

## The Deloitte CFO Survey Q1 2015

### Election casts a long shadow

Uncertainty over post-election policy change represents the greatest threat to UK business according to the Chief Financial Officers of the UK's largest companies. CFOs rank a referendum on EU membership as the second greatest risk facing their businesses, followed by concerns over weakness and political instability in the euro area.

Risk appetite appears to have decoupled from its usual drivers, the economic outlook and equity market performance. Sentiment about growth in the US, UK and the euro area has improved since the previous CFO Survey in December. And the FTSE100 rose by 14% between mid-December and late March to reach an all-time high.

Yet political worries and the threat of a renewed euro crisis seem to have offset the impact of generally good economic news and buoyant equity markets, dragging down corporate risk appetite to a two-year low. CFO expectations for investment spending have also dipped.

Last September, as CFO risk appetite reached its peak, a majority of CFOs rated government policy as being appropriate across ten separate areas.

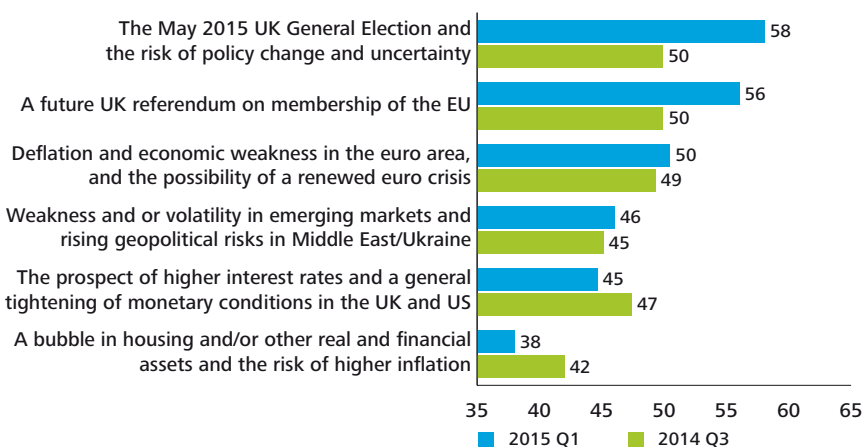
The highest levels of satisfaction, with scores of 90% or more, went to monetary policy, the labour market and taxation. On average 77% of CFOs rated policy as appropriate, up from 67% in 2012.

This quarter's survey shows that CFOs think the General Election poses risks to what is seen as a benign policy environment. A clear majority of CFOs see the potential for adverse changes on regulation and taxation. And, on balance, the expectation is that post-election changes will be negative for fiscal, monetary and labour market policies. Meanwhile the risk of a future referendum on EU membership ranks not far below the General Election itself as a threat.

Corporate hiring and investment has led the recovery in the last two years. Yet this quarter's CFO Survey demonstrates that business-hostile policy change remains a potent threat to the recovery. The last seven years have provided ample evidence of the corrosive effects of uncertainty on corporate behaviour. A weakening of corporate risk appetite and investment intentions provides an ominous reminder that the business recovery is not assured.

**Chart 1. 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



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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](http://www.deloitte.co.uk/cfosurvey)

# Uncertainty up

CFO perceptions of economic and financial uncertainty rose again in the first quarter.

63% of CFOs now rate the level of uncertainty facing their businesses as above normal, high or very high – the highest reading in almost two years.

Rising uncertainty has coincided with a continued reduction in risk appetite, which is now at a two-year low.

51% of CFOs say that now is a good time to take greater risk onto their balance sheets, down from a record high of 72% six months ago.

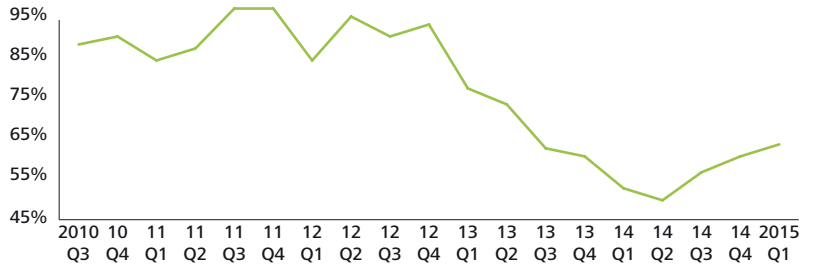
This fall in risk appetite appears to be driven by CFO concerns over policy change after the General Election, as highlighted in Chart 1.

Corporates see the current policy environment as fairly benign. Last September, as risk appetite hit a record high, a majority of CFOs rated UK government policy as appropriate across ten areas.

More than 90% of them reported policy settings as appropriate for labour market, taxation and monetary policy.

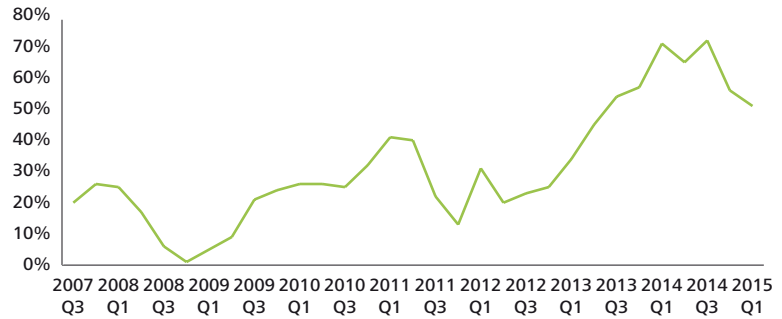
**Chart 2. Uncertainty**

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



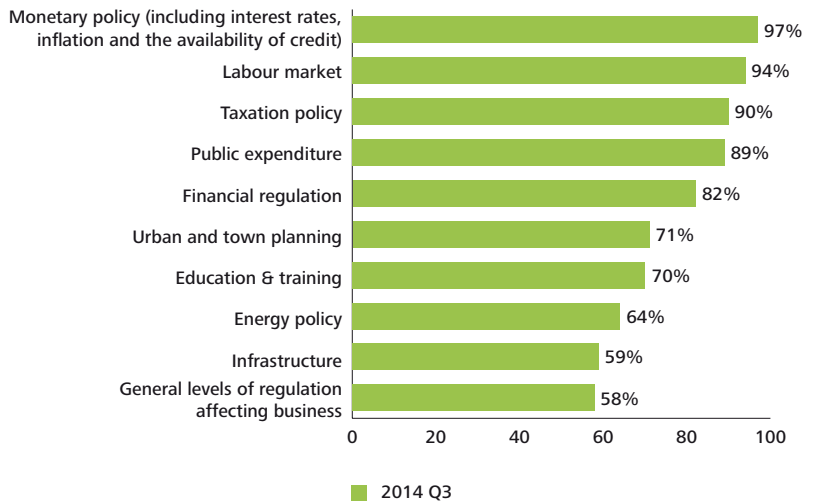
**Chart 3. Risk appetite**

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



**Chart 4. Policy appropriateness index**

% of CFOs reporting that policy settings in the following areas are appropriate for the long-term success of businesses in the UK



# Policy change key concern

CFOs believe that the General Election poses risks to what is seen as a generally benign policy environment. A clear majority of CFOs see the potential for adverse changes on regulation and tax. And, on balance, the expectation is that post-election changes will be negative for fiscal, monetary and labour market policies.

At the same time, CFOs anticipate that changes to policy on infrastructure, education and training, and urban and town planning would be beneficial for their businesses.

The rise in uncertainty over UK economic policy is also reflected in an uptick in press references to economic policy uncertainty.

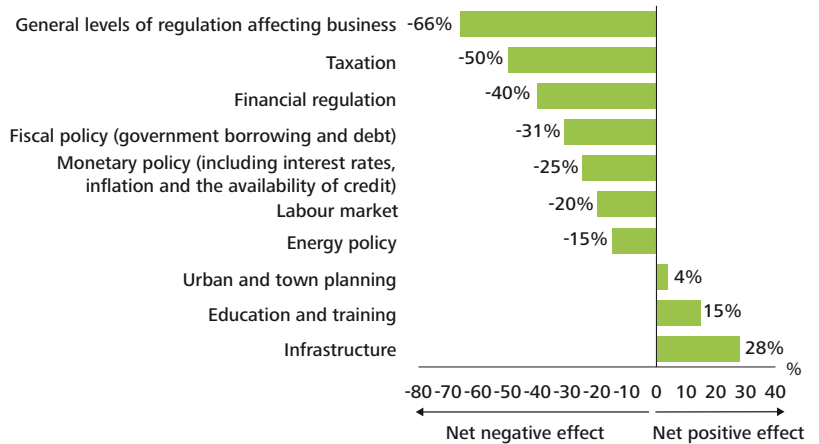
Developments in Europe have also weighed on corporate risk appetite.

Despite recent improvements in the economic outlook for the euro area, political wrangling over Greek austerity and debt repayments has kept the euro crisis in the headlines.

The probability of a Greek default – as inferred from the cost of insuring against this event – has risen sharply this year.

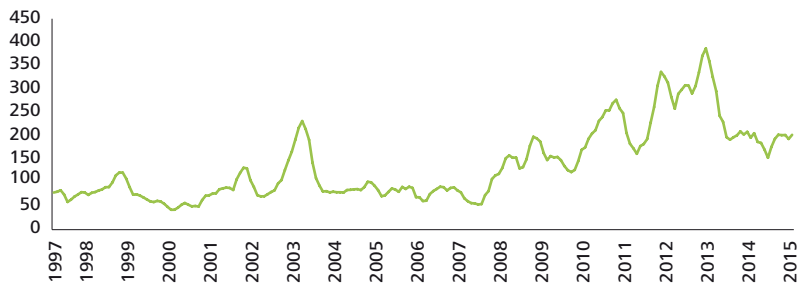
**Chart 5. Effect of policy change**

Net % of CFOs who see policy change in the following areas, after the General Election, as having a positive effect on their business



**Chart 6. Economic Policy Uncertainty Index**

News-based index of UK economic policy uncertainty index (four-month quarter moving average)

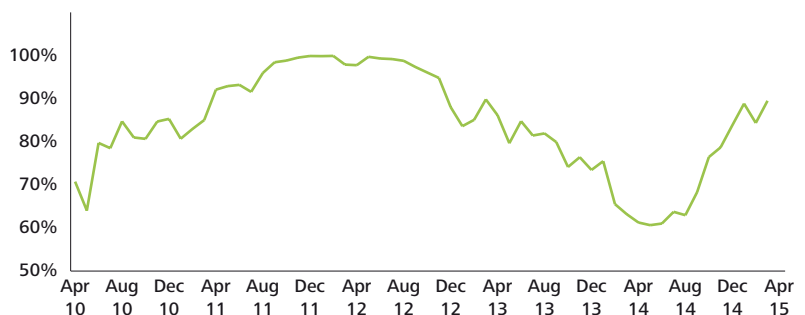


The Economic Policy Uncertainty Index, developed by academics at Stanford University and the University of Chicago, measures the share of articles containing terms related to economic policy uncertainty in the overall UK newsflow.

Source: Policyuncertainty.com

**Chart 7. Probability of Greek default**

The percentage probability of a Greek sovereign default, based on credit default swap prices



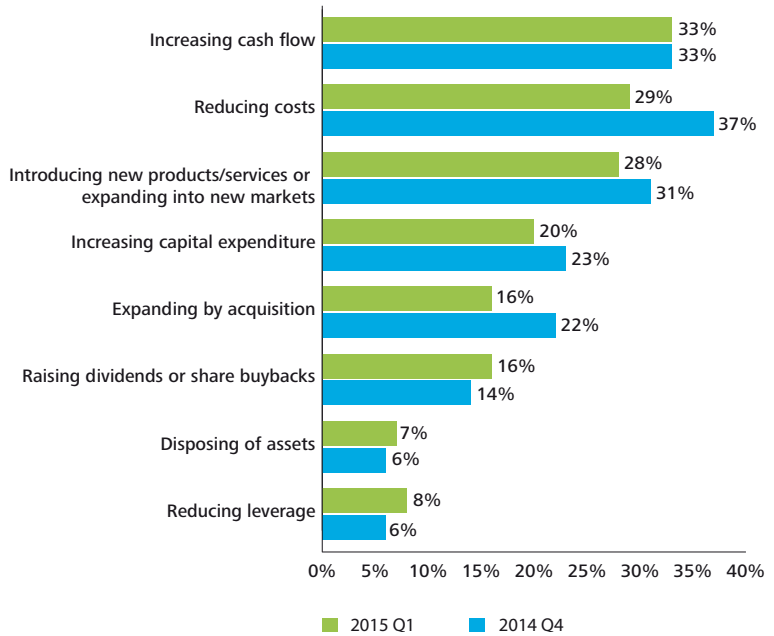
Source: Fathom Consulting, Thomson Reuters Datastream

# Defensive strategies in favour

Defensive strategies – increasing cash flow and reducing costs – remain the top priorities for CFOs.

Compared to the fourth quarter of last year CFOs are placing less emphasis on expansionary strategies such as introducing new products or services, expanding by acquisition and capital expenditure.

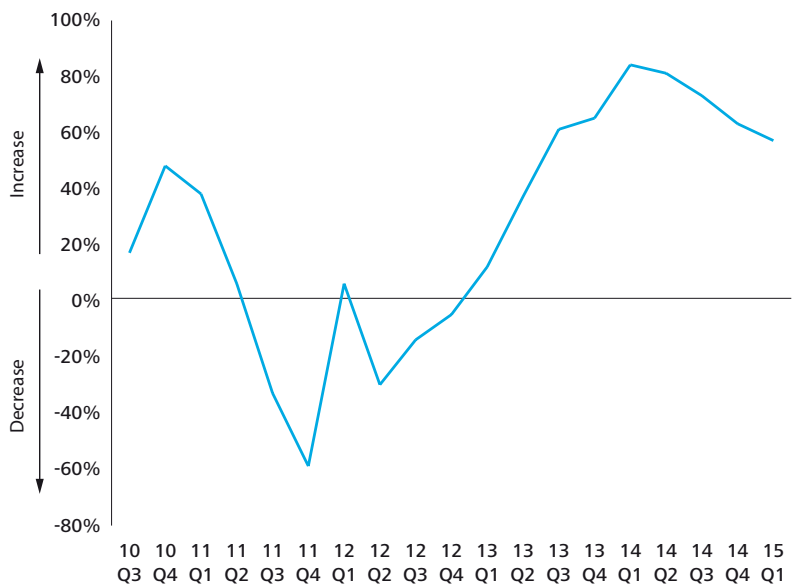
**Chart 8. Corporate priorities in the next 12 months**  
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



CFOs have scaled down their expectations for growth in capital spending.

A net 53% expect UK corporates to increase capital expenditure over the next 12 months, down from a peak of 80% a year ago.

**Chart 9. Outlook for capital expenditure**  
Net % of CFOs who expect UK corporates' capital expenditure to increase over the next 12 months



# Uncertainty weighing on investment plans

Chart 10 compares the effect of nine key factors on corporate investment plans between the first quarter of last year and now. The further a coloured line in the chart is from the centre, the more the factor acts to support investment.

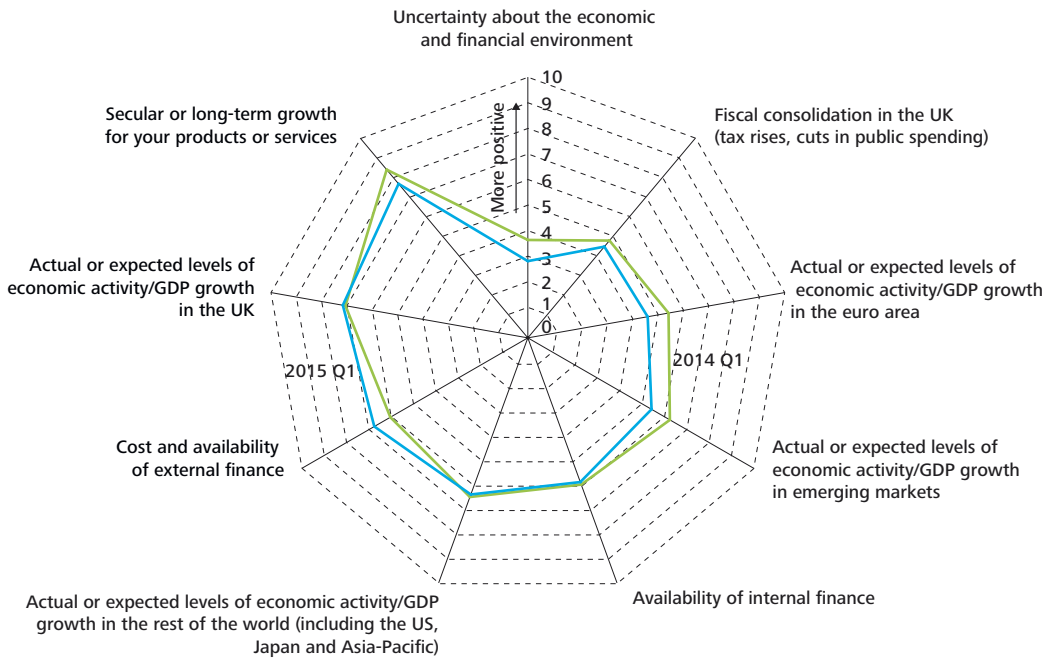
Uncertainty is the biggest, and a growing, depressant on investment.

The main drivers of investment are easy access to external financing, a strengthening UK recovery and rising demand for businesses' products and services.

### Chart 10. Factors affecting corporate investment plans

CFOs' assessment of the effect of each of the following factors on their investment plans:

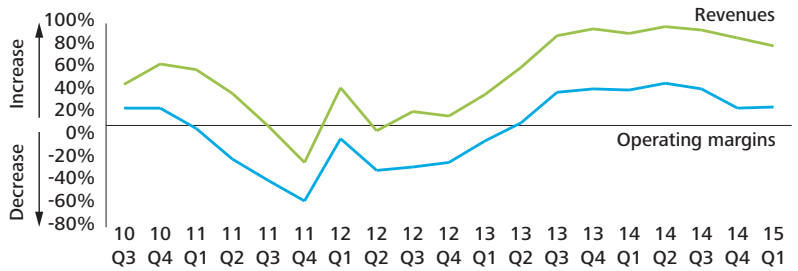
On a 10-point scale where 0 implies the most negative effect and 10 the most positive



# Strong fundamentals

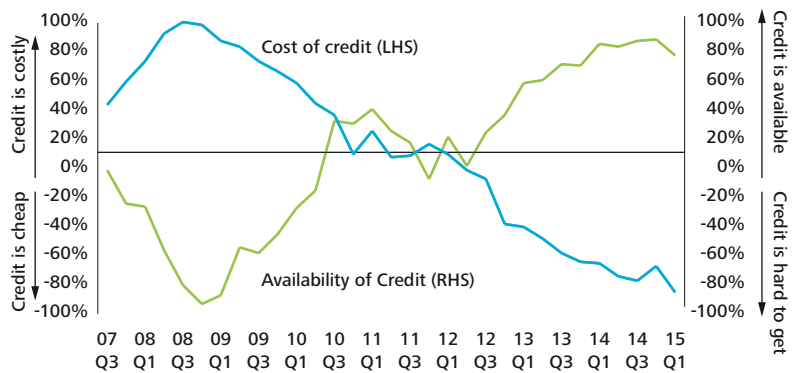
Despite rising uncertainty, expectations for revenues and operating margins have softened modestly and remain well above their long-term averages.

**Chart 11. Outlook for corporate revenues and margins**  
Net % of CFOs who expect UK corporates' revenues and margins to increase over the next 12 months



Financing conditions remain benign for the large corporates on our survey panel. The cost of credit has hit a seven-and-a-half-year low this quarter and availability remains close to a seven-year high.

**Chart 12. Cost and availability of credit**  
Net % of CFOs reporting credit is costly and credit is easily available



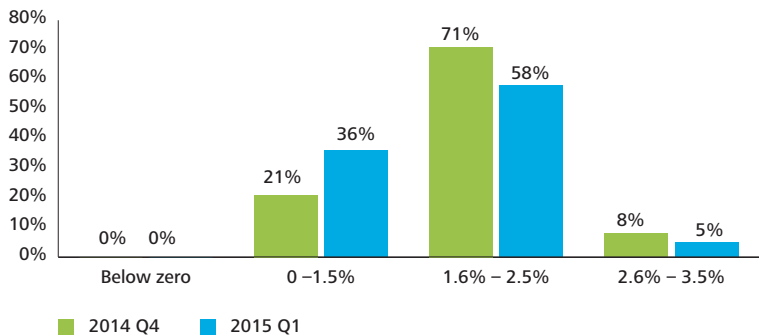
CFOs also rate debt finance – bank borrowing and bond issuance – as the most attractive source of external funding.

Compared to the average reading from our sister surveys across 13 major European countries, a significantly larger proportion of UK CFOs rated debt finance as an attractive source of funding.

A majority of UK CFOs expect inflation to hover around the Bank of England's 2.0% target rate in two years' time.

**Chart 13. Inflation expectations**  
% of CFOs who expect consumer price inflation in the UK to lie between the following ranges in two years' time

However, a growing proportion expect lower inflation, with more than a third anticipating it to be between zero and 1.5%.

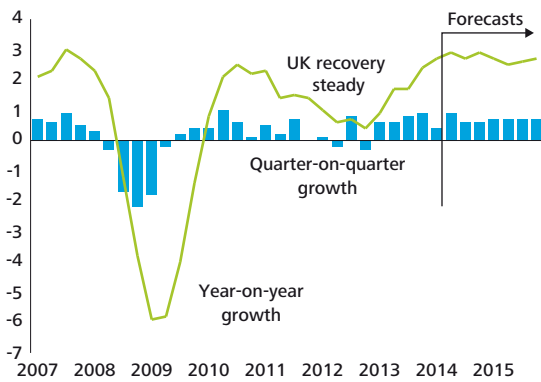


# CFO Survey: Economic and financial context

## The macroeconomic backdrop to the Deloitte CFO Survey Q1 2015

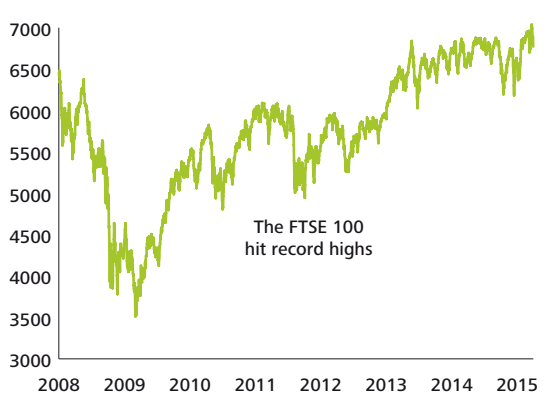
Global equity markets rose 4.5% in the first quarter and yields on developed economy sovereign bonds fell. The price of oil stabilised somewhat although at a significantly lower level than its 2014 peak. Lower oil prices provided a boost to consumers across the globe through lower inflation and a rise in disposable incomes. Financial markets reacted positively to the launch of the European Central Bank's (ECB) quantitative easing programme, with risk assets rallying in Europe and equities hitting a record high in Germany. European bond yields also fell and Spanish and Italian yields hit record lows. Despite renewed concerns over a euro area break-up following the election of anti-austerity party Syriza in Greece, a number of euro area economic indicators showed signs of improvement. The ECB upgraded its euro area growth forecast for 2015 to 1.5% from 1.0%. Economists also upgraded growth forecasts for the UK. The FTSE 100 continued to perform strongly, breaking through the 7,000 mark for the first time, with markets buoyed by the prospect of UK and US interest rates remaining lower for longer.

**UK GDP growth: Actual and forecast (%)**



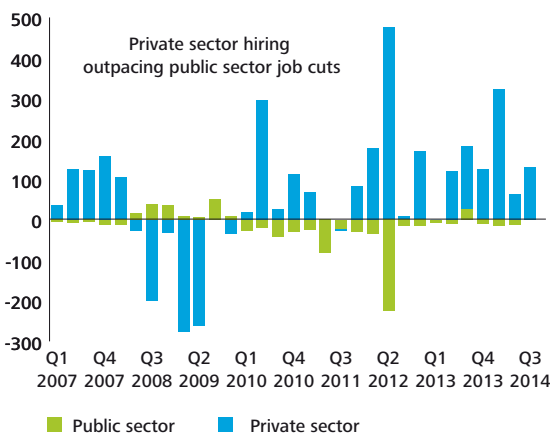
Source: ONS, consensus forecasts from *The Economist* and Deloitte calculations

**FTSE 100 price index**



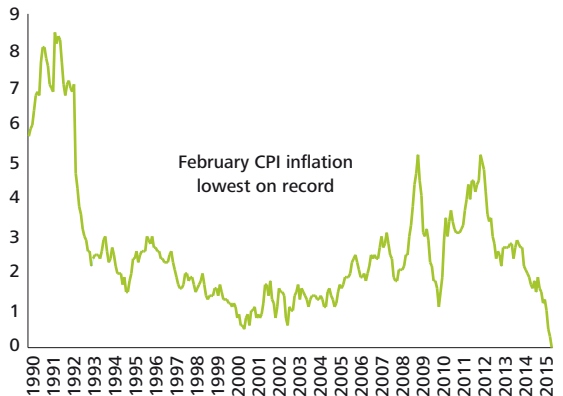
Source: Thomson Reuters Datastream

**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

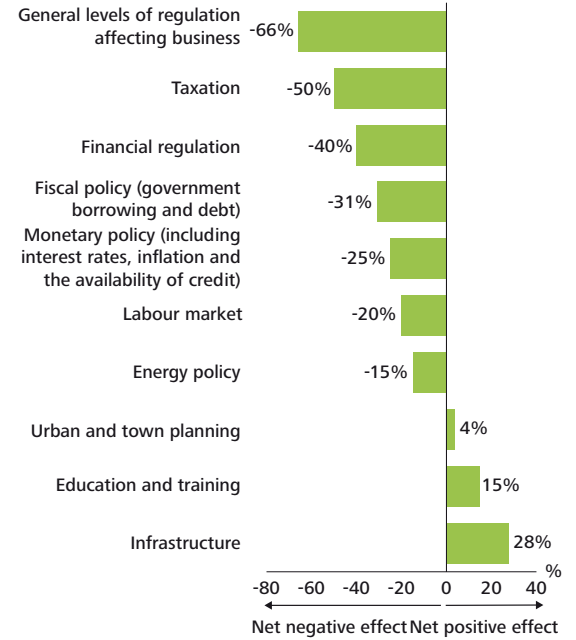
## Risk appetite

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



## Effect of policy change

Net % of CFOs who see policy change in the following areas, after the General Election, as having a positive effect on their business



### About the survey

This is the 31<sup>st</sup> quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2015 first quarter survey took place between 6<sup>th</sup> and 23<sup>rd</sup> March. 108 CFOs participated, including the CFOs of 21 FTSE 100 and 45 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 72 UK-listed companies surveyed is £380 billion, or approximately 16% 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](mailto:aneagle@deloitte.co.uk).

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Designed and produced by The Creative Studio at Deloitte, London. 43243A