of an emerging positive trend as shorter-term data show confidence on an upward path since the Q3 BCM report. This final BCM report of 2012 suggests that business prospects are stronger going into 2013 than at the end of 2011, as the Confidence Index has now avoided a negative reading for three consecutive quarters.

Business optimism is on the rise year on year: the proportion of businesses that are more confident about prospects for the coming year compared to the past 12 months is

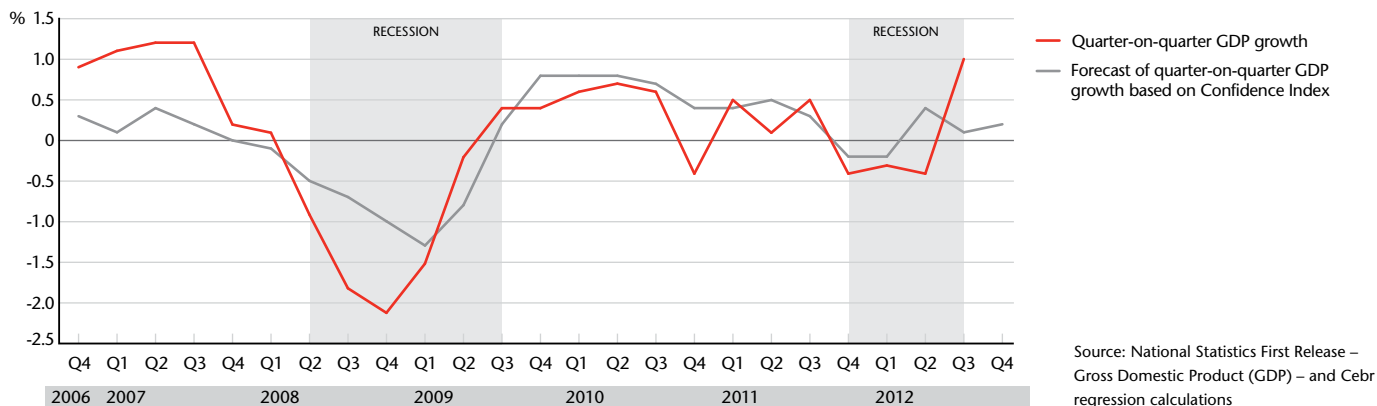
FIG. 2 UK CONFIDENCE INDEX – DETAILED RESPONSES



up to 34% this quarter, compared to 27% of businesses in Q4 2011. At the same time, pessimism has decreased: 26% are less confident about their prospects for the coming year, down from 40% in the same quarter a year ago.

CONFIDENCE SIGNIFICANTLY UP ON LAST YEAR • CONFIDENCE INDEX POSITIVE THREE CONSECUTIVE QUARTERS

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



The economy grew in the third quarter of 2012 for the first time since Q3 2011, taking the UK out of technical recession. Preliminary estimates from the Office for National Statistics (ONS) show the economy expanding at a quarter-on-quarter rate of 1.0% in Q3 2012. Despite this latest rise, the previous three quarters of contraction mean that the economy has seen zero growth compared to Q3 2011.

BCM POINTS TO CONTINUED BUT SLOWER GROWTH AHEAD

Although the 1.0% quarterly growth in Q3 2012 looks strong at first glance, figures were boosted by distorting factors including Olympic ticket sales, and underlying growth in the economy is likely to be much slower. Growth in Q4 2012 is expected to fall back once these distorting factors fall out of the comparison.

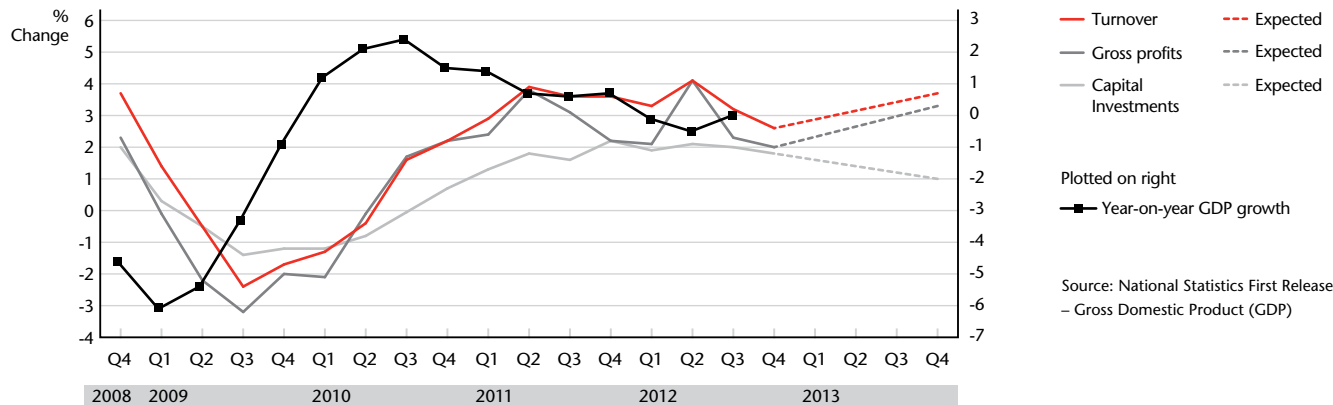
The latest BCM findings suggest that the economy will expand by 0.2% in Q4 2012. Although this remains well below the average before the financial crisis, it compares favourably to a contraction of 0.4% in the final quarter of 2011 and the two successive quarters of contraction that followed.

However, even with this expansion in Q4, growth over 2012 as a whole is expected to be zero.

UK OUT OF RECESSION • ECONOMY EXPANDED BY 1% IN Q3 • ZERO GROWTH EXPECTED FOR 2012 OVERALL

BUSINESS FINANCIAL PERFORMANCE

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



In line with marginally positive confidence levels, businesses have recorded modest turnover and profit growth over the last 12 months. Turnover growth has been on a downward path in 2012, reflecting weaker business conditions, while profit growth of 2.0% over the past year remains well below levels of more than 6.0% seen before the financial crisis. Expectations for the next 12 months are more positive, with businesses expecting to increase turnover and profit growth over the coming year.

FEW SIGNS OF INVESTMENT-DRIVEN RECOVERY

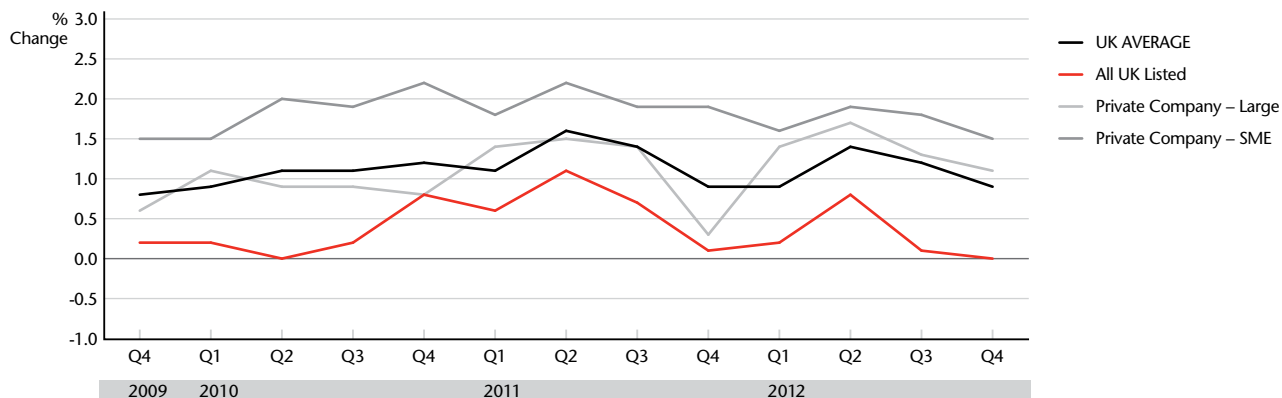
This quarter, companies report capital investments rising by 1.8% year on year, down on the 2.2% recorded in the 12 months to Q4 2011. This downward movement is likely to continue: businesses expect capital investment to increase by just 1.0% over the coming 12 months.

These figures cast doubt on the Office for Budget Responsibility's latest Economic and Fiscal Outlook, which forecasts business investment growth of 6.4% in 2013.

As business investment is a key driver of economic growth, this expected slowing of investment spending is

likely to act as a constraint on the UK's economic prospects. Although business confidence remains just in positive territory, investment growth is typically fastest when optimism levels are high. Until confidence reaches more robust levels, businesses are likely to continue to plan for low investment growth.

FIG. 5 NUMBER OF EMPLOYEES – EXPECTED CHANGE OVER NEXT 12 MONTHS



The private sector expects to continue adding jobs over the next year. This quarter, businesses across the whole economy forecast 0.9% headcount growth over the coming 12 months. With government job cuts planned over the coming years, private sector employment growth is needed to absorb job losses from the public sector.

PROSPECTS FOR JOB CREATION LIE WITH SMALLER FIRMS

On average, businesses in the UK continued to expand their number of employees over the last year, despite economic contraction in Q4 2011 and the first half of 2012. This quarter businesses report headcount up 0.5% year on year. Job creation in the private sector has helped to bring down the unemployment rate from 8.3% at the start of 2012 to 7.9% by the three months to August, according to figures from the ONS.

However, the rate at which jobs are being added varies between different types of business. Listed companies report zero growth in their staffing levels over the past year, while

privately-owned businesses saw employee numbers rising by 0.7%.

For the next 12 months, employment levels are expected to rise by 1.1% for large private companies, and 1.5% for small and medium-sized enterprises (SMEs). This far outpaces growth forecast by listed companies, where employee numbers are expected to remain unchanged over the coming year.

FIG. 6 EXPORTS – EXPECTED CHANGE OVER NEXT 12 MONTHS



Businesses expect further export growth over the coming year despite a weakening global economic outlook.

Companies forecast exports to rise by 3.6% on average over the next 12 months, the same rate of growth which was expected in Q3 2012.

LISTED FIRMS EXPECT LOW EXPORT GROWTH

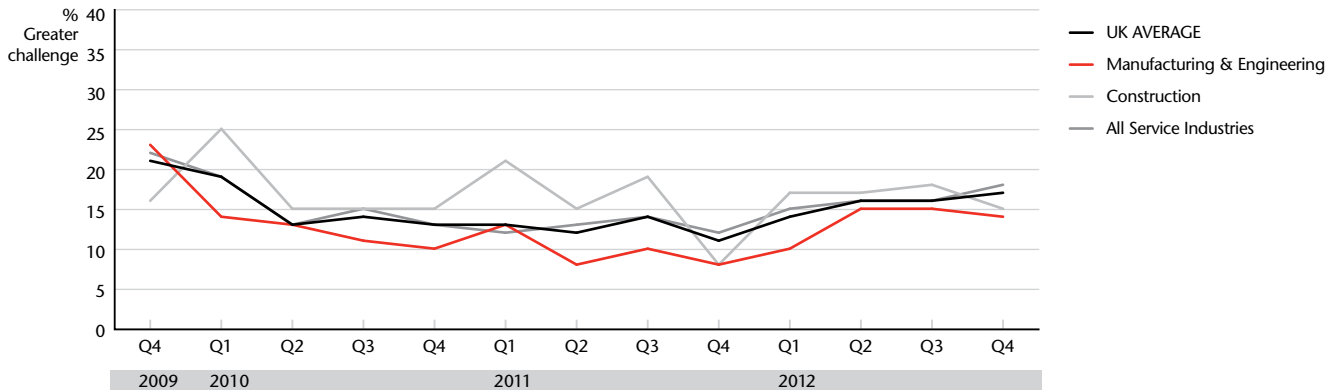
During 2012, annual export growth has been slowing for businesses in the UK to stand at 3.0% this quarter, down from 4.1% over the year to Q2 2012. This comes as global trade volume growth has slowed significantly to levels last seen in the global recession of 2008–09.

In addition, in October the International Monetary Fund downgraded its global economic growth forecast for 2013 from 3.9% to 3.6% as growth prospects weakened across the globe, notably among emerging economies.

However, despite the weaker global outlook, privately-owned companies remain optimistic and on average expect export growth of 4.6% over the next year, rising to 5.6% for large private companies. This compares favourably with publicly-listed companies which expect growth to slow to 2.4% over the coming 12 months. Combined with expected employment growth figures, this suggests that listed companies are experiencing the most difficult business conditions in the current global economic climate.

FACTORS AFFECTING BUSINESS PERFORMANCE

FIG. 7 ABILITY TO EXPAND INTO NEW AREAS – CHANGE V. 12 MONTHS AGO



Businesses are finding their prospects for expanding into new areas limited in the current weak economic climate. This quarter 17% of UK businesses report that their ability to expand into new areas is a greater challenge now than a year ago, a share that has increased from just over one in ten businesses (11%) in the final quarter of 2011.

TOUGH BUSINESS ENVIRONMENT HOLDING FIRMS BACK

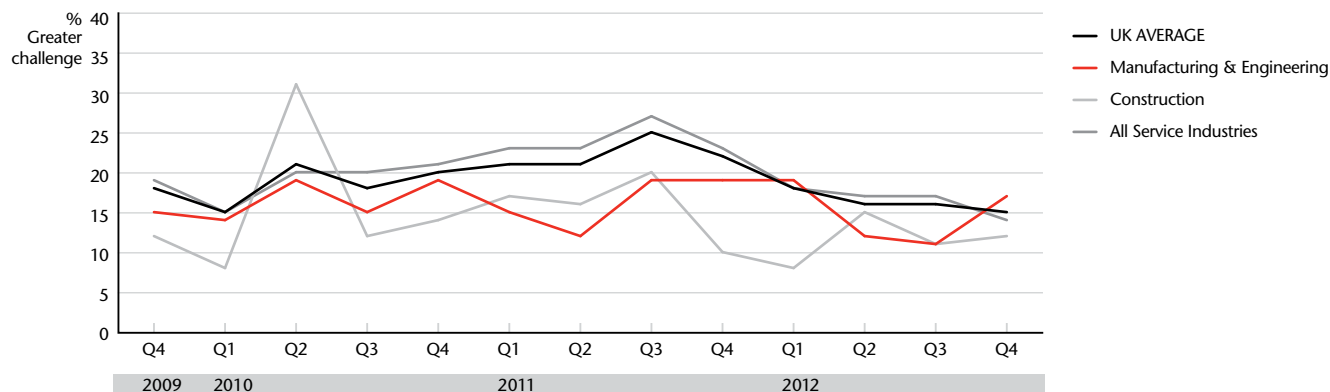
Across the economy, businesses are finding it hard to expand into new areas. In the service sector, the share of companies reporting their ability to expand into new areas as a greater challenge now than a year ago rose from 12% in Q4 2011 to almost one in five (18%) this quarter. These latest findings come despite the service sector holding up relatively well during the recession of 2011–12, with output reaching its highest ever level in Q3 2012.

There is also a six percentage point rise in the share of manufacturing businesses finding their ability to expand a greater challenge now

than a year ago. Output in the UK manufacturing sector has largely declined since the recession of 2008–09 and remains well below its peak before the financial crisis.

SHARE OF BUSINESSES FINDING IT CHALLENGING TO EXPAND INTO NEW AREAS INCREASING ACROSS ECONOMY

FIG. 8 TAX BURDEN – CHANGE V. 12 MONTHS AGO



There are signs that some businesses are feeling the benefits of recent changes to the UK tax system, as this quarter 15% of UK businesses consider the tax burden they face a greater challenge than a year ago, down from 25% in Q3 2011.

CHANGES TO TAX REGIME FAVOUR SERVICE SECTOR

Alongside this improving picture, the UK rate of corporation tax has fallen from 26% in 2011 to 24%, with a further cut to 23% planned for 2013, taking five percentage points off the rate since 2010. However, improvements in the tax burden are not being felt equally across all parts of the economy.

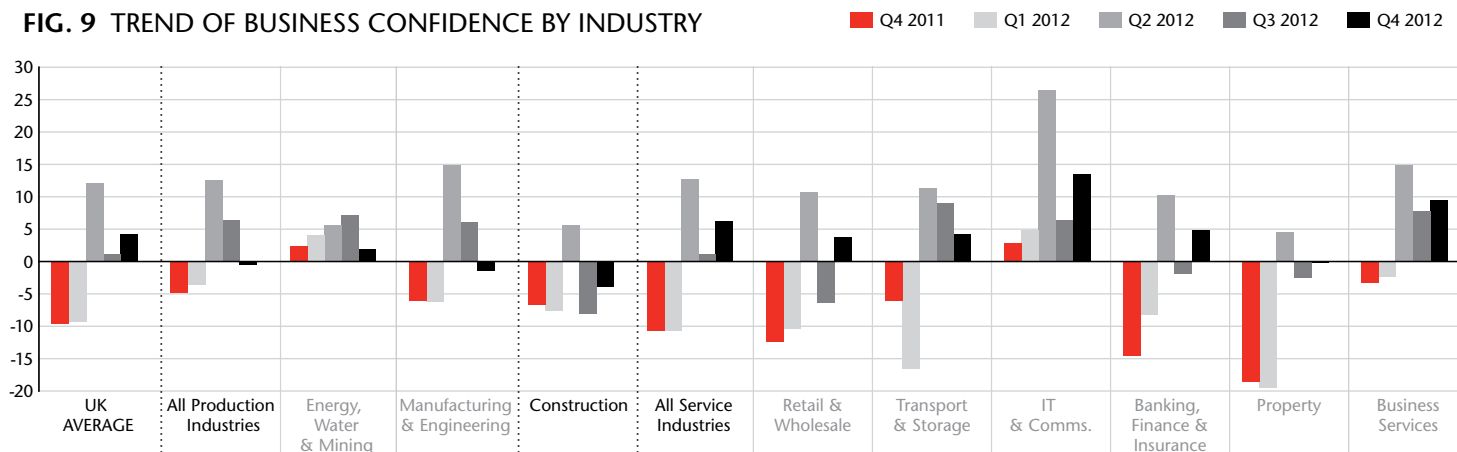
Perceptions in the service sector have improved the most. This quarter roughly one in seven service sector businesses (14%) report that their tax burden is a greater challenge now than a year ago, markedly down from 27% in Q3 2011.

Over the same period the picture is more mixed for manufacturing and construction companies. As well as falling corporation tax, the annual tax-free capital investment allowance was also reduced in April 2012 from £100,000 to £25,000, a policy change that is most likely to affect construction and manufacturing businesses.

TAX REGIME CHANGES COINCIDE WITH IMPROVED ATTITUDE TO TAX BURDEN, THOUGH ONLY IN SERVICE SECTOR

TRENDS IN BUSINESS CONFIDENCE INDUSTRY

FIG. 9 TREND OF BUSINESS CONFIDENCE BY INDUSTRY



Although there are bright spots in the economy, confidence remains at a low ebb outside of the service sector. Confidence among production and construction businesses is in negative territory this quarter, reflecting the tough business conditions seen in these sectors in 2012.

BUSINESS SERVICES AND IT COMPANIES MOST POSITIVE

Confidence among service sector businesses, in contrast to the production sector, stands in positive territory at 6.2 in Q4 2012. Confidence for the year ahead remains well above that seen at the end of 2011.

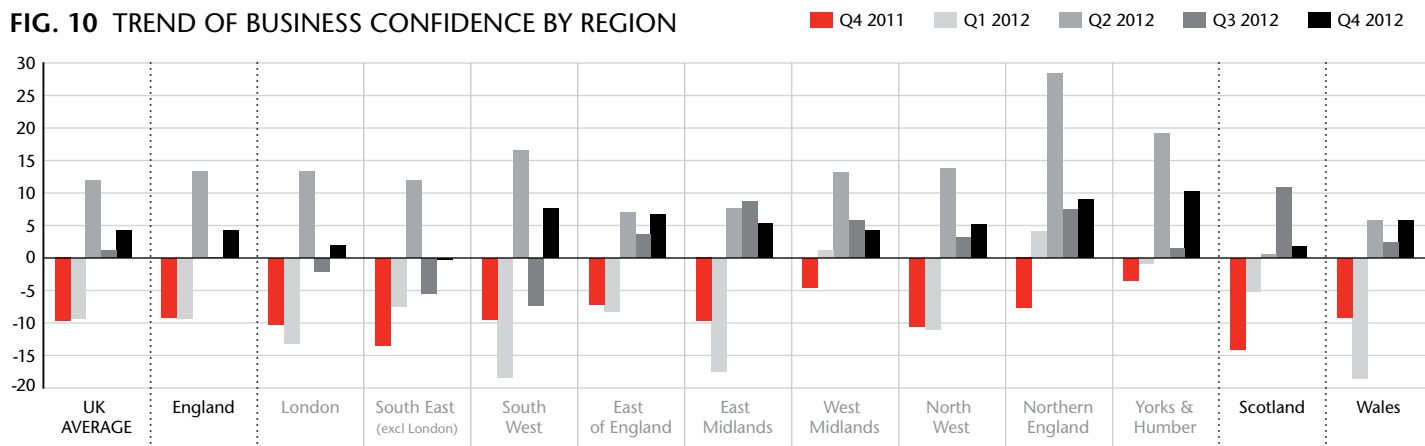
Within the service sector, organisations in Business Services and IT & Communications have the strongest Confidence Index readings. The Business Services sector in particular has performed well over the past year, with output in the sector rising by 2.8% year on year in Q2 2012 according to the ONS. Strong confidence levels in these

high-value-added sectors are encouraging for the UK economy.

The Confidence Index for the Banking, Finance & Insurance sector has been on a general upward trend year on year and stands at 4.7 this quarter, up from -14.6 in the final quarter of 2011. Although output in this sector has been hit hard in this year's recession, the Confidence Index reading suggests that the coming year will not be quite as tough as 2012.

TRENDS IN BUSINESS CONFIDENCE REGION

FIG. 10 TREND OF BUSINESS CONFIDENCE BY REGION



Confidence generally increased across much of the UK this quarter, but remains weak in some regions. Over 2012, the Confidence Index in the regions in the north of England has been on a general upward trend while remaining more muted in southern regions.

IN ENGLAND, LONDON AND SOUTH EAST LEAST CONFIDENT

This quarter confidence is relatively high in Northern England, the North West and Yorkshire & Humberside, with Confidence Index readings firmly in positive territory. In each of these regions, this quarter's confidence levels are much stronger than in the same period last year and have generally trended up in 2012. The growth in confidence in these regions coincides with strengthening labour markets, as regional unemployment rates have been falling back.

At the same time, although confidence in London and the South East is stronger now than in the same quarter last year, these regions

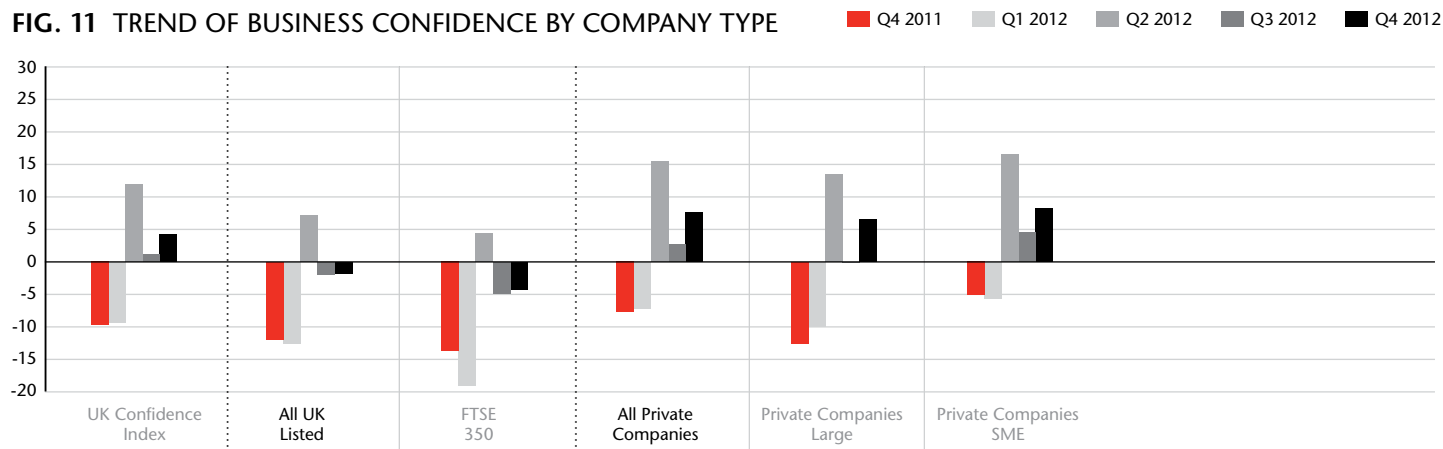
have seen only a weak upward trend over 2012. Confidence levels remain low and suggest robust economic growth will remain elusive over the coming year in these regions. London businesses are more likely than others to be global-facing, and as a result are likely to be affected most by the expected global economic slowdown over 2013.

The overall outlook for businesses in Scotland is also relatively weak this quarter, particularly compared to the position through 2010 and the early part of 2011 when confidence in Scotland consistently outstripped that in England and Wales.

OUTLOOK IN ENGLAND'S NORTHERN REGIONS STRONGER THAN IN SOUTH • SCOTLAND ALSO RELATIVELY WEAK

TRENDS IN BUSINESS CONFIDENCE TYPE

FIG. 11 TREND OF BUSINESS CONFIDENCE BY COMPANY TYPE



The gap in optimism levels between the largest UK businesses and the smallest widened this quarter.

The Confidence Index for FTSE 350 listed companies stands at -4.2 this quarter, compared to confidence levels of 8.3 among small and medium-sized privately-owned enterprises.

PRIVATE FIRMS STILL MORE CONFIDENT THAN LISTED COMPANIES

The Confidence Index for privately-owned companies rose to 7.6 in Q4 2012, following a general upward trend from -7.7 in the same quarter a year ago. Strong confidence among SMEs and large private companies is encouraging for the UK's growth prospects.

This is in contrast to the weak confidence readings among publicly-listed businesses. Listed companies are typically more exposed to world trends so may be feeling more affected by the weakening global growth outlook. These low confidence levels are reflected in strong dividend payments in Q3 2012 – rather than re-investing

profits, large businesses are sitting on cash and returning dividends to their shareholders as economic prospects remain uncertain.

LISTED FIRMS' CONFIDENCE REMAINS IN NEGATIVE TERRITORY • OUTLOOK FOR PRIVATE FIRMS ENCOURAGING

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 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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