Deloitte.

The Deloitte CFO Survey

Corporate caution, financial market optimism

The second quarter CFO Survey examined sentiment among the UK's largest businesses in the last two weeks of June. This coincided with the campaign for the leadership of the Conservative Party and growing concerns over global trade and growth. A more challenging environment is weighing on the corporate sector with risk appetite among UK Chief Financial Officers falling to the lowest level since the failure of Lehman Brothers in 2008. Just 4% of CFOs say now is a good time to take risk onto their balance sheet with 96% disagreeing.

Brexit is the top concern for CFOs, with geopolitical worries and trade fears in second and third position on the worry list. CFOs are now more pessimistic about the long-term impact of Brexit than at any time in the last three years, with a record 83% believing that it will lead to a deterioration in the economic environment in the long term. Events in the last three years have clearly added to, rather than reduced, worries about the impact of Brexit.

This is not solely a question of the long-term outlook. Brexit has not happened, but it is acting as a drag on corporate sentiment and spending. 62% of CFOs expect to reduce hiring in the next three years because of Brexit and 47% expect to reduce capital spending.

UK unemployment hit a 45-year low in May while growth in average earnings has gathered pace over the last year. So as well as contending with slower revenue growth, corporates also face mounting wage pressures. Almost half of CFOs say that recruitment difficulties have risen, up from less than a third 18 months ago.

The hesitant mood captured by the CFO Survey is in marked contrast to the buoyant spirits recently on display in financial markets. Hints from the Federal Reserve and the European Central Bank of easier monetary policy to come have boosted equities.

Equity valuations imply that investors believe that central banks will save the day. The downbeat mood of UK CFOs, one that is also on view in the German IfO and the US ISM surveys, suggests business is less sanguine.

Authors

Ian Stewart
Chief Economist
020 7007 9386
istewart@deloitte.co.uk

Debapratim De
Senior Economist
020 7303 0888
dde@deloitte.co.uk

Tom Simmons
Economic Analyst
020 7303 7370
tsimmons@deloitte.co.uk

Peter Ireson
Economic Analyst
0117 984 1727
pireson@deloitte.co.uk

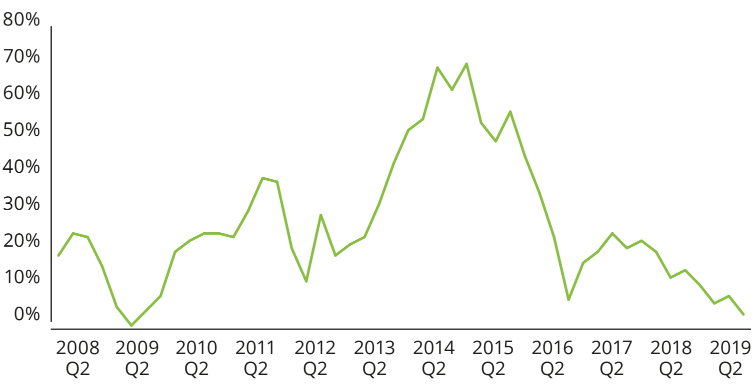
Key contacts

Ian Stewart
Chief Economist
020 7007 9386
istewart@deloitte.co.uk

Richard Muschamp
CFO Programme Leader
020 7007 0724
rmuschamp@deloitte.co.uk

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



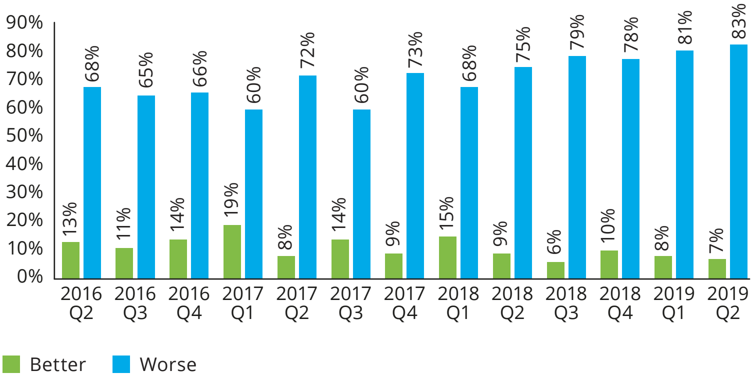
Uncertainty weighing on investment

CFO pessimism over the long-term impact of Brexit is at its highest level since we started asking the question in the summer of 2016.

83% of CFOs now expect Brexit to lead to a worsening of the business environment in the long term.

Chart 2. 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)

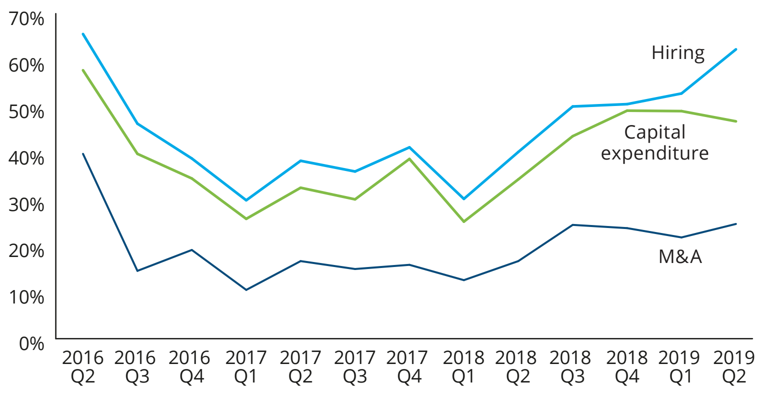


CFOs expect short-term spending and hiring to be negatively impacted by Brexit.

62% of them expect hiring to decrease over the next three years due to Brexit – the highest level since 2016.

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

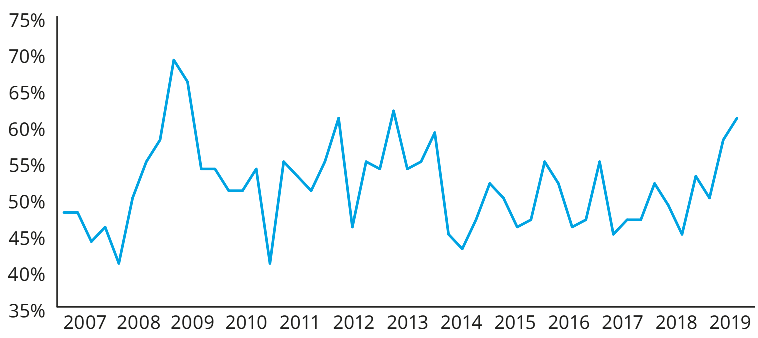
% of CFOs who expect M&A activity, capital expenditure and hiring by their business to decrease over the next three years as a consequence of Brexit



Elevated levels of uncertainty are acting as a drag on business investment. In the latest CBI Industrial Trends Survey, 61% of manufacturers cited demand uncertainty as a factor limiting capital expenditure, the highest reading in six years.

Chart 4. Effect of uncertainty on investment

% of manufacturers rating demand uncertainty as a factor limiting investment



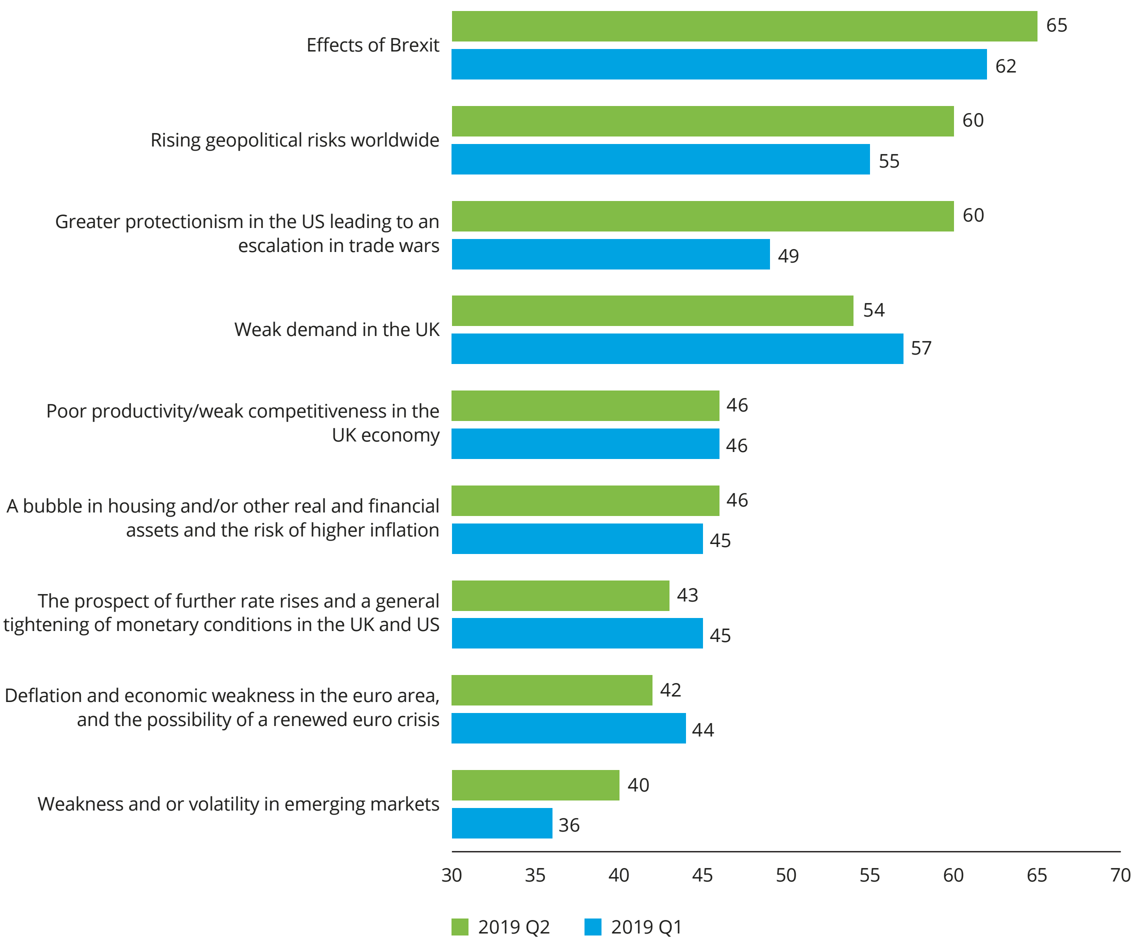
Source: CBI Industrial Trends Survey

Brexit remains top risk

CFOs continue to rank Brexit as the biggest risk facing their businesses. Concern has risen over the risks posed by geopolitics and the threat of an escalation in trade wars. Despite the recent thawing of tensions between the US and China, the breakdown of trade talks in May has weighed heavily on global financial markets and business sentiment.

CFOs are less worried about further interest rate rises after the US Federal Reserve and European Central Bank signalled an increased likelihood of monetary easing.

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



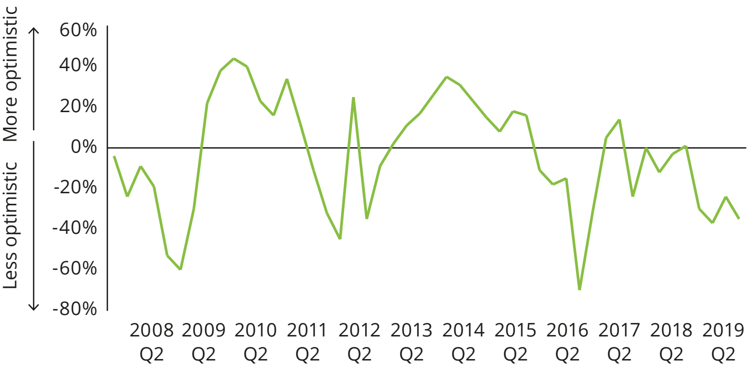
Optimism down

CFO optimism continues to track downwards, though it is still some way above the level seen after the 2016 referendum.

A net 35% of CFOs are more pessimistic about the financial prospects for their company than they were three months ago.

Chart 6. Business optimism

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

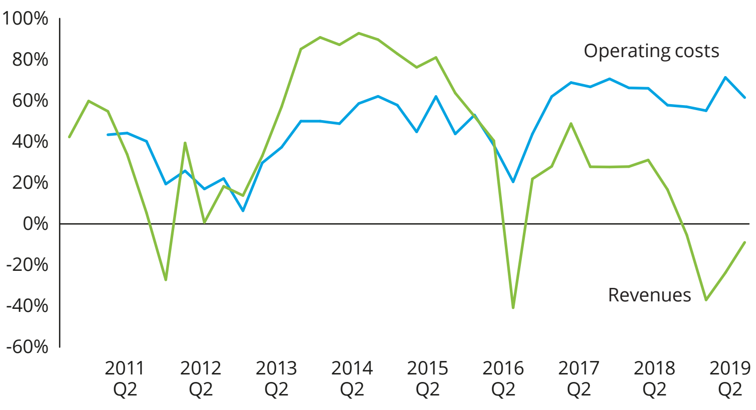


The outlook for revenues has ticked up but remains negative, with CFOs on balance expecting UK corporates' revenues to fall over the next year.

By contrast, CFOs expect operating costs to rise over the next 12 months.

Chart 7. Outlook for corporate revenues and operating costs

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

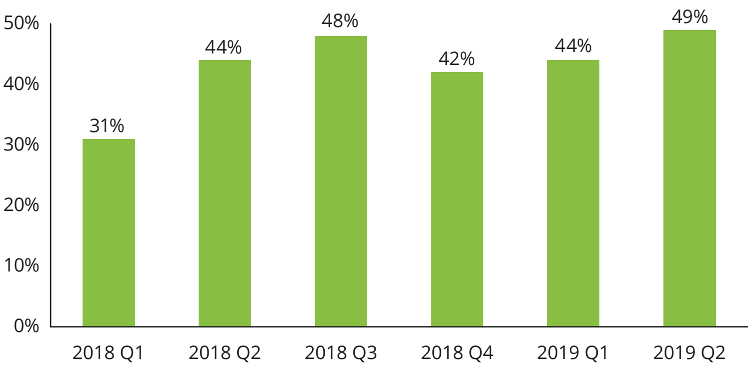


Almost half of CFOs reported increased difficulties in recruiting staff in the second quarter, the highest proportion since we started asking the question.

This fits with a strong UK labour market, with the unemployment rate running at a 45-year low.

Chart 8. Recruitment difficulties

% of CFOs reporting an increase in recruitment difficulties or skills shortages experienced by their businesses over the past three months



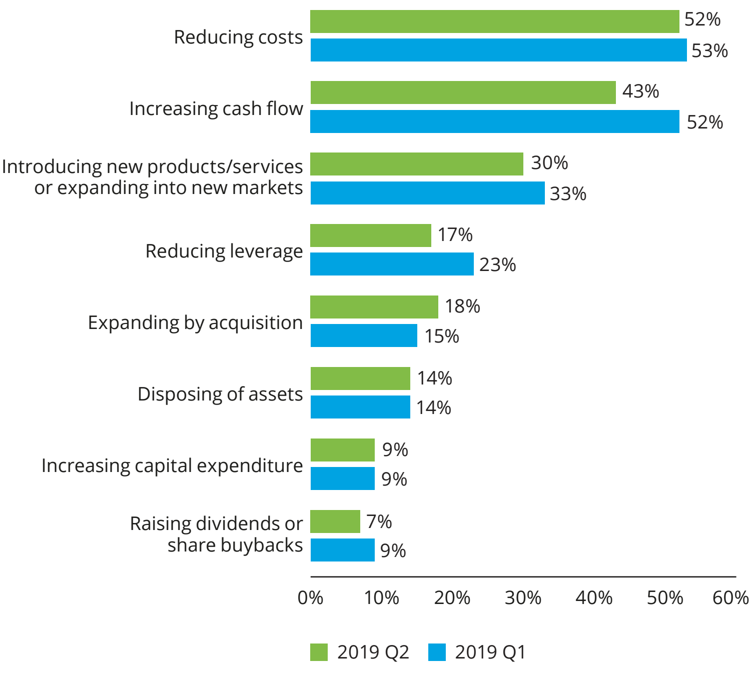
Cost reduction is top priority

Cost reduction is still the top priority for CFOs. Increasing cash flow remains in second place, despite fewer respondents calling it a strong priority.

CFOs are placing less emphasis on reducing leverage than they were three months ago, possibly reflecting the easing of credit conditions.

Chart 9. Corporate priorities in the next 12 months

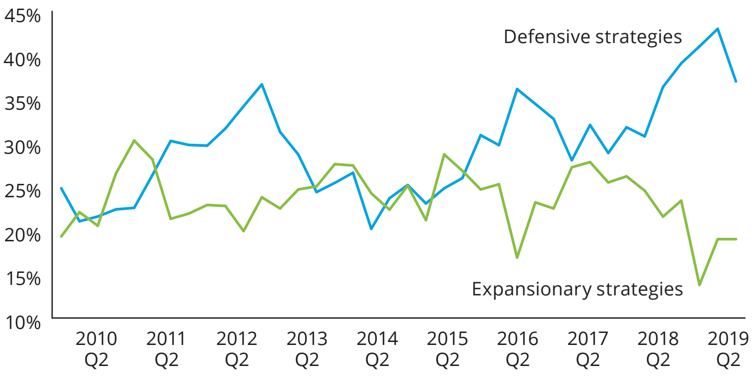
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



Defensive strategies – reducing costs, increasing cash flow and reducing leverage – are still heavily favoured by CFOs.

Chart 10. 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.

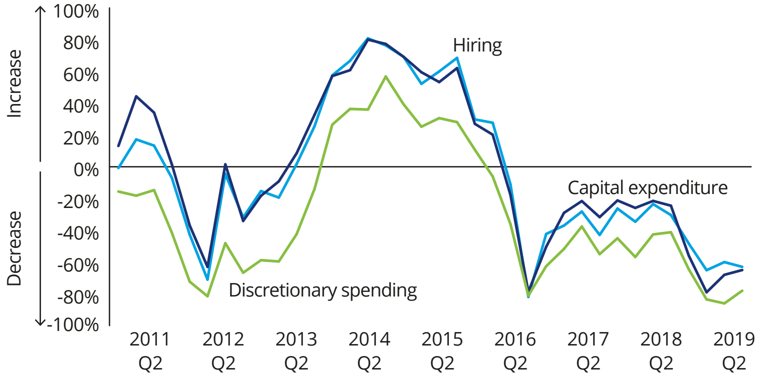
Rate expectations pushed back

Expectations for capital expenditure, discretionary spending and hiring remain at very low levels.

On balance, CFOs expect UK corporates to reduce activity in each area over the next year.

Chart 11. 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

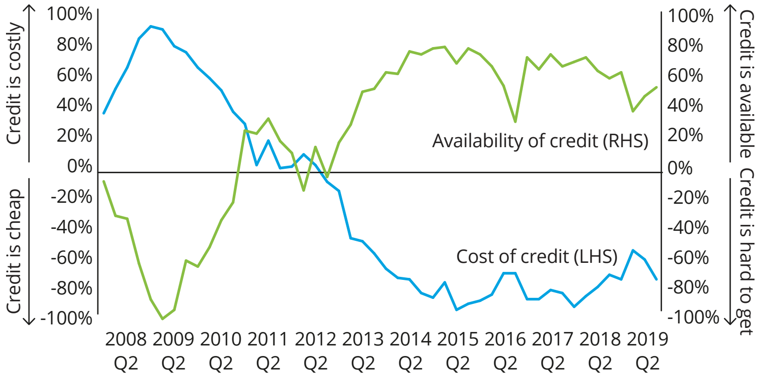


Compared to the previous quarter credit is cheaper and more easily available for the large corporates on our panel.

This relative easing of credit conditions fits with the dovish mood among Western central banks.

Chart 12. Cost and availability of credit

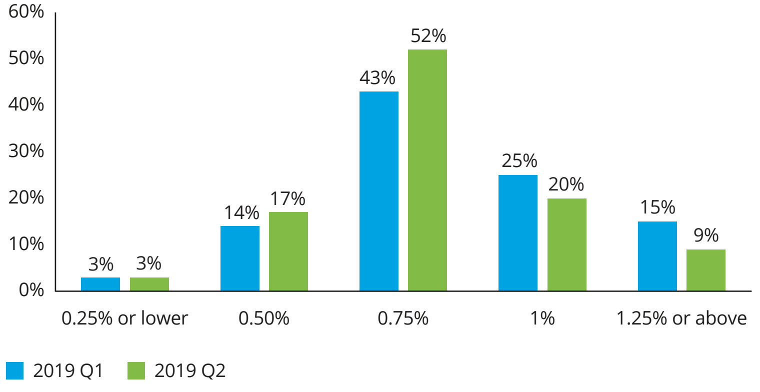
Net % of CFOs reporting credit is costly and credit is easily available



Interest rate expectations have fallen. Only 29% of CFOs now expect the base rate to be higher than the current level of 0.75% in a year's time, compared to 40% in the first quarter.

Chart 13. 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

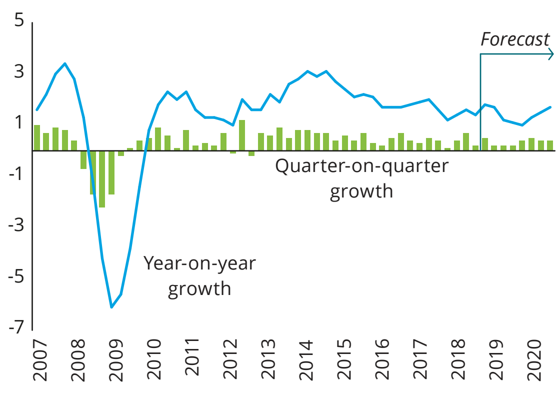


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q2 2019

The global economy continued to slow in the second quarter of 2019, with the OECD further downgrading its full-year growth forecast on increased policy uncertainty, ongoing trade tensions and the erosion of business and consumer confidence. Activity in the US and China was hit by the ongoing trade dispute with significant new tariffs imposed by the US on Chinese imports in May and China retaliating with its own tariffs. The US Federal Reserve and the European Central Bank signalled they are prepared to ease policy as growth slows, sending the US S&P 500 equity index to an all-time high and driving down bond yields. Euro area activity was particularly soft. German manufacturing was hit by weak global demand and Italy is likely to have stagnated following two previous quarters of negative growth. In the UK, prime minister Theresa May resigned after failing to secure support for her Brexit deal. Activity in the UK, particularly in manufacturing, has been negatively affected by a reversal of the stockpiling activity seen prior to the expected Brexit date of 29th March. The Bank of England is predicting growth will be at a standstill in the second quarter. Despite this, employment and earnings growth across developed markets has been robust, with the unemployment rate at multi-decade lows in both the UK and the US. The oil price rose towards the end of the quarter due to supply disruptions and tensions in the Gulf, having previously fallen over fears of slowing global growth.

UK GDP growth: Actual and forecast (%)

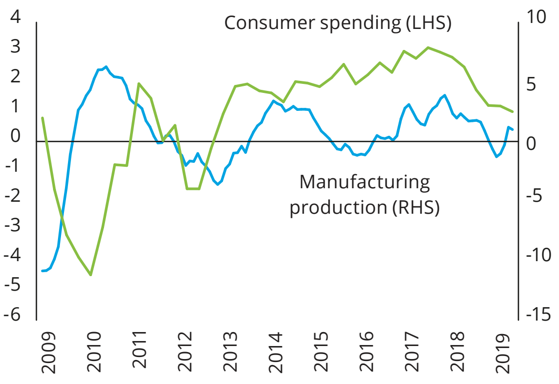


Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index

Source: Thomson Reuters Datastream

UK consumer spending and manufacturing production growth (%)



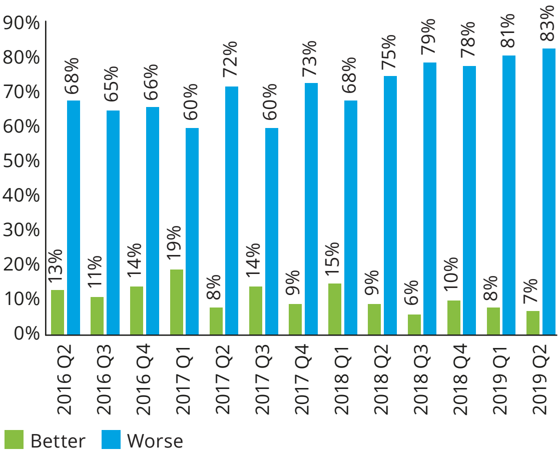
Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

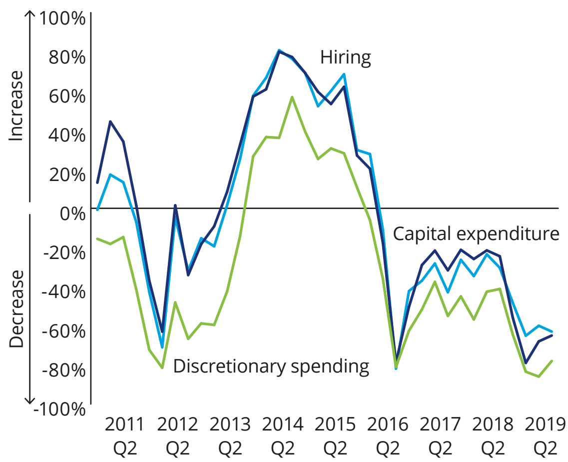
Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

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)



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



About the survey
This is the 48th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2019 second quarter survey took place between 12th June and 28th June. 79 CFOs participated, including the CFOs of 19 FTSE 100 and 29 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 55 UK-listed companies surveyed is £345 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 Annie Perdoni on 020 7007 2692 or email **apperdoni@deloitte.co.uk**.

Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2019 Deloitte LLP. All rights reserved.

Designed and produced by 368 at Deloitte. J18301