

The Deloitte CFO Survey

Cost is king

The fourth quarter survey of Chief Financial Officers reveals that uncertainty over Brexit is driving a marked shift towards defensive balance sheet strategies among British businesses. With the UK's growth prospects heavily dependent on the so far uncertain nature of its exit from the EU, corporates are cutting back on plans for capital expenditure and hiring. Cost reduction is the top priority for CFOs, who are placing a greater emphasis on it now than at any time in the last nine years.

CFOs continue to be pessimistic about the long-term effects of Brexit, with more than three-quarters expecting it to lead to a deterioration in the business environment. They rate Brexit as the biggest threat to their businesses by far, followed by greater US protectionism and weak demand in the UK. But domestic risks seem to be the dominant concern. Despite slowing global growth leading to a weaker external environment, CFOs rate emerging market and euro area weakness among the bottom three risks to their businesses.

Uncertainty over the timing and nature of the UK's departure from the EU has hit corporate risk appetite, which is down to its lowest level in more than nine years. CFO expectations for revenue and margin growth have also hit multi-year lows.

After a long period of easy access to cheap credit, funding conditions have begun to tighten for the large corporates on our survey panel.

CFOs report that the cost of credit for their businesses has risen to its highest level in almost six years and availability has dropped to a two-year low. Rising interest rates have also brought a renewed focus on corporate leverage. For the first time in eight years, a net balance of CFOs rate UK corporate balance sheets as overleveraged.

The survey reveals a divergence of opinion between economists and CFOs on the likely nature of Brexit. The latest consensus growth forecasts suggest that economists expect a transition deal. But CFOs are positioned for the hardest of Brexits, with risk appetite at recessionary levels and an intense focus on cost control. Businesses seem to be increasingly pricing in a worst-case outcome. Anything better, including a delay or a deal, could deliver a Brexit bounce in sentiment.

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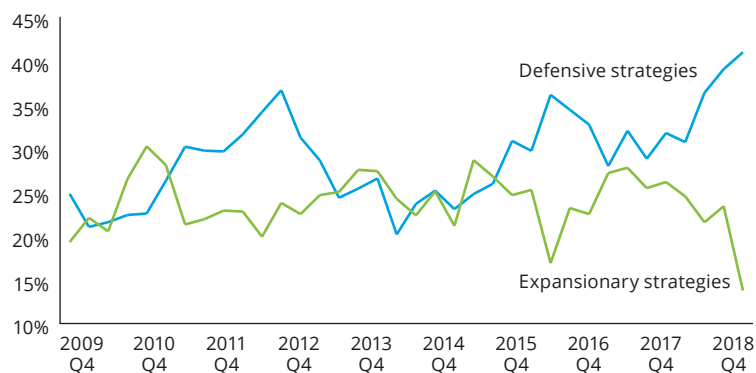
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For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:
www.deloitte.co.uk/cfosurvey

Chart 1. 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.

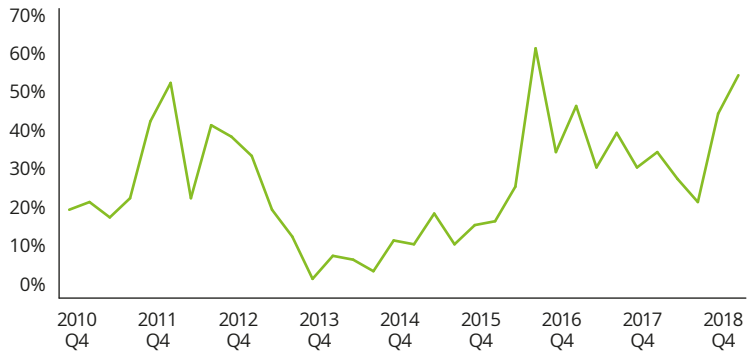
Uncertainty up

CFO perceptions of economic and financial uncertainty continued to rise in the fourth quarter.

58% of CFOs rate current levels of uncertainty as high or very high, the highest reading since the summer of 2016.

Chart 2. Uncertainty

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

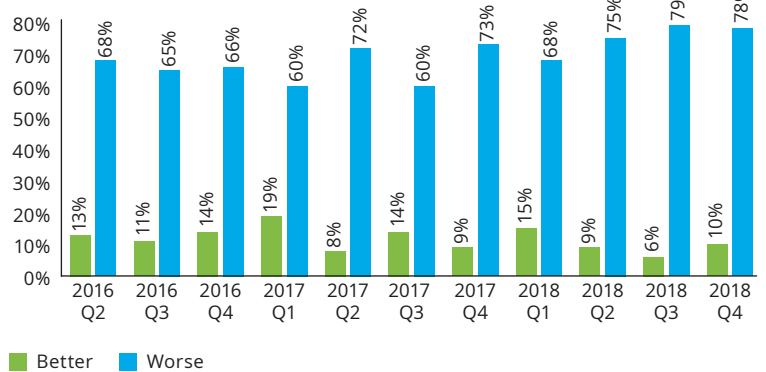


CFO pessimism over the long-term effects of Brexit remains close to its highest level since the EU referendum in 2016.

78% now expect Brexit to lead to a deterioration in the overall environment for business in the long term.

Chart 3. 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 (excluding those who expect no material change)

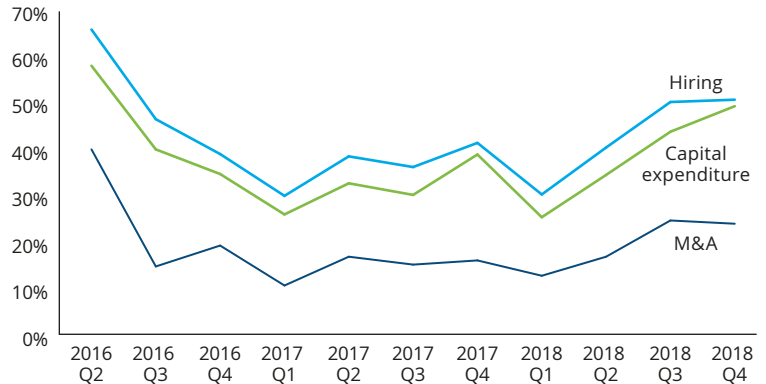


CFO pessimism about the short-term effects of Brexit also remains elevated.

The percentage of CFOs who expect to reduce their own capital expenditure over the next three years, as a consequence of Brexit, is at its highest level in more than two years.

Chart 4. Effect of Brexit on own spending and hiring decisions

% of CFOs who expect M&A activity, capital expenditure and hiring by their business to decrease over the next three years as a consequence of Brexit



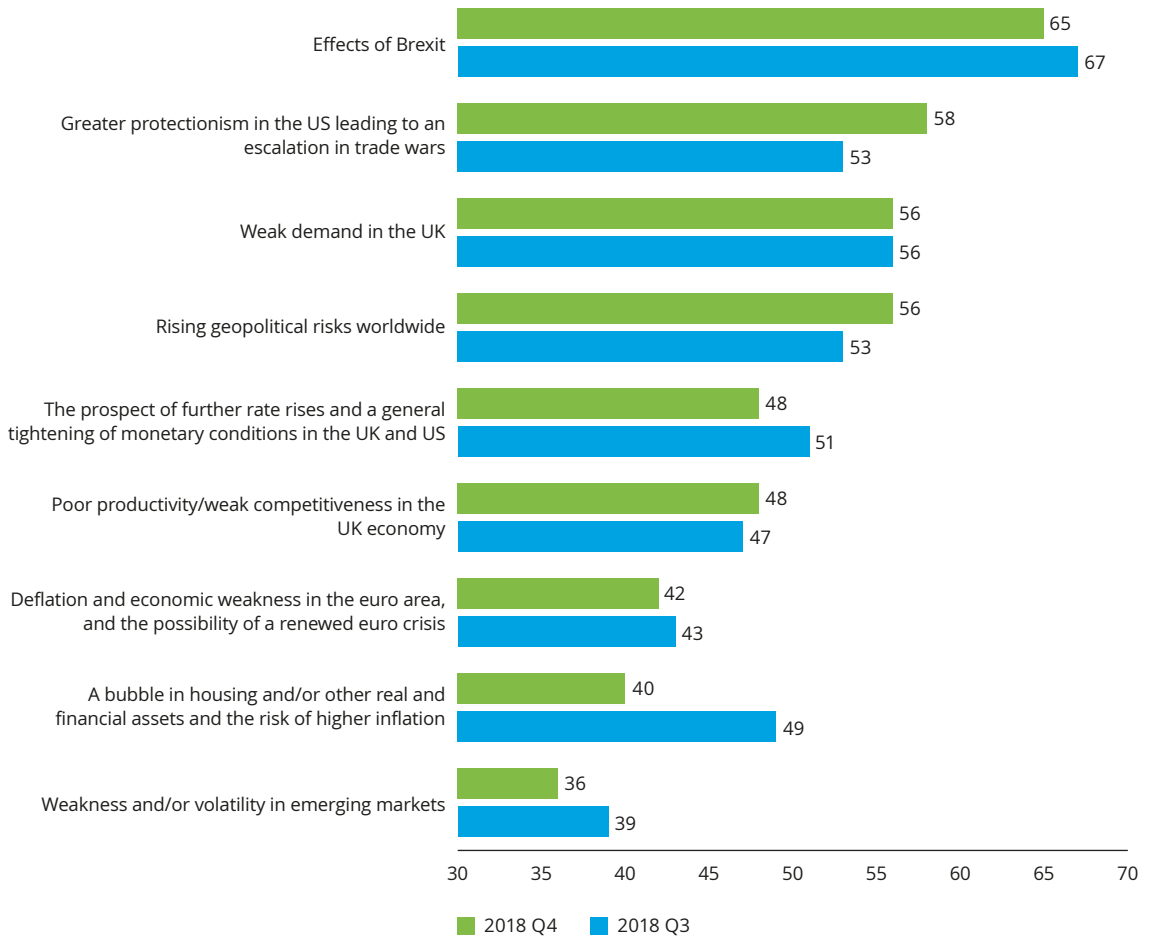
Brexit still top risk

CFOs continue to rank Brexit as the top risk facing their businesses. Concerns over greater US protectionism have risen sharply and it now features as the second highest risk, followed by weak demand in the UK.

With markets expecting a slowdown in the pace of tightening by the US Federal Reserve, concerns over rate rises have receded. Despite Chinese growth slowing and other emerging markets hit by US rate rises and protectionism, CFOs continue to rank emerging market weakness at the bottom of their risk list.

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



Drop in revenue expectations

CFO risk appetite has dropped to its lowest level in more than nine years.

Chart 6. Corporate risk appetite

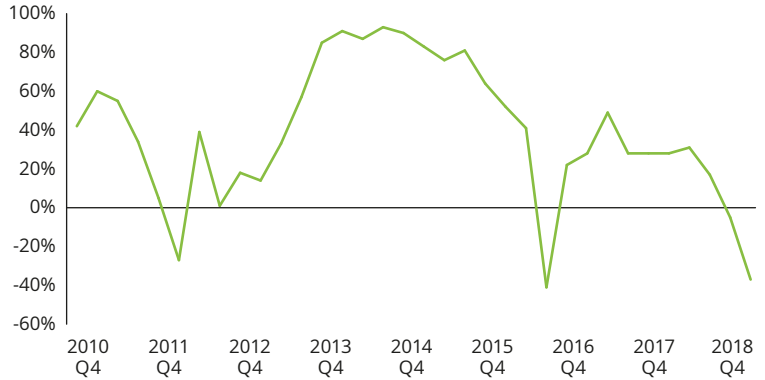
% of CFOs who think this is a good time to take greater risk onto their balance sheets



Revenue growth expectations have dropped to the lowest level since the EU referendum in the summer of 2016.

Chart 7. Outlook for corporate revenues

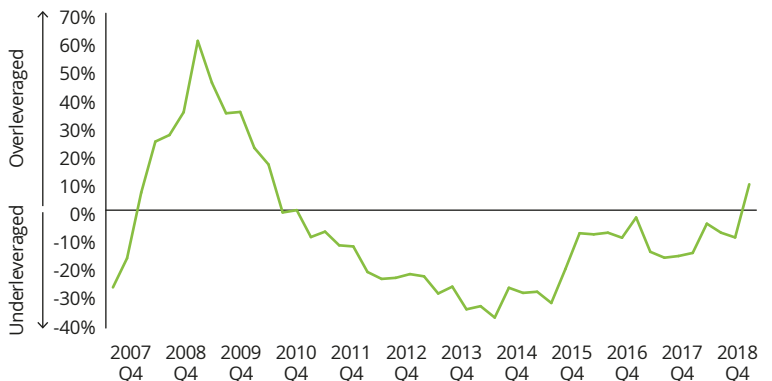
Net % of CFOs who expect UK corporates' revenues to increase over the next 12 months



Rising interest rates seem to have brought a renewed focus on corporate leverage.

Chart 8. Corporate leverage

Net % of CFOs who think UK corporate balance sheets are overleveraged



For the first time in eight years, a net balance of CFOs rate UK corporate balance sheets as overleveraged.

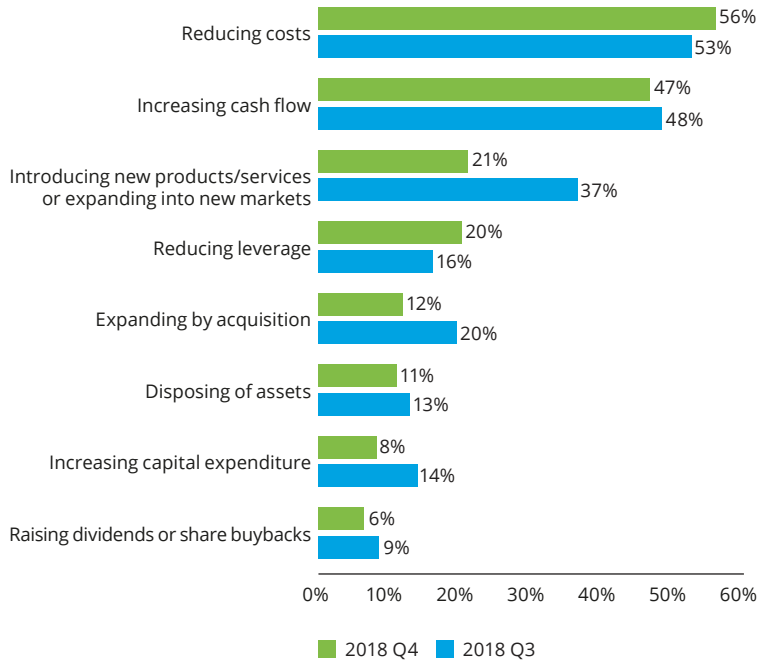
Defensive strategies in favour

Defensive strategies – reducing costs and increasing cash flow – are the top two priorities for CFOs. They have a sharper focus on cost reduction now than at any time in the last nine years.

By contrast, they have reduced their emphasis on expansionary strategies such as introducing new products/services or expanding into new markets, increasing capital expenditure and expanding by acquisition.

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

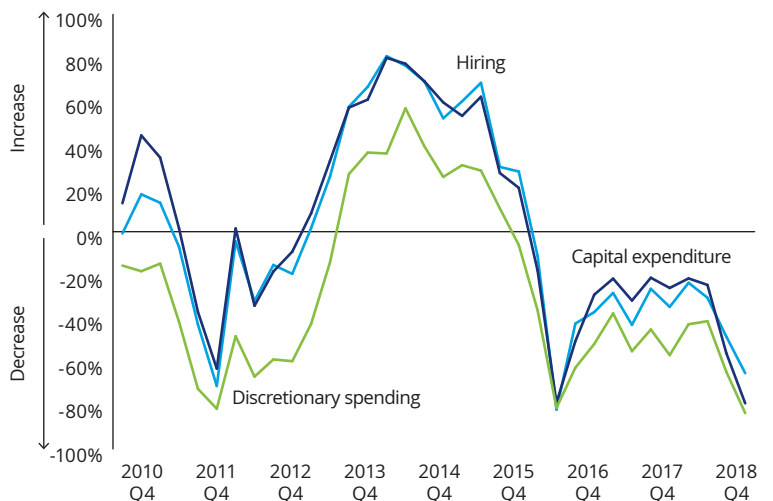


The outlook for capital expenditure, hiring and discretionary spending has continued to deteriorate.

On balance, CFOs expect UK corporates to decrease activity in each area over the next 12 months, with expectations down to their lowest levels in more than two years.

Chart 10. 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



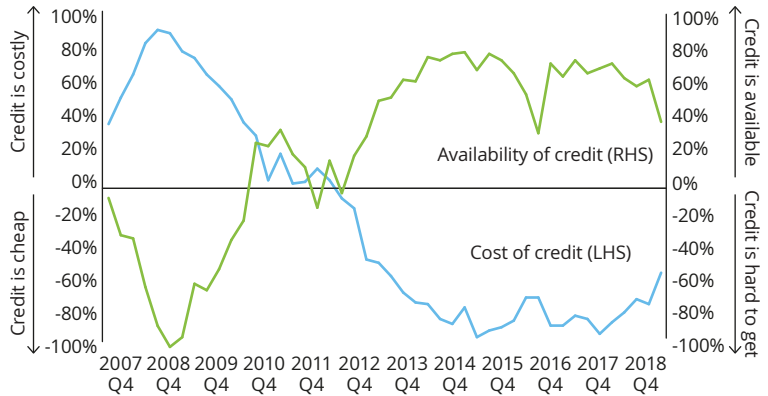
Credit costs on the rise

Funding conditions have tightened for the large corporates on our survey panel.

CFOs report that the cost of credit for their businesses has risen to its highest level in almost six years and availability has dropped to a two-year low.

Chart 11. Cost and availability of credit

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

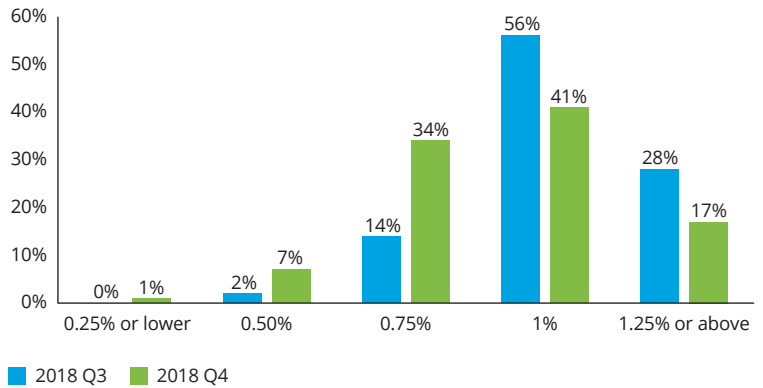


Interest rate expectations have fallen back from the previous quarter.

58% of CFOs now expect the Bank of England's base rate to be 1% or higher in a year's time, down from 84% 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

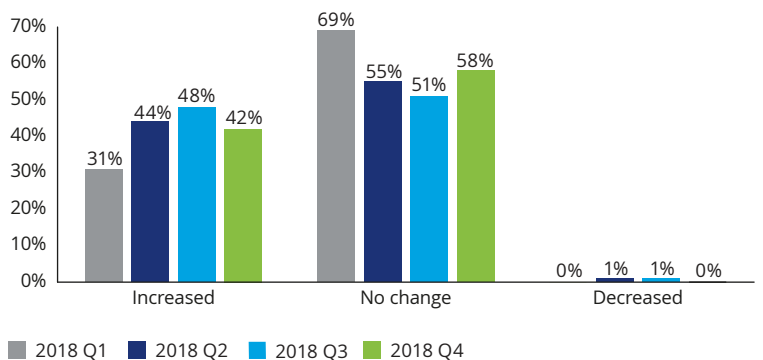


More than two-fifths of CFOs – 42% – report that their businesses have experienced a rise in recruitment difficulties or skills shortages over the last three months.

With UK employment at a record high, the continued rise in skills shortages should exert further upward pressure on wages.

Chart 13. Recruitment difficulties

% of CFOs reporting how recruitment difficulties or skills shortages experienced by their businesses have changed over the past three months

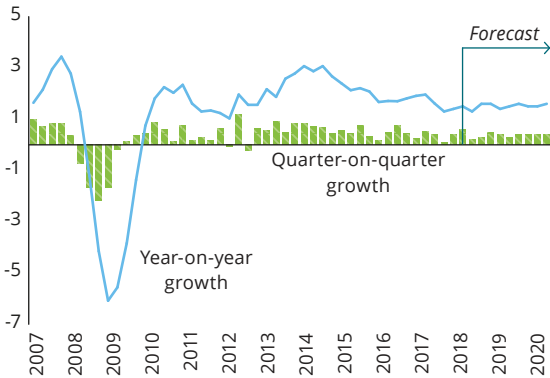


CFO Survey: Economic and financial context

The macroeconomic backdrop to the Deloitte CFO Survey Q4 2018

Global activity slowed in the last quarter and the IMF downgraded its global growth forecasts for this year and the next. Equity markets sold off in December due to worries over the slowdown. The S&P 500 fell almost a fifth from its October peak, before regaining its footing in January. US activity remained robust in the fourth quarter, but a 35-day partial government shutdown at the beginning of this year is expected to have hit growth. The US Federal Reserve raised interest rates in December to 2.5% but has adopted a dovish tone so far this year, putting further rate rises on hold. The escalation in US-China trade tensions seems to have abated as trade talks continue between the two nations. Chinese activity continued to slow, with full-year growth hitting a 28-year low in 2018. Chinese authorities responded with monetary and fiscal easing. Economic data from the euro area also weakened in the fourth quarter and Italy fell into recession in the second half of last year. The European Central Bank ended its €2.5tn quantitative easing programme in December. In the UK, uncertainty over Brexit grew, with the government failing to win support in Parliament for its transition deal agreed with the EU. Analysts take the view that events since October have raised the likelihood of either a no-deal Brexit or a second referendum, with prospects for UK growth heavily dependent on the outcome.

UK GDP growth: Actual and forecast (%)



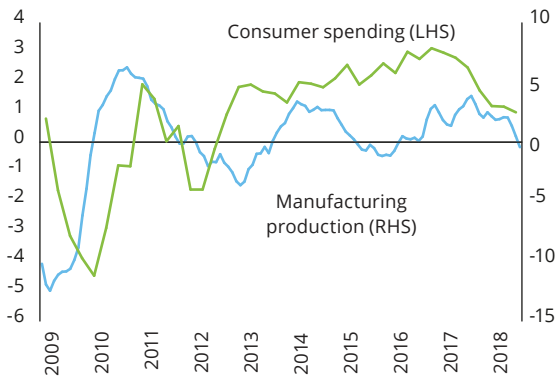
Source: ONS, Consensus Economics and Deloitte calculations

FTSE 100 price index



Source: Thomson Reuters Datastream

UK consumer spending and manufacturing production growth (%)



Source: Thomson Reuters Datastream

UK annual CPI inflation (%)

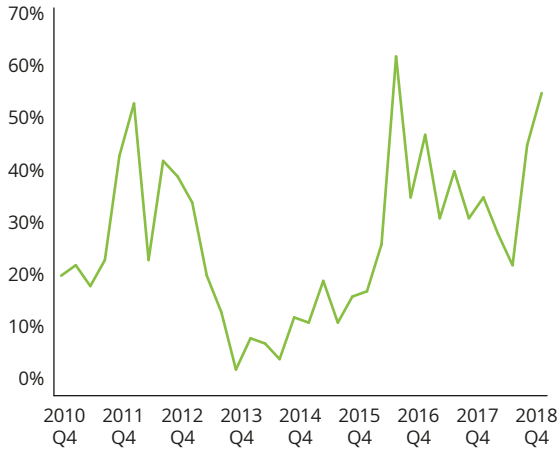


Source: Thomson Reuters Datastream

Two-chart summary of key survey messages

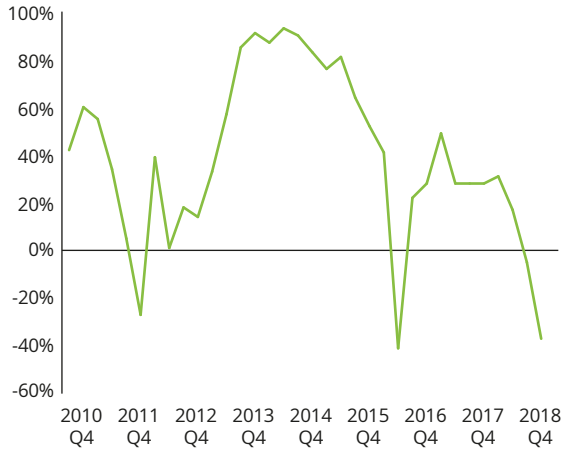
Uncertainty

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



Outlook for corporate revenues

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



About the survey

This is the 46th quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2018 fourth quarter survey took place between 8th and 24th January. 110 CFOs participated, including the CFOs of 20 FTSE 100 and 41 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 75 UK-listed companies surveyed is £390 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 Hayley Baty on 020 7007 9209 or email hbaty@deloitte.co.uk

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