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Q4 2016

The Deloitte CFO Survey

Greater optimism yet to ignite risk appetite

Britain's relationship with the EU exercised a significant influence on UK business sentiment through 2016. Ahead of the referendum CFOs viewed Brexit as the most significant risk facing their business. And in the wake of the vote, in late June, optimism dropped to the lowest level since the global financial crisis. CFOs battened down the hatches, pulling back on investment and spending.

Since then the UK has proved more resilient than expected and talk of the UK falling into recession has abated. In the wake of the vote, consensus or market forecasts for UK GDP growth in 2017 plunged from 2.1% to just 0.6%, but then edged up to 1.3% by December. Our latest CFO Survey shows that against a backdrop of continued UK growth CFOs have become markedly more positive on the outlook for their own businesses. CFOs enter 2017 in better spirits than at any time in the last 18 months.

Yet this brighter mood does not represent a return to business as usual. Corporate risk appetite is depressed and running at well below average levels. Perceptions of uncertainty remain high. CFOs see Brexit as the top risk facing their business, and the extent of concern has risen since the last survey, in the third quarter.

Such concerns have left corporates positioned defensively, with cost reduction and building up cash ranking as the top balance sheet priorities.

CFOs continue to expect that their own spending and investment will be weaker as a result of the UK exiting the EU. And in the long term, CFOs expect that leaving the EU will damage the business environment. 66% of CFOs see Brexit as being negative for the business environment in the long term and 14% see it as a positive.

CFO confidence has surged since the post-referendum lows. But this survey paints a picture of a continued backwash from the referendum, with uncertainty keeping a lid on expansion and corporates focused on costs.

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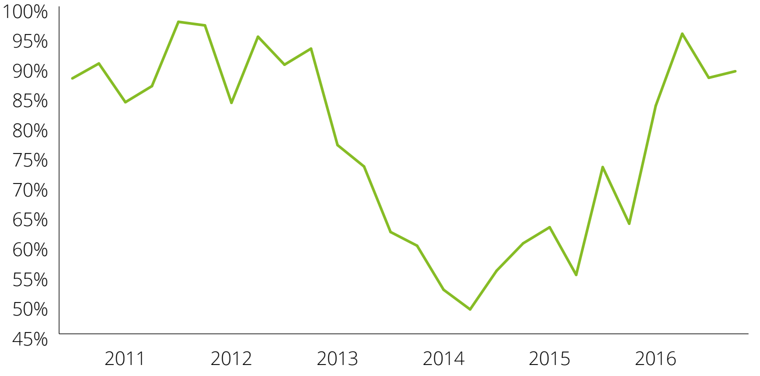
For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:

www.deloitte.co.uk/cfosurvey

Chart 1. Uncertainty

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

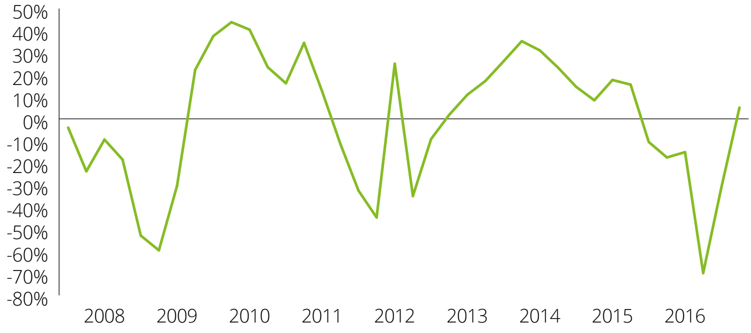


Optimism up

Business confidence has rebounded strongly from its post-EU referendum low and is now running at the highest level in a year and a half.

Chart 2. Business optimism

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

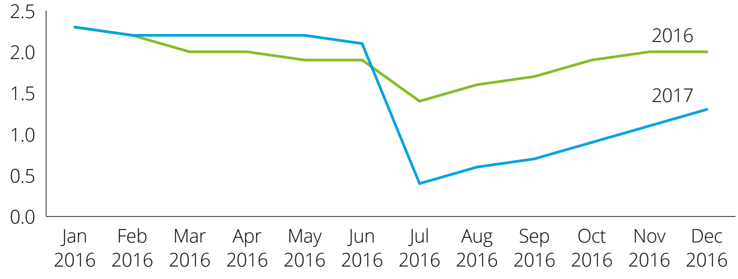


Higher levels of business confidence coincide with an improvement in the UK's growth prospects since August.

Better than expected economic data has resulted in economists upgrading their 2016 and 2017 GDP growth forecasts, to 2.0% and 1.3% respectively.

Chart 3. Evolution of 2016 and 2017 GDP growth forecasts

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

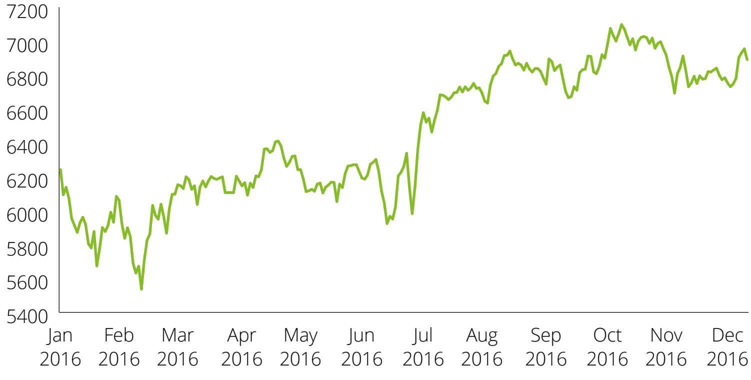


Source: Consensus Economics

The equity market has also rebounded since the Brexit vote.

The FTSE100 hit a peak in October and in mid December was 17% above its trough on 27th June.

Chart 4. FTSE 100 equity index



Risk appetite depressed

Despite edging up in the fourth quarter corporate risk appetite remains depressed.

Just 21% of CFOs think that now is a good time to take greater risk onto their balance sheets, a reading well below the long-term average.

Chart 5. Corporate risk appetite

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

CFOs see the effects of Brexit as the top risk facing their businesses and their concerns have risen since the last survey, in the third quarter.

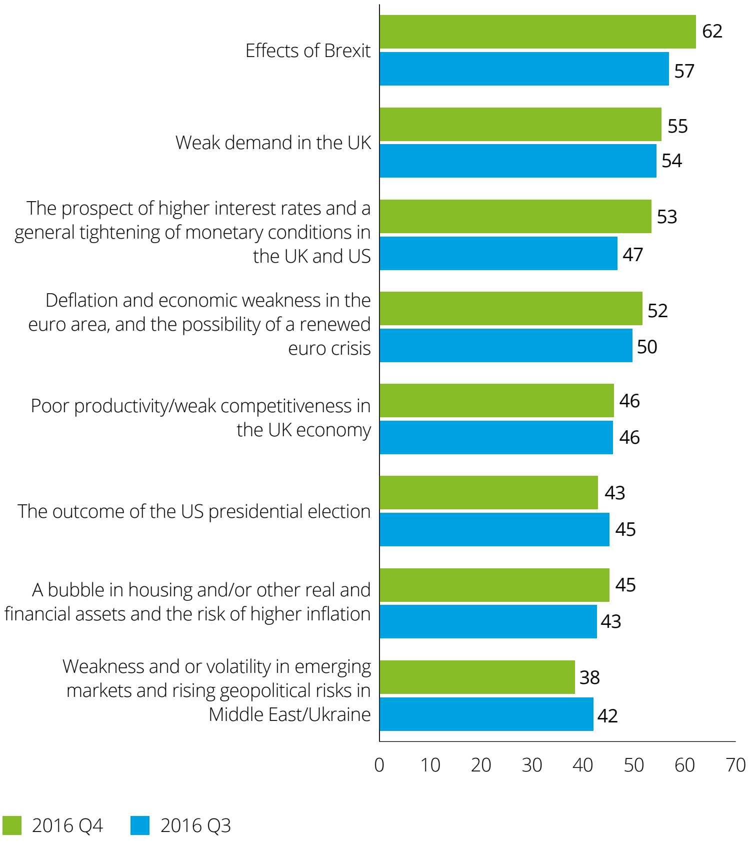
Weak demand in the UK ranks as the second-highest risk.

Interest rates on government bonds rose sharply in the fourth quarter driven in part by US president-elect Donald Trump's pledges to raise government spending. CFOs have taken notice and their concerns about the prospect of tighter monetary policy in the US and the UK have mounted.

By contrast, concerns over weak growth in emerging markets have continued to ease.

Chart 6. 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



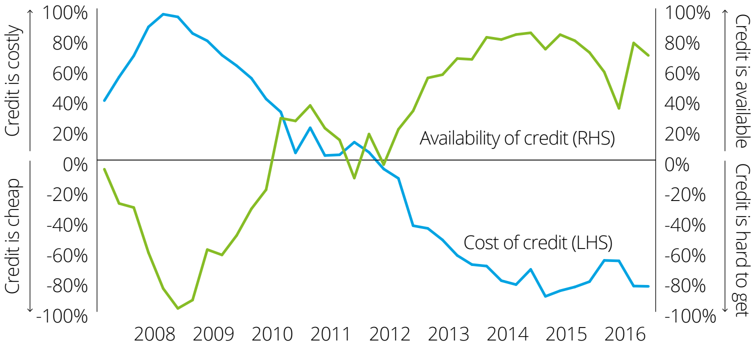
Benign credit conditions

Financing conditions remain benign for the large corporates on our survey panel.

On balance, CFOs view credit as being cheap and easily available, despite a modest fall in availability in the fourth quarter.

Chart 7. Cost and availability of credit

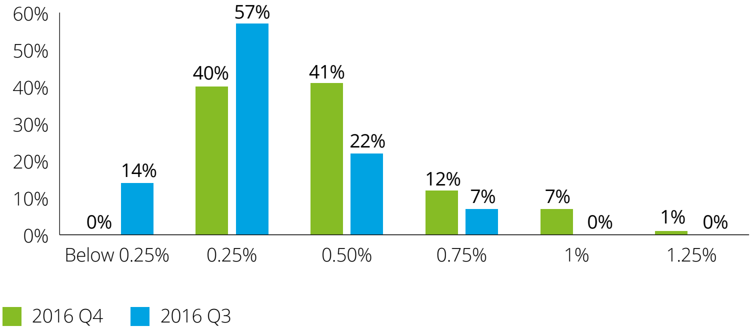
Net % of CFOs reporting credit is costly and credit is easily available



CFOs have brought forward their rate rise expectations. A majority – 61% – now expect the Bank of England's base rate to be above its current level 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

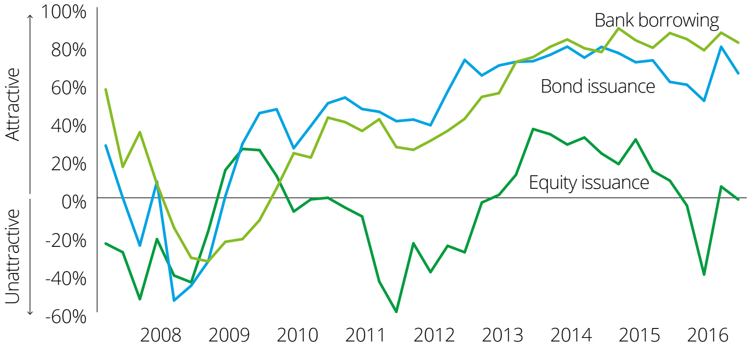


Debt finance – bank borrowing and bond issuance – remains the most attractive source of funding for CFOs.

Equity issuance continues to be less appealing, with its attractiveness edging lower in the fourth quarter.

Chart 9. Favoured source of corporate funding

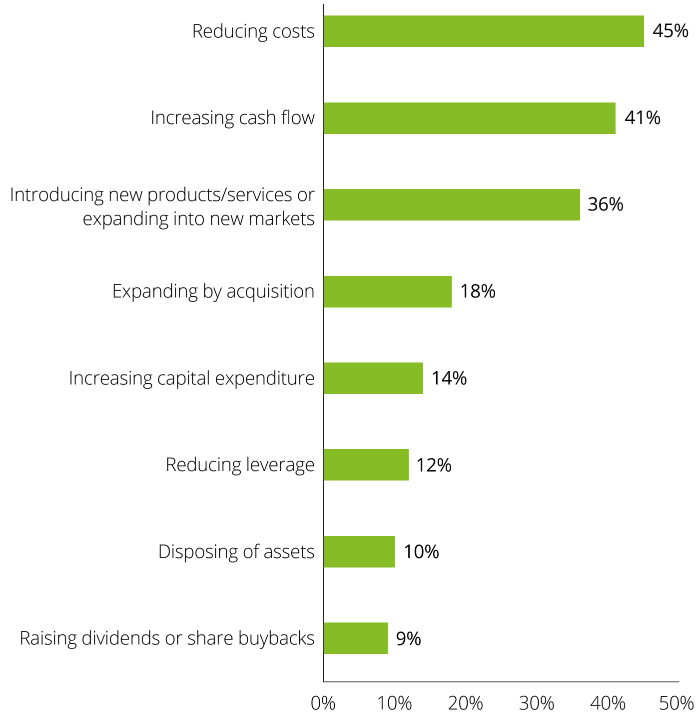
Net % of CFOs reporting the following sources of funding as attractive



Focus on defensive strategies

CFOs enter 2017 with a focus on defensive strategies. Reducing costs and increasing cash flow remain the top priorities for CFOs.

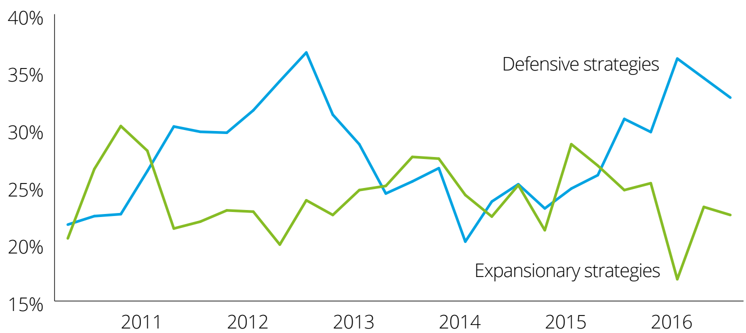
Chart 10. Corporate priorities in the next 12 months
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



Following the initial shock of the Brexit vote, CFOs have become rather less defensive in the second half of the year.

However, the balance of strategies favoured by CFOs is more defensive than it was before the vote.

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



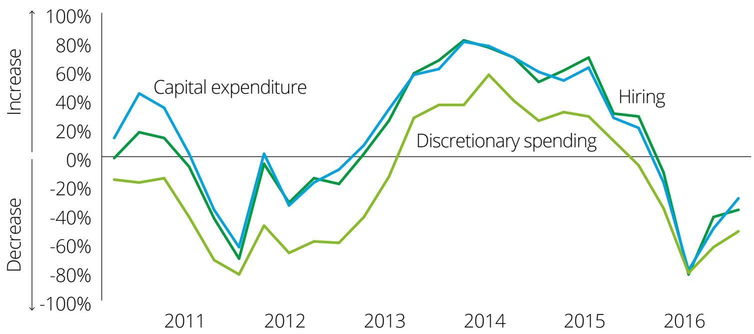
Note: Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure.
Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

Effects of Brexit

The outlook for capital expenditure, hiring and discretionary spending improved again in the fourth quarter.

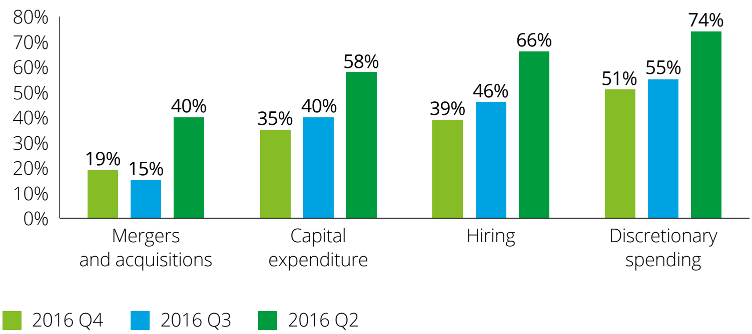
But, on balance, CFOs still expect UK corporates to decrease spending in each area over the next year.

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



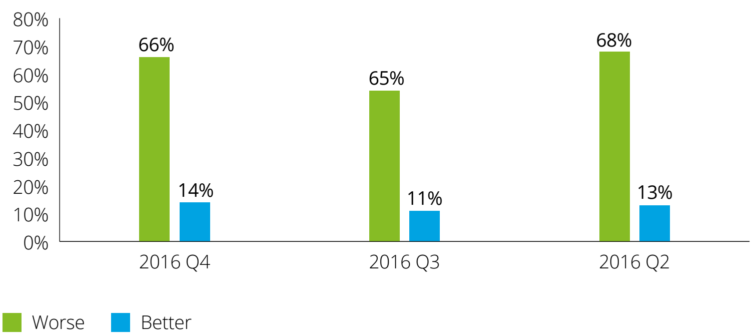
CFOs expect Brexit to reduce their own spending, though they are rather less negative than in the second and third quarters.

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



In the long run CFOs expect Brexit to have a negative impact on the overall environment for business. Two-thirds expect worsening conditions in the long term, largely unchanged from the previous quarter.

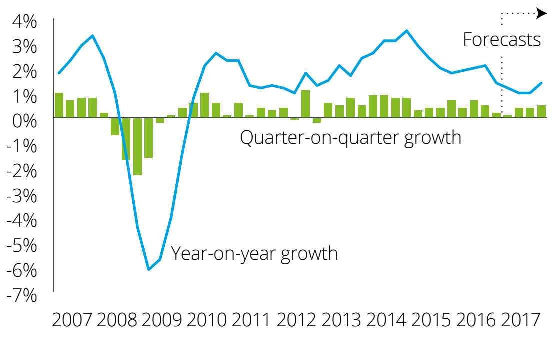
Chart 14. Long-term impact of Brexit
% of CFOs who think the overall environment for business In the long term will be better/worse if the UK leaves the EU



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q4 2016
Uncertainties about the nature and timing of the UK's exit from the EU remained centre stage, but UK activity was generally resilient towards the end of the year. UK GDP seems likely to have increased by 2.0% in 2016, marginally higher than many were predicting even before June's EU referendum and the fastest rate of growth in the G7 group of industrialised nations. UK equity markets touched new highs in early October and consensus forecasts for UK growth in 2017, which fell sharply after the referendum, edged higher. A weaker pound helped push inflation to a two-year high in November, with markets expecting significant further increases in 2017. Donald Trump's surprise victory in the US presidential election stoked expectations of tax cuts, increased public spending and borrowing. In response equity markets and US growth and interest rate forecasts rose; US bonds sold off sharply. The rise in the oil price and the price of some other commodities, coupled with steady growth in China, eased perceptions of risk in emerging markets. GDP growth in emerging economies seems likely to have accelerated in 2016, following five consecutive years of slowing growth. Markets reacted positively to the European Central Bank's announcement that it would extend its euro area stimulus programme.

UK GDP growth: Actual and forecast (%)

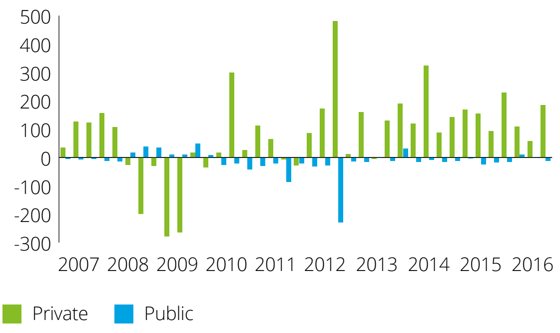


Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 equity index

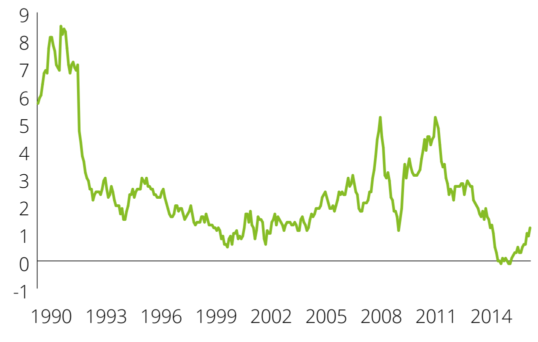
Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

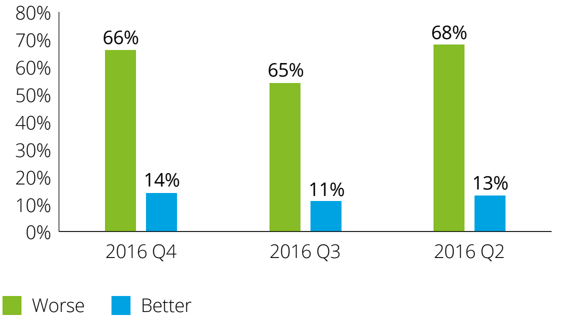


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

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

Long-term impact of Brexit
Net % of CFOs who think the overall environment for business In the long-term will be better if the UK leaves the EU



About the survey
This is the 38th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2016 fourth quarter survey took place between 29th November and 12th December. 119 CFOs participated, including the CFOs of 25 FTSE 100 and 43 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 81 UK-listed companies surveyed is £396 billion, or approximately 17% 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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