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Q1 2019

The Deloitte CFO Survey

The dash for cash

The first quarter CFO Survey gauges sentiment among the UK's largest businesses in the wake of Parliament's rejection of Mrs May's Brexit deal. The survey ran between 26th March and 7th April, opening just after the announcement of the first delay in Brexit and covering a period that saw the failure of the House of Commons to agree a new plan and the start of Brexit talks between the government and the Labour Party.

It has been, to put it mildly, a turbulent few weeks. Despite this the latest survey shows little change in confidence and risk appetite among Chief Financial Officers. The reason is that CFOs priced in a tougher environment earlier, at the start of the year. CFOs went into March braced for tough times and the latest round of Brexit uncertainties has not materially changed that picture. The fact that balance sheets are being readied for turbulence fits with findings by the Bank of England's agents which show that around 80% of companies judge themselves ready for a no-deal, no-transition Brexit. When expectations are low it is harder to be disappointed.

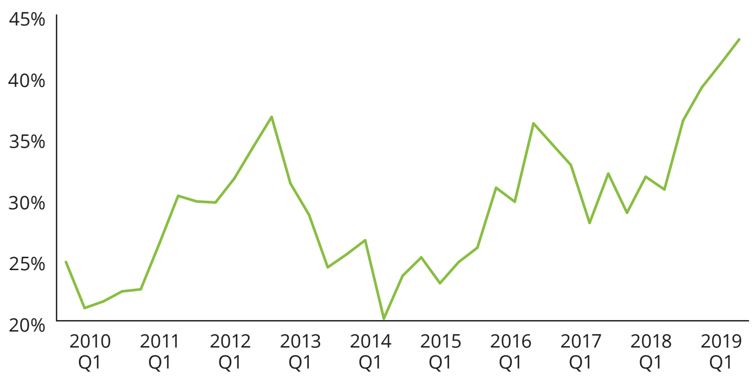
Corporates face three pressures. First, growing economic headwinds mean that CFOs have become markedly more negative on revenue growth in the last six months. Second, cost pressures are increasing, with a record 79% of CFOs expecting operating costs to rise in the next year. Wages have been the swing factor, with official data showing average earnings growing at close to their fastest pace in 11 years.

Third, credit conditions have become less accommodative. CFOs report that credit pricing and availability have deteriorated in the last two years and CFO concern about excessive leverage has ticked up.

Large businesses are looking to protect themselves against these risks by bullet-proofing balance sheets. At the heart of this strategy is a drive to raise cash levels. Official data show that at the end of 2018 UK corporates held a record £747 billion in cash, equivalent to 35% of GDP and almost one-third higher than in early 2016. Cash piles look set to rise still further. The latest survey shows that CFOs are placing greater emphasis on cash accumulation than at any time since 2010.

Since the last CFO survey closed, on 24th January, UK equities have risen 8% buoyed by falling interest rate expectations and hopes of a US-China trade deal. CFOs have been largely untouched by such sentiment. They are battening down hatches for tougher times.

Chart 1. 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.

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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**

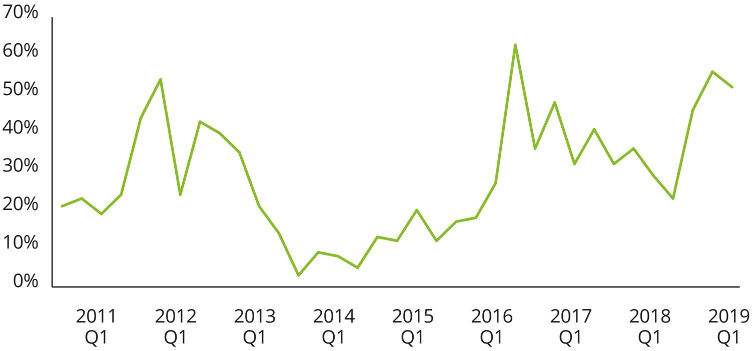
Elevated uncertainty

CFO perceptions of economic and financial uncertainty have eased slightly but remain close to their highest level in more than two years.

More than half of CFOs continue to rate current levels of uncertainty as high or very high.

Chart 2. Uncertainty

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

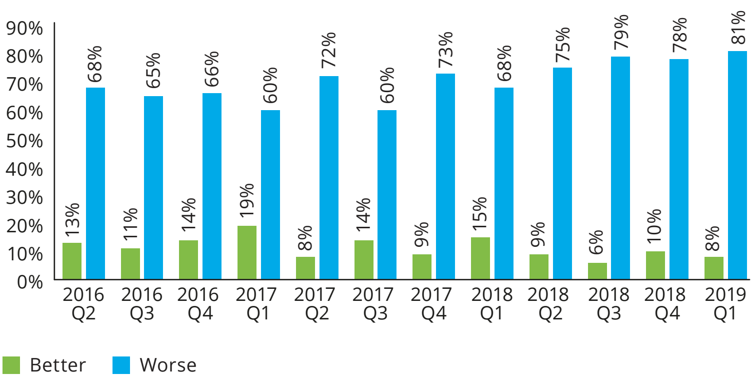


CFO pessimism over the long-term effects of Brexit rose to its highest level since the EU referendum in 2016.

81% 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)

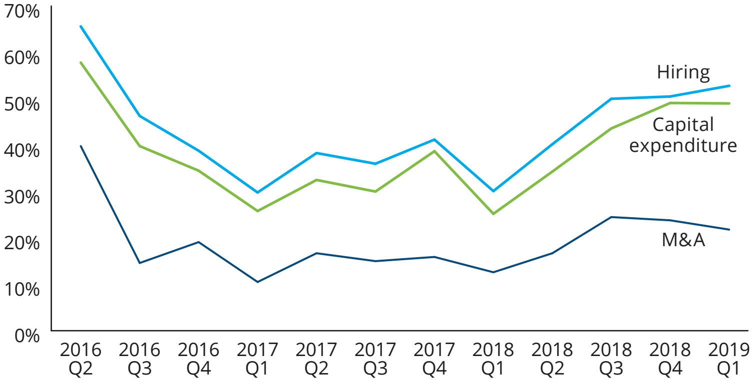


CFO pessimism about the short-term effects of Brexit also remains elevated.

The percentage of CFOs who expect to reduce hiring, as a consequence of Brexit, is at its highest level 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

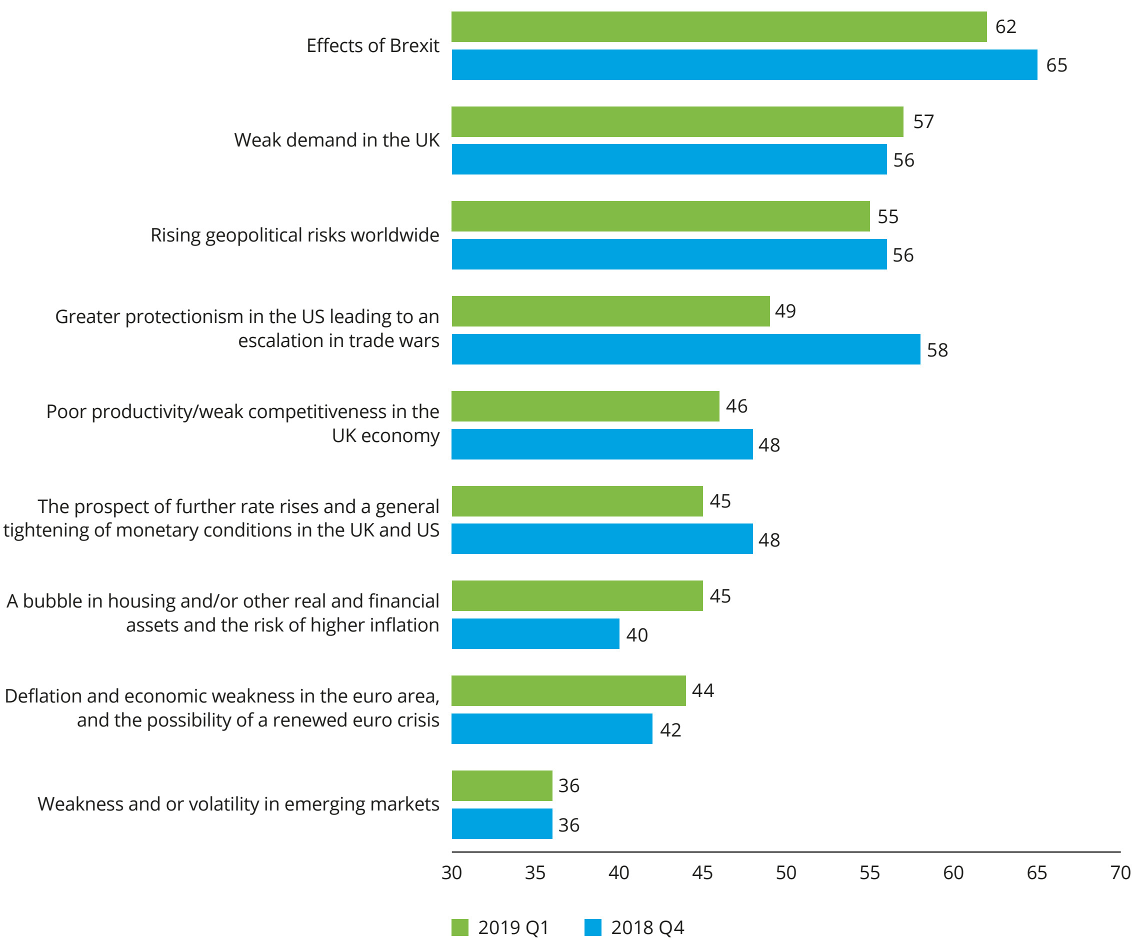


Brexit remains top risk

CFOs rank Brexit as the top risk facing their businesses, followed by weak demand in the UK. Rising geopolitical risks worldwide ranks as the third highest risk. Several rounds of trade talks between the US and China have raised hopes of a de-escalation in trade tensions, easing concerns over greater US protectionism.

With the US Federal Reserve and the European Central Bank pulling back from monetary tightening, concerns over rate rises have continued to recede. Risks of a bubble in asset prices and a sharp slowdown in the euro area have risen somewhat, the former most likely driven by the growing divergence between rallying equities and a slowing global economy.

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

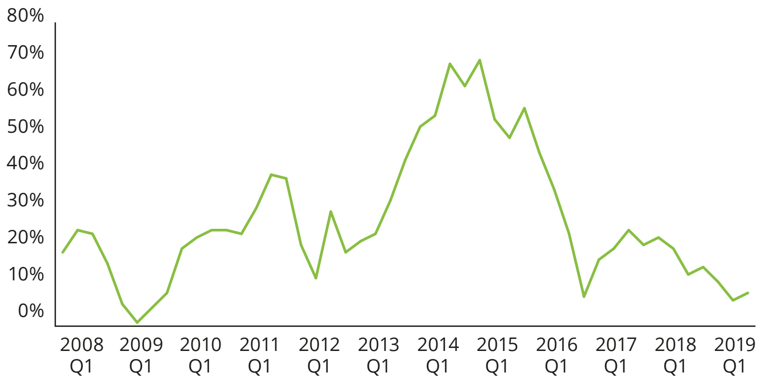


Risk appetite low

CFO risk appetite has edged up slightly but remains close to its lowest level in nine years.

Chart 6. Corporate risk appetite

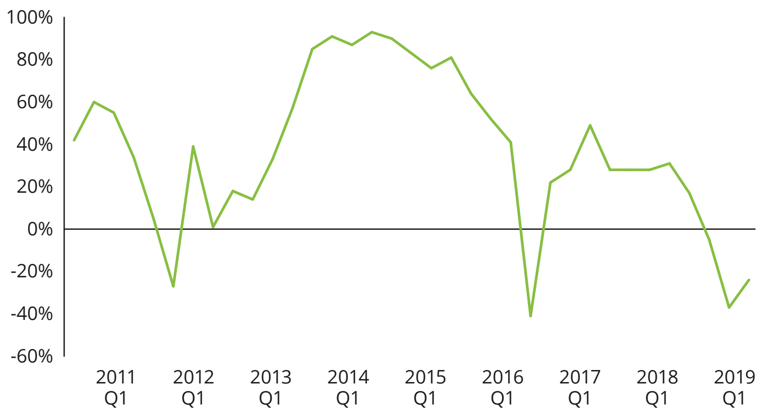
% of CFOs who think this is a good time to take greater risk onto their balance sheets



Expectations for revenue growth also remain depressed. On balance, CFOs expect a decline in UK corporates' revenues over the next 12 months.

Chart 7. Outlook for corporate revenues

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

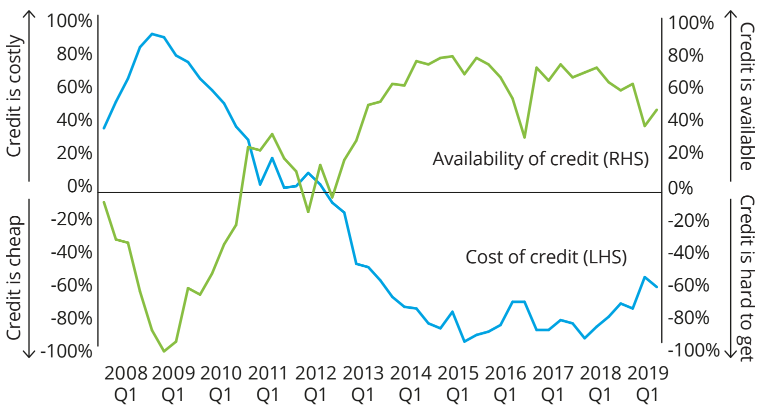


Funding conditions for the large corporates on our panel are tighter than those enjoyed over the last five years.

CFOs report a higher cost of credit and lower credit availability than the average levels seen since 2014. This seems to fit with the widening spread between the yield on investment grade bonds and that on 10-year gilts since October.

Chart 8. Cost and availability of credit

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



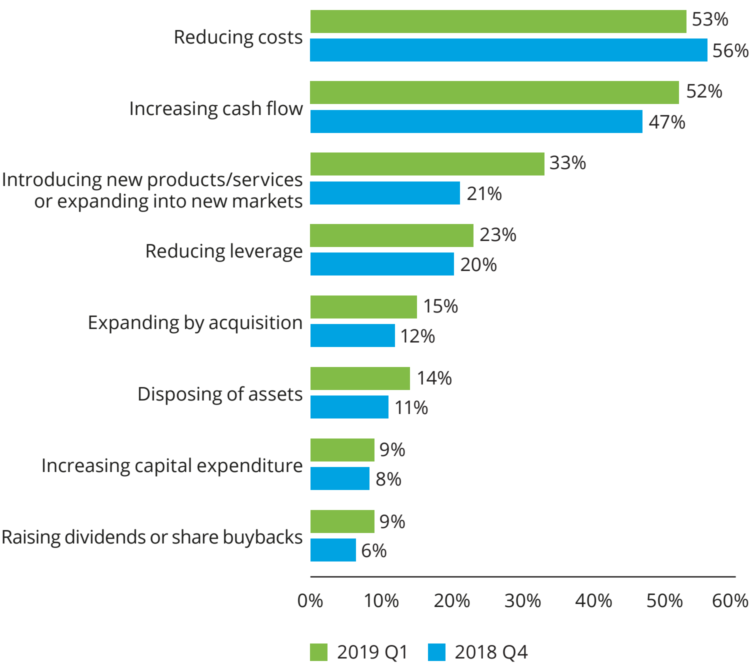
Cost reduction is top priority

Defensive strategies – cost reduction and increasing cash flow – remain the top priorities for CFOs. They now have a sharper focus on increasing cash flow 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

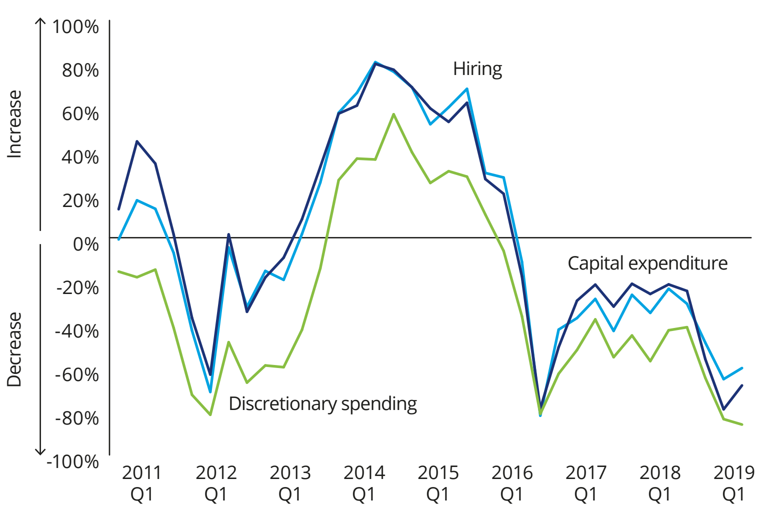


CFO expectations of capital expenditure, hiring and discretionary spending remain depressed.

On balance, CFOs expect UK corporates to decrease activity in each area over the next 12 months, with expectations for discretionary spending down to the lowest level in more than eight years.

Chart 10. Outlook for capital expenditure, hiring and discretionary spending

Net % of CFOs who expect UK corporates' capital expenditure, hiring and discretionary spending to increase over the next 12 months



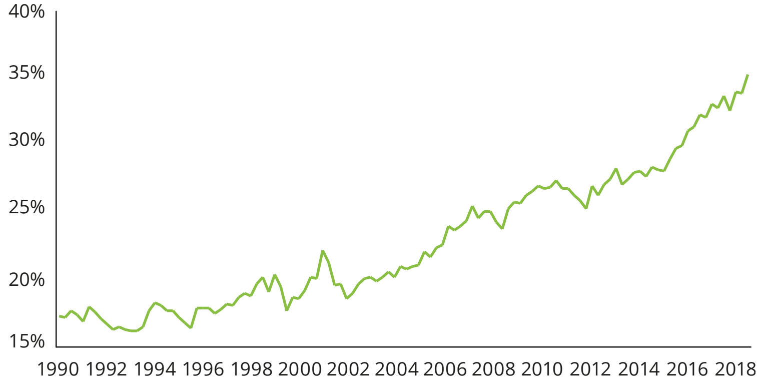
Cash is king

Large businesses are holding high levels of cash on their balance sheets to protect against risks in an uncertain business environment.

Official data show that at the end of 2018 UK corporates held a record £747 billion in cash, equivalent to 35% of GDP and almost one-third higher than in early 2016.

Chart 11. Cash holdings of UK corporates

Cash and cash equivalents on UK corporates' balance sheets (% GDP)



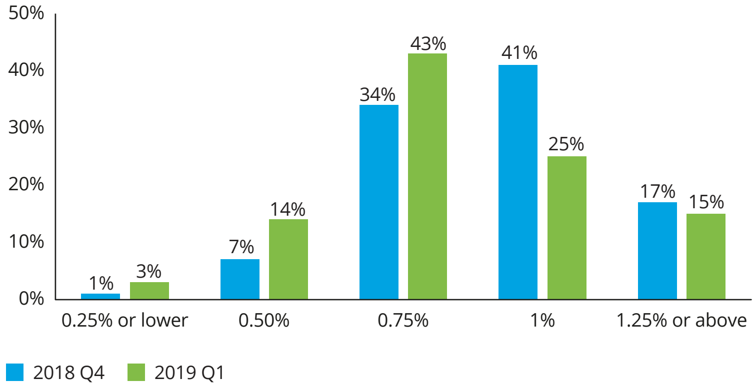
Source: ONS

Interest rate expectations have fallen back from the previous quarter.

40% of CFOs now expect the Bank of England's base rate to be 1% or higher in a year's time, down from 58% in the fourth quarter.

Chart 12. 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

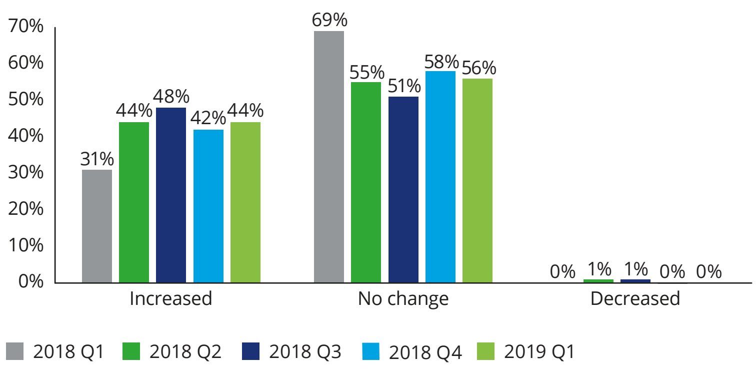


More than two-fifths of CFOs – 44% – report that their businesses have experienced a rise in recruitment difficulties or skills shortages over the last three months.

This fits with historically low unemployment rates and rising real wages.

Chart 13. Recruitment difficulties

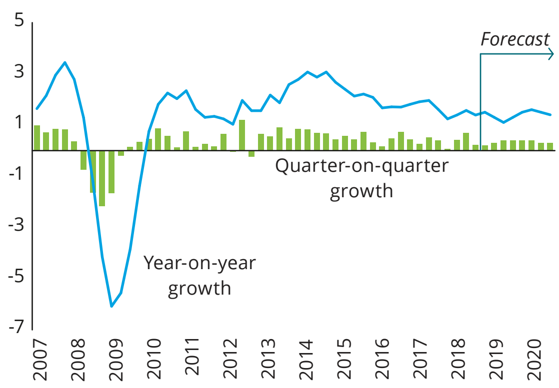
% of CFOs reporting how recruitment difficulties or skills shortages experienced by their businesses have changed over the past three months



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q1 2019
Global growth continued to slow in the first three months of 2019, with the IMF downgrading its global growth forecast for 2019. The US Federal Reserve and the European Central Bank responded by pulling back from monetary tightening. In the US, growth has softened as the effects of last year's tax cuts fade. The labour market remains robust with jobless claims at their lowest level since 1969. Activity in the euro area slowed considerably, with German manufacturing activity hit by weak external demand and Italy in recession for the third time in a decade. Concerns over a sharp slowdown in China have eased somewhat, with monetary and fiscal stimulus driving a modest pickup in activity. International trade developments were mixed. While the US issued increasingly vocal threats of tariffs on European exports, several rounds of China-US trade talks were deemed positive by negotiators. Both sides are yet to agree a trade deal. Central bank dovishness and progress in China-US trade talks supported equity markets, which recovered strongly from a sharp sell-off in December. The S&P 500 is up 15% this year. UK growth remained resilient in the first quarter despite elevated levels of uncertainty around the timing and nature of its exit from the EU. The British parliament rejected Theresa May's Brexit deal but failed to agree on an alternative. The EU agreed to delay Brexit to 31st October, giving politicians time to resolve this deadlock.

UK GDP growth: Actual and forecast (%)

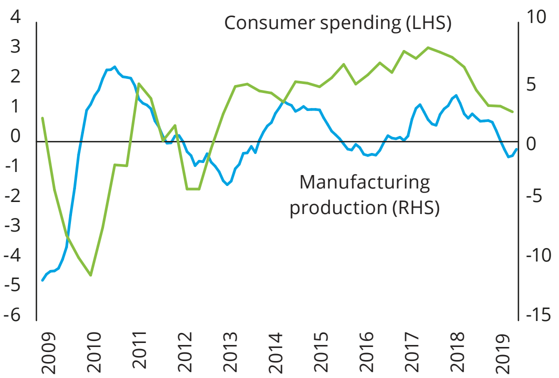


Source: ONS, Consensus Economics and Deloitte calculations

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

Corporate risk appetite

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

Cost and availability of credit

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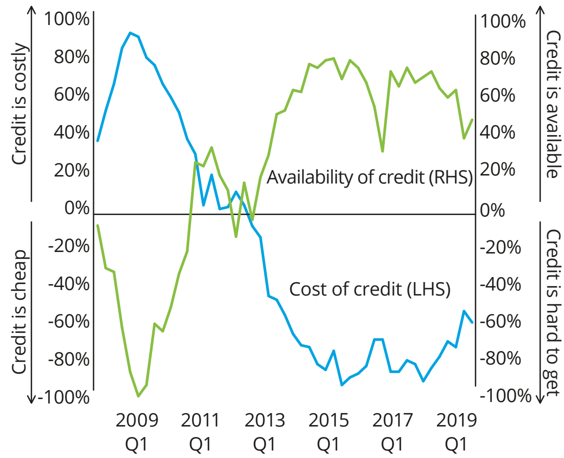

About the survey

This is the 47th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2019 first quarter survey took place between 26th March and 7th April. 89 CFOs participated, including the CFOs of 18 FTSE 100 and 31 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 60 UK-listed companies surveyed is £377 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 Hayley Baty on 020 7007 9209 or email **hbaty@deloitte.co.uk**

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