Deloitte CFO Survey Q1 2024

Turning the corner

Optimism among the UK's largest businesses is running at well above average levels suggesting that the worst of the economic downturn is behind us. The latest Deloitte CFO Survey, conducted between 12th and 25th March, shows sentiment among the Chief Financial Officers (CFOs) of large UK businesses rising for the third consecutive quarter. Sentiment is well above its long-term average, and at levels that preceded periods of good growth in 2010, 2014 and 2021. Greater optimism is also reflected in expectations of corporate profitability. For the first time in three years, CFOs expect margins to increase over the next 12 months.

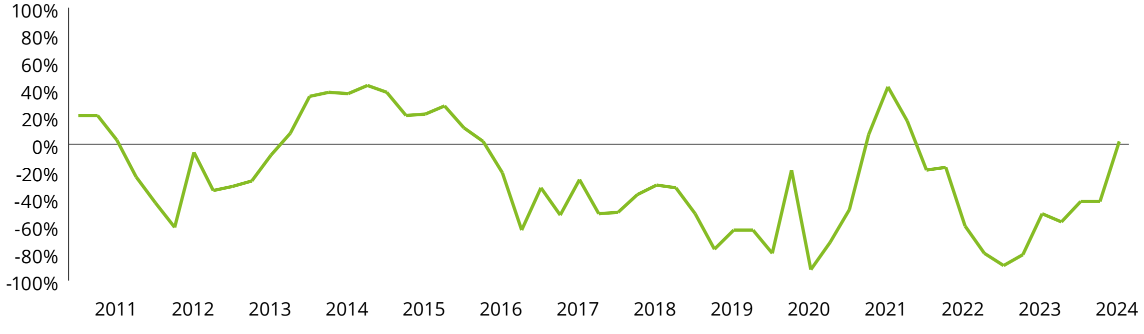
The uncertainties that have clouded the business scene for much of the last eight years, driven by Brexit, domestic politics, COVID and, in recent years, inflation, seem to be clearing. CFOs' perceptions of external risk facing their businesses have dropped to a two-and-a-half-year low. Our uncertainty index is running at less than half the peak seen in autumn 2022 in the wake of Russia's invasion of Ukraine as inflation gathered pace. A period of exceptionally high inflation that has dominated CFO thinking since late 2021 seems to be drawing to an end. Concerns about inflation, energy supply, labour shortages and interest rates have dropped down CFOs' list of worries. With inflation in retreat, CFOs believe the UK is on the verge of a significant easing of monetary policy. Over the next 12 months CFOs expect the Bank of England to cut the UK base rate from the current level of 5.25% to 4.25%. Credit conditions for major corporates, measured in the survey by asking about the pricing and availability of debt, deteriorated significantly in 2022 and early 2023. CFOs report that credit conditions have improved in the last six months with credit now reported to be more available than at any time in the last two years.

While the latest survey testifies to a broad-based improvement in sentiment, areas of concern remain.

CFOs see geopolitics as posing the greatest risk to their businesses over the next 12 months. This quarter's special question asked CFOs to assess the channels through which adverse geopolitical events could damage their own businesses. Of these, by far the greatest concern was that geopolitical developments could trigger cyber-attacks. Weaker demand and higher energy prices or reduced energy supply, ranked in second and third place in the list. And while CFOs are more optimistic about the general outlook, that does not apply to geopolitics. The overwhelming majority of CFOs expect geopolitical risk to increase or stay the same in the next three years. On this front at least, CFOs are anticipating further uncertainty.

The other qualification to an otherwise upbeat survey relates to firm strategies. Risk appetite and optimism are rising, and credit conditions have improved, but CFOs remain focussed on controlling costs and building up cash. For now, expansionary strategies, such as capital spending and bringing in new products or services, are on the backburner. Given the challenges of recent years it is perhaps unsurprising that, for all the good news, a degree of caution remains.

Chart 1. Outlook for corporate operating margins
Net % of CFOs who expect UK corporates' operating margins to increase over the next 12 months

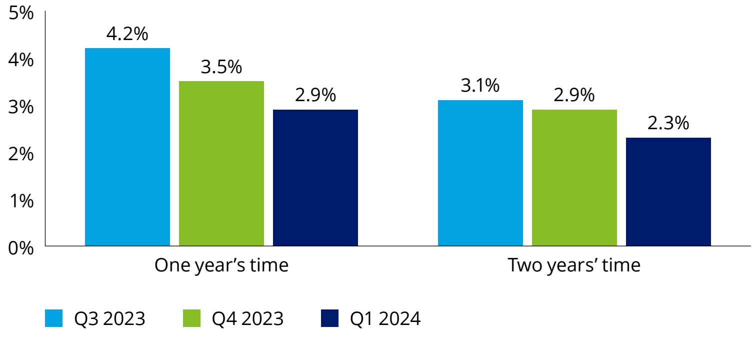


Credit conditions improve

Finance leaders' expectations for inflation have continued to fall. CFOs now expect inflation in a year's time to be at 2.9% and in two years' time to be at 2.3%, close to the Bank of England's 2% target.

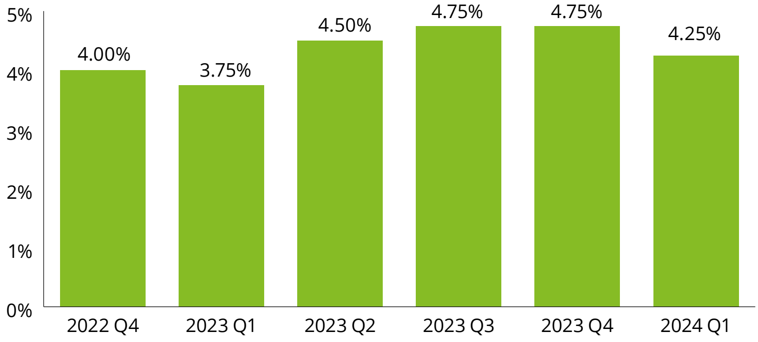
CFOs have a more cautious outlook on inflation than economists, who now expect it to approach the Bank's 2% target in the coming months.

Chart 2. Inflation expectations
CFOs' median expectations for inflation in one year's time and two years' time



CFOs expect the Bank of England's base rate to fall by one percentage point to 4.25% over the next 12 months. This is in line with financial market expectations.

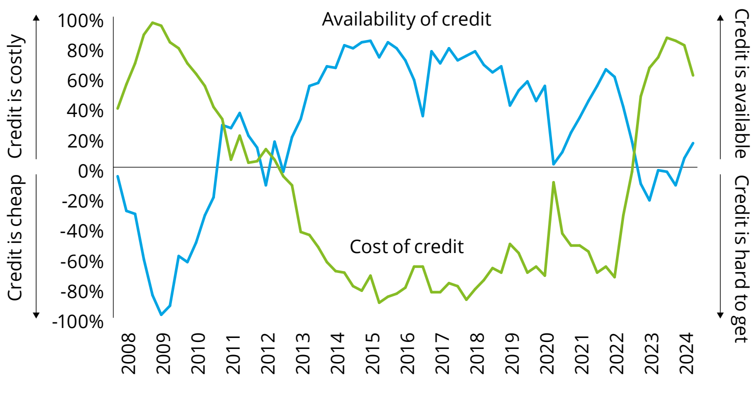
Chart 3. Interest rate expectations
CFOs' median expectations for the Bank of England's base rate in one year's time



A smaller majority of CFOs report that credit is costly this quarter, resulting in the lowest survey reading on credit costs since the autumn of 2022.

Credit availability has also improved, rising to its highest level in almost two years.

Chart 4. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available



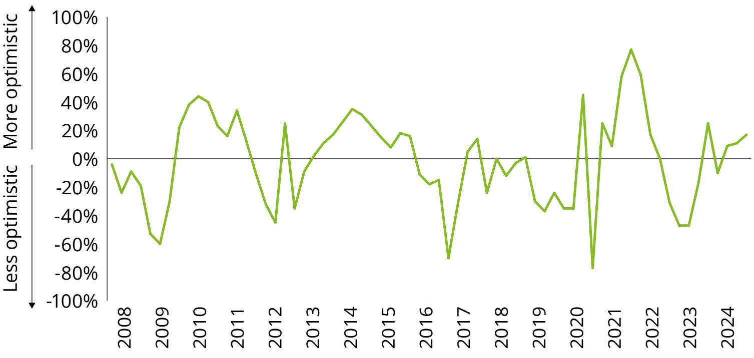
Business optimism up

Easing uncertainty and lower inflation and interest rate expectations seem to have fed through to a continued improvement in CFO optimism.

On balance, CFOs report feeling more optimistic about the financial prospects of their businesses now than three months ago.

Chart 5. Business optimism

Net % of CFOs who are more optimistic about the financial prospects of their business than three months ago

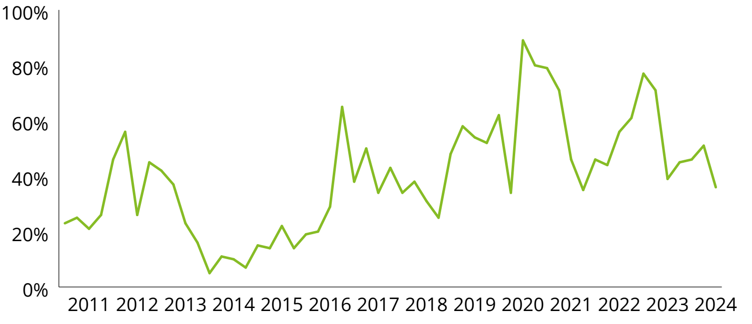


The proportion of CFO panellists reporting high or very high levels of uncertainty facing their businesses has fallen to 36% - a two-and-a-half-year low.

On this measure, uncertainty is running at less than half the peak seen in mid-2022, when energy prices and inflation rose sharply in the wake of Russia's invasion of Ukraine.

Chart 6. Uncertainty

% of CFOs who rate the level of external financial and economic uncertainty facing their business as high or very high



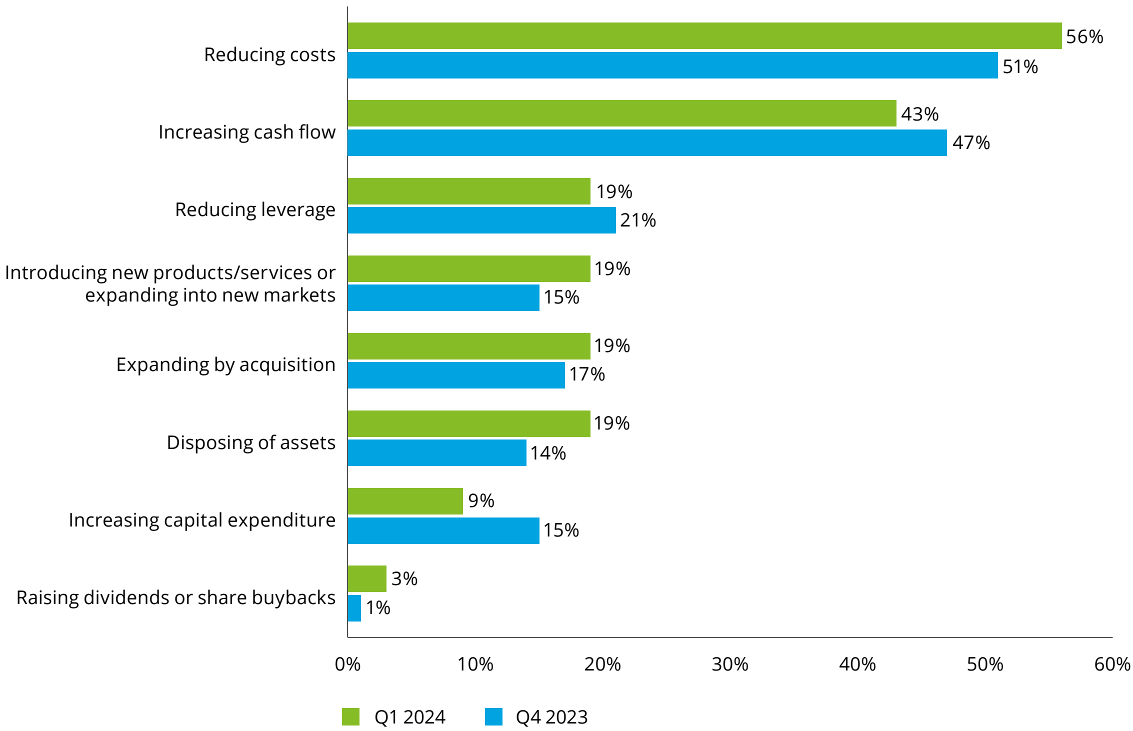
The percentage of CFOs who see this as a good time to take greater risk onto their balance sheets has risen slightly to 20%.

Chart 7. Corporate risk appetite

% of CFOs who think this is a good time to take greater risk onto their balance sheets

Defensive strategy stance

Chart 8. Corporate priorities in the next 12 months
% of CFOs who rate each of the following as a strong priority for their business in the next 12 months

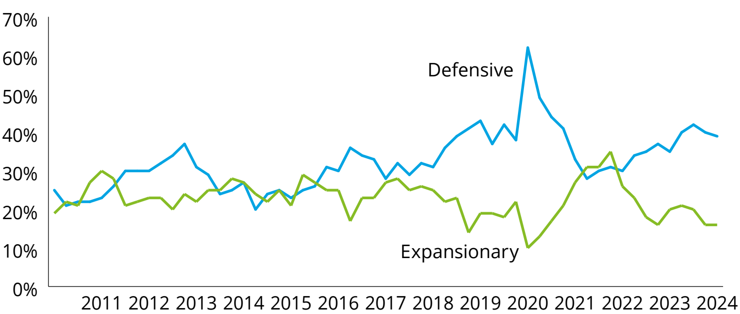


Despite greater optimism, CFOs plan to maintain a defensive strategy stance over the next 12 months. Cost reduction, boosting cash flow and paying down debts remain the first order of business for the large UK corporates represented on our panel. While CFOs are placing greater emphasis on some expansionary strategies, such as introducing new products or expanding into new markets and pursuing acquisitions, their capex intentions have fallen to the lowest level in three-and-a-half years.

CFOs seem to be waiting for evidence of a more established recovery before tilting towards a more expansionary strategy stance.

For now, the gulf between defensive and expansionary strategies remains at its widest since the third quarter of 2020.

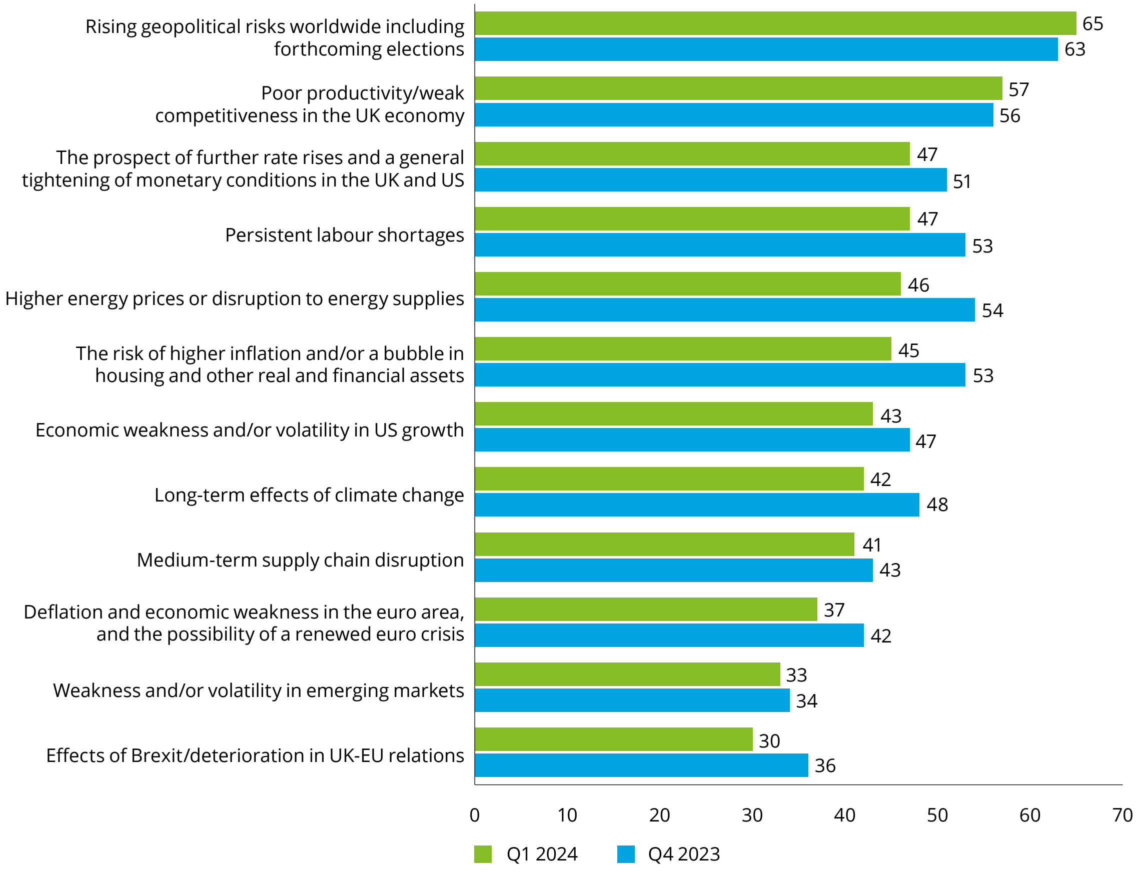
Chart 9. Expansionary and defensive strategies*
Arithmetic average of the % of CFOs who rate expansionary and defensive strategies as a strong priority for their business in the next 12 months



* Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

Geopolitics is top risk

Chart 10. Risk to business posed by the following factors
Weighted average ratings on a scale of 0-100 where 0 stands for no risk and 100 stands for the highest possible risk



Geopolitics has topped CFOs' risk list for the seventh time in nine quarters. Concerns about an escalation of the war in Ukraine, risks to regional stability and further disruption to Red Sea shipping posed by continued conflict in Gaza, and the impact of forthcoming elections, including in the US, on ongoing conflicts and global trade seem to be weighing on CFOs' minds.

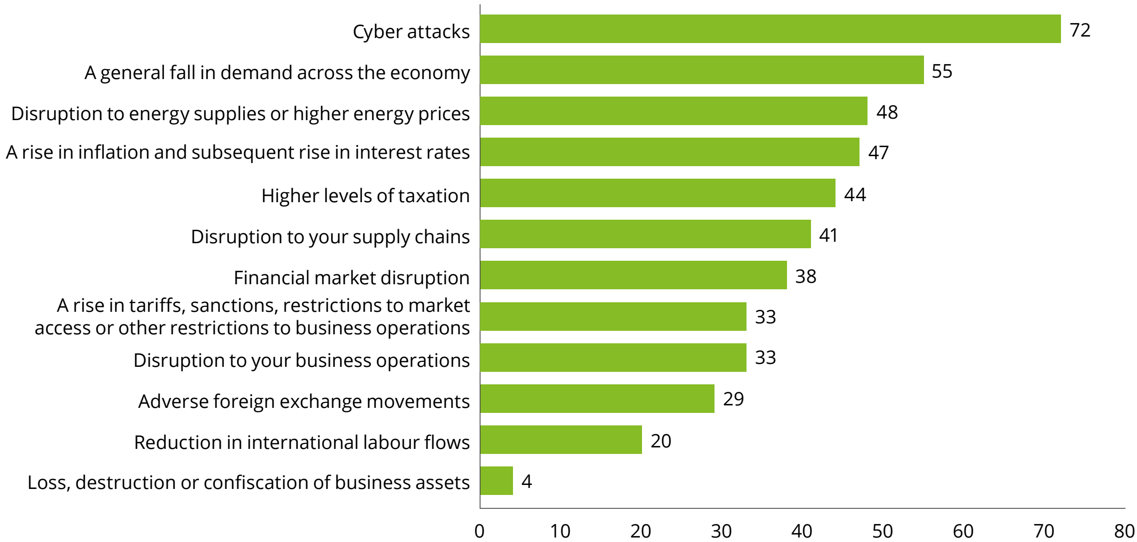
With the UK economy having barely grown since early 2022, worries over poor productivity and competitiveness have risen. They rank second on the risk list this quarter, with CFOs assigning them the joint-highest risk rating in ten years.

More encouragingly, concerns over inflation and further rate rises have reduced, fitting with a picture of improving credit conditions. Easing concerns over energy prices and labour shortages also seem consistent with decreasing inflation expectations.

Worries over the effects of Brexit or a deterioration in UK-EU relations have fallen to the bottom of the risk list, with CFOs assigning it the lowest risk rating on record.

Cyber danger faces UK firms

Chart 11. Consequences of adverse geopolitical developments
CFOs' concern over the following possible consequences of adverse geopolitical developments on their business over the next three years considering both their likelihood and potential impact on their business. Results are presented as a weighted average on a scale from 0-100 where 0 stands for no concern and 100 stands for significant concern



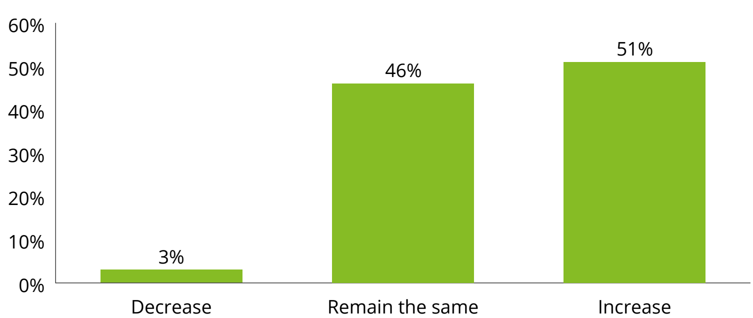
This quarter, we asked CFOs to assess the channels through which adverse geopolitical events could damage their own businesses over the next three years. By far, their greatest source of concern was cyber attacks. This seems to reflect growing media coverage of UK business outages caused by cyber incidents and warnings to corporates from public bodies such as the National Cyber Security Centre, which recently highlighted an "enduring and significant threat" from various state-aligned groups to critical national infrastructure and the businesses running them.

Corporates are also concerned about a potential repeat of the recent energy crisis, which pushed inflation to multi-decade highs and crimped demand across the economy. Weaker demand and higher energy prices or reduced energy supply came in second and third on CFOs' list of adverse consequences of geopolitical events.

On a brighter note, our panellists rate loss, destruction or confiscation of their business's assets due to geopolitical developments as a negligible source of concern.

CFOs' optimism about the general outlook does not seem to apply to geopolitics. The overwhelming majority of CFOs expect geopolitical risk to increase or stay the same over the next three years.

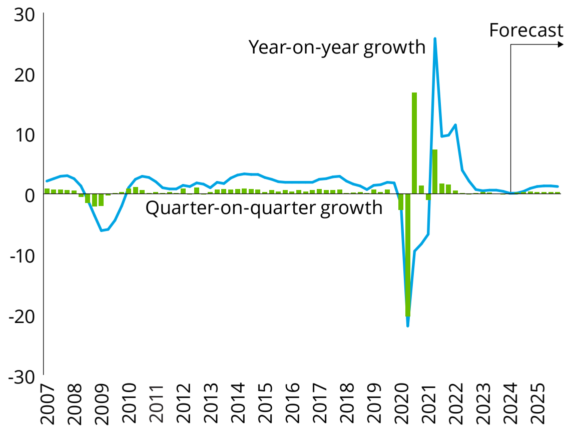
Chart 12. Outlook for geopolitical risk
% of CFOs who expect the level of geopolitical risk facing their business to do the following over the next three years



CFO Survey: Economic and financial context

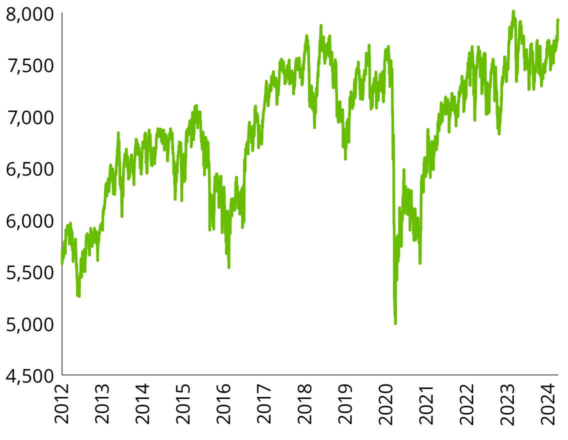
The macroeconomic backdrop to the Deloitte CFO Survey Q1 2024
Restrictive monetary policy from major western central banks continued to weigh on economic output in the first quarter of 2024. Euro area activity remained particularly weak while the UK economy showed signs it was gradually recovering from the technical recession it suffered in the second half of 2023. US growth remained strong and forecasts for this year were upgraded as economists became increasingly confident the world's largest economy has managed to engineer a soft landing. In China, growth remains well below its pre-pandemic average due to several headwinds, including deflation and a sharp slowdown in its housing market. Despite below-par global growth, the outlook has improved over recent months, with activity remaining broadly resilient and inflation falling faster than expected. The impetus for inflation, supply chain disruption and higher energy prices has faded and higher interest rates have squeezed demand. Despite this, labour markets remain relatively tight, with low unemployment and strong wage growth. The US Federal Reserve, the Bank of England and the ECB held rates constant at their multi-decade highs and have intimated they will start cutting rates this year. Financial markets expect the first rate cuts to come in the summer of this year. Equity markets were buoyed by the brighter economic outlook and the prospect of interest rate cuts with the S&P 500 reaching a record high. Global geopolitical tensions remain elevated due to the ongoing conflicts in the Middle East and Ukraine.

UK GDP growth: Actual and forecast (%)



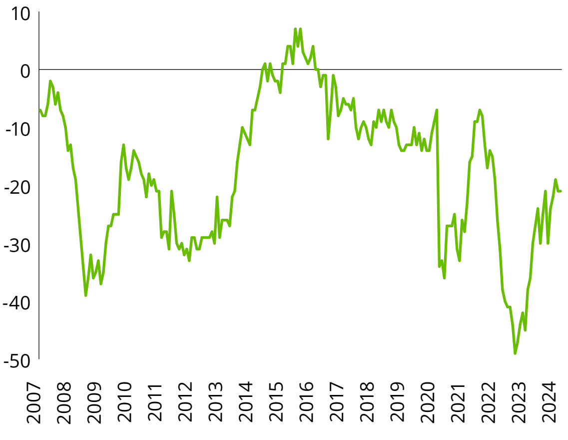
Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index



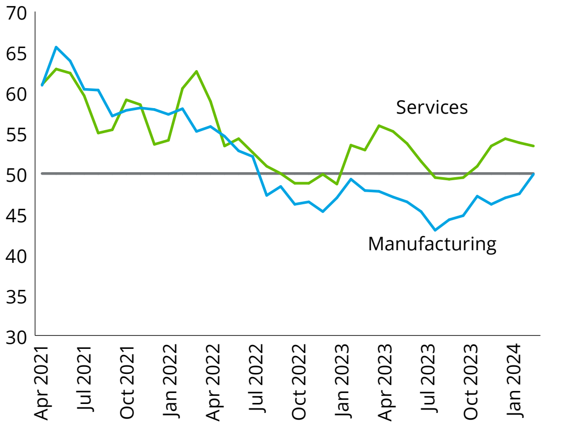
Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)



Source: Refinitiv Datastream

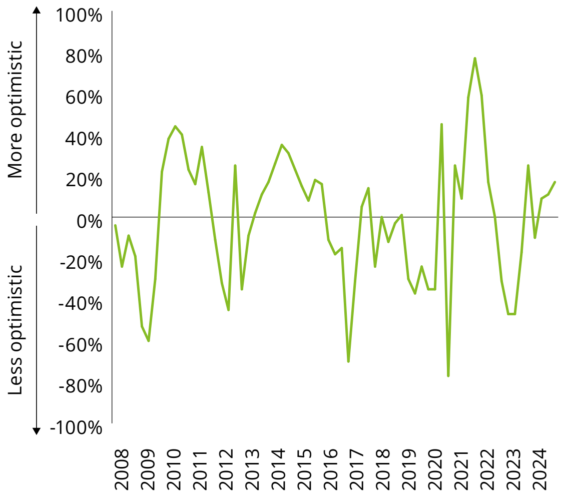
S&P Global/CIPS Purchasing Managers' Indices (UK)



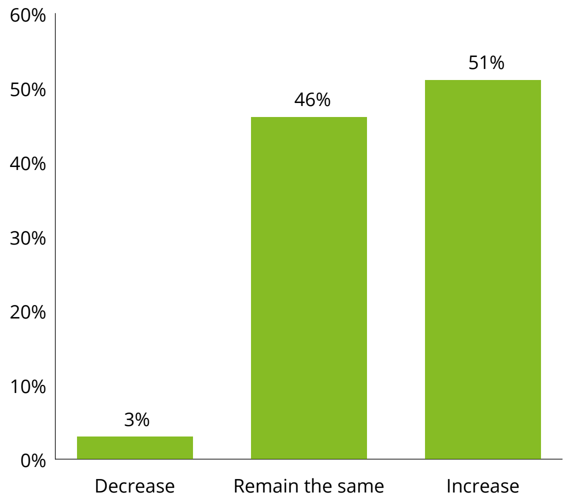
Source: Refinitiv Datastream, readings above 50 indicate expansion

Two-chart summary of key survey messages

Business optimism
Net % of CFOs who are more optimistic about the financial prospects of their business than three months ago



Outlook for geopolitical risk
% of CFOs who expect the level of geopolitical risk facing their business to do the following over the next three years



About the survey
This is the 67th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2024 first quarter survey took place between 12th March and 25th March. Overall, 64 CFOs participated, including the CFOs of 8 FTSE 100 and 23 FTSE 250 companies. The rest were CFOs of other UK-listed companies, large private companies and UK subsidiaries of major companies listed overseas. The combined market value of the 37 UK-listed companies surveyed is £201 billion, or approximately 8% of the UK quoted equity market.

The Deloitte CFO Survey is the only survey of major corporate users of capital that gauges attitudes to valuations, risk and financing. To join our panel of CFO respondents and for additional copies of this report, please contact Elaine Hoang on 020 7007 4717 or email ehhoang@deloitte.co.uk.

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For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit: **www.deloitte.co.uk/cfosurvey**

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