

The Deloitte CFO Survey

No quick bounce back

After the sharpest contraction in activity in more than a century, a recovery is underway in the UK. But Chief Financial Officers of Britain's largest businesses are not expecting it to be 'V-shaped'. CFO expectations of demand point to a slow and gradual pickup in activity rather than a strong bounce back this year. Almost half of them do not expect demand for their own businesses to reach pre-pandemic levels for a year or more.

This is consistent with CFOs' assessment of external uncertainty, which remains higher than at any point before the COVID-19 pandemic, albeit slightly below April's reading. The crisis has knocked the animal spirits of corporates, with just 9% of CFOs saying now is a good time to take greater risk onto their balance sheets, close to the lowest readings on record.

The pandemic overshadows all other sources of concern, with CFOs rating it as the greatest risk facing businesses – and by a wide margin. As new fronts open in the ongoing US-China economic conflict, geopolitics is ranked second on their risk list while Brexit takes the third spot.

Against a backdrop of elevated uncertainty and very weak demand, CFOs are firmly focused on protecting their balance sheets by bearing down on costs and building cash. Official data confirm that corporates are building cash reserves, and at the fastest pace

on record. Views on corporate leverage have changed too. In the last ten years, CFOs have been relaxed about levels of corporate debt. But following a recent surge in borrowing views have changed and the balance of opinion among CFOs is that corporate balance sheets are now overleveraged.

Business investment, which has slowed dramatically since the EU referendum, is also facing a continued squeeze. Almost two-thirds of CFOs expect their capital expenditure to decrease over the next three years due to the COVID-19 pandemic or the UK leaving the EU. 25% attribute this reduction to both the pandemic and Brexit.

As the lockdown eases growth is set to rebound. But UK corporates are planning on a slow recovery, one in which corporate revenues and activity remain below normal well into next year.

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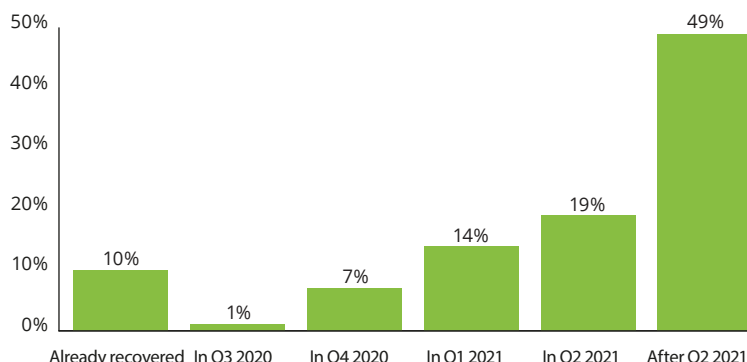
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Chart 1. Recovery of demand to pre-pandemic levels
 % of CFOs that expect demand to return to pre-pandemic levels in the following quarters



COVID-19 is top risk

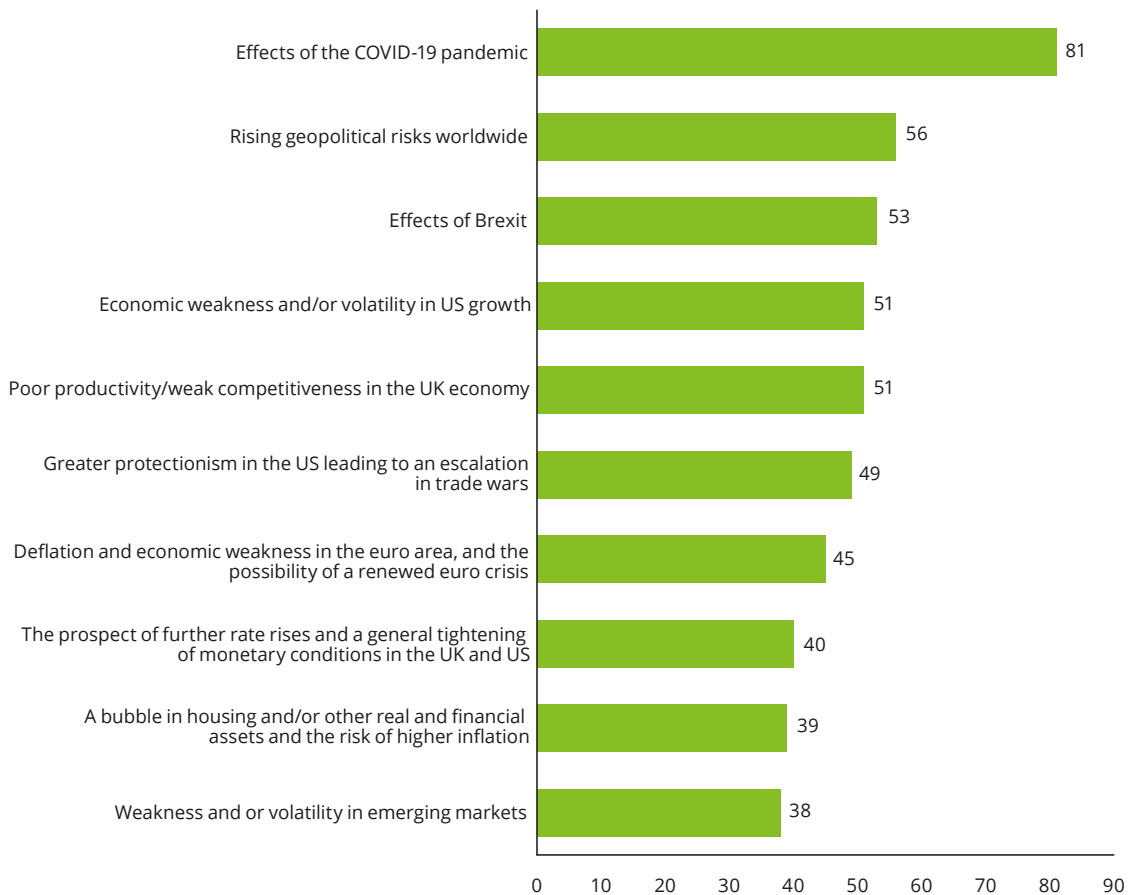
CFOs rank the effects of the COVID-19 pandemic as the top risk facing their businesses.

With new fronts opening in the ongoing US-China economic conflict, geopolitics ranks second on their list of concerns. Brexit takes the third spot, followed by economic weakness in the US, where the pandemic has continued to intensify. Weak productivity in the UK and a further escalation in the US-China trade war are rated as the fifth and sixth biggest risks.

CFOs are relatively less concerned about growth in emerging markets and asset bubbles or a spike in inflation, both of which feature at the bottom of their risk list.

Chart 2. 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



Impact of COVID-19 overshadows Brexit

COVID-19 overshadows Brexit as a depressant of business investment.

A total 65% of CFOs expect their capital expenditure to decrease over the next three years due to the COVID-19 crisis or the UK leaving the EU. 25% attribute this reduction to both the pandemic and Brexit.

35% of CFOs expect their capital expenditure to rise or to remain unchanged.

CFO perceptions of external uncertainty remain elevated, despite having fallen slightly from the record level in the previous quarter.

80% of CFOs now rate the level of external financial and economic uncertainty as high or very high.

Risk appetite ticked up in the second quarter, but remains at a very low level.

Just 9% of CFOs think now is a good time to take greater risk onto their balance sheets.

Chart 3. Reduction in capital expenditure

% of CFOs who expect capital expenditure by their businesses to decrease over the next three years due to the COVID-19 pandemic or the UK leaving the EU

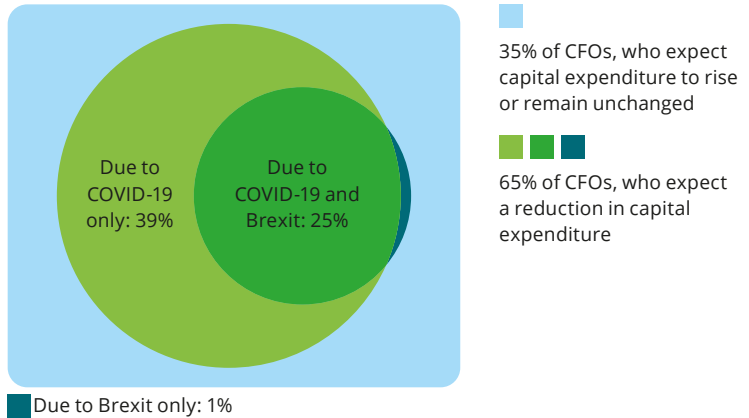


Chart 4. Uncertainty

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

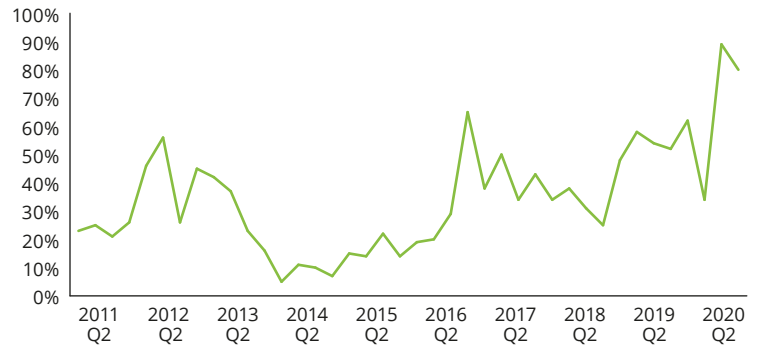
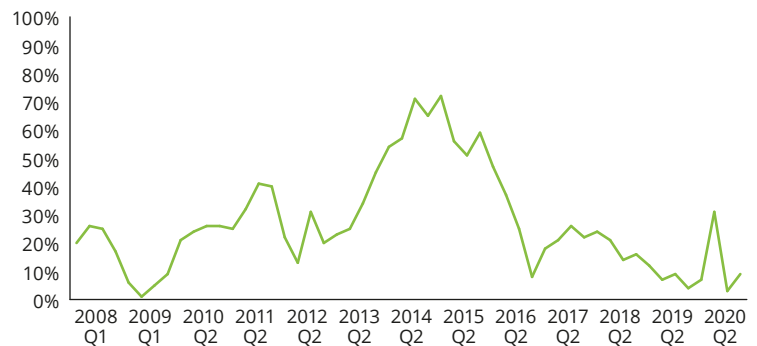


Chart 5. Corporate risk appetite

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

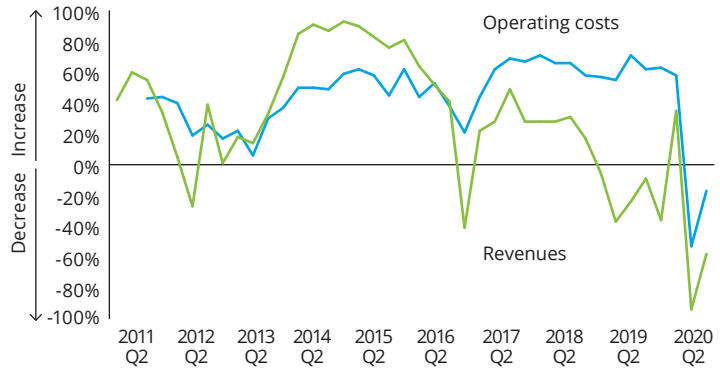


Sharper focus on leverage

Despite a slight improvement in their outlook, CFOs continue to expect a decline in UK corporates' revenues over the next 12 months, on balance.

Chart 6. Outlook for corporate revenues and operating costs

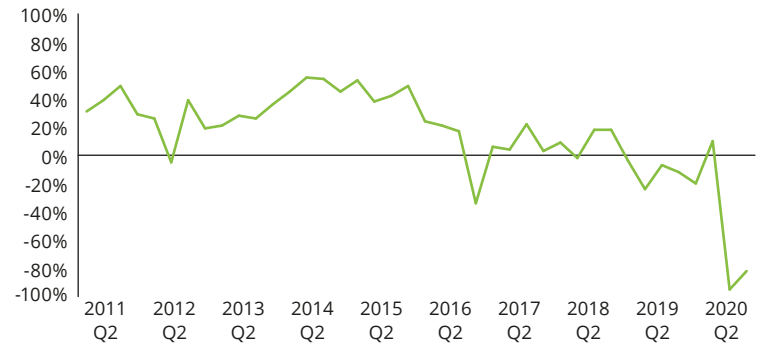
Net % of CFOs who expect UK corporates' revenues and operating costs to rise over the next 12 months



CFO expectations of dividend payments and share buybacks remain close to their lowest level in ten years.

Chart 7. Cash returns to shareholders

Net % of CFOs who expect dividends and share buybacks by UK corporates to increase over the next 12 months



Corporates have scaled back intentions for returning cash to shareholders as they look to shore up their balance sheets.

Chart 8. Corporate leverage

Net % of CFOs who think UK corporates' balance sheets are, in general, overleveraged



A surge in corporate borrowing and concerns about the outlook for growth have sharpened CFOs' focus on leverage.

A net 40% of CFOs think corporate balance sheets are overleveraged.

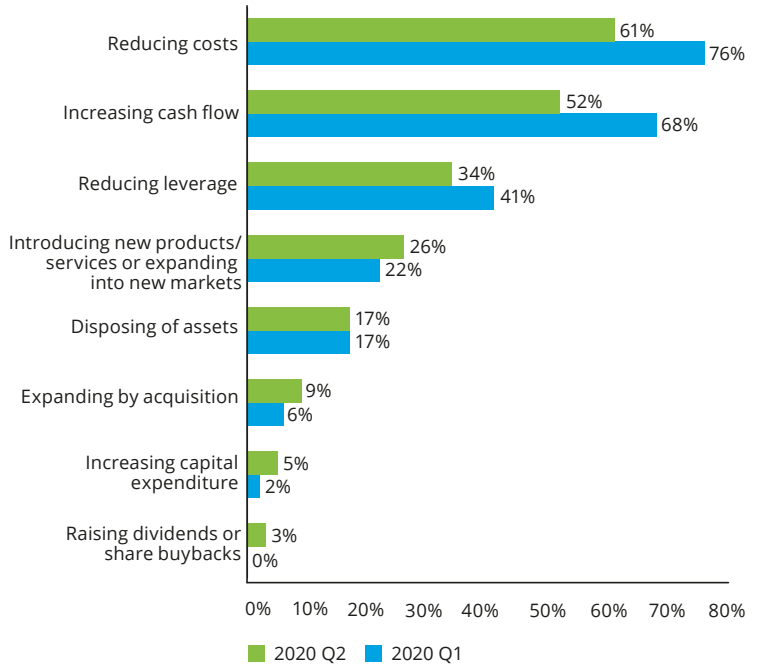
Defensive strategies remain in favour

Defensive strategies – reducing costs, increasing cash flow and reducing leverage – remain the top priorities for CFOs, despite a softer focus on them than in the first quarter.

Expansionary strategies – introducing new products, expanding by acquisition and increasing capital expenditure – have very slightly risen in popularity.

Chart 9. Corporate priorities in the next 12 months

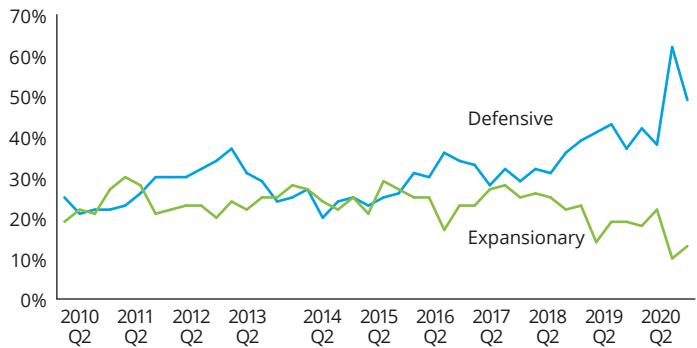
% of CFOs who rate each of the following as a strong priority for their business in the next 12 months



The gap between expansionary and defensive strategies has narrowed a bit in the second quarter. Nonetheless, corporates maintain a more defensive strategy stance now than at any point before the COVID-19 pandemic.

Chart 10. Expansionary and defensive strategies

Arithmetic average of the % of CFOs who rate expansionary and defensive strategies as a strong priority for their business in the next 12 months



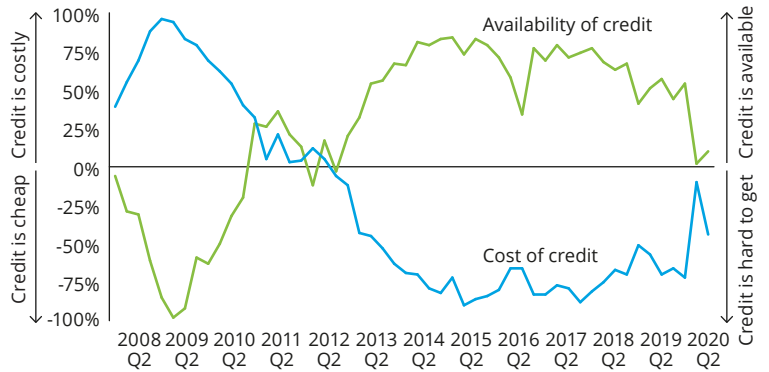
Expansionary strategies are introducing new products/services or expanding into new markets, expanding by acquisition and increasing capital expenditure.

Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

Modest improvement in credit conditions

Despite the post-COVID-19 tightening in credit conditions, credit remains cheaper and more easily available now than in the depths of the financial crisis.

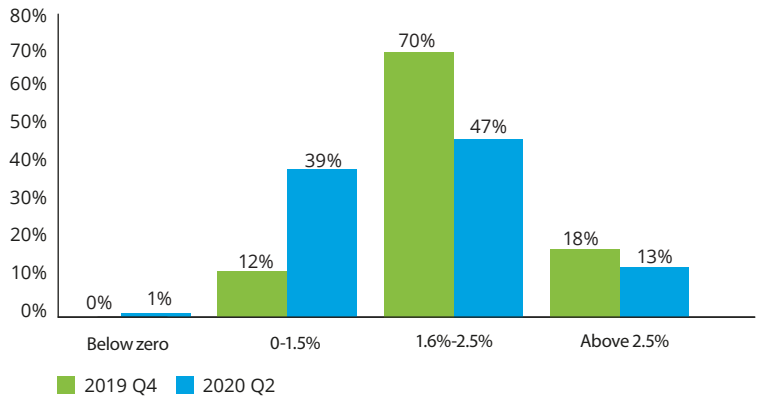
Chart 11. Cost and availability of credit
Net % of CFOs reporting credit is costly and credit is easily available



CFOs' inflation expectations have fallen since the fourth quarter of 2019.

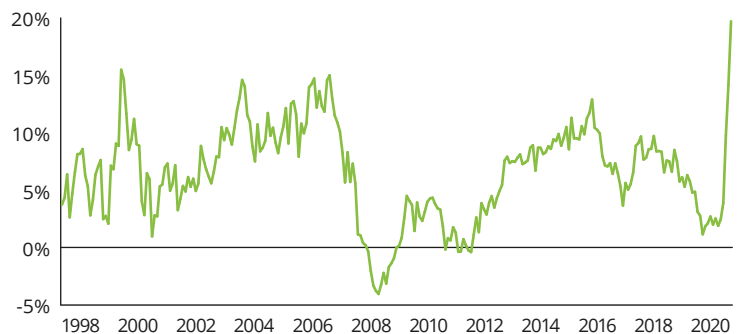
40% of CFOs now expect inflation to be below 1.6% in two-years' time, up from 12% at the end of last year.

Chart 12. Inflation expectations
% of CFOs who expect UK inflation to be at the following levels in two-year's time



UK corporate cash holdings grew at their fastest pace on record in May as businesses preserve cash to weather the COVID-19 pandemic.

Chart 13. Corporate cash holdings
Growth in broad money holdings of UK industrial and commercial businesses (% YoY)



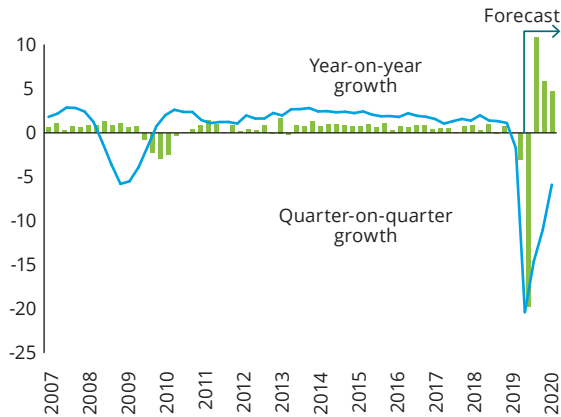
Source: Refinitiv Datastream

CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q2 2020

The COVID-19 pandemic intensified over the second quarter, with its locus shifting from Europe in April to the US and emerging markets now. Developed economies, especially in Europe, broadly succeeded in flattening the curve of new infections and have reduced the pandemic to localised outbreaks. Europe has also led in the easing of lockdowns, and economic data from May and June show signs of a pickup in activity. In the UK, April saw the sharpest contraction in output on record, with leisure, hospitality and retail the worst hit sectors. Data indicate a slow recovery in May. A major exception among developed economies is the US, where new cases have accelerated. Policymakers across the developed world have stepped in with massive fiscal and monetary easing to support businesses and suppress unemployment. Governments are considering further stimulus to boost a fledgling recovery and encourage the reabsorption of labour into their economies. Emerging markets are now in the eye of the storm, with cases rising rapidly in India, Brazil, Mexico and others, alongside a squeeze in activity. Policymakers there have responded with significant easing but many lack the capacity to match the response in the developed world. Among emerging economies, a major exception is China, which has succeeded in containing the pandemic and registered a rebound in activity in the second quarter. Supported by monetary and fiscal stimuli, equities ended June well above their March trough but volatility remains elevated. The price of oil has stabilised somewhat and is now well above the two-decade low it hit in April.

UK GDP growth: Actual and forecast (%)



Source: Refinitiv Datastream, Deloitte calculations

FTSE 100 price index



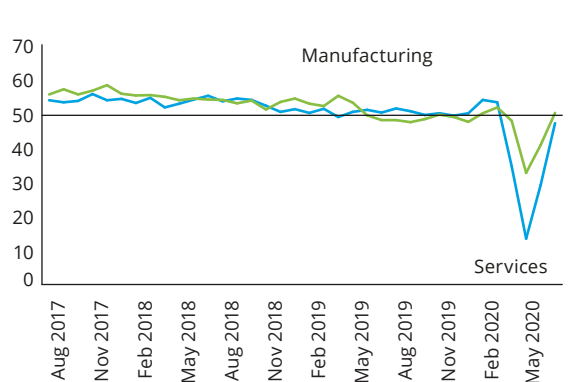
Source: Refinitiv Datastream

GfK Consumer Confidence Index (UK)



Source: Refinitiv Datastream

Markit Purchasing Manager Indices (UK)

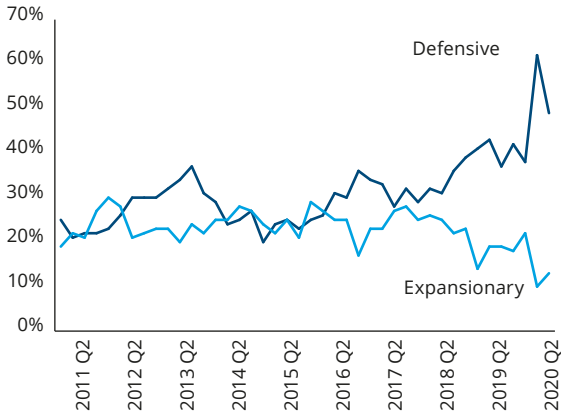


Source: Refinitiv Datastream, readings above 50 indicate expansion

Two-chart summary of key survey messages

Expansionary and defensive strategies

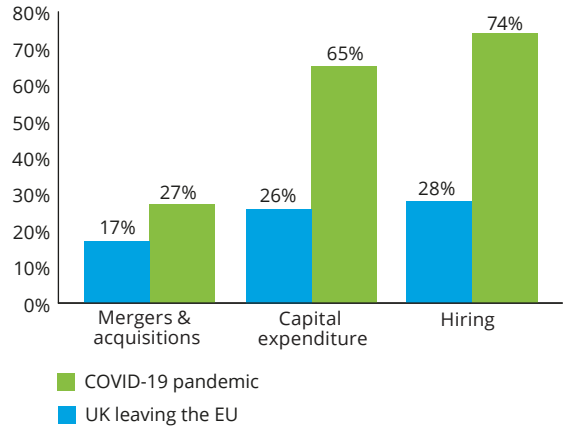
Arithmetic average of the % of CFOs who rate expansionary and defensive strategies as a strong priority for their business in the next 12 months



Definition of expansionary and defensive strategies on page 5

Impact of COVID-19 and Brexit

% of CFOs who expect the following to decrease over the next three years as a result of the UK leaving the EU or the COVID-19 pandemic



About the survey

This is the 52nd quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2020 second quarter survey took place between 26th June 2020 and 8th July 2020. 109 CFOs participated, including the CFOs of 23 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 76 UK-listed companies surveyed is £404 billion, or approximately 19% 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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