Q1 2023

The Deloitte CFO Survey

Business confidence bounces

Sentiment among the Chief Financial Officers of the UK's largest firms has improved significantly since the start of the year. The latest Deloitte CFO Survey, conducted between 21 March and 3 April, shows the largest increase in CFO confidence since the rollout of COVID-19 vaccines at the end of 2020. Having run markedly below average throughout last year business confidence has risen sharply and is now well above its long-term average.

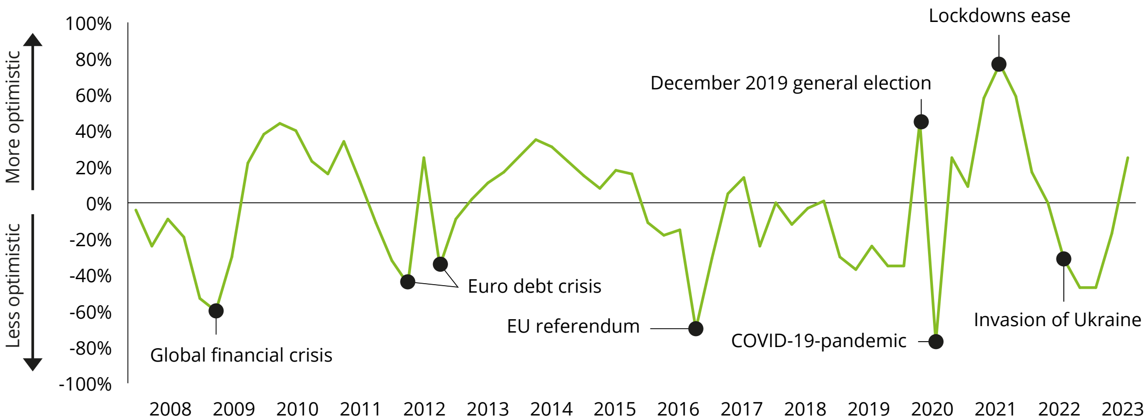
The failure of Silicon Valley Bank on 10 March and pressures on some regional US banks seem to have had little if any impact on CFO sentiment. On the contrary, CFOs' perceptions of external financial and economic uncertainty have fallen at the fastest rate since we first asked this question more than 12 years ago. CFOs now rate external uncertainty as being at levels far below the previous peaks seen last autumn, at the start of the pandemic in 2020 and in the wake of the EU referendum in 2016. CFOs report little change in credit conditions, suggesting that March's events in the US banking system have not affected the pricing and availability of credit for large UK corporates.

CFOs see Brexit and high energy prices or disrupted energy supply as posing significantly less risk to business than in December. The announcement on 27 February of the Windsor Framework, which aims to improve the flow of goods between Britain and Northern Ireland, is likely to have contributed to the easing of CFO concerns around Brexit which are now close to the lowest level in over six years. With wholesale gas prices down by almost 70% since we surveyed CFOs in December, the risks posed by elevated energy prices have reduced. The survey shows an improvement in CFO sentiment about the US economy that is consistent with recent upgrades to consensus, or market, forecasts for US GDP growth this year. CFOs also report a marked easing of supply chain and recruitment problems while expectations for inflation in one year's time have declined from 5.8% to 4.2%.

While sentiment has bounced back, CFOs maintain a defensive strategy stance. Risk appetite is below normal levels and CFOs are heavily focussed on cost control and building up cash. Although CFOs' revenue expectations have jumped, almost two-thirds of respondents expect margins to shrink in the next 12 months reflecting continued growth in input costs.

This quarter's special question examines the impact of artificial intelligence on the business sector. CFOs expect to see substantial growth in capital spending on AI which, they anticipate, will help drive UK productivity. CFOs are, however, almost equally divided between those who believe that AI will lead to an increase in the number of jobs and those who believe it will shrink the human workforce.

Chart 1. Business optimism
Net % of CFOs who are more optimistic about the financial prospects of their business than three months ago

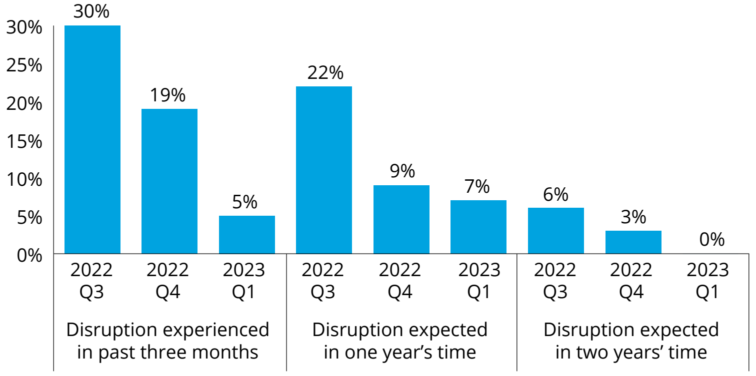


Inflation tide turning

CFOs report a fall in supply disruptions faced by their businesses in the three months before the survey. A small proportion of panellists expect significant or severe levels of disruption to persist in a year's time and the panel expects such disruption to ease entirely in two years from now.

Chart 2. 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

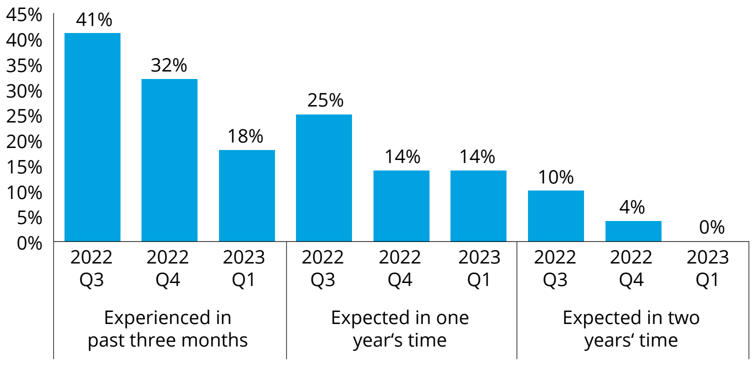


CFOs also reported a considerable easing of recruitment difficulties in the first quarter. Nonetheless, almost a fifth continue to say their businesses experienced significant or severe recruitment difficulties or labour shortages in the three months before the survey.

They expect a marginal improvement over the next 12 months and the elimination of significant or severe recruitment difficulties in two years' time.

Chart 3. 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

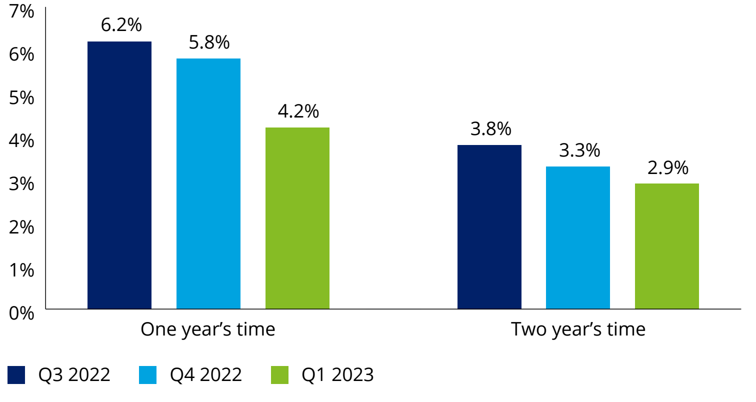


The moderation of supply disruptions and labour shortages translates into a continued easing in CFOs' inflation expectations.

They expect inflation to fall to 4.2% in a year's time and to 2.9% in two years' from now.

Chart 4. Inflation expectations

CFOs' median expectations for inflation in one year's time and two years' time



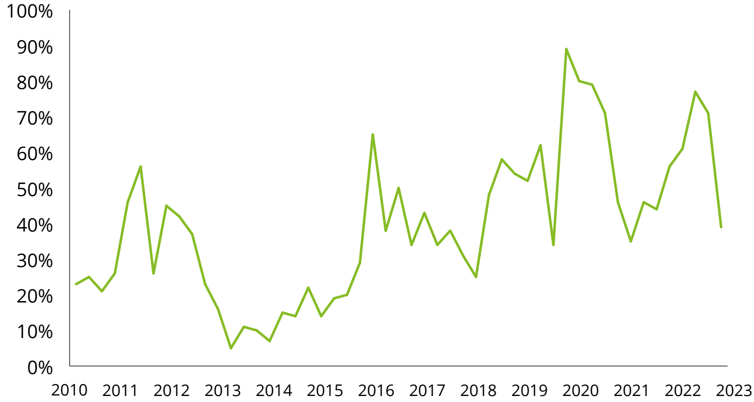
Uncertainty down sharply

CFOs reported the sharpest fall in perceptions of uncertainty since we started asking this question in 2010.

They now rate external economic and financial uncertainty as being close to levels last seen in early 2021, when the early vaccine rollout demonstrated a route out of the COVID-19 pandemic, or at the end of 2019, when the outcome of the UK general election broke a long political deadlock over the terms of Brexit.

Chart 5. Uncertainty

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

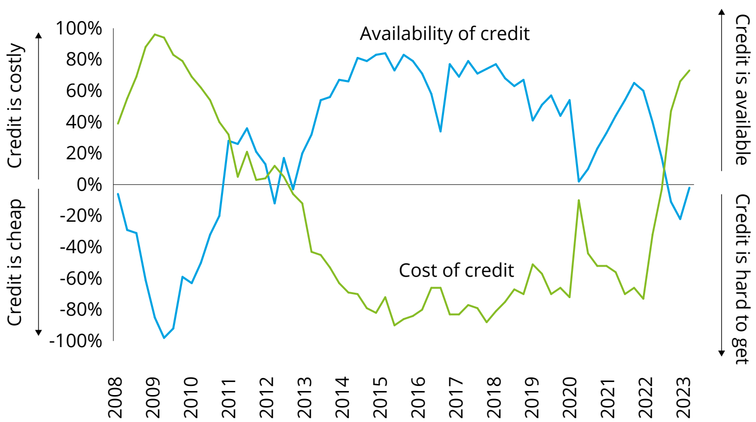


CFOs report a slight rise in the cost of credit and a marginal improvement in credit availability in the first quarter.

The survey findings suggest little change in credit conditions for the large UK corporates on our panel, despite the failure of Silicon Valley Bank in March and ensuing turmoil in the US regional banking system.

Chart 6. Cost and availability of credit

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

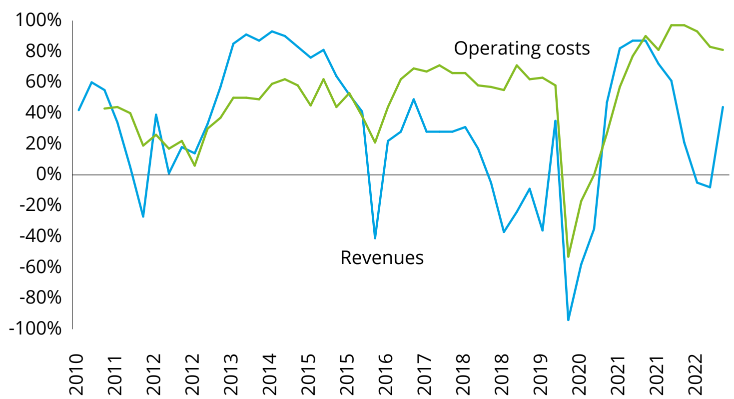


CFOs' revenue growth expectations have improved significantly but a large majority expect corporate margins to decrease over the next 12 months, reflecting persistent cost pressures.

Indeed, the overwhelming majority of respondents expect operating costs to rise over the same period.

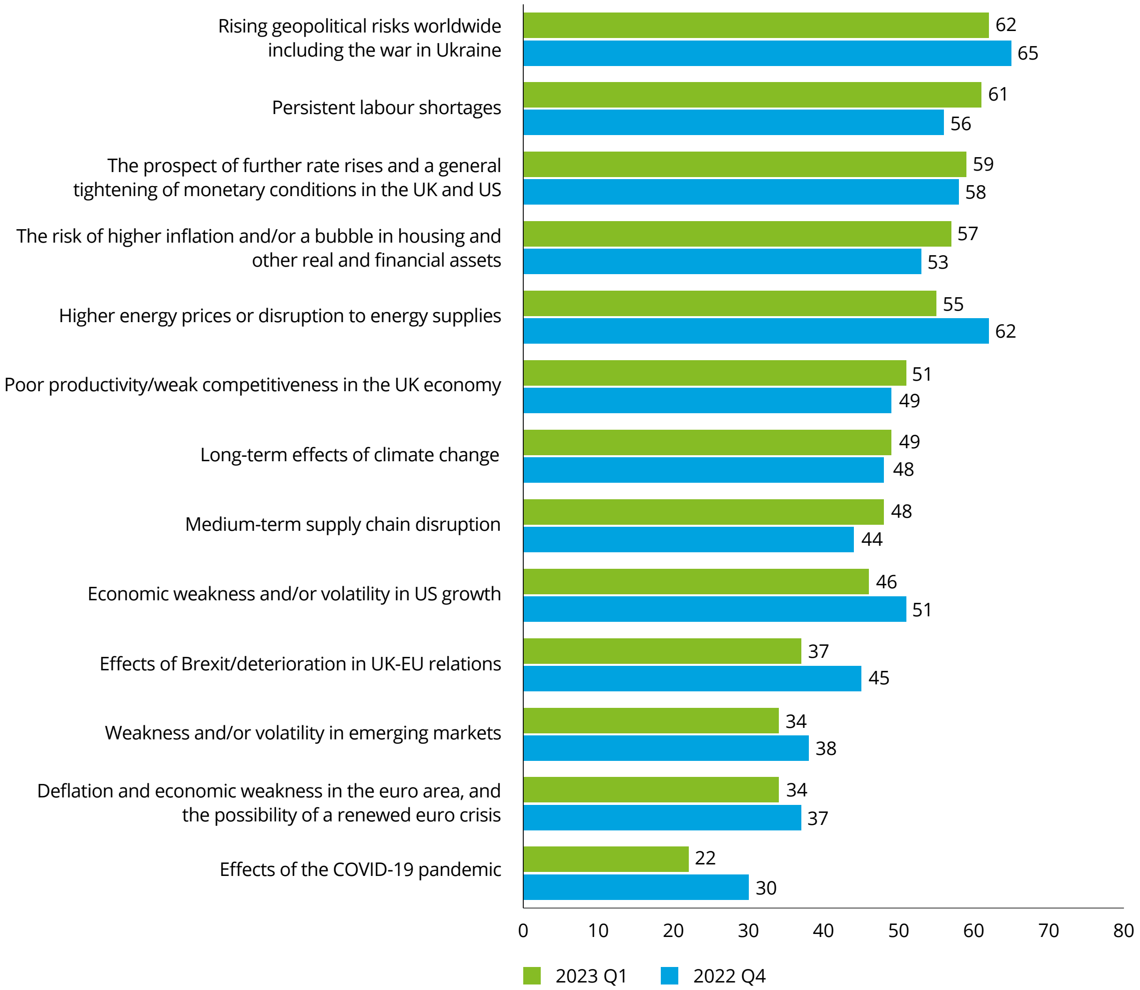
Chart 7. Outlook for corporate revenues and operating costs

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



Geopolitics remains top risk

Chart 8. 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



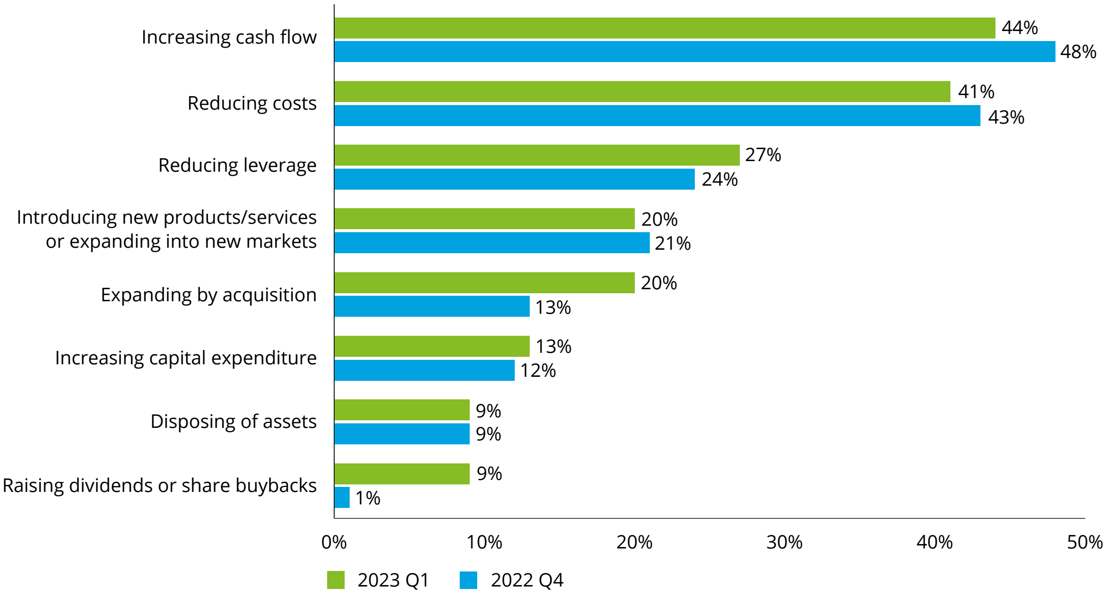
Geopolitics remains the top risk for CFOs. Persistent labour shortages comes a close second, followed by monetary tightening and the risk of higher inflation or bursting asset price bubbles.

CFOs report a significant reduction in the risks posed to businesses by Brexit and high energy prices or disruptions to energy supply since the fourth quarter survey. With wholesale gas prices down by almost 70% since December, the risks posed by elevated energy prices have reduced. The announcement on 27 February of the Windsor Framework, which aims to improve the flow of goods between Britain and Northern Ireland, is likely to have contributed to the easing of CFO concerns around Brexit which are now close to their lowest level in over six years.

The survey shows an improvement in CFO sentiment about the US and emerging economies. This is consistent with recent upgrades to consensus, or market, forecasts for US GDP growth this year and a pickup in Chinese economic activity after the late-2022 reopening.

Focus on defensive strategies

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

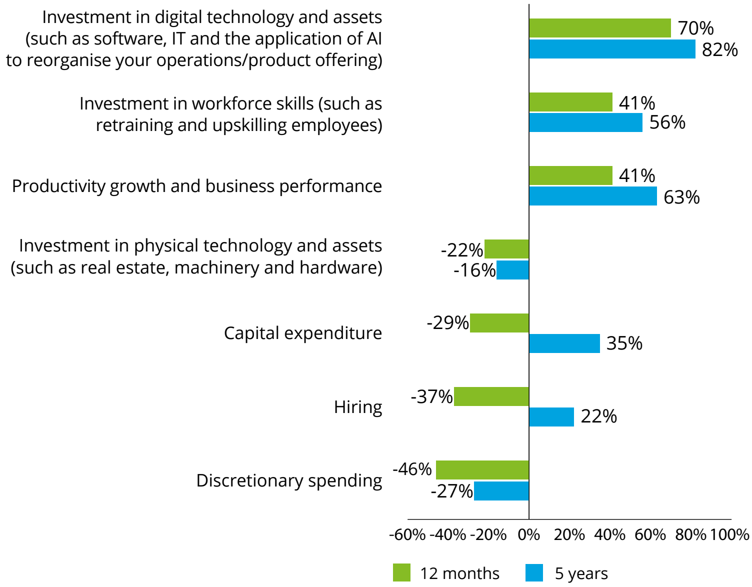


Defensive strategies – increasing cash flow, reducing costs and reducing leverage – are the top three priorities for CFOs. Despite a softening focus on cost reduction and increasing cash flow in the first quarter, CFO priorities remain overwhelmingly defensive.

Although CFOs expect cuts to overall capital expenditure, hiring and discretionary spending in the next 12 months, they remain positive on investment in certain areas over the short and medium terms.

The overwhelming majority expect higher investment in digital technology and assets over the next 12 months and over a five-year timeframe. They also expect greater investment in workforce skills and increased productivity growth and business performance over the short and medium terms. By contrast, investment in physical technology and assets is expected to decline over both time periods.

Chart 10. Corporate spending and productivity
Net % of CFOs who expect the following to increase for UK corporates as a whole over the next 12 months and 5 years relative to current levels

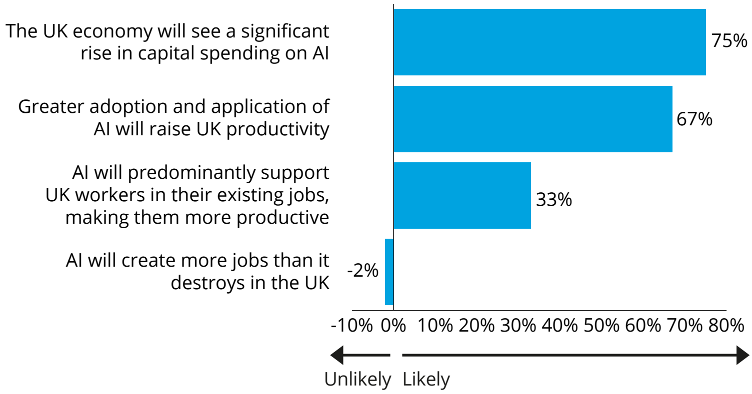


Greater spending on AI

An overwhelming majority of CFOs expect to see a significant rise in capital spending on AI, both well-established and more recently introduced technologies such as ChatGPT, over the next five years. They expect AI to predominantly support UK workers in their existing jobs and help drive UK productivity.

However, CFOs are almost equally divided between those who believe that AI will lead to an increase and those who believe it will reduce jobs over the next five years.

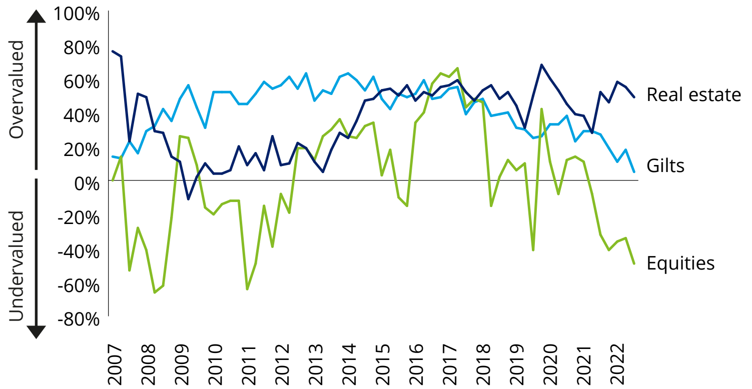
Chart 11. Artificial intelligence
Net % of CFOs who assess the following scenarios as likely over the next five years



CFOs continue to rate real estate and gilts as overvalued while equities are rated as undervalued.

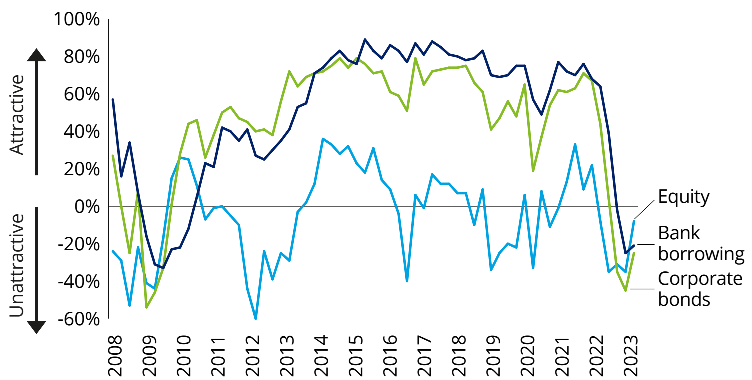
Yet, rising interest rates and quantitative tightening mean the proportion of CFO panellists assessing gilts as overvalued has fallen to the lowest level since the survey began in 2007.

Chart 12. Valuations
Net % of CFOs who rate UK real estate, gilts and UK equities as overvalued



Rising rates and bond market developments are also affecting the relative attractiveness of sources of corporate financing. For the first time since 2010, CFOs have rated equities as a more attractive source of funding than debt finance, be it bank borrowing or corporate bond issuance.

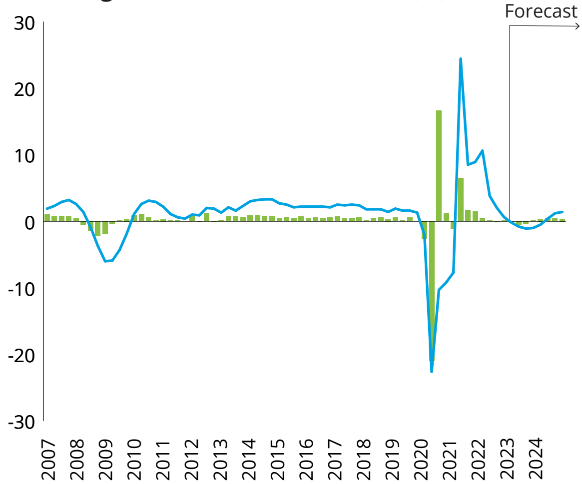
Chart 13. Corporate financing
Net % of CFOs who rate the following sources of funding for UK corporates as very or somewhat attractive



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q1 2023
Growth prospects for advanced economies improved over the first quarter. Inflation peaked in major western economies, driven by lower energy prices as fears of gas shortages faded away. Labour markets stayed resilient with record-low unemployment rates. China's reopening eased supply chain pressures and supported global demand. Economists upgraded their growth forecasts for the US, the UK and the euro area. Idiosyncratic factors and, to an extent, rising interest rates drove a crisis of confidence in certain banks leading to the collapse of Silicon Valley Bank and Signature Bank in the US and Credit Suisse in Europe. Swift action by the US and Swiss governments and regulators has limited contagion, but investors remain wary of risks to the financial system from further tightening. Despite the turmoil in banking, major western central banks stayed the course on rate rises, with the Bank of England raising its benchmark rate to 4.25% in March – the highest level since 2008. With the recent turbulence in banking widely expected to result in tighter credit conditions, central banks are seen to be nearing the end of their tightening cycles.

UK GDP growth: Actual and forecast (%)

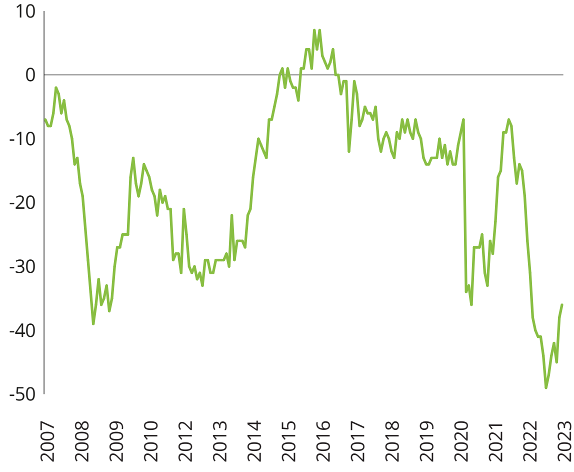


Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index

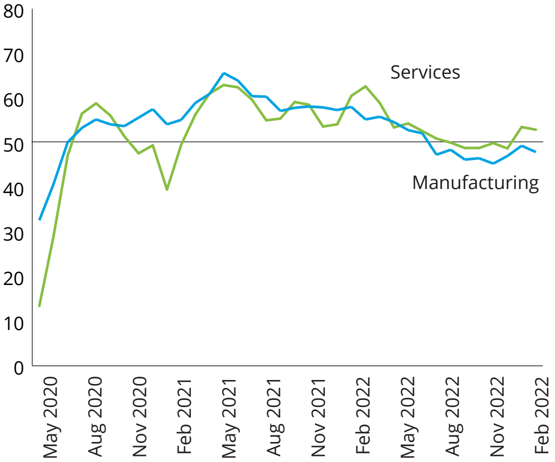
Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)



Source: Refinitiv Datastream

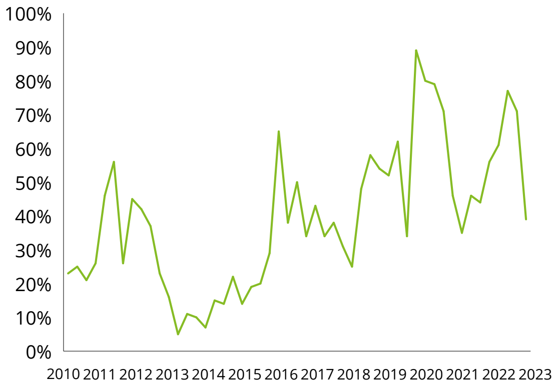
Markit Purchasing Manager Indices (UK)



Source: Refinitiv Datastream, readings above 50 indicate expansion

Two-chart summary of key survey messages

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



Artificial intelligence
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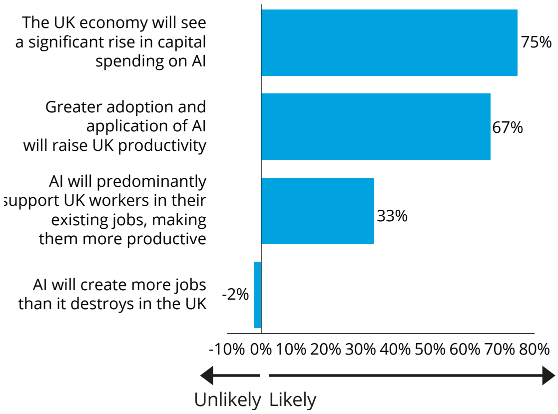

About the survey

This is the 63rd quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2023 first quarter survey took place between 21 March and 3 April. 64 CFOs participated, including the CFOs of 11 FTSE 100 and 24 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 38 UK-listed companies surveyed is £253 billion, or approximately 10% 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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