Q3 2016

The Deloitte CFO Survey

Brexit looms large

Three months after the UK referendum, Brexit risks continue to loom large for the UK corporate sector. The period since our previous CFO Survey, carried out in the immediate aftermath of the referendum vote, has seen Mrs Theresa May's appointment as Conservative Party leader and Prime Minister, a strong rally in equity markets and a run of solid UK economic data. Yet CFOs continue to see significant risks in the economic environment and perceptions of uncertainty remain elevated.

Levels of concern about macro risk have risen across five of the six areas where we regularly poll CFOs. Brexit tops the risk list while concerns about UK growth and competitiveness have soared in the last six months. The one category of risk where concerns have declined, albeit marginally, is emerging markets and geopolitics. This fits with market expectations for an acceleration in emerging market activity next year as well as reduced anxiety about the risk of a hard landing for the Chinese economy.

Brexit concerns are weighing on corporate risk appetite, with only 18% of CFOs saying that now is a good time to take risk onto their balance sheet (see Chart 1). CFOs expect their investment spending and hiring to be weaker over the next three years as a result of Brexit. And most expect spending in these areas to decline over the next 12 months.

This caution is reflected in the way in which corporates plan to run their balance sheets, with cost reduction and building up cash ranking as the top two priorities.

Views on the long-term effects of Brexit remain largely unchanged from three months ago. Roughly two-thirds of CFOs think Brexit will lead to a deterioration in the business environment in the UK, while one-third believe it will have no effect or will improve the business environment.

The animal spirits of the corporate sector took a battering in the wake of the UK referendum vote. Three months on CFOs remain cautious and focussed on the risks and uncertainties generated by Brexit.

Chart 1. Corporate risk appetite

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

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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

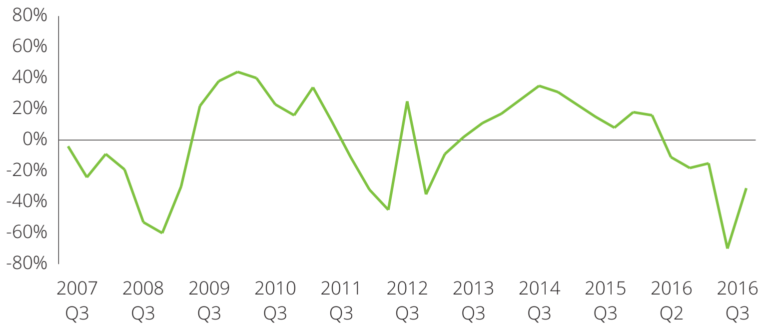
Caution remains

Business optimism improved partially in the third quarter, following the sharp decline seen in the aftermath of the Brexit vote.

CFO confidence remains subdued however, and is at its lowest since Q2 2012.

Chart 2. Business optimism

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

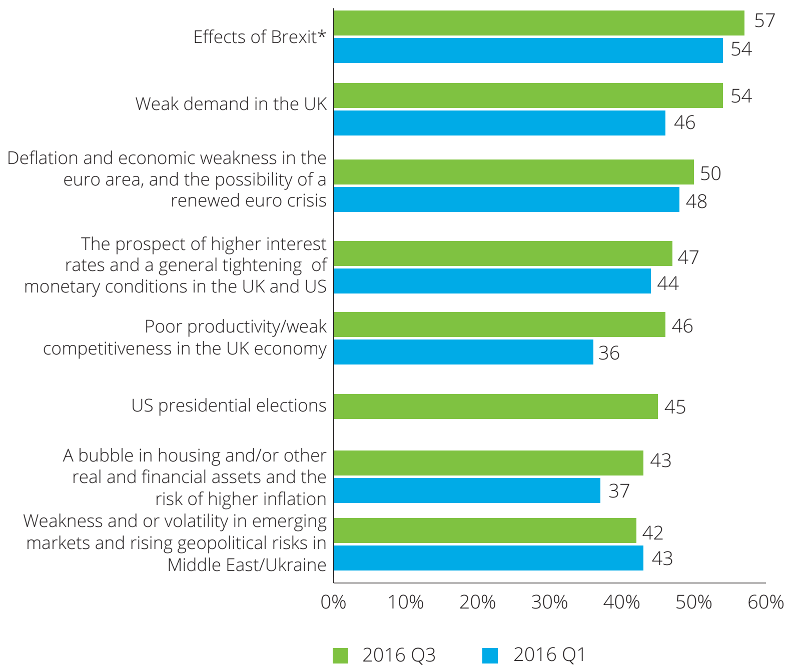


CFOs rate the effects of the Brexit vote as the greatest risk facing their business over the next 12 months. Weak demand in the UK now ranks as the second highest concern.

The upcoming US presidential election does not feature prominently as a concern for CFOs, while concerns over emerging markets have receded further.

Chart 3. 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



*In Q1 CFOs were asked what risk the EU referendum posed to their business

Growth outlook

In the run-up to the EU membership referendum in June, forecasts for UK GDP growth in 2016 and 2017 were downgraded.

Forecasts were cut further in the immediate aftermath of the Brexit vote, although a string of positive economic data has since led to many growth forecasts being upgraded. Economists now on average expect growth of 1.7% in 2016 and 0.7% in 2017.

Despite an improvement in the third quarter, CFO perceptions of uncertainty remain elevated.

88% of CFOs now rate the level of external economic and financial uncertainty facing their business as above normal, with uncertainty remaining at levels last seen in 2012.

Expectations for revenue and margin growth have both improved in the third quarter, regaining much of the losses seen in Q2.

CFOs are once more positive about revenue growth over the next year, although they remain negative on margins.

Chart 4 . Evolution of 2016 and 2017 GDP growth forecasts

Evolution of Consensus GDP growth forecasts for the UK economy in 2016 and 2017 (% YoY)

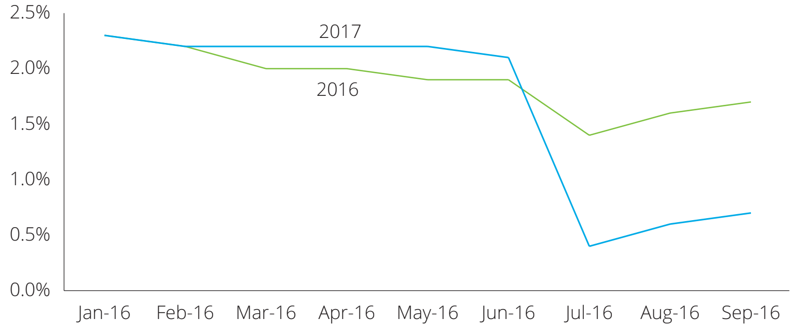
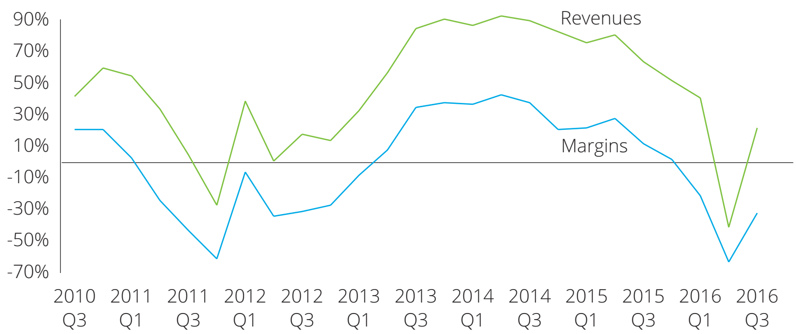


Chart 5. Uncertainty

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

Chart 6. Outlook for corporate revenues and margins

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



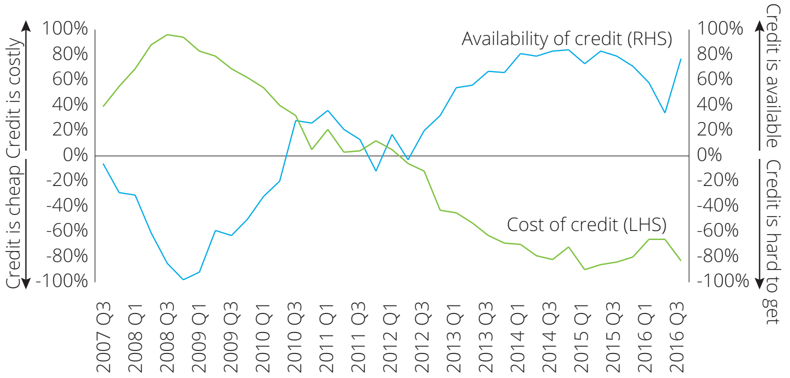
Favourable financing conditions

On balance, our panel of large corporates continue to view credit as being available and cheap.

In recent quarters credit conditions were perceived to have tightened but, following additional post-referendum monetary easing from the Bank of England, conditions are reported to have eased once again.

Chart 7. Cost and availability of credit

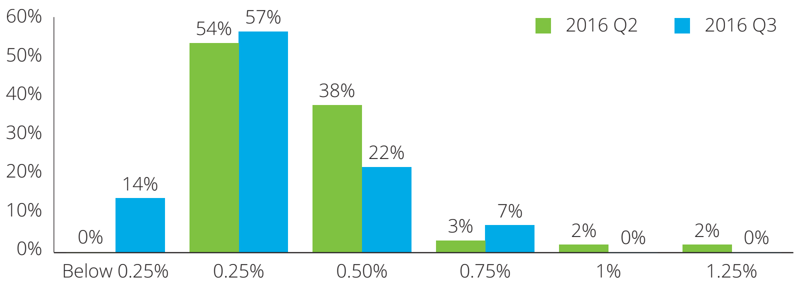
Net % of CFOs reporting credit is costly and credit is easily available



CFOs have further reduced their expectations for interest rates. A clear majority – 71% – now expect the Bank's base rate to remain at or below its current all-time low of 0.25% in a year's time.

Chart 8. 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

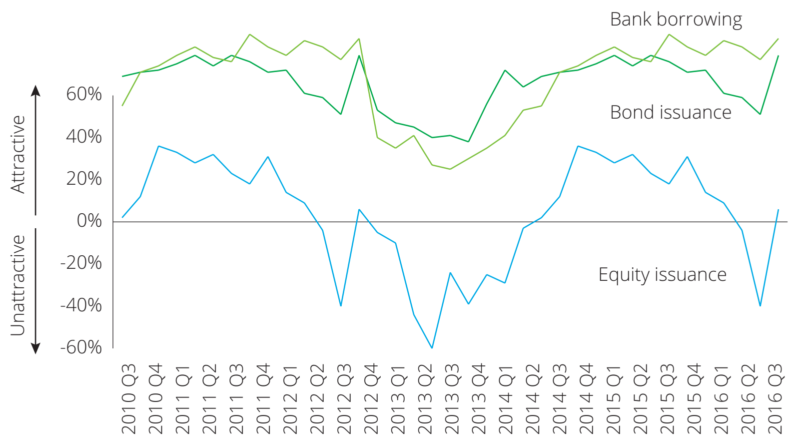


Debt finance – bank borrowing and bond issuance – remains the most attractive source of funding for CFOs.

Equity markets have performed strongly in recent months and equity issuance has become more attractive as a result, although it remains the least attractive of the three sources of funding.

Chart 9. Favoured source of corporate funding

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



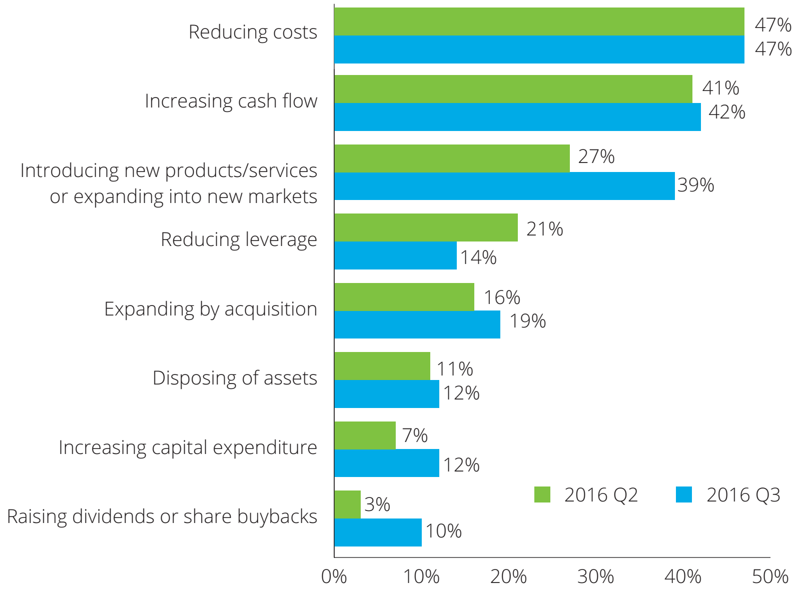
Focus on defensive strategies

CFOs have retained their focus on defensive strategies in Q3. Reducing costs and increasing cash flow rank as the top priorities and have both become more popular since Q2.

However, there has also been a strong rise in the percentage of CFOs who rate introducing new products or services, or expanding into new markets as a strong priority.

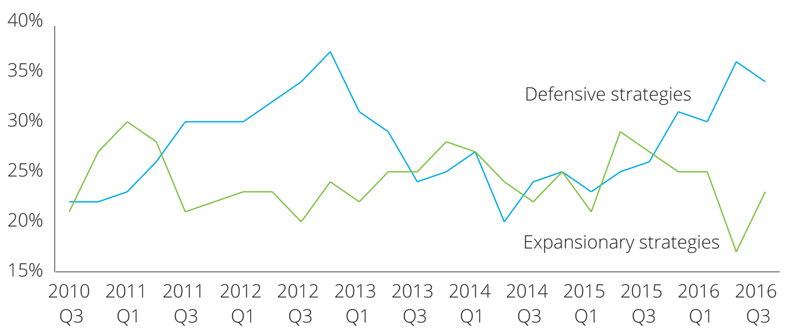
Chart 10. Corporate priorities in the next 12 months

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



Defensive strategies remain most popular but the mix of balance sheet strategies has become more expansionary in the third quarter, driven by the increased focus on introducing new products or services, or expanding into new markets.

Chart 11. 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.

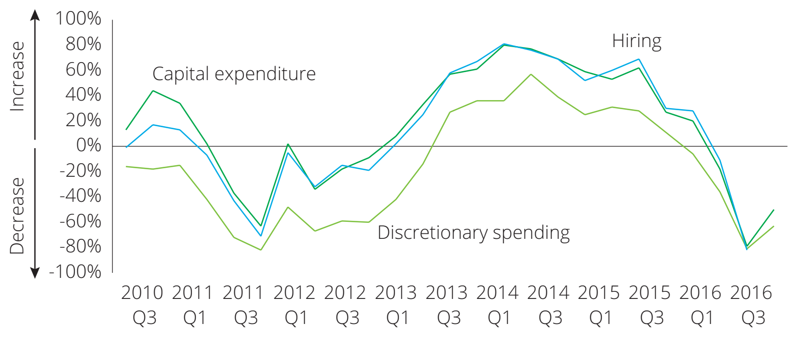
Factors affecting investment

The outlook for capital spending, hiring and discretionary spending by UK corporates has improved somewhat in the third quarter.

Expectations for each remain net negative, however, and below pre-referendum levels.

Chart 12. 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

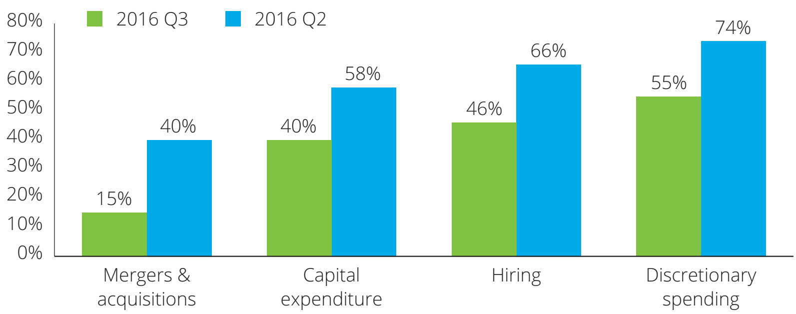


For the second time we asked CFOs what effect they expect Brexit will have on their own spending and hiring decisions.

In comparison to Q2, CFOs are less pessimistic about the effect of Brexit in each area. Discretionary spending is the only area where a majority of CFOs still expect a decrease over the next three years.

Chart 13. Effect of Brexit on own spending and hiring decisions

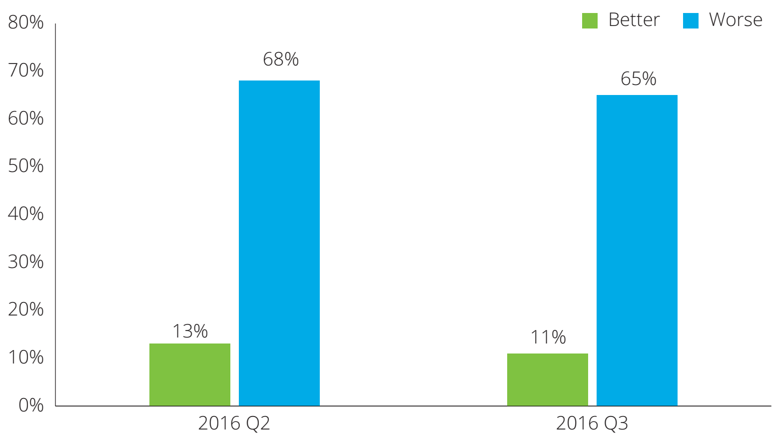
% of CFOs who expect M&A activity, capital expenditure, hiring and discretionary spending by their business to decrease over the next three years as a consequence of Brexit



CFOs' views on the long-term effects of Brexit remain largely unchanged from three months ago. Around two-thirds of CFOs think Brexit will lead to a deterioration in the business environment in the UK, while 11% think it will lead to an improvement. The remainder believe it will have no effect.

Chart 14. Long-term impact of Brexit

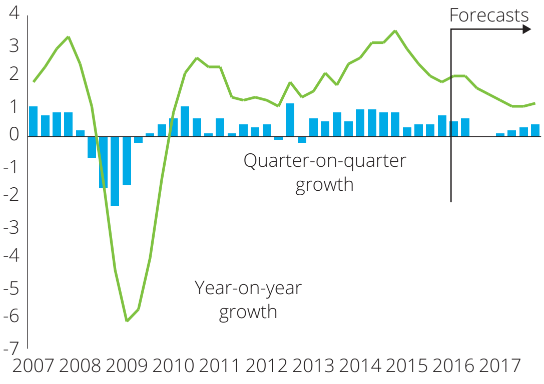
% of CFOs who think the overall environment for business in the long-term will be better/worse if the UK leaves the EU



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q3 2016
Following the shock of the UK's Brexit vote the FTSE100 and 250 equity indices more than recovered their initial post-referendum losses. Economic data showed signs of a post-referendum rebound and suggest the UK, though likely to see a slowdown next year, has a good chance of avoiding a full-blown recession. UK manufacturing export orders rose to the highest level in two years on the back of sterling's continued weakness and consumer confidence rebounded strongly after a sharp post referendum decline. Sterling fell to a 31-year low against the dollar on the news that the UK will trigger the start of the Brexit process by March 2017 and concerns that the UK may leave Europe's single market. US consumer confidence rose to the highest level in nine years, while jobs growth remained robust. The US Federal Reserve provided a strong signal that US interest rates are likely to rise before the end of the year. The euro area's steady, unspectacular recovery continued and the EU sought to regain political momentum with the a plan to strengthen Franco-German defence cooperation. The outlook for emerging markets continued to improve, with Chinese growth stabilising and Brazil and Russia emerging from recession.

UK GDP growth: Actual and forecast (%)

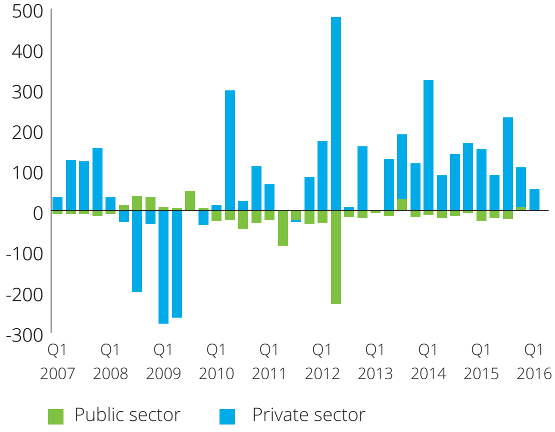


Source: ONS, consensus forecasts from The Economist and Deloitte calculations

FTSE 100 price index

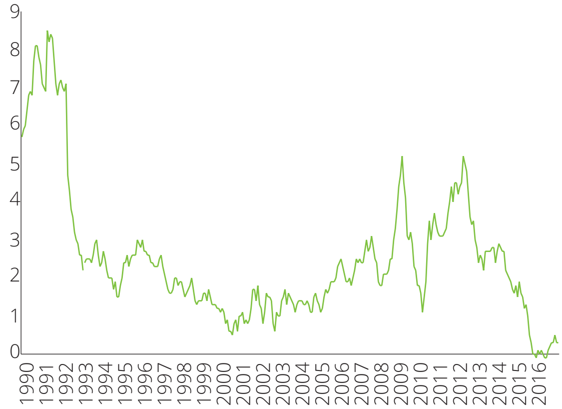
Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

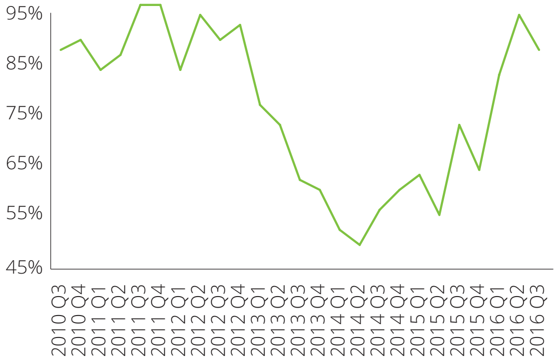


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

Uncertainty

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



Long-term impact of Brexit

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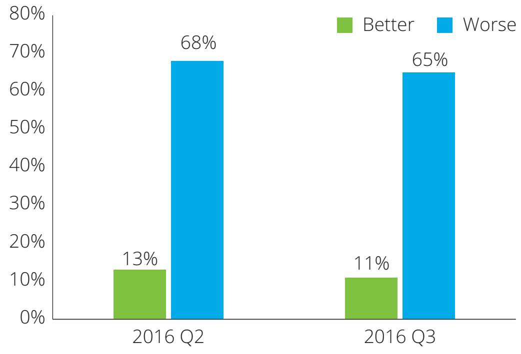

About the survey

This is the 37th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2016 third quarter survey took place between 12thand 26thSeptember. 124 CFOs participated, including the CFOs of 27 FTSE 100 and 50 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 86 UK-listed companies surveyed is £452 billion, or approximately 19% 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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