



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

Q1 2008

UK BUSINESS CONFIDENCE MONITOR

South East Summary Report



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In times of turmoil in financial markets the attitude of business can be a determining factor in coping with economic uncertainty. Although UK business confidence is low currently there are a number of practical things businesses can do, no matter what size they are, to help ensure they get through this period. I'd recommend, for example seeking to maximise cash flow, controlling working capital tightly and looking critically at capital expenditure. Steps such as these will ensure firms are geared up to take advantage of opportunities as the economic climate recovers.

The **ICAEW UK Business Confidence Monitor** (BCM) provides a snapshot of the state of the economy informed by senior finance professionals advising and running businesses of all sizes across every economic sector in the UK. It is one of the largest and most comprehensive quarterly reviews of UK business confidence.

Please visit www.icaew.com/bcm for further analysis and detail about BCM.

A handwritten signature in black ink that reads "Michael Izza". The signature is written in a cursive, flowing style.

Michael D M Izza
Chief Executive
The Institute of Chartered Accountants in England and Wales

Q1 2008 KEY POINTS

- Business confidence declines for a third consecutive quarter to an all-time low.
- Fall-out from financial turmoil caused by US home loan crisis continues to impact. Slowing UK housing market suppresses confidence further.
- Slowdown in the economy more paced than slippage in business confidence. Tone of recent press reports is perhaps depressing business outlook more than is justified.
- Given the drivers of current downward pressure on confidence, no surprise that the City of London and estate agents are leading pessimism in the economy.
- We predict very low economic growth for 2008, but no true recession thanks to opportunities for export driven markets in the run up to the Olympics, likely interest rate cuts, and an expectation that consumers will draw on savings to support spending.

FOREWORD

JONATHAN SAID, CEBR – ECONOMIC ADVISER TO THE ICAEW



UK BUSINESS CONFIDENCE HITS ALL-TIME LOW

With the US housing slump and financial sector defaults persisting into 2008, the odds of a strong US economic slowdown – if not recession – have risen. Similarly the UK economy is entering a housing and consumer deceleration which looks likely to have a significant impact on economic growth. These factors have combined to drive confidence down further this quarter, taking it to the lowest level since this survey began.

Fig. 1 BCM Confidence Index trend



Source: ICAEW UK Business Confidence Monitor

While the gap between the underlying rate of economic growth suggested by our survey and the official measure (Annual GDP Growth) remains relatively large, both measures are now in decline. However, we are seeing a more paced slowdown in the economy compared to the sharp slippage observed for business confidence, which perhaps simply reflects business reaction to the tone of recent media coverage.

CITY AND PROPERTY MARKET CONTINUE TO LEAD DECLINE

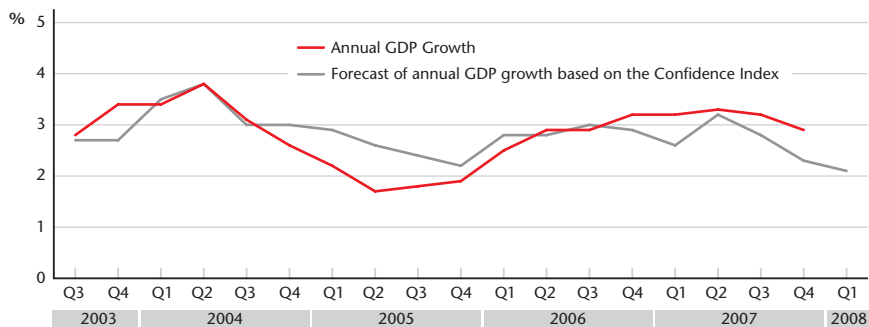
Given the drivers of current downward pressure on confidence, it is of no surprise that the City of London and estate agents are leading pessimism in the economy.

Most financial sectors are now dealing with consequences of the US sub-prime mortgage situation which emerged in the second half of last year. Merger and acquisition and private equity deals continue to be hit by the lack of available finance, the equity markets have fallen 13% relative to the cyclical peak hit in late October, and investors are selling off corporate bonds in favour of gilts. In addition, bond insurers (monolines) are suffering from the defaults and from an inability to re-finance their obligations.

One positive for the financial services sector is that emerging markets continue to come to the rescue through sovereign funds – effectively providing City institutions with the credit they need – and by keeping commodity prices at record levels.

Year-on-year house price inflation slowed from a high of 11.6% last August to 5.3% in December, and the number of mortgage approvals fell 35% from the November 2006 peak.

Fig. 2 Forecast of annual GDP growth based on ICAEW Confidence Index



Source: National Statistics First Release – Gross Domestic Product (GDP) – and cebr regression calculations

The housing market is set to continue to slow, with year-on-year inflation likely to turn negative this year.

Combined with the pessimistic Construction and Retail & Wholesale sectors – according to official statistics December retail sales saw the largest month-on-month real term fall since 2001 – it appears that UK plc is in for a bumpy ride.

DESPITE NEGATIVE INDICATORS, TRUE RECESSION UNLIKELY

However, I am yet to be convinced that the economy faces a recession. The historic relationship between the Confidence Index and GDP growth suggests growth in the economy of 2.1% – still above the low of 1.7% seen in the trough of the 2005 cycle.

While I expect growth to slow below this level through 2008, a number of factors should mean that we do not see the two quarters of economic contraction which would constitute a technical recession.

The Bank of England is likely to cut interest rates substantially through the year. Although unlikely to react as fast as the Federal Reserve, pressure from the City will force the Bank to make cuts when the financial sector needs them, as occurred last December.

In addition, some sectors remain robust, namely Business Services and Communications. At least up to the Beijing Olympics, growth in emerging markets such as China, India, Brazil, Russia and Middle East will support export-driven sectors, and the wealth generated in these areas will lend a hand to the financial sector through the international transfer of funds.

Finally, although consumers are likely to face a tough year through 2008 on the back of tight personal finances, they will support their current level of expenditure by drawing from their savings. So while 2008 is set to prove a bumpy year for most businesses, the economy is likely to hold up with positive, if painfully low, levels of growth.

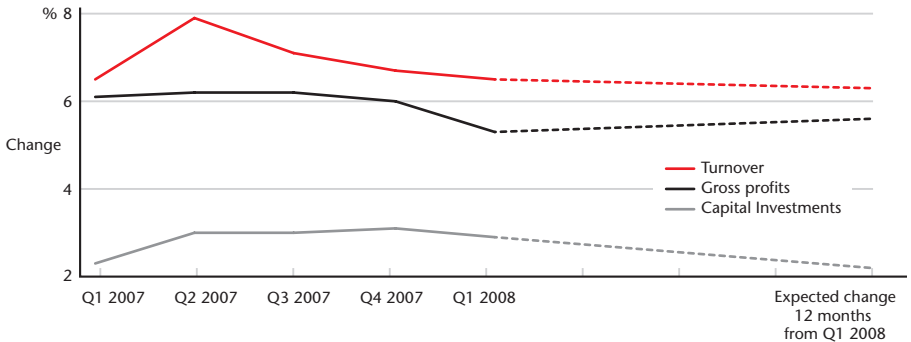
Jonathan Said, cebr – Economic adviser to the ICAEW

MAIN FINDINGS

BUSINESS FINANCIAL PERFORMANCE

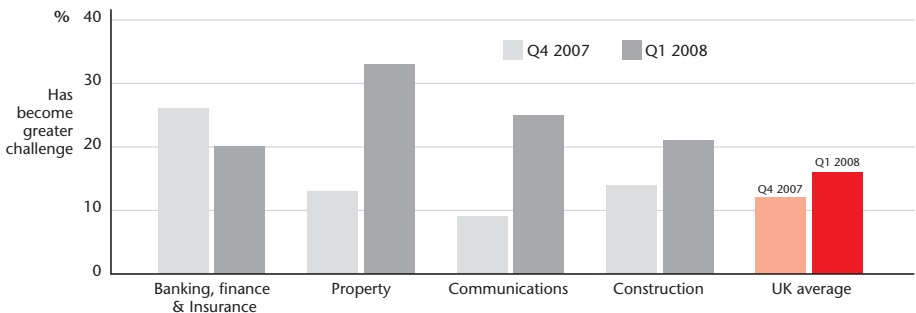
The negative trend in the rate of growth for turnover which began in Q2 2007 is expected to continue. Although a modest upturn is expected in profit growth, the predicted level of growth looks relatively weak when compared with performance through 2007, when profit growth was consistently at 6.0% or above.

Fig. 3 Change over 12 months to...



In line with the expected slowdown in predicted capital spending growth, a greater proportion of firms report increased challenge in raising capital currently compared with 12 months ago. This is particularly the case for those in the Property, Communications and Construction sectors. For Banking, Finance & Insurance firms the situation regarding access to capital may have been mitigated somewhat compared to last quarter, though still one in five reports a deterioration in access to capital compared to 12 months ago.

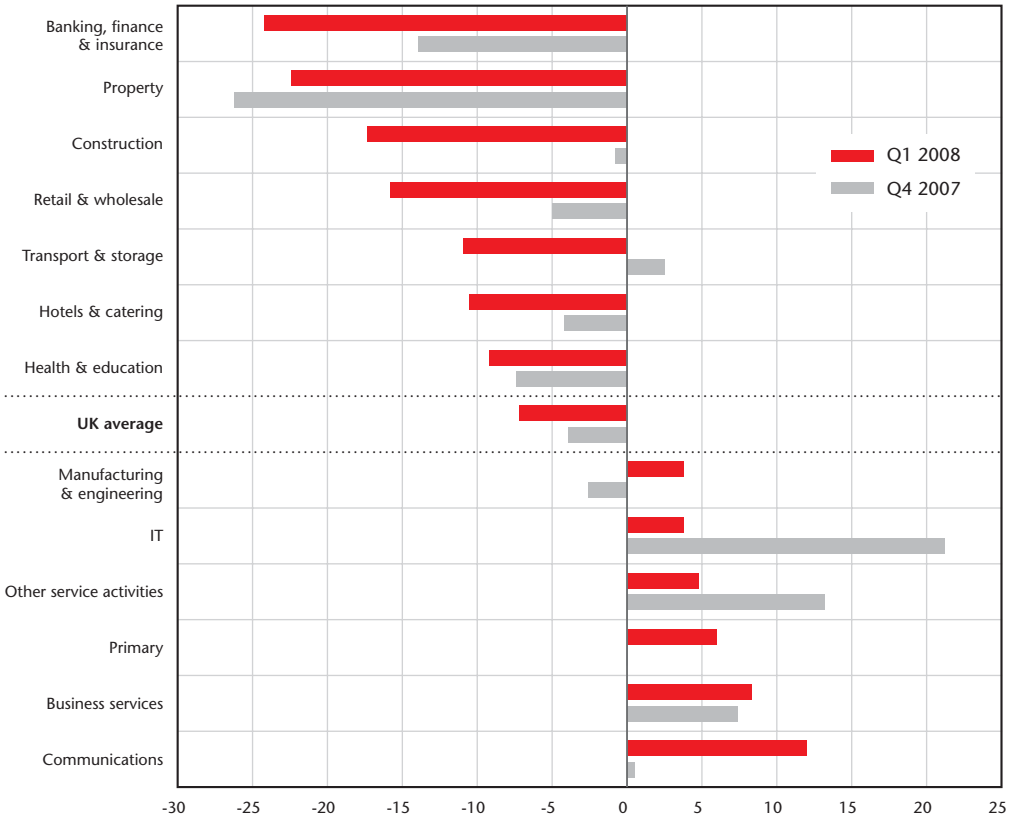
Fig. 4 Access to capital over last 12 months



TRENDS BY INDUSTRY

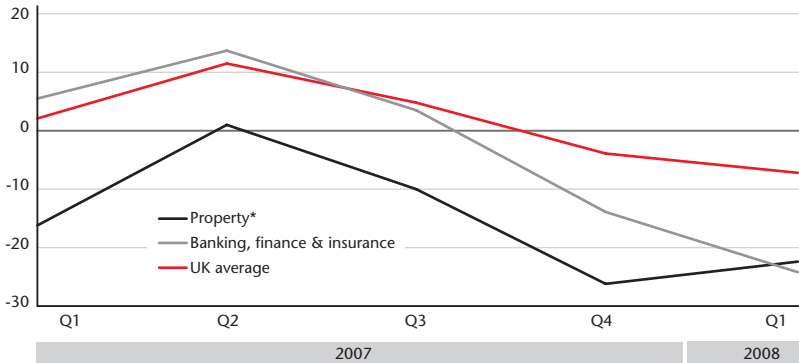
The Banking, Finance & Insurance and Property sectors continue to put the greatest downward pressure on the overall UK Confidence Index.

Fig. 5 BCM Confidence Index trend



Confidence in the Banking, Finance & Insurance sector stands at its lowest since this survey began. Banks are likely to remain uneasy for some time about providing credit, and concerns over exposure to a possible US recession will also continue to suppress confidence in this sector. At the same time, the decline in activity in the housing market has kept confidence in the Property sector low.

Fig. 6 BCM Confidence Index trend

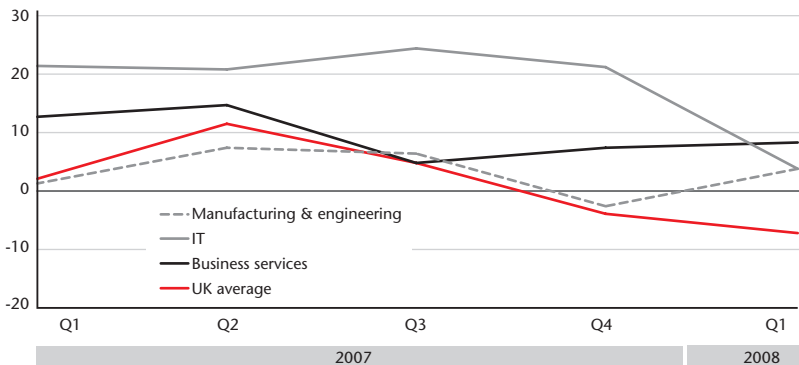


* Property low base in Q1 and Q2 2007

After recording the highest confidence of all sectors for six consecutive quarters, the IT sector saw its score plummet this quarter by 17.5 points. Despite the global boom of the internet the IT sector has, like most other sectors, become concerned that the US housing slump and possible recession could affect consumers, hence reducing growth in sales of IT products.

Confidence rose in the Manufacturing & Engineering sector this quarter, while the emerging positive trend for business confidence in the Business Services sector also continued.

Fig. 7 BCM Confidence Index trend



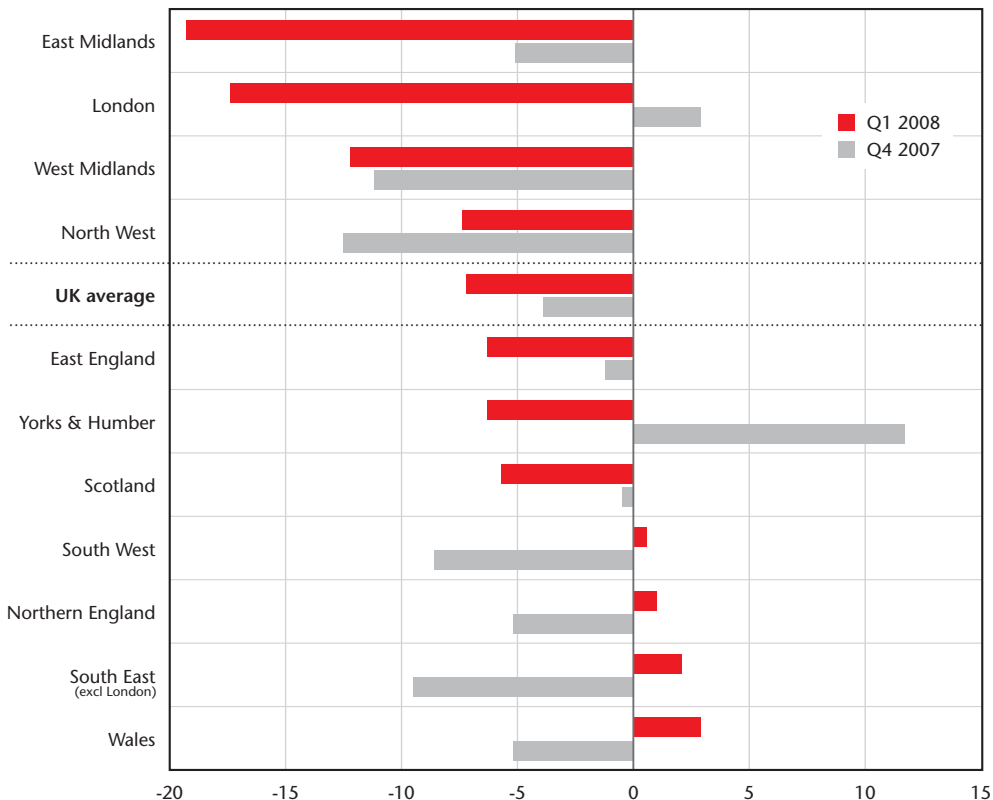
The decline in the pound over the past three months is likely to have boosted the outlook for Manufacturing while Business Services continue to be supported by sales of services such as law, architecture and accountancy to emerging markets. In addition, given contract time lags, the sector has not yet been affected by the turmoil in the City of London.

TRENDS ACROSS UK REGIONS

Confidence in London has slipped to the lowest level since this survey began. The decline in confidence in the IT sector this quarter added to overall pessimism in the City of London and Canary Wharf on how current financial uncertainties will play out.

The most negative region is the East Midlands where finance professionals record an index score of -19.3, down from -5.1 three months ago. The West Midlands region also registers a weak Confidence Index at -12.2. All but four other regions are also in the red.

Fig. 8 BCM Confidence Index trend



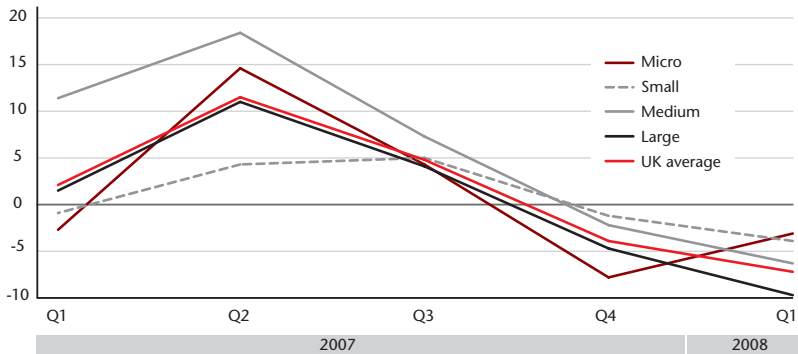
However, in some regions confidence has rebounded following a weak score three months ago. In the South East, confidence has strengthened on the back of a sustained positive outlook for Business Services and emerging markets. In the South West confidence also improved, supported by a more positive outlook for the Communications sector, while in Wales and the Northern region confidence also improved, returning the index in these regions to the black.

TRENDS BY SIZE OF BUSINESS

This quarter sees business confidence negative across all sizes of firm, with a clear relationship between company size and confidence: the larger the firm, the deeper the pessimism for business prospects.

The global outlook typically impacts large firms (250+ employees) more than smaller size businesses, as large firms are more likely to serve an international market.

Fig.9 BCM Confidence Index trend



The very largest firms – those employing more than 1,000 people – are more pessimistic still, registering a Confidence Index score of -12.5.

SOUTH EAST FINDINGS

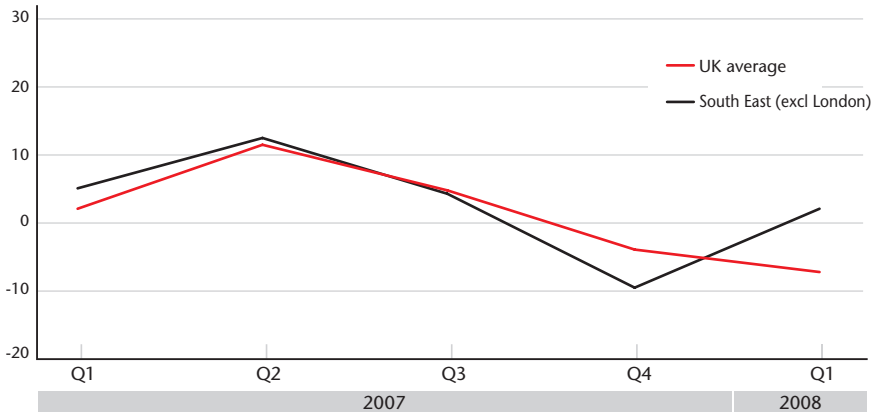


CONFIDENCE REBOUNDS IN SOUTH EAST FOLLOWING SHARP DECLINE LAST QUARTER

One hundred and forty-eight finance and accountancy professionals in the South East were interviewed and record a **Confidence Index score of +2.1** in the Q1 2008 ICAEW UK Business Confidence Monitor. In contrast with the UK-wide index, confidence in the region has rebounded this quarter from a low of -9.5 three months ago.

This rebound in confidence is probably an adjustment following a sharp decline in optimism last quarter. The longer-term trend in confidence remains in decline. Barring last quarter's score, the Q1 08 index is the lowest since the first quarter of 2007. Hence, while finance professionals in the region are becoming more pessimistic about their outlook, confidence has adjusted in line with a paced economic slowdown. In addition, the South East has been supported by sustained optimism in Business Services – the largest sector in the region.

Fig. 10 Trend of Business Confidence in the South East



TURNOVER GROWTH EXPECTATIONS ALSO REBOUND

In keeping with the overall business confidence in the region, turnover and profit expectations have also rebounded this quarter. However, at 6.8% and 6.1% respectively, expectations of turnover and profit growth remain below levels seen through most of 2006 and 2007.

OPTIMISTIC ON EXPORT GROWTH AND ON INFLATION

Over the past three months, expectations have readjusted regarding the annual rate of expansion for domestic sales and for exports. Sales volumes are seen increasing 6.9%, while exports are seen rising 4.7%. There is, however, the risk of these expectations not holding through, given the tight outlook for businesses and consumers through 2008.

Finance professionals in the South East also remain buoyant on inflation. They see price growth receding to 1.9%, from the 2.1% reported for the past 12 months. Across the country as a whole, consumer price inflation currently stands at 2.1%. A contributor to inflation will be input prices, which firms in the region believe will rise only 2.6% in the next 12 months, after rising 3.4% in the past 12 months.

INVESTMENT GROWTH TO SLUMP, BUT JOB CREATION TO HOLD OUT

In the South East businesses believe capital spending will only increase 1.4% in the coming 12 months, down from a surge of 3.4% seen in the past 12 months. This is likely to be caused by less finance being provided by banks and other investors. However, despite confidence being marginally above zero in the region, expectations are for job creation to be sustained. Headcount is foreseen increasing 2.0% in the coming 12 months, after a 1.9% increase since Q1 2007.

TECHNICAL INFORMATION

This research was conducted by the Institute of Chartered Accountants in England & Wales (ICAEW) with assistance from centre for economic and business research (cebr).

During the period 22 October 2007 to 8 January 2008, 1036 ICAEW members working in industry in the UK were interviewed by telephone. Questions covered past performance and future prospects for their businesses and perceived changes in impact of factors such as availability of skills, Government regulation and the tax regime.

Data has been weighted to ensure the profile of the survey sample accurately represents the UK Economy for company size (no. of employees), regional location and industry sector.

Further technical details and the full question set available upon request.

DETAILED RESULTS AND FURTHER INFORMATION

For more detailed results and analyses, and further information on BCM, please visit:

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