Deloitte.

Q4 2022

The Deloitte CFO Survey

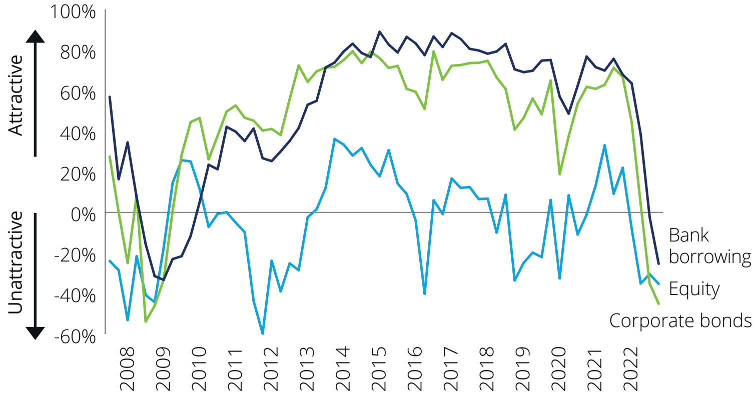
Credit conditions tighten

By raising interest rates, the Bank of England aims to make credit less attractive and dampen inflation. On the evidence of Deloitte's latest survey of Chief Financial Officers, the Bank's policy is working.

Between December 2009 and December 2021 UK base rates averaged 0.5% and the CFOs of Britain's largest corporates saw debt as offering by far the most attractive form of finance for their business. Today, with interest rates at 3.5%, CFOs rate credit as being more expensive than at any time since 2009. Debt is increasingly out of favour. Not since the financial crisis have CFOs rated bank borrowing and debt issuance as being less attractive than they do today.

The most aggressive tightening of monetary policy in more than 30 years is reshaping corporate attitudes to debt. In the era of ultra-low interest rates debt finance easily eclipsed equity. Now they are roughly on par in the eyes of CFOs. Demand for credit is well below average levels and flagging.

Chart 1: Corporate financing
Net % of CFOs who rate the following sources of funding for UK corporates as very or somewhat attractive



Concerns about levels of leverage in the corporate sector have edged up.

Despite the challenging macro environment CFOs' perception of external risk, particularly inflation, has eased since October's peak. The CFO risk rating for eleven of the areas tracked in the survey have declined with only two, relating to weakness in the US economy and in emerging markets, increasing. The largest decline relates to inflation, a shift that is reflected in reduced perceptions of risk around supply chains, labour shortages and the prospect of higher interest rates. Concerns about energy prices and supply have eased significantly, consistent with the decline in energy prices since the summer and high levels of European stocks of gas.

CFOs also report a fall in supply disruptions faced by their businesses and expect significant further falls over the next two years. Only one in ten CFOs expect significant or severe supply disruptions in a year's time, the lowest reading since we started asking this question in mid-2021.

Although CFOs report an easing of recruitment difficulties, almost a third said their businesses experienced severe or significant recruitment difficulties or labour shortages. However, they see a sharp improvement in hiring conditions in a year's time with just 17% expecting severe or significant recruitment difficulties by then.

Expectations for hiring have fallen sharply, with far more CFOs expecting to reduce hiring in the next 12 months than to increase it. The easing of CFOs' concerns about inflation, and reduced expectations for labour shortages and supply bottlenecks, fit with the idea that the UK has passed the peak in inflation for this cycle.

Although CFOs expect cuts in capital expenditure, discretionary spending and hiring over 2023, they remain positive on investment in certain areas over the medium term. The overwhelming majority (92%) expect higher investment in workforce skills over the next three years, almost eight in ten (79%) expect greater investment in digital technology and assets, and more than 70% expect increased productivity growth and business performance over a three-year timeframe.

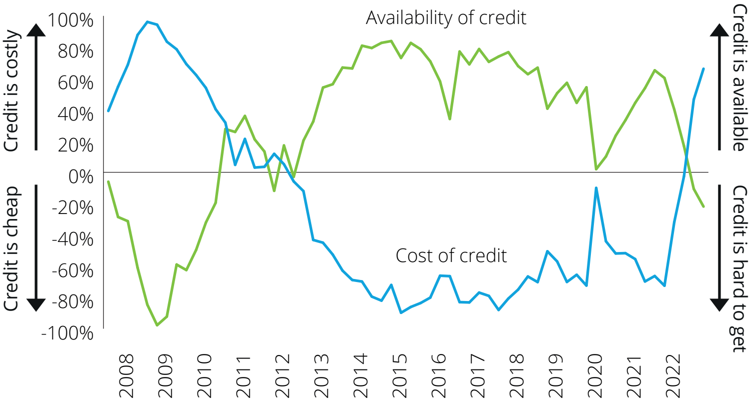
Finance leaders also see some opportunities in the coming downturn. About one in three see the more competitive environment allowing stronger firms to grow their market share. 29% see this as an opportunity to implement/accelerate structural change in their businesses and 26% see an opportunity to optimise the pricing of their products and services.

Credit conditions tighten

Between December 2009 and December 2021 UK base rates averaged 0.5%. Today, with interest rates at 3.5%, CFOs rate credit as being more expensive than at any time since 2009.

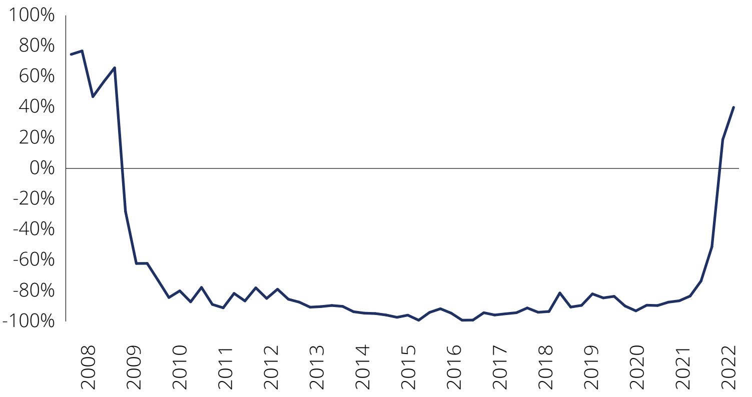
The availability of credit has also declined, and is now at its lowest level in more than ten years.

Chart 2. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available



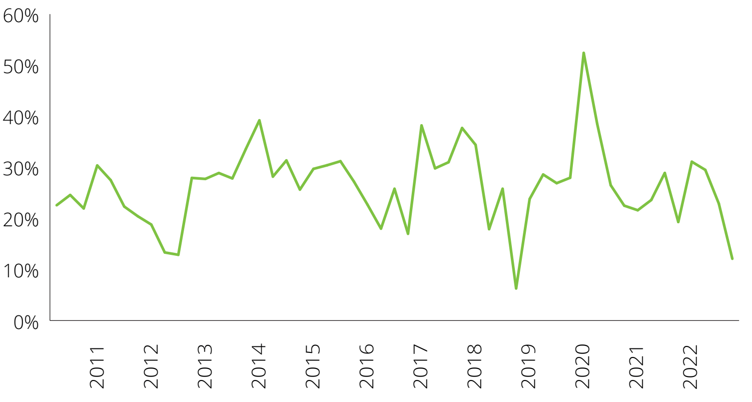
This increase in rates is reflected in CFOs' characterisation of short-term interest rates as being at their highest level since 2008.

Chart 3. Short-term interest rates
Net % of CFOs who characterise short-term market interest rates in the UK as quite high or very high



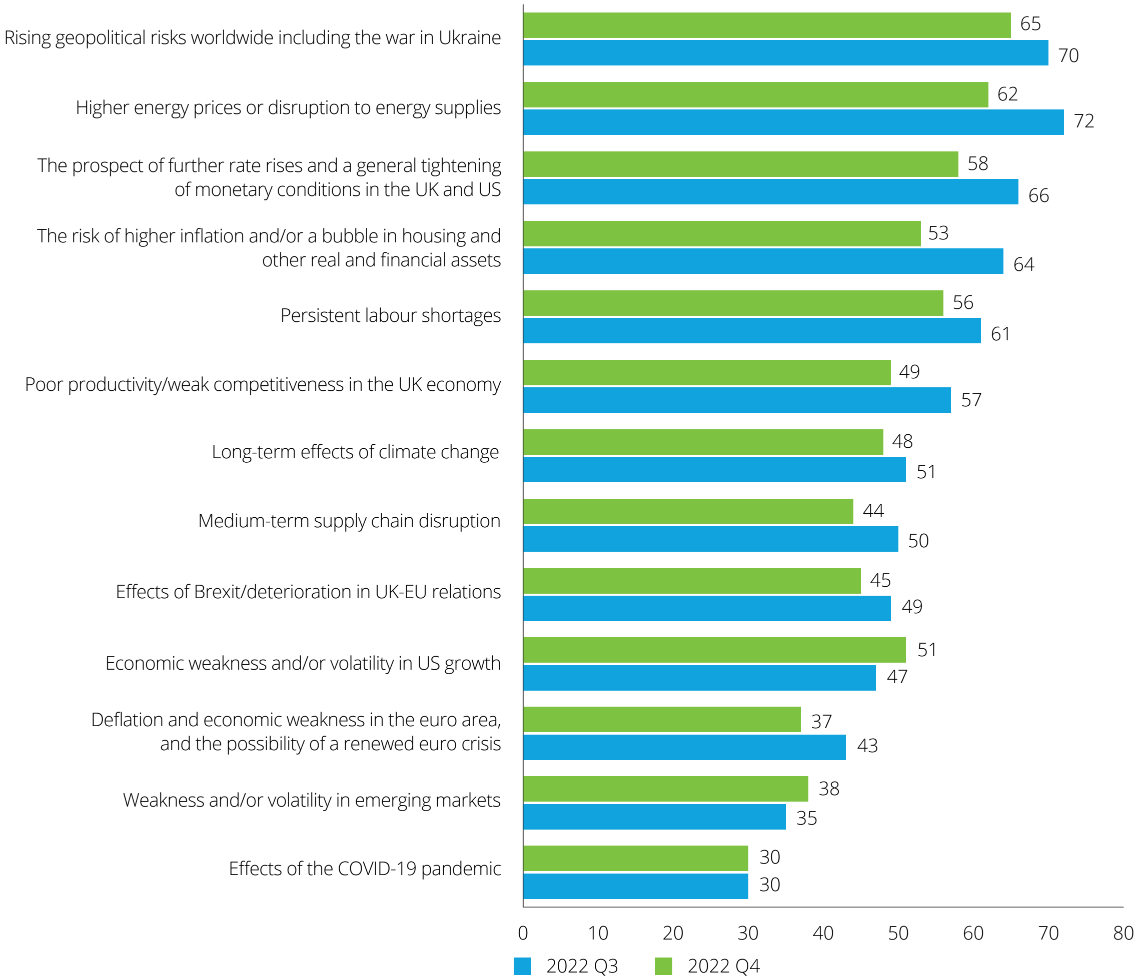
The higher cost of credit is reducing demand for borrowing. CFOs expect the weakest demand for new credit since 2018.

Chart 4. Corporate credit demand
Net % of CFOs who expect their own business's demand for new credit to increase over the next 12 months



Reduced risks of energy disruption and inflation

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

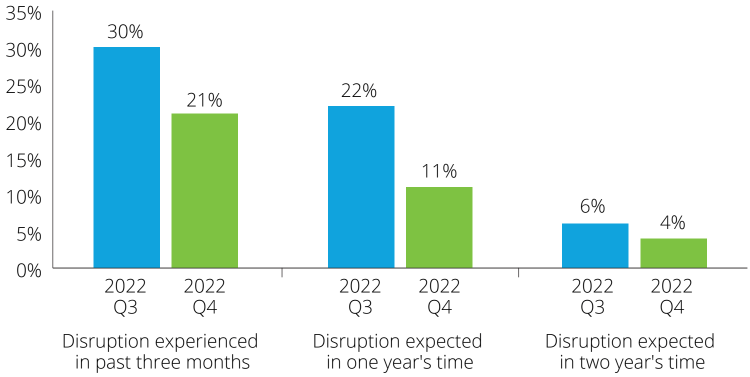


Despite the challenging macro environment CFOs' perception of external risk, particularly inflation, has eased since October's peak. The CFO risk ratings for ten of the thirteen areas tracked in the survey have declined. Only two areas, relating to weakness in the US economy and in emerging markets, have seen an increase in risk ratings. The largest decline relates to inflation, a shift that is reflected in reduced perceptions of risk around supply chains, labour shortages and the prospect of higher interest rates. Concerns about energy prices and supply have eased significantly, consistent with the decline in energy prices since the summer and high levels of European stocks of gas.

Inflation tide turning

CFOs report a fall in supply disruptions faced by their businesses and expect further significant falls over the next two years. Around one in ten CFOs expect significant or severe supply disruptions in a year's time, the lowest reading since we started asking this question in mid-2021.

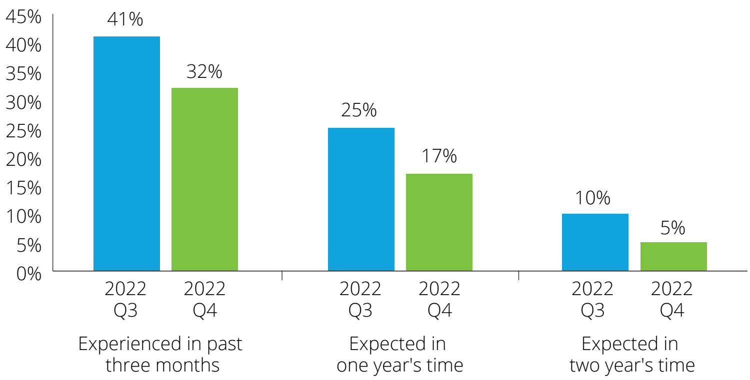
Chart 6. Supply chain disruption
% of CFOs who report significant or severe levels of supply chain disruption experienced by their business over the last three months and those expecting similar levels of disruption in one year's and two years' time



CFOs reported some easing of recruitment difficulties in the fourth quarter. Yet, almost a third continue to say their businesses experienced severe or significant recruitment difficulties or labour shortages in the three months before the survey.

CFOs expect to see significant improvements in future with just 17% expecting severe or significant recruitment difficulties in a year's time.

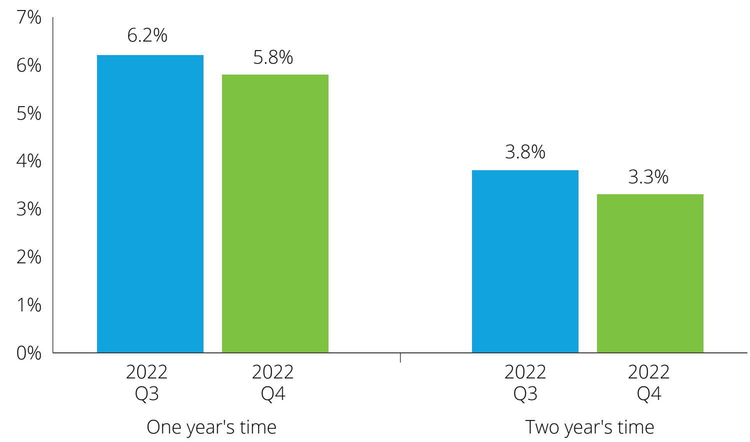
Chart 7. Recruitment difficulties and labour shortages
% of CFOs who report significant or severe levels of recruitment difficulties or labour shortages experienced by their business over the last three months and those expecting similar levels of disruption in one year's and two years' time



The moderation of supply chain disruptions and labour shortages also translates into an easing in CFOs' inflation expectations.

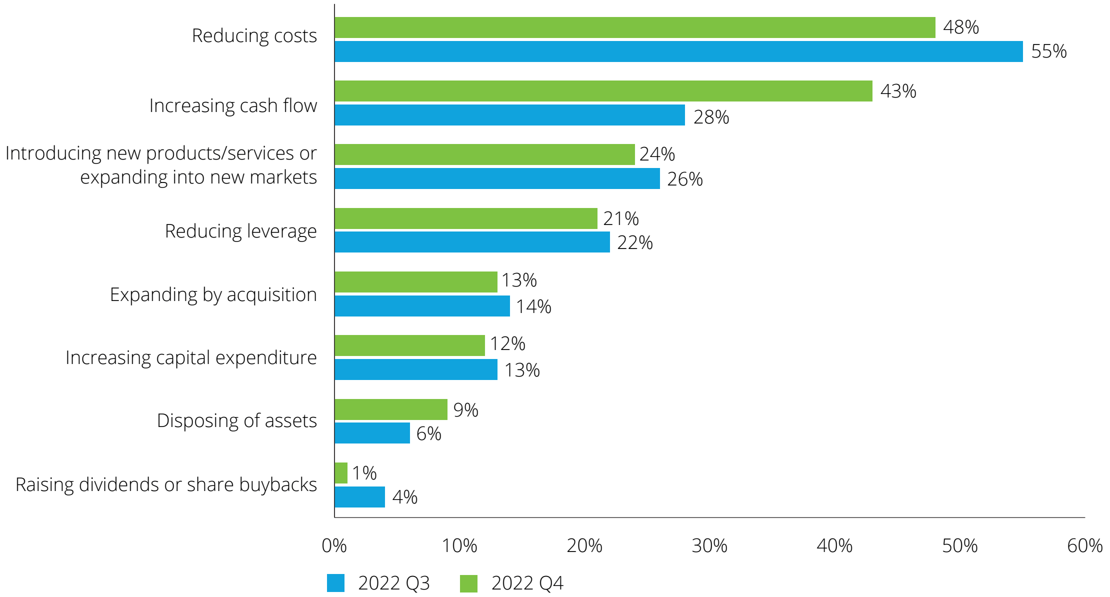
They expect inflation to fall to 5.8% in a year's time and to 3.3% in two years' time. This represents a marked softening of inflation expectations relative to the last quarter.

Chart 8. Inflation expectations
CFOs' median expectations for inflation in one year's time and two years' time



Cost reduction remains top priority

Chart 9. 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



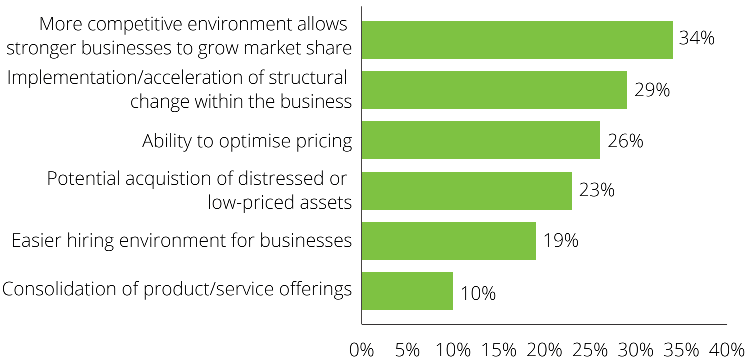
UK CFOs maintained a cautious strategy stance in the fourth quarter, with the weakest focus on expansionary strategies in two-and-a-half years and the strongest focus on defensive strategies in two years. The increased focus on defensive strategies was driven by a sharp rise in the priority given to increasing cash flow. With CFOs also reporting significant rises in operating costs and margin pressure it is unsurprising that cost reduction remains the top priority overall.

The priority given to returning cash to shareholders by raising dividends or buying back shares is at its second-lowest point on record – only during the very beginning of the pandemic did this reading dip lower than 1%. With the attractiveness of debt as a source of finance now down to similar levels as that of equity, it is perhaps not surprising that companies are in no rush to return cash to shareholders.

Despite the challenging backdrop, over a third of CFOs see a more competitive environment as a significant opportunity for their business, allowing them to grow market share.

Similarly, almost three in ten CFOs see this downturn as an opportunity to implement or accelerate structural change within their businesses.

Chart 10. Opportunities in the coming downturn
% of CFOs who identify the following as a significant opportunity for their business in the coming downturn



Risk appetite remains low

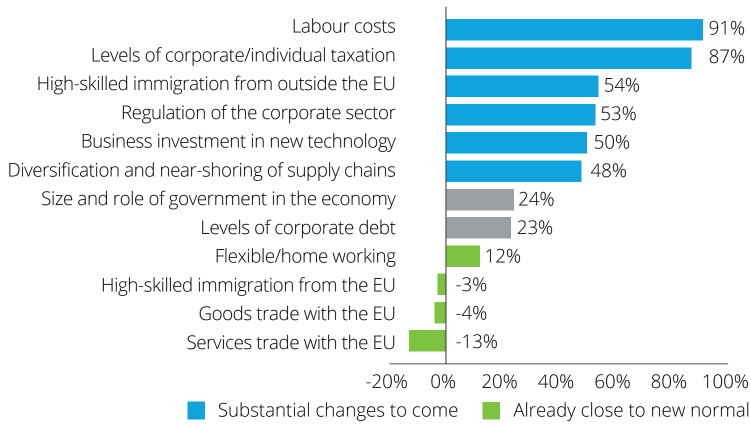
Only one in ten CFOs think that now is a good time to take greater risk onto their balance sheets. Risk appetite remains well below its long-term average of 26%.

Chart 11. Corporate risk appetite
% of CFOs who think this is a good time to take greater risk onto their balance sheets

When asked their views on the external and business environment in the long term, CFOs report that the most likely changes relative to 2022 are higher labour costs, higher taxation and more high-skilled immigration to the UK from non-EU countries.

Levels of flexible or home working, high-skilled immigration from the EU and volumes of trade with the EU appear to be closer to a new normal following Brexit and the pandemic.

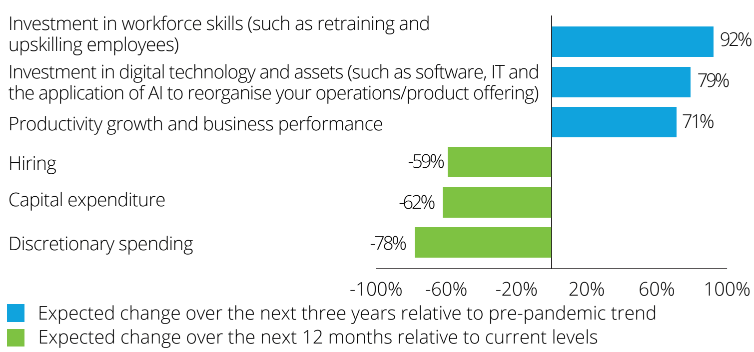
Chart 12. Long-term changes
% of CFOs who expect the following to increase in the longer term compared to this year



Although CFOs expect cuts in capital expenditure, discretionary spending and hiring over 2023, they remain positive on investment in certain areas over the medium term.

The overwhelming majority expect higher investment in workforce skills over the next three years, almost eight in ten expect greater investment in digital technology and assets, and more than 70% expect increased productivity growth and business performance over a three-year timeframe.

Chart 13. Changes in corporate focus
Net % of CFOs who expect investment in workforce skills, investment in digital technology assets, investment in physical technology and assets, and productivity growth and business performance to increase over the next three years relative to the pre-pandemic trend, and net % of CFOs who expect UK corporates' hiring, capital expenditure and discretionary spending to increase over the next 12 months relative to current levels

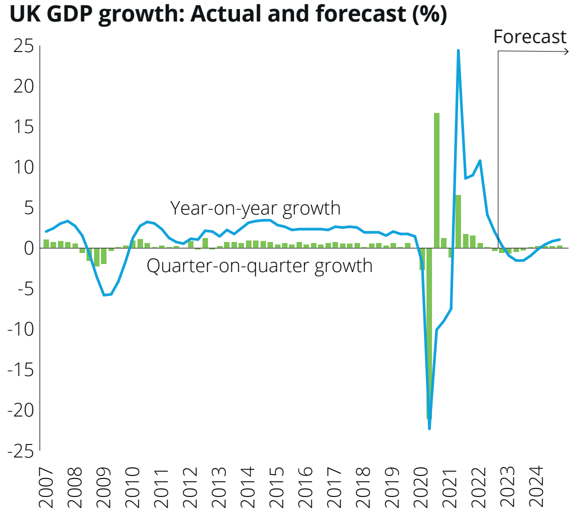


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q4 2022

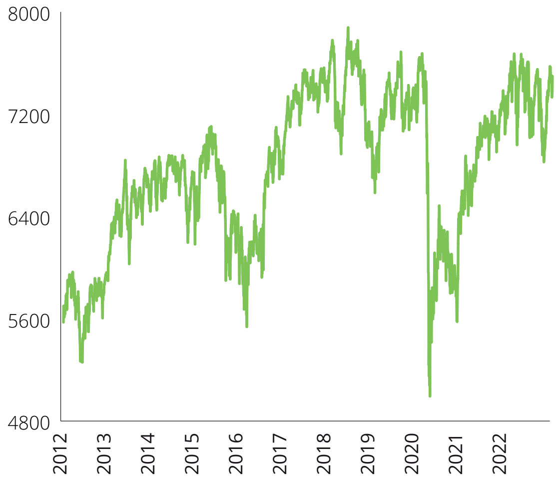
Although 2022 saw the highest inflation rates across developed economies in 40 years, the fourth quarter brought some reassuring signs of inflation potentially peaking in the US, UK and Europe. Energy prices fell as the risk of gas shortages in Europe receded, and supply chain pressures eased significantly. Economic activity is slowing down as the impact of tighter monetary policy and price pressures squeezes real incomes and demand, especially in the developed world. Despite raising interest rates throughout the fourth quarter, western central banks have slowed down the pace of monetary tightening. Labour markets remained resilient, with unemployment rates at historically low levels. We saw some early signs of cooling, with a decline in job vacancies in the UK. Although China's shift away from its zero-COVID policy is likely to ease supply bottlenecks, the subsequent surge in Chinese COVID-19 cases has dampened growth. UK fiscal policy was tightened substantially alongside the reversal of policies announced in the September mini-budget, easing pressures on gilts and leading to an appreciation of the pound.

UK GDP growth: Actual and forecast (%)



Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index

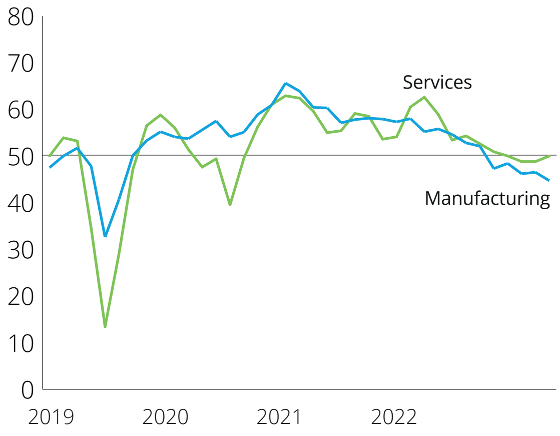


Source: Refinitiv Datastream

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

Chart 2. Cost and availability of credit
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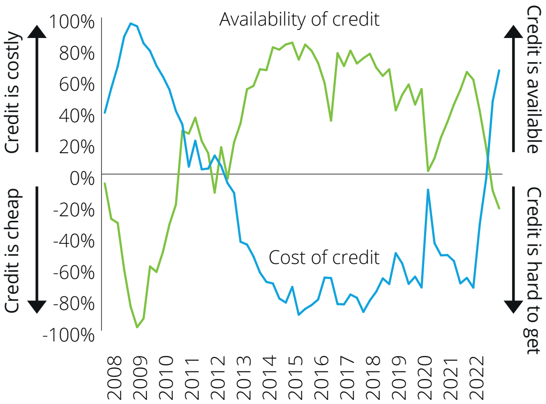

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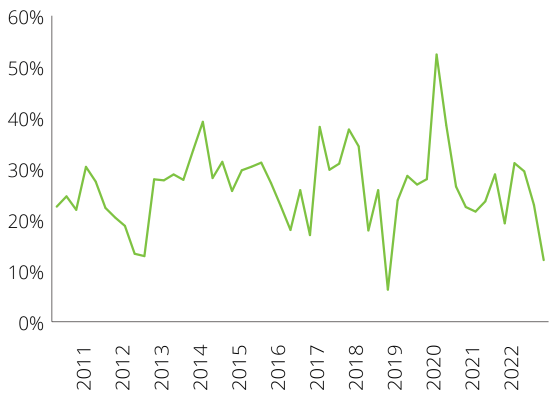

About the survey
This is the 62nd quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2022 fourth quarter survey took place between 6th December and 16th December. 78 CFOs participated, including the CFOs of 17 FTSE 100 and 32 FTSE 250 companies. 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 53 UK-listed companies surveyed is £363 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 Elaine Hoang on 020 7007 4717 or email ehhoang@deloitte.co.uk.

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