

The Deloitte CFO Survey

Deal or no deal – that is the question

In our second quarter CFO Survey we concluded that the spirits of large businesses would be “heavily dependent on the unfolding negotiations between the UK and the EU”. So it has proved. The disappointing pace of those negotiations and growing speculation about a no-deal Brexit weighed heavily on business sentiment in the third quarter.

CFOs have become more pessimistic about the long-term effect of the UK’s departure from the EU. Brexit is rated as being by far the biggest threat to business over the next 12 months, ahead of weak UK demand, trade wars and geopolitics, in the league table of CFO concerns. Indeed, CFOs are more negative about the effects of Brexit today than at any time since the EU referendum.

Meanwhile CFO confidence has fallen to the lowest level in two years, but remains above the record low seen in the aftermath of the Brexit referendum. Perceptions of uncertainty have also risen sharply.

Large corporates are pulling in their horns, with just 12% of CFOs saying now is a good time to take risk. CFOs say Britain’s departure from the EU is likely to act as a drag on their spending decisions.

CFOs have become much more defensive in the way they run their balance sheets, continuing a trend underway since early 2017.

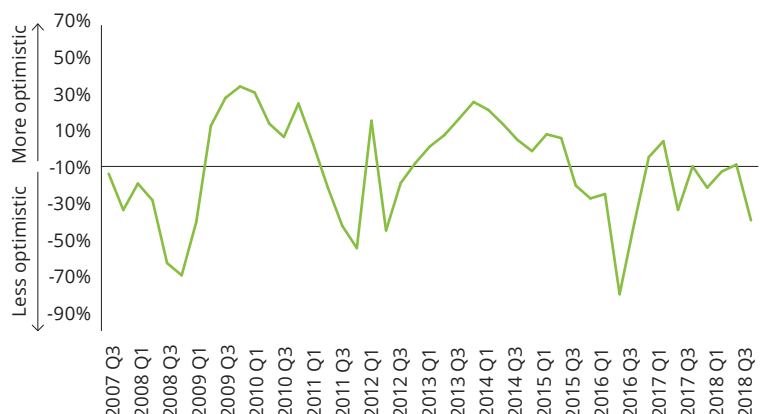
Cost reduction is the top corporate priority and CFOs are more focused on reducing costs than at any time in the last eight years.

The paradox in our findings is that this quarter’s survey took place in the wake of a modest rebound in UK economic activity. Having grown by a weak 0.1% in the first quarter the economy expanded by 0.4% in the second quarter. Monthly data show the pickup extending into July. Following a run of weak activity numbers earlier in the year, UK data have been coming in above market expectations in recent months. In August the Bank of England’s Monetary Policy Committee felt sufficiently emboldened by the momentum of growth to raise UK interest rates.

Brexit is drowning out better news on growth. With CFOs having to contemplate the risk of a no-deal exit from the EU, Brexit seems the only game in town for now. If the UK and the EU strike a deal, and agree a smooth transition, there could be scope for a relief rally in sentiment. The reverse, of course, also holds.

Chart 1. Business optimism

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



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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

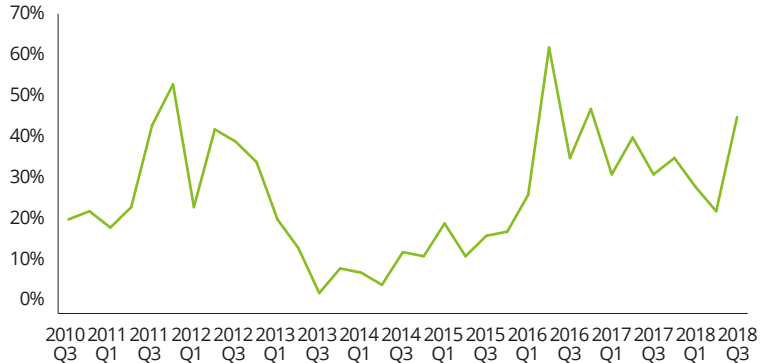
Uncertainty up

CFO perceptions of uncertainty rose sharply in the third quarter.

48% of CFOs rate current levels of external financial and economic uncertainty as high or very high, the highest reading since December 2016.

Chart 2. Uncertainty

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

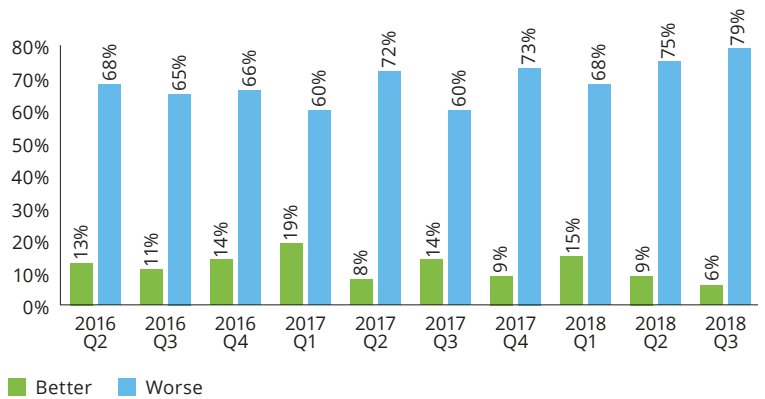


CFO pessimism over the long-term effects of Brexit is at its highest level since we started asking the question in the summer of 2016.

79% of CFOs now expect Brexit to lead to a deterioration in the overall environment for business in the long term.

Chart 3. 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)

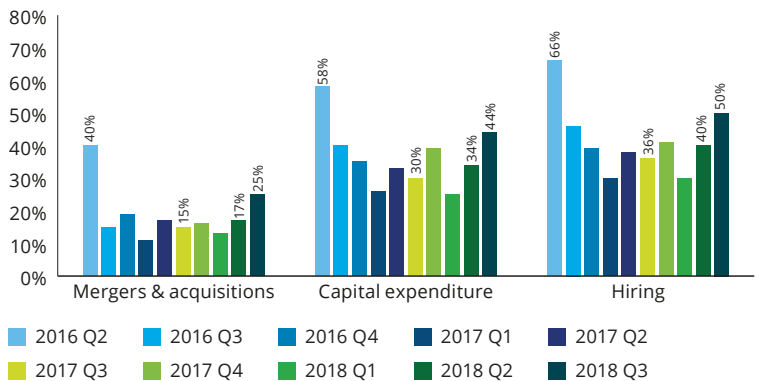


CFOs have also become more pessimistic about the short-term effects of Brexit.

The proportions of CFOs who expect to reduce their own capital expenditure, M&A activity and hiring, as a consequence of Brexit, are at their highest levels in more than two years.

Chart 4. 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



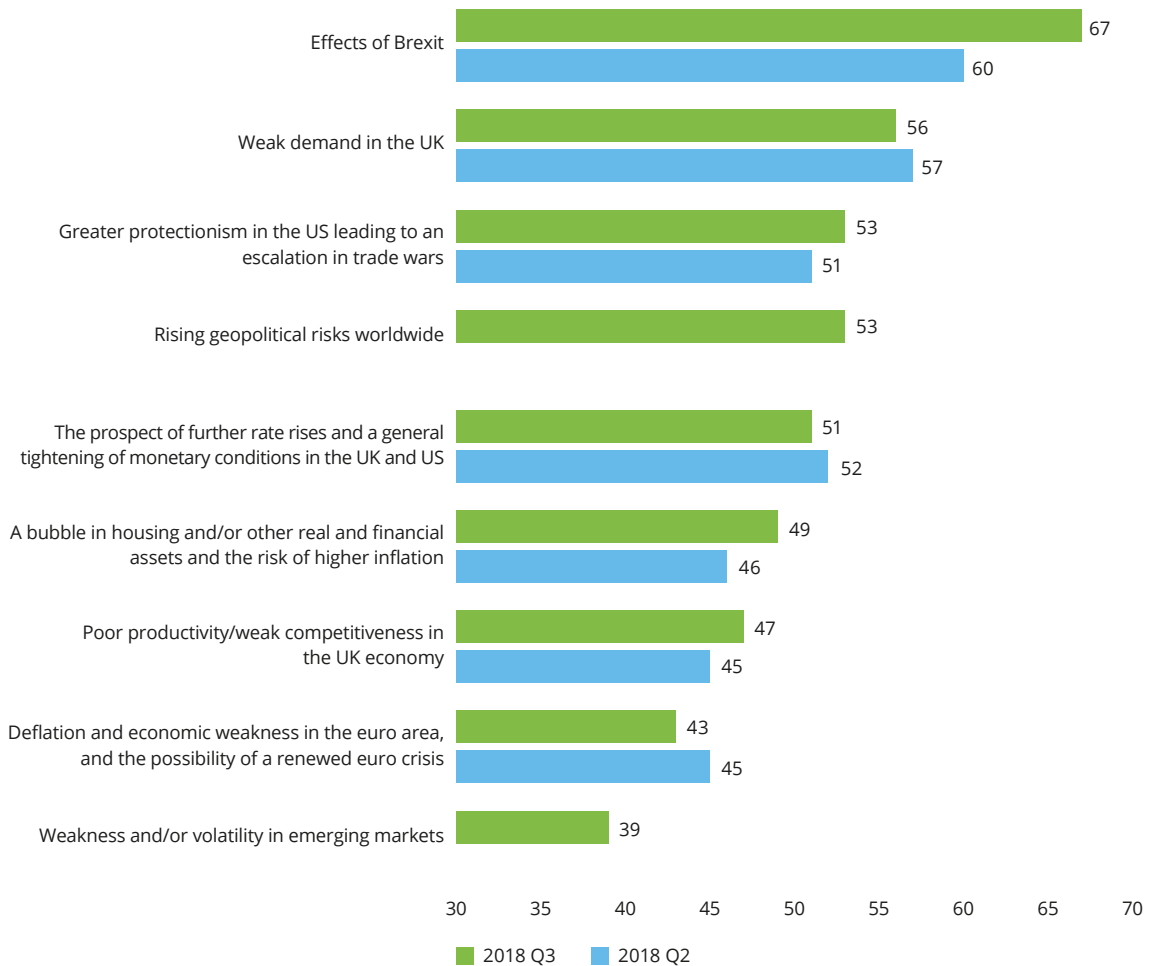
Brexit remains top risk

CFOs rank Brexit as their top risk, followed by concerns over weak demand in the UK. Greater protectionism in the US and a subsequent escalation in trade wars is rated as the third highest risk. Brexit is seen by far as the biggest threat to business, and more so than at any time since the EU referendum in 2016.

Despite US rate rises and protectionism buffeting emerging markets and further signs of slowing euro area growth over the summer, CFOs rank emerging market and euro area weakness at the bottom of their 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 risk and 100 stands for the highest possible risk



Risk appetite low

CFO risk appetite has edged lower and remains well below its long-term average.

Chart 6. Corporate risk appetite

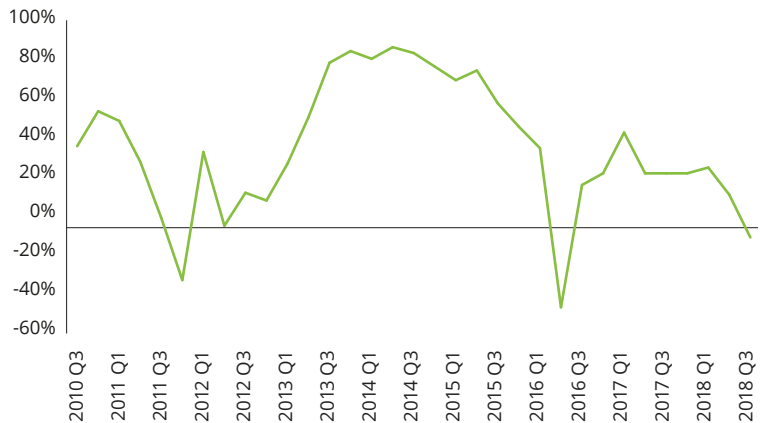
% of CFOs who think this is a good time to take greater risk onto their balance sheets



Revenue growth expectations among CFOs have slumped to their lowest level since the EU referendum in 2016.

Chart 7. Outlook for corporate revenues

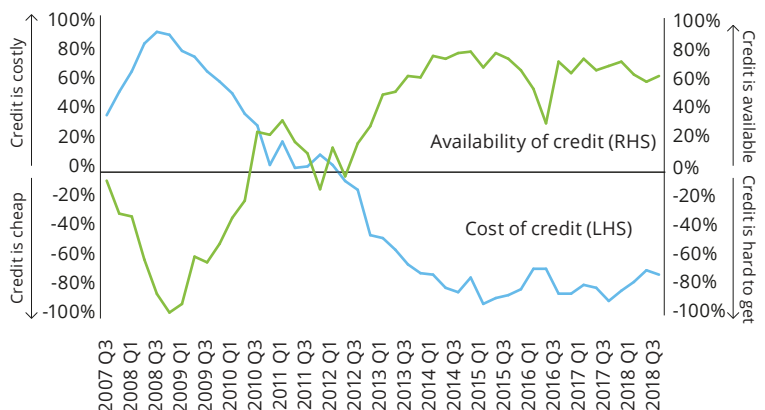
Net % of CFOs who expect UK corporates' revenues to increase over the next 12 months



Funding conditions remain favourable for the large corporates on our survey panel. CFOs continue to view credit as being cheap and easily available.

Chart 8. Cost and availability of credit

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



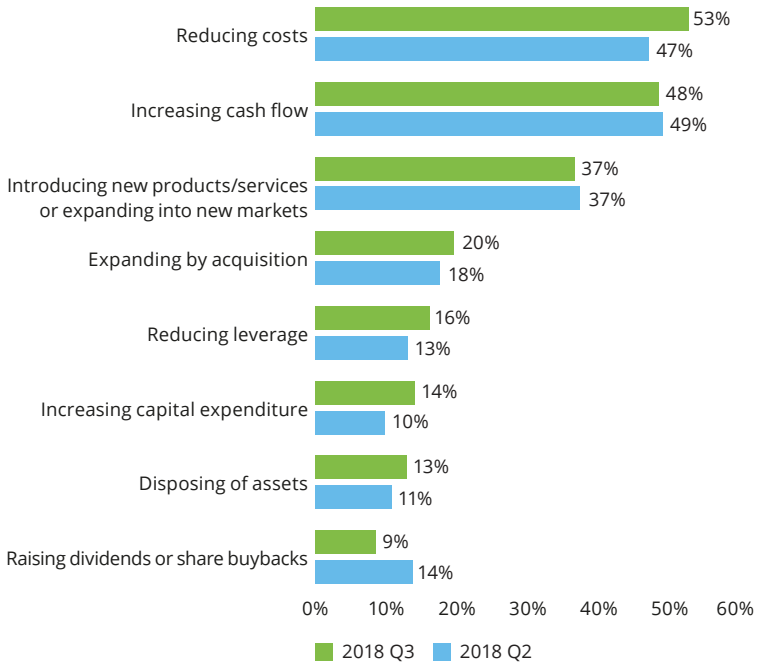
Cost reduction top strategy

Defensive strategies – cost reduction and increasing cash flow – make up the top priorities for CFOs. They have a sharper focus on cost reduction now than at any time in the last nine years.

Despite their defensive stance, CFOs rate introducing new products/services or expanding into new markets as their third highest priority.

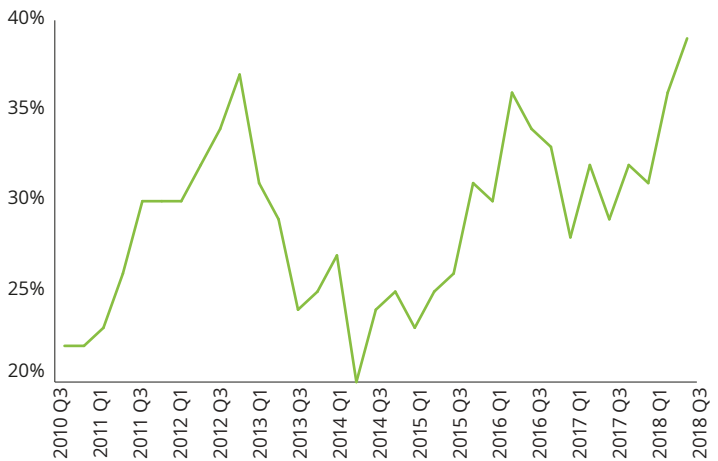
Chart 9. Corporate priorities in the next 12 months

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



CFOs have the sharpest focus on defensive strategies in eight years. They are placing more emphasis on defensive strategies now than they did during the height of the euro debt crisis in 2012 and immediately after the EU referendum.

Chart 10. CFO priorities: Defensive strategies



Arithmetic average of 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.

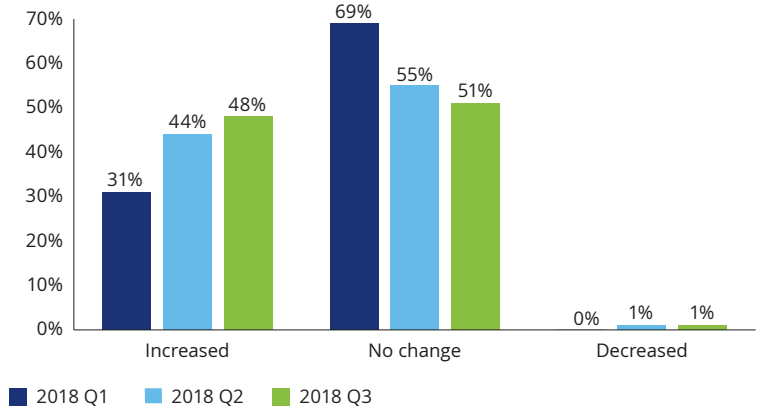
Recruitment difficulties continue to rise

The proportion of CFOs reporting an increase in recruitment difficulties or skills shortages experienced by their businesses rose to almost half in the third quarter.

With the unemployment rate at a 43-year low, rising skills shortages seem likely to exert upward pressure on wages.

Chart 11. Recruitment difficulties

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

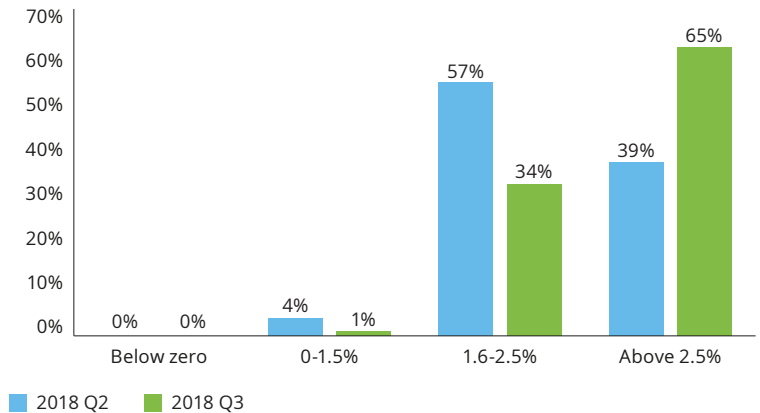


Higher oil prices drove inflation to a higher-than-expected 2.7% in August and seem to have raised inflation expectations among CFOs.

65% think inflation will be above 2.5% in two years' time, up from 39% last quarter.

Chart 12. Inflation expectations

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

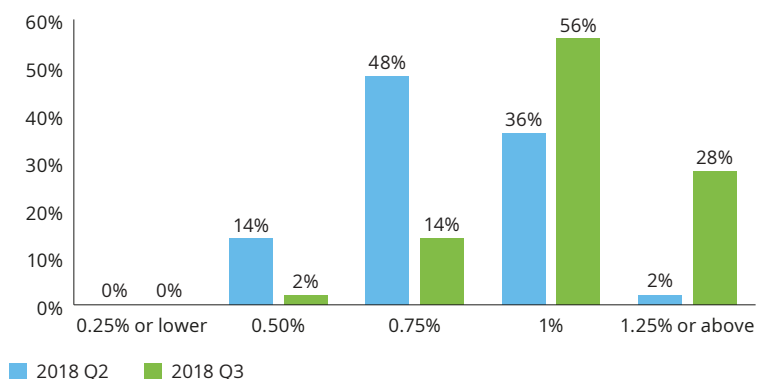


CFOs have brought forward their interest rate expectations following the Bank of England's decision to raise the base rate by 25 basis points to 0.75% in August.

84% now expect the Bank of England's base rate to be 1% or higher in a year's time, up from 38% 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

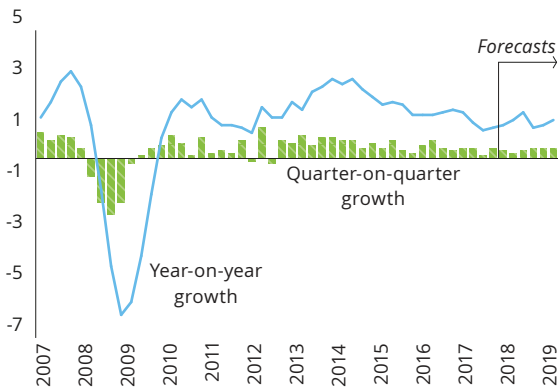


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q3 2018

Global growth remained robust over the last quarter, but downside risks rose. In the US, tax cuts and public spending have driven strong consumer and business expenditure. The Federal Reserve raised interest rates for the third time this year and markets are pricing in a further hike in December. US stock markets outperformed most major bourses in the third quarter. The S&P 500 hit an all-time high in August as US firms benefited from strong economic growth and tax cuts. Rising US interest rates and an escalation in the trade war between the US and China buffeted emerging markets. Turkey and Argentina saw sharp falls in their currencies, prompting fears of wider contagion and sending emerging market equities lower. Economic data from the euro area, notably manufacturing activity and consumer confidence, remained consistent with a moderate slowdown this year, but fears over protectionism and the fiscal stability of Italy have raised downside risks. UK growth rebounded in the second quarter thanks to a pickup in consumption and service sector activity. The Bank of England raised interest rates by 25 basis points. Unemployment continued to fall and wage growth strengthened moderately in the US, the euro area and the UK. Oil prices rose to a four-year high of \$85 a barrel, on anticipated disruptions in Iranian supply as the US begins to reimpose sanctions after its withdrawal from the 2015 nuclear agreement.

UK GDP growth: Actual and forecast (%)



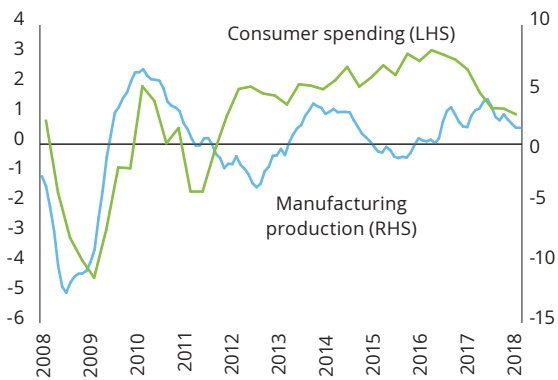
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



Source: Thomson Reuters Datastream

UK consumer spending and manufacturing production growth (%)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

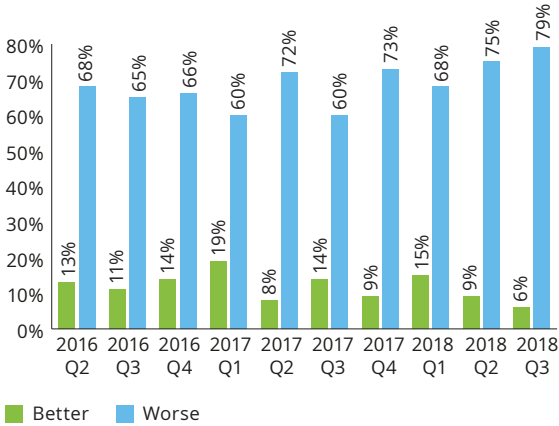


Source: Thomson Reuters Datastream

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)



CFO priorities: Defensive strategies



Definition of defensive strategies on page 5.

About the survey

This is the 45th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2018 third quarter survey took place between 14th and 27th September. 95 CFOs participated, including the CFOs of 18 FTSE 100 and 36 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 66 UK-listed companies surveyed is £383 billion, or approximately 15% 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 Rebecca Porter on 020 7007 5728 or email reporter@deloitte.co.uk.

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