

The Deloitte CFO Survey

Risk appetite at new high

Risk appetite among the UK's largest corporates has reached a seven-year high in the third quarter as Chief Financial Officers shrugged off the effects of rising uncertainty and a sluggish euro area economy. Risk appetite is being supported by a resurgent US economy, good UK growth and plentiful liquidity. Optimism among big corporates about prospects for the UK and US economies has improved in the last six months even as sentiment about emerging markets and the euro area has declined. Expectations for corporate revenues and margins remain close to the four-year high reached in the second quarter.

CFOs are also increasingly positive about public policy. We asked CFOs to rate the appropriateness of official policy – from government, regulators and the Bank of England – repeating a question we asked in 2012 at the trough of the UK's double-dip slowdown. On average, 77% of CFOs rate policy as being appropriate in the 11 areas they judged, up from 67% in 2012. Confidence has risen across all areas with the largest improvements in the approval ratings on public spending, tax policy, immigration policy and financial regulation.

The Bank of England gets the strongest vote of confidence, with 97% of CFOs rating monetary policy, including the availability of credit and inflation, as appropriate.

Large corporates face few obstacles to raising finance, with CFOs reporting that credit is cheaper and more available than at any time in the last seven years. In a reversal of the situation during the credit crunch, CFOs say that financing conditions are a key factor in enabling companies to raise investment spending.

Yet it is not all plain sailing for the corporate sector. CFOs' perceptions of economic and financial uncertainty rose in the third quarter for the first time in two years. While events in the euro area and emerging markets will have played a role, Scotland's independence referendum seems to have been the dominant factor. Perceptions of financial and economic uncertainty among CFOs completing the survey before the result was known were twice as high as those among CFOs who responded after the result.

The Scottish referendum illustrates how political developments can create uncertainty for business. This quarter's survey shows that political risk continues to eclipse worries about the economy as the key concern for CFOs. Next May's general election and a possible referendum on EU membership rate as greater risks to CFOs than interest rate rises or weakness in the euro area.

After several years of economic and financial turbulence CFOs now see political uncertainty as being a central risk for their businesses.

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

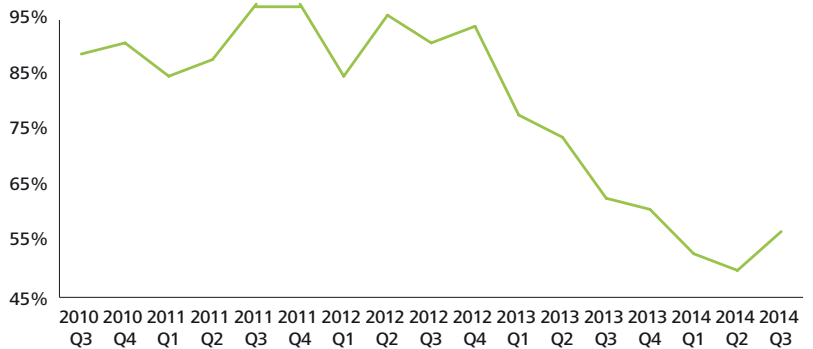


Rise in uncertainty

CFO perceptions of economic uncertainty rose for the first time in two years in the third quarter. Scotland's referendum on independence seems to have had considerable influence on CFO thinking. Among a quarter of the panellists who responded after the result of the referendum was known, 30% rated the level of uncertainty facing their businesses as above normal or higher. The figure before the result was 63%.

Chart 2. Uncertainty

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

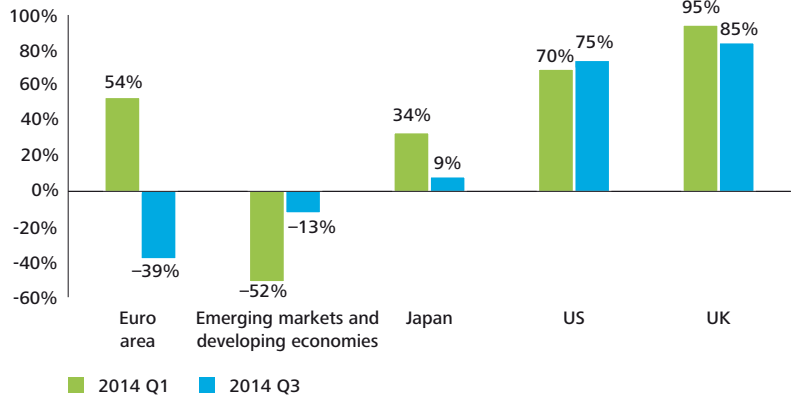


This quarter's survey shows a sharp decline in optimism about prospects for the euro area. Sentiment about emerging markets has continued to deteriorate.

By contrast, CFOs remain positive on growth in the UK and the US.

Chart 3. Prospects for economic activity

Net % of CFOs reporting an improvement in prospects for economic activity over the last six months in the UK, US, euro area, Japan and emerging markets



CFOs rate political issues – the general election in May and a possible referendum on the UK's membership of the EU – as the two greatest risks facing their businesses. These rank above economic challenges such as weak growth in Europe and emerging markets or the bursting of asset price bubbles.

Chart 4. Risk to business posed by the following factors

Risk ranking from highest to lowest	
1	A future UK referendum on membership of the European Union
1	The May 2015 UK general election and the risk of policy change and uncertainty
3	Deflation and economic weakness in the euro area, and the possibility of a renewed euro crisis
4	The prospect of higher interest rates and a general tightening of monetary conditions in the UK and US
5	Weakness and or volatility in emerging markets
6	A bubble in housing and/or other real and financial assets and the risk of higher inflation
7*	Scotland's referendum on independence on 18th September

* The referendum for Scottish independence ranked 4th until 19th September

Expansion is top priority

Despite softening this year, our optimism index remains above its long-term average and absolute levels of optimism continue to improve.

Chart 5. Business confidence

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



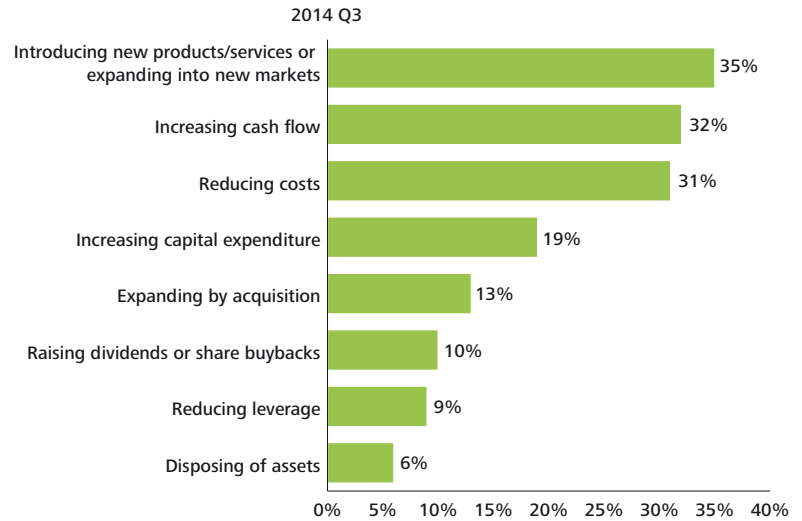
Introducing new products/services or expanding into new markets is the top priority for CFOs.

Compared to the second quarter, CFOs are placing greater emphasis on increasing capital expenditure.

While growth has returned to the UK, CFOs continue to focus on increasing cash flow and reducing costs.

Chart 6. Corporate priorities in the next 12 months

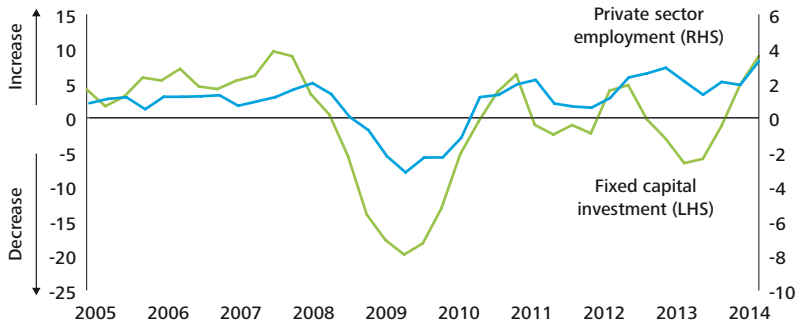
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



Corporates optimistic about profits

Fixed capital investment has risen by 9.6% in the last year and private sector employment, after excluding the effects of reclassifications of some major employers, has risen by 3.2%.

Chart 7. Fixed capital investment and private sector employment
Growth in fixed capital formation (%YoY, 2Q moving average) and growth in private sector employment (% YoY)

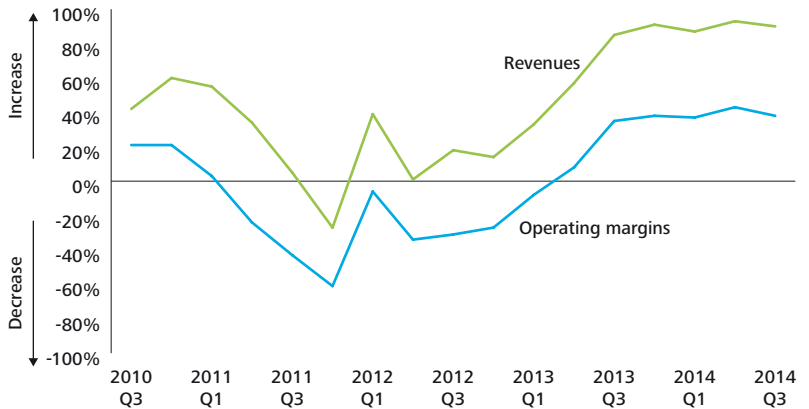


Source: Thomson Reuters Datastream

Corporates remain optimistic about profitability.

CFO expectations for growth in revenues and operating margins remain close to four-year highs.

Chart 8. Outlook for corporate revenues and margins
Net % of CFOs who expect UK corporates' revenues and margins to increase over the next 12 months



On balance, CFOs rate UK corporate balance sheets as underleveraged.

Chart 9. Attitudes to leverage
Net % of CFOs who think UK corporate balance sheets are overleveraged

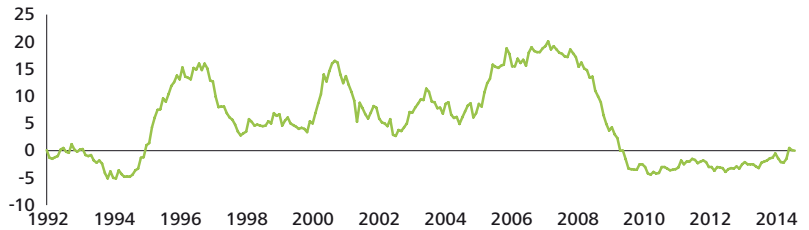


Public policy appropriate

A period of sharply declining lending to corporates seems to be coming to an end.

Official data show that the flow of credit to private non-financial corporations has turned positive for the first time in five years.

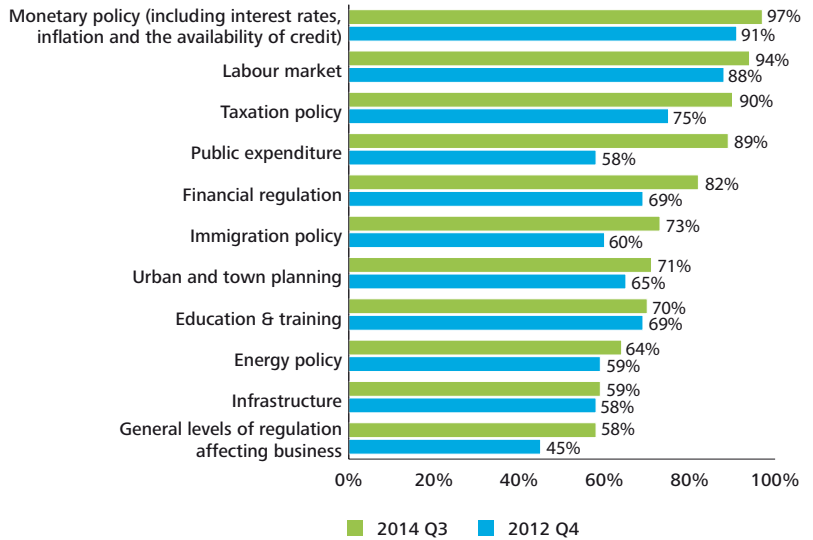
Chart 10. Lending to corporate sector
Growth in bank and building society lending to private non-financial corporations (% YoY)



Source: Thomson Reuters Datastream

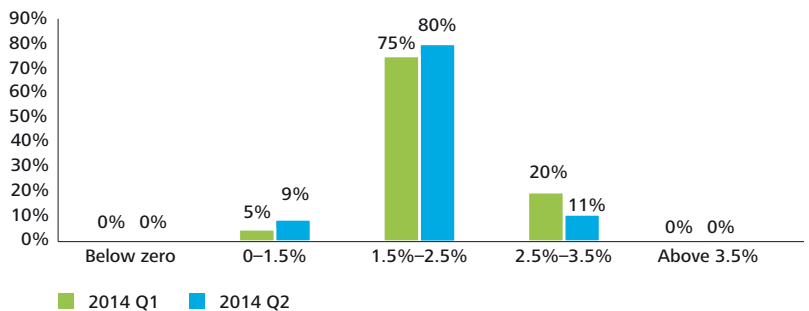
We asked CFOs to rate the appropriateness of official policy across 11 areas, repeating a question we asked in 2012 at the trough of the UK's double-dip slowdown. On average, 77% of CFOs rate policy as being appropriate across the areas, up from 67% in 2012. Confidence has risen across all areas with the largest improvements in the approval ratings on public spending, tax policy, immigration policy and financial regulation. The Bank of England gets the strongest vote of confidence, with 97% of CFOs rating monetary policy, including the availability of credit and inflation, as appropriate.

Chart 11. Policy appropriateness index
% of CFOs reporting that current policy settings in the following areas are appropriate for the long-term success of businesses in the UK



CFOs' inflation expectations have fallen since the first quarter. An overwhelming majority, 80%, expect CPI inflation to hover around the Bank of England's 2.0% target in two years' time. The proportion who expect inflation to overshoot its target has almost halved, from 20% to 11%.

Chart 12. Inflation expectations
% of CFOs who expect consumer price inflation in the UK to lie between the following ranges in two years' time



Easy financing conditions

Financing conditions continue to improve for the large corporates on our survey panel.

CFOs report credit as being cheaper and more easily available now than at any time in the last seven years.

Chart 13. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available

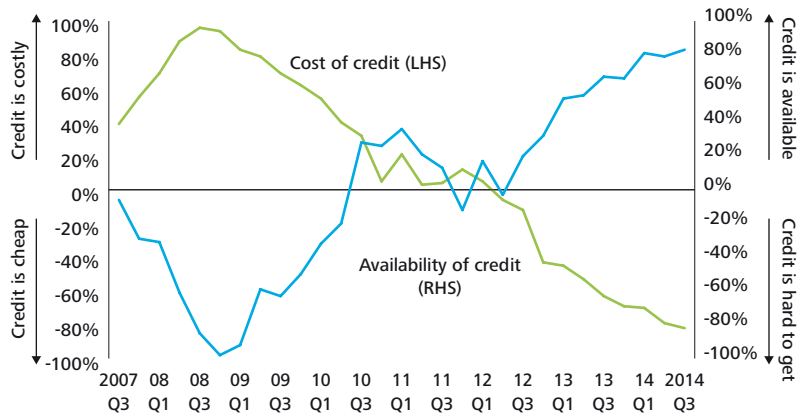
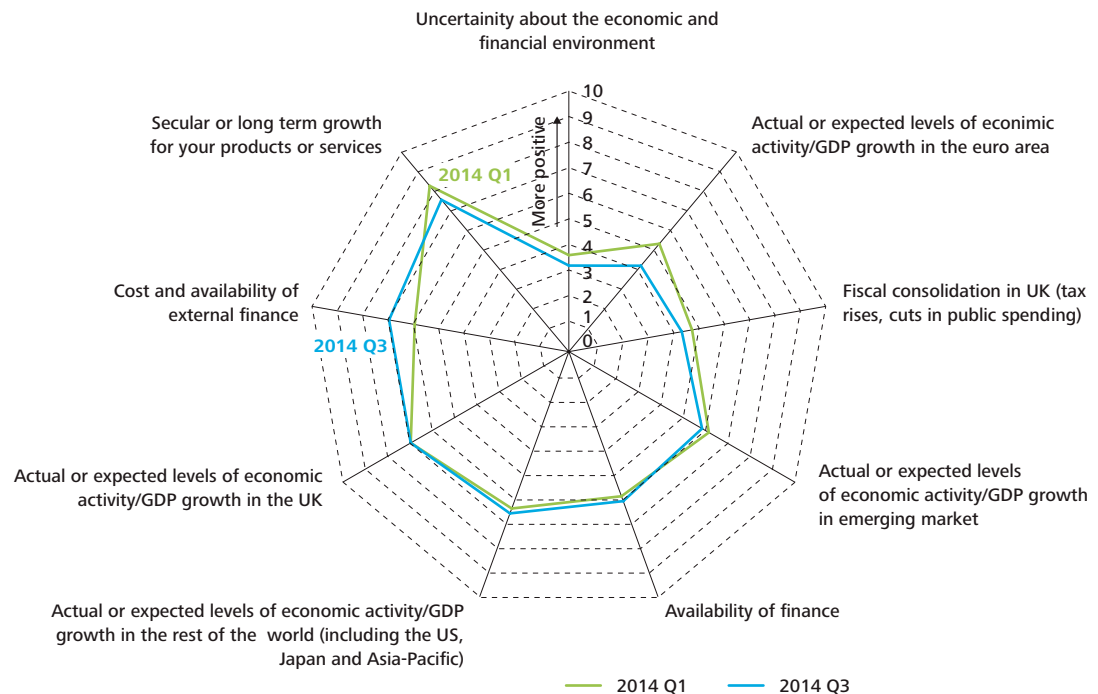


Chart 14 compares the effect of nine key factors on corporate investment plans between Q1 2014 and now.

Uncertainty remains the largest, and a growing, constraint on investment plans. Weakness in the euro area is also weighing on investment. The main drivers of investment are easy access to finance, the strength of the UK economy and rising demand for businesses’ products and services.

Chart 14. Factors affecting corporate investment plans
CFOs’ assessment of the effect of each of the following factors on their investment plans

On a 10-point scale where 0 implies the most negative effect and 10 the most positive

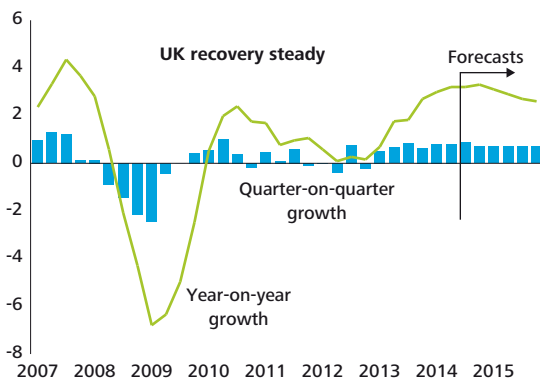


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q3 2014

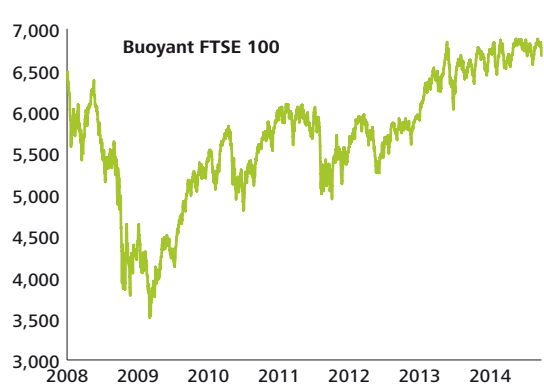
UK activity remained strong, with output rising above its pre-crisis peak and unemployment falling to a six-year low. The Bank of England signalled that it anticipates a slowing of UK activity towards the end of the year as the effects of sterling strength and weakness in the euro area kick in. Euro area growth remained disappointingly weak and fears of deflation grew. The European Central Bank announced further measures to support lending including the introduction of negative deposit rates for the first time. US economic activity rebounded in the second quarter bolstering sentiment about the world's largest economy. Geopolitical uncertainties surrounding the conflicts in the Ukraine and the Middle East moved centre stage. In Scotland, support for independence rose in the month before the September 18th vote. In the referendum 55% of voters chose to stay in the United Kingdom. Financial markets remained generally strong, with the S&P 500 reaching new record highs and risk assets rallying in Europe on hopes of further monetary easing.

UK GDP growth: Actual and forecast (%)



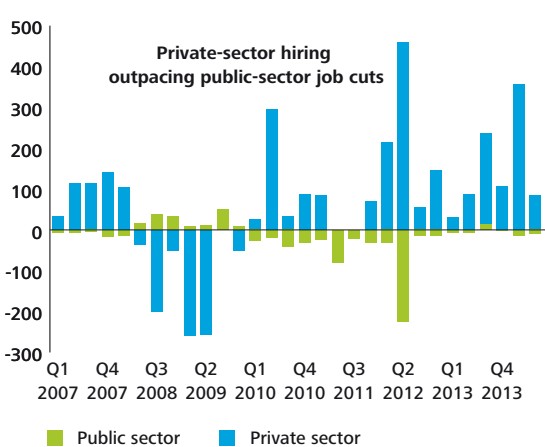
Source: ONS, consensus forecasts from *The Economist* and Deloitte calculations

FTSE 100 price index



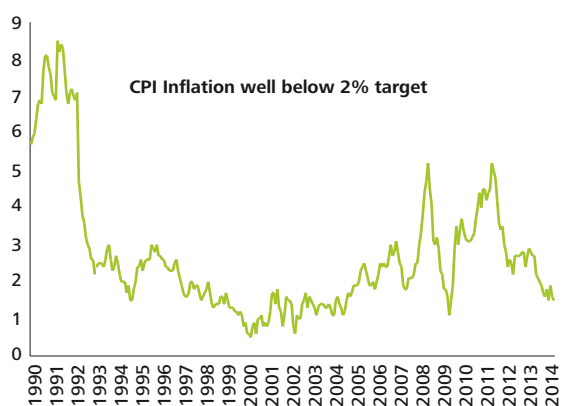
Source: Thomson Reuters Datastream

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

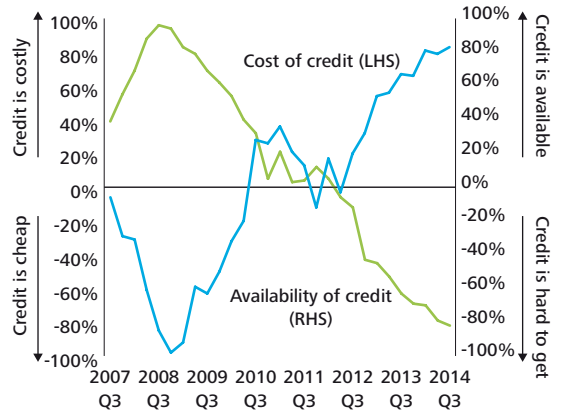
Uncertainty

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



Cost and availability of credit

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



About the survey

This is the 29th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2014 third quarter survey took place between 8th and 22nd September. 118 CFOs participated, including the CFOs of 28 FTSE 100 and 40 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 79 UK-listed companies surveyed is £462 billion, or approximately 20% 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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