
IoD Business Opinion Survey
December 2000

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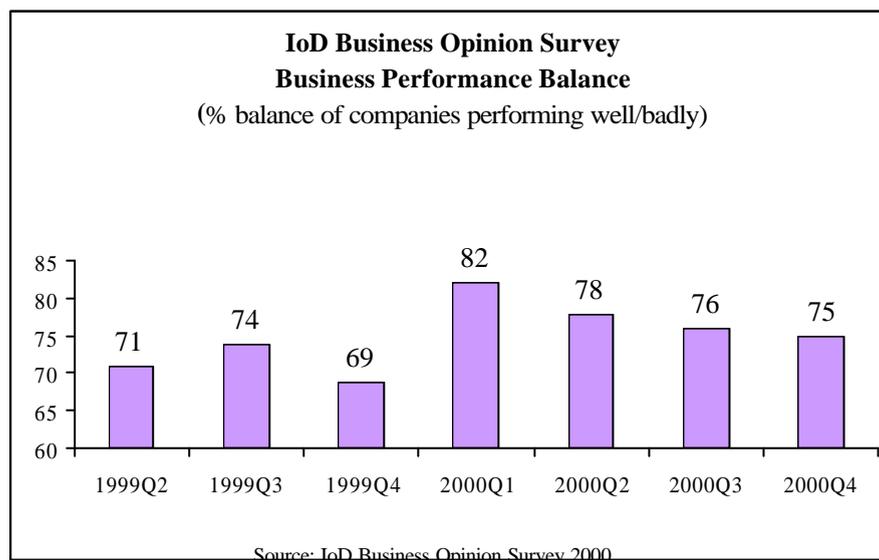
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Summary

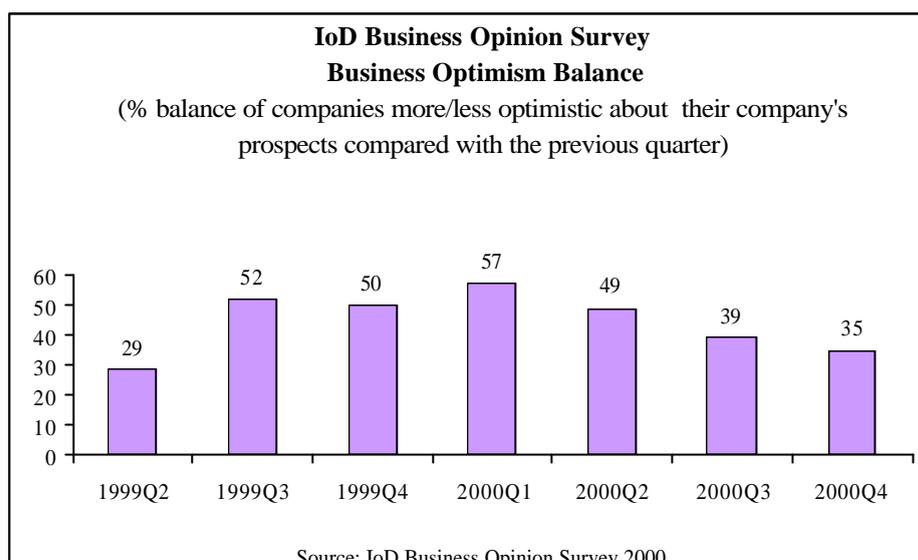
The latest Business Opinion Survey (BOS) from the IoD shows that company performance levels continue to be maintained. Across a whole range of indicators the latest results are very similar to those in the previous survey. Whilst inflationary pressures remain benign, the survey shows that there are no grounds for complacency. Pay settlements have edged upwards to 4.5%. In addition, the balance of company directors expecting higher versus lower prices has jumped from 10% to 23% in the latest survey.

In the latest survey the balance of those companies performing well, versus those performing badly, showed a balance of 75%. Almost identical to the two previous survey results.



The survey results show significant differences in performance across different sectors. In the previous survey the sectoral balance ranged from 70% in manufacturing to 81% in business services. In the latest survey the range has widened from 59% in manufacturing to 86% in non-business services.

The balance of respondents who describe themselves as more rather than less optimistic about their company's prospects - relative to three months previously - slipped further to 35%. In September the balance was 39%, in June 49% and in March 2000 it was 57%.



As with the business performance measure, there are variations in optimism by sector, although this is partly explained by sampling issues. The balance of company optimism fell in manufacturing and business services, but rose in distribution and non-business services.

The capacity utilisation balance improved a fraction from -8% to -6% in the latest survey. The balance now stands at its highest level for three years. However, the manufacturing balance remains in the doldrums, having fallen from -27% to -31% in the latest survey.

The balance on order books is roughly flat compared with the previous survey, having moved from 24% to 27%. The export order books balance is also flat, having moved from 2% to zero in the latest survey.

Compared with the previous survey, both reported and expected employment balances are little changed. The reported employment balance edged up from 22% to 25%, whilst the expected employment balance rose from 27% to 31%.

With the exception of manufacturing, reported and expected employment balances are very similar across sectors.

In the latest survey the reported output balance stands at 43%, compared with 41% in the previous survey. The expected output balance has fallen from 55% to 48% over the same period. Reported and expected profits balances are flat. The balance on reported profits has moved from 19% to 18% whilst that for expected profits has also fallen slightly from 36% to 34%. It should also be noted that the expected profits balance exhibited a sharp fall in the previous survey, when it declined from 48% to 36%.

Both reported and expected costs balances are flat. The reported costs balance edged a little higher from 36% to 38%, whilst the expected costs balance increased from 38% to 39%.

The balance in reported prices was 8% in the latest survey, compared with 7% previously. However, there was a big swing in the expected prices balance which moved upwards from 10% to 23%.

The balance on reported prices was weakest in manufacturing and distribution, and strongest in non-business services, business services and the 'other' sector. This was similar to the previous survey result.

The balance of those company directors reporting a higher pay award - compared with their previous pay award - versus those reporting a lower pay award, fell back from 23% to 16% in the latest survey. In June 2000 this balance was 14% and in March 2000 it was zero.

Survey Method

The IoD Business Opinion Survey is designed to provide an up-to-date indication of current trends within the UK economy. The survey is carried out on behalf of the IoD by NOP Business and is conducted every three months by telephone.

The results presented in this summary are based on interviews with 500 members of the IoD carried out between 28 November - 12 December 2000. The sample was randomly drawn from the IoD membership database and is structured so as to be representative in terms of company size, industrial sector and region. A detailed breakdown of the sample structure is provided in the data tables. For simplicity, different types of firms are referred to as follows:

Size

1 - 20 employees	“Micro”
21 - 100 employees	“Small”
101 - 200 employees	“Medium”
201+ employees	“Large”

Sectors

Manufacturing	
Distribution	
Others including construction/mining/transport	“Others (including construction)”
Government/Educational/Medical/Personal services	“Non-business services”
Business/Finance/Professional services	“Business services”

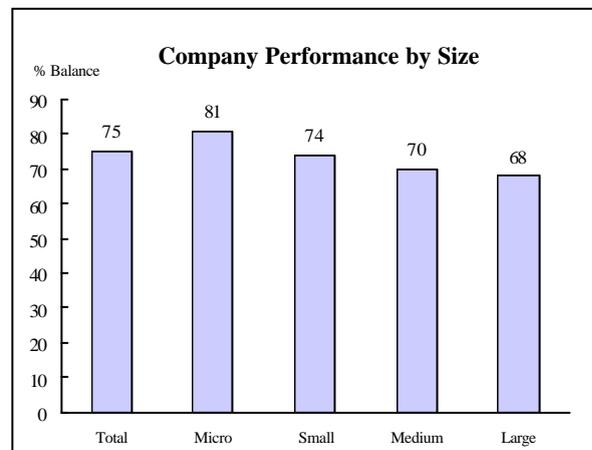
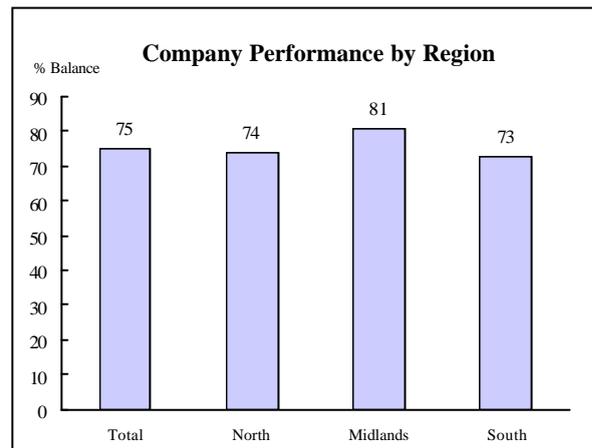
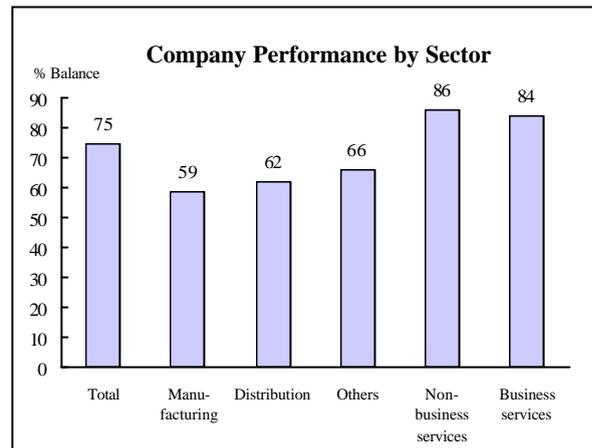
In order to give a simple, clear indication of the trend in any particular variable, the survey results are summarised throughout in terms of a positive or negative balance. The balance is computed by simply subtracting the number of respondents replying less/down/badly to a question from those replying up/more/well to give a single number.

Survey Results

Company Performance

<i>How well is your company performing overall?</i>	
Well	81%
Neither well nor badly	12%
Badly	7%
Balance	+75

- The latest Business Opinion Survey (BOS) from the IoD shows that company performance levels continue to be maintained. In the latest survey the balance of those companies performing well, versus those performing badly, showed a balance of 75%. Almost identical to the two previous survey results.
- The latest survey shows greater differences in performance across different sectors. In the previous survey the sectoral balance ranged from 70% in manufacturing to 81% in business services. In the latest survey the range has widened from 59% in manufacturing to 86% in non-business services.
- Company performance by region is very similar to before, ranging from 73% in the South to 81% in the Midlands.
- There has been a sharp turnaround in company performance by size. In the previous survey the performance balance was highest in the largest companies, at 85%. However, in the latest survey the performance balance is lowest in the largest companies, at 68%. This may well be attributable to the relatively small size of the disaggregated sample groups.

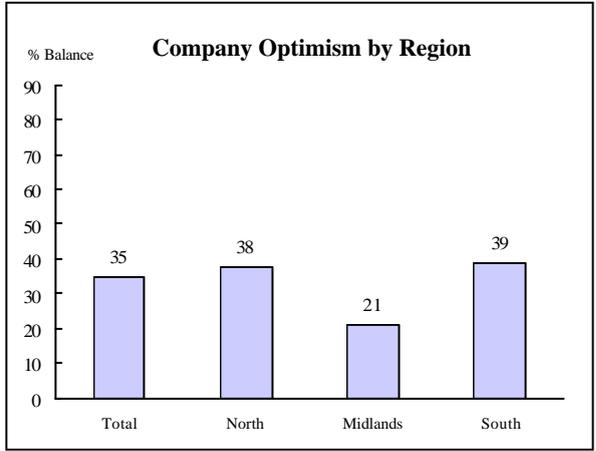
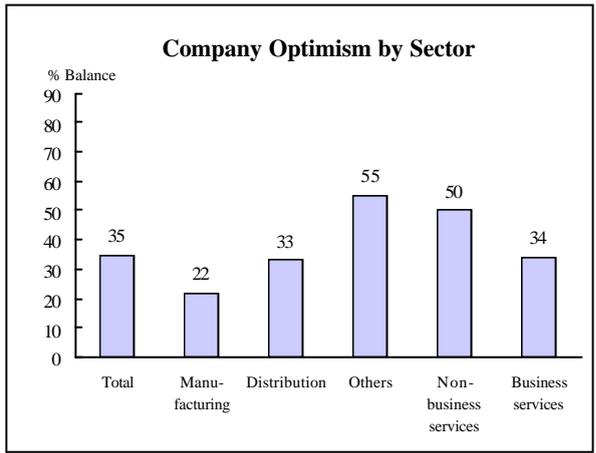


Company Optimism

- In the latest survey the balance of respondents who describe themselves as more rather than less optimistic about their company's prospects - relative to three months previously - slipped further to 35%. In September the balance was 39%, in June 49% and in March 2000 it was 57%.
- The survey shows considerable variation in optimism by sector, although this again could partly be attributable to sampling issues. The balance of company optimism fell in manufacturing and business services, but rose in distribution and non-business services.
- Company optimism by region is very similar to that in the previous survey, although the balance for Midlands based companies has deteriorated. The deterioration in optimism in Midlands based companies accounts for the overall fall in company optimism.

Are you generally more or less optimistic than you were three months ago about your company's prospects?

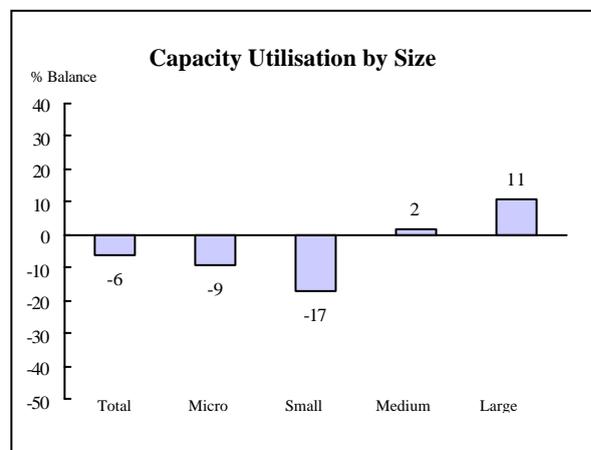
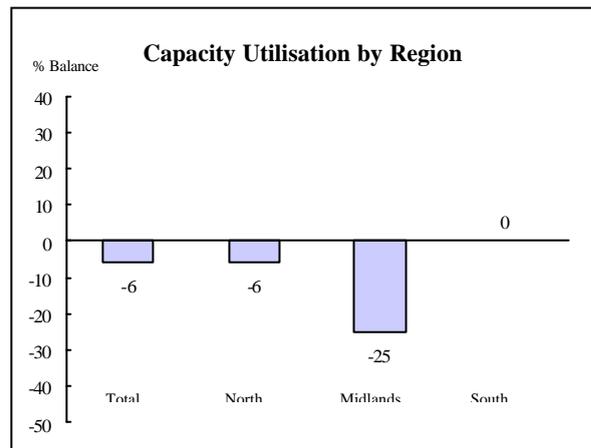
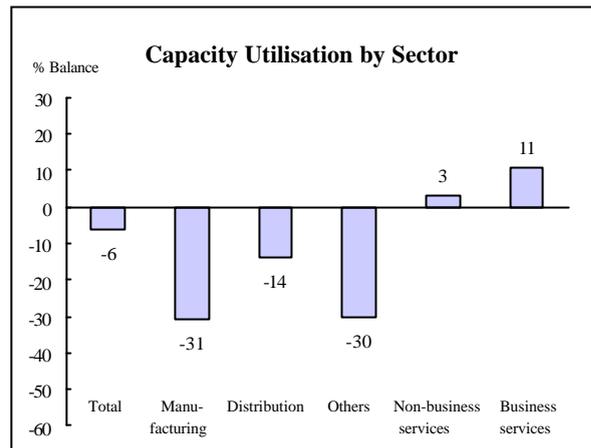
More	53%
Same	29%
Less	18%
Balance	+35



Capacity Utilisation

<i>Are you currently operating at full capacity?</i>	
Yes	47%
No	53%
Balance	-6

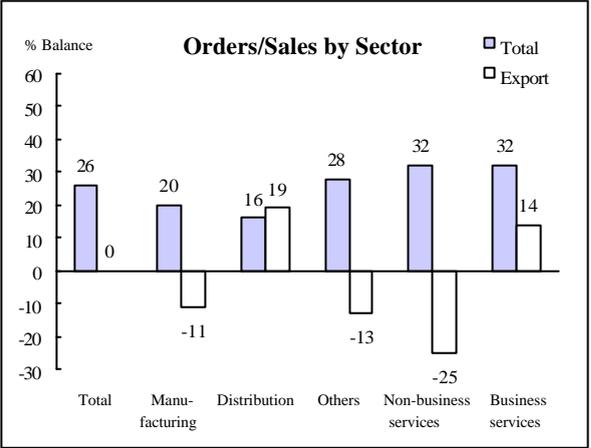
- The capacity utilisation balance improved a fraction from -8% to -6% in the latest survey. The balance now stands at its highest level for three years.
- Clear sectoral differences are evidenced in the capacity utilisation balance. The balance for business and non-business services is positive whilst that for manufacturing and distribution is negative. The manufacturing balance remains in the doldrums having fallen from -27% to -31% in the latest survey whilst that for the 'other' sector has also noticeably deteriorated.
- Capacity utilisation by region also shows the Midlands to be the most downcast, whereas in the previous survey it was the North.
- Capacity utilisation by company size is very similar to the previous survey, although it has fallen in medium sized companies and increased in large enterprises.



Order Books

- The balance on order books is roughly flat compared with the previous survey, having moved from 24% to 27%. The export order books balance is also flat, having moved from 2% to zero in the latest survey.
- The order books balance by sector ranges from 16% in distribution to 32% in business and non-business services. This is similar to the previous survey profile, although there has been a pick-up in non-business services.
- The export order books balance ranges from -25% in non-business services to 19% in distribution. This represents a big swing because in the previous survey the balance ranged from -27% in distribution to 10% in non-business services.
- Overall order books by region are very similar, whilst export order books differ widely, from -12% in the North to 17% in the Midlands. In the previous survey the order balance ranged from -23% in the Midlands to 10% in the North.

<i>Order books</i>	
Above normal	40%
Normal	42%
Below normal	14%
Balance	+27
<i>Export order books</i>	
Above normal	14%
Normal	19%
Below normal	14%
Balance	0%

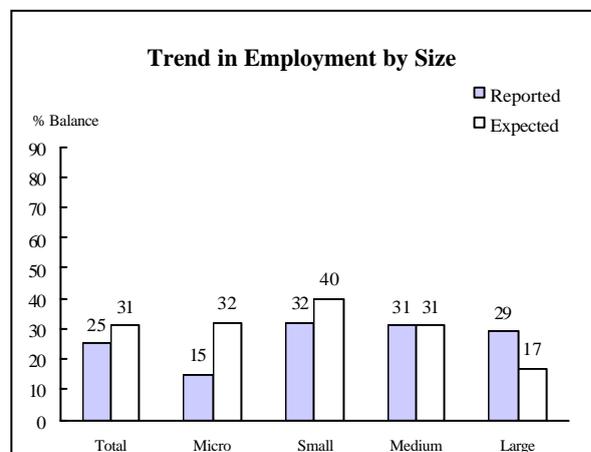
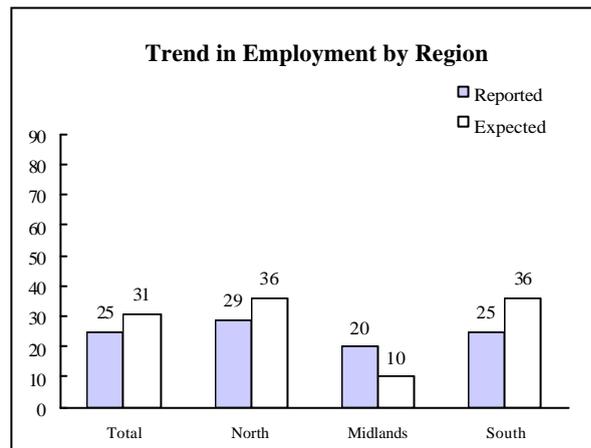
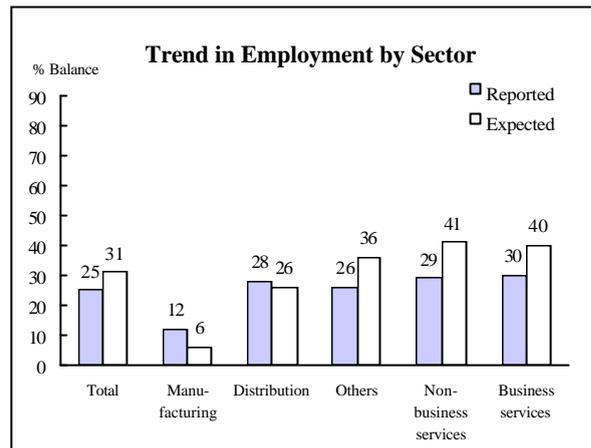


Employment

Trend in Numbers Employed

	Reported	Expected
Up	40%	41%
Same	44%	49%
Down	15%	9%
Balance	+25	+31

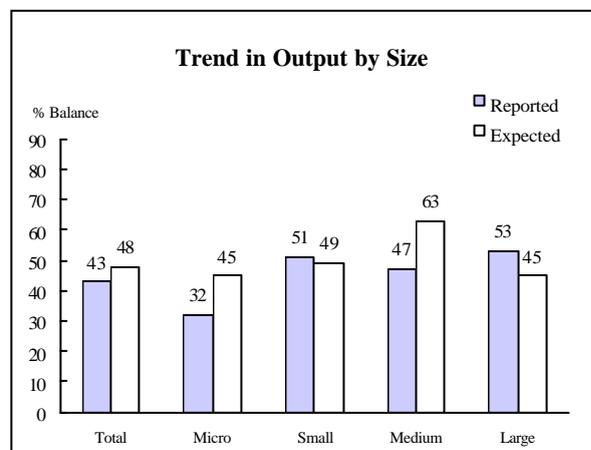
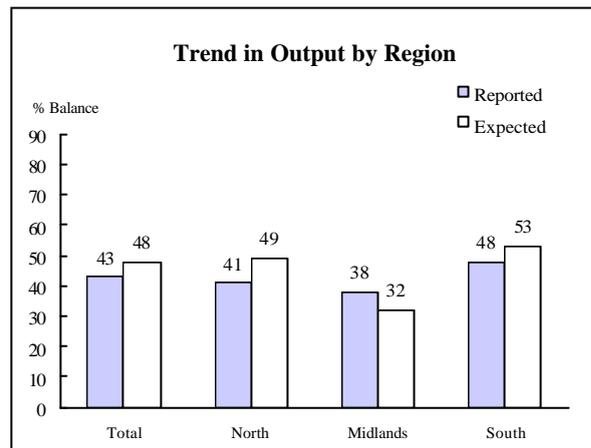
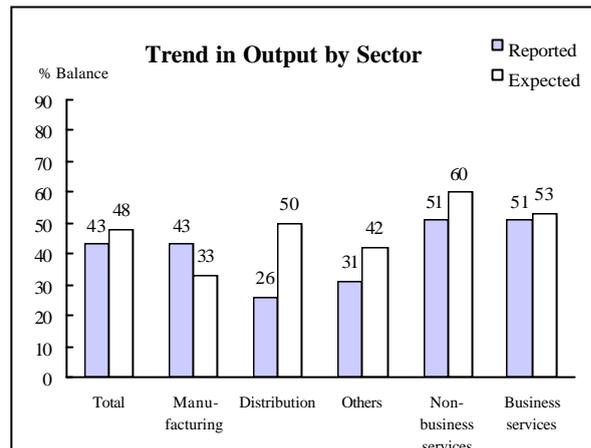
- Compared with the previous survey, both reported and expected employment balances are essentially flat. The reported employment balance edged up from 22% to 25%, whilst the expected employment balance rose from 27% to 31%.
- With the exception of manufacturing, reported and expected employment balances are very similar across sectors.
- Both reported and expected employment balances are noticeably worse in the Midlands. Reported employment balances are similar across different company sizes, with the exception of micro enterprises where the balance is weakest. In contrast, expected employment balances are also similar across different sizebands, with the exception of the largest enterprises, where the balance is weakest.



Output

<i>Trend in Output</i>		
	Reported	Expected
Up	53%	57%
Same	33%	35%
Down	11%	8%
Balance	+43	+48

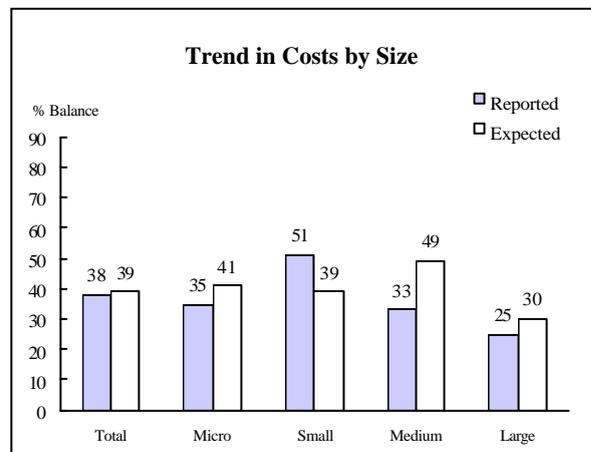
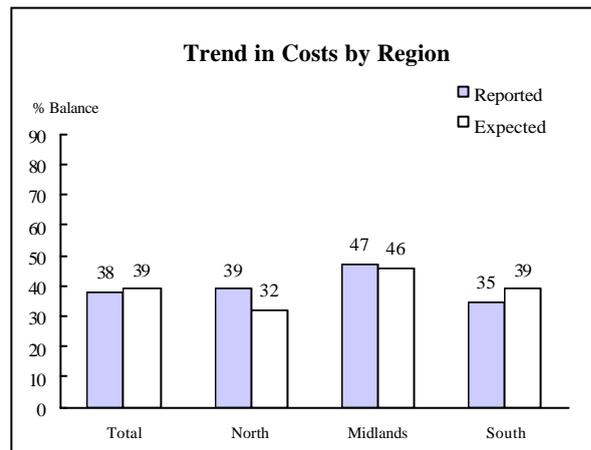
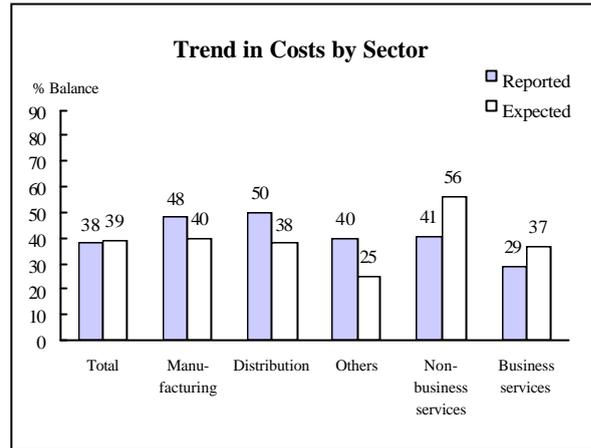
- In the latest survey the reported output balance stands at 43%, compared with 41% in the previous survey. The expected output balance has fallen from 55% to 48% over the same period.
- By sector, reported output balances have improved in manufacturing, business and non-business services. Expected output balances have fallen sharply in manufacturing, slightly in distribution and also from a high position in non-business services. The expected output balance has improved in business services.
- Trends in output by region are similar to before, although again, the performance in the Midlands is weakest.



Costs

	Reported	Expected
Up	47%	48%
Same	43%	42%
Down	9%	10%
Balance	+38	+39

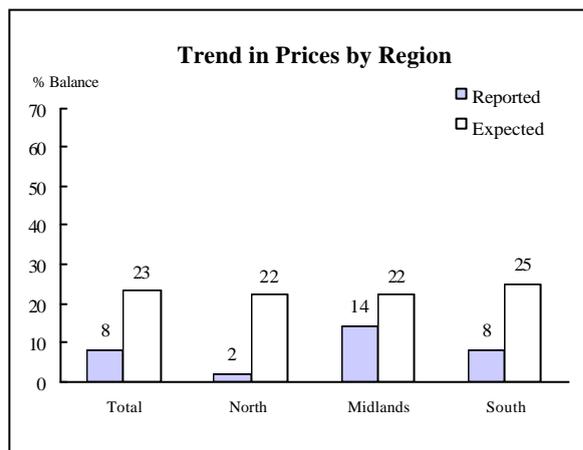
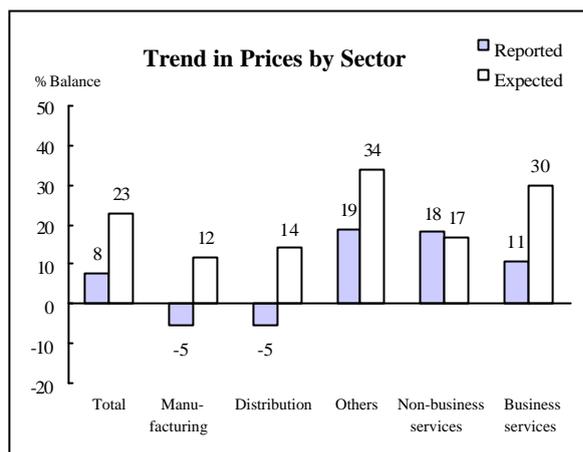
- Both reported and expected costs balances are very similar to those recorded in the previous survey. The reported costs balance edged a little higher from 36% to 38%, whilst the expected costs balance increased from 38% to 39%.
- Sectorally there was a noticeable pick-up in the reported costs balance for manufacturing which jumped from 35% to 48%, in distribution from 42% to 50% and in non-business services from 27% to 41%. However, in the 'other' sector it fell from 50% to 40%.
- Trends in the reported cost balance by region were unchanged in the South but moved higher in the Midlands and the North.



Prices

	Reported	Expected
Up	19%	30%
Same	70%	63%
Down	11%	7%
Balance	+8	+23

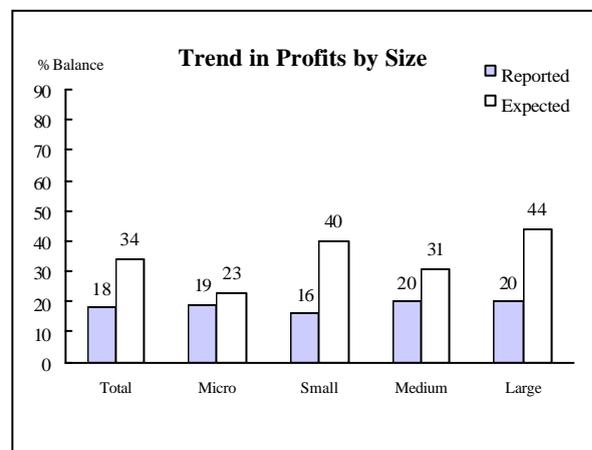
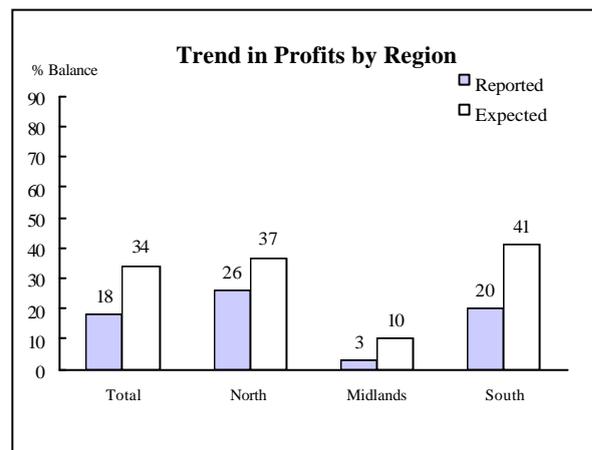
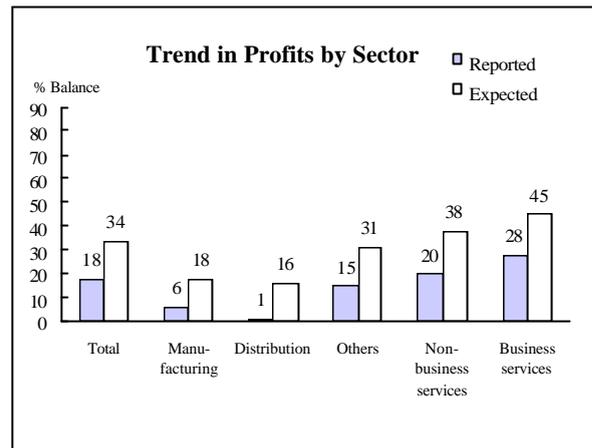
- The balance in reported prices was 8% in the latest survey, compared with 7% previously. However, there was a big swing in the expected prices balance which moved upwards from 10% to 23%.
- The balance on reported prices was weakest in manufacturing and distribution, and strongest in non-business services, business services and the 'other' sector. This was similar to the previous survey result.
- The expected prices balance picked up from 6% to 12% in manufacturing, from 7% to 14% in distribution, from 17% to 34% in the 'other' category and from 10% to 30% in business services.



Profits

<i>Trend in Profits</i>		
	Reported	Expected
Up	40%	46%
Same	39%	41%
Down	21%	12%
Balance	+18	+34

- Reported and expected profits balances are flat. The balance on reported profits has moved from 19% to 18% whilst that for expected profits has also fallen slightly from 36% to 34%. It should also be noted that the expected profits balance exhibited a sharp fall in the previous survey, when it declined from 48% to 36%.
- Unsurprisingly, the balances for both reported and expected profits are highest in business and non-business services. Whilst the balances on reported profits for the business and non-business services sectors have been essentially flat quarter on quarter, the reported balance for manufacturers has fallen from 17% to 6% and in distribution from 9% to 1%.
- The expected profits balance has collapsed from 43% to 18% in manufacturing, whilst rising sharply from 9% to 31% in the 'other' category.

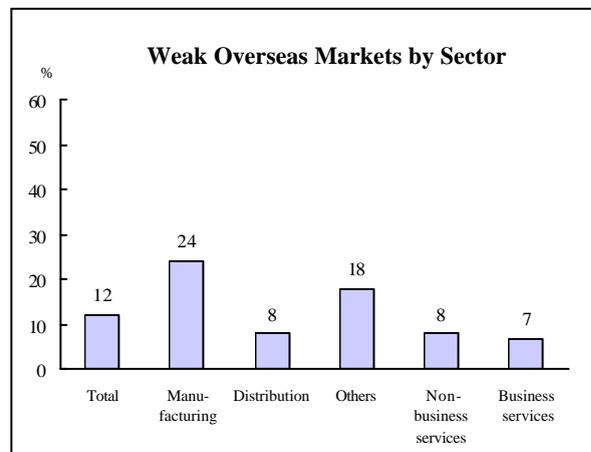
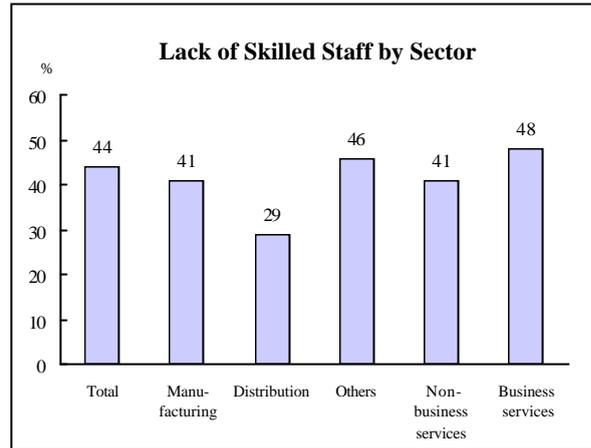


Factors limiting output

What factors are likely to limit output over the next three months?

Lack of skilled staff	44%
Lack of orders/sales	40%
Weak overseas markets	12%
Credit or finance	12%
Other staffing problems	20%
Plant capacity	9%
Lack of materials or components	8%

- **Factors limiting output show little change compared with the previous survey. Lack of skilled staff and lack of orders/sales remain the priority concerns.**



Pay

- The balance of those company directors reporting a higher pay award - compared with their previous pay award - versus those reporting a lower pay award, fell back from 23% to 16% in the latest survey. In June 2000 this balance was 14% and in March 2000 it was zero.
- The average pay settlement has edged upwards to 4.5% in the latest survey from 4.1% previously. The latest settlement figure reverses the Autumn 2000 decline and takes pay settlements back towards the June 2000 survey figure of 4.6%.

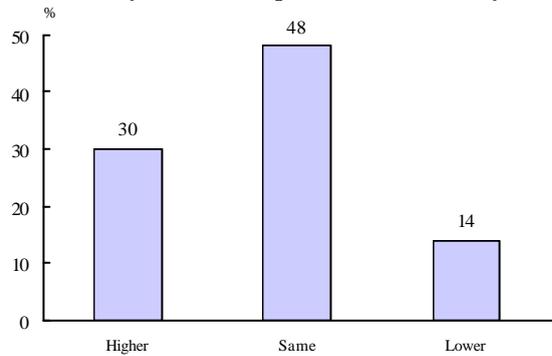
If you made a pay award in the last 3 months, what was the average percentage increase?

2% or less	5%
2-3%	27%
3-4%	19%
4-5%	20%
5-7.5%	9%
7.5% or more	21%

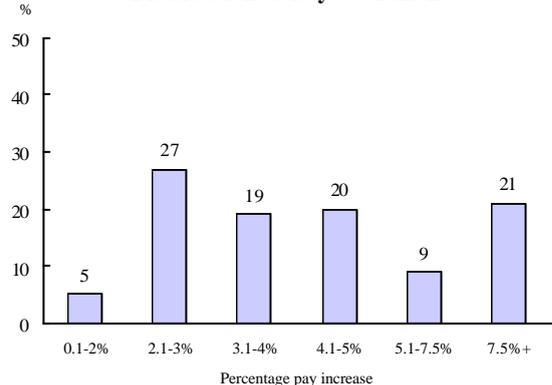
How did it compare with the previous pay award?

Higher	30%
Same	48%
Lower	14%
Balance	+16

Current Pay Award Compared to Previous Pay Award



Distribution of Pay Settlements



Investment

- Investment intentions in buildings are almost identical to the previous survey. However, investment intentions in plant, machinery and equipment have edged up in the latest survey. The balance of those expecting to invest more versus less in plant, machinery and equipment has edged up from 32% to 38%. There has been a similar rise in the balance for product and process innovation/R&D from 31% to 37%.
- The balance of those planning to invest more/or less in training over the next twelve months than in the previous twelve months, rose from 41% to 50% in the latest survey.

Do you plan to invest more, the same, or less in the following areas over the next twelve months than you did in the previous twelve months?

Buildings

More	28%
Same	18%
Less	15%
None in either period	38%

Plant, machinery and equipment

More	52%
Same	27%
Less	14%
None in either period	7%

Product and process innovation/R&D

More	42%
Same	30%
Less	5%
None in either period	23%

Training

More	53%
Same	35%
Less	3%
None in either period	9%

UK Economic Update: Recent Developments and Prospects

Economic commentary is currently dominated by the debate over the outlook for the US economy, with the oft-quoted remark that if the US sneezes we're bound to catch a cold in the UK. The surprise 50 basis point reduction in the Federal Funds rate in early January has sparked off a debate as to whether interest rates should be reduced in response in the UK as well. What is not in dispute is that over the past year (oil price hike) and over the coming year (fears over Wall Street and the US economy) the threats to the UK economy which have provided the most concern are external.

Despite the recent decision of the US Federal Reserve, the IoD doesn't believe that the Monetary Policy Committee should feel panicked into an interest rate cut in the UK. However, we do believe that there will be scope for interest rate reductions this year, and by the year-end we expect interest rates to be down to 5.25%.

The evidence presented below shows why the IoD believes the balance of probability still favours the UK economy achieving a soft landing this year.

The world economy

Over recent years the IoD has consistently argued that the combination of very high share prices and a very low savings ratio in the US, must inevitably lead to a correction. Over the past year credit risk¹ and stock market volatility have increased (Financial Stability Review, Bank of England, Issue 9, December 2000).

The US economy is now adjusting towards a more sustainable rate of GDP growth. Over the past year we have seen the Nasdaq index halve in value, but savings rates in the US remain very low - even after allowing for measurement issues associated with the treatment of capital gains. Despite the market correction in the Nasdaq and S&P500, estimates of the expected future dividend growth (see: Financial Stability Review) for the total US market, implied by equity prices, are still higher than three years ago.

The fear is that greater precautionary saving by US consumers could now tip the US economy into recession. President Bush has spoken of the risk that the US economy might move into a downward tailspin. Despite these justifiable fears, there is considerable reassurance that both a monetary and fiscal stimulus could be applied if needed.

In addition to the fiscal option of deep tax cuts, monetary policy also has the potential to place a floor under economic growth and prevent a slide into recession. What we don't yet know is whether precautionary behaviour by consumers is sufficiently strong to outweigh the latest interest rate cut. However, what is beyond dispute is that substantial monetary easing could be put in place if required. We have placed greater emphasis on monetary policy because of time factors. Even

1. Not just in the US, credit spreads have risen in the euro and sterling markets as well.

allowing for forward looking behaviour by consumers, the political battles and legislative timetable for tax cuts suggest the responsibility for beating off a recession will rest on Federal Reserve Chairman, Alan Greenspan.

What does this tell us? The previous analysis strongly suggests that the monetary and fiscal levers of economic policy have the potential to avert a hard landing for the US economy, providing they are operated swiftly and effectively in response to signs of rising precautionary saving by consumers. Consensus Forecasts show GDP growth of 2.6% in the US in 2001. Half the 2000 rate but nowhere near a recession either.

Over the October 2000-January 2001 period Consensus Forecasts for US GDP growth in 2001 have fallen by 1% point. In contrast, the Consensus Forecasts for the UK economy have fallen by just 0.1% point over the same period. Further reassurance for the UK stems from the fact that whilst the US economy is a colossus, less than 5% of UK GDP is accounted for by trade with the largest economy in the world.

At the beginning of 2001 Consensus Forecasts show Japanese GDP rising by only 1.8% this year. Forecasts for Euroland show 2.9% GDP growth in 2001. In other words, Euroland is not expected to perform particularly strongly and given the degree of forecast error, it is still conceivable that the US economy could outperform Euroland this year. Confidence over the outlook for the Euroland economy has waned in the wake of the recent reversal in the value of the euro.

The UK economy

IoD research shows that whilst the overwhelming majority of companies in the UK have continued to perform well over the past year, their confidence about the year to come has diminished over each quarter.

The December 2000 quarterly Business Opinion Survey by the IoD shows that company performance levels continue to be maintained. In the December survey the balance of those companies performing well, versus those companies performing badly, showed a balance of 75%. Almost identical to the two previous survey results.

The balance of respondents who describe themselves as more rather than less optimistic about their company's prospects - relative to three months previously - slipped further to 35%. In the September 2000 survey the balance was 39%, in June 49% and in March 2000 it was 57%.

We have already examined the global economic position, but are the IoD member's views expressed in the survey results, too complacent about domestic economic conditions? UK real GDP growth in 2000Q3 stood at 3% (yr-on-yr) and household consumption rose by 4.2% (yr-on-yr), but is this false assurance based on the past?

Three areas generate possible concerns of a future recession:

- Household finances
- Future inflation and earnings growth
- Corporate finances

The household and corporate sector position could theoretically lead to a recession without any future change in monetary policy, owing to debt exposure. The future inflation and earnings scenario

refers to the potential for higher interest rates in order to kill-off inflationary pressures. Our analysis shows that there are good reasons to be confident that threat from all three is exaggerated.

The household savings ratio fell to 3% in 2000Q3 and now matches the low-point reached in 1988. If households are to restore the long-term average rate then the ratio will need to rise to 7.5% of disposable income. The outstanding household debt to income ratio now stands at an all time high, above the 117% of disposable income recorded in 1989 (see Annex table 58, OECD Economic Outlook, June 2000 and chart 2.8, Inflation Report, Bank of England, November 2000). Ironically, the ratio of household debt to wealth has actually declined over recent years. Estimates by Lloyds TSB (Economic Bulletin, October 2000) show that two thirds of the increase in household wealth over recent years was attributable to equities whilst a third was due to housing equity. Given widespread acceptance that on traditional measures, share prices are overvalued and remembering the late 1980s and early 1990s, it is not difficult to generate scenarios whereby equities/housing fall in value, the savings ratio rises and consumption growth falls sharply. The key question is whether such a scenario is realistic.

There is no doubt that such a scenario is possible. However, the IoD would question its validity based on current conditions. First, because there is a legitimate debate as to what drove the late 1980s boom and the strong performance in the second half of the 1990s. If it is primarily driven by productivity led income growth, then the underlying fundamentals are clearly stronger than if merely based on a debt spree - in other words there is a 'New Economy' debate to be had in the UK as well.

Second, the current debt exposure of the household sector has one fundamental difference with that a decade ago. Virtually all of the rise in the savings ratio at the beginning of the 1990s was due to the burden of debt repayments in the wake of higher interest rates. A decade ago headline inflation reached double digit levels and as a result interest rates peaked at 15%.

In 2001 the situation is very different - in 2000 RPIX was the lowest since records began, at 2.1%. Inflationary pressures are vastly reduced with the result that interest rates are far lower. This means that if GDP growth slows, interest rates can be cut without risking a dangerous ignition of inflation - the MPC can put a floor under GDP growth. Inflationary pressures continue to remain weak, with RPIX at 2.0% (yr-on-yr) in December 2000. RPIX has undershot its 2.5% target for the past 21 months. The EU harmonised index of consumer prices (HICP) shows UK inflation at just 1% in November - easily the lowest rate in the EU. Oil prices have also come back sharply from their 2000 peak - as of mid-January Brent crude prices were around \$26 per barrel.

Fears for future inflation are primarily tied to the tight labour market and monetary growth. The claimant count measure shows unemployment at 3.6% in December 2000. With household consumption rising by 4% (yr-on-yr) at a time when public expenditure is accelerating to the fastest rate since the early 1970s, the fear is that inflation might pick-up given that unemployment is already very low. Thus far however the signs have been muted. Average earnings figures for the whole economy show a rise of 4.2% (yr-on-yr) - within the 4.5% comfort zone after allowing for productivity improvements.

Public expenditure's stimulus to economic activity has thus far been reduced by underspending. According to HM Treasury contacts interviewed by David Smith, Economics Editor of The Sunday Times, underspend in the current financial year will reach £5 billion (Dangers in turning on the tap, D. Smith, Sunday Times, 14th January 2001)².

2. The inflationary risk is that Departments catch up in the next financial year and attain their future expenditure targets as well.

A combination of market competition, productivity improvements and labour market change³ may keep inflation under control. Productivity will have been stimulated by the strong business investment growth over the 1996-1999 period which increased from £83 billion to £113 billion at constant prices. Inflationary pressures may also be siphoned off by a deterioration in net exports. Consensus Forecasts show the UK current account deficit widening from £14 billion in 2000 to £17.6 billion in 2001.

Another area of concern has been the growth in indebtedness of the corporate sector. The corporate sector (non-financial corporations financial balance, % of GDP) has moved deep into the red in recent years. The corporate sector was £17 billion in the red in 1999 and £7 billion in the red in the first half of 2000 (Economic Trends, Table 2.12, December 2000). How serious is the threat that jobs and investment will be slashed to restore profits and cash flow? We have seen a slowdown in business investment growth in 2000 which will continue into 2001, but investment is still expected to increase. Net borrowing, as a proportion of GDP, is lower than in the late 1980s/early 1990s. The current indications are that the corporate sector will slow their increases in investment enough for the financial deficit to narrow slowly.

The UK economy can achieve a soft landing in 2001. Monetary growth is not consistent with a sharp economic slowdown. M4 lending rose by almost 12% (yr-on-yr) in November. Monetary and fiscal policy changes in the pipeline also support the soft landing scenario. Since October, sterling has fallen by around 10% against the euro and by around 5% on a trade-weighted basis.

IoD Economic forecasts - central scenario

Indicator	2001	2002
GDP	2.5	2.6
Household consumption	2.6	2.6
Government expenditure	4.0	4.4
Fixed investment	2.3	2.7
RPIX (end Q4)	2.3	2.5
Unemp. millions, end Q4	0.9	0.9
Unemp. rate end Q4	3.6	3.6
Base rate % end Q4	5.25	5.75

3. There was a shift in bargaining power possibly attributable to trade union reform in the 1980s. In recent years bargaining power for those finding work may have been reduced because unemployment has fallen sharply amongst the long term unemployed. Participation rates for the 50 plus age cohort have risen. Part-time hours have increased as a proportion of total hours - all sourced from Labour Force Survey.

