

The Deloitte CFO Survey

Brexit shock eases

The first quarter survey of Chief Financial Officers shows that the Brexit shock that hit corporate spirits in the wake of the EU referendum has eased. After a collapse in CFO confidence in the wake of the referendum vote, optimism among CFOs has reached an 18-month high.

The survey shows a decline in perceptions of risk in six of the eight key areas we poll CFOs on. Brexit continues to top the risk list, but with a lower reading than in the last two quarters. Crucially, two longstanding and acute sources of external risk for CFOs have diminished in importance – concerns about weakness in emerging markets and in the euro area have fallen to the lowest levels since we first asked this question at the end of 2014. The decline in concern about the euro area is the largest we have recorded for any category of risk, testifying to growing confidence about the region's recovery.

CFOs are switching away from the defensive strategies of the last year towards pro-growth policies. They have softened their laser-like focus on cost control and building cash flow, and are placing more weight on capital spending and introducing new products and services.

CFOs believe that the headwinds from Brexit have eased. The proportion of CFOs who expect Brexit to reduce their own hiring

plans in the next three years has more than halved, from 66% to 30%, since the vote. The proportion expecting it to hit investment and M&A has also fallen sharply. Most CFOs think Brexit will have an adverse effect in the long term on the business environment but even here the degree of negativity has fallen in the last year.

The UK's exit from the EU is a long and uncertain negotiating game. The CFO Survey has demonstrated time and again that business sentiment is changeable. But what is clear is that the UK corporate sector enters the negotiating phase of the UK's withdrawal from the EU in far better spirits than seemed likely in the months after last year's referendum vote.

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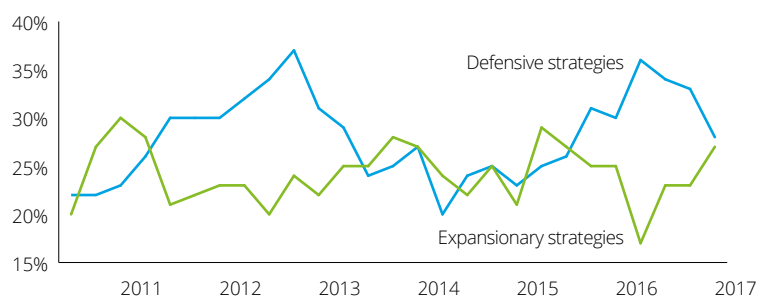
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For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:

www.deloitte.co.uk/cfosurvey

Chart 1. CFO priorities: Expansionary vs defensive strategies

Arithmetic average of the % of CFOs who rated expansionary and defensive strategies as a strong priority for their business in the next 12 months



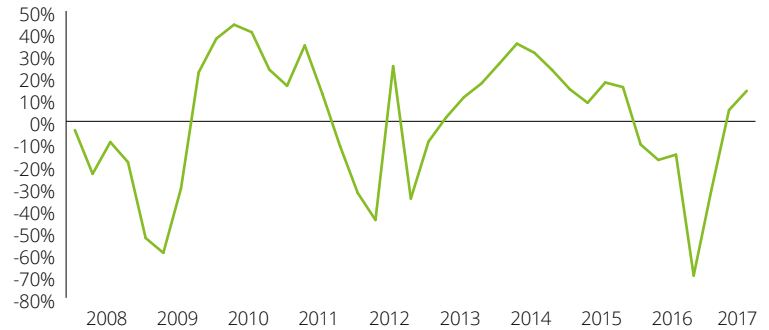
Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure. Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

CFOs less pessimistic about Brexit

Business optimism continued to improve, hitting an 18-month high in the first quarter.

Chart 2. Business optimism

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



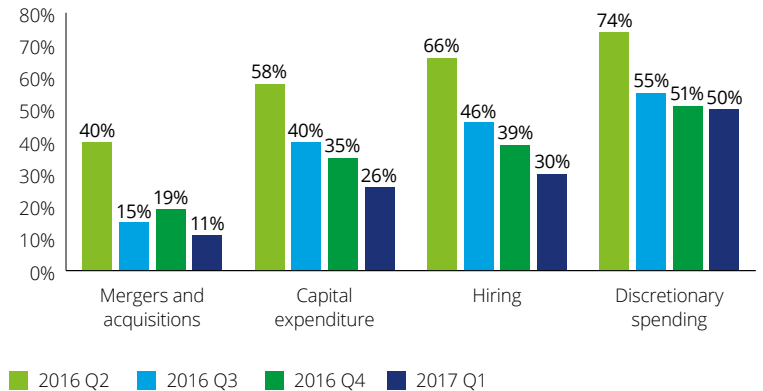
CFOs have continued to scale down their pessimism about the effects of Brexit.

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

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

The proportion of CFOs who expect Brexit to reduce their own hiring plans in the next three years has more than halved, from 66% after the vote to 30% now.

Over the same period, the percentage of CFOs expecting it to hit investment has fallen from 58% to 26% while those expecting Brexit to lower M&A activity are down from 40% to 11%.

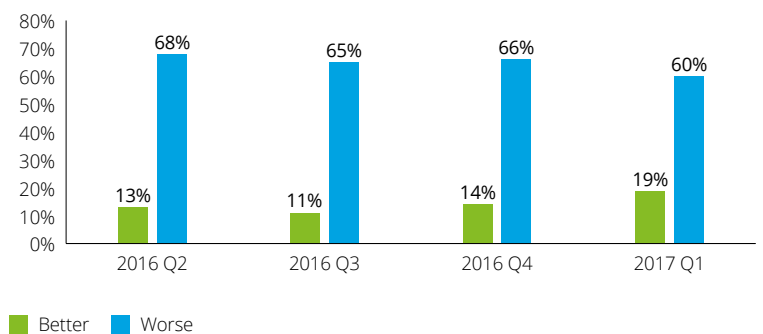


In the long run, CFOs expect Brexit to have a negative impact on the overall environment for business but the degree of negativity has fallen since the referendum.

60% expect a worsening in conditions, down from 68% in July.

Chart 4. 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



Decline in perceptions of risk

CFOs have reported a decline in perceptions of risk in six of the eight key areas we poll them on.

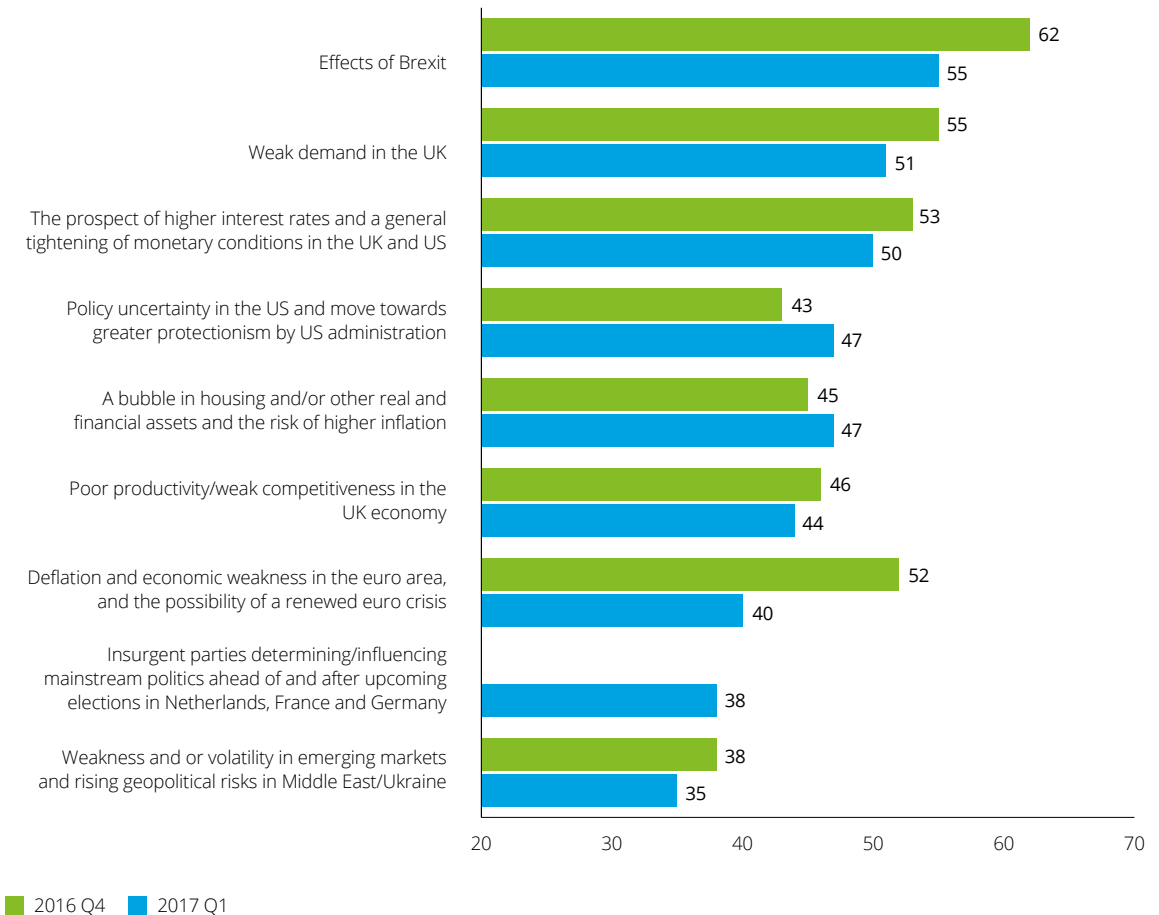
Brexit continues to top the risk list, but with a lower reading than in the last two quarters. Weak demand in the UK and the prospect of interest rate rises in the US and UK make up the top three risks. CFOs report a rise in concerns over policy uncertainty in the US and potential moves towards greater protectionism by the Trump administration.

Meanwhile, two longstanding sources of external risk – weakness in emerging markets and the euro area – have diminished in importance. They are down to the lowest levels since we first asked this question at the end of 2014. The decline in concern about the euro area is the largest we have recorded for any category of risk, testifying to growing confidence about the region's recovery.

CFOs are also less concerned about the impact of insurgent parties on mainstream politics in the Netherlands, France and Germany, with it featuring near the bottom of the 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



Shift towards expansion

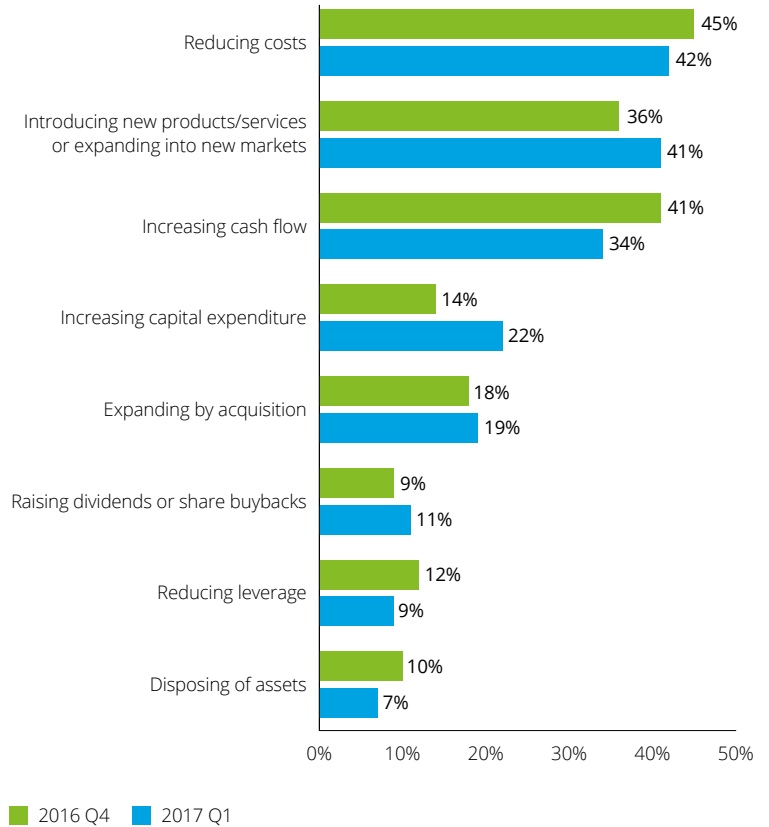
Cost reduction continues to remain the top priority for CFOs.

But, compared to last quarter, they have softened their focus on defensive strategies such as reducing costs and increasing cash flow.

CFOs are placing greater emphasis on expansionary strategies such as introducing new products and services and increasing capital spending.

Chart 6. 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

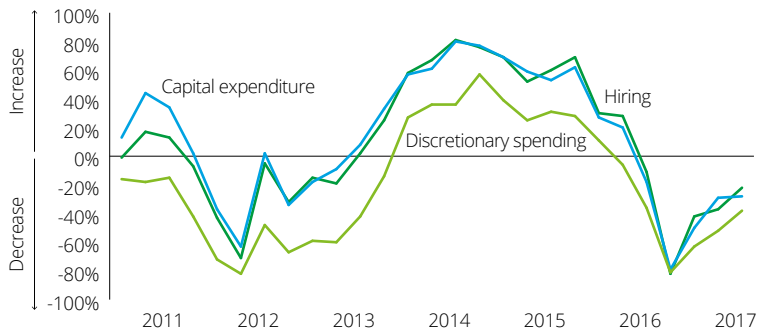


CFO expectations for growth in capital expenditure, hiring and discretionary spending continued to improve in the first quarter.

Yet, on balance, they expect UK corporates to decrease spending in each area over the next 12 months.

Chart 7. 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



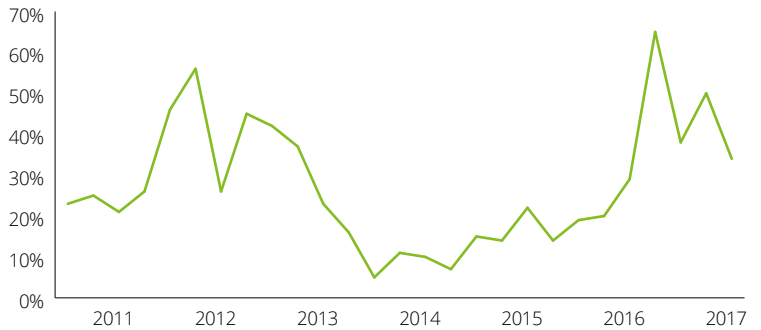
Uncertainty down

Uncertainty continued to be a key theme in the first quarter with 34% of CFOs rating current levels of external financial and economic uncertainty as high or very high.

Perceptions of uncertainty have dipped since the last survey, however, and are further below their peak after last year's referendum.

Chart 8. Uncertainty

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

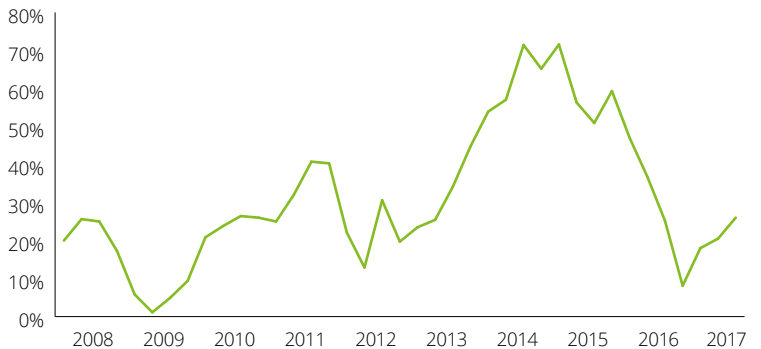


Corporate risk appetite has improved for the third consecutive quarter but remains below long-term averages.

26% of CFOs think now is a good time to take greater risk onto balance sheets.

Chart 9. Corporate risk appetite

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



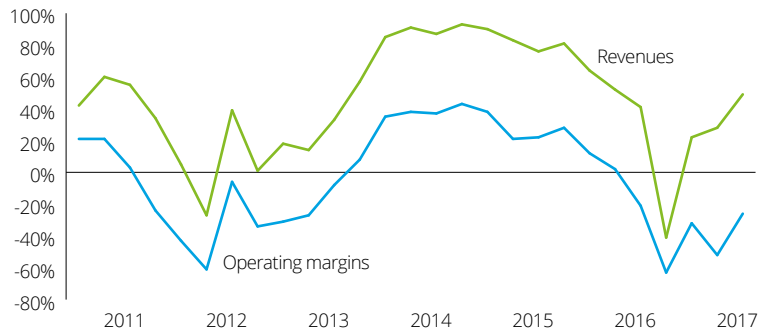
The outlook for corporate revenue growth has improved once again.

A net 49% of CFOs expect UK corporate revenues to increase over the next year, up sharply since last summer.

The outlook for operating margins remains challenging. On balance, CFOs expect operating margins to fall over the next year.

Chart 10. Outlook for corporate revenues and margins

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

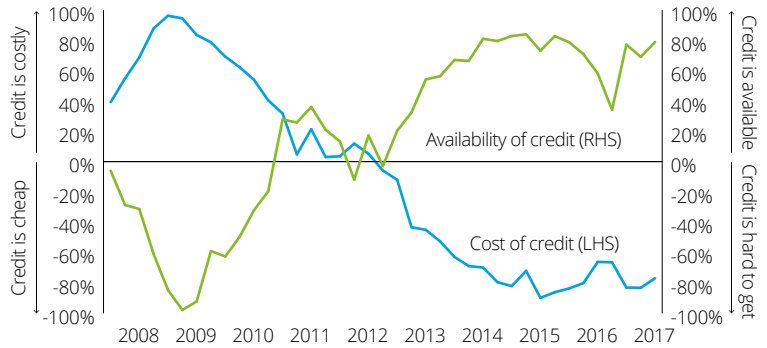


Credit conditions benign

Financial conditions remain favourable for the large corporates on our survey panel, with CFOs continuing to view credit as being cheap and easily available.

Chart 11. Cost and availability of credit

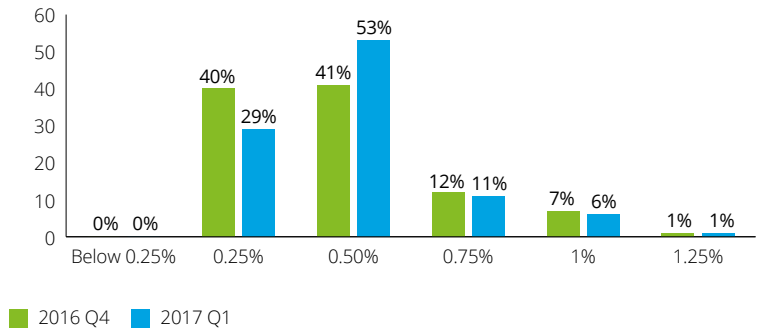
Net % of CFOs reporting credit is costly and credit is easily available



In recent quarters CFOs have brought forward their expectations for rate rises. A significant majority – 71% – of CFOs now expect the Bank of England's base rate to be above its current level of 0.25% in a year's time.

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

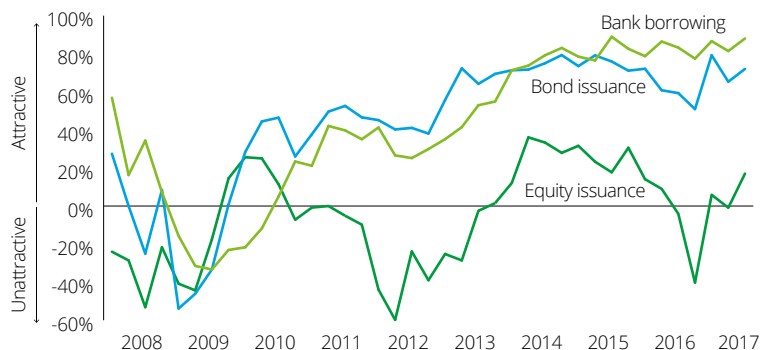


Debt finance – bank borrowing and bond issuance – remains the most attractive source of funding for CFOs.

Equity issuance has become more appealing on the back of stronger equity markets.

Chart 13. Favoured source of corporate funding

Net % of CFOs reporting the following sources of funding as attractive



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q1 2017

Continuing political uncertainty – including the Dutch general election, the run up to formal Brexit negotiations and some high-profile complications for the Trump administration – failed to derail the global recovery in the first quarter. A number of leading global growth indicators strengthened, with German business confidence reaching a near three-year high, optimism among UK manufacturers rising to its highest level since 1995 and US consumer confidence hitting its highest level since July 2001. For the first time since 2010, activity is picking up in both developed and emerging markets this year. Oil prices softened slightly in the first quarter but remained well above their levels at the start of 2016. Stronger growth and rising commodity prices drove up inflation across the West. UK inflation rose to 2.3% in February, its highest rate in more than three years and euro area inflation reached a four-year high. With euro area growth and inflation accelerating, the European Central Bank signalled victory in its fight against deflation. The Federal Reserve raised interest rates to 1.0% and stuck with previous projections for two further rate increases this year. UK and US equity markets remained at or near record highs, although rising rate expectations led to a sell-off in government bonds.

UK GDP growth: Actual and forecast (%)



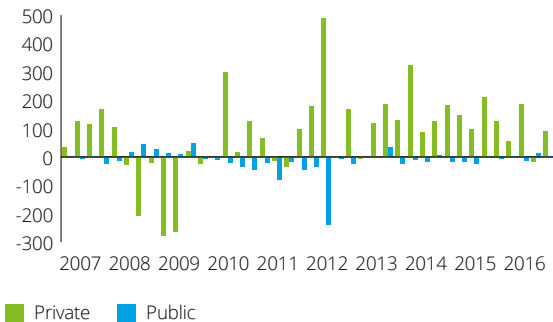
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



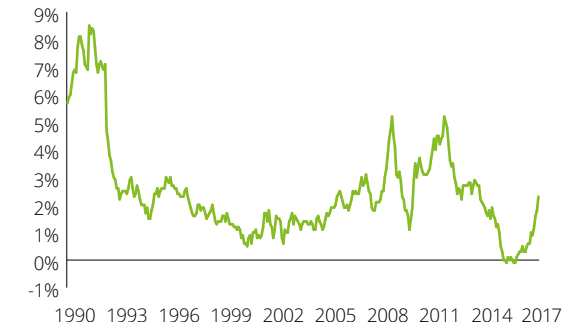
Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

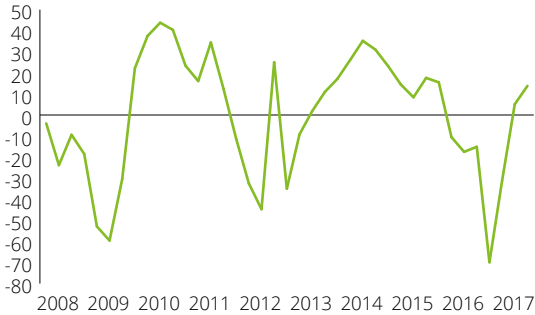


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

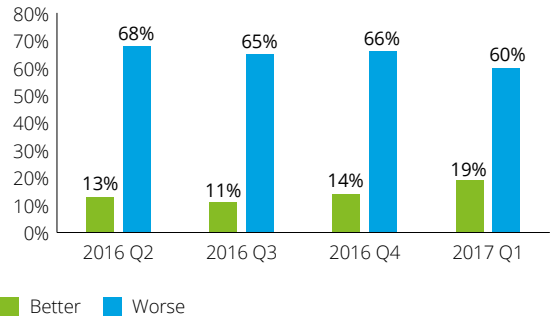
Business optimism

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



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



About the survey

This is the 39th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2017 first quarter survey took place between 8th and 22nd March. 130 CFOs participated, including the CFOs of 25 FTSE 100 and 53 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 91 UK-listed companies surveyed is £376 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 Anthea Neagle on 020 7303 0116 or email aneagle@deloitte.co.uk.

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