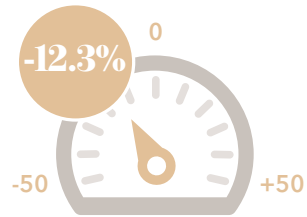


ICAEW UK BUSINESS CONFIDENCE MONITOR

Q4 2018

Introduction

OVERALL CONFIDENCE



Plunges further into negative territory

Confidence has fallen to its lowest level for nearly a decade. The decline is widespread across most sectors and all regions.

SALES VOLUMES GROWTH



Remains on-track

Sales growth has been consistent this year. Export growth, which was briefly outpacing domestic sales, has fallen back after many quarters of gradual improvement.

PROFIT GROWTH



Marginally down

Profit growth is marginally down, as are expectations, broadly tracking sales growth.

IMPLICATIONS

Business confidence is at its lowest point since the financial crisis ten years ago. Leaving the EU and its potential impact is at the front of everyone's minds. This is a difficult time to run a business, let alone finance the major investments the UK economy will desperately need post Brexit to drive growth. The Budget offered some relief to business but more significant action is needed by Government to provide stability and reassurance.

CAPITAL INVESTMENT



Subdued

Capital investment is growing well under profit growth - reflecting caution on the part of businesses. Planned capital investment growth is particularly weak.

EMPLOYEE NUMBERS



Continue to grow

Employment continues to grow, but at a low rate, maintaining the existing trend. No significant change in the pace of growth is expected.

REGULATORY REQUIREMENTS



Concerns still dominate

Concerns over regulation still dominate the increases in challenges businesses face, though the pace at which these concerns are rising has eased a little.

Business confidence in Q4 2018

CONFIDENCE HAS FALLEN TO ITS LOWEST LEVEL FOR NEARLY A DECADE

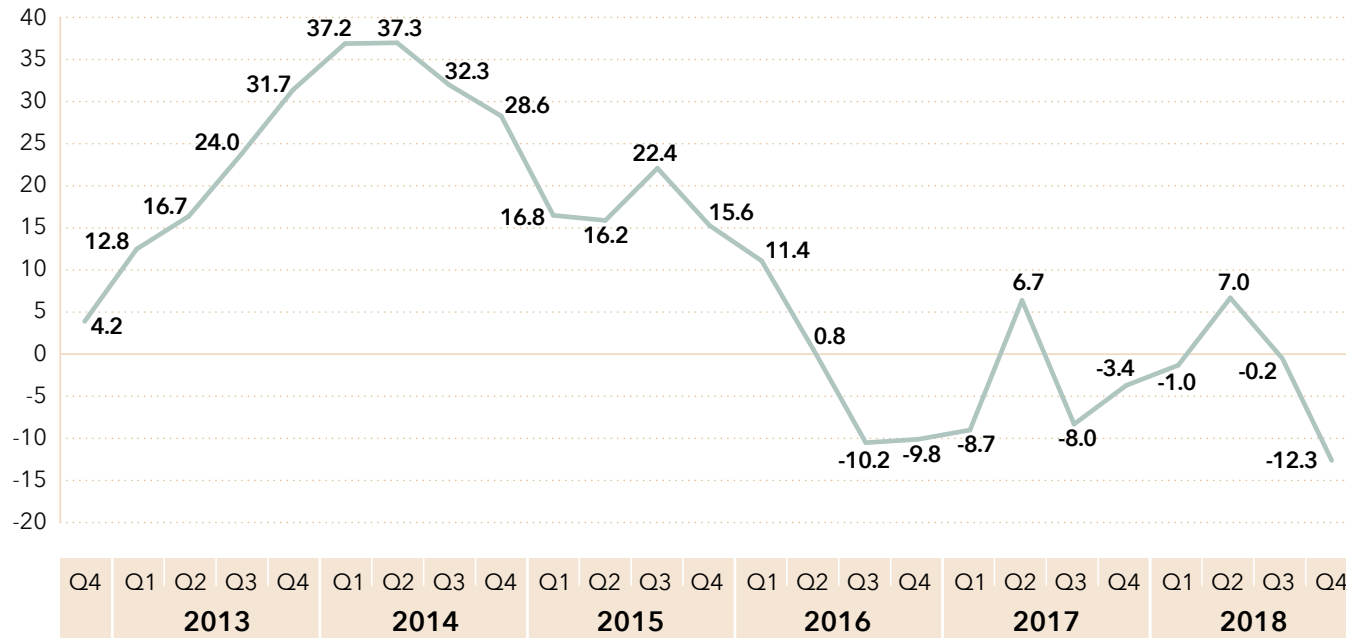


FIG. 1 TREND IN UK BUSINESS CONFIDENCE



COMPARED TO THE LAST 12 MONTHS

According to the latest ICAEW Business Confidence Monitor, confidence has fallen to -12.3 this quarter, its lowest level since Q2 2009. Brexit anxieties, reflecting lack of progress in the negotiations, are a likely reason.

Business confidence has fallen for the second quarter in a row and is now firmly negative. Indeed, the Confidence Index is now lower than it was following both the 2016 referendum and the 2017 general election. The decline is widespread across most sectors and all regions, and is shared by both quoted and unquoted

companies, and larger and smaller businesses.

Recent months have been characterised by mixed economic news. August's monthly GDP data showed no rise in output in the month, but the three-month-on-three-month growth rate remained at 0.7%; the same as in July and the strongest gain since February 2017. There have been continuing concerns over the threat of global trade wars, but this has been far from a new development. And the BCM data on sales growth and business challenges have broadly continued the existing trends, with no major changes.

The decline in confidence this quarter seems to have set-in immediately after the Prime Minister's meeting with other EU leaders in Salzburg, at which her 'Chequers' Brexit proposals were firmly rebuffed. Confidence then remained low through the rest of the quarter, amid uncertainty regarding whether any Brexit deal can be devised that will satisfy both EU leaders and politicians at home. And although history suggests that declines in business confidence tend to reverse themselves, it is not possible to say how quickly that will occur in this case.

Business confidence in Q4 2018

THE FALL IN CONFIDENCE MAY TRANSLATE INTO WEAKER GDP GROWTH

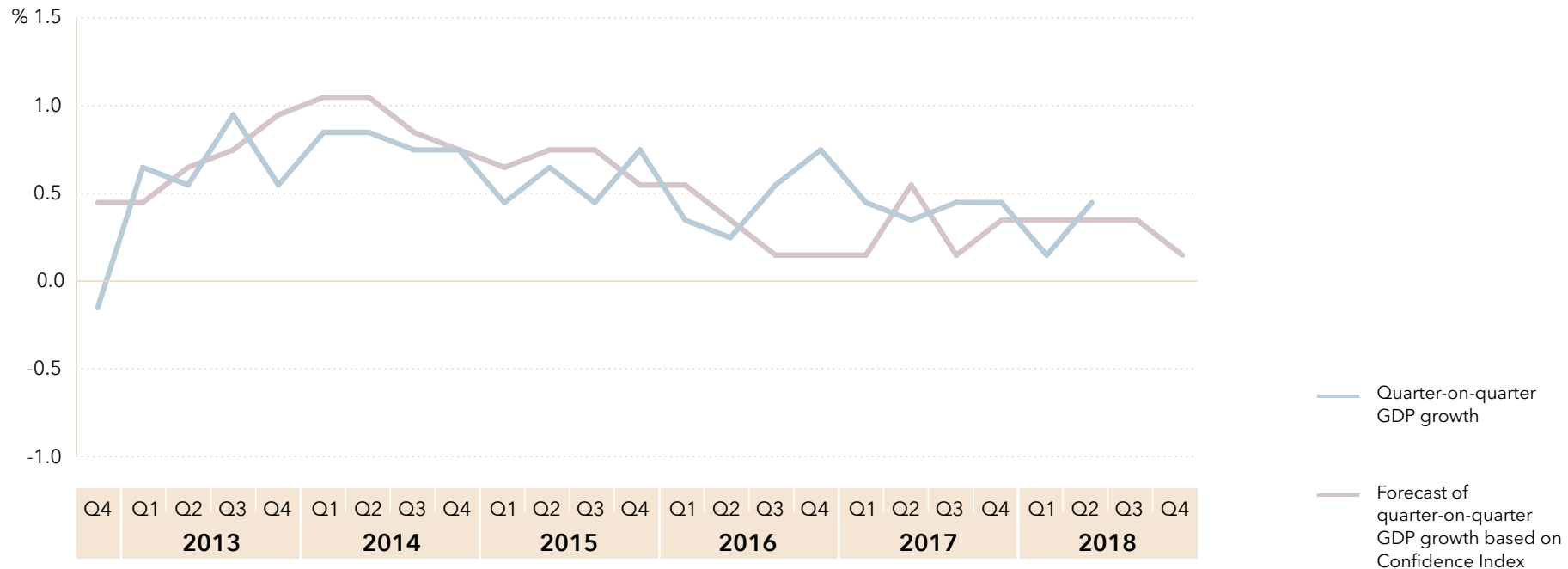


FIG. 2 FORECAST OF QUARTERLY GDP GROWTH BASED ON ICAEW CONFIDENCE INDEX

The UK economy has continued to expand, while the US has provided welcome momentum for the global economy. Indeed, concerns have risen that the Federal Reserve may raise interest rates, with potentially damaging consequences not least for global financial markets. Indeed, there are significant risks for the year ahead, and the drop in confidence increases the chances of GDP growth slowing in Q4 2018.

In August 2018, total production output increased by 0.2% compared with July 2018, due primarily

to rises in electricity and gas supply of 1.8% and mining and quarrying of 2.1%. In contrast there was a decrease in manufacturing output of 0.2%, with the majority of manufacturing sub-sectors contributing to the decline.

Meanwhile, the CPI inflation rate remained above-target at 2.4% for September, down from 2.7% in August. There was little evidence from wages to suggest a need to slow demand (an annual 0.4% rise in real terms including bonuses), although as expected the MPC nudged interest rates up

slightly from 0.5% to 0.75% on August 2nd.

Globally, growth in the US economy remains robust, but there is evidence from a number of economies of growth elsewhere slowing. Meanwhile, risks for 2019 include the possibility of interest rates rising in the US and hurting growth. Major global tariff-war remain. Relations between the US and its allies have worsened, and there are signs of potential problems in the Middle East. Oil prices and the dollar have both risen.

Business financial performance

GROWTH IN TOTAL SALES VOLUME HAS CHANGED LITTLE, WHILE EXPORTS HAVE SLOWED

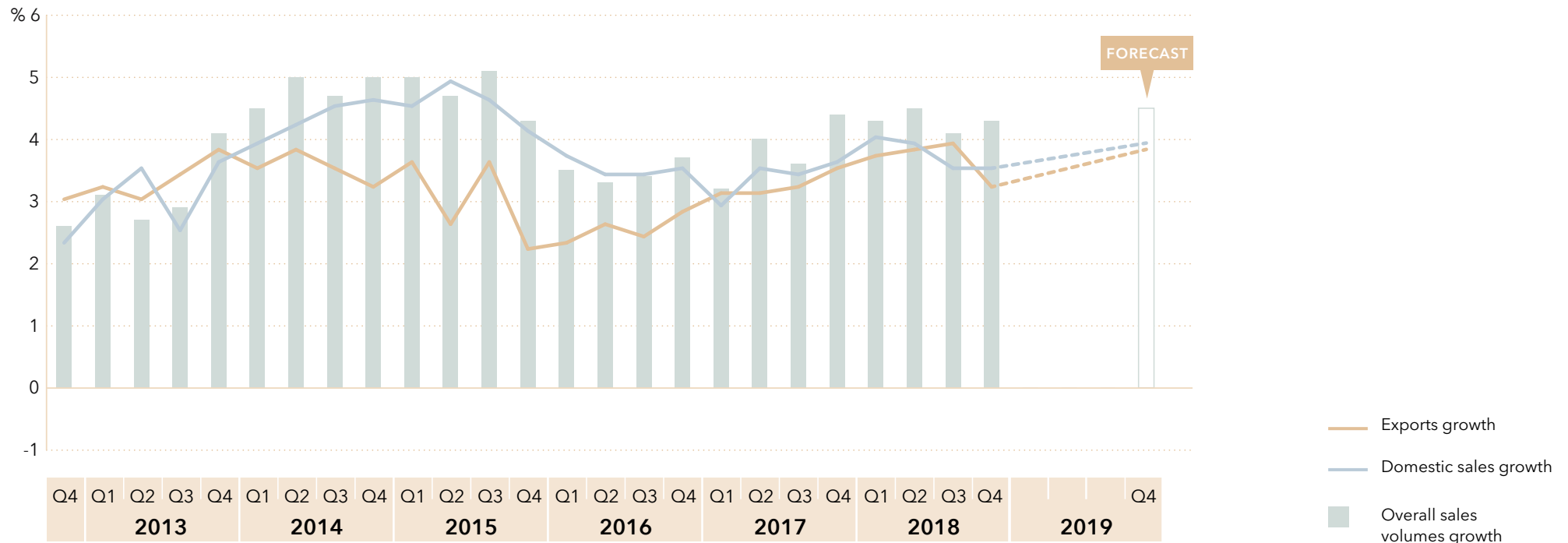


FIG. 3 DOMESTIC, EXPORT SALES AND TOTAL SALES VOLUMES GROWTH - ANNUAL % CHANGE

Companies report broadly stable trends in sales growth, with little variations other than a slight easing in export performance. Though patterns differ across sectors, the data suggest that businesses are planning for expansion at a similar rate despite the risks that Brexit may pose to those plans.

While there has been a clear decline in business confidence, companies are experiencing sales growth which is broadly comparable with existing trends. In particular, total sales continue to grow, at 4.3% in volume terms, year-on-

year in Q4 2018, with a similar performance expected over the coming year. The latter is significant: it suggests that businesses are planning to grow their businesses despite the possible risks of Brexit to those plans.

That said, in Q4 export growth has slipped below that of domestic sales, having moved slightly ahead in the previous quarter. Across sectors, IT & Communications, Manufacturing, and Business Services are experiencing the strongest export growth, while Banking, Finance & Insurance is amongst those whose export performance in

the current quarter is below the average for companies as a whole. The Banking, Finance & Insurance sector is, however, reporting strong growth in domestic sales, exceeded only by the Business Services and Construction sectors.

For the year ahead, the IT & Communications sector has the strongest expectations, with regard to both exports and total sales volumes. The former are projected to rise by a strong 5.4%, compared with an average of 4.0% for all Service industries and 3.4% for Production industries.

Business challenges

MARKET CONDITIONS ARE CHALLENGING, BUT WORRIES OVER REGULATION ARE RISING FASTER

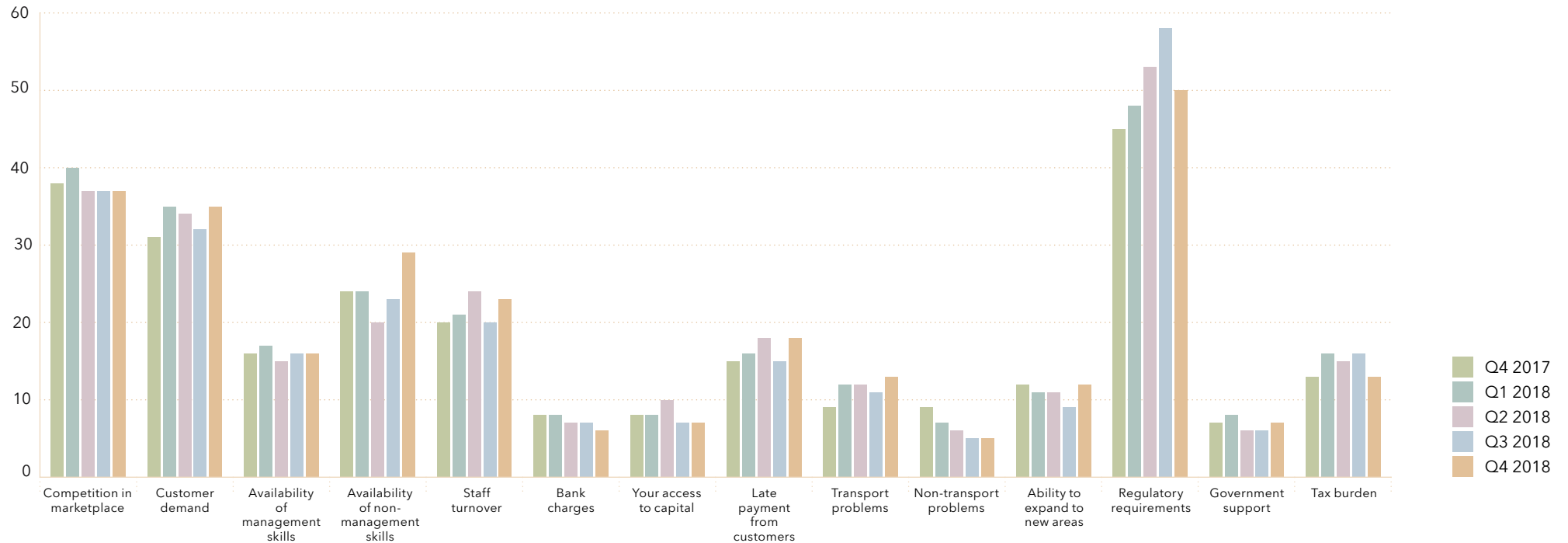


FIG. 4 FACTORS SEEN AS A GROWING CHALLENGE TO BUSINESS PERFORMANCE COMPARED TO 12 MONTHS AGO

Concerns over regulatory requirements still dominate the increases in challenges that businesses face. Market conditions are also commonly cited, while there are also modest increases in some other factors.

Competition in the marketplace and customer demand both continue to present growing challenges to businesses, but not to any greater extent than in recent quarters. That no doubt reflects the stability apparent in companies' sales growth.

The challenge which continues to show the highest rate of expansion is regulatory requirements. Although the number of businesses referencing these as a growing concern has fallen away in the current quarter compared with Q3 2018, this concern remains close to its historical high point. It is also above the level of a year ago, and it is well above all other factors that are causing difficulties for businesses.

Among those other factors, some are nevertheless edging upwards. Three in particular stand-out: the availability of non-management skills, staff turnover, and late payments by customers. The first two may reflect the fact that unemployment rates are at historically low levels, while the third could be linked to the recent modest rise in interest rates.

Business financial performance

INPUT PRICE INFLATION HAS FALLEN. WAGE GROWTH REMAINS MODEST

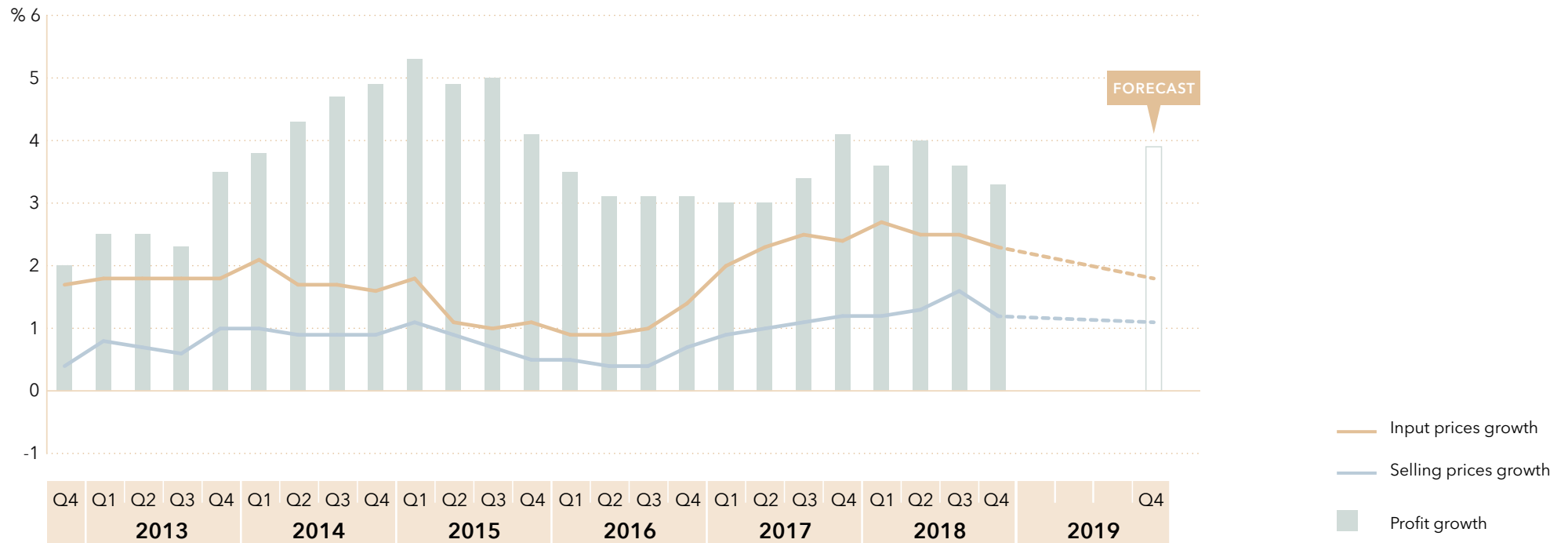


FIG. 5 INPUT PRICES, SELLING PRICES AND PROFIT GROWTH GROWTH - ANNUAL % CHANGE

Costs and price growth remain under control - with small increases in Q4. Moderation in 2019 is also likely, though this will depend largely on commodity markets and movements in sterling.

Input prices rose by 2.3% in the year to Q4 2018, continuing a modest downward trend seen in recent quarters. Companies expect a further slowdown to just 1.8% over the coming 12 months. Whether that happens will largely depend on commodity prices and movements in the currency. If the oil

market achieves a degree of stability, and if sterling is not battered by adverse news, then it is possible that these expectations will be realised in the year ahead, rather than defied as they were this year.

Clearly, however, there is considerable uncertainty involved, including tensions between the US and Iran, political uncertainties in Saudi Arabia, and the possibility of the UK leaving the EU without a deal in place. Two of the biggest factors in price movements will be the exchange rate and commodity prices.

Meanwhile, total salaries continue to rise by only 2.2%, with no sign of the surge that many analysts (and some Monetary Policy Committee members) have warned against. A similar story is apparent for selling prices: indeed, the Q4 increase is a modest 1.2%. This suggests that consumer prices are also likely to rise at moderate rates, although it does mean that the scope for companies to achieve large margin gains remains modest.

Business financial performance

EMPLOYMENT AND INVESTMENT SPENDING GROW MORE SLOWLY THAN SALES OR PROFITS

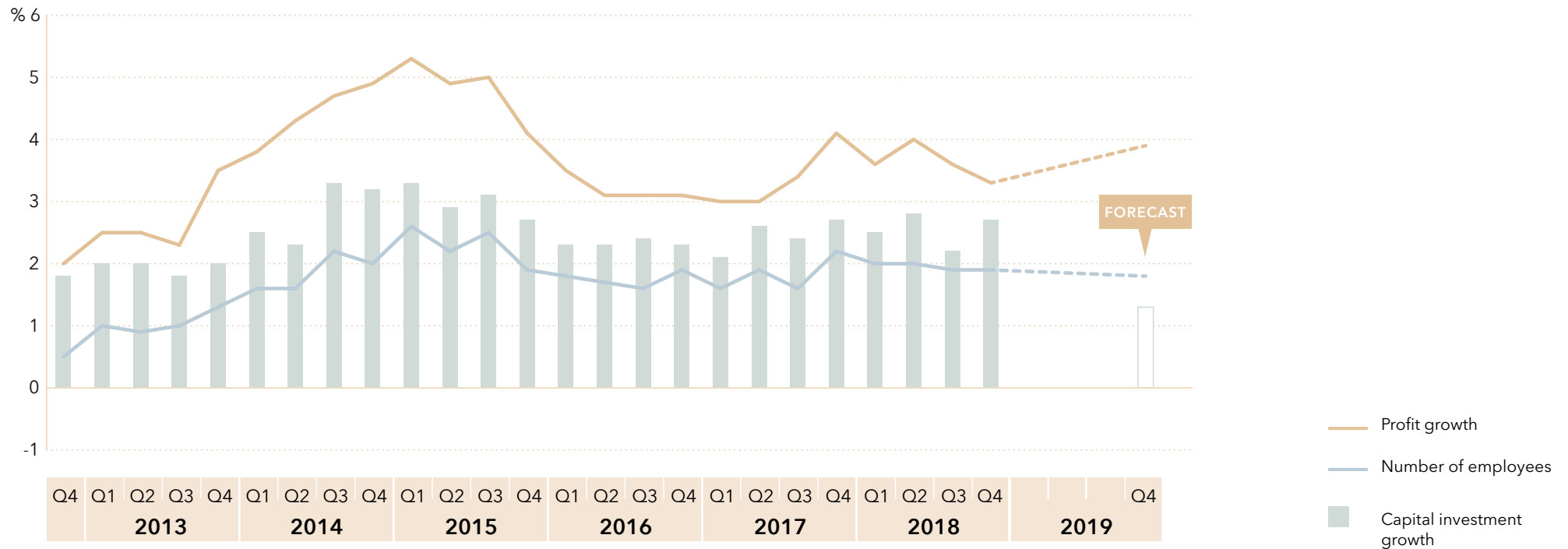


FIG. 6 CAPITAL INVESTMENT GROWTH, NUMBER OF EMPLOYEES AND PROFIT GROWTH - AVERAGE % CHANGE

Employment, and spending on all forms of investment, are growing only slowly. Although 44% of businesses are operating at full capacity, that measure is not trending upwards. So, there is no great pressure on companies to accelerate their capital spending. With business confidence very weak, investment is unlikely to increase significantly.

Growth in profits, while remaining positive, has been tracking downwards to 3.3% year-on-year in Q4 2018, after 4.1% a year earlier. In response to that,

companies are exercising caution with respect to their spending.

Both employment and capital investment are slower than the growth in sales and profit this quarter, at modest 1.9% and 2.7% respectively. A factor here is likely to be the proportion of businesses who are operating at full capacity. At 44% this is higher than earlier in the decade, but it has been on a flat trend for the past three years. That reduces the likelihood of any rapid pick-up in investment rates. But the lack of business confidence is probably the major

consideration here with the Budget's increase in investment allowances unlikely to be a tipping point for decisions.

Spending on Research and Development (R&D) and also on staff development is similarly modest. The rises are 2.0% and 1.7% respectively, year-on-year. Looking forward, expectations for all types of investment are below 2% growth.

Trends in business confidence: Industry

MOST SECTORS SHARE IN THE DECLINE IN CONFIDENCE

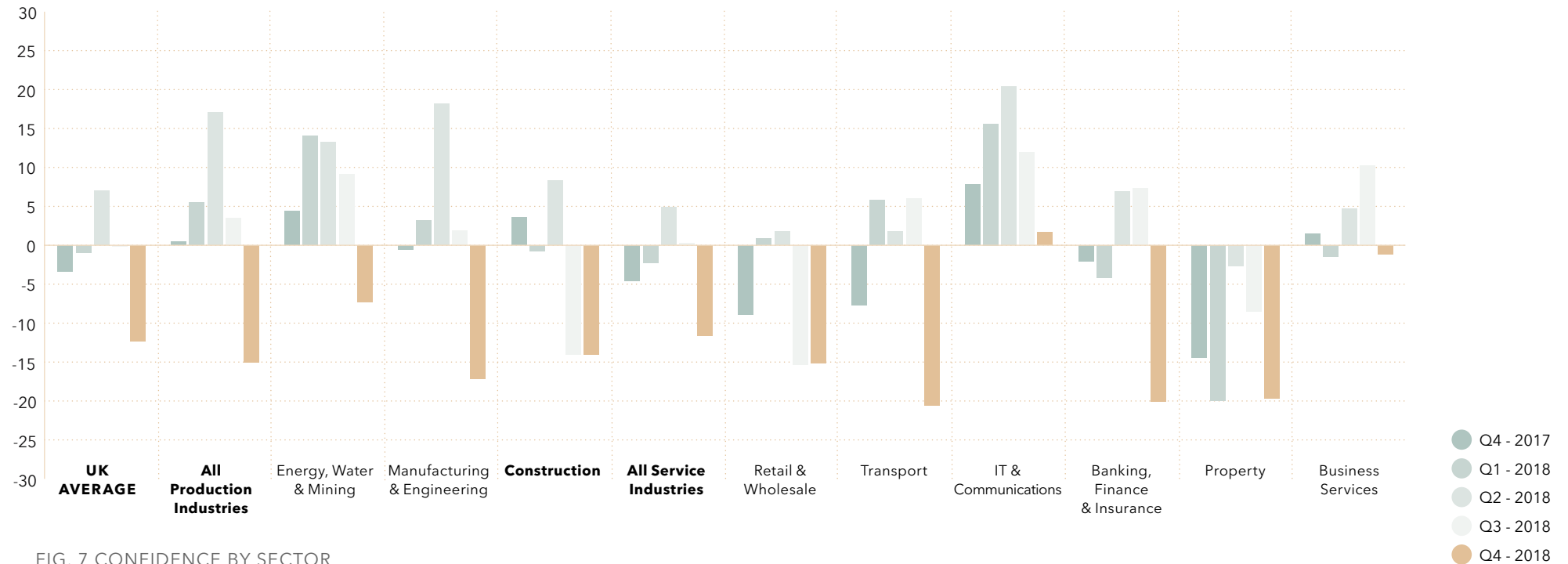


FIG. 7 CONFIDENCE BY SECTOR

Confidence is neutral or negative across sectors. While the Government’s proposed Brexit deal has been criticised for providing insufficient protection to businesses in the Service Sector, it is not the case that these are generally less confident than Production companies.

Confidence is negative in almost all sectors. The weakest sentiment is in the Transport & Storage and Banking, Finance & Insurance sectors at -20.6 and -20.1 respectively. That is consistent with the concerns that

have been widely expressed that the UK Government’s proposed Brexit deal does not explicitly seek to protect the trading arrangements of service sectors. However, the least pessimistic sectors are also service-based: IT & Communications and Business Services. Indeed, where confidence is concerned, Service Sectors are represented right across the spectrum.

It is likely that the relative resilience of the IT & Communications and Business Services sectors reflects the fact that sales growth over the year to Q4 2018 has been stronger in these sectors than in almost

any other. However, businesses in Banking, Finance & Insurance have also seen solid sales growth, but that has not provided much support to their overall sentiment.

One possibility is that companies in this sector feel more exposed to Brexit disruption than businesses in the other two sectors. Another is that Banking, Finance & Insurance companies are more affected by the growing challenges posed by regulations, some of which do relate exclusively to the finance sector.

Trends in business confidence: Region

ALL REGIONS ALSO SHARE IN THE DECLINE IN CONFIDENCE



FIG. 8 CONFIDENCE BY REGION

Confidence is in negative territory in every region, with the South West, Scotland, Northern England as well as West Midlands showing the greatest concerns. London is towards the least-pessimistic end of the range, probably helped by its IT & Communications and Business Services sectors.

All regions report confidence in negative territory, compared with six out of eleven in the third quarter. The West Midlands region is one of the most pessimistic regions, at -16.7. It is possible that more

companies in the region are deeply embedded in pan-EU supply chains than in other regions, reflecting its particular reliance on medium-sized engineering companies in the automotive and related sectors. These supply chains are widely seen as being particularly vulnerable to Brexit. Unsurprisingly, concern about marketplace competition in this region is on the way up, as is concern about non-managerial skills, to 40% and 39% of companies.

The South West confidence index is even more negative. The region has seen the second slowest

sales growth over the past year, at just 2.9%, with only Northern England reporting a weaker figure (1.7%).

It is also striking that London is among the least negative regions. It has experienced faster and more stable sales growth than most, although not markedly so. It seems likely that the strongly negative sentiment in the Banking, Finance & Insurance sector is being offset by the neutral position of the IT & Communications and Business Services sectors: all three are important to the capital.

Trends in business confidence: Company size

CONFIDENCE IS WEAKER AMONG QUOTED COMPANIES THAN UNQUOTED ONES

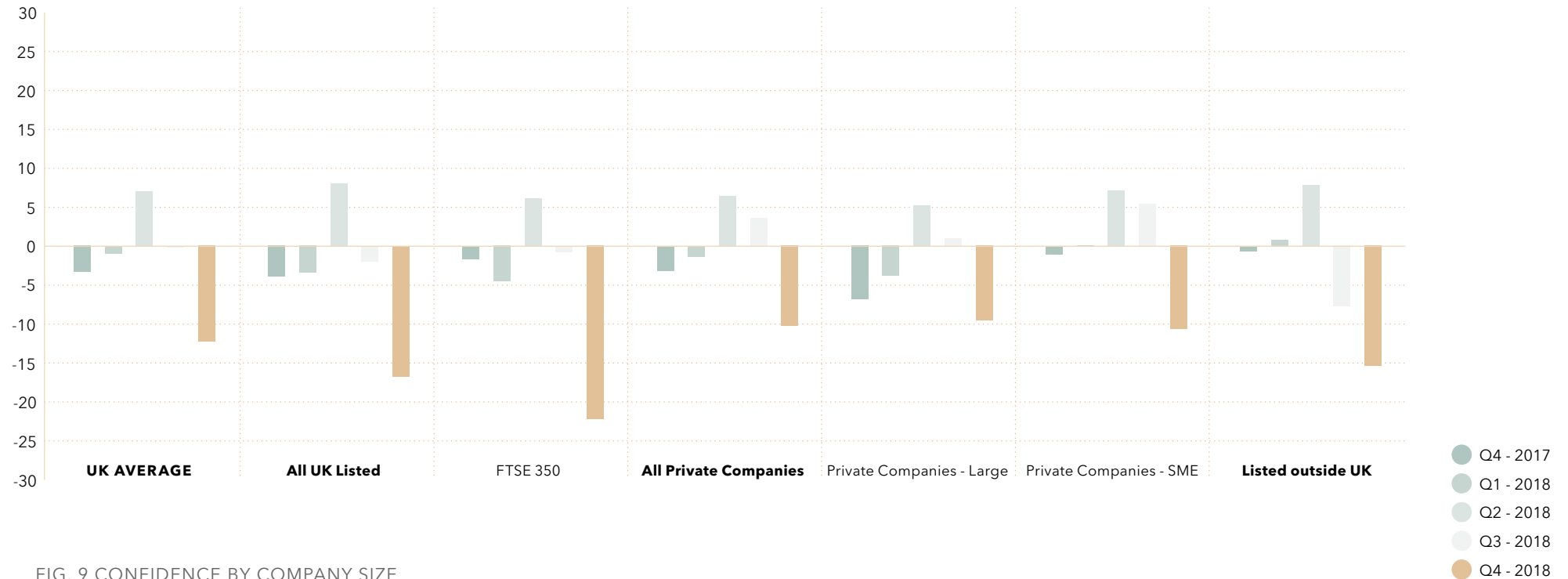


FIG. 9 CONFIDENCE BY COMPANY SIZE

Confidence is negative across all types of companies, with larger quoted businesses particularly anxious. It is possible that those companies have greater exposure to any difficulties created by Brexit.

Both quoted and non-quoted companies report confidence in negative territory. The same is true for both UK-quoted and overseas quoted businesses, and for large as well as small and medium-sized unquoted companies. Sentiment is therefore negative across all types of business.

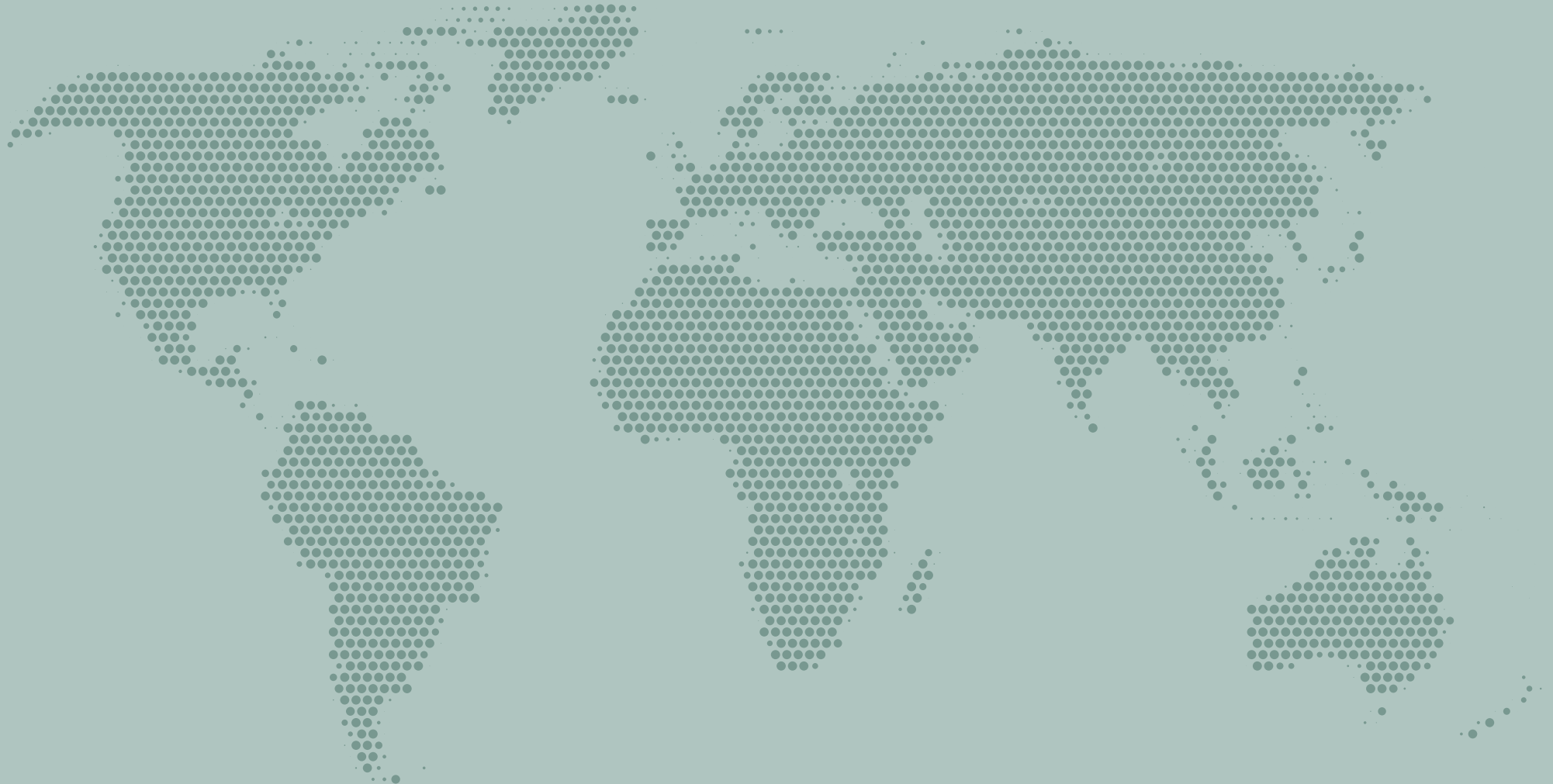
That said, the most negative balance applies to FTSE-350 companies. More generally, quoted companies listed in the UK are more pessimistic than privately-owned ones.

It is possible that this pattern reflects their concern around Brexit - if and how it would affect their plans for expansion, but also growing trade wars that perhaps may impact these types of companies more.

A higher proportion of companies in the UK-listed category are reporting concerns about customer demand (42%) and the availability of non-management skills (31%). This compares to 31% and 23% respectively at this time last year. The story is similar for non-UK listed companies. In contrast for privately owned companies, these concerns are neither as widespread or on such an upward trend.

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