ICAEW UK BUSINESS CONFIDENCE MONITOR

Q1 2020

Menu

INTRODUCTION

BUSINESS CONFIDENCE

BUSINESS FINANCIAL PERFORMANCE

TRENDS IN BUSINESS CONFIDENCE: INDUSTRY

TRENDS IN BUSINESS CONFIDENCE: REGION

TRENDS IN BUSINESS CONFIDENCE: COMPANY SIZE

ABOUT BCM

OUR ECONOMIC REPORTS

Introduction

OVERALL CONFIDENCE

Significantly up

Confidence Index rises into positive territory, at least partly due to the general election. But underlying economic fundamentals remain challenging. GDP may experience a small bounce in Q1, but growth is likely to remain subdued through 2020.

SALES GROWTH

Slowing

Both domestic sales and exports are slowing compared to previous years. Expectations for the year ahead have improved but are no higher than they have been for most of the last few years.

PROFIT GROWTH

Modest

The gap between input price inflation and selling price inflation remains sizeable, so the slowdown in sales growth is leading directly into a duller picture for profits growth.

PRODUCTIVITY

Weak

Slow growth in investment is a major cause of weak productivity performance. The IT & Communications sector has the largest proportion of companies improving their productivity, while the Construction sector has the fewest.

REGULATORY CHALLENGES

Remain widespread

Concerns over regulations remain the most commonly cited challenge, and will be a factor to watch during this year's trade negotiations.

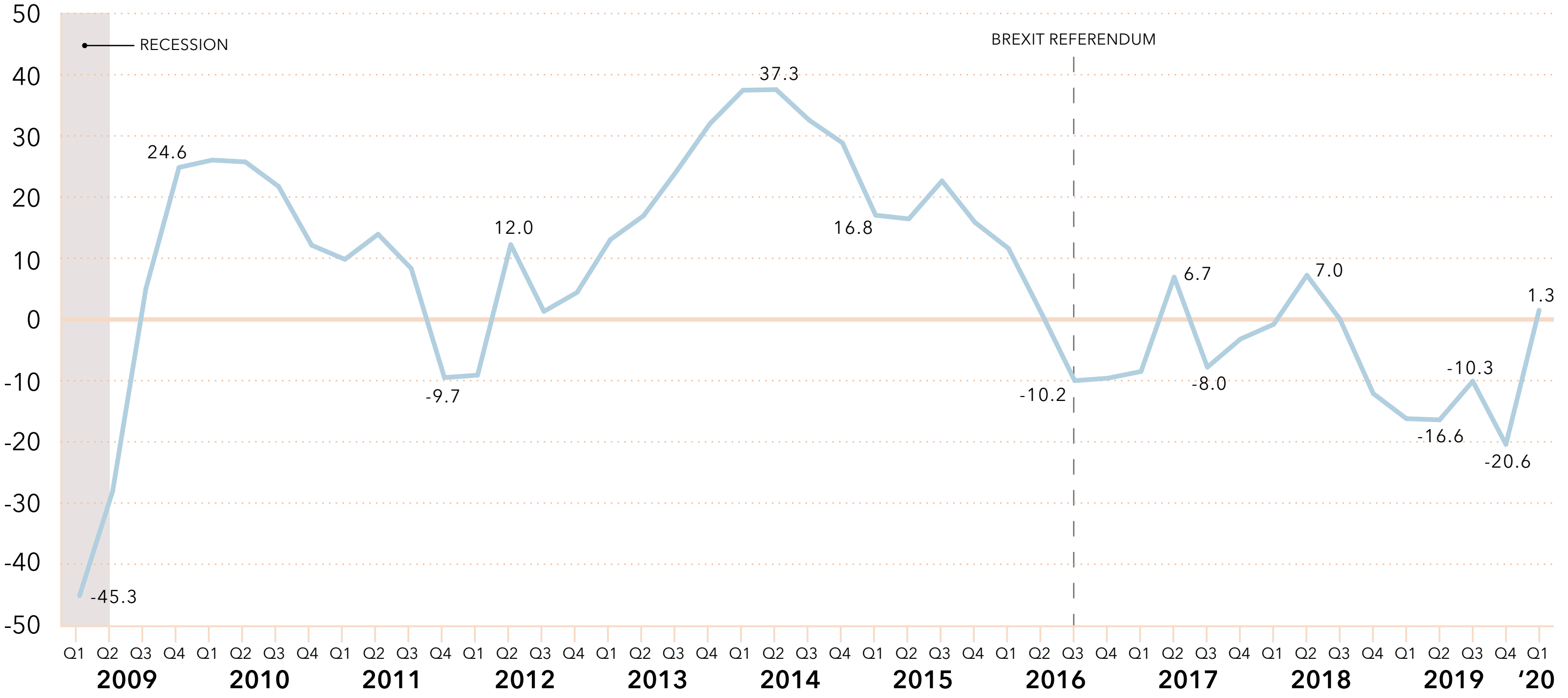
CAPITAL INVESTMENT GROWTH

Low

Remains low due to a slowdown in profits growth, widespread spare capacity, and continuing uncertainty - including over future trade deals. Investment plans for the year ahead are still very weak, despite the rise in confidence.

Business confidence in Q1 2020

CONFIDENCE IS NOW POSITIVE, HELPED BY THE CLEAR ELECTION RESULT



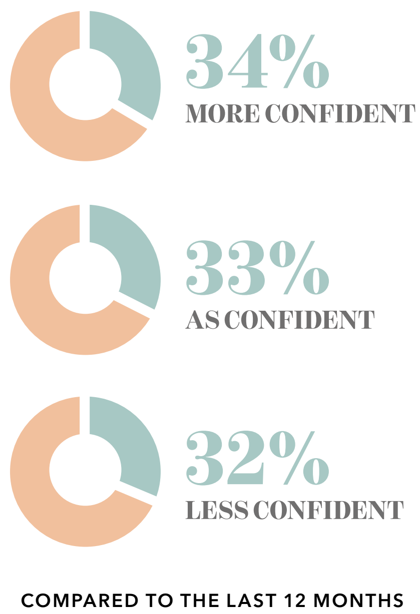


FIG. 1 TREND IN UK BUSINESS CONFIDENCE

In the first quarter of 2020 the Business Confidence Index is up significantly on Q4, at +1.3. The improvement in confidence began before the general election but was doubtless helped by it. The results resolved Parliament's deadlock, particularly over Brexit. Underlying economic fundamentals remain challenging.

The Confidence Index started rising in October, and for the three months as a whole it is in positive territory for the first time since Q2 2018, albeit only just. The improvement in confidence is the largest quarterly movement in the index since Q3 2009 – the period when the UK exited the last recession.

This pickup in sentiment is likely to be largely attributable to political factors. In October the deadline for Brexit was pushed to the end of January (thus avoiding an immediate cliff-edge no-deal Brexit). That was followed by the build up to the general election in mid-December, with all main parties committing to increase spending. The election itself resulted in the largest majority for a government since 2001, and hence the clearest path towards Brexit since the referendum. The House of Commons subsequently approved the government's Withdrawal Agreement Bill, ensuring the UK's exit from the EU at the end of January. The election also lifted uncertainty over the future ownership of energy and water companies, and (in most cases) rail companies.

Also helpful for business confidence in the period was the news in early October that President Trump had cancelled an imminent increase in tariffs against Chinese goods, and the conclusion of a tentative deal between the two governments in late December.

Business confidence in Q1 2020

GDP GROWTH REMAINS WEAK, WITH LITTLE SUPPORT FROM EITHER HOME OR EXPORT MARKETS

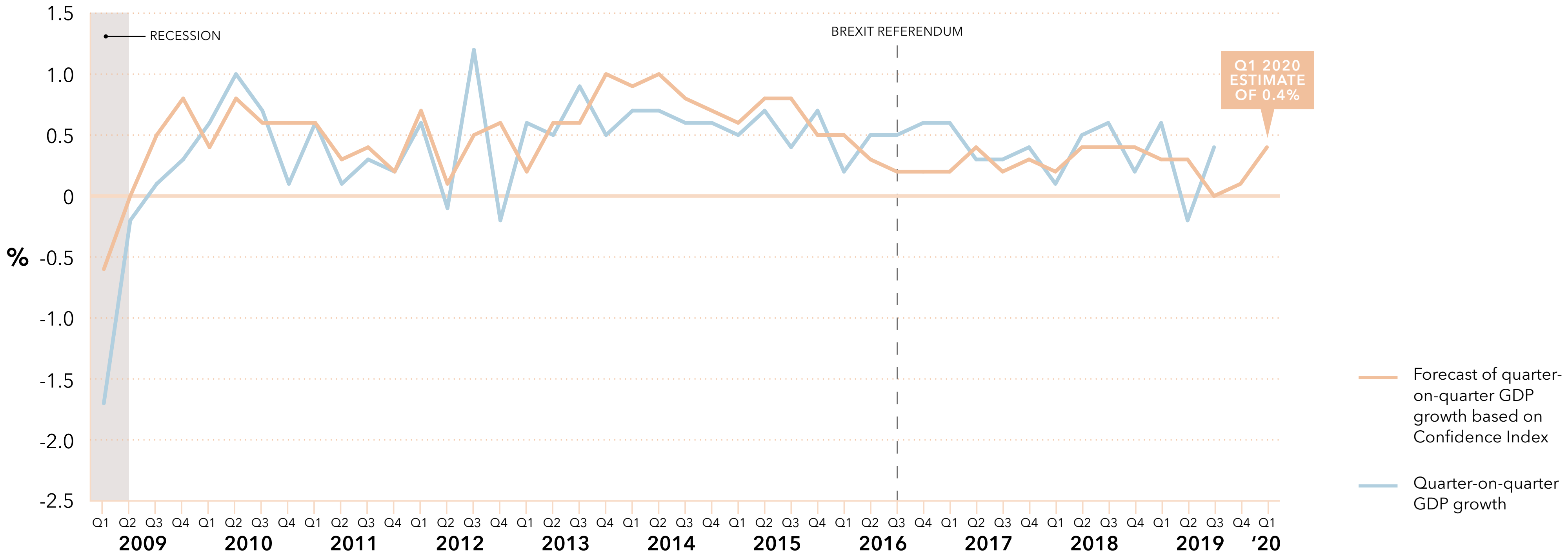


FIG. 2 FORECAST OF QUARTERLY GDP GROWTH BASED ON ICAEW CONFIDENCE INDEX

The end of 2019 confirmed the weak nature of underlying growth in the UK economy, as various distortions from earlier in the year faded. Among recent difficulties was a decline in retail sales in Q4 and slow growth in export markets.

The pattern of growth in the first half of 2019 was distorted by stock building and by unusual trade flows, both of them reflecting the (subsequently abandoned) March 2019 Brexit deadline. Now that these effects have faded, the underlying sluggishness of growth is being revealed. Office for National Statistics (ONS) estimates of GDP for the three months to November show GDP up by just 0.1% against the three months to August, and 0.9% compared to the same period a year earlier – the weakest rate of increase since June 2012.

Within that, the output of production industries declined by -1.1% (three months on three months) with only water supply showing positive growth. At 1.2%, services grew at half the pace of a year earlier, with falls in most components. Whereas consumer spending has been the driver of overall growth over the last few decades, its expansion is now waning. In Q3 it increased at its slowest annual rate since the beginning of 2012, and retail sales declined in Q4. Although the unemployment rate is at its lowest level since 1974, real earnings are lower than they were before the 2008-09 recession.

Meanwhile, the global economy is being less than supportive for exports. Although the US-China trade dispute has eased somewhat, the US economy grew by only 2.1% year on year in Q3 2019, Germany by just 0.5%, and China by 6.0%, all down on the corresponding rates of the year before.

Looking ahead, the ICAEW Confidence Index, together with ONS data up to and including November, suggests that GDP may experience a small bounce in Q1 2020, of 0.4% quarter on quarter, after just 0.1% in Q4 2019. However, growth is likely to remain subdued through 2020, especially if the challenge of striking a trade deal with the EU impacts on business confidence and investment.

Business financial performance

SALES GROWTH IS VERY SUBDUED BUT WITH A SMALL PICKUP EXPECTED

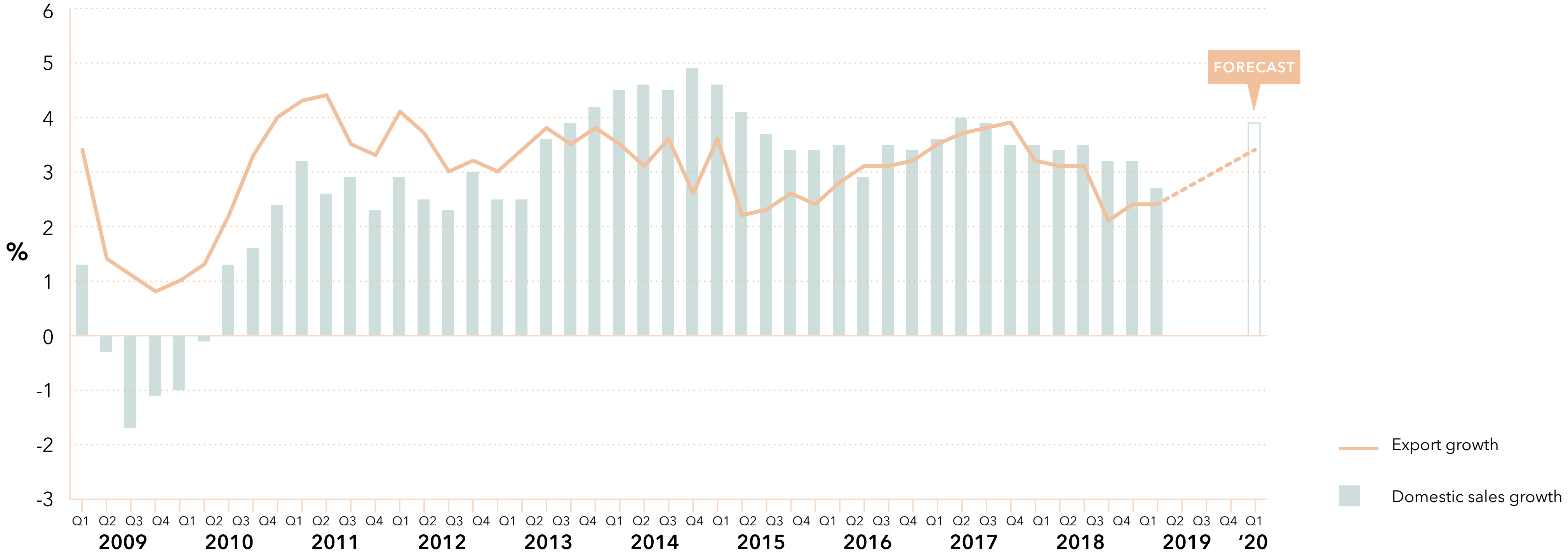


FIG 3. DOMESTIC SALES AND EXPORT GROWTH - AVERAGE % CHANGE

Both domestic sales and exports growth are slowing. Companies anticipate stronger performance in the year ahead, but their expectations are no higher than they were throughout most of the last decade. Exports are currently expanding more slowly than domestic sales.

Consistent with weak official ONS data, the *ICAEW Business Confidence Monitor* shows sales volumes in the year to Q1 2020 rising by 2.5%, their weakest pace in a decade. Domestic sales growth is 2.7% annually, while exports are 2.4%.

The slowdown is apparent across all sectors. Those with the weakest sales growth are most linked to the consumer sector, namely Property and Retail & Wholesale which are also the least confident. Meanwhile the temporary boost to Manufacturing from a surge in stock-building in early 2019 is now unwinding.

While sales have slowed, the percentage of companies reporting customer demand as a growing challenge to their businesses is at much the same level as it was in 2014, when UK GDP was growing at 2.6% per year, so double the current rate. This suggests that companies may have come to accept slow growth as a 'new normal' – something that is likely to feed into their investment and other plans. That said, they do expect an increase in sales growth over the next 12 months, to 4.1%. Indeed, this is the largest gap between outturn and expectations since 2013. Even so, it is not a radical change as it only puts expectations back to the rates that businesses have been predicting for most of the last year.

Business financial performance

SLOWING SALES ARE HURTING PROFITS GROWTH, BUT BETTER IS EXPECTED OVER THE YEAR

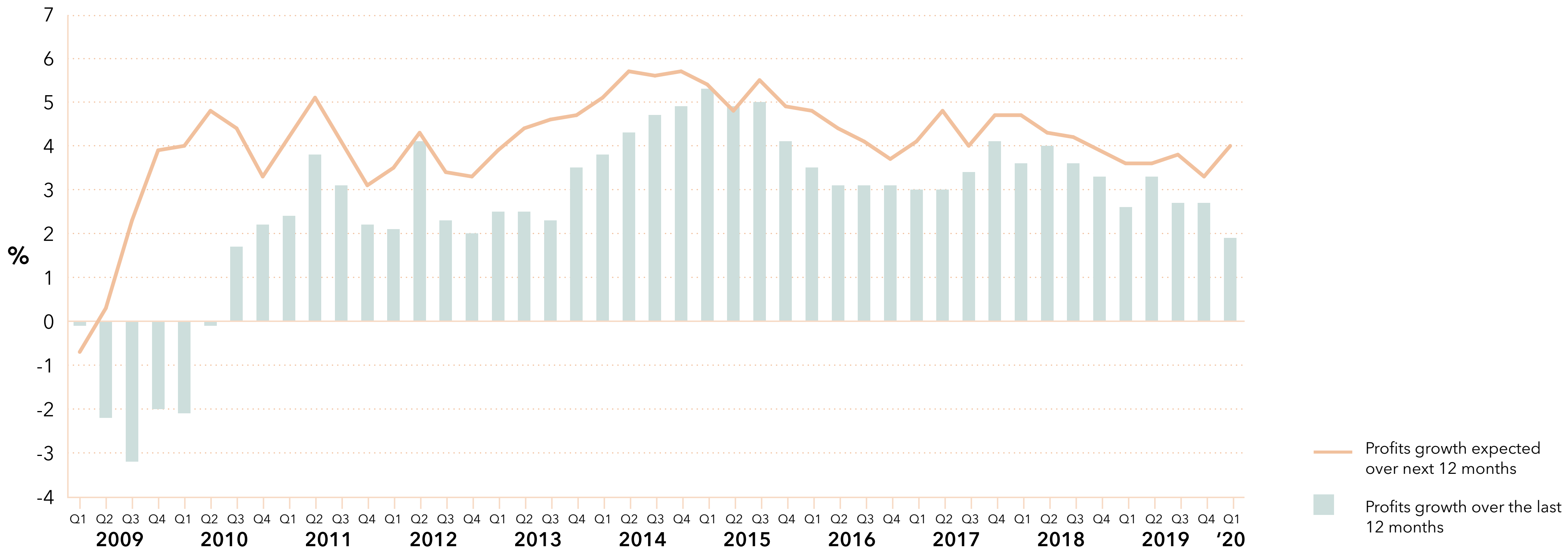


FIG 4. PROFITS GROWTH OVER THE LAST 12 MONTHS VS EXPECTED NEXT 12 MONTHS - AVERAGE % CHANGE

The gap between input price inflation and selling price inflation remains sizeable, and so the slowdown in sales growth is leading directly into a duller picture for profits. Companies do expect an upturn in profits growth, although they tend to be overly optimistic.

Selling prices are rising at a slightly slower rate than in recent quarters, at 0.8% year on year in Q1 2020 against 1.1% a year ago. This trend is apparent across companies of varying size, and across nearly all sectors. One reason may be that, with demand weak, companies are discounting their prices in order to achieve volume growth.

In addition, annual input price inflation has edged down to 2.1%, from 2.5% a year ago. Some of this will be due to a modest rise in sterling in H2 2019, making imports slightly cheaper, while crude oil prices were on average lower in 2019 than they were in 2018.

Overall, and as a consequence of no significant change in the cost-price gap, slowing sales over the last year have led to a downward trend in profits growth. At just 1.9% year on year in Q1 2020, profits are currently rising at their slowest rate since 2010. It's no surprise that the Retail & Wholesale sector has been suffering the most – profits are down 0.5% on the previous year, the first decline for the sector since Q4 2012.

Looking ahead, companies predict an acceleration in profits growth to 4.0%, thanks to an expected rise in sales growth and a narrowing of the gap in input and selling price inflation. It must be noted that companies often do have higher expectations for profits than they end up achieving.

Business financial performance

COMPANIES EXPECT WEAK INVESTMENT GROWTH TO CONTINUE

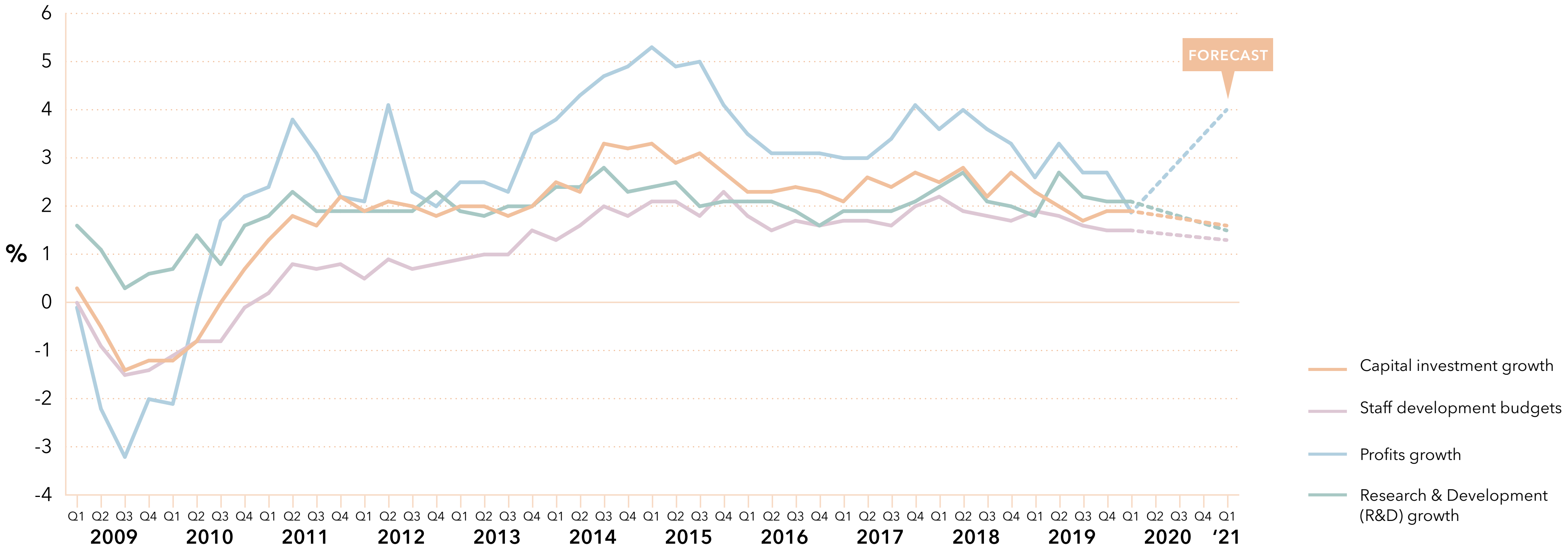


FIG 5. PROFITS, CAPITAL INVESTMENT, RESEARCH & DEVELOPMENT (R&D) AND STAFF DEVELOPMENT BUDGET GROWTH - AVERAGE % CHANGE

Low rates of investment growth continue, reflecting a slowdown in profits growth, widespread spare capacity, and perhaps uncertainty over the details of the trade deals to be agreed with the EU and others. Looking ahead, spending plans (unlike those for sales) have been revised up only slightly, and remain below even the rates shown in the year to date.

Capital investment growth has ebbed away over the last year or so, to just 1.7% year on year in Q1 2020. The last time it was slower than this was in the year to Q3 2011. Much the same is true for staff development budgets, which are up just 1.5% in the year to Q1 2020.

Factors behind these trends include slowing profits, widespread spare capacity (54% of companies are operating below capacity) and Brexit uncertainty. And while companies expect the next 12 months to show improvements in profits, sales and therefore, potentially, capacity utilisation, they remain very cautious over investment spending. Likely reasons include weak consumer confidence and uncertainty over the outcome of trade talks with the EU, and indeed with other nations.

Slow growth in investment is an important reason for weak productivity performance. Only 39% of businesses say that they made gains in this area in the year to Q1 2020. The IT & Communications sector has the largest proportion (58%) of companies saying that they have improved productivity, while the Construction sector has the fewest, at just 28%.

Business financial performance

THE CHALLENGES POSED BY REGULATIONS MAY SHIFT AS TRADE NEGOTIATIONS GET UNDERWAY

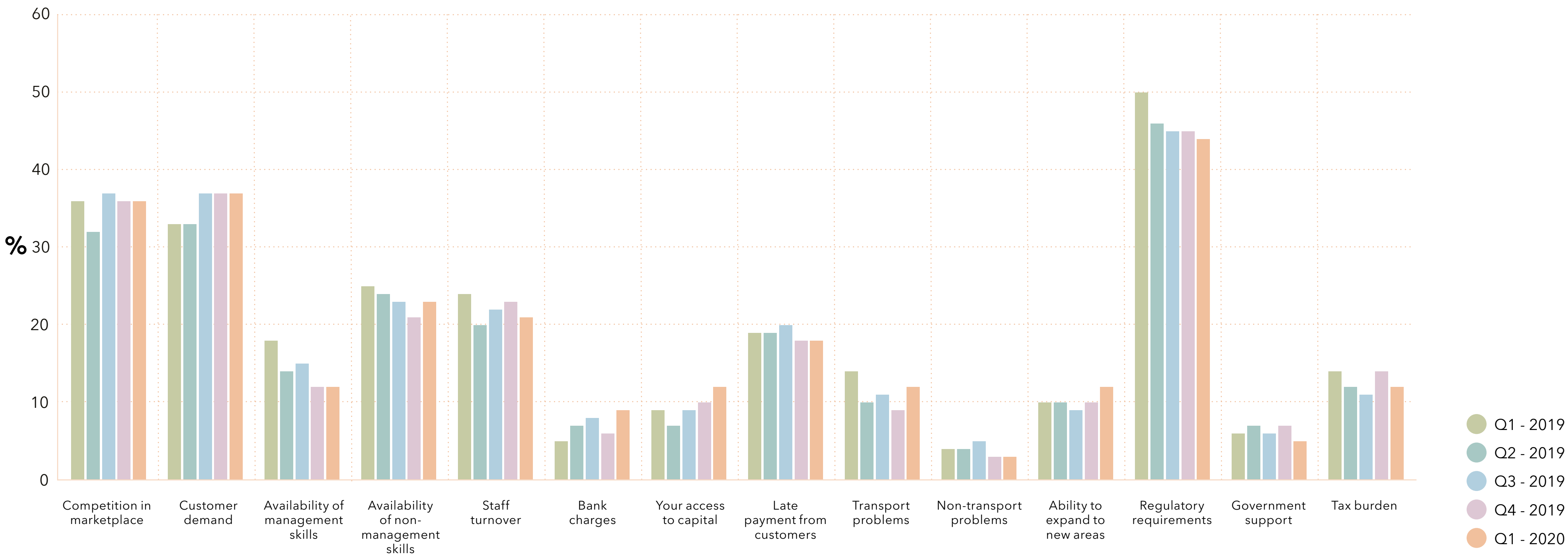


FIG. 6 FACTORS SEEN AS A GROWING CHALLENGE TO BUSINESS PEFORMANCE COMPARED TO 12 MONTHS AGO

Concerns over regulations remain the most commonly cited challenge, and will be a factor to watch during this year's trade negotiations. Competition in the marketplace is another significant challenge, while access to capital and bank charges are creeping up too.

The number of companies citing regulatory requirements as an increasing challenge for their business has been easing over the last year, as companies have adapted to meet such requirements as GDPR, the publication of executive and gender pay gaps, and the new Making Tax Digital arrangements.

However, this remains the factor that is most widely cited (by 44% of companies) as a growing challenge. Its importance may be affected over the year ahead by the progress of trade negotiations with the EU and with other nations, although whether the net impact will be positive or negative is very unclear. Indeed, the answer will probably vary markedly between businesses, depending partly on whether they are mostly focused on export markets or on selling to domestic customers.

Among other growing challenges, competition in the marketplace is cited by 36% of companies, largely as a result of either more competitors, or product innovations by those competitors. The latter does not, however, seem to be acting as a spur to investment. Concerns over access to capital, although not widely cited, are creeping up – to 12% in the latest quarter – as are bank charges (9%).

Trends in business confidence: Industry

THE MOST CONFIDENT SECTORS ARE MOST AFFECTED BY THE GENERAL ELECTION RESULT

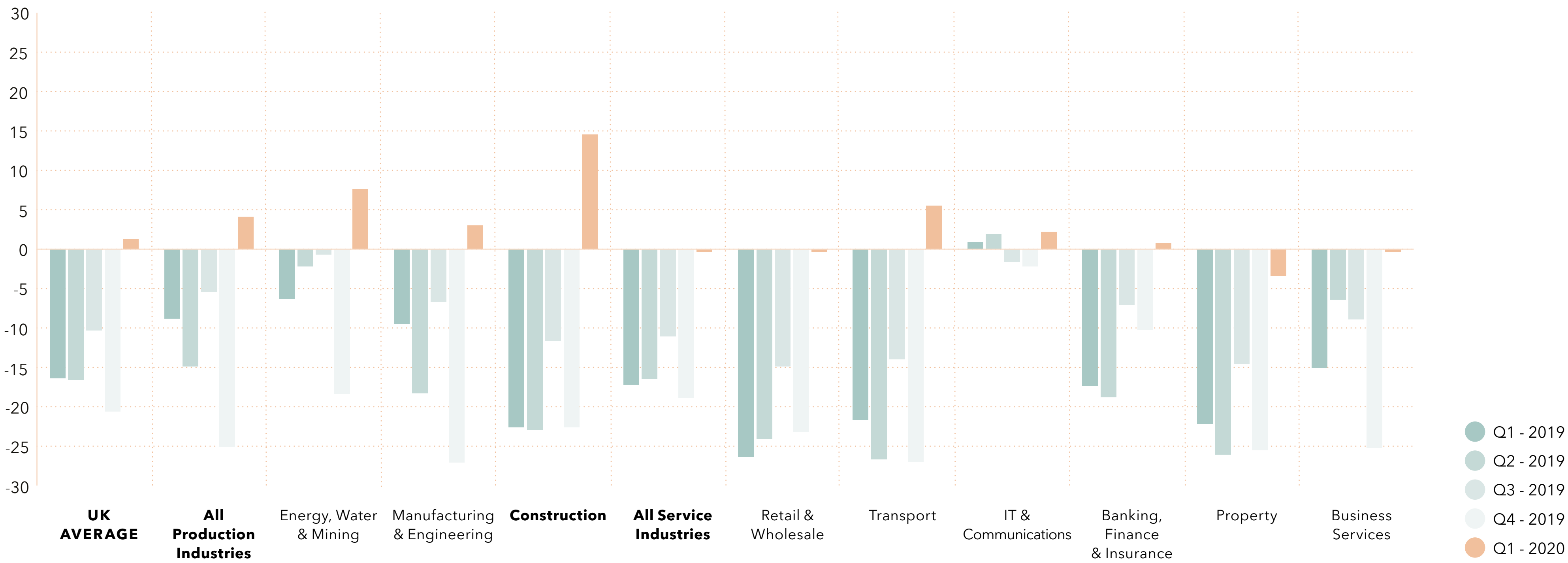


FIG. 7 CONFIDENCE BY SECTOR

All sectors have shown improved confidence this quarter, both compared to last quarter and to a year ago, although some have remained in negative territory. Those that are most confident have probably been particularly affected by the general election result. Sales and profits growth largely explain the relative confidence among other sectors.

Recent government promises of increased infrastructure spending help to explain stronger Construction sector confidence, at +14.5. Meanwhile, the threat of nationalisation is no longer looming over many Energy, Water & Mining companies, which probably partly explains that sector's renewed confidence (+7.6). Some Transport & Storage companies are likely to be gaining from both effects. Their sector has experienced a confidence boost to +5.5.

At the other extreme, the confidence of Property (-3.4) and Retail & Wholesale (-0.4) is still in negative territory. The latter sector is experiencing declining profits and weak sales due to online competition and caution on the part of consumers, while sales volumes for the Property sector have been almost flat over the last 12 months (up just 0.3%). Both residential and commercial markets are suffering from the uncertainty of consumers and investors.

Among other sectors, variations in confidence tend to be closely linked to sales performance. IT & Communications companies have seen consistently stronger sales growth than most sectors over the last year (exports 3.1%, domestic sales 4.8%), and also stronger confidence in most quarters. An exception in the current quarter are Manufacturers, which are currently struggling in terms of both exports and domestic sales, but which nevertheless have confidence which is in slightly positive territory. A likely reason is that, at 3.2%, their profits growth compares favourably against the average of all sectors (1.9%). They have also benefitted from the resolution of Brexit uncertainty.

Trends in business confidence: Region

CONFIDENCE HAS IMPROVED ACROSS ALL REGIONS AND NATIONS

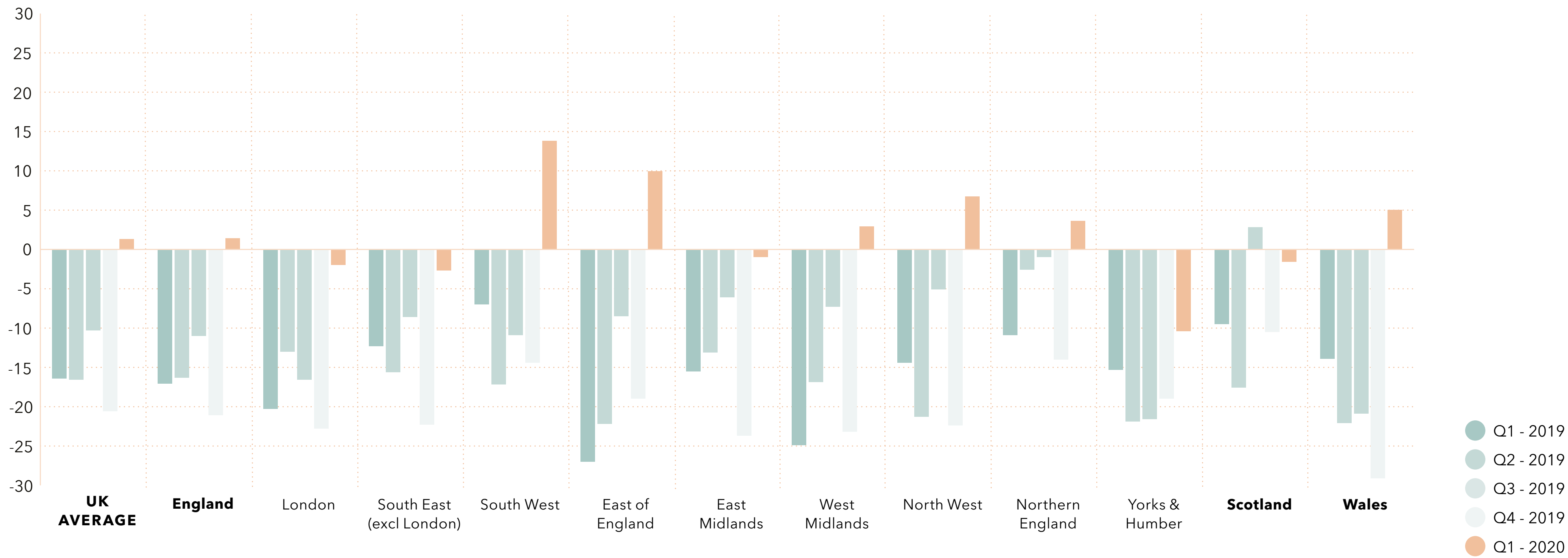


FIG. 8 CONFIDENCE BY REGION

All regions and nations of the UK are showing a rise in confidence compared to both the last quarter and Q1 2019, with sentiment moving into or close to positive territory. The South West is the most confident, whereas Yorkshire and Humber is lagging behind all other regions.

The South West is the most confident region in the UK, at 13.8 in Q1 2020. It has benefitted from some of the strongest domestic sales increases (3.9% against the UK average of 2.7%), and from a drop-off in concern about customer demand (cited by 32% of companies as a growing challenge this quarter, compared to 45% a year ago).

The North West's Confidence Index is also clearly positive. The region benefits from sales volumes growing at 5.0% annually, and also perhaps from government promises of increased infrastructure spending, despite the continuing uncertainty over HS2.

At the other extreme, Yorkshire & Humber's confidence is still some way into negative territory, at -10.4. This is the region where the highest percentage of companies are operating below capacity (73% against the UK average of 54%) and may also be partly to do with the flooding in Yorkshire during November.

Trends in business confidence: Company size

CONFIDENCE HAS PICKED UP ACROSS ALL TYPES OF COMPANY

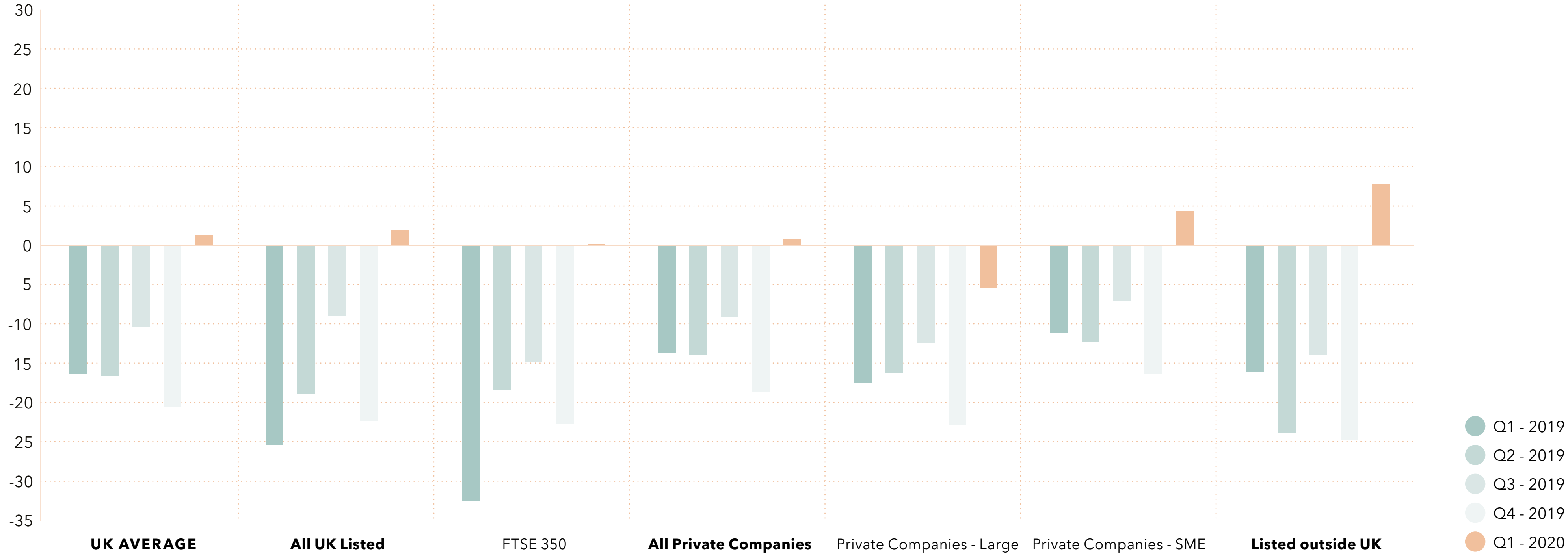


FIG. 9 CONFIDENCE BY COMPANY SIZE

Overseas listed companies are slightly more optimistic than UK-owned, although the differences are not large, with both moving into modest positive territory in Q1 2020. Among privately-owned companies, SMEs are more confident than large companies.

There is some variation in confidence between different type of size and ownership, but not much. Certainly, the difference between privately-owned companies (+0.8) is not markedly different from those that are listed in the UK (+1.9). However, those that are listed outside of the UK do stand out just a little, with a Confidence Index of +7.8.

Among UK-listed companies there is very little difference between the FTSE 350 and the rest. However, within privately owned-companies there is a split between those that are large (250+ employees) and SMEs (less than 250 employees). The former's Confidence Index remains in negative territory (-5.4) while SMEs are now positive (+4.4). This may be linked to differences in sales growth, which dropped to just 2.3% in the year to Q1 2020 for large companies, compared to 3.2% for SMEs. In conjunction with this, a significantly higher proportion of large companies (43%) report customer demand as a growing challenge, compared to 34% for SMEs. And given the weakness in sales performance, 58% of large companies now say that they are operating below capacity, up considerably from 48% a year ago.

It is also noticeable that investment rates among large companies are subdued. Notably, capital investment growth by large companies has fallen away – down from 2.9% in the 12 months to Q1 2019, to just 1.4% in the year to Q1 2020. That is below the rate for SMEs for only the third time on record (since 2012).

About ICAEW Business Confidence Monitor (BCM)

The *ICAEW Business Confidence Monitor* (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 policymakers, 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 1,000 telephone interviews each quarter with ICAEW members working in industry and commerce. Interviews gather opinions on past performance and future prospects for members' businesses, and investigate perceived changes in the impact of factors such as availability of skills, government regulation and the tax regime. Data are weighted to ensure the profile of each quarter's survey sample accurately represents the UK economy (by value) for company size (no. of employees), regional location and industry sector.

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?'

Further details on methodology are available upon request.

ACKNOWLEDGEMENTS

OXFORD ECONOMICS

Oxford Economics is one of the world's foremost advisory firms, providing analysis on 200 countries, 100 industries and 7,000 cities. Their analytical tools provide an unparalleled ability to forecast economic trends and their economic, social and business impact. Headquartered in Oxford, England, with regional centres in London, New York and Singapore and offices around the world, they employ one of the world's largest teams of macroeconomists and thought leadership specialists.

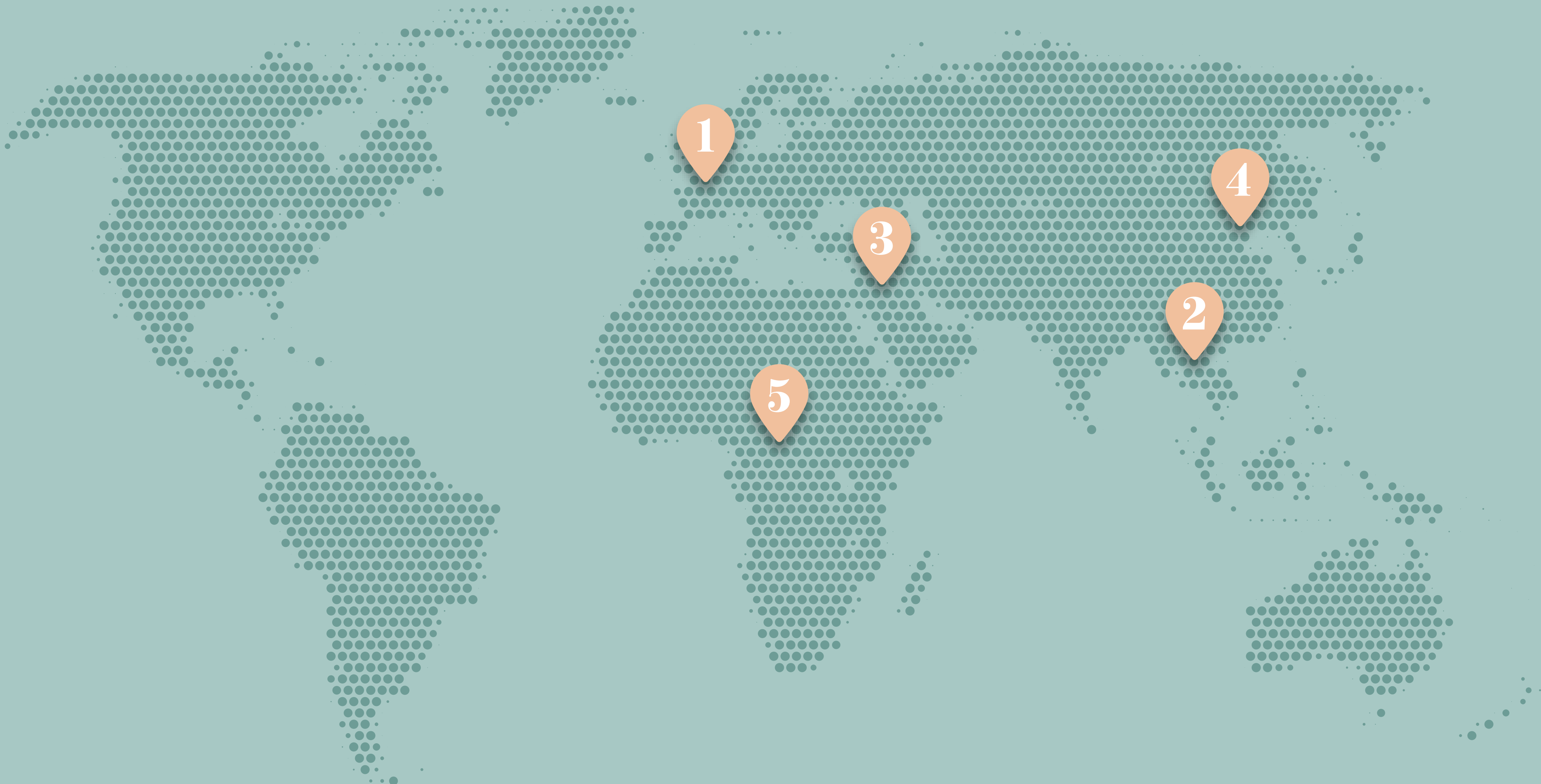
KUDOS RESEARCH

Interviewing and data analysis was undertaken by Kudos Research.

They specialise 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 in-depth interviews.

Our Economic Insight reports

CLICK ON THE MAP TO SEE THE REGIONAL REPORTS



UK ECONOMIC UPDATE

Produced with ICAEW's partner Oxford Economics, the report focuses on economic outlook and projections for the UK economy with a focus on key trends.

ECONOMIC INSIGHT

Economic Insight reports are produced with ICAEW's partner Oxford Economics. The reports focus on key trends, including country analysis and comparative data across four global regions.

1 UK
2 SOUTH EAST ASIA
3 MIDDLE EAST
4 GREATER CHINA
5 AFRICA

There are over 1.8m chartered accountants and students around the world – talented, ethical and committed professionals who use their expertise to ensure we have a successful and sustainable future.

Over 181,500 of these are ICAEW Chartered Accountants and students. We train, develop and support each one of them so that they have the knowledge and values to help build local and global economies that are sustainable, accountable and fair.

We've been at the heart of the accountancy profession since we were founded in 1880 to ensure trust in business. We share our knowledge and insight with governments, regulators and business leaders worldwide as we believe accountancy is a force for positive economic change across the world.

www.charteredaccountantsworldwide.com
www.globalaccountingalliance.com

ICAEW
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA
UK

T +44 (0)20 7920 3508
E bcm@icaew.com
icaew.com/bcm

Chartered Accountants Worldwide Member

GAA Global Accounting Alliance