

## The Deloitte CFO Survey

### Political risk and corporate expansion

Political risk has eclipsed worries about the economy as a concern for the Chief Financial Officers of the UK's largest companies. CFOs rank next May's general election and the possibility of a referendum on EU membership as greater risks for their businesses than higher interest rates, bubbles in housing or financial markets, or weakness in emerging markets or the euro area.

Such views contrast with CFO beliefs that levels of economic and financial risk have fallen sharply in the last year and with lower readings on news-based measures of policy uncertainty. CFOs are increasingly shifting away from a focus on balance-sheet repair towards growth. Growth is the top balance-sheet priority for UK corporates and 65% of CFOs say now is a good time to take risk. Expectations for capital spending, hiring and discretionary spending have risen strongly in the last year.

The weight CFOs attach to defensive strategies, including cost control, fell to a four-year low in the second quarter.

This sort of positive sentiment is increasingly being reflected in the official data. Hiring by the private sector has risen by 3.2% in the last year and business investment has risen by 10.6%. In May corporate bank borrowing saw the first year-on-year increase in five years.

The message from the CFO Survey is that corporates are prioritising expansion over further strengthening of their balance sheets. Against a backdrop of easy credit and high risk appetite companies are upbeat on revenues and margins. Economic and financial risk has declined significantly in the last year. But with the general election less than a year away uncertainties around policy risk have moved centre stage.

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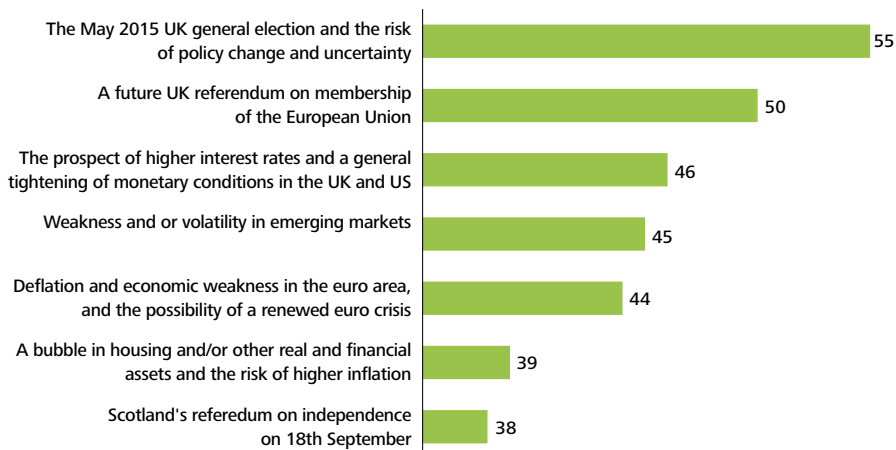
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For current and past copies of the survey, historical data and coverage of the survey in the media and elsewhere, please visit:

[www.deloitte.co.uk/cfosurvey](http://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



# Declining uncertainty

CFO perceptions of economic uncertainty have continued to fall.

49% of CFOs now rate the level of financial and economic uncertainty facing their business as above normal, high or very high – the lowest reading in four years.

**Chart 2. Uncertainty**

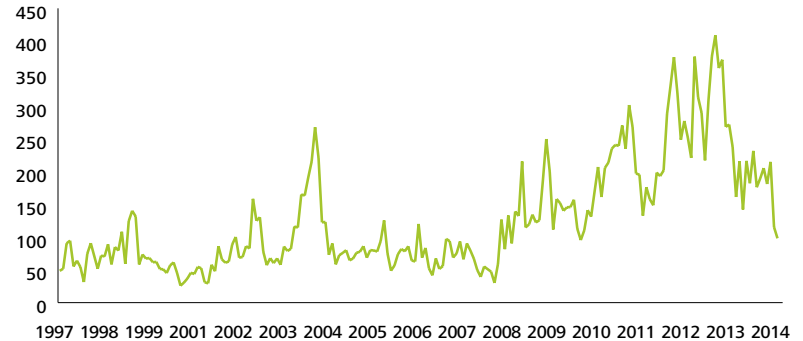
% of CFOs who rate the level of external financial and economic uncertainty facing their business as above normal, high or very high



This fits with the dramatic fall in uncertainty over economic policy during the last two years, as measured by this news-based index of uncertainty.

**Chart 3. Economic policy uncertainty**

News-based index of economic policy uncertainty



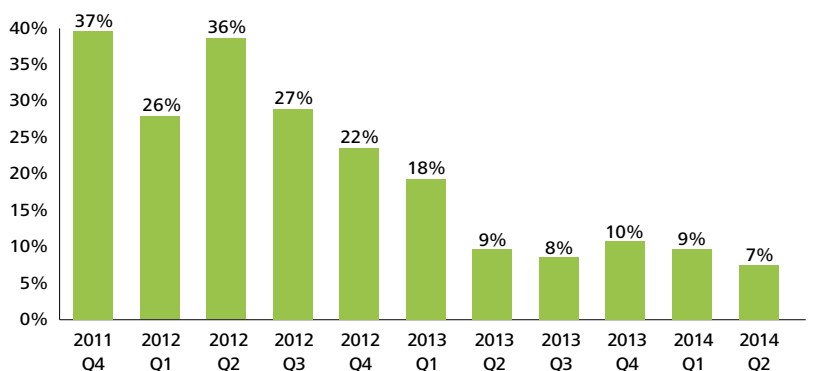
The Economic Policy Uncertainty index, developed by academics at Stanford University and the University of Chicago, measures the share of articles containing terms related to economic policy uncertainty in the overall UK newsflow  
 Source: [Policyuncertainty.com](http://Policyuncertainty.com)

Fears of a euro break-up have also subsided.

CFOs now assign a 7% probability to the euro area breaking up in the next 12 months – the lowest reading since the euro crisis began in 2011.

**Chart 4. Average probability of euro secession**

Probability assigned by UK CFOs to the likelihood of any of the existing members of the euro area not being in the single currency in the next 12 months

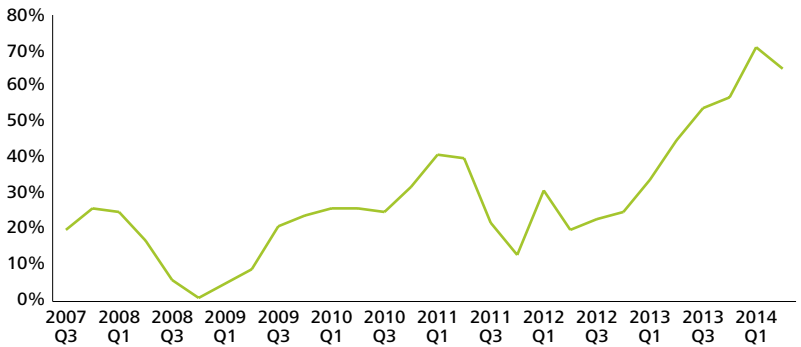


# Profitability to rise

The decline in economic and financial uncertainty has coincided with a surge in corporate appetite for risk.

65% of CFOs say that now is a good time to take risk, down only slightly from the record reading of 71% in the first quarter.

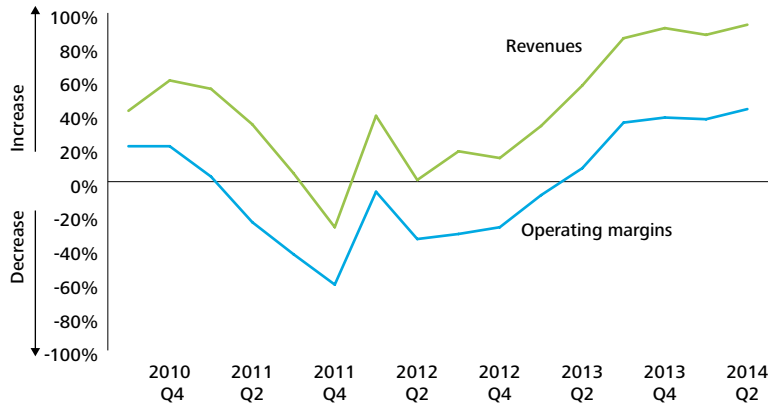
**Chart 5. Risk appetite**  
% of CFOs who think this is a good time to taker greater risk onto their balance sheets



Corporates are also more optimistic about their profitability.

CFO expectations of a rise in revenues and operating margins have hit four-year highs.

**Chart 6. Outlook for corporate revenues and margins**  
Net % of CFOs who expect UK corporates' revenues and margins to increase over the next 12 months



CFO optimism has eased slightly in the second quarter but continues to run well above its long-term average.

**Chart 7. Business confidence**  
Net % of CFOs who are more optimistic about financial prospects for their company now than three months ago

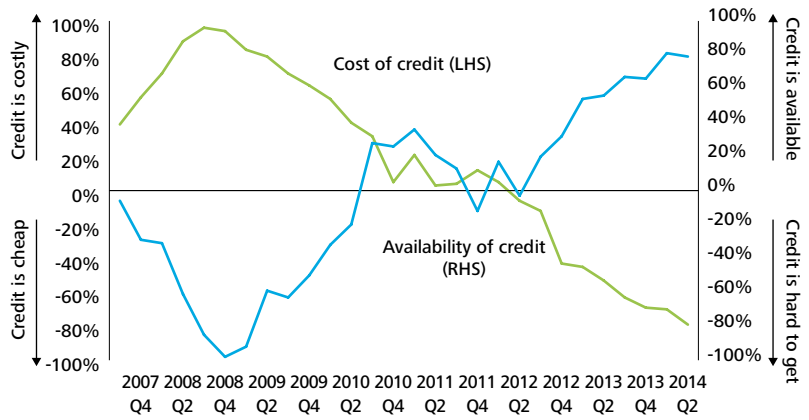


# Easy credit

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

CFOs report that the cost of credit has fallen to a seven-year low in the second quarter while credit availability is close to the highest level in seven years.

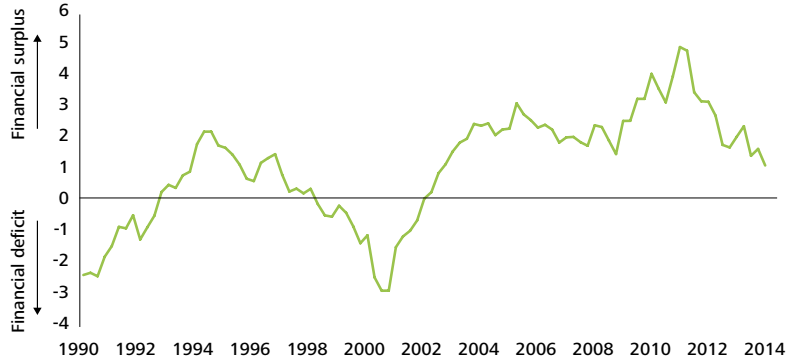
**Chart 8. Cost and availability of credit**  
Net % of CFOs reporting credit is costly and credit is easily available



In the aftermath of the financial crisis, corporates paid down debt, cut costs and held on to cash, realising a huge financial surplus.

Reflecting greater confidence on the strength of their balance sheets, corporates have narrowed this surplus during the last two years.

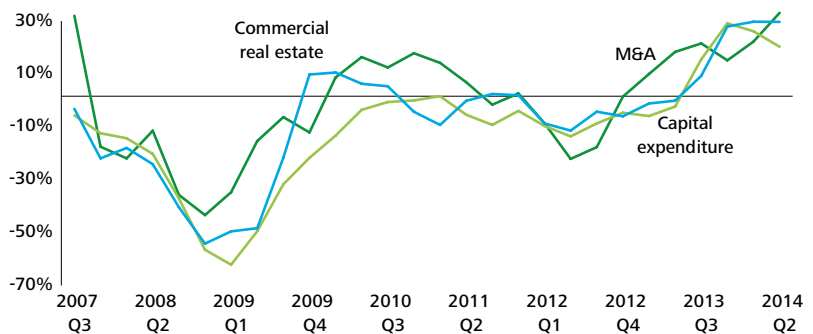
**Chart 9. Financial balance of corporate sector**  
Financial balance of UK private non-financial corporations as a % of GDP



Bank lending to corporates rose by 1% in the year to May, the first increase in five years.

The Bank of England's Credit Conditions Survey reveals that mergers and acquisitions, investment into commercial real estate and capital expenditure have been major drivers of corporate demand for loans.

**Chart 10. Factors supporting demand for loans from corporates**  
Net % of banks reporting each of the following factors as a contributor to changes in corporate demand for lending over the past three months (2Q moving average)



Source: Bank of England's Credit Conditions Survey

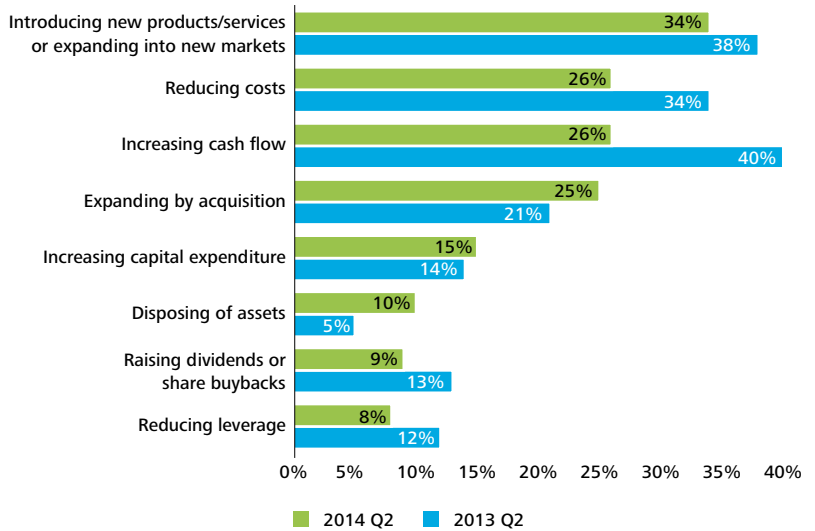
# Focus on expansion

The top priority for UK CFOs is introducing new products and services or expanding into new markets.

Compared to a year ago, there has been a marked softening of their focus on defensive strategies such as reducing costs and increasing cash flow.

CFOs are placing greater emphasis on expansionary strategies such as increasing capital expenditure and expanding by acquisition.

**Chart 11. 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



Corporate defensiveness hit a four-year low in the second quarter of 2014.

CFOs have rated expansionary balance-sheet strategies as a higher priority than defensive ones for the fourth consecutive quarter.

**Chart 12. 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.

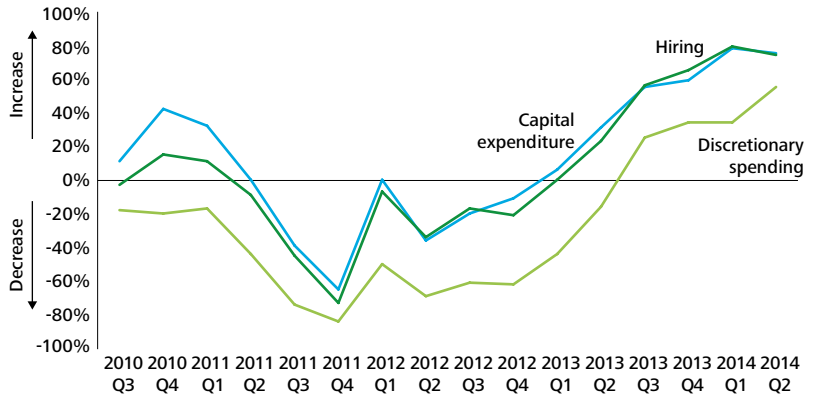
Defensive strategies are reducing costs, reducing leverage and increasing cash flow.

# Investment on the rise

CFO expectations for growth in discretionary spending have hit a four-year high.

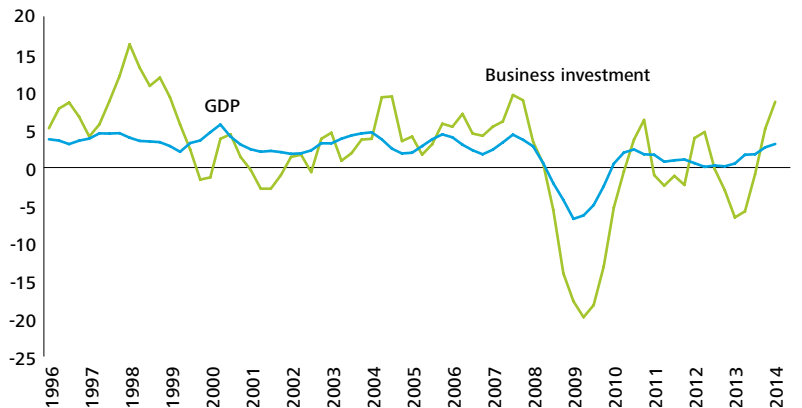
Expectations for growth in hiring and capital expenditure are close to their highest levels in four years.

**Chart 13. Outlook for hiring, capital expenditure and discretionary spending**  
Net % of CFOs who expect UK corporates' hiring, capital expenditure and discretionary spending to increase over the next 12 months



Official data shows that investment is outpacing GDP growth. Business investment has risen by 10.6% over the last year.

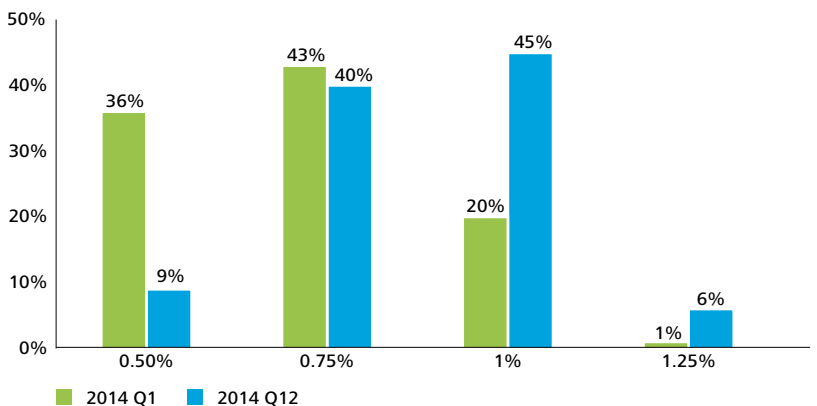
**Chart 14. GDP growth and business investment**  
UK GDP growth (% YoY) and growth in business investment (% YoY, 2Q moving average)



In his Mansion House speech on 12th June, the Governor of the Bank of England warned that UK interest rates could rise sooner than widely expected.

CFOs have taken this message on board. On average our panel sees base rates rising to around the 0.9% mark in a year's time, amounting to roughly two 25-basis-point rises by June 2015.

**Chart 15. Bank rate expectations**  
% of CFOs who expect the Bank of England's base rate to be at the following levels in a year's time

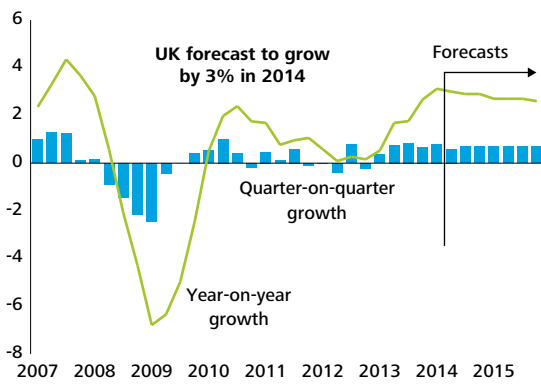


# CFO Survey: Economic and financial context

## The macroeconomic backdrop to the Deloitte CFO Survey Q2 2014

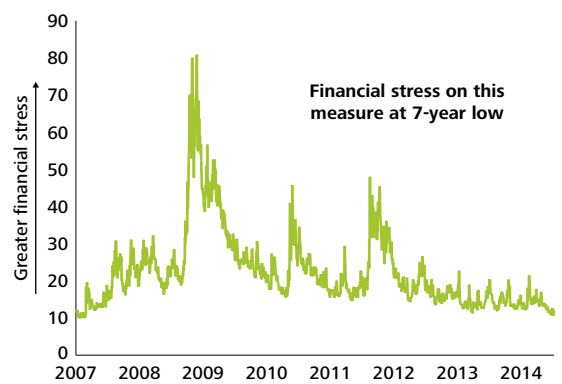
Global equity markets rose 4.2% in the second quarter and yields on US and German bonds fell. Growth forecasts for emerging economies edged lower on a mix of geopolitical, financial and economic concerns. The US economy shrank in the first quarter, although the effects of an unusually harsh winter and business inventory restocking appear to be temporary. Portugal exited its bailout programme and Greece successfully raised money in the markets but concerns about deflation and low growth prompted the European Central Bank to cut interest rates. In the UK, inflation softened and output rose by 3.1% in the year to Q1 2014, the strongest performance in the developed world. In his Mansion House speech the Governor of the Bank of England claimed that a rise in UK interest rates could “happen sooner than markets currently expect”, although Mr. Carney subsequently sought to play down expectations of an early rate rise.

**UK GDP growth: Actual and forecast (%)**



Source: ONS, consensus forecasts from *The Economist* and Deloitte calculations

**VIX Index – a measure of equity market volatility**



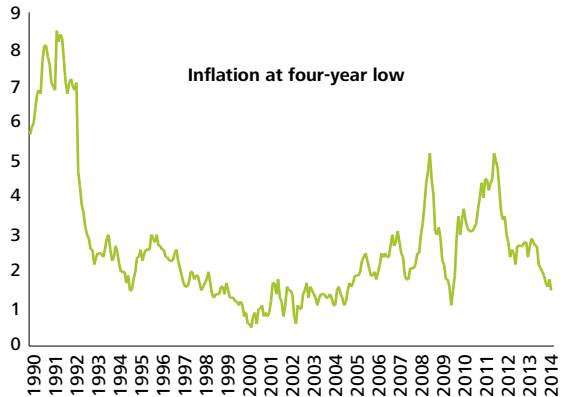
Source: Thomson Reuters Datastream

**UK private and public sector job growth (thousands)**



Source: ONS

**UK annual CPI inflation (%)**



Source: ONS

# Two-chart summary of key survey messages

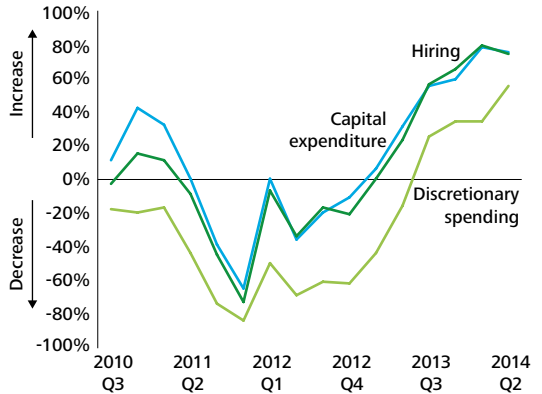
### Uncertainty

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



### Outlook for hiring, capital expenditure and discretionary spending

Net % of CFOs who expect UK corporates' hiring, capital expenditure and discretionary spending to increase over the next 12 months



### About the survey

This is the 28<sup>th</sup> quarterly survey of Chief Financial Officers and Group Finance Directors of major companies in the UK. The 2014 second quarter survey took place between 6<sup>th</sup> and 23<sup>rd</sup> June. 112 CFOs participated, including the CFOs of 31 FTSE 100 and 37 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 68 UK-listed companies surveyed is £473 billion, or approximately 21% 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 Linda Elston on 020 7303 0526 or email [l.elston@deloitte.co.uk](mailto:l.elston@deloitte.co.uk)

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