

BDO MONTHLY BUSINESS TRENDS INDICES

March 2013

INTRODUCTION

The BDO Monthly Trends Indices are ‘polls of polls’ that pull together the results of all the main UK business surveys. The Indices results in this March edition of the BDO Business Trends Report give the February Index numbers, using the results from business surveys that were carried out between the first and last days of last month.

Summary and key findings

| Index | Current reading | Movement in month | Index level |
|----------------------|-----------------|-------------------|---|
| BDO Output Index | x | — | 92.1 in February from 92.3 in January |
| BDO Optimism Index | x | ▲ | 90.6 in February from 88.9 in January |
| BDO Inflation Index | ✓ | ▲ | 101.5 in February from 100.4 in January |
| BDO Employment Index | x | — | 95.0 in February from 95.1 in January |

KEY: ✓ = above 100; ✓✓ = highest in 12 months; x = below 100; xx = lowest for 12 months

KEY FINDINGS

There have been further signs of weakening in the short term UK business outlook, as the BDO Output Index fell back to 92.1 in February, marginally down on a January reading of 92.3. This low but broadly stable Index level suggests that growth will remain muted during the first half of 2013, as the Output Index continues to stand below the 95.0 level that indicates positive growth in three months' time. The Output Index stood at 94.1 for manufacturers in February, up on January's reading of 92.3, but still signalling contraction in three months' time. The Index fell to 91.5 for services firms, down from 92.3 in January. This is a cautionary sign for the UK economy, as the services sector makes up about three quarters of total output.

Confidence among UK businesses strengthened in February as the BDO Optimism Index rose to 90.6. This is up on January's Index reading of 88.9, which was the lowest reading since the index began in 1992. Despite this small rebound, business confidence is still weak. Elevated inflation, combined with weak wage growth, will constrain consumer spending. The export environment remains challenging, as UK businesses still rely on the struggling Eurozone as their largest trading partner. Finally, government spending cuts will act as a drag in 2013. Overall, substantial downside risks remain for the UK economy which will limit businesses' confidence and their willingness to invest.

Inflationary pressures are returning to the UK business environment as the BDO Inflation Index climbed to 101.5 in February, up from a January reading of 100.4. The last time the Index was higher was in September 2012. Recent depreciation in the value of sterling means the price of crude oil remains high, following dollar price increases earlier in the year. This is increasing the costs faced by businesses, particularly in energy-intensive sectors such as manufacturing. Rising energy costs combined with high food price inflation means the cost of living continues to rapidly grow for consumers, constraining real spending power.

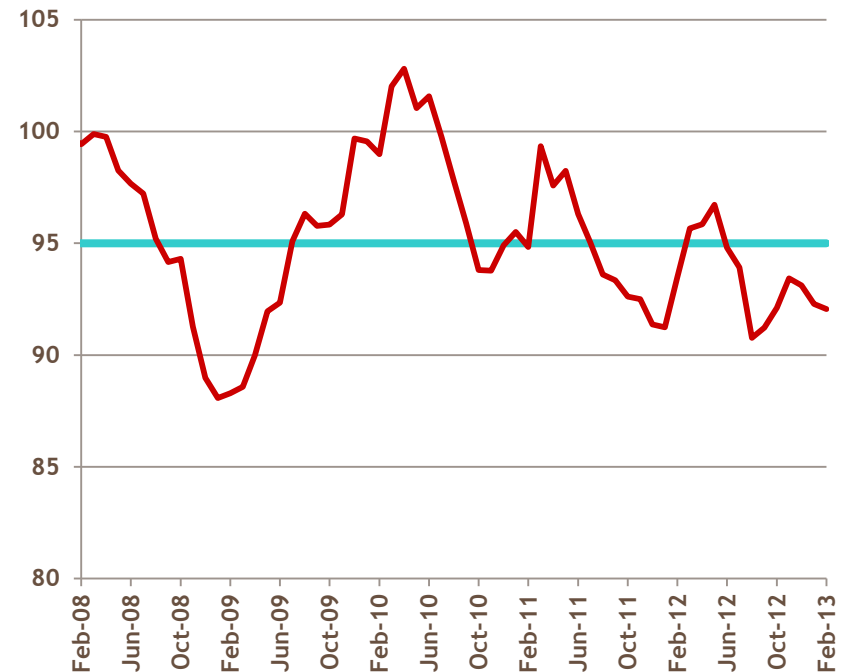
The BDO Employment Index stood at 95.0 in February. While this is just down on the January reading of 95.1, it still indicates that employment intentions are holding up better than output growth. Unemployment fell over 2012 even as the economy stagnated. During the last three months of 2012, the unemployment rate stood at 7.8%, down 0.6 percentage points on a year earlier. Although February's Index score suggests that private sector employment could rise over the coming three months, planned public sector job losses will act in the opposite direction, placing upward pressure on the unemployment rate.

OUTPUT INDEX DOWN FOR A THIRD CONSECUTIVE MONTH AS GROWTH REMAINS ELUSIVE

- The short term business outlook was marginally down in February, as the BDO Output Index fell slightly to a reading of 92.1 from 92.3 in January.
- The Index has now been below the 95.0 level which indicates output growth a quarter down the line since June 2012. The Index has generally been declining since November.
- These weak readings suggest economic conditions will remain challenging until at least mid-2013.
- The latest Office for National Statistics data confirmed that the UK economy shrunk by 0.3% over Q4 2012. Services sector output declined by 0.1%, while output in the manufacturing sector fell by 1.3%.
- An unusually long maintenance period for North Sea oil fields contributed to the decline in overall Q4 economic activity. Stripping out this North Sea oil effect, the on-shore economy performed marginally better than the headline figure suggests for the final three months of 2012.
- February's weak Index reading, combined with constrained consumer spending power, subdued Eurozone demand and Government fiscal austerity, suggests the economy will struggle to grow over the first half of 2013.

BDO OUTPUT INDEX

100 = average trend growth. Greater than 95 = positive growth



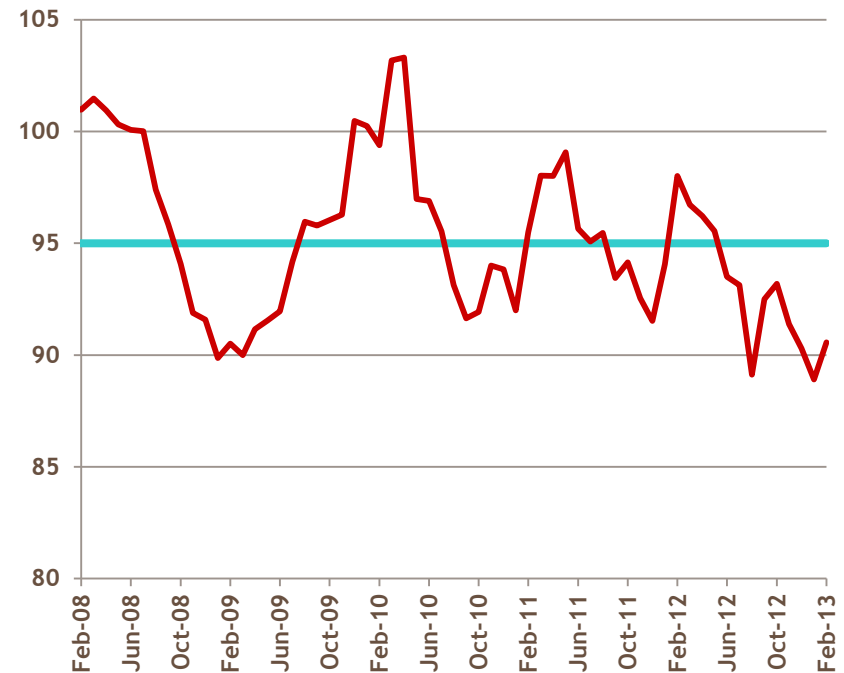
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

CONFIDENCE REMAINS FRAGILE GIVEN WEAK BUSINESS OUTLOOK

- Business confidence remained weak in February, as the BDO Optimism Index reported a low reading of 90.6.
- While the Index reading was muted, it is up on January's reading of 88.9, which was the lowest reading since the Index began in 1992. February's upward movement also broke a string of three consecutive monthly declines in the Index.
- However, February was the ninth consecutive month that the Index has recorded a score of less than 95.0, indicating continued weak conditions six months down the line. This highlights the lackluster UK business outlook and suggests that the economy will struggle to grow significantly this year.
- Weak demand from the moribund Eurozone, the UK's main trading partner, is likely to be subduing confidence. In addition, domestic demand is expected to be held back in real terms by persistently high inflation.
- Although just up on last month, the Optimism Index was 89.6 for the services sector. The sector constitutes roughly three quarters of the UK economy, so this very subdued reading is cause for concern.

BDO OPTIMISM INDEX

100 = average trend growth. Greater than 95 = positive growth



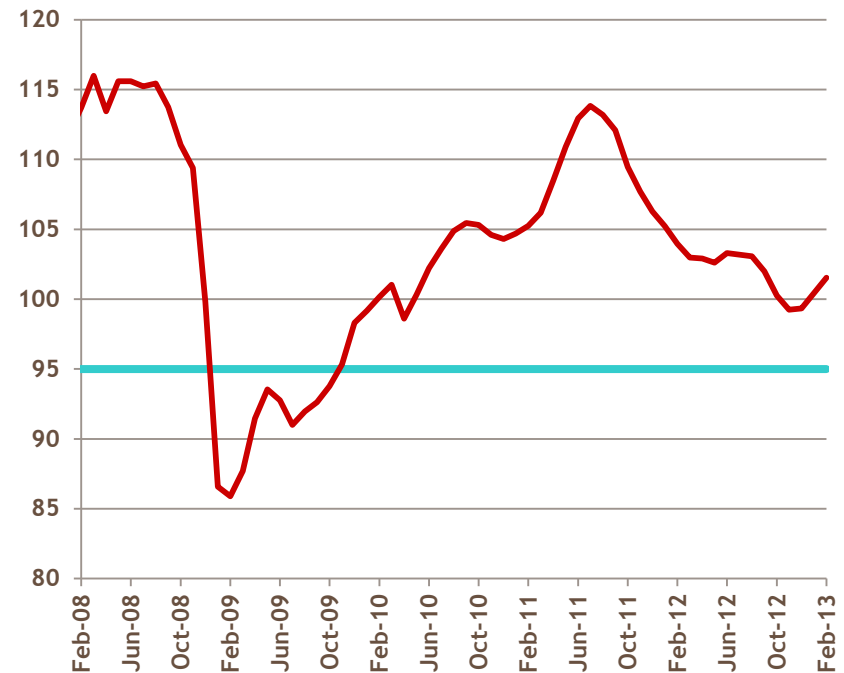
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

STERLING DEPRECIATION STOKES INFLATIONARY PRESSURE

- The BDO Inflation Index rose to 101.5 in February, up from January's reading of 100.4. The Index has now risen for three consecutive months and is at its highest level since September 2012.
- This indicates that inflationary pressures could hamper business performance over the coming three months.
- Sterling has weakened markedly over the past two months as the Government has struggled to get the UK's fiscal house in order. A weak sterling feeds through into higher import prices, pushing up businesses' costs.
- UK businesses in energy-intensive sectors such as manufacturing will be particularly sensitive to rises in energy prices arising from sterling depreciation.
- Moreover, a modest acceleration in global economic growth in 2013, driven by emerging markets as developed economies remain weak, is likely to put further upward pressure on commodity prices.
- Consumer price inflation held steady at 2.7% for the fourth consecutive month in January, above the Bank of England's 2.0% target, driven by rising energy and food prices.

BDO INFLATION INDEX

100 = average trend growth. Greater than 95 = positive growth



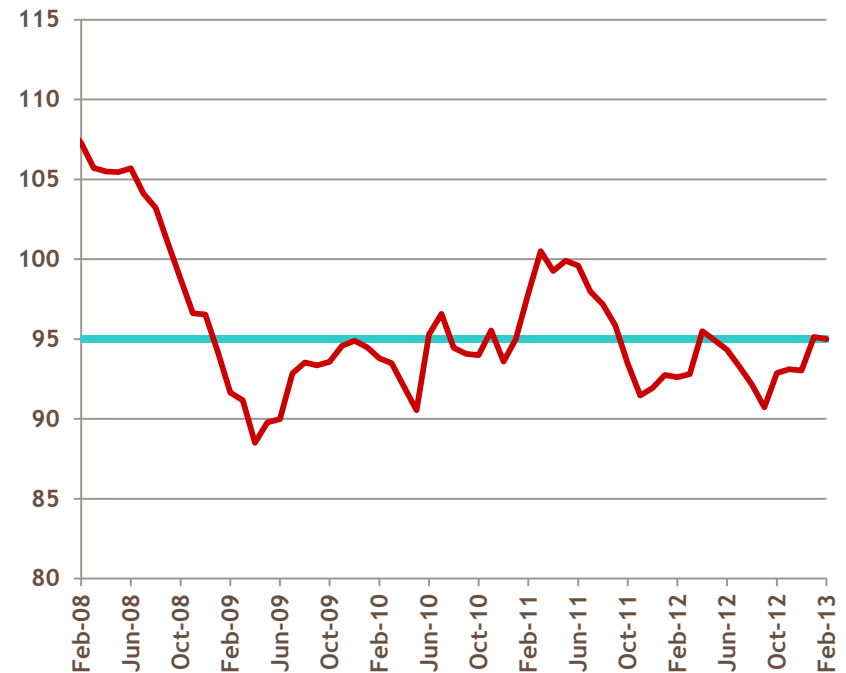
Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

EMPLOYMENT INDEX POINTS TO STRENGTHENED HIRING INTENTIONS

- February's BDO Employment index shows businesses are increasing their hiring intentions despite the weak economic environment. The Index stood at 95.0 in February, just down on January's reading of 95.1 but well above the low of 90.7 recorded in September.
- A reading of 95.0 or higher points to intentions to increase staffing levels three months down the line.
- The latest Office for National Statistics labour market data show that the unemployment rate stood at 7.8% over the final quarter of 2012. This is down 0.1 percentage points on the previous quarter and 0.6 percentage points on Q4 2011.
- Given the fragile state of the economy, a declining unemployment rate is welcome news. However, planned public sector headcount cuts will put upward pressure on the unemployment rate, despite February's Index score suggesting that private sector employment could rise over the coming quarter.
- The price of falling unemployment has been weak wage growth. Over the year to Q4 2012, regular pay rose by only 1.3%. This is far lower than the rate of inflation and shows that real incomes continue to decline.

BDO EMPLOYMENT INDEX

100 = average trend growth. Greater than 95 = positive growth



Source: Markit / CIPS PMI, Bank of England, CBI, Eurostat, Office for National Statistics and Cebr analysis

BDO INDICES TO LATEST MONTH

| | | Feb | Mar | Apr | May | June | July | Aug | Sept | Oct | Nov | Dec | Jan | Feb |
|--------------------------|--------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|-------|-------|
| The BDO Optimism Index | Total | 98.0 | 96.7 | 96.2 | 95.5 | 93.5 | 93.1 | 89.1 | 92.5 | 93.2 | 91.4 | 90.3 | 88.9 | 90.6 |
| | Small | 96.9 | 95.7 | 95.2 | 94.5 | 92.5 | 92.1 | 88.1 | 91.5 | 92.2 | 90.4 | 89.3 | 87.9 | 89.6 |
| | Large | 98.7 | 97.5 | 96.9 | 96.3 | 94.2 | 93.8 | 89.8 | 93.2 | 93.9 | 92.1 | 91.0 | 89.6 | 91.3 |
| | Manuf. | 96.9 | 94.6 | 96.5 | 92.2 | 83.8 | 90.5 | 80.5 | 90.2 | 89.2 | 85.9 | 91.9 | 95.2 | 94.5 |
| | Service | 98.3 | 97.3 | 96.1 | 96.4 | 95.9 | 93.8 | 91.3 | 93.1 | 94.2 | 92.8 | 89.9 | 87.3 | 89.6 |
| The BDO Output Index | Total | 93.5 | 95.7 | 95.8 | 96.7 | 94.8 | 93.9 | 90.8 | 91.2 | 92.1 | 93.4 | 93.1 | 92.3 | 92.1 |
| | Small | 91.9 | 94.1 | 94.2 | 95.1 | 93.2 | 92.3 | 89.3 | 89.7 | 90.6 | 91.9 | 91.6 | 90.7 | 90.5 |
| | Large | 94.8 | 97.0 | 97.1 | 98.0 | 96.1 | 95.2 | 92.0 | 92.5 | 93.4 | 94.7 | 94.4 | 93.5 | 93.3 |
| | Manuf. | 93.6 | 95.5 | 96.6 | 94.6 | 90.5 | 89.2 | 85.1 | 87.3 | 87.0 | 88.8 | 90.6 | 92.3 | 94.1 |
| | Service | 93.5 | 95.7 | 95.6 | 97.3 | 95.9 | 95.1 | 92.2 | 92.2 | 93.4 | 94.6 | 93.8 | 92.3 | 91.5 |
| The BDO Inflation Index | Total | 104.0 | 103.0 | 102.9 | 102.6 | 103.3 | 103.2 | 103.1 | 102.0 | 100.2 | 99.2 | 99.3 | 100.4 | 101.5 |
| The BDO Employment Index | Total | 92.6 | 92.8 | 95.5 | 94.9 | 94.3 | 93.3 | 92.1 | 90.7 | 92.9 | 93.1 | 93.0 | 95.1 | 95.0 |

FOR FURTHER DETAILS

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METHODOLOGICAL NOTES

The BDO Monthly Business Trends Indices are prepared on behalf of BDO LLP by the Centre for Economics and Business Research, a leading independent economics consultancy. Cebr has particular strengths in all forms of macroeconomic and market forecasting for the UK and European economies and in the use of business survey techniques.

The indices are calculated by taking a weighted average of the results of the UK's main business surveys. It incorporates the results of the quarterly CBI Industrial Trends Survey (and the CBI Monthly Trends Enquiry which is carried out in the intervening months); the Bank of England Agents' summary of business conditions; the Chartered Institute of Purchasing and Supply's Surveys of Manufacturing and of Services; and Eurostat's monthly business surveys.

Taken together the surveys cover over 4,000 different respondent companies, covering a range of different industries and of different business functions. Together they make up the most representative measure of business trends available.

The surveys are weighted together by a three-stage process. First, the results of each individual survey are correlated against the relevant economic cycles for manufacturing and services. This determines the extent of the correlations between each set of survey results and the relevant timing relationships. Then the surveys are weighted together based on their scaling, on the extent of these correlations and the timing of their relationships with the relevant reference cycles. Finally, the weighted total is scaled into an index with 100 as the mean, the average of the past two cyclical peaks as 110 and the average of the past two cyclical troughs as 90.

The results can not only be used as indicators of turning points in the economy but also, because of their method of construction, be seen as leading indicators of the rates of inflation and growth.