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Q3 2017

The Deloitte CFO Survey

Optimism bounces

Business confidence has been on the rise in the US, Europe and Japan since last summer. In the UK domestic events have been in the driving seat, leading to big ups and downs in sentiment among UK Chief Financial Officers. CFO optimism collapsed in the wake of the EU referendum vote, rebounded in the second half of 2016 before dropping on the result of June's General Election. Our latest survey shows a bounce back from the post-election lows with optimism close to levels seen at the end of last year. CFOs believe the environment has become less uncertain, with perceptions of uncertainty dropping to almost half the levels prevailing immediately after the EU referendum.

CFO concerns over Brexit have also eased, with 60% of CFOs expecting the UK's exit from the EU to affect the business environment adversely, down from 72% in the second quarter. Nonetheless, CFOs continue to see Brexit as the top risk facing their businesses. Almost a third expect to reduce investment over the next three years as a result of Brexit and 36% expect it to hit hiring.

CFOs rate weak UK demand as the second greatest risk, with prospects for higher interest rates in third place. CFOs have brought forward their expectations for a UK rate rise and 92% now expect base rates to be higher than the current 0.25% level in a year's time.

The post-referendum surge in inflation also seems to be squeezing corporate margins. CFOs report that cost pressures are running at the highest level in more than six years. As a result, while optimism and expectations for revenues have recovered from last year's lows, profit expectations continue to languish.

Businesses are rather more upbeat today than in July and see fewer risks in the world. Nonetheless, perceptions of uncertainty remain elevated and Brexit continues to top the CFO worry list. With margins under pressure CFOs are operating cautiously. It is testament to the changeable business environment that eight years into the UK recovery cost control is the top balance sheet priority for major UK corporates.

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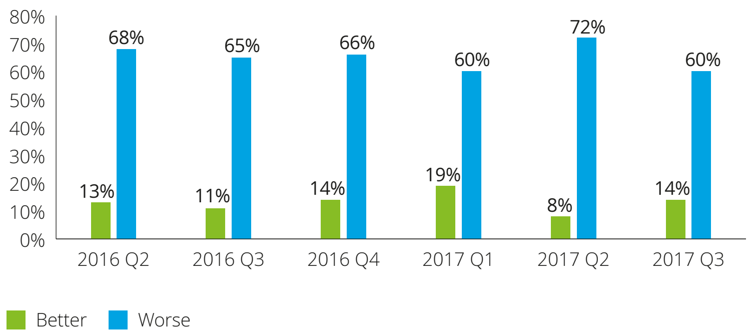
For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:

www.deloitte.co.uk/cfosurvey

Chart 1. 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 (excludes 'little changed')

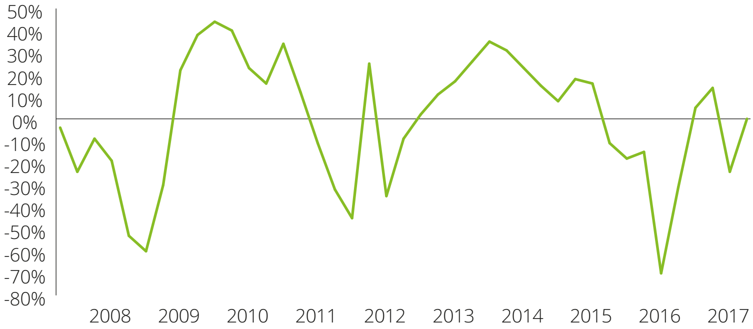


Optimism up

After its post-election drop, business optimism has recovered in the third quarter.

Chart 2. Business optimism

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

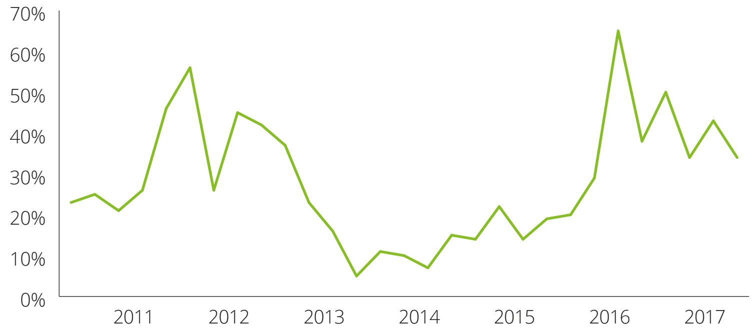


Perceptions of uncertainty dipped since the last survey, back to levels seen before the General Election and is now running at almost half their post-referendum highs in July last year.

34% of CFOs rate current levels of external financial and economic uncertainty as high or very high.

Chart 3. Uncertainty

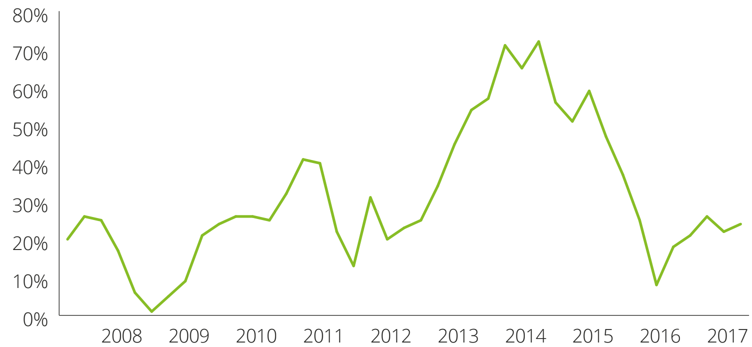
% CFOs who rate the level of external financial and economic uncertainty facing their business as high or very high



Corporate risk appetite has seen a modest rise in the third quarter but remains well below its long-term average.

Chart 4. Corporate risk appetite

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



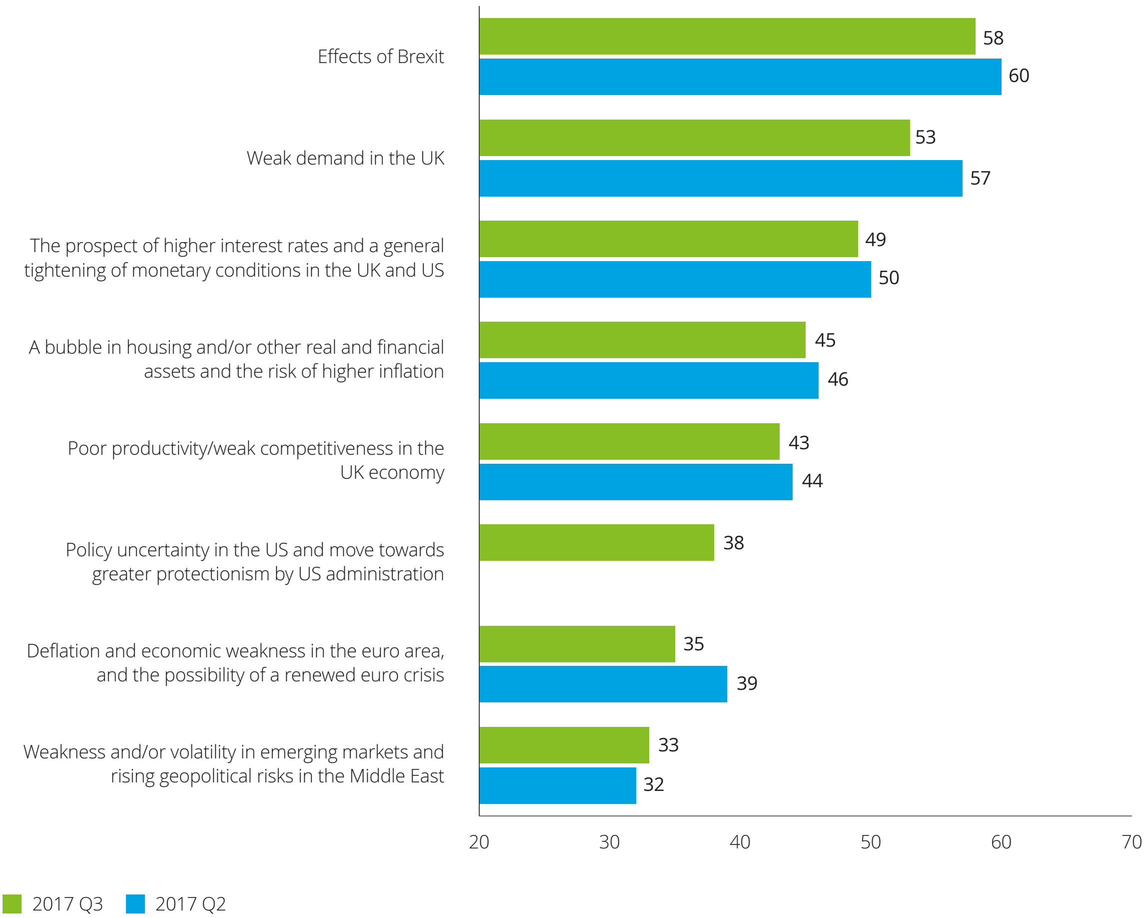
Brexit tops risk list

Despite a reduction in concerns, CFOs continue to cite Brexit as the biggest risk to their businesses. Weak demand in the UK and the prospect of rate rises in the US and UK, which have both diminished in importance, make up the top three risks. Concerns over weak demand feature as a prominent risk for the second consecutive quarter.

The risks of an asset price bubble and poor productivity in the UK have also receded.

As growth picks up in the euro area, concerns over economic weakness and deflation in the region have dropped to the lowest levels since the end of 2014. Meanwhile, the risk posed by weakness in emerging markets and geopolitical tensions has risen slightly.

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



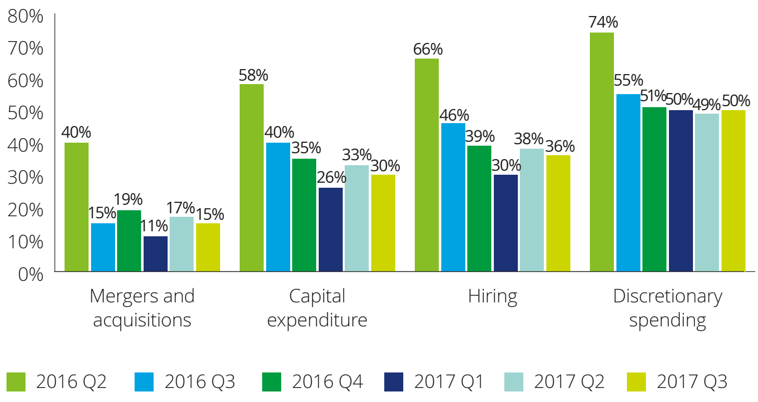
Operating costs rising

CFO pessimism about the effects of Brexit has edged lower.

30% or more now expect Brexit to reduce their own investment and hiring plans over the next three years.

15% expect it to lower M&A activity over the same period.

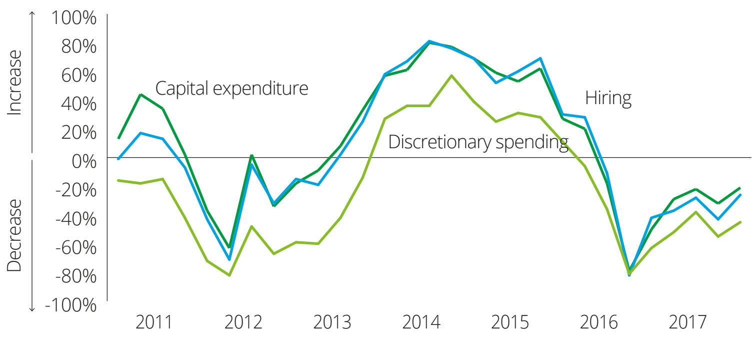
Chart 6. Effect of Brexit on own spending and hiring decisions
% of CFOs who expect M&A activity, capital expenditure, hiring and discretionary spending by their business to decrease over the next three years as a consequence of Brexit



The outlook for capital expenditure, hiring and discretionary spending has improved slightly in the third quarter.

Yet, on balance, CFOs 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

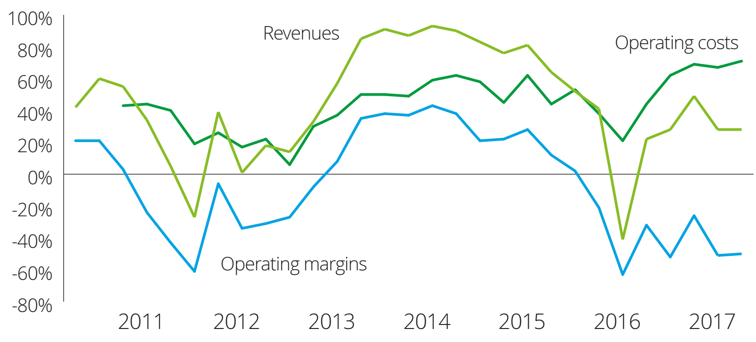


The outlook for corporate revenue and margin growth remains largely unchanged in the third quarter.

However, expectations of an increase in operating costs have grown.

A net 71% of CFOs expect operating costs to increase over the next 12 months, the highest reading in more than six years.

Chart 8. Outlook for corporate revenues and margins
Net % of CFOs who expect UK corporates' revenues and margins to increase over the next 12 months



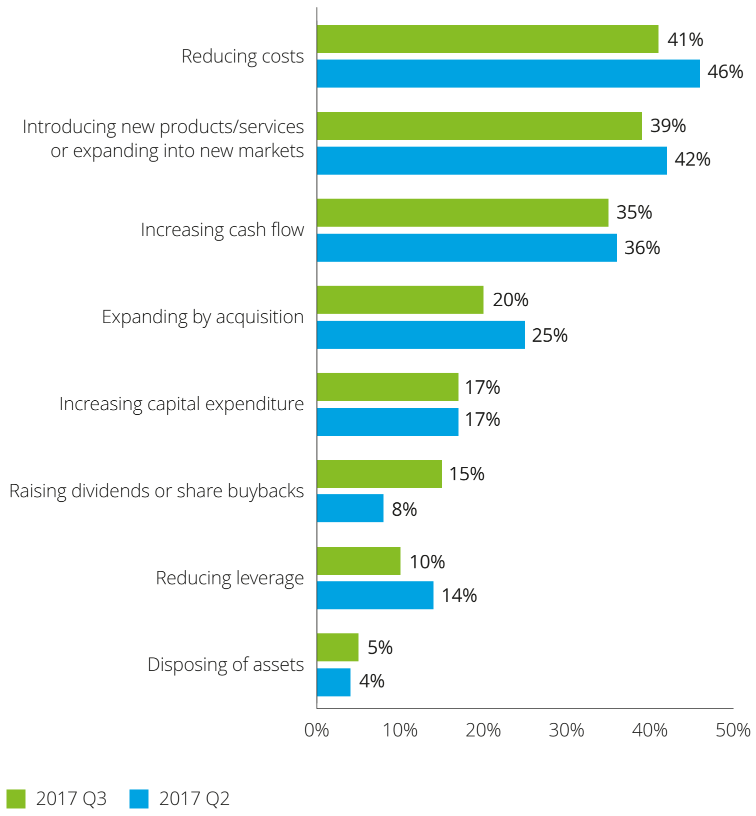
Focus on defensive strategies

CFOs are placing less emphasis on expansionary strategies such as introducing new products and services and expanding by acquisition.

They have also softened their focus on defensive strategies such as cost reduction, which still remains the top priority, increasing cash flow and reducing leverage.

Chart 9. Corporate priorities in the next 12 months

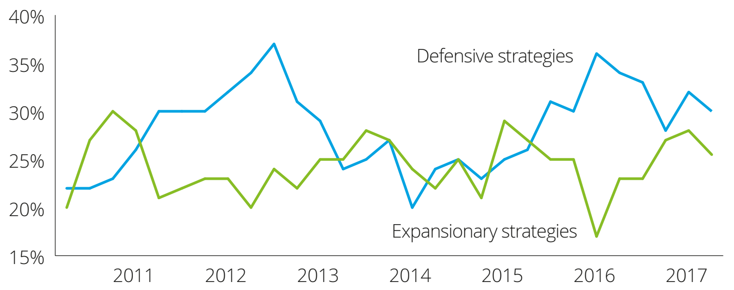
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



On balance, CFOs maintain a defensive stance despite placing less emphasis on both defensive and expansionary strategies relative to the second quarter.

Chart 10. 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



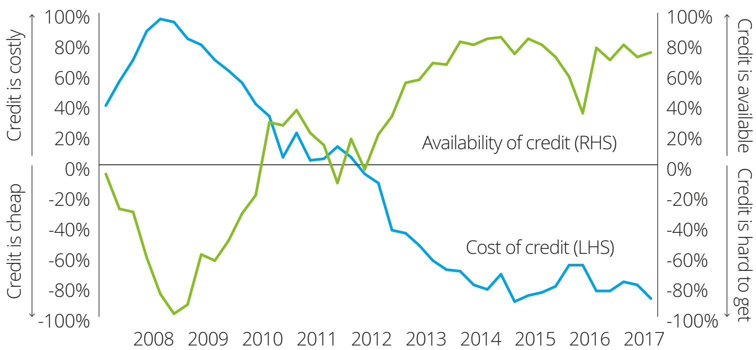
Arithmetic average of the % of CFOs who rated expansionary and defensive strategies as a strong priority for their business in the next 12 months.
Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure.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

Easy access to credit

The large corporates on our survey panel have easy access to credit.

CFOs continue to view credit as being easily available and close to its cheapest in ten years.

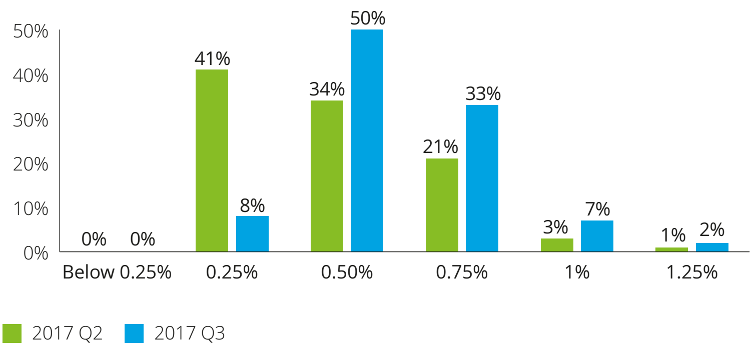
Chart 11. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available



CFOs have brought forward their expectations for rate rises.

A large majority – 92% – expect the Bank of England's base rate to be above its current level of 0.25% in a year's time, up from 56% in the second quarter.

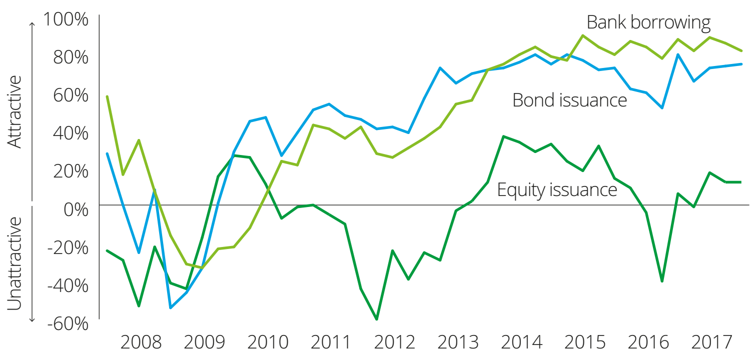
Chart 12. Interest rate expectations
% of CFOs who expect the Bank of England's base rate to be at the following levels in a year's time



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

Equity issuance remains relatively less appealing.

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 Q3 2017
The momentum in the global recovery picked up as growth became more synchronised across countries. Growth in the euro area has been particularly strong and the European Central Bank (ECB) now expects it to reach 2.2% in 2017, the fastest rate in a decade. Business and consumer confidence was buoyant, particularly in the euro area and the US. Business confidence in Japan reached a 25-year high and the economy posted its longest unbroken period of growth in more than a decade. In the UK, growth remains subdued and although unemployment is at its lowest level in 42 years, wage pressure has not yet emerged. The weakness of sterling has made British exports more competitive, with survey data showing that manufacturing export orders are close to their highest levels in 20 years. With high levels of consumer debt and inflation running at 2.9%, there is renewed speculation that the Bank of England will raise rates at its next meeting in November. Other central banks have also begun to normalise monetary policy. Having raised rates four times since 2015, the US Federal Reserve plans to start unwinding its Quantitative Easing (QE) programme at the end of October. Meanwhile, the Bank of Canada has begun to raise rates and the ECB also intends to announce how it plans to unwind its QE programme at the end of October.

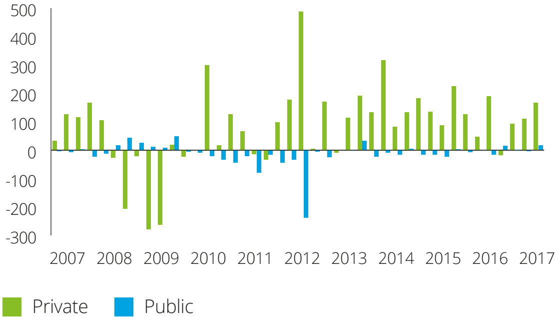
UK GDP growth: Actual and forecast (%)

Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index

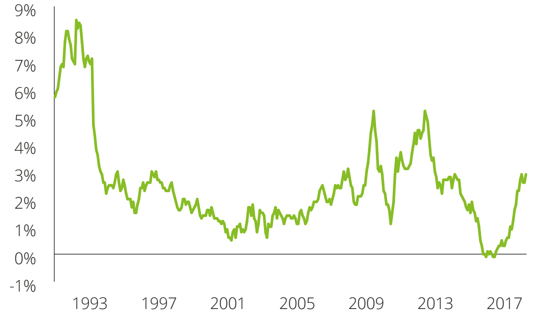
Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands)



Source: Thomson Reuters Datastream

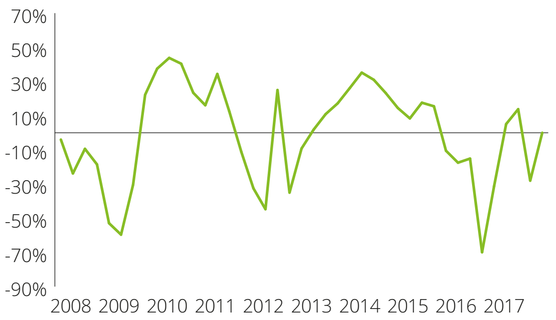
UK annual CPI inflation (%)



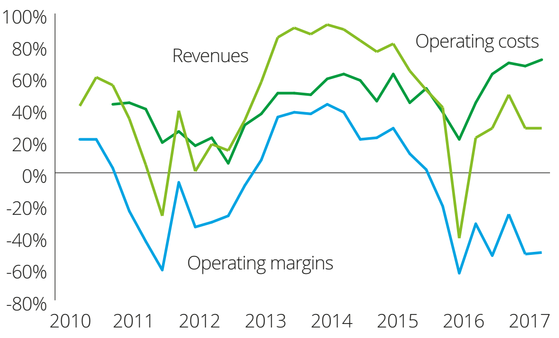
Source: Thomson Reuters Datastream

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



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



About the survey
This is the 41st quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2017 third quarter survey took place between 14th September and 4th October. 102 CFOs participated, including the CFOs of 20 FTSE 100 and 40 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 75 UK-listed companies surveyed is £416 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 Anthea Neagle on 020 7303 0116 or email **aneagle@deloitte.co.uk**

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