



UK corporate environment

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UK corporate environment - key messages

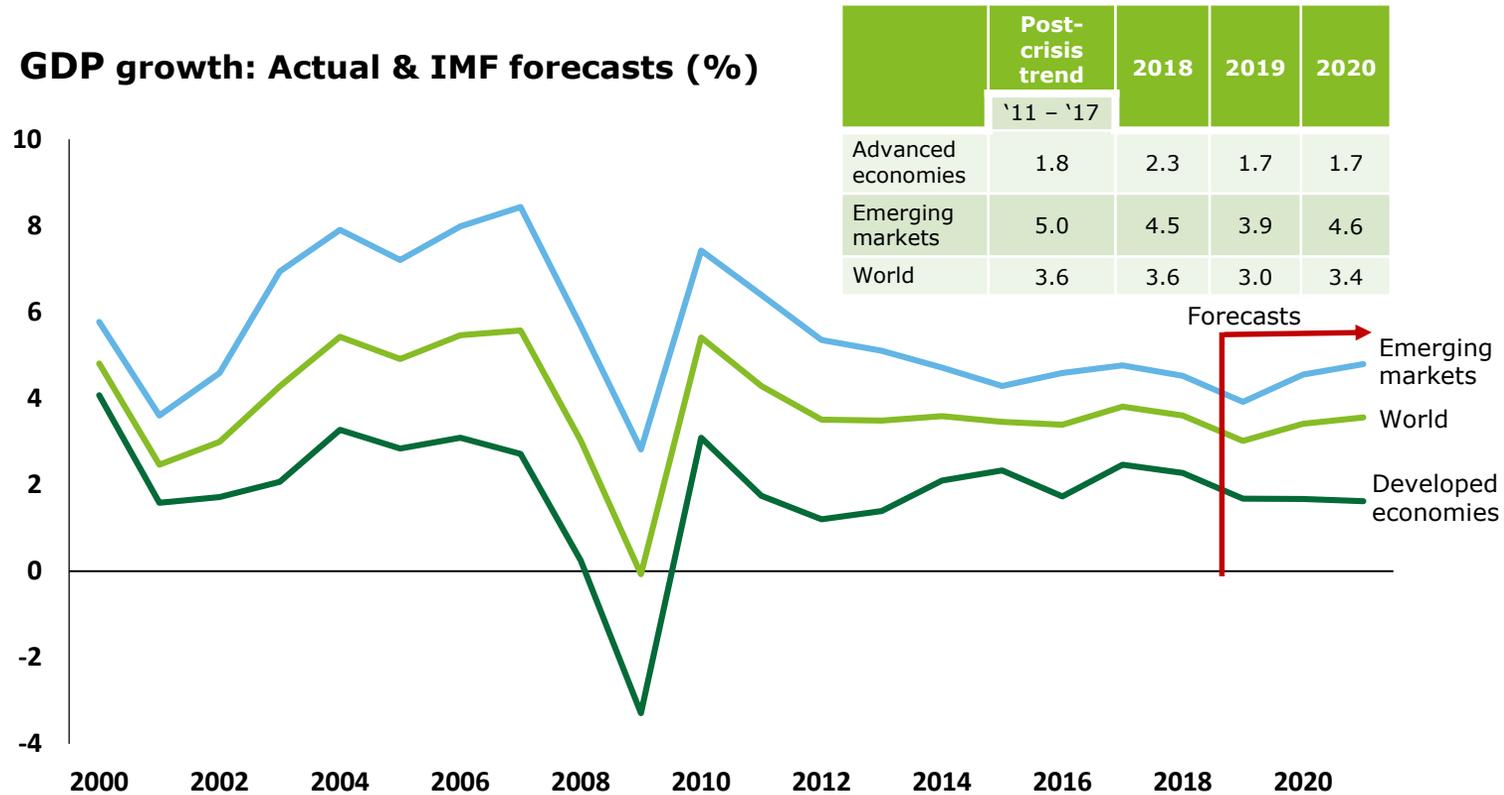
as at November 2019

1. Macro environment - Global economy set to grow at slowest pace since 2010 this year, and remain below trend in 2020. UK growth to remain soft this year and next. Brexit and geopolitical uncertainty loom large. Pages 3-7
2. Momentum - UK avoided recession in Q3, business investment declining, manufacturing activity soft, household spending holding up but slowing. Pages 8-10
3. Operating costs - cost pressures due to tight labour market but may loosen as firms pull back on hiring. Commodity prices and rental values soft. Credit conditions expected to tighten. Pages 11-15
4. Corporate stance - risk appetite near lowest level since 2008, focus on cost reduction, deleveraging and increasing cash flow. Pages 16-17
5. Balance sheet - cash rich, credit still relatively cheap and easily available but signs of tightening, profits falling. Pages 18-21
6. Risks - effects of Brexit and weak domestic demand, rising global geopolitical risk and protectionism also a worry for large UK corporates. Pages 22-23

Macro environment

Continued global slowdown

Synchronised slowdown in developed and emerging markets this year. The IMF's 2020 forecasts, which show an acceleration in emerging markets, look too optimistic given current economic weakness. Risks are mainly to the downside.



Source: IMF World Economic Outlook Update, October 2019

Macro environment

UK growth to remain soft, uncertainty here to stay

Growth is expected to remain below trend but stable if current arrangements continue, crucially this assumes a Brexit deal and a two-year transition period. Risk of disorderly Brexit remains, but has been pushed back.

NIESR Central Forecast

Year	GDP growth
2018	1.4
2019	1.4
2020	1.4
2021	1.5

The National Institute for Economic and Social Research (The NIESR) key assumptions: Brexit deal and two-year transition period

Assumptions and risks

- NIESR's main case scenario is that the government gets its Brexit deal through parliament and asks for a two-year transition period
- If prime minister Boris Johnson gets his Brexit deal through parliament by the 31st January then the challenge turns to reaching a free trade agreement with the EU by the end of the transition period (December 31st 2020)
- Completing a free trade agreement by the end of next year seems implausible, and if the government do not ask Brussels for an extension to the transition period, there is a risk of the UK reverting to WTO terms with the EU in 2021

Macro environment

UK's main export markets are slowing

Activity is expected to remain soft next year in all major export markets. Growth will slow, but remain respectable in the US. German growth is expected to recover to a modest 1.3% in 2020 after a sharp slowdown this year but business confidence remains in the doldrums.

Country (share of total UK export market)	GDP growth (% YoY)			
	Average '11 - '17	2018	2019 forecast	2020 forecast
US (19%)	2.1	2.9	2.4	2.1
Germany (9%)	1.9	1.5	0.5	1.3
France (6%)	1.2	1.5	1.3	1.3
Netherlands (6%)	1.3	2.5	1.8	1.6
Ireland (5%)	7.3	6.8	4.3	3.5
Switzerland (4%)	1.7	2.5	0.8	1.3
Italy (3%)	0.0	0.9	0.0	0.5
China (3%)	7.6	6.6	6.1	5.8
Belgium (3%)	1.2	1.4	1.2	1.3
Spain (3%)	0.8	2.5	2.2	1.9



German business confidence has fallen sharply

German growth is expected to recover modestly next year after a sharp slowdown in 2019

*Numbers in brackets denote share of total UK exports in 2016, ranked by size

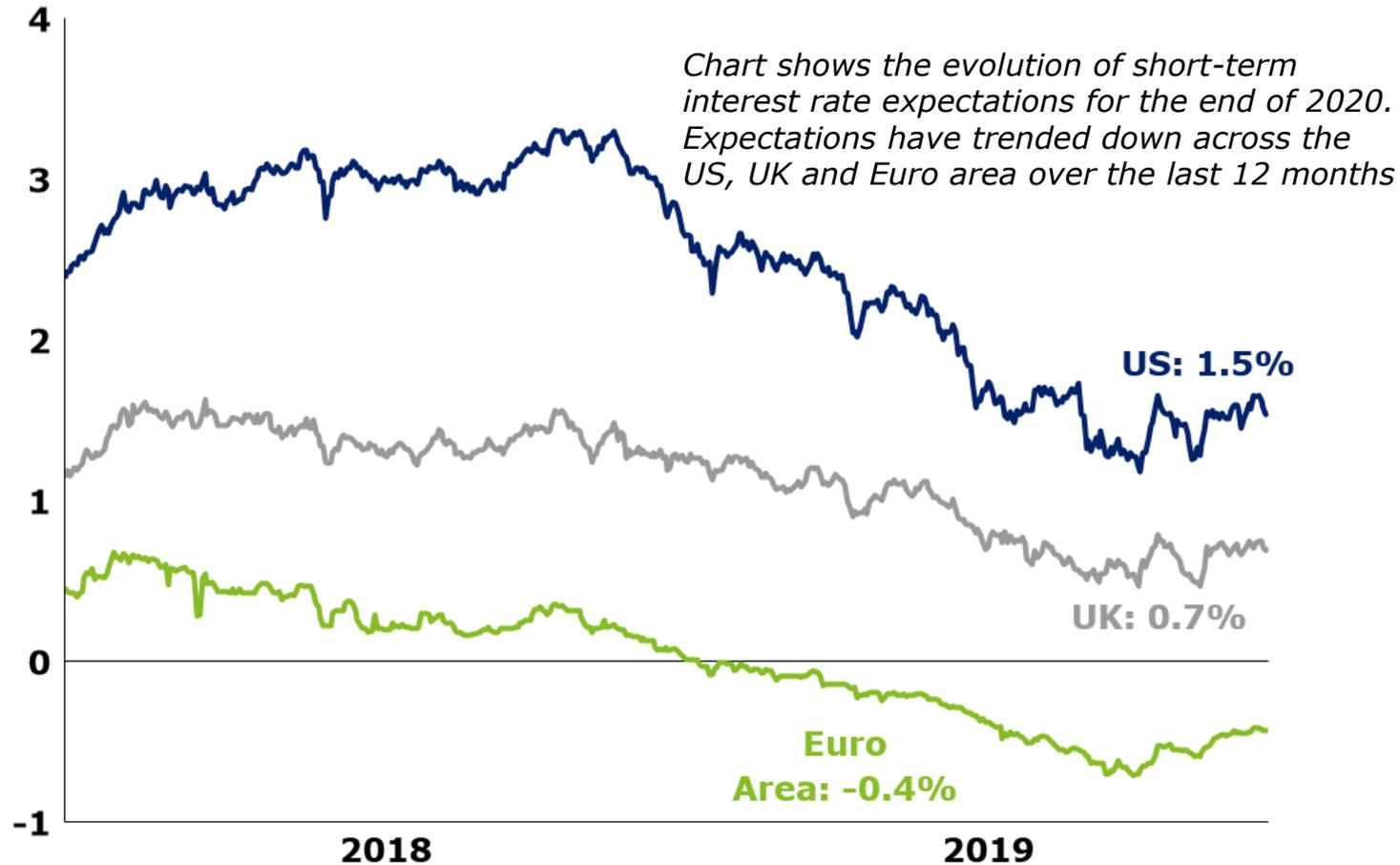
** IMF World Economic Outlook Update, October 2019

Macro environment

Short-term interest rates expected to remain at low levels until 2021

Markets expect rates to edge lower in the UK and the US and flatline in the euro area over next 12 months.

Expected 3m interest rates by December 2020



Source: Refinitiv Datastream

Current 3-month deposit rates	GDP growth
UK	0.8
US	1.9
Euro area	-0.4

Macro environment

Sterling has made gains against the euro and the dollar this year

Remains more than 10% below its pre-referendum value against the euro and dollar.

Sterling/ euro exchange rate



Source: Refinitiv Datastream

Sterling/ US dollar exchange rate

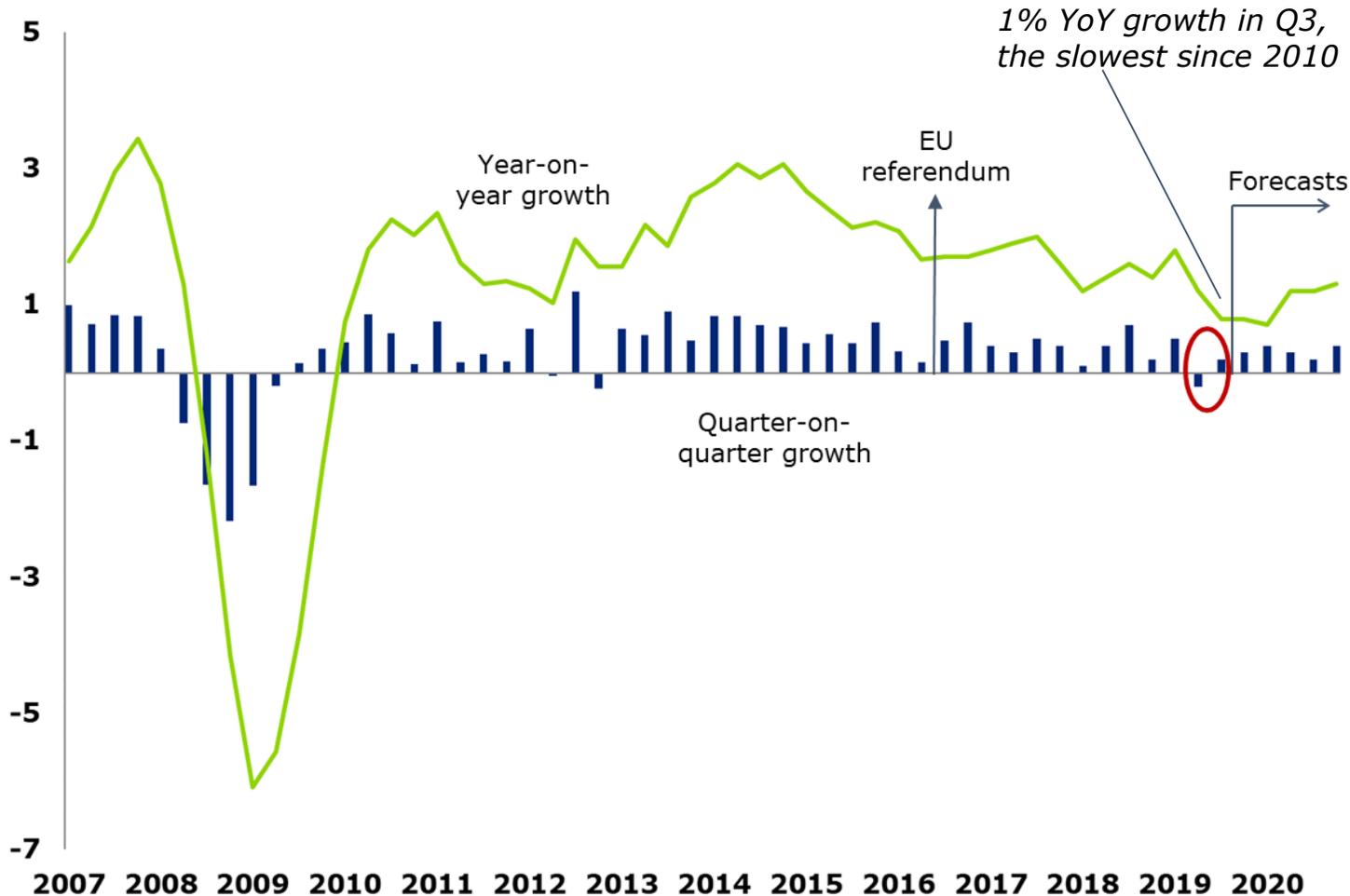


Source: Refinitiv Datastream

UK avoided recession in Q3 but expanded by slowest annual pace since 2010

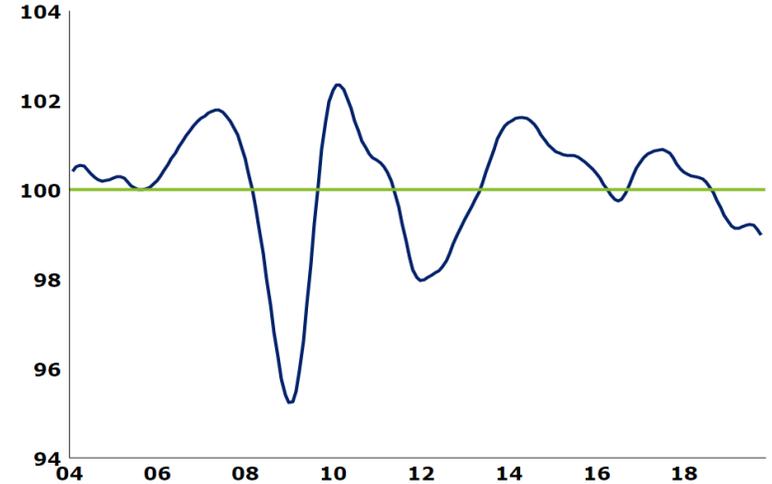
Industrial and manufacturing activity remain weak, and leading activity indicators are slowing.

UK GDP growth: Actual and forecast



Source: ONS

UK leading activity indicator



Source: OECD

Manufacturing output growth



Source: Refinitiv Datastream

Consumer spending slowing but still a bright spot, Brexit uncertainty tempers outlook

Consumers' confidence in their own financial situations remains positive thanks to real wage growth and low levels of unemployment, but concern over the outlook for the economy is keeping a lid on spending.

UK retail sales volumes

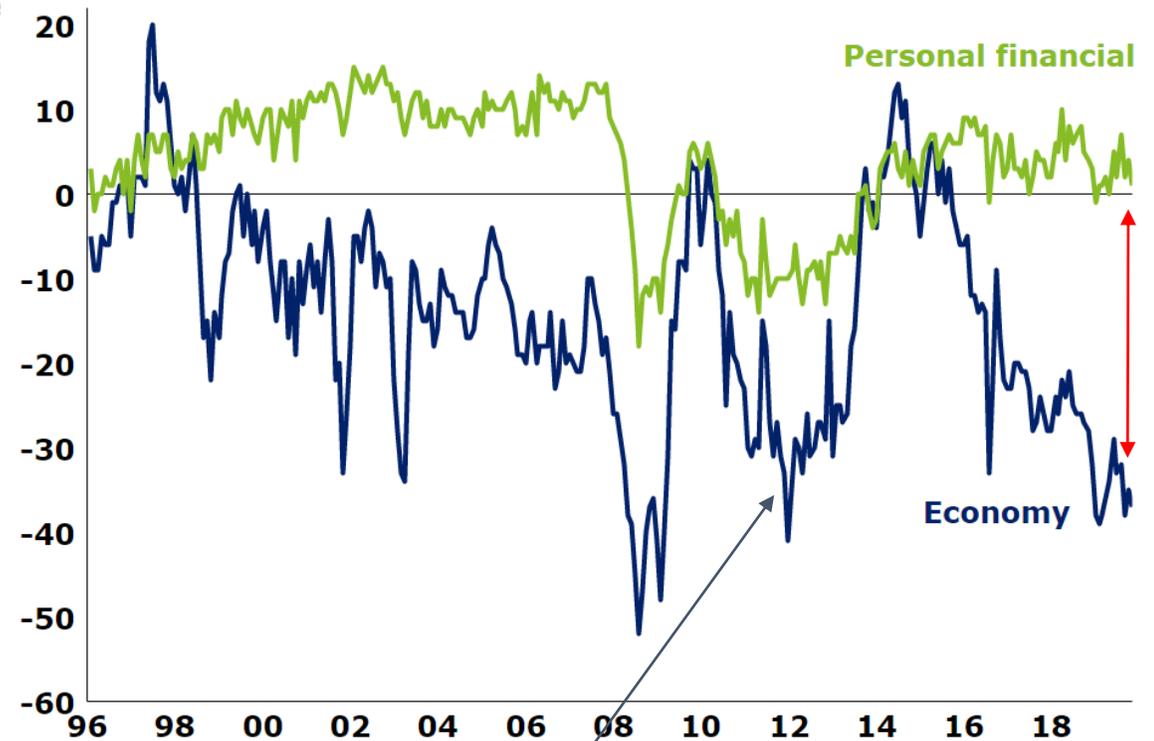
Excluding auto fuel, 12-month percentage changes, 3-month moving average



Source: Refinitiv Datastream

UK consumer confidence about the economy vs own financial situation

Next 12m, net balance



Source: Refinitiv Datastream

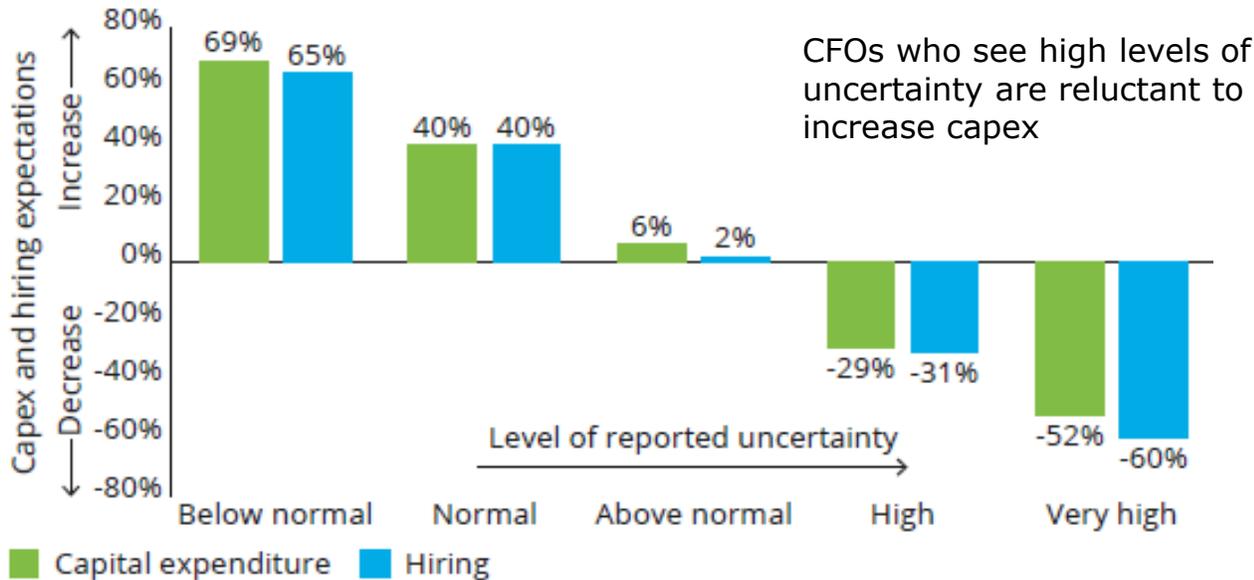
Consumers' confidence in the economy is at very low levels but confidence in their own financial situations is well above the post financial crisis average

Persistent uncertainty is dampening investment

Business optimism is down and Brexit uncertainty is weighing heavily on investment, which has hardly grown since the referendum.

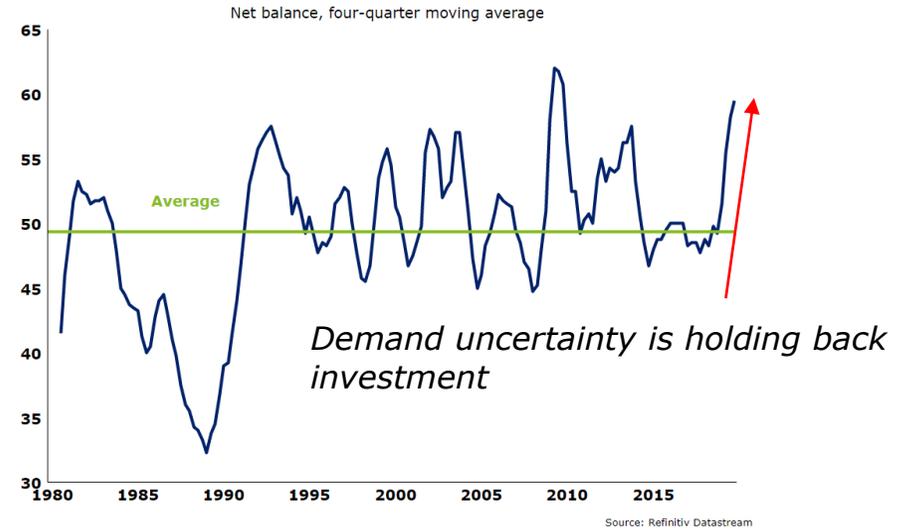
Chart 3. Uncertainty and expectations of capex and hiring

Net % of CFOs who expect UK corporates' capital expenditure and hiring to increase over the next 12 months by level of reported economic and financial uncertainty (readings averaged between 2010 Q3 and 2019 Q2)

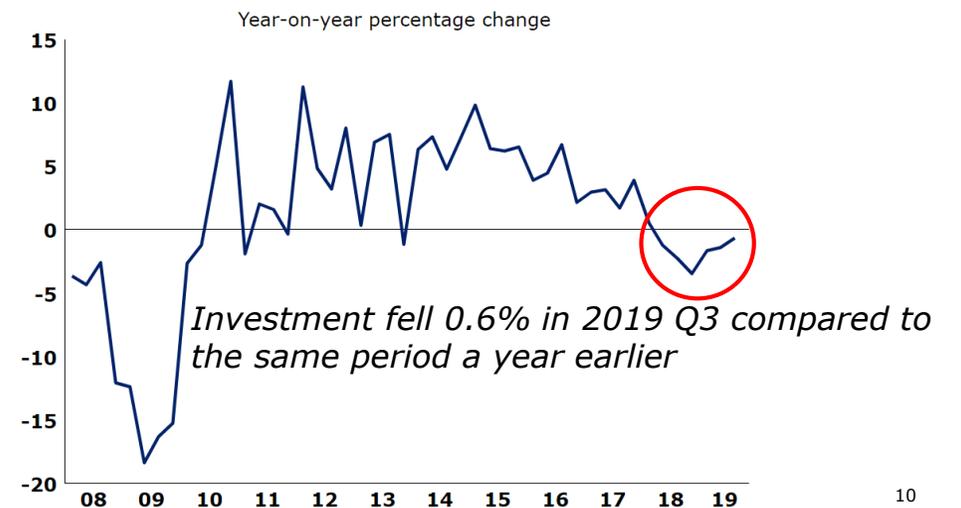


Bank of England analysis of Deloitte CFO Survey data

UK CBI: demand uncertainty as a constraint on investment



UK business investment



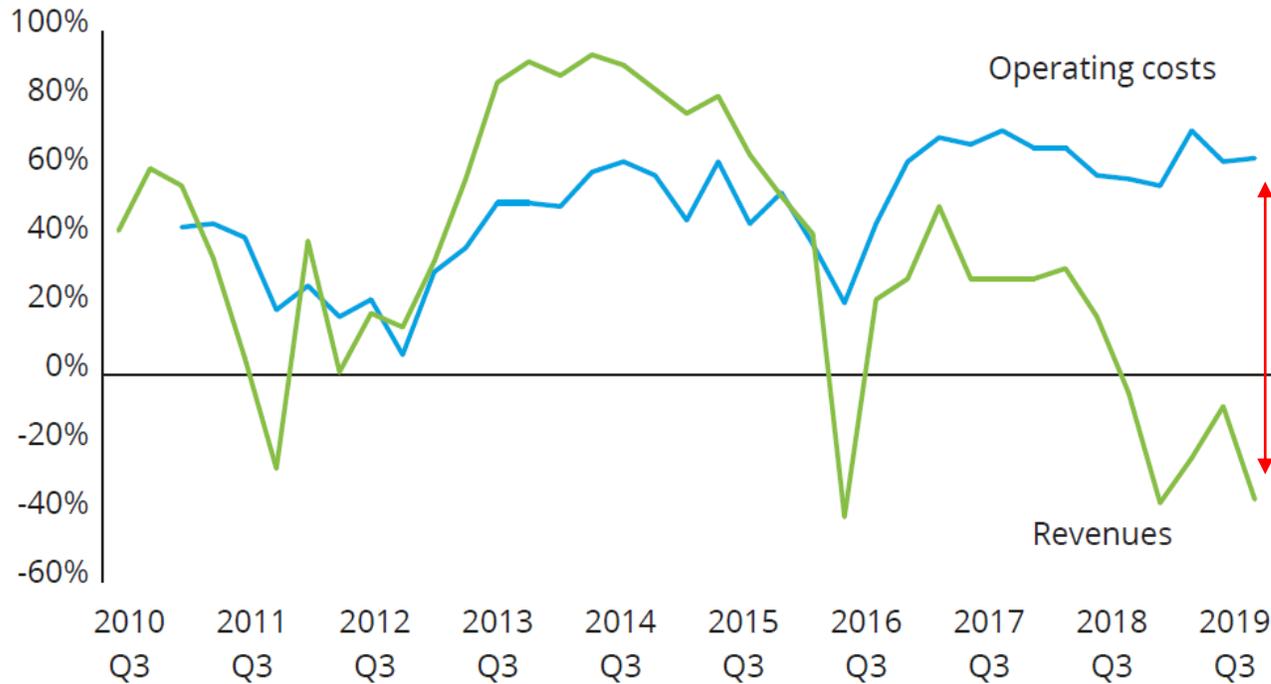
Operating costs

CFOs expect a rise in operating costs and a fall in revenues

76% of CFOs expect operating costs to rise over the next 12 months, squeezing margins.

Chart 7. 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



Margins squeezed

Deloitte CFO Survey: Corporate priorities: Cost reduction

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



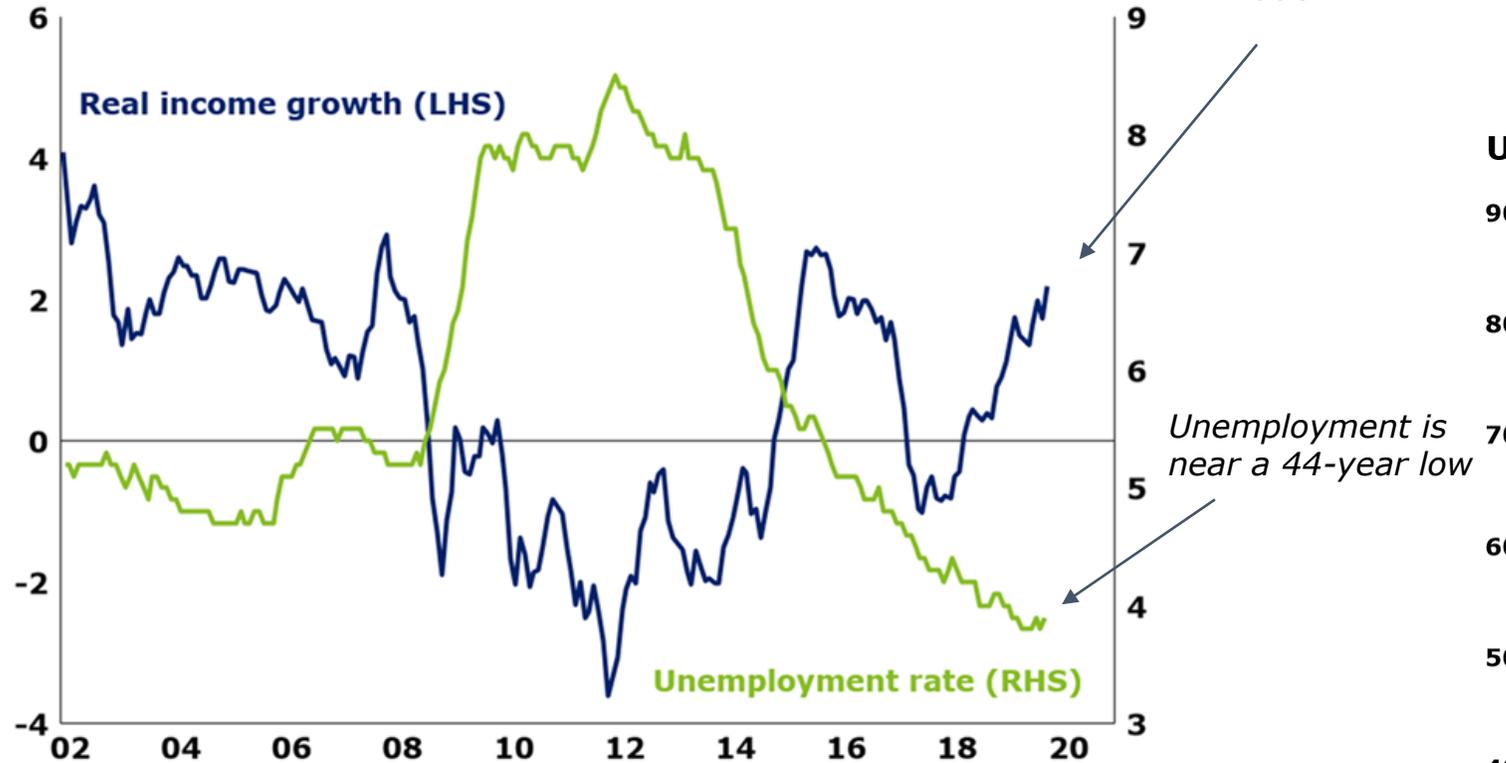
Source: Deloitte CFO Survey

Operating costs

Employment near record high, but pace of job creation has slowed markedly

Leading indicators suggest strength of the labour market is starting to wane.

UK real earnings growth and unemployment rate



Source: Refinitiv Datastream

UK vacancies



Source: Refinitiv Datastream

Operating costs

Retail rents falling sharply outside of London, slight declines in the capital

The falling cost of letting retail space in the UK is symptomatic of the difficulties high street shops are facing.



Source: MSCI Real Estate

Retail rents outside of London fell 4.4% in Q2 on the same period a year earlier

Office rents are increasing at a modest pace



Source: MSCI Real Estate

Operating costs

Commodity prices soft this year as global slowdown exerts downward pressure

Weakness in global trade and manufacturing will continue to have a negative impact on energy and metals demand.

Oil price

(Brent Crude, \$/b)



Trade concerns and weaker global growth have weighed on expected demand

	World Bank commodity price forecasts and out-turns (YoY %)		
	2018	2019	2020
Crude oil	29	-12	-3
Energy index	22	-16	-5
Metals & minerals index	1	-7	-3

Average annual price for given year

Source: World Bank - Commodity Markets Outlook, October 2019

The slowdown in the global economy and particularly in the energy-intensive manufacturing sector is expected to keep energy and metals prices soft next year

Source: Refinitiv Datastream

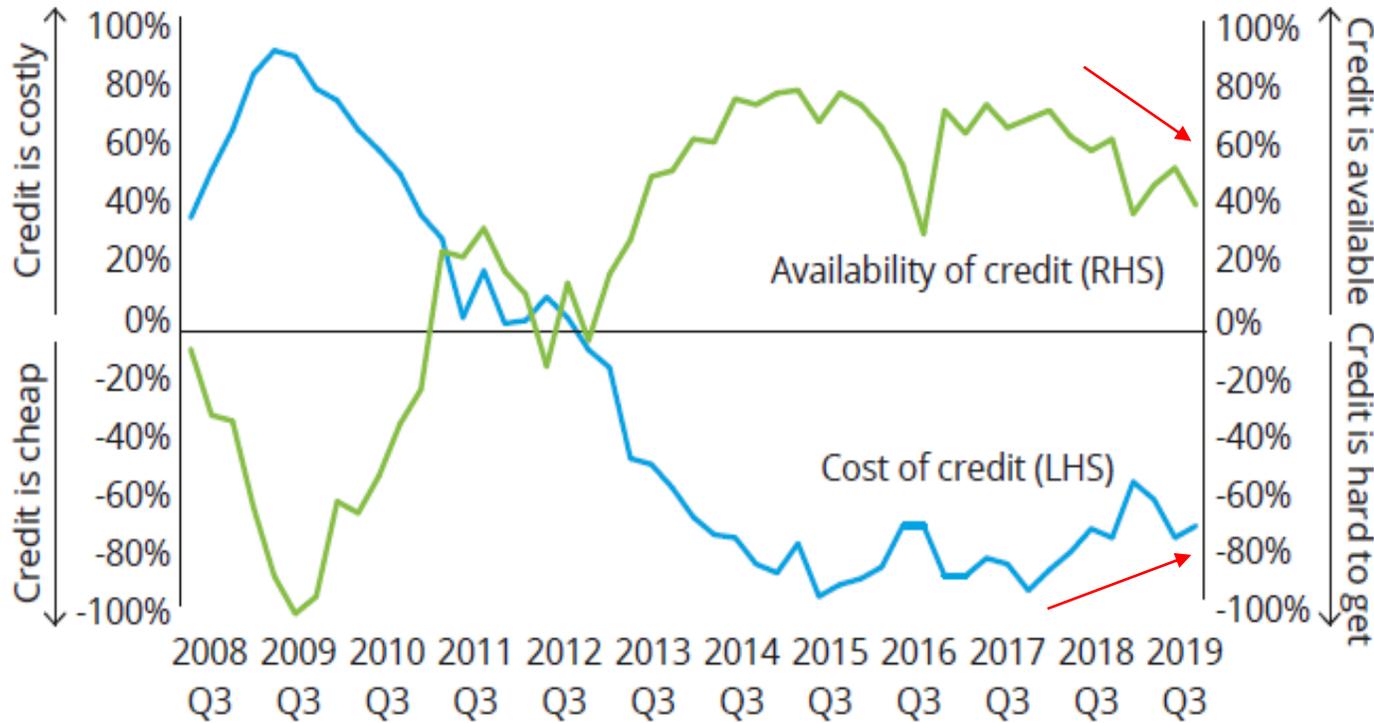
Operating costs

Availability of credit is expected to tighten

Although CFOs on our panel suggest a modest deterioration in very accommodative credit conditions, the BoE highlight the risk of a more severe tightening in lending conditions.

Chart 12. Cost and availability of credit

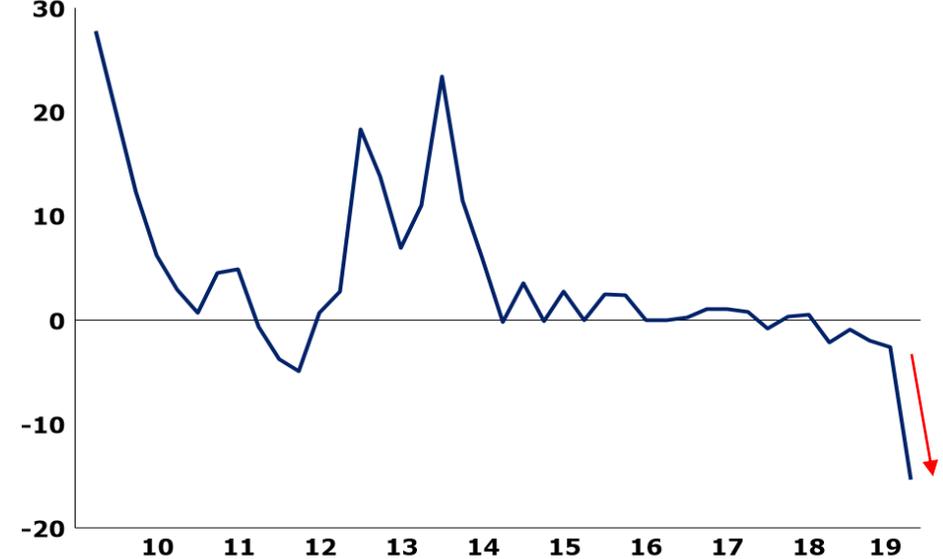
Net % of CFOs reporting credit is costly and credit is easily available



Source: Deloitte CFO Survey

Availability of credit

next three months compared to previous three months, large corporates



Source: Refinitiv Datastream

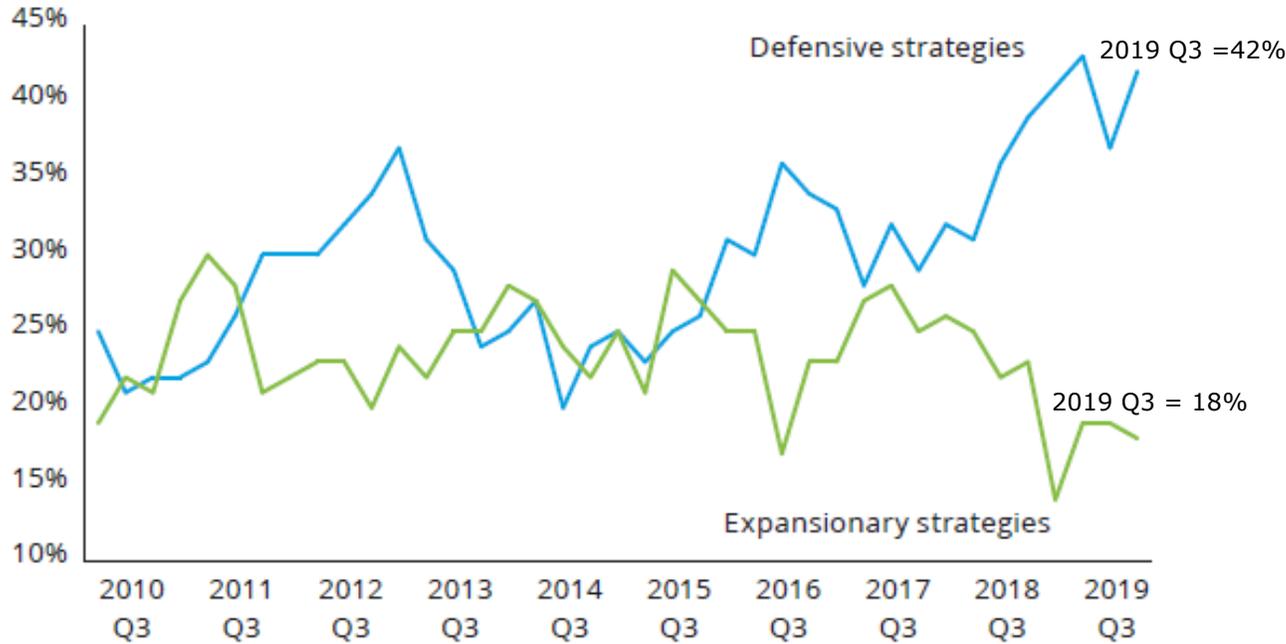
Source: Bank of England Credit Conditions Survey - lenders are asked how they expect overall availability for lending to businesses to change in the next three months

Corporates are bullet-proofing their balance sheets

The Deloitte CFO survey shows UK companies strongly favour defensive strategies. Risk appetite is close to its lowest level since 2008.

Deloitte CFO Survey: 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.

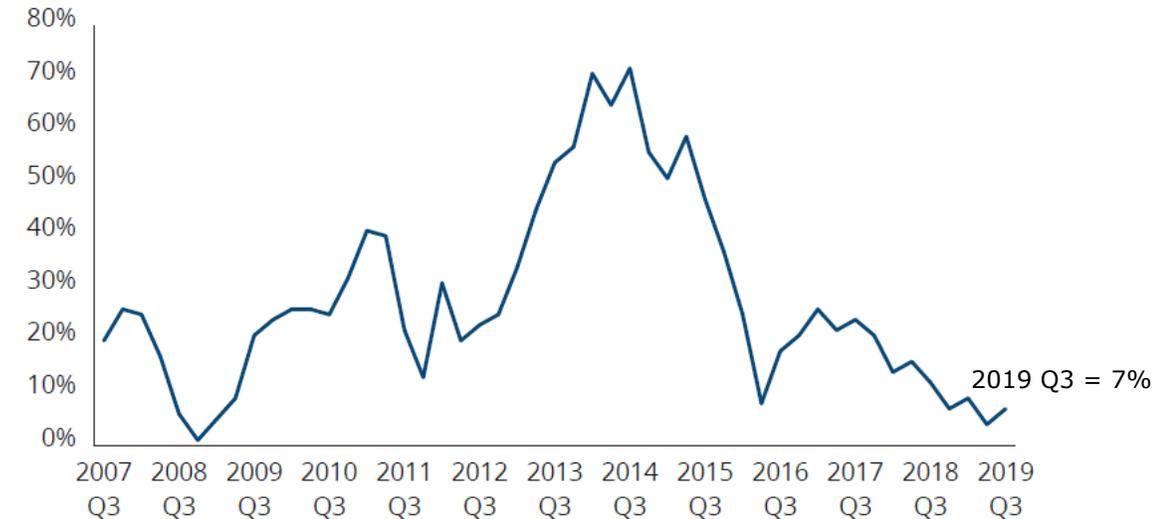
Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

Emphasis on defensive strategies – reducing costs, increasing cash flow and reducing leverage – is near a record high among CFOs

Risk appetite edged up in the third quarter but remains close to its lowest level in ten years

Deloitte CFO Survey: Corporate risk appetite

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



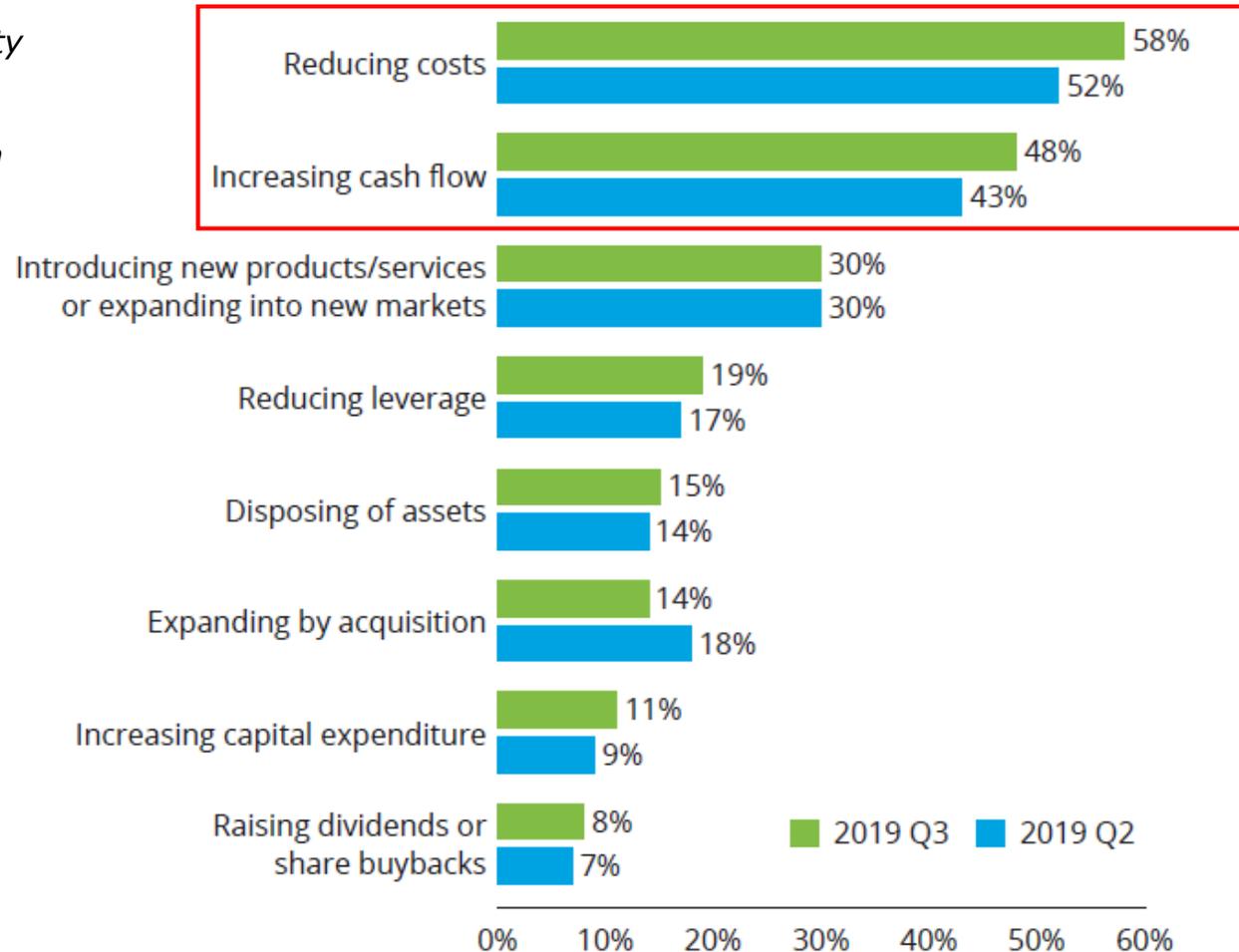
Businesses are set on cutting costs and increasing cash flow

CFOs are in defensive mode, with focus on expansionary strategies falling further.

Deloitte CFO Survey: 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

Cost reduction is the top priority for CFOs, who are placing the greatest emphasis on it since we started asking this question ten years ago.

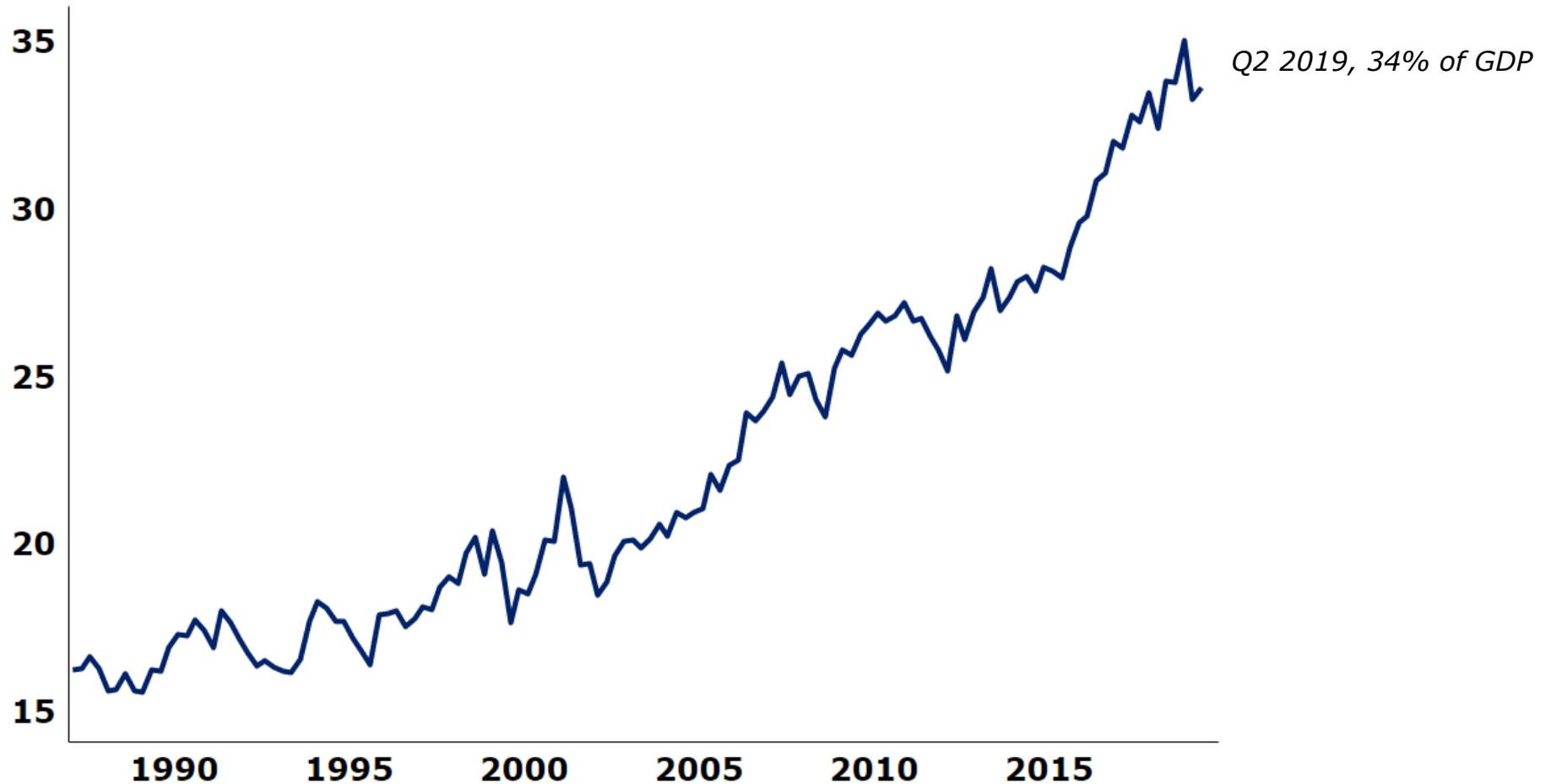


Companies are flush with cash

In mid-2019, UK corporates held a near-record £732bn in cash, equivalent to 34% of GDP and over one-quarter higher than in early 2016.

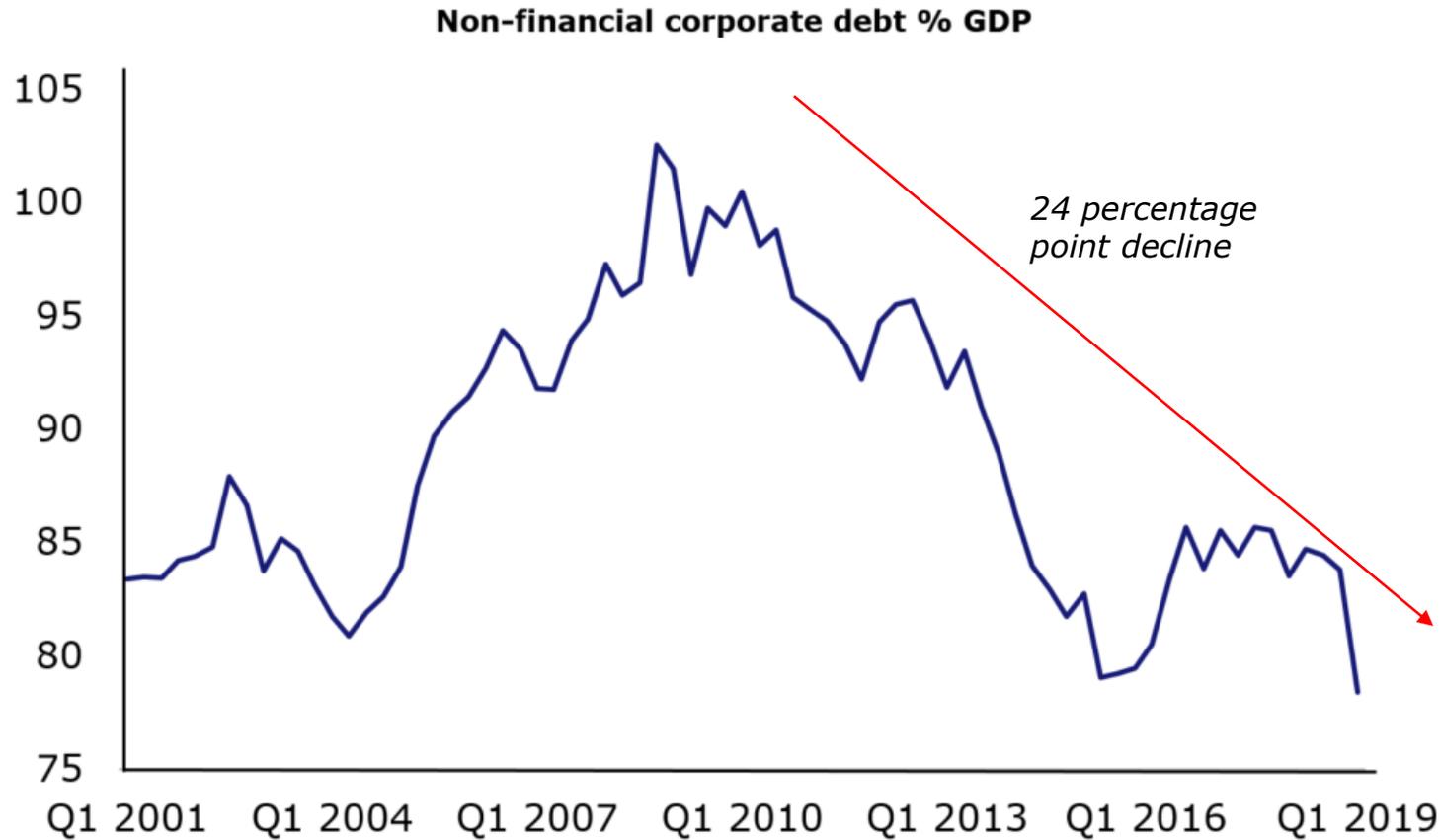
Cash holdings of UK corporates

Cash and cash equivalents on UK corporates' balance sheets (% GDP)



Major deleveraging of non-financial corporate sector since the financial crisis

Lower corporate debt levels should be a source of strength in a downturn.



Source: IIF

Profits have trended down since the end of 2018

Profit margins are under pressure, consistent with the CFO Survey findings on expectations for revenues and costs.

UK corporate profits



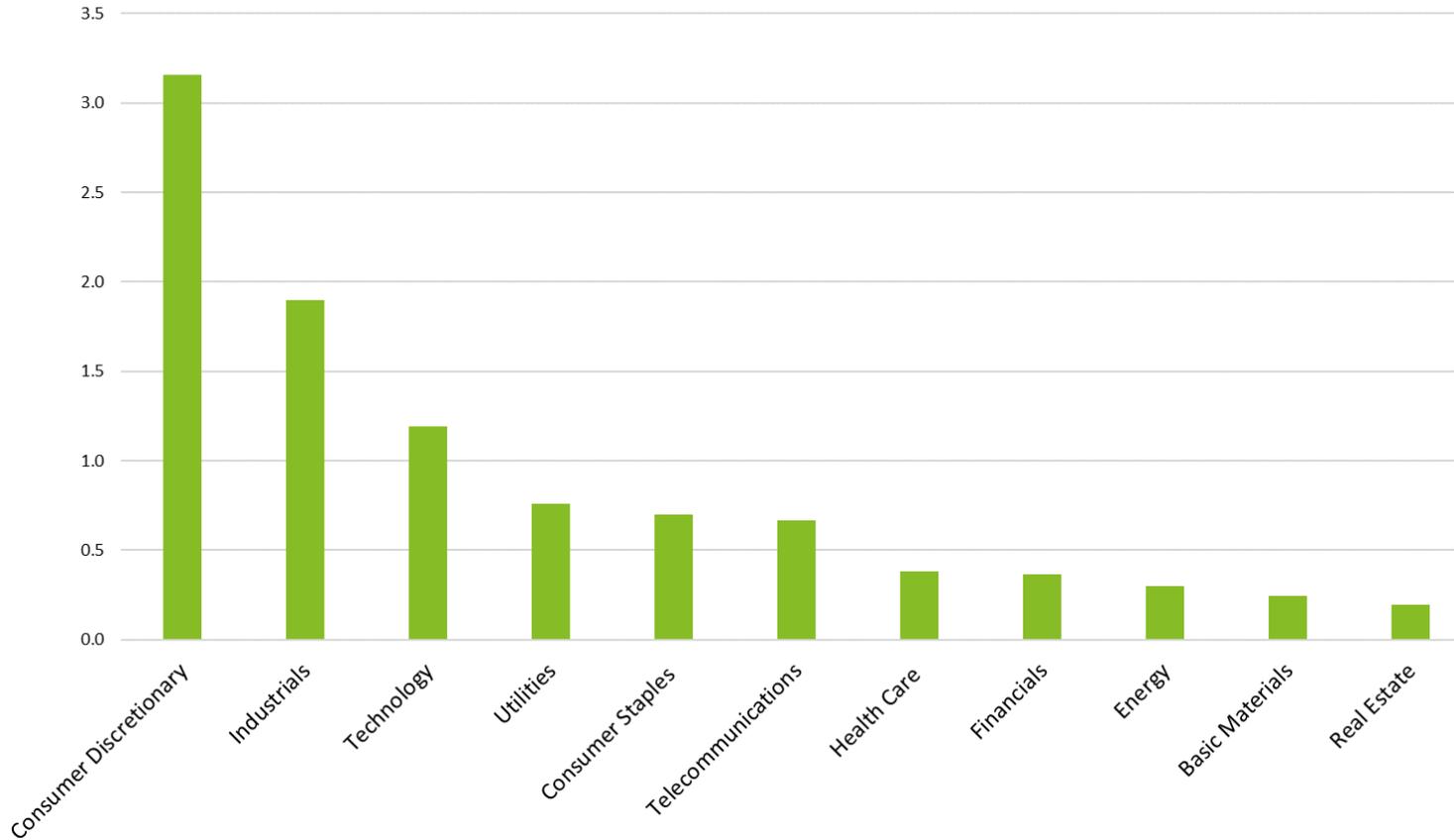
Source: Refinitiv Datastream

Profits warnings have been concentrated in the consumer and industrial sectors

Brexit was referenced in over one-third of profit warnings we observed since the beginning of the year.

Profit warnings indicator by sector

(share of profit warnings/ share of companies; last 12 months)



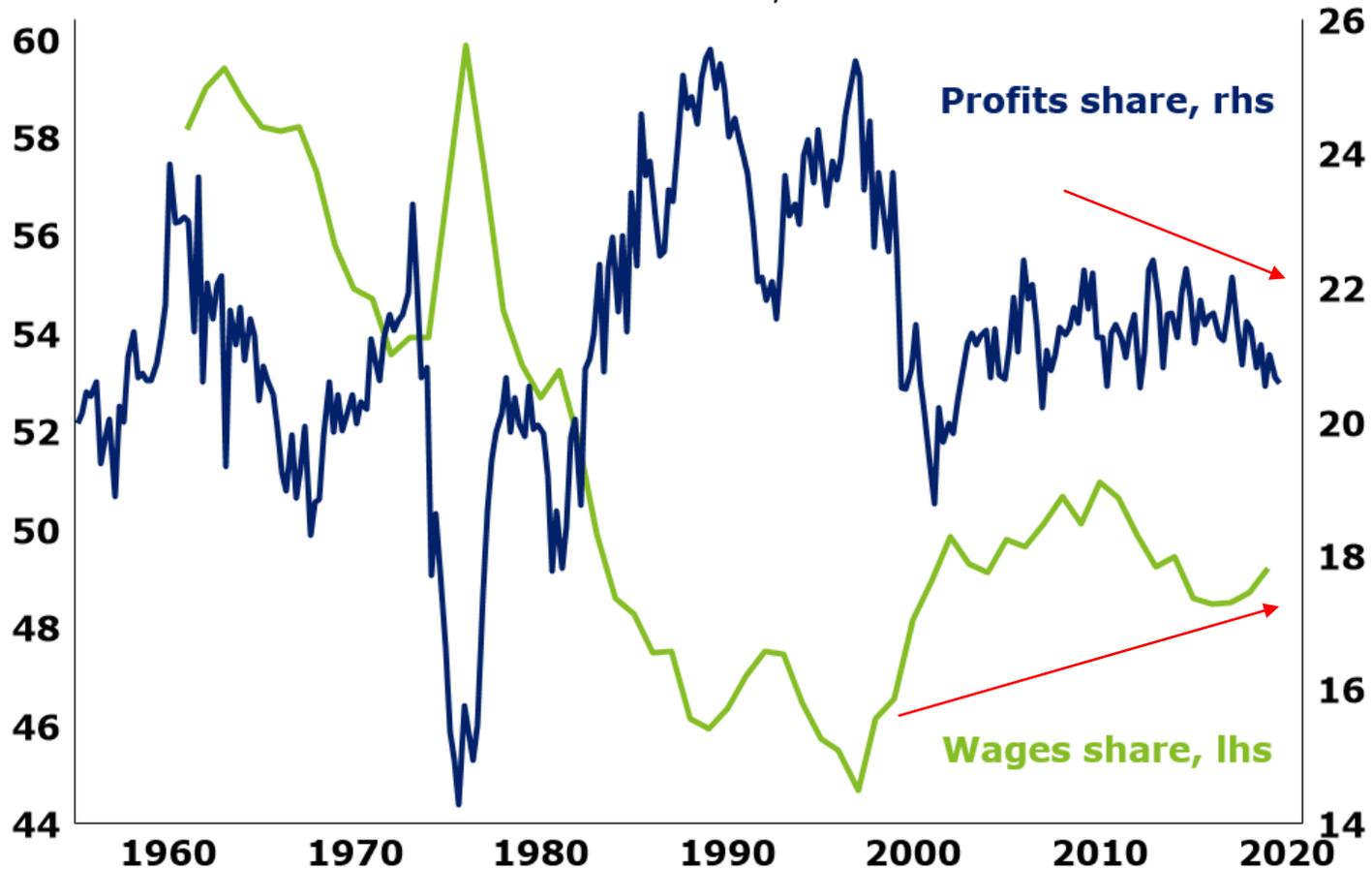
Brexit was referenced in 37% of profit warnings we observed over the last 12 months

Source: Deloitte profit warning news flow measure, not exhaustive

Real earnings are rising, productivity is stagnating and profits are falling
Margins are in the crosshairs as a tight labour market drives up wages.

UK wage share vs. profit share

share of GDP, %



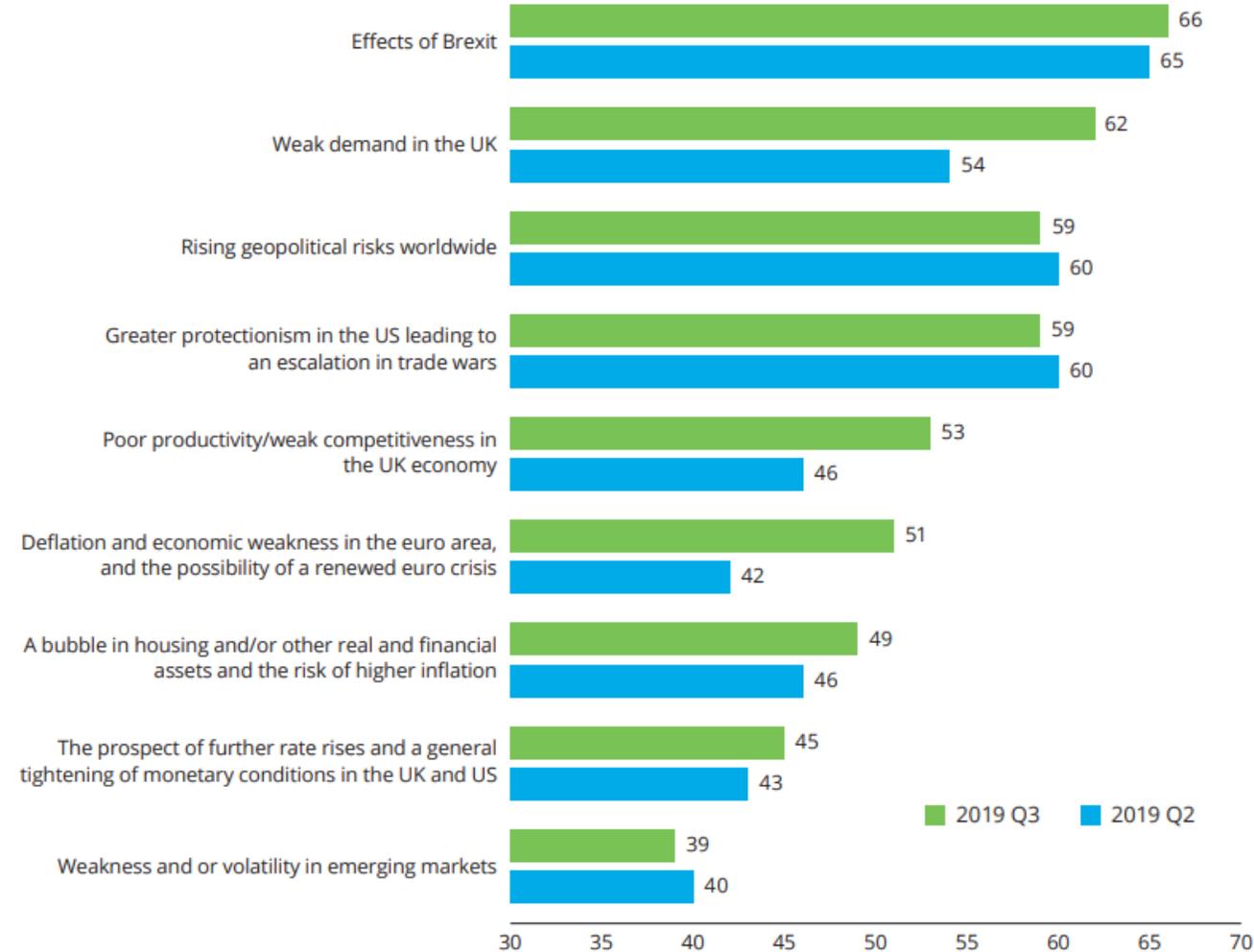
Source: Refinitiv Datastream

Brexit still the biggest risk for businesses

Concern has risen over the risks posed by weak domestic demand and productivity.

Deloitte CFO Survey: 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

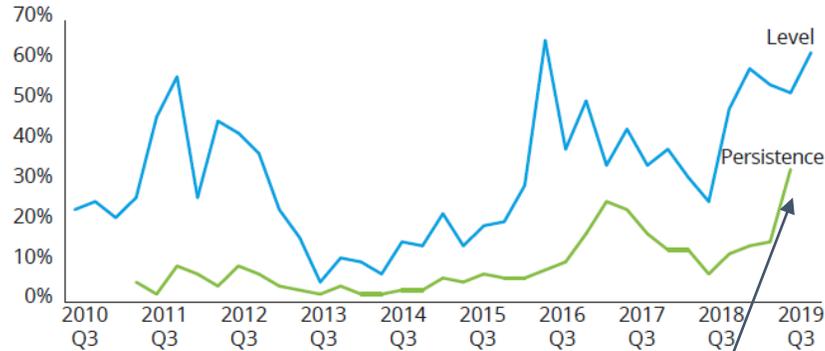


Indicators highlight risk of a sharper slowdown

The persistence of uncertainty is at an all-time high, euro area activity is softening and credit conditions are likely to tighten.

Chart 2. Level and persistence of uncertainty

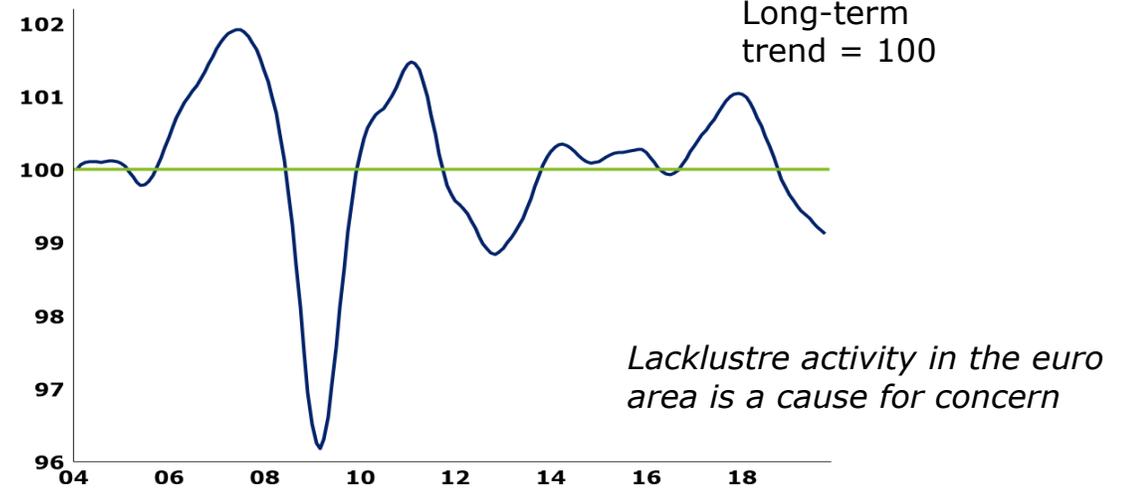
% of CFOs who rate the level of external financial and economic uncertainty facing their business as high or very high and % of CFOs reporting those levels of uncertainty for four consecutive quarters for four consecutive quarters



Persistence data from Bank of England analysis of anonymised Deloitte CFO Survey responses

The persistence of external financial and economic uncertainty facing CFOs has never been higher

Euro area leading activity indicator

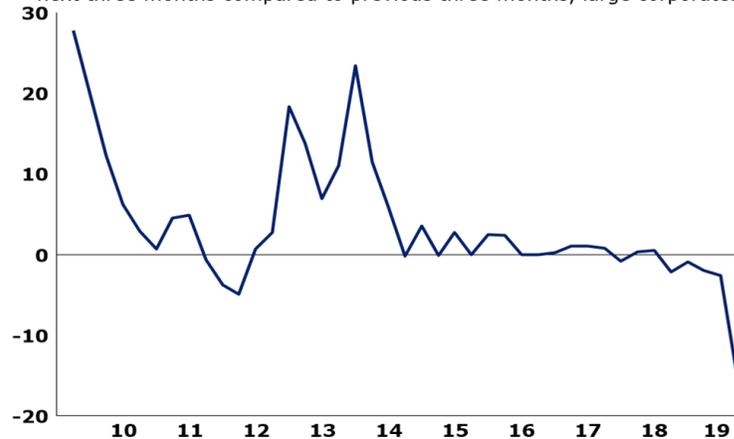


Lacklustre activity in the euro area is a cause for concern

Source: Refinitiv Datastream

Availability of credit

next three months compared to previous three months, large corporates



A tightening of credit conditions would pose problems for highly-leveraged corporates

Source: Refinitiv Datastream

Source: Bank of England Credit Conditions Survey - lenders are asked how they expect overall availability for lending to businesses to change in the next three months.

Growth headwinds > tailwinds

Headwinds

- uncertainty around Brexit and geopolitics
- mature recovery
- global, Europe slowdown
- trade tensions
- possible tightening of credit conditions

Tailwinds

- robust labour market
- low inflation
- corporate balance sheets in good shape
- easy monetary policy
- scope for fiscal easing



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Data for all the charts in this document was sourced from Thomson Reuters Datastream unless otherwise stated.
Charts as on 19th November 2019.

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