

The Deloitte CFO Survey

Defensive and watchful

The second quarter survey of Chief Financial Officers reveals growing concerns about Brexit on the part of CFOs and a marked shift towards more defensive balance sheet strategies. Uncertainty about the timing and the nature of the Brexit settlement has added to CFO worries about the final destination of the process. Three-quarters of CFOs expect Brexit to lead to a deterioration in the business environment in the long term, the highest proportion since we asked this question in the immediate aftermath of the referendum in late June 2016.

The boost to CFO spirits that we saw in the last survey, carried out in March following the announcement of the Brexit transition deal, has been short-lived. CFOs once again rank Brexit as the top risk facing their business, with concerns about weak UK demand in second place. In a sign of a more challenging international backdrop CFO concerns around protectionism and a slowdown in the euro area increased in the second quarter.

CFOs are reacting to a weaker domestic outlook with a sharper focus on cost control and building up cash. UK corporates are placing as much emphasis on running defensive balance sheet strategies as they did at the height of the euro crisis in 2012 and immediately after the EU referendum. Increasing cash flow is CFOs' top balance sheet priority with cost reduction in second place.

Wage inflation has been relatively muted in recent years. But with the unemployment rate at a 43-year low, and inflows to the UK labour force from overseas slowing, skills shortages are building up. 44% of CFOs report that recruitment difficulties or skills shortages have risen in the last three months, up from 31% in the first quarter. Any sustained rise in wages would clearly add to the challenges facing corporates as they seek to rein in costs.

Business sentiment continues to be buffeted by the news on Brexit. The mid-year position of the UK corporate sector is defensive and watchful. How that changes over the rest of 2018 will be heavily dependent on the unfolding negotiations between the UK and the EU in the next six 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

Chart 1. CFO priorities: Defensive strategies



The % of CFOs who rated defensive strategies as a strong priority for their business in the next 12 months. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

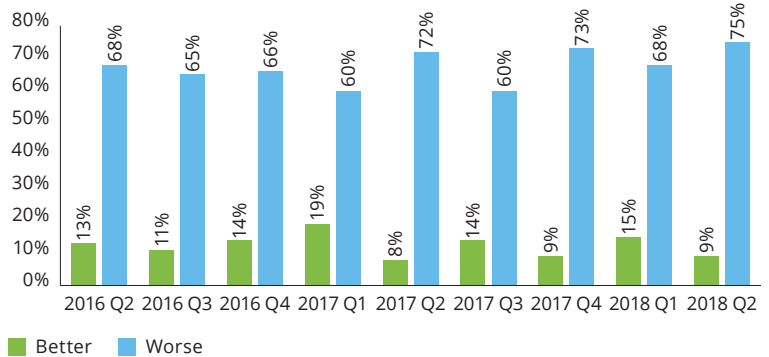
Brexit pessimism rises

CFO pessimism over the long-term impact of Brexit is at its highest level since we started asking the question in the summer of 2016.

Three-quarters of CFOs expect Brexit to lead to a worsening in the overall environment for business in the long term.

Chart 2. Long-term impact of Brexit

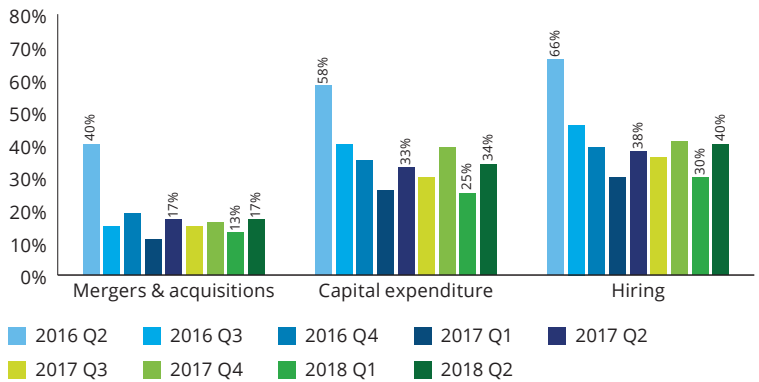
% of CFOs who think the overall environment for business in the long term will be better/worse if the UK leaves the EU (excluding those who expect no material change)



CFOs expect to reduce their own spending as a result of Brexit. 40% intend to scale back their hiring plans and those who plan on reducing capital expenditure over the next three years has risen to a third from 25% last quarter.

Chart 3. Effect of Brexit on own spending and hiring decisions

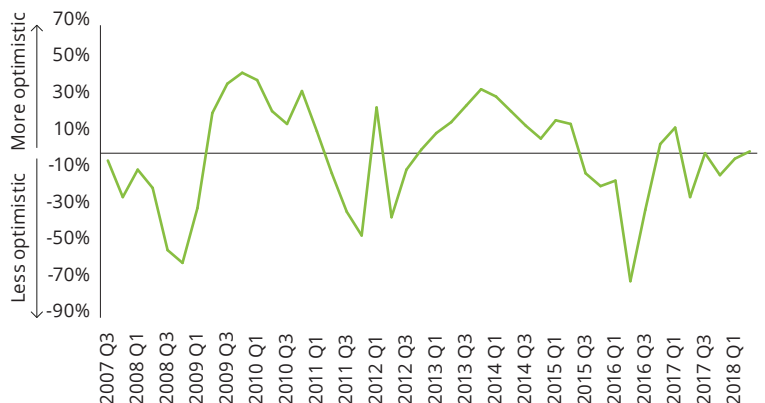
% of CFOs who expect M&A activity, capital expenditure and hiring by their business to decrease over the next three years as a consequence of Brexit



Despite concerns over the effects of Brexit, CFO optimism edged higher in the second quarter.

Chart 4. Business optimism

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



Rise in recruitment difficulties

CFO risk appetite remains well below its long-term average.

Chart 5. Corporate risk appetite

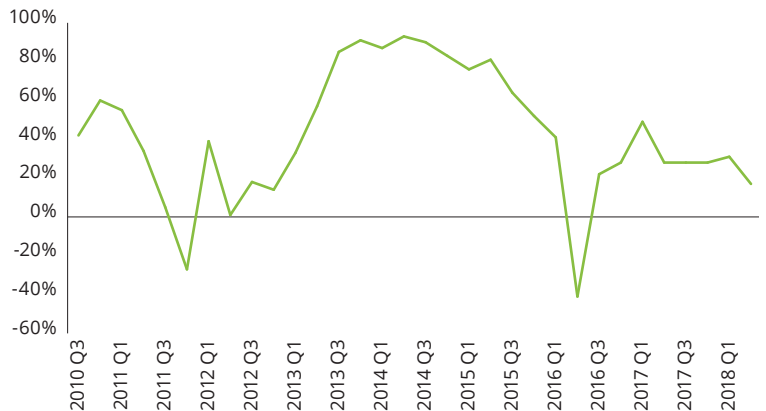
% of CFOs who think this is a good time to take greater risk onto their balance sheets



Revenue expectations among CFOs have dipped in the second quarter. A net 17% of CFOs expect revenues to rise over the next 12 months, down from 31% in the first quarter.

Chart 6. Outlook for corporate revenues

Net % of CFOs who expect UK corporates' revenues to increase over the next 12 months

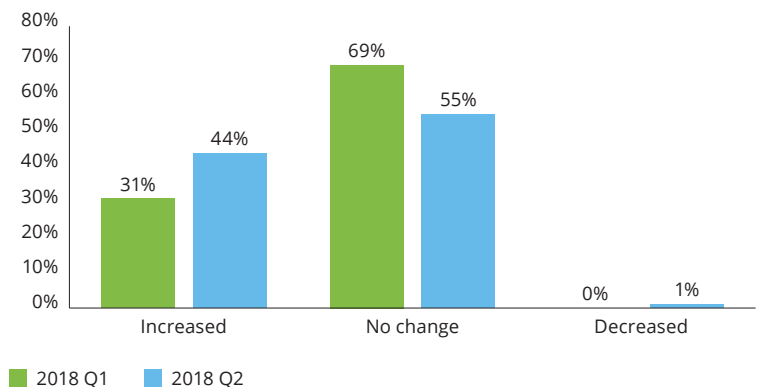


Almost half of CFOs – 44% – report that their businesses have experienced a rise in recruitment difficulties or skills shortages over the last three months.

Rising skills shortages are likely to exert upward pressure on wages this year.

Chart 7. Recruitment difficulties

% of CFOs reporting how recruitment difficulties or skills shortages experienced by their businesses have changed over the past three months



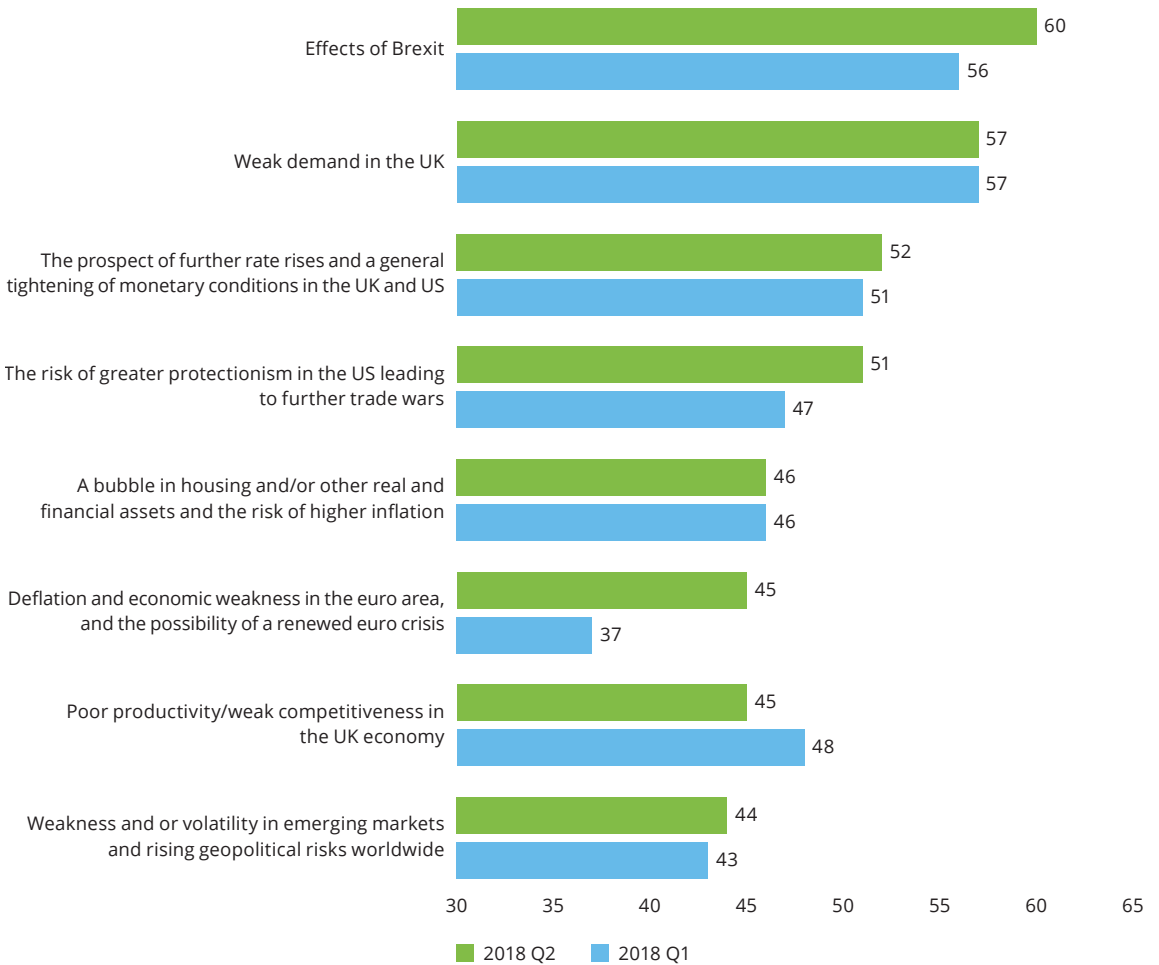
Brexit tops the risk list again

CFOs rank Brexit as their top risk, followed by concerns over weak demand and the prospect of tighter monetary policy in the UK and US.

CFOs have become considerably more concerned about the risks posed by greater protectionism in the US and economic weakness in the euro area in the second quarter. Concerns over poor productivity in the UK have receded.

Chart 8. 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



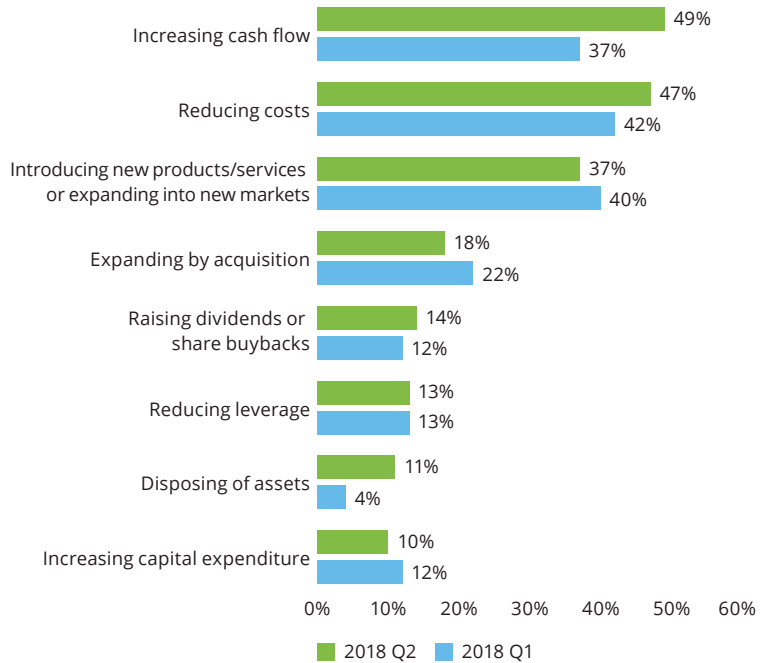
Focus on defensive strategies

CFOs are placing greater emphasis on defensive strategies such as increasing cash flow, which is their top priority, and reducing costs, which is their second highest priority.

Despite their more defensive stance, CFOs rate introducing new products/services or expanding into new markets, which is an expansionary strategy, as their third highest priority.

Chart 9. Corporate priorities in the next 12 months

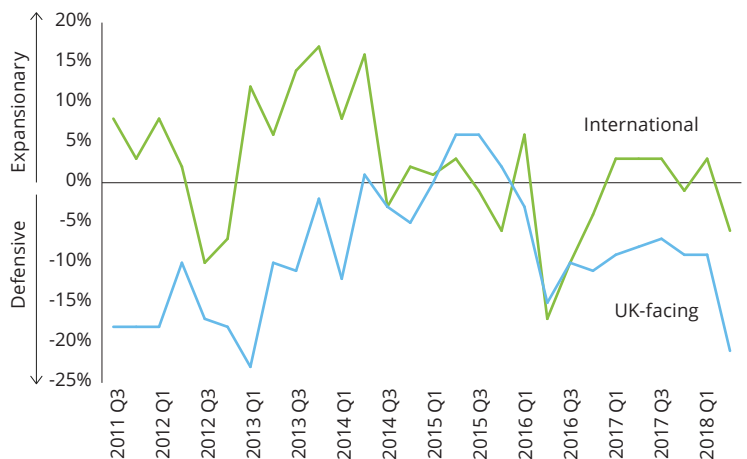
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



There is a clear distinction between the priorities of UK-facing firms – those that report more than 70% of their revenues from the UK – and companies that receive the majority of their revenues from overseas.

Internationally focused firms are markedly less defensive than their domestic counterparts, who have a particular emphasis on cost reduction and increasing cash flow.

Chart 10. Index of corporate expansion: International & UK-facing corporates



International corporates are those that derive more than 70% of their revenues abroad while UK-facing corporates derive more than 70% of their revenues from the UK.

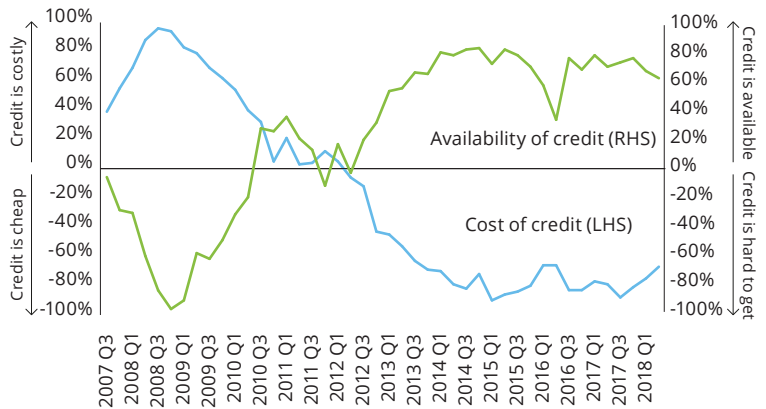
Difference between the arithmetic averages of the % of CFOs who rated expansionary and defensive strategies as a strong priority for their business in the next 12 months. Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

Inflation expectations fall back

Financing conditions remain favourable for the large corporates on our panel.

Credit is still easily available and although CFOs have reported a slight increase in its cost over recent quarters, it is still seen as cheap by historical standards.

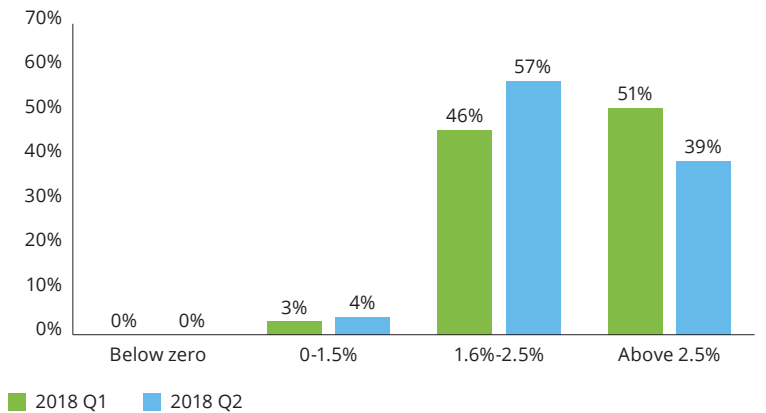
Chart 11. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available



Inflation fell to 2.4% in May, suggesting the post-Brexit surge in prices may be behind us.

Subsequently, inflation expectations among CFOs have fallen. Only 39% of CFOs now expect inflation to be above 2.5% in two years' time, down from 51% in the first quarter.

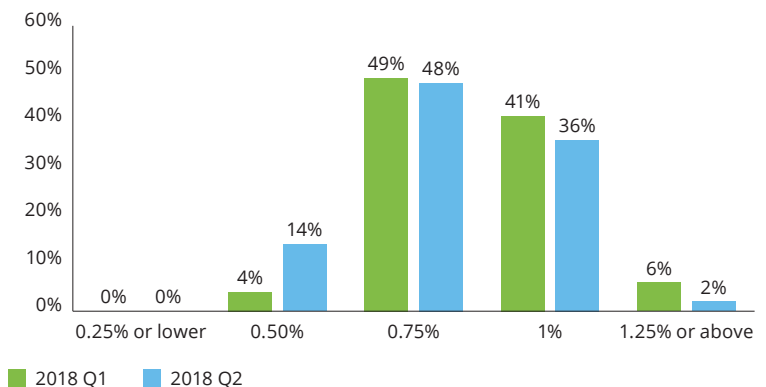
Chart 12. Inflation expectations
% of CFOs who expect UK inflation to be at the following levels in two years' time



Interest rate expectations have fallen back from the previous quarter.

38% of CFOs now expect the Bank of England's base rate to be 1% or higher in a year's time, down from 47% in the previous quarter.

Chart 13. 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

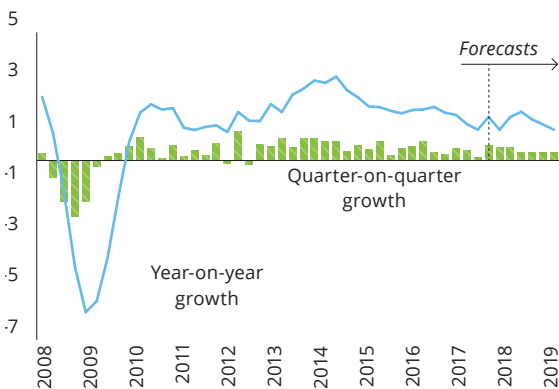


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q2 2018

Growth forecasts for 2018 edged lower following a weaker than expected start to the year, driven in particular by slower activity in the euro area and the UK. In the UK, Brexit uncertainties and persistently high inflation led to an unexpectedly sharp slowdown in the first quarter. There are signs that inflationary pressures may have peaked and UK consumers were offered some respite with real wages rising in February after 12 months of falling living standards. US activity continued to strengthen and inflationary pressures rose following further fiscal stimulus. The Federal Reserve raised interest rates by 25bps and set out a course for two further increases this year. Two anti-establishment Italian parties, Five Star Movement and the far-right Northern League, agreed to form a coalition government. The event sparked unease in financial markets and led to a sharp surge in government bond yields. Markets were also unnerved by rising global trade tensions after the US imposed tariffs on steel and aluminium imports from the EU, China, Canada and Mexico, sparking retaliatory measures. The price of oil climbed above \$80 a barrel for the first time in almost four years over geopolitical tensions in the Middle East and continued OPEC production quotas.

UK GDP growth: Actual and forecast (%)



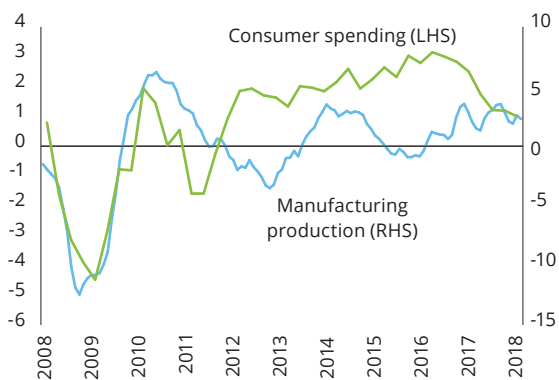
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



Source: Thomson Reuters Datastream

UK consumer spending and manufacturing production growth (%)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

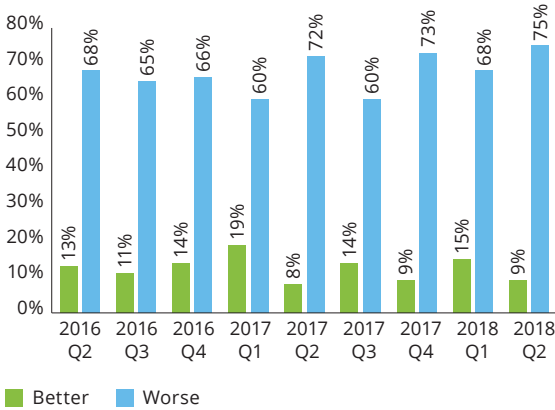


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

Long-term impact of Brexit

% of CFOs who think the overall environment for business in the long term will be better/worse if the UK leaves the EU (excluding those who expect no material change)



Outlook for corporate revenues

Net % of CFOs who expect UK corporates' revenues to increase over the next 12 months



About the survey

This is the 44th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2018 second quarter survey took place between 3rd and 14th June. 103 CFOs participated, including the CFOs of 20 FTSE 100 and 45 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 76 UK-listed companies surveyed is £504 billion, or approximately 19% 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 Anthea Neagle on 020 7303 0116 or email aneagle@deloitte.co.uk.

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