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Q1 2022

The Deloitte CFO Survey

Growth in a riskier world

Elevated geopolitical risk in the wake of the invasion of Ukraine and high inflation mean that external risks to business are greater today than at any time in the last seven years, according to the Chief Financial Officers of the UK's largest companies. Geopolitics and inflation now far eclipse Brexit and the pandemic, which have dominated the list of CFO concerns in recent years.

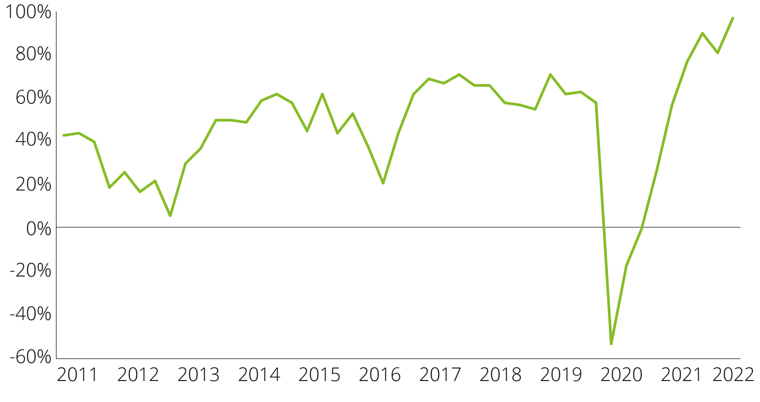
Rising inflation is the great challenge for business, with CFOs' expectations for operating cost rises at a record high. Just two years ago a majority of CFOs anticipated a decline in costs, now 98% expect them to rise. More than a quarter reported significant or severe supply chain disruption in the last 3 months and more than a third faced significant or severe recruitment difficulties.

CFOs expect supply chain and recruitment problems to moderate, but persist, and are more concerned about the longer-term outlook for inflation.

Most CFOs do not expect the Bank of England to succeed in returning inflation to its 2.0% target within its two-year forecasting horizon, indeed almost 80% expect inflation to exceed 2.5% in two years' time. A mix of rising costs and slower growth is set to squeeze margins, with 71% of CFOs expecting margins to decline in the next 12 months.

The 13 years in which the CFO Survey has been running have been a period of unimagined risk, Brexit, geopolitical tensions, deflation and inflation, the pandemic and now war in Europe. For CFOs, elevated uncertainty is increasingly a fact of life that has to be managed and mitigated. Despite the risks facing business today, CFOs remain upbeat on the prospects for revenue growth, with three-quarters expecting revenues to be higher in a years' time. Introducing new products or services or entering new markets remains their top priority. And, while expectations for capital spending are down from the all-time highs seen last quarter, they remain well above the long-term average.

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



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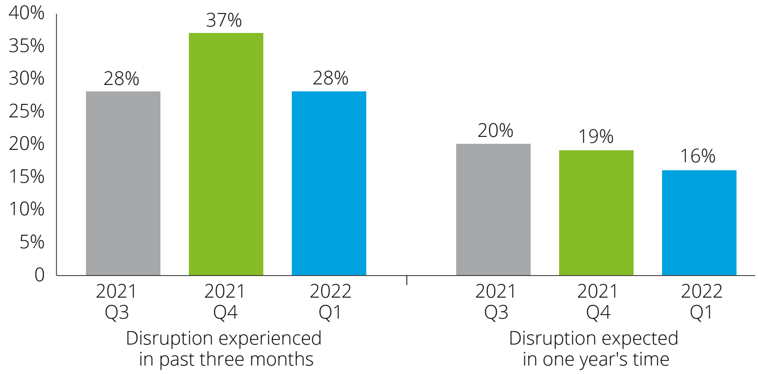
For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:
www.deloitte.co.uk/cfosurvey

Inflation expectations at record high

More than a quarter of CFOs reported significant or severe levels of supply chain disruption in the first quarter. They expect a modest improvement in conditions, with one in six CFOs anticipating similar levels of disruption in a year's time.

Chart 2. Supply chain disruption

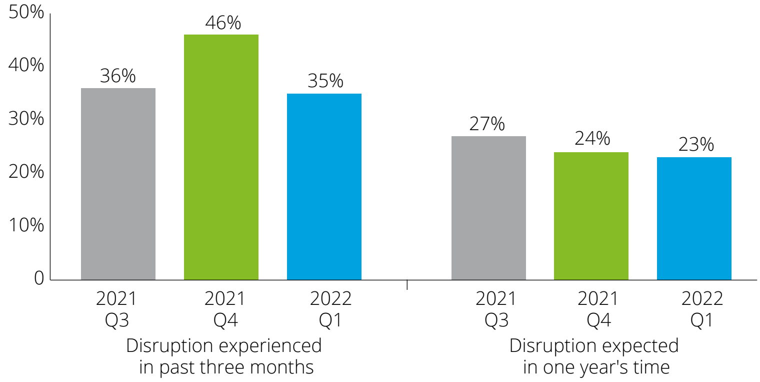
% of CFOs who report significant or severe levels of supply chain disruption experienced by their business over the last three months and those expecting similar levels of disruption in one-year's time



Just over a third of CFOs surveyed reported that their firms have faced significant or severe recruitment difficulties in the first quarter, an improvement from the fourth quarter's reading. But there's little change in expectations for labour shortages in a year's time, which around one in four CFOs continue to rate as significant or severe.

Chart 3. Recruitment difficulties and labour shortages

% of CFOs who report significant or severe levels of recruitment difficulties or labour shortages experienced by their business over the last three months and those expecting similar levels of disruption in one-year's time

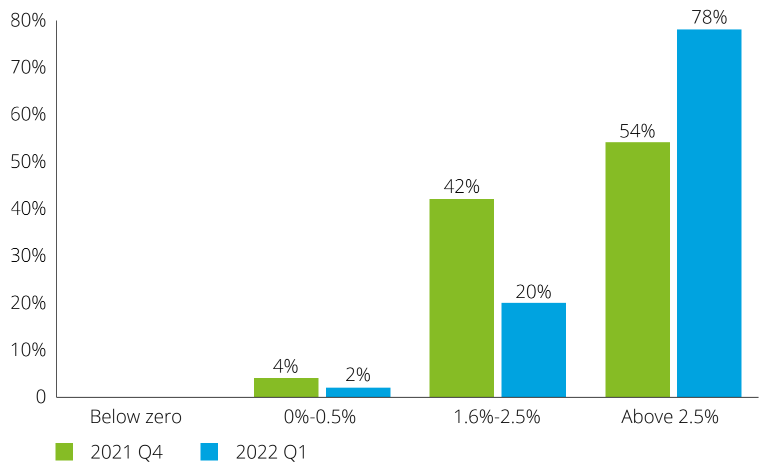


Anticipating persistent labour shortages and supply disruptions, CFOs also expect inflation to run higher for longer.

78% expect inflation to exceed 2.5% in two-years' time – the highest reading since we started asking this question in 2013. More than half of the CFOs surveyed expect inflation to settle between 2.5% and 3.5% in two-years' time and a quarter expect it to remain above 3.5%.

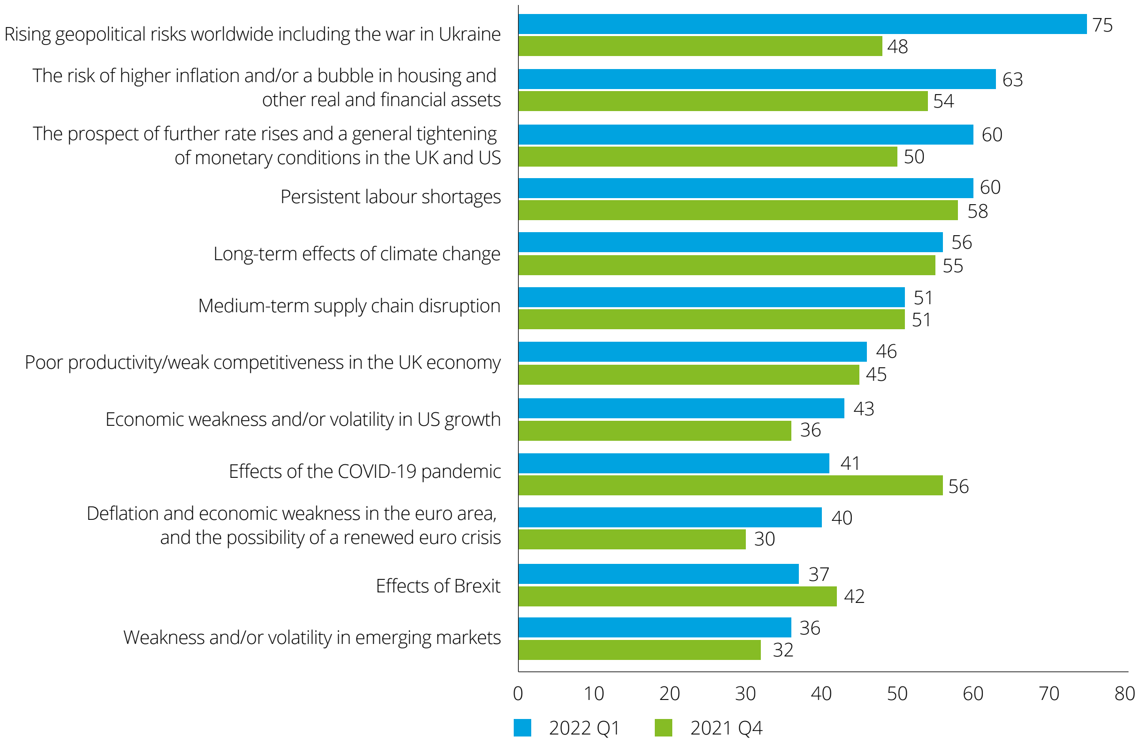
Chart 4. Inflation expectations

% of CFOs who expect inflation to be at the following levels in two-years' time



Geopolitics surges to top of risk list

Chart 5. Risk to business posed by the following factors
Weighted average ratings on a scale of 0-100 where 0 stands for no riskand 100 stands for the highest possible risk



With the war in Ukraine pushing up energy prices and disrupting supply chains, geopolitics has surged to the top of CFOs' risk list. They have assigned a higher risk rating to it than that assigned to Brexit or any other factor on record, with the exception of the pandemic in 2020. Higher inflation, the prospect of further rate rises and persistent labour shortages also rank high up CFOs' list of concerns.

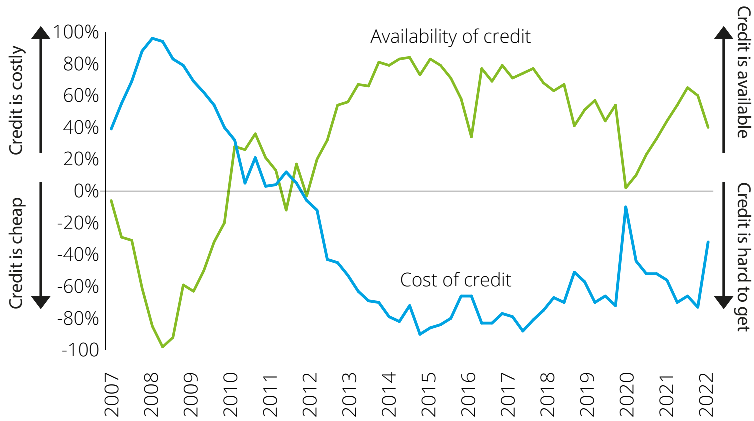
As talk of US recession risk grows, CFOs have rated US economic weakness as a greater risk to their businesses than the effects of the pandemic, which has registered the largest decrease in risk ratings from the previous quarter. Concern over European and emerging market economies has also risen, although they continue to feature at the bottom of the list.

Tighter credit conditions, margins under pressure

CFOs report some deterioration in credit conditions. The cost of credit has risen sharply and availability fallen. However, on balance, the large corporates on our panel continue to rate credit as cheap and easily available.

Chart 6. Cost and availability of credit

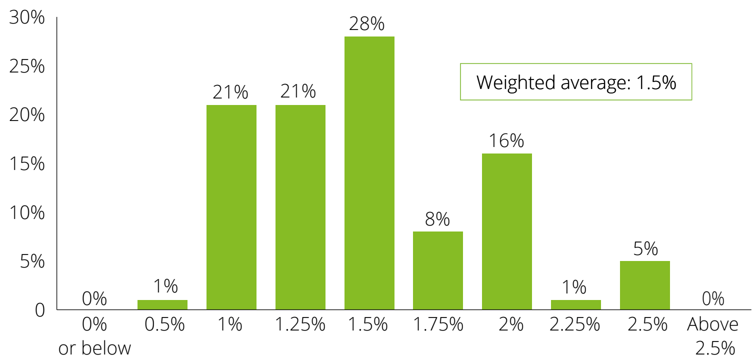
Net % of CFOs reporting credit is costly and credit is easily available



CFOs expect interest rates to rise substantially over the next twelve months. On average, they expect the base rate to be 1.5% in a year's time, double its present level of 0.75% but below current market expectations.

Chart 7. Interest rate expectations

% of CFOs who expect the Bank of England's base rate to be at the following levels in a year's time

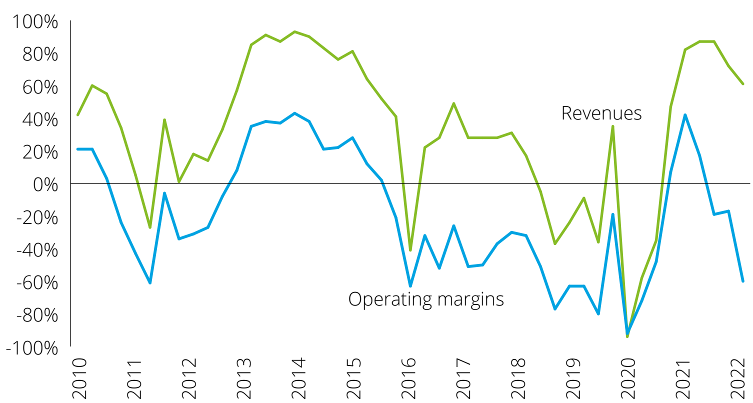


There has been a sharp deterioration in the outlook for margins over recent quarters as operating costs have surged. A net 60% of CFOs expect margins to fall over the next 12 months.

Since we began asking this question, margin and revenue growth expectations have tended to move together. For the first time, a wide divergence has opened up between the two, with CFO expectations for revenue growth still at very high levels despite a slight decline in the first quarter.

Chart 8. Outlook for revenue and margins

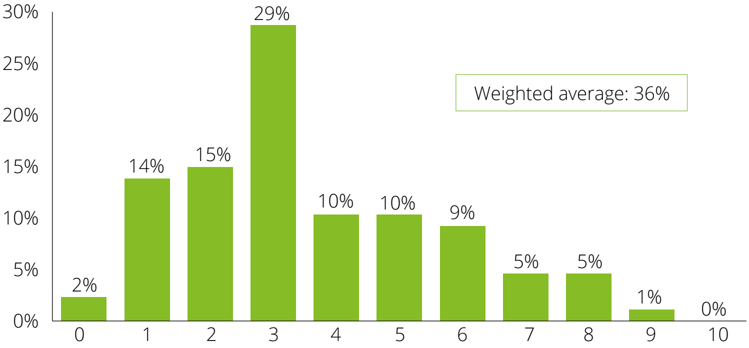
Net % of CFOs who expect UK corporates' revenue and operating margins to rise over the next 12 months



Modest fall in risk appetite

While the risk rating assigned by CFOs to the pandemic has never been lower, they still see a distinct possibility of future COVID-19 restrictions. On average, CFOs assign a more than one in three chance to the imposition of new restrictions in the next three years.

Chart 9. COVID-19 restrictions
CFOs' assessment of the likelihood that COVID-19 restrictions are reimposed in the UK at any time in the next three years on scale of 0-10 where 0 is no possibility and 10 is a complete certainty



The war in Ukraine has heightened CFO perceptions of financial and economic uncertainty facing their businesses, with 56% rating it as high or very high – well below levels seen during the pandemic in 2020.

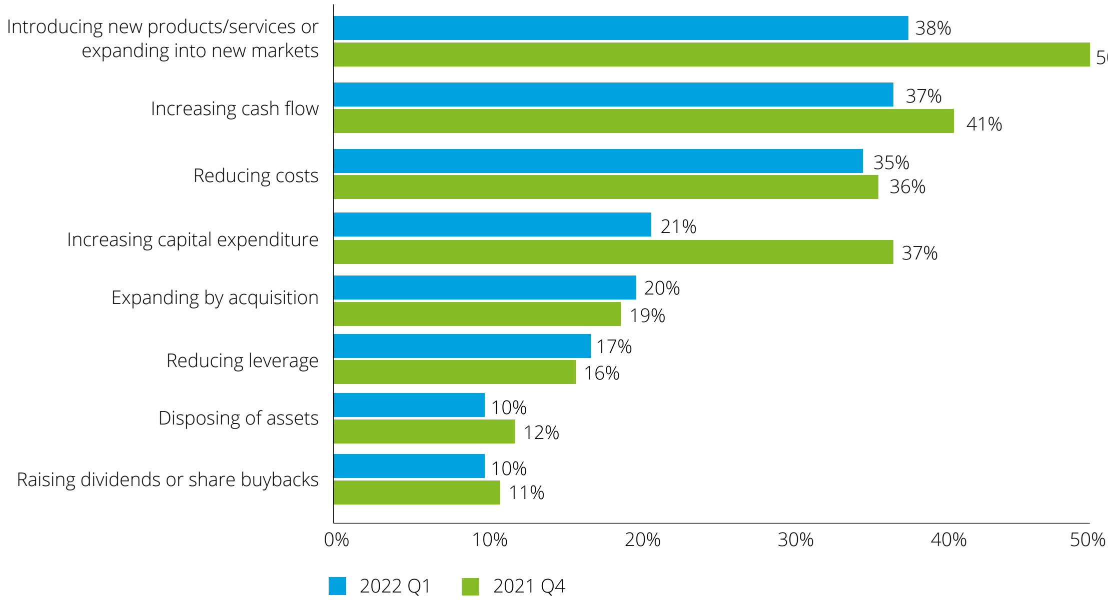
Chart 10. Uncertainty
% of CFOs who rate the level of external financial and economic uncertainty facing their business as high or very high

In keeping with the rise in uncertainty, corporate risk appetite has decreased in the first quarter. However CFOs' current enthusiasm for risk is greater than in 11 of the last 16 quarters.

Chart 11: Corporate risk appetite
% of CFOs who think this is a good time to take greater risk onto their balance sheets

Capex intentions remain above pre-pandemic levels

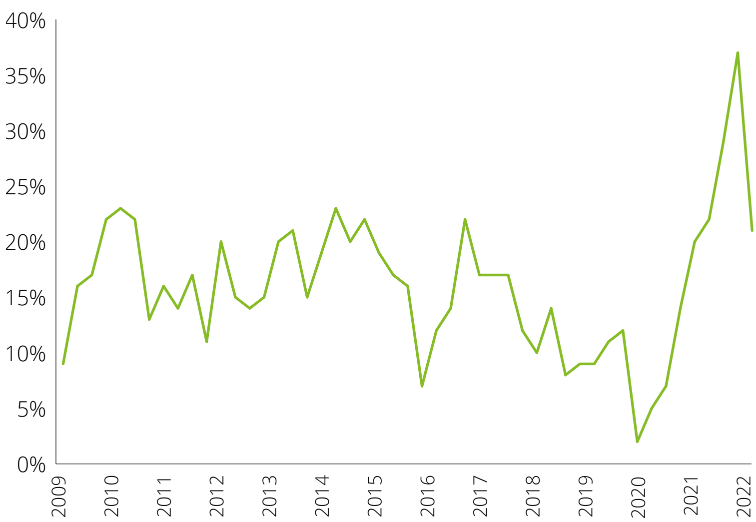
Chart 12. Corporate priorities in the next 12 months
% of CFOs who rate each of the following as a strong priority for their business in the next 12 months



CFOs have responded to the increase in external uncertainty by weakening their focus on expansionary strategies such as introducing new products or expanding into new markets, and increasing capital spending. But this is not a wholesale shift towards defensiveness. In fact, CFOs are also placing less emphasis on defensive strategies such as reducing costs or increasing cashflow.

Following a record reading in the last quarter of 2021, the proportion of CFOs reporting that increasing capital spending is a strong priority has dropped to 21% but remains well above its five-year average of 14%.

Chart 13. Corporate capital expenditure
% of CFOs who rate increasing capital expenditure as a strong priority for their business in the next 12 months

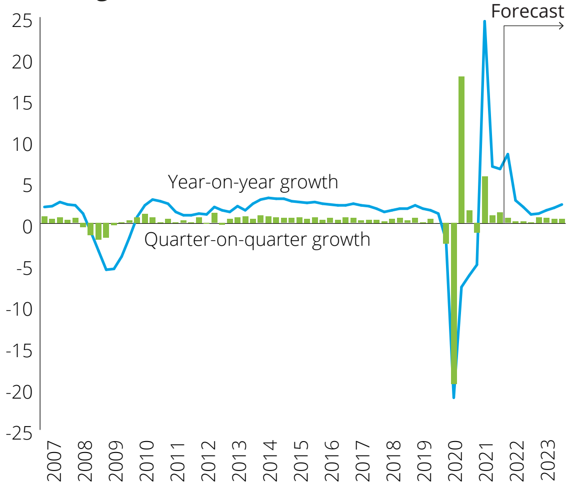


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q1 2022

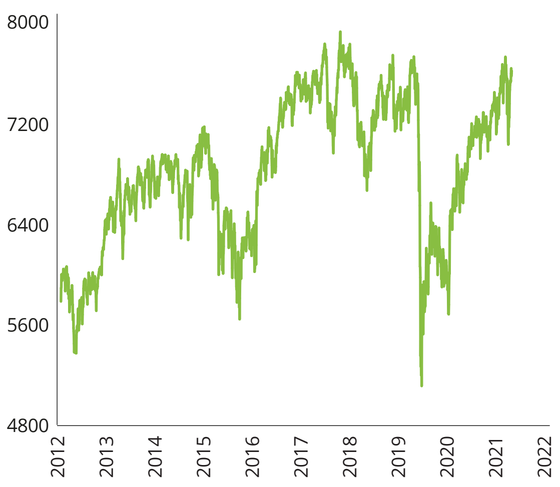
The first quarter of 2022 began with reported new COVID-19 cases in the UK at record levels and England under 'Plan B' restrictions including advice to work from home. The restrictions continued through January, hitting consumer mobility. Fears of a Russian invasion of Ukraine were confirmed on 24 February, shocking the world. Global equity markets sold off sharply before recovering while commodity prices soared. Europe saw the largest downgrades to its growth forecasts amid reports of supply chain disruption and loss of trade. Fears over the supply of Russian gas, which continues to flow at the time of writing, and sanctions on Russian oil drove energy prices to extraordinary highs. Energy prices later stabilised, but remain elevated relative to pre-invasion levels. The rising cost of energy, in addition to existing price pressures, drove inflation in the US, UK and euro area to multi-decade highs and raised expectations of faster monetary tightening by western central banks. Activity growth remained strong in the UK, US and euro area but fears over falling real consumer incomes and the inversion of the yield curve in the US have led to growing talk of the risk of recession. Concerns also rose over weaker demand in China as a sharp rise in COVID-19 cases and its zero-COVID policy resulted in strict lockdowns, disrupting output in several major cities.

UK GDP growth: Actual and forecast (%)



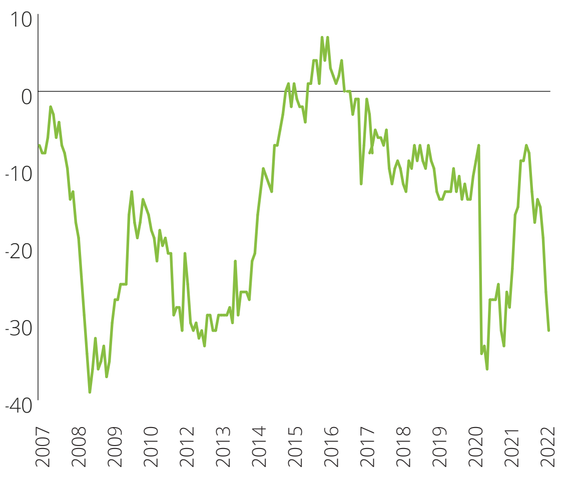
Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index



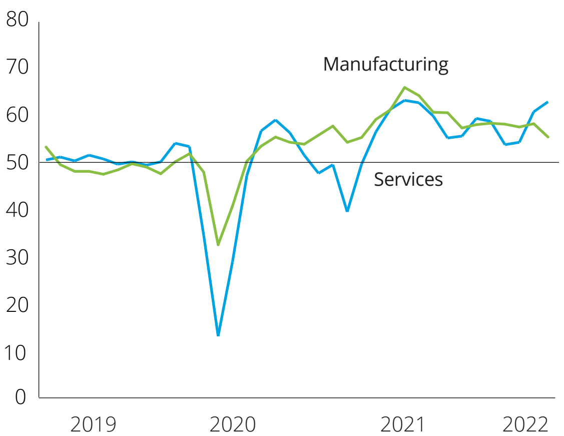
Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)



Source: Refinitiv Datastream

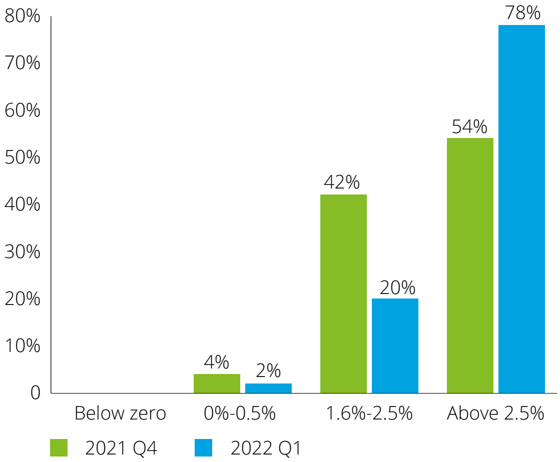
Markit Purchasing Manager Indices (UK)



Source: Refinitiv Datastream, readings above 50 indicate expansion

Two key survey messages

Inflation expectations
% of CFOs who expect inflation to be at the following levels in two-years' time



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

About the survey
This is the 59th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2022 first quarter survey took place between 16th March and 30th March. 89 CFOs participated, including the CFOs of 22 FTSE 100 and 34 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 58 UK-listed companies surveyed is £526 billion, or approximately 20% 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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