

The Deloitte CFO Survey

Braced for recession

The Chief Financial Officers of the UK's largest companies are braced for a recession. On average, CFOs see a 63% chance of the UK going into recession within the next 12 months. Increases in the Bank of England's base rate since the start of the year are having a pronounced effect, with CFOs reporting that credit is more costly than at any time in the last ten years. Respondents think credit conditions will continue to tighten, with interest rates expected to double from 1.25% to 2.5% by July 2023.

Geopolitics features as the greatest risk facing business, with higher interest rates and inflation in second and third place on the CFO risk list. The Bank of England estimates that inflation is likely to reach about 11% later this year. CFOs believe it will then decline, to 5.0% by mid-2023 and 3.4% by mid-2024. However, CFOs worry that inflation is likely to remain higher for longer; two in three expect inflation to exceed economists' expectations.

This quarter's survey asked CFOs how they are responding to the highest levels of inflation seen in the UK since the 1980s.

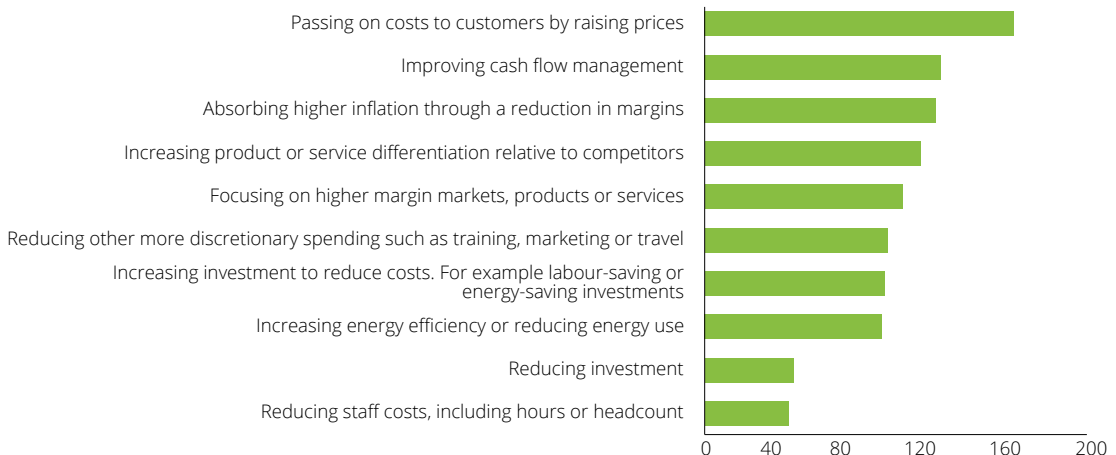
The most widespread approach is to pass on price rises, followed by measures to improve cash flow and reductions in margins. (A separate question finds that CFOs' expectations for margins have dropped sharply, and are not far off the all-time lows seen during the pandemic). Other popular responses to inflation include shifting revenues towards higher margin products and services, differentiating their product/services from their competitors and reducing discretionary spending, for example on training and travel.

With recession now a central risk CFOs have edged towards more defensive balance sheet strategies, particularly cost control and building up cash. Yet CFOs are not in batten down the hatches mode. Risk appetite is only slightly below average levels, and well above the lows seen in the financial crisis, at the time of the EU referendum and during the pandemic. CFOs are optimistic about medium-term prospects for investment. Most CFOs expect business productivity, spending on skills and investment in digital technology and assets to speed up in the next three years.

CFOs are alive to the risks of recession yet continue to look for growth.

Chart 1. Corporate responses to inflation

Index of CFOs' assessment of the extent to which their business is pursuing the following strategies in response to rising costs



The index of CFOs' responses is on a scale of 0 to 300 where 300 represents all CFOs pursuing a strategy to a very significant extent, 200 represents all CFOs pursuing a strategy to a large extent, 100 represents all CFOs pursuing it to a small extent and 0 represents no CFOs pursuing that strategy.

CFOs expect high inflation to persist

CFOs expect high inflation to persist, despite easing price pressures next year.

The median CFO expectation for inflation next summer is 5%. By mid-2024, inflation is expected to have fallen further – to 3.4% – still well above the Bank of England’s 2% target.

More than two in three CFOs expect inflation to be higher and more persistent than forecast by economists.

Higher raw material prices and rising labour costs are reflected in CFO expectations for profitability. CFOs expect UK corporates’ margins to fall over the next 12 months, in their most pessimistic assessment since the first wave of the COVID-19 pandemic.

Chart 2. Inflation expectations

Historical UK inflation rates, the Bank of England’s expectation for peak inflation and the median of CFOs’ expectations for inflation in one year’s and two years’ time

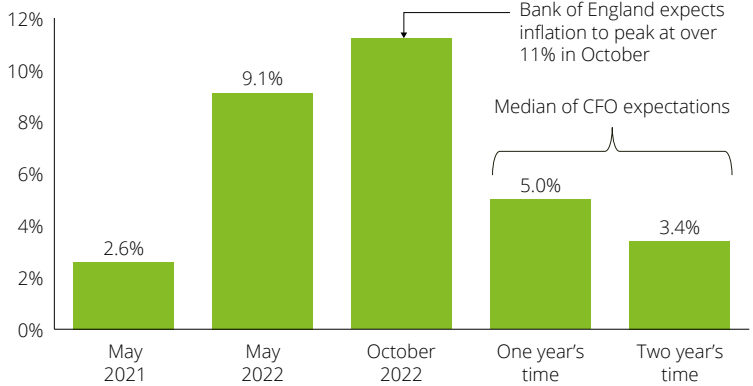


Chart 3. Outlook for inflation

% of CFOs who think the following scenarios are either quite likely or very likely

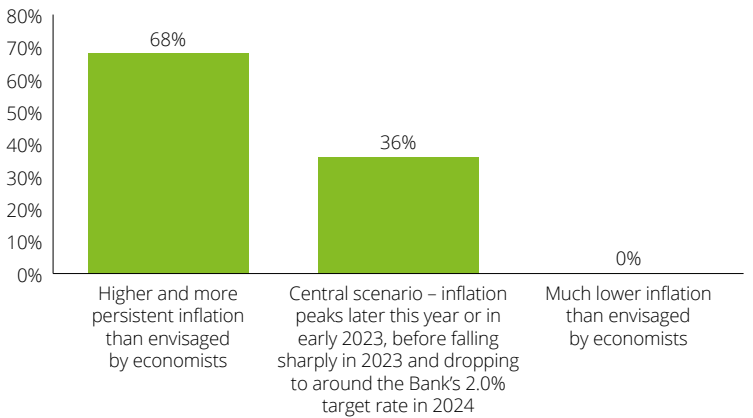
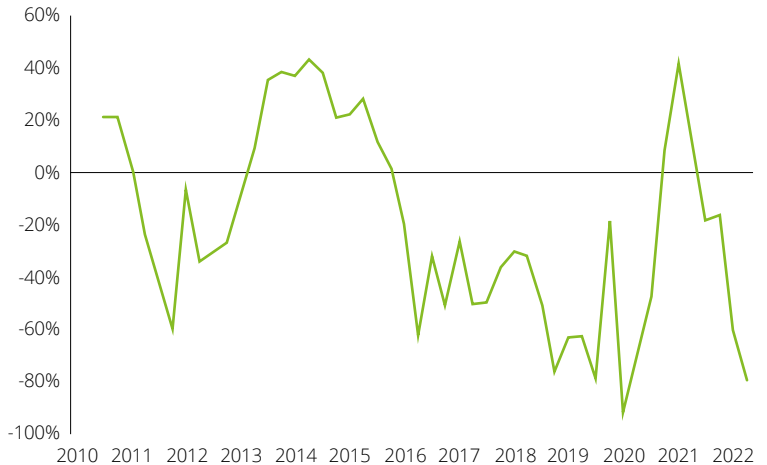


Chart 4. Outlook for margins

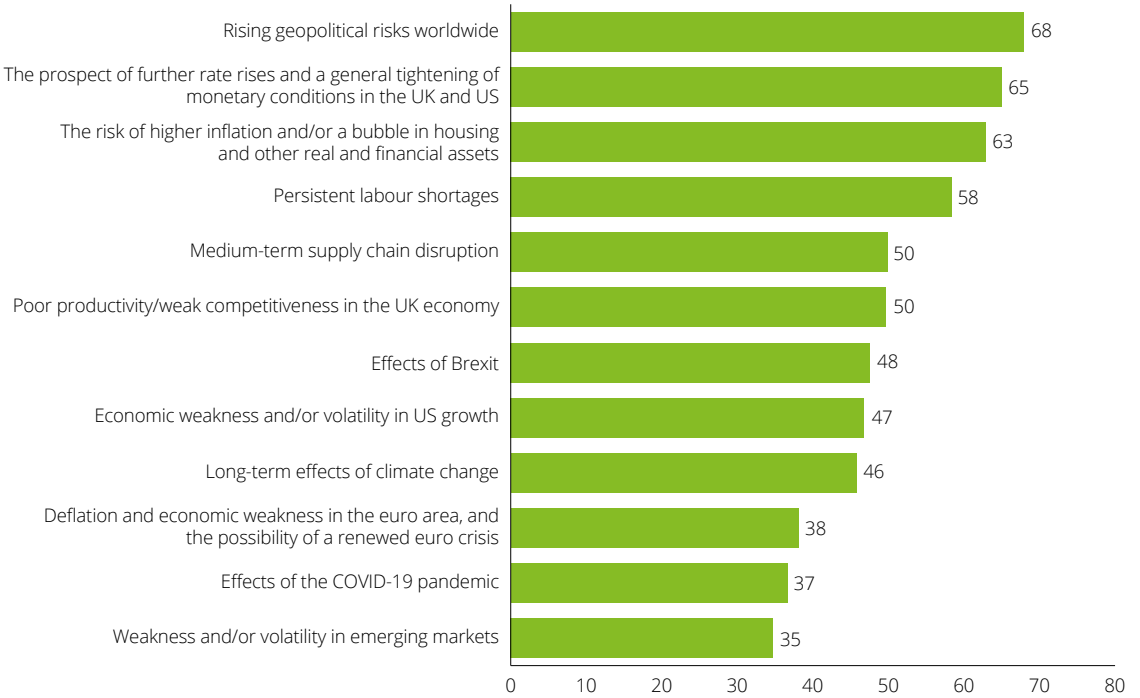
Net % of CFOs who expect UK corporates’ operating margins to rise over the next 12 months



Geopolitics and interest rate rises top 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



Geopolitics remains the top concern for CFOs with the war in Ukraine driving commodity prices higher and adding pressure to supply chains. The prospect of further rate rises, the risk of higher inflation and persistent labour shortages are seen as the next biggest threats. With inflation continuing to climb to multi-decade highs, interest rate expectations implied by financial markets have increased sharply over the last quarter.

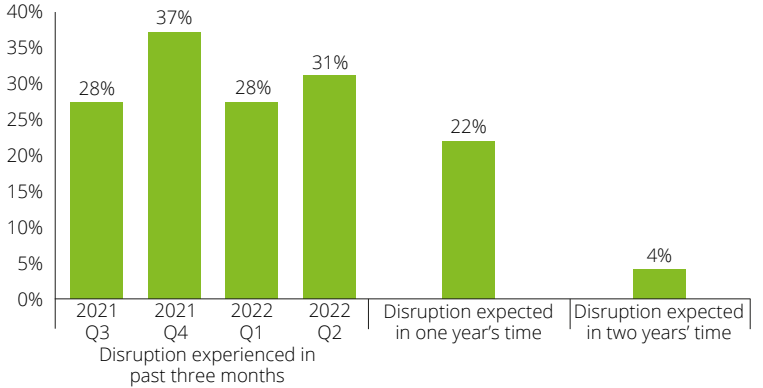
The effects of Brexit have risen up the risk list, perhaps partly reflecting uncertainties caused by the UK government’s plan to amend the Northern Ireland protocol.

Supply chain and recruitment difficulties to persist

Almost a third of CFOs reported significant or severe supply chain disruption in the second quarter, a slight increase from the previous quarter. Just over a fifth expect the same level of disruption in a year's time. Only in two year's time is the level of disruption expected to fall significantly.

Chart 6. Supply chain disruption

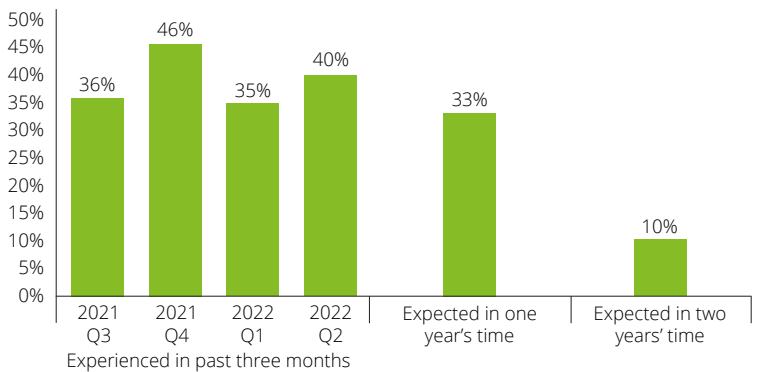
% of CFOs who report significant or severe levels of supply chain disruption experienced by their business over the last three months and those expecting similar levels of disruption in one-year's time



40% of CFOs reported significant or severe recruitment difficulties and labour shortages in the second quarter. A third of CFOs expect those difficulties to remain in one year's time while 10% expect them in two year's time.

Chart 7. 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



61% of CFOs rate the level of external financial and economic uncertainty as high or very high, up from recent quarters but still well below the peak at the height of the pandemic in 2020.

Chart 8. Uncertainty

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

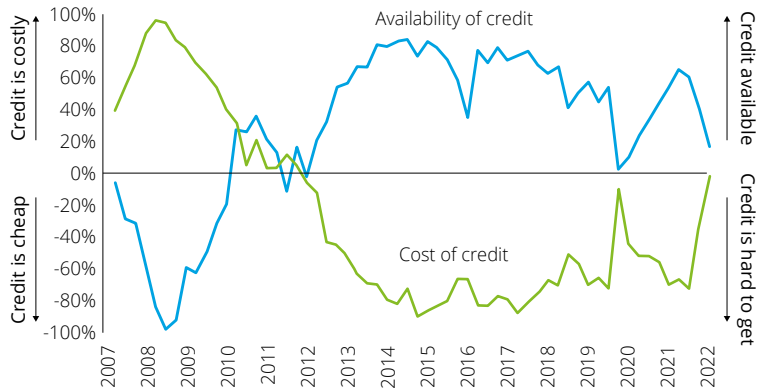


Financing costs rising

CFOs report that the cost of credit has increased substantially since the end of last year and is now at its most costly since 2012. The availability of credit has also declined but remains above the lows seen during the pandemic and the Global Financial Crisis.

Chart 9. Cost and availability of credit

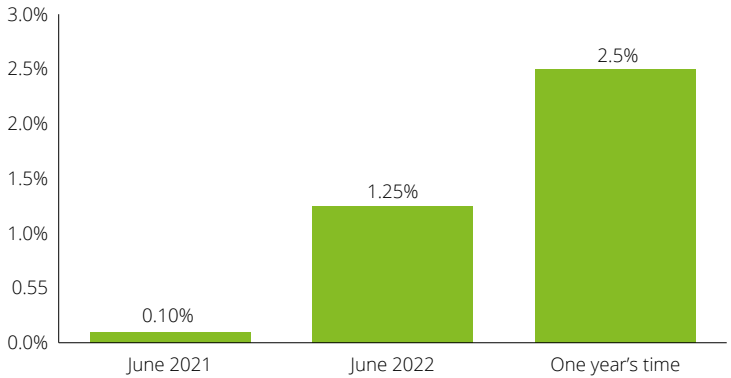
Net % of CFOs reporting credit is costly and credit is easily available



CFOs expect the Bank of England to double interest rates over the next 12 months, taking them to levels not seen since 2008. A tightening of monetary policy such as that foreseen by our panel is likely to further raise the cost of financing for corporates.

Chart 10. Interest rate expectations

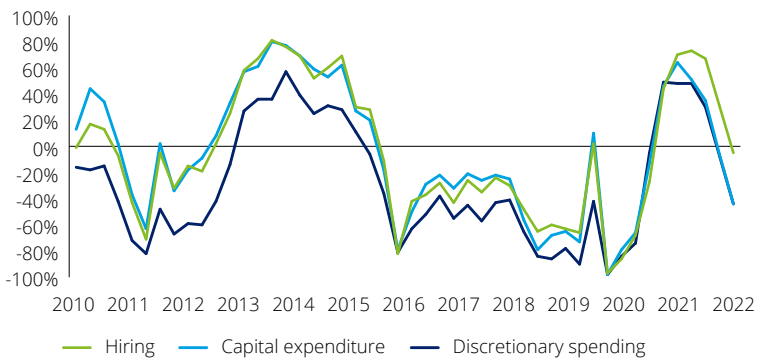
Historic and current levels of the Bank of England's base rate and the median of CFOs' expectations for its level in a year's time



While CFOs are almost unanimous in their expectation of a rise in corporates' operating costs, they expect a fall in discretionary and capital spending. In line with corporates' defensive shift, they expect to see a slight fall in hiring activity over the next 12 months.

Chart 11. Outlook for corporate spending

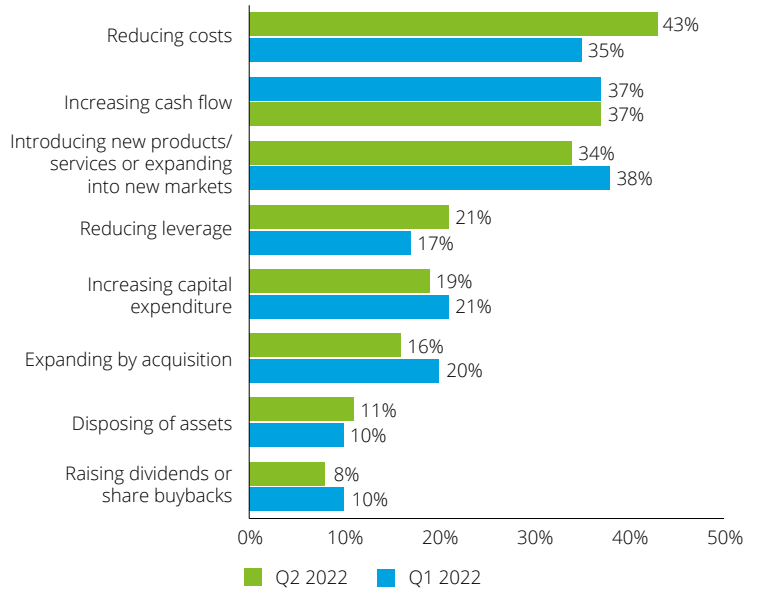
Net % of CFOs who expect UK corporates' hiring, capital expenditure and discretionary spending to rise over the next 12 months



Corporates plan for growth in medium-term

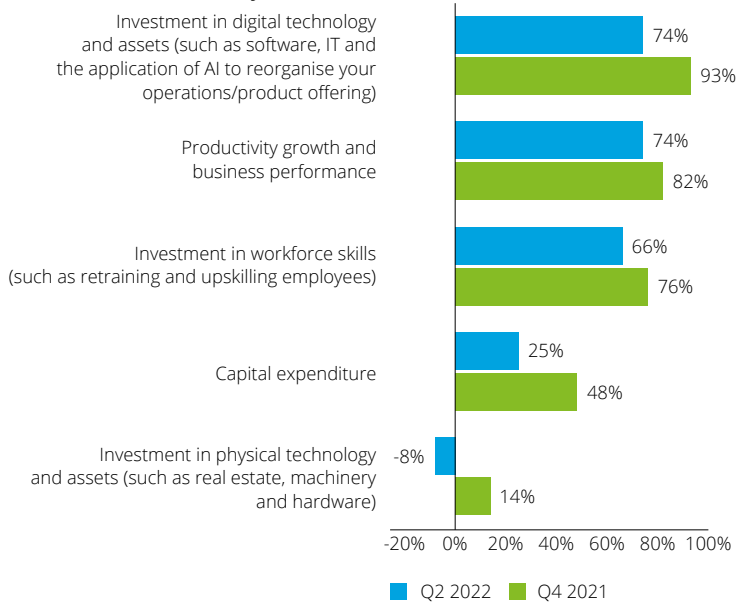
The increase in uncertainty, high inflation and growing recession fears have led CFOs to weaken their focus on expansionary strategies such as introducing new products or expanding into new markets, expanding by acquisition or increasing capital expenditure. Defensive strategies are being given greater weight. Given the sharp increase in costs that many businesses are facing, there is a renewed focus on cost reduction, with over four in ten CFOs saying it is a strong priority for the coming year.

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



While the mood among business leaders has clearly shifted since the end of last year, the vast majority still expect faster growth in productivity and capital expenditure than was seen prior to the pandemic, a period marked by weak investment and disappointing growth. Investment in digital technology and workforce skills is expected to increase.

Chart 13. Post-pandemic investment and productivity
% of CFOs who expect the following to increase relative to the pre-pandemic trend over the next three years



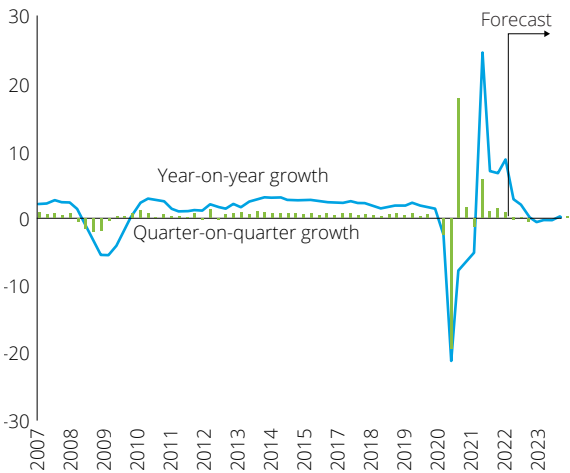
CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q2 2022

The second quarter of 2022 saw the economic implications of the war in Ukraine continue to weigh on global growth. Western countries imposed new rounds of sanctions and moved to drastically cut their imports of energy from Russia. The escalation in tensions meant that energy and food prices remained at unusually high levels, driving inflation above 8% in the euro area, UK and US. Authorities in China responded to highly transmissible COVID-19 variants with strict lockdowns, hitting supply chains and activity in the country before reopening towards the end of the quarter.

Despite growing fears of a global recession, central banks struck an increasingly hawkish tone and continued to signal that a further tightening of policy was likely over the rest of the year. This drove further declines in equity and bond markets. The confluence of all these factors led economists to revise their growth forecasts down for almost all advanced and most emerging markets. Commodity exporters benefitted from higher commodity prices but rising energy prices and the strength of the dollar put a number of commodity-importing emerging markets under particular pressure.

UK GDP growth: Actual and forecast (%)



Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index



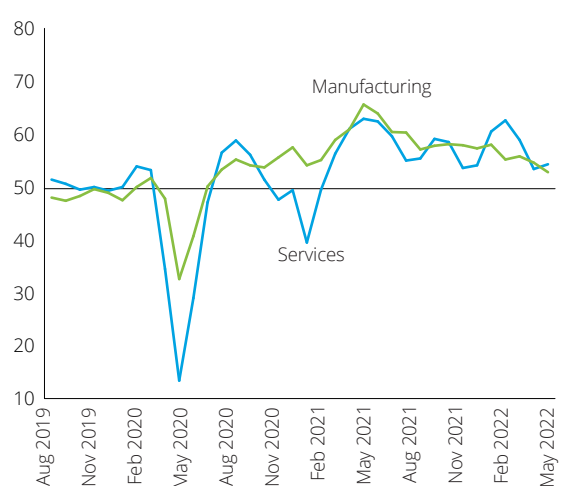
Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)



Source: Refinitiv Datastream

Markit Purchasing Manager Indices (UK)

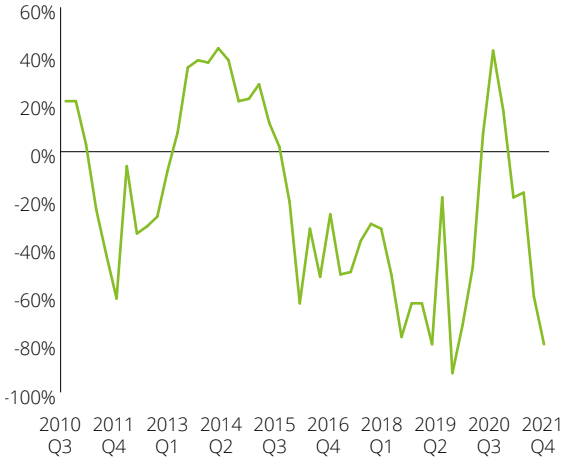


Source: Refinitiv Datastream, readings above 50 indicate expansion

Two-chart summary of key survey messages

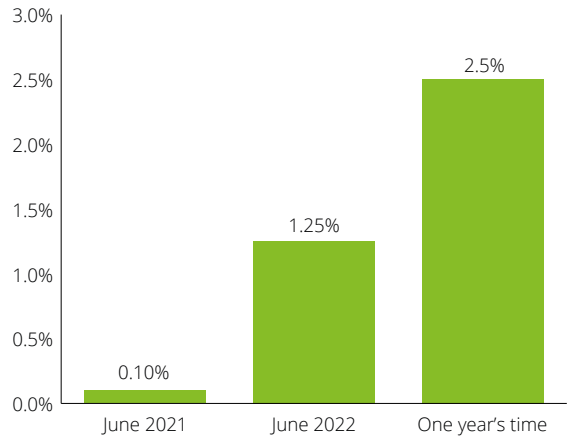
Outlook for margins

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



Interest rate expectations

Historic and current levels of the Bank of England's base rate and the median of CFOs' expectations for its level in a year's time



About the survey

This is the 60th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2022 second quarter survey took place between 16th June and 30th June. 77 CFOs participated, including the CFOs of 15 FTSE 100 and 32 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 49 UK-listed companies surveyed is £392 billion, or approximately 16% 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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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



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