

The Deloitte CFO Survey

Focus on cost control, no retreat from growth

The UK's largest businesses enter 2018 more focussed on controlling costs than at any time in the last eight years. Although the UK is in the ninth year of recovery corporates seem to be reacting to slower UK growth and Brexit uncertainties with a renewed focus on costs.

Despite December's agreement between the UK and the EU to proceed to trade talks, CFOs' concerns about Brexit have mounted. It tops the list of risks for businesses in 2018. Weak UK growth ranks as the second greatest risk facing businesses this year, with growing concern about productivity in third place. In a world of accelerating growth and buoyant equity markets domestic risks loom large for UK CFOs.

Yet strikingly, a sharper focus on risk and cost control has not led to a collapse in business sentiment. CFOs are more optimistic today than they have been, on average, in the last couple of years. Perceptions of uncertainty are far lower than during the euro crisis in 2011-12 and following the EU referendum in 2016.

Far from backing away from growing their businesses, as happened during previous periods of uncertainty, CFOs are putting increased weight on growth. The priority CFOs attach to expansion over the next 12 months, whether organically, through acquisitions, or introducing new products/services or moving into new markets, is at its highest level since we first asked this question in 2009.

So why, in an environment where home-grown risks and cost control loom large, are CFOs still committed to growth?

For a business cost control counters the risk from weaker UK growth. But beyond these shores activity is accelerating and opportunities are increasing. 2017-2018 looks set to be the best two-year period for growth in Britain's core export market, the EU, in ten years. Nor is it all doom and gloom at home. On average, economists see the UK economy growing this year in line with what the Office of Budget Responsibility sees as its trend rate. Some CFOs may anticipate an easing of Brexit risks, feel that their own business is less directly affected by Brexit or that they can mitigate the risks.

The backwash from Brexit is the dominant theme for UK corporates as they enter 2018. But it has not crushed the animal spirits of the business sector nor forced a retreat from expansion. The central challenge for UK business will be to achieve growth in an environment of stringent cost-control.

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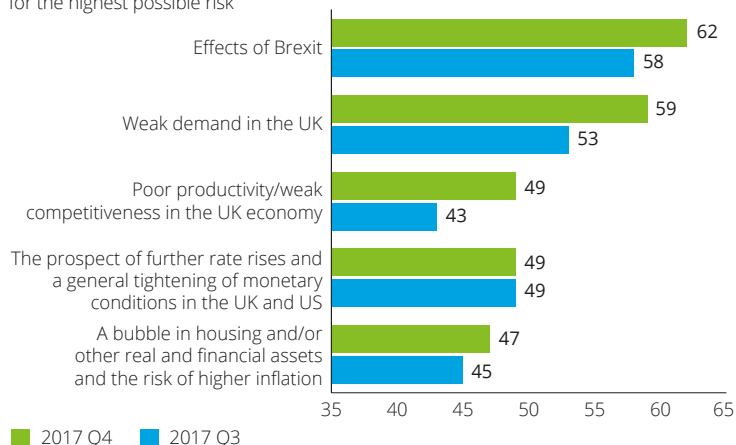
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For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:

www.deloitte.co.uk/cfosurvey

Chart 1. Risk 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



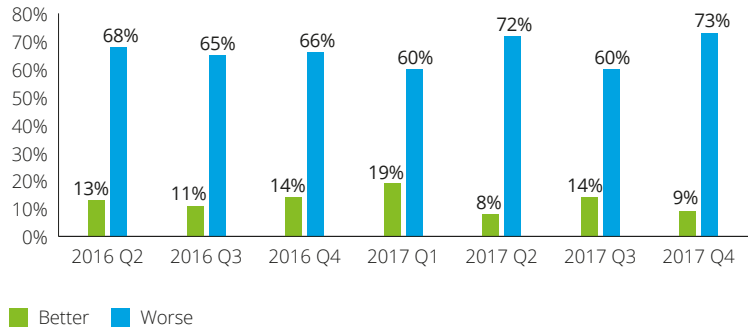
Brexit pessimism rises

CFOs enter 2018 with greater pessimism about the effects of Brexit.

About three-quarters expect Brexit to lead to a worsening of conditions in the long term, up from 60% in the previous quarter.

Chart 2. 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

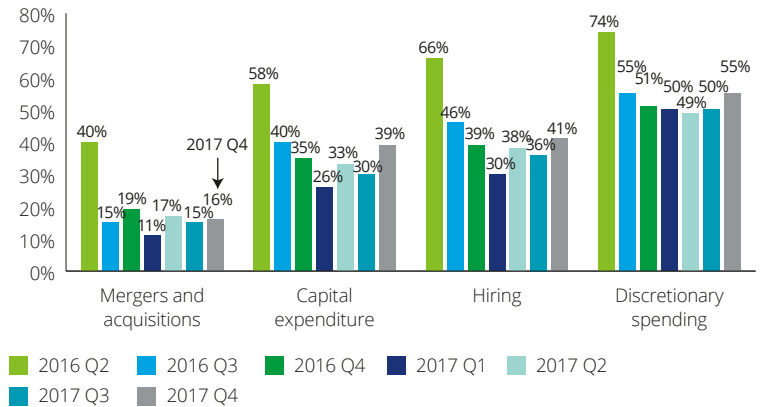


CFOs continue to expect to reduce their own spending as a result of Brexit.

More than half say it will lower their discretionary spending. A third or more will scale down their capital investment and hiring plans.

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

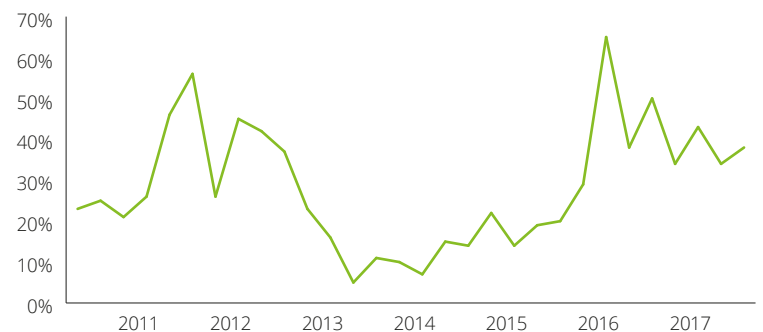


CFO perceptions of uncertainty edged up marginally in the fourth quarter.

38% of CFOs rate the level of external financial and economic uncertainty facing their businesses as high or very high, a significantly lower proportion than during the euro crisis in 2011-12 and following the EU referendum in 2016.

Chart 4. Uncertainty

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

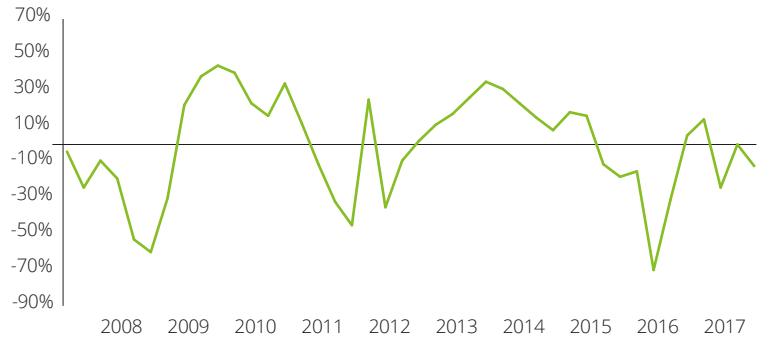


Optimism declines

CFO optimism edged lower in the fourth quarter. But CFOs are more optimistic today than they have been, on average, in the last two years.

Chart 5. Business optimism

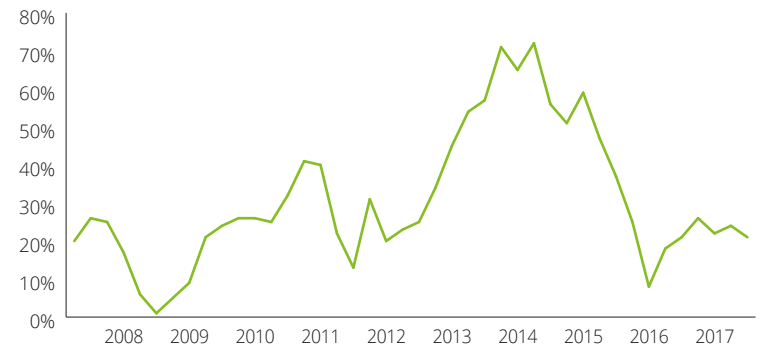
Net % of CFOs who are more optimistic about the financial prospects of their company than three months ago



21% of CFOs think that now is a good time to take greater risk onto their balance sheets. Risk appetite has remained broadly around these levels since late 2016.

Chart 6. Corporate risk appetite

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

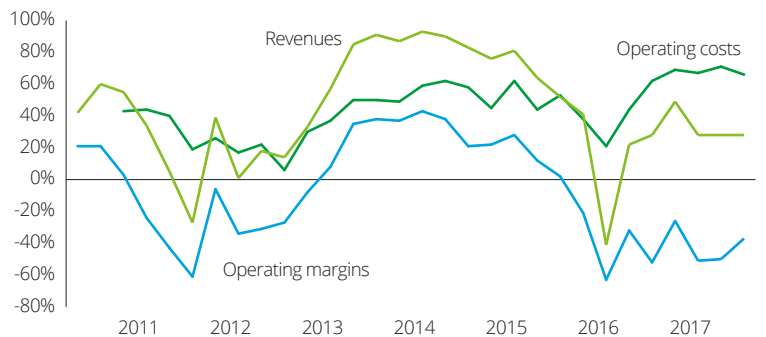


A net 66% of CFOs expect operating costs to rise over the next 12 months, close to the highest reading in more than six years.

Despite a slight improvement, CFO expectations of a decrease in operating margins over the next 12 months persist.

Chart 7. Outlook for corporate revenues, costs and margins

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



Focus on UK-specific risks

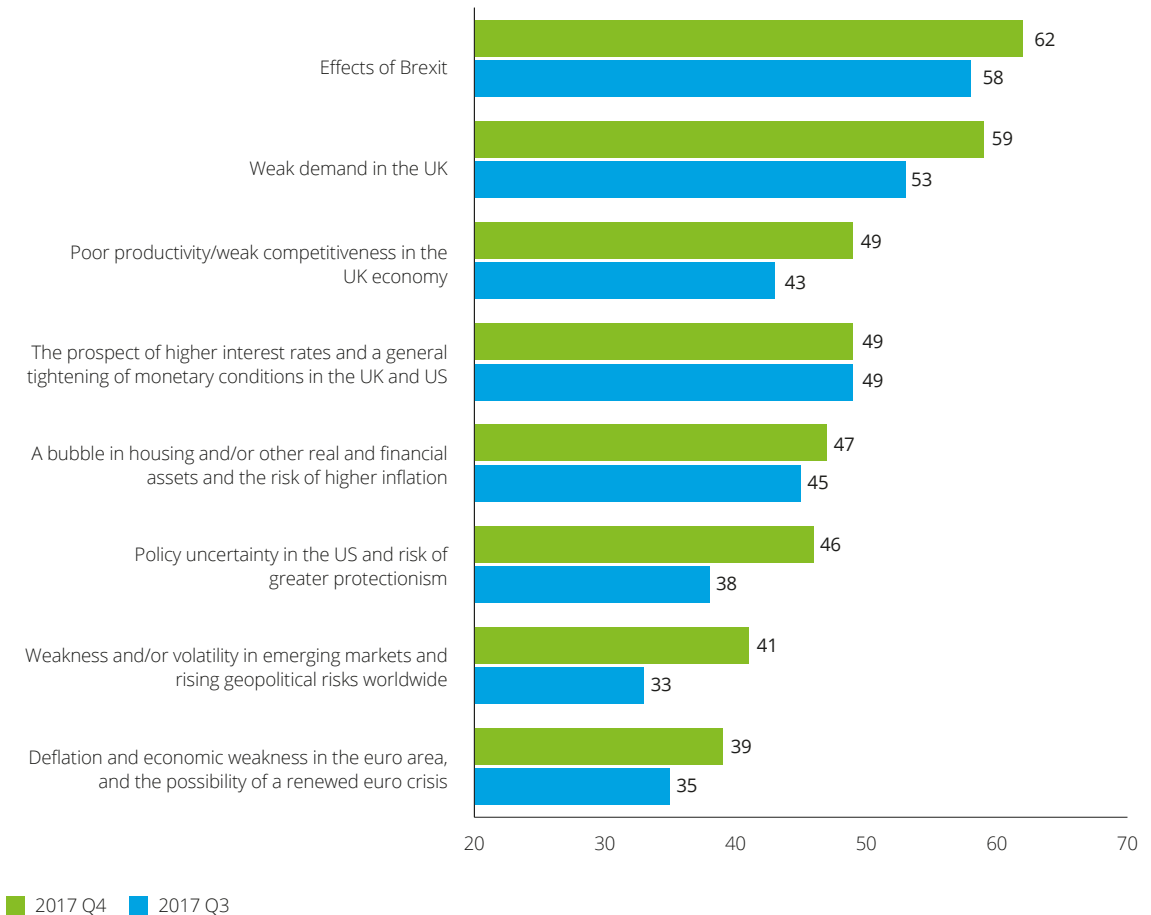
CFOs see issues related to the domestic environment as the biggest risks facing their businesses. They rank Brexit as their top risk, followed by concerns over weak demand and poor productivity/weak competitiveness in the UK economy. Concerns over each have increased since the third quarter.

CFOs have also become markedly more concerned about the risks posed by US policy uncertainty/ protectionism as well as weakness or volatility in emerging markets/rising geopolitical risks worldwide.

The continued recovery of the euro area economy means that concerns over deflation and economic weakness in the region remain the lowest ranked risk for CFOs – with such concerns having fallen sharply over the last three years.

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

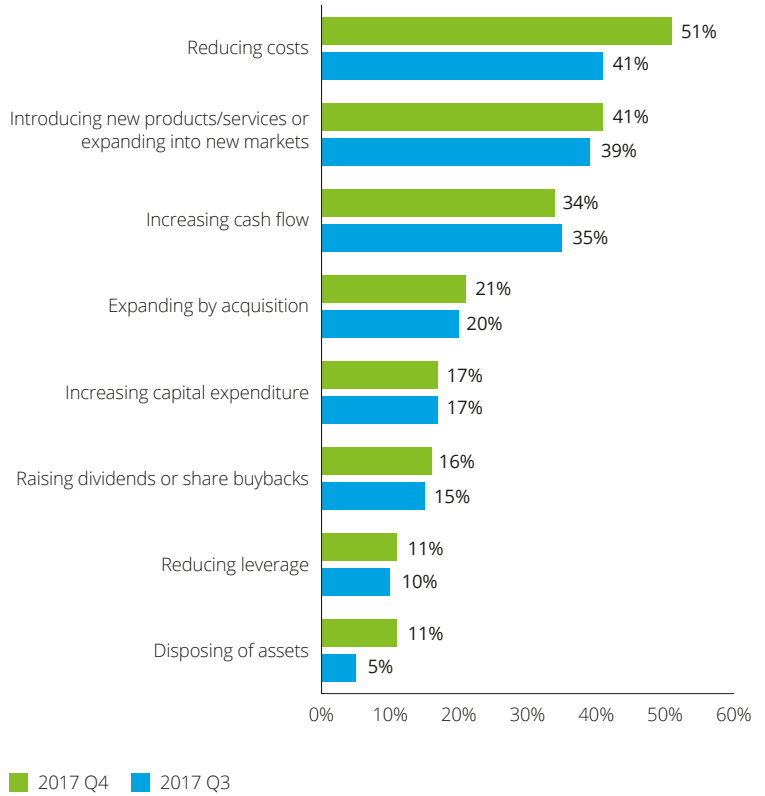


Corporate strategies defensive

CFOs enter 2018 with a sharper focus on cost than at any time in the last eight years.

Chart 9. 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



Despite their focus on cost reduction, CFOs have not turned their backs to growth. In marked contrast to previous periods of uncertainty such as during the euro debt crisis, when the euro recovery seemed to have halted and after the EU referendum, CFOs are placing much greater emphasis on growth now.

Chart 10. CFO priorities: Growth

Arithmetic average of the % of CFOs who rated growth strategies as a strong priority for their business in the next 12 months



Growth strategies are expanding organically, introducing new products/services or expanding by acquisition

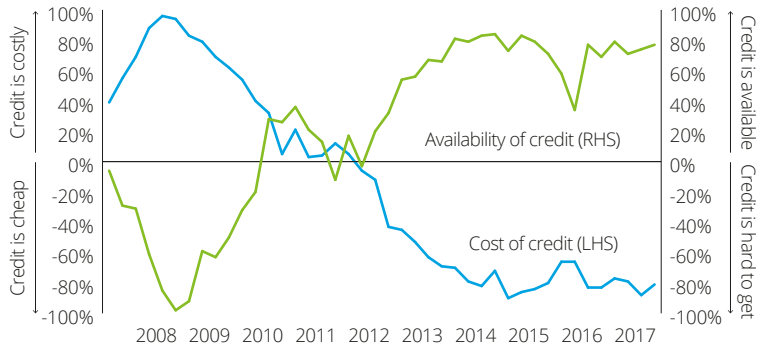
Accommodative credit conditions

Funding conditions remain extremely favourable for the large corporates on our survey panel.

CFOs continue to view credit as being cheap and available.

Chart 11. Cost and availability of credit

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

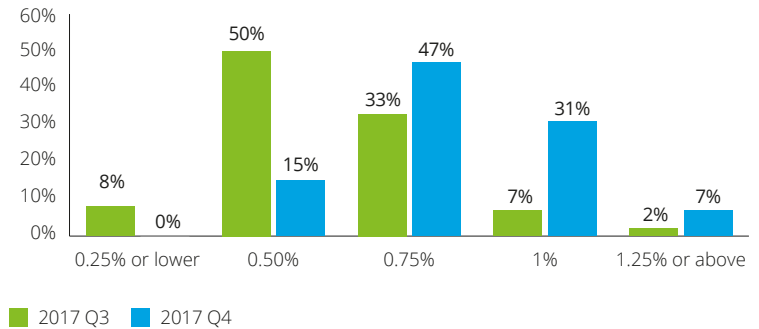


Following the Bank of England's November rate rise – the first since the financial crisis – CFOs see rates rising further in 2018.

85% of them expect the base rate to be 0.75% or above in a year's time, up from 42% in the third quarter.

Chart 12. Interest rate expectations

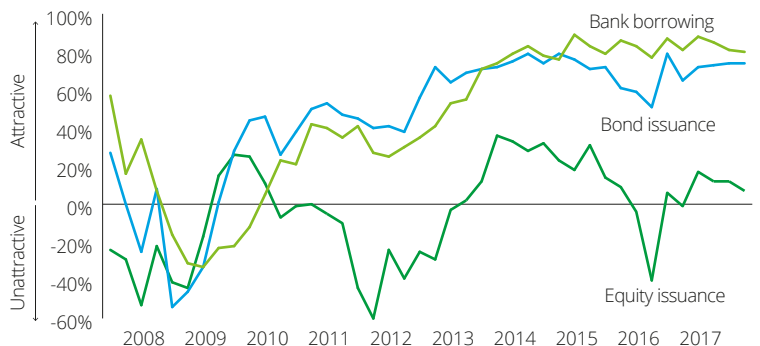
% of CFOs who expect the Bank of England's base rate to be at the following levels in a year's time



CFOs continue to see debt as the most attractive form of financing, with bond issuance and bank loans easily trumping equity issuance.

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 Q4 2017

The global recovery picked up pace in the second half of 2017, driven by faster growth in developed economies. The euro area saw a broad-based acceleration in growth across member nations, while Japan grew for the seventh successive quarter, its longest period of growth since 2001. Business and consumer confidence rose in the developed world, particularly in the euro area and the US. Unemployment continued to decline globally, with UK unemployment falling to a 43-year low and the EU's unemployment rate reaching its lowest level in nine years. Despite falls in unemployment, wage growth has picked up only modestly. Inflation in the UK reached a five-year high in November but remains subdued in other developed countries. Central banks continued to tighten monetary policy during the final quarter of 2017. The European Central Bank announced that it would slow its quantitative easing programme. In moves which were widely anticipated by financial markets, the Bank of England raised interest rates for the first time in a decade and the US Federal Reserve raised rates for the fifth time since 2015. Following elections in Germany, Angela Merkel's ruling CDU/CSU coalition and the Social Democrats are in talks of a renewed 'grand coalition'. In the UK, Chancellor Phillip Hammond's Autumn Budget eased the pace of austerity and the Office for Budget Responsibility downgraded official forecasts for productivity and GDP growth. Brexit talks achieved a breakthrough with the UK and EU agreeing a deal on the 'divorce' payment, paving the way for talks over future trading arrangements.

UK GDP growth: Actual and forecast (%)



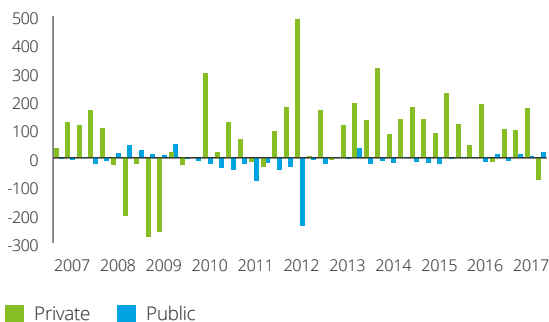
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



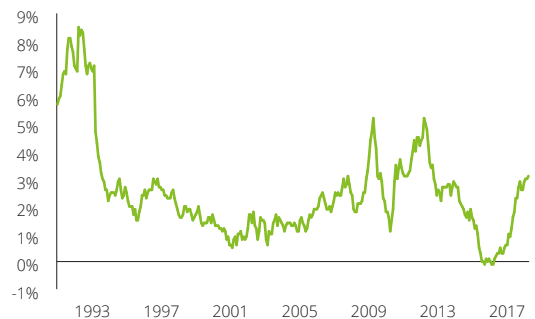
Source: Thomson Reuters Datastream

UK private and public sector job growth (thousands, quarterly)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)



Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

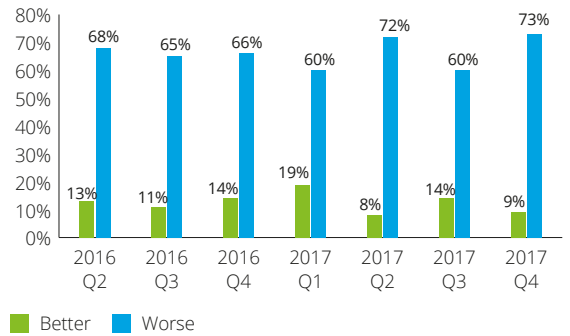
Business optimism

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



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



About the survey

This is the 42nd quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2017 fourth quarter survey took place between 3rd and 15th December. 112 CFOs participated, including the CFOs of 23 FTSE 100 and 46 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 83 UK-listed companies surveyed is £512 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 Anthea Neagle on 020 7303 0116 or email aneagle@deloitte.co.uk

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