

The Deloitte CFO Survey

Post-election dip in confidence

In the wake of the General Election on 8th June, optimism among Chief Financial Officers has fallen back from the 18-month high seen in the first quarter. Despite speculation that the result of the election outcome could mean a closer long-term relationship between the UK and the EU, CFO concerns about Brexit have risen and it is seen as the top risk facing business. 72% of CFOs expect some negative long-term effects on the business environment as a result of the UK's departure from the EU, up from 60% in the first quarter.

The second quarter survey of CFOs took place between 12th and 27th June and provides the first insight into the thinking of major UK corporates in the aftermath of the UK General Election. CFO perceptions of uncertainty facing businesses rose in the second quarter, a development which seems to reflect both the outcome of the General Election and concerns about growth. Worries about UK growth have risen and are now seen as posing a greater risk to business than at any time in two-and-a-half years. Such concerns rank second on CFOs' risk list after Brexit.

For much of the last three years external risks have been the focus of CFO concern. But the worries about geopolitics and growth overseas, which dominated CFO concerns in 2015 and 2016, have receded.

A recovery in emerging markets and a pickup in growth combined with an easing of political risk in the euro area, have pushed both to the bottom of the worry list. Today CFOs see Brexit and the prospect of slower UK growth as being the main risks.

Business sentiment has been on a roller coaster ride in the last 18 months, slumping on the surprise referendum result before staging a strong recovery and then falling back in the wake of the General Election.

Although CFO confidence has taken a knock since the election, sentiment and risk appetite are well above the levels seen last summer. Perceptions of uncertainty are also lower. Favourable financial conditions and an improving global backdrop are partially offsetting the effects of domestic uncertainties for UK CFOs.

Authors

Ian Stewart
Chief Economist
 020 7007 9386
 istewart@deloitte.co.uk

Debapratim De
Senior Economic Analyst
 020 7303 0888
 dde@deloitte.co.uk

Alex Cole
Economic Analyst
 020 7007 2947
 alecole@deloitte.co.uk

Rebecca Porter
Economic Analyst
 020 7007 5728
 reporter@deloitte.co.uk

Key contacts

Ian Stewart
Chief Economist
 020 7007 9386
 istewart@deloitte.co.uk

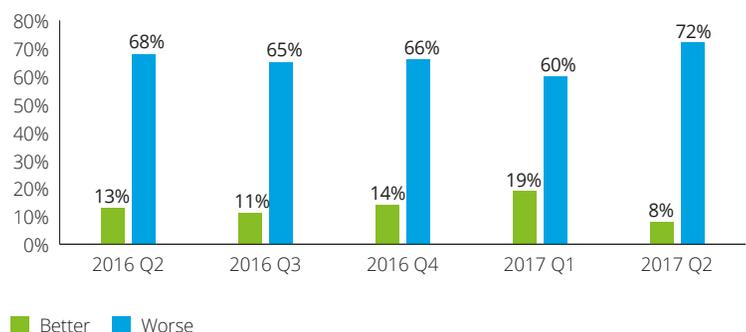
Richard Muschamp
CFO Programme Leader
 020 7007 0724
 rmuschamp@deloitte.co.uk

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. 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 (excludes 'little changed')

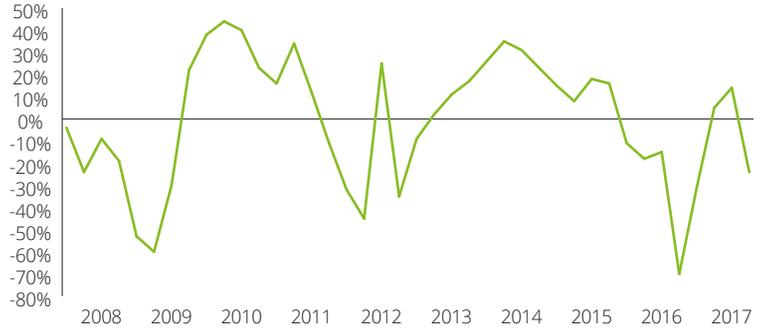


Optimism down

Business optimism fell sharply in the second quarter.

Chart 2. Business optimism

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



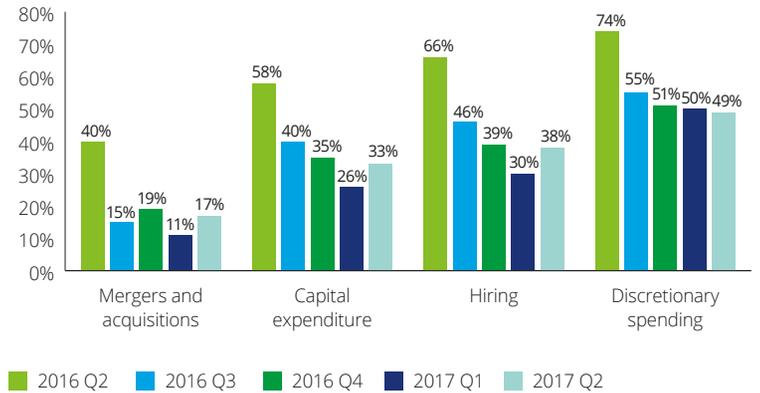
CFO pessimism about the effects of Brexit has edged up. But it remains at substantially lower levels than right after the EU referendum.

A third or more expect Brexit to reduce their own investment and hiring plans over the next three years.

17% expect it to lower M&A activity over the same period.

Chart 3. 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

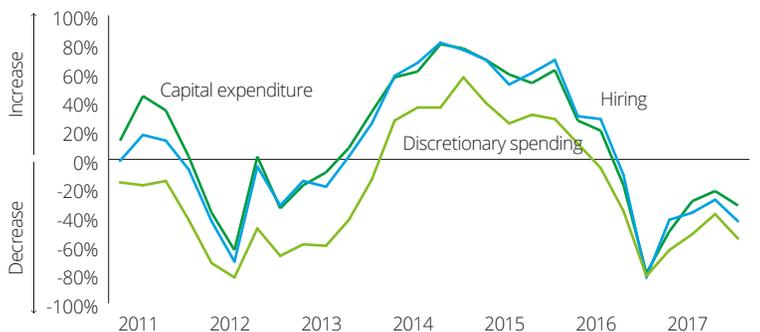


The outlook for capital expenditure, hiring and discretionary spending has deteriorated in the second quarter.

On balance, CFOs expect UK corporates to decrease spending in each area over the next 12 months.

Chart 4. 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



Brexit tops risk list

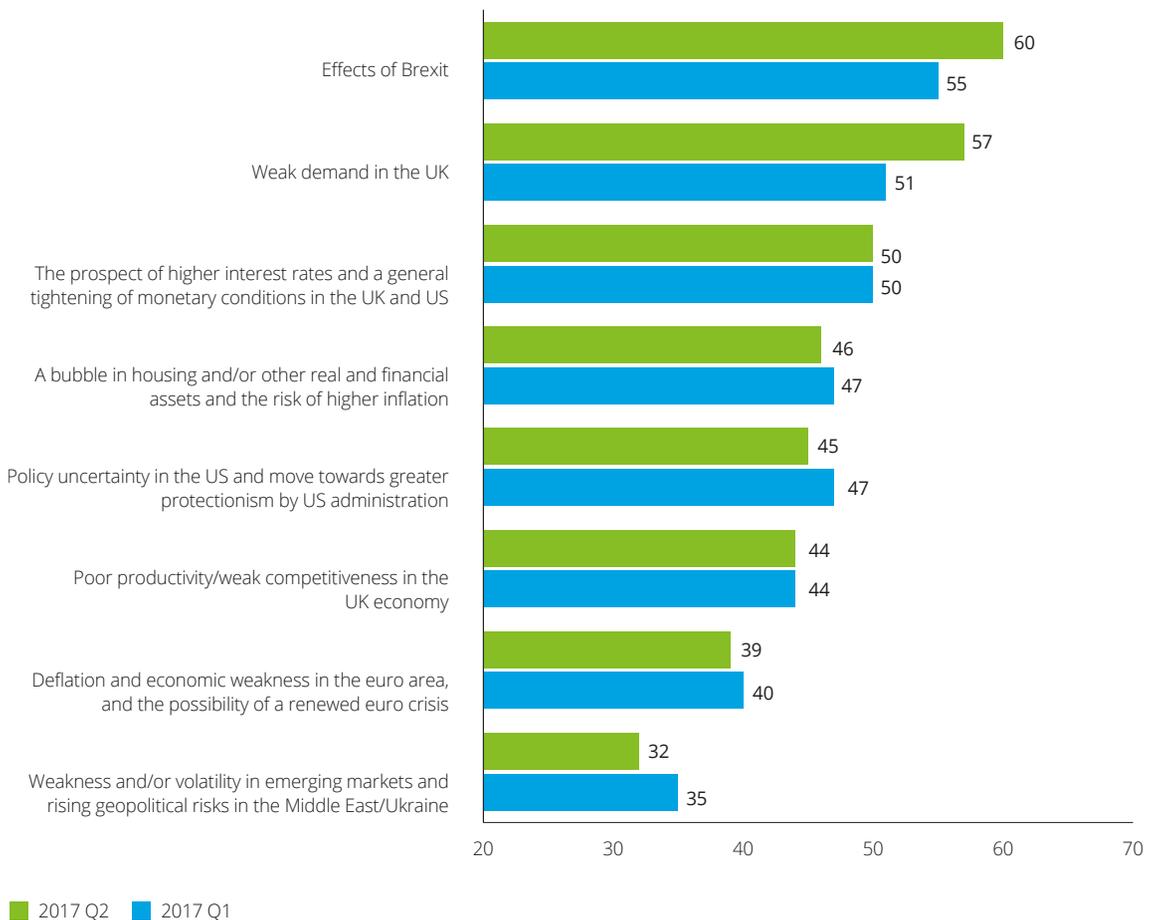
CFOs continue to cite Brexit as the biggest and a growing risk to their businesses. Weak demand in the UK and the prospect of rate rises in the US and UK, make up the top three risks. Concerns over weak demand in the UK have risen to the highest level since we started asking this question at the end of 2014.

Meanwhile, the risks of an asset price bubble, and policy uncertainty and greater protectionism in the US have diminished in importance.

Concerns over two major sources of external risk – weakness in emerging markets and the euro area, which make up the bottom of the list – have continued to decrease and are now at the lowest levels since the end of 2014.

Chart 5. 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



Corporate strategies defensive

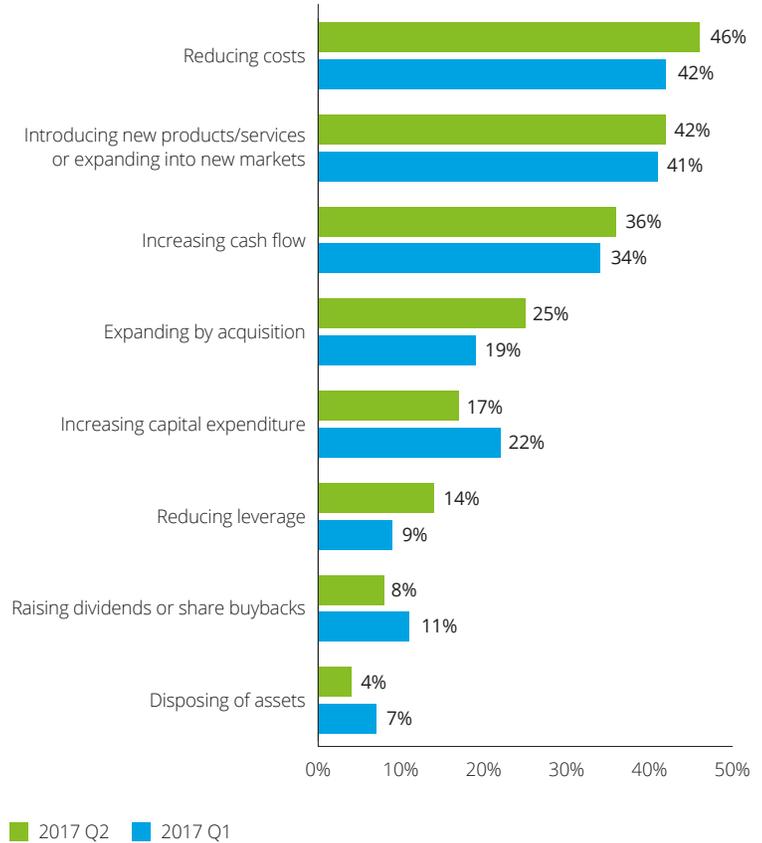
The balance of corporate strategies has tilted further towards the defensive.

CFOs have sharpened their focus on expansionary strategies such as introducing new products and services, and expanding by acquisition.

But, relative to the first quarter, they are placing much greater emphasis on defensive strategies such as cost reduction, which remains the top priority, increasing cash flow and reducing leverage.

Chart 6. Corporate priorities in the next 12 months

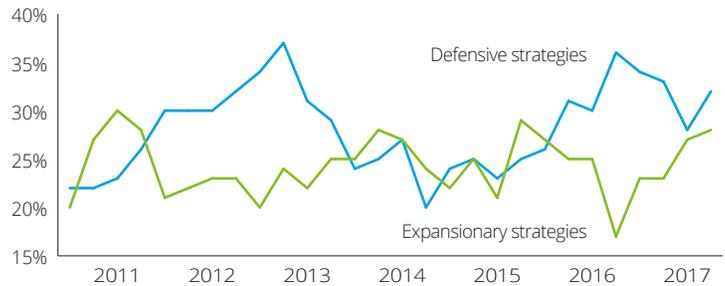
% of CFOs who rated each of the following as a strong priority for their business in the next 12 months



CFOs have become significantly more defensive in the second quarter, more than offsetting their slightly sharper focus on expansionary strategies.

Chart 7. 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.

Uncertainty up

CFO perceptions of uncertainty have risen in the second quarter survey, conducted immediately after the surprise outcome of a hung parliament in the UK General Election.

43% of CFOs rate current levels of external economic and financial uncertainty as high or very high.

Chart 8. Uncertainty

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



Corporate risk appetite has decreased slightly in the second quarter.

22% of CFOs think now is a good time to take greater risk onto their balance sheets, a reading well below the long-term average.

Chart 9. Corporate risk appetite

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



The outlook for corporate revenue and margin growth has deteriorated in the second quarter.

A net 28% of CFOs expect revenues to increase over the next 12 months, down sharply from the first quarter.

On balance, CFOs expect operating margins to fall over the same period.

Chart 10. Outlook for corporate revenues and margins

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



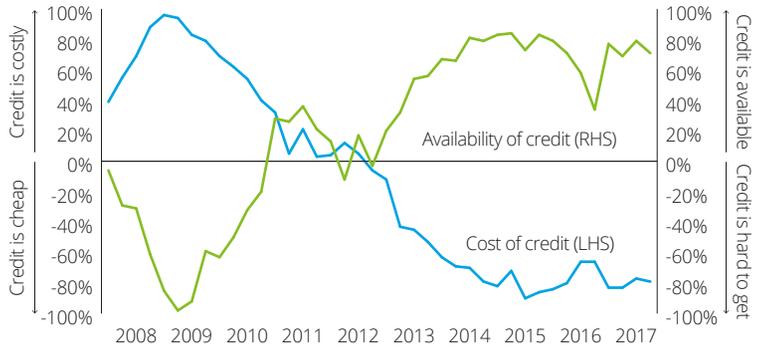
Favourable credit conditions

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

CFOs continue to view credit as being cheap and easily available.

Chart 11. Cost and availability of credit

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

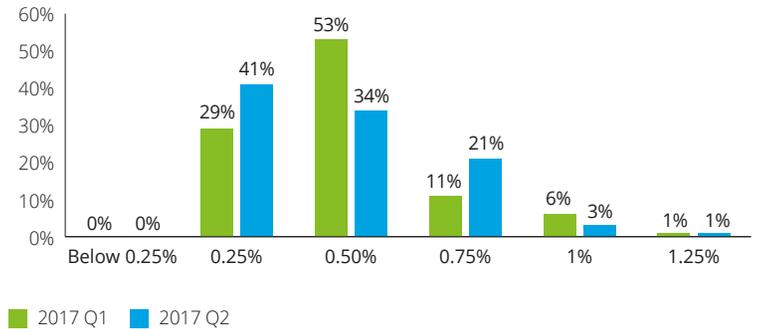


CFOs seem to have pushed back their expectations for rate rises.

Nonetheless, a sizeable majority – 59% – expect the Bank of England's base rate to be above its current level of 0.25% in a year's time, down from 71% in the first quarter.

Chart 12. 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

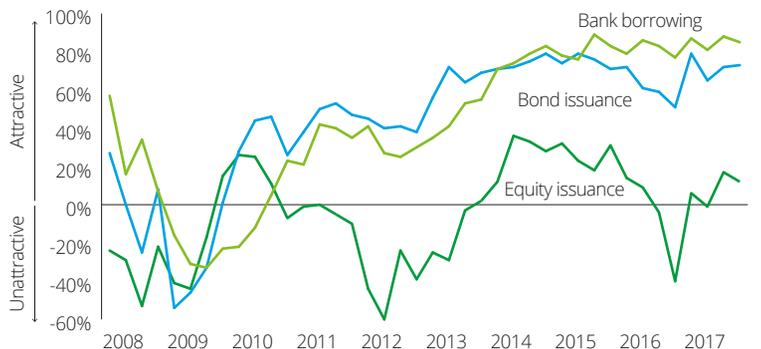


Debt finance – bank borrowing and bond issuance – remains the most attractive source of funding for CFOs.

Equity issuance is still less appealing, with a fall in attractiveness in the second quarter.

Chart 13. Favoured source of corporate funding

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



CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q2 2017

The UK General Election on 8th June unexpectedly delivered a hung parliament, creating new political uncertainties. British households saw a further squeeze on earnings as inflation rose to 2.9% in June. In a sign that rising prices and weak pay growth are squeezing consumers, the household savings ratio fell to 1.7%, its lowest level since 1963. In contrast, British manufacturing activity grew at its fastest pace in three years and the Confederation of British Industry's measure of export order books climbed to the highest level in almost 30 years on sterling weakness and a pickup in global growth. With a synchronised recovery underway in advanced and emerging markets the International Monetary Fund revised up its global growth forecasts for 2017. A convincing victory for the pro-EU centrist, Emmanuel Macron, in France's presidential election helped ease perceptions of political risks in Europe. Survey data indicated an acceleration in the euro area recovery, with consumer confidence rising to its highest level since 2007 and German business sentiment rising to its highest ever level. Euro area, US and UK equity prices rose while government bond prices fell as investors anticipated a tightening of monetary policy in advanced economies. The Federal Reserve demonstrated its confidence in the US recovery by raising interest rates for the third time on 14th June.

UK GDP growth: Actual and forecast (%)



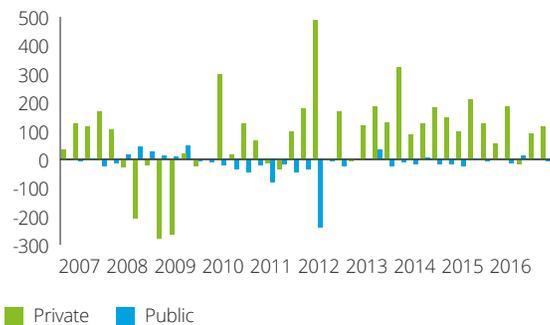
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

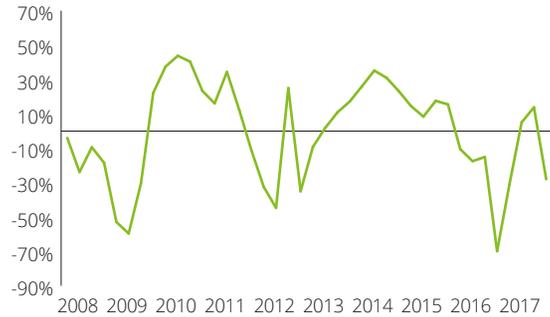


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

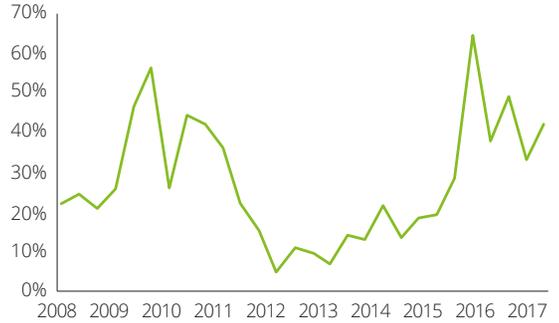
Business optimism

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



Uncertainty

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



About the survey

This is the 40th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2017 second quarter survey took place between 12th and 27th June. 122 CFOs participated, including the CFOs of 22 FTSE 100 and 54 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 92 UK-listed companies surveyed is £509 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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