IoD Business Opinion Survey
December 2001

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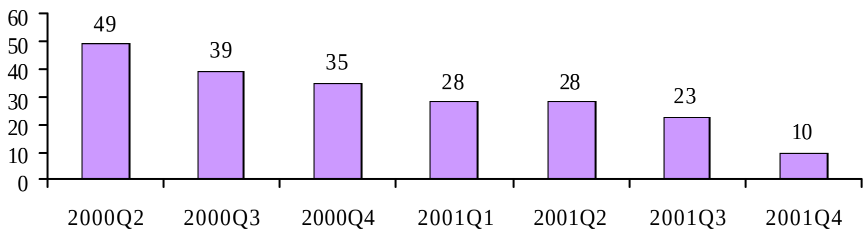
Summary

Demand, output & profits

In the latest December Business Opinion Survey director optimism has continued the declines exhibited over the past two years - see Business Optimism Balance figure below.

Company optimism has deteriorated significantly in the latest survey as compared with previously. The latest survey shows a balance of 10% of companies who were more, rather than less optimistic about their company's prospects, compared with three months ago. In the previous September survey the balance was 23% and in June it stood at 28%. However, we should also point out that the previous September survey was undertaken both before and after the terrorist attacks in New York. The fact that some of the returns were prior to the attacks means that the September survey probably overstated the level of business confidence. In other words, whilst the latest survey results provide a clear picture of the current situation, they probably overstate the scale of the decline in confidence between surveys - some of the decline had already occurred last September.

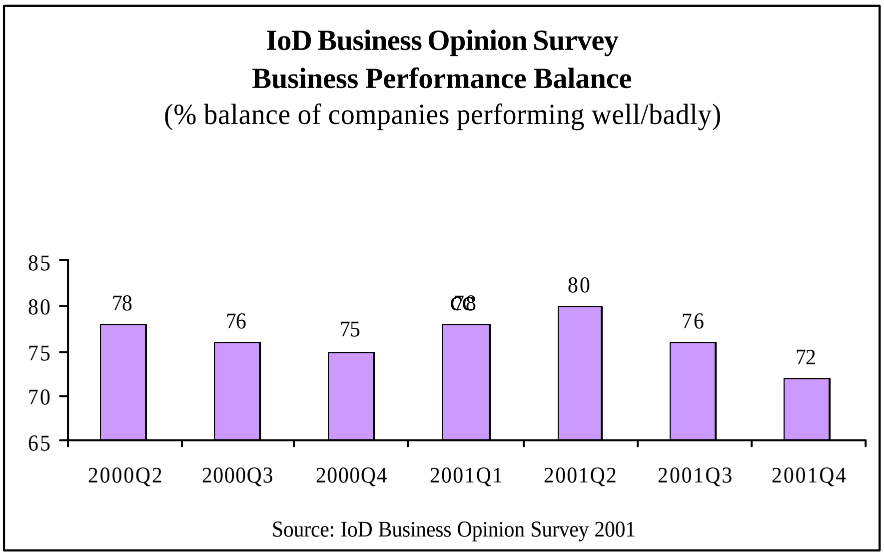
IoD Business Opinion Survey
Business Optimism Balance
(% balance of companies more/less optimistic about their company's prospects compared with the previous quarter)



Source: IoD Business Opinion Survey

The survey results for company performance display a slight weakening as compared with the previous survey. The latest survey shows that the balance of those companies performing well, versus those performing badly, stood at 72%. In the previous survey this balance stood at 76% and in the survey before that, the balance measured 80%. Over the past two years this measure has displayed a gentle deterioration.

The performance balance is weakest in manufacturing (63%) and strongest in the 'others' sector (85%) which includes construction, mining & transport.



Capacity utilisation levels have fallen significantly in the latest survey. Between the September and December surveys the balance on capacity utilisation fell from -7% to -21%. The latest capacity utilisation survey reveals contrasting changes in sectoral performance. The balance of those companies currently operating at full capacity, versus those who were not, fell from -4% to -34% in manufacturing, whilst it improved from -35% to -15% in the distribution sector.

The latest survey reveals a sharp contrast in total order books and export order books. The balance of those companies reporting above normal order books, versus those reporting below normal order books, fell to 6% from 11% in September. The balance of those companies reporting above normal export order books versus those reporting below normal order books fell sharply from -1% to -17% in the latest survey.

The reported employment balance - of those reporting the trend in the number of employed up versus down - has fallen sharply to 11% from 28% in the previous September survey. In June 2001 the reported employment balance stood at 18%. The expected employment balance has also deteriorated significantly, from 24% in September to 13% in the latest December survey. In June 2001 the expected employment balance stood at 25%.

The balance of those company directors reporting output up, versus those reporting it down, slipped to 33% in the latest survey. This compares to a figure of 38% in September and 40% in June 2001.The balance of those company directors expecting output to be up, versus those expecting it to be down, stood at 35% in the latest survey, down from 48% in September and 45% in June 2001.

The balances on both reported profits and profit expectations have deteriorated in the latest survey having improved between June and September 2001. The balance of company directors reporting profits up, versus those reporting profits down, fell to 13% in December, from 21% in September and 17% in June 2001.

The balance of those company directors expecting profits to be up, versus those expecting them to be down, fell to 24% in December, from 36% in September and 30% in June 2001.

Costs, prices & pay

The balance on both reported and expected costs has weakened significantly in the latest December survey, following on from the slide exhibited in the September survey. The balance of those company directors reporting costs up, versus those reporting costs down, fell from 31% to 26% between June and September. In December this balance plunged to 14%. The balance of those company directors expecting costs to be up, versus those expecting them to be down, fell sharply to 10% from 22% in September and 31% in June 2001.

The balance of those company directors reporting prices up, versus those reporting them down, declined from 2% to -1% in the latest survey. In the June 2001 survey this balance stood at 8%. The balance of those company directors expecting prices to be up versus those expecting them to be down, stood at 6% in the latest survey compared with 4% previously. In the June 2001 survey this balance stood at 7%.

The balance of those company directors reporting a higher company pay award - compared with the previous pay award - versus those reporting a lower pay award, fell to 16% in December from 20% in September. In June 2001 this balance stood at 25%. In the latest survey the average pay settlement was 4.6%. This compares with a figure of 4.3% in September and 4.1% in June 2001.

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 in December 2001. 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:

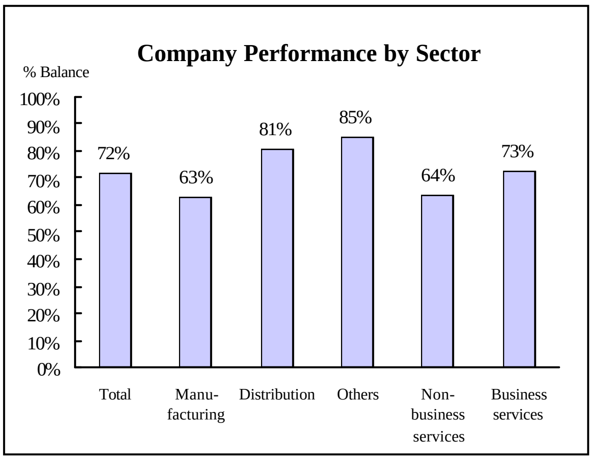
Size	
1 - 20 employees	"Micro"
21 - 100 employees	"Small"
101 - 200 employees	"Medium"
201+ employees	"Large"
Sectors	
Manufacturing	
Distribution	
Others including construction/mining/transport	"Others (including construction)"
Government/Educational/Medical/Personal services	"Non-business services"
Business/Finance/Professional services	"Business services"

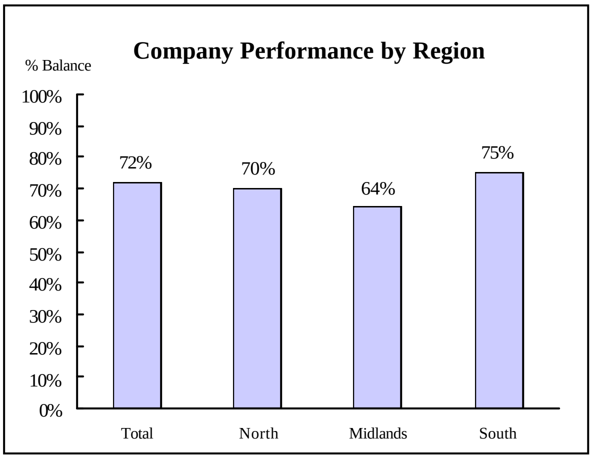
In order to give a simple, clear indication of the trend in any particular variable, the survey results are summarised throughout in terms of a positive or negative balance. The balance is computed by simply subtracting the number of respondents replying less/down/badly to a question from those replying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

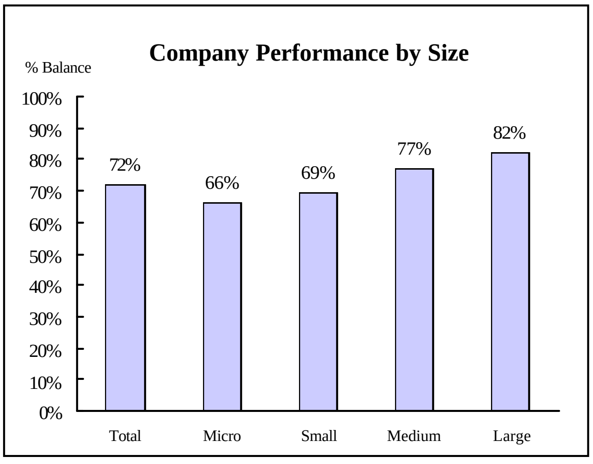
Survey Results
Company Performance

How well is your company performing overall?	
Well	78%
Neither well nor badly	17%
Badly	6%
Balance	+72

- The survey results for company performance display a slight weakening as compared with the previous survey. The latest survey shows that the balance of those companies performing well, versus those performing badly, stood at 72%. In the previous survey this balance stood at 76% and in the survey before that, the balance measured 80%. Over the past two years this measure has displayed a gentle deterioration.
- The performance balance is weakest in manufacturing (63%) and strongest in the 'others' sector (85%) which includes construction, mining & transport.





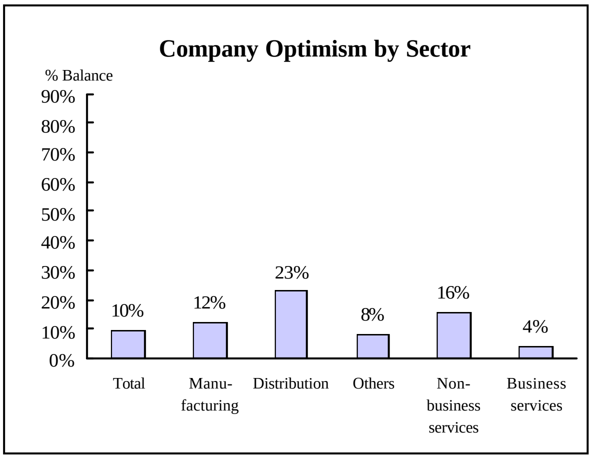


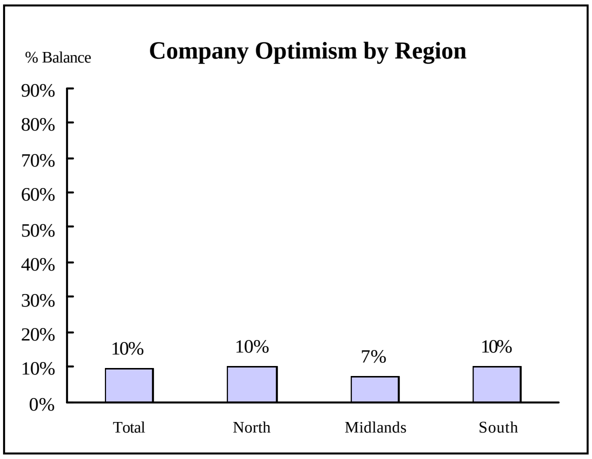
Company Optimism

- Company optimism has deteriorated significantly in the latest survey as compared with previously. The latest survey shows a balance of 10% of companies who were more, rather than less optimistic about their company's prospects, compared with three months ago. In the previous September survey the balance was 23% and in June it stood at 28%.
- The company optimism balance was strongest in the distribution sector (23%) and weakest in the business services sector (4%).

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

More	42%
Same	25%
Less	32%
Balance	+10

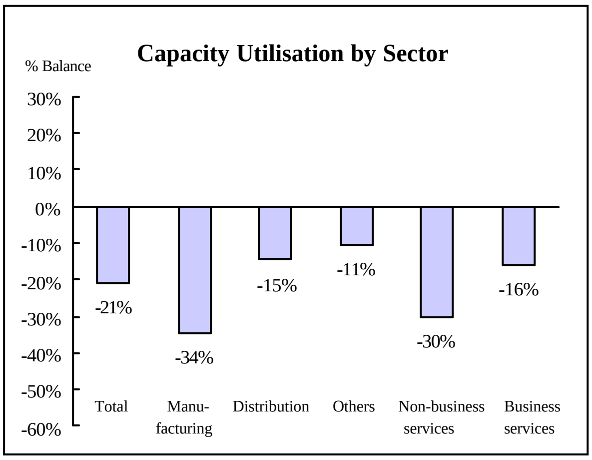


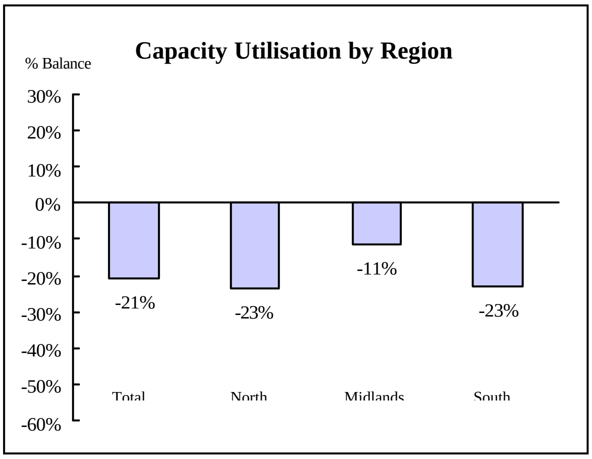


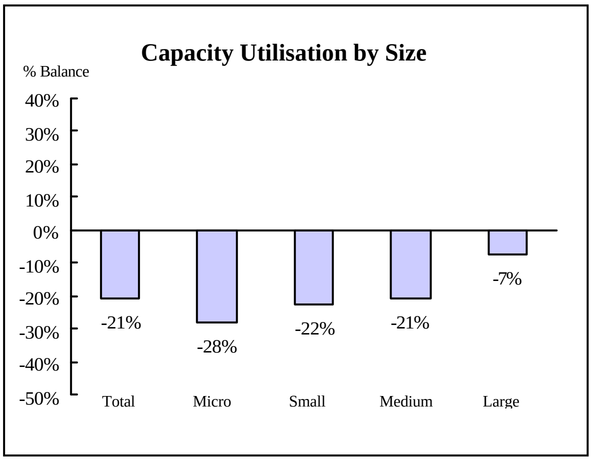
Capacity Utilisation

Are you currently operating at full capacity?	
Yes	40%
No	60%
Balance	-21

- Capacity utilisation levels have fallen significantly in the latest survey. Between the September and December surveys the balance on capacity utilisation fell from -7% to -21%.
- The latest capacity utilisation survey reveals contrasting changes in sectoral performance. The balance of those companies currently operating at full capacity, versus those who were not, fell from -4% to -34% in manufacturing, whilst it improved from -35% to -15% in the distribution sector.



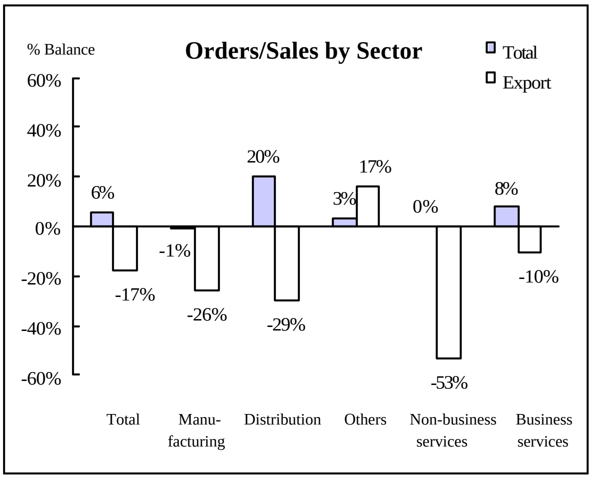


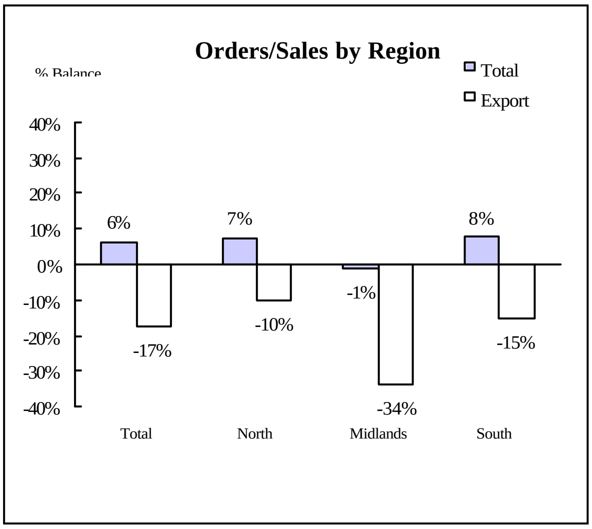


Order Books

- The latest survey reveals a sharp contrast in total order books and export order books. The balance of those companies reporting above normal order books, versus those reporting below normal order books, fell to 6% from 11% in September.
- The balance of those companies reporting above normal export order books versus those reporting below normal order books fell sharply from -1% to -17% in the latest survey.

Order books	
Above normal	32%
Normal	41%
Below normal	26%
Balance	+6
Export order books	
Above normal	23%
Normal	37%
Below normal	40%
Balance	-17



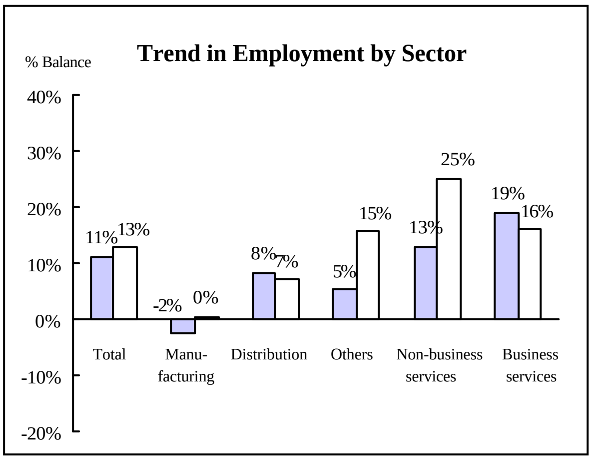


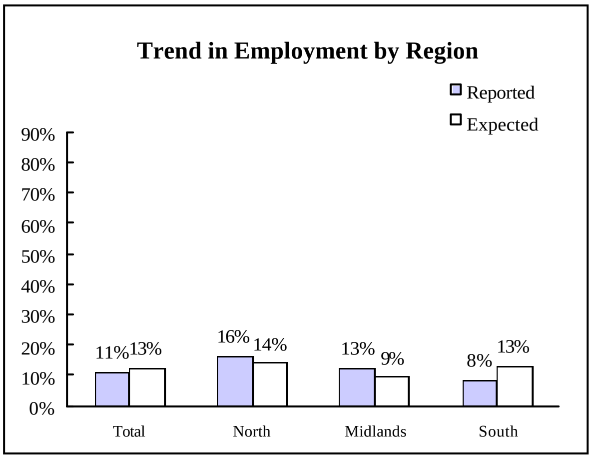
Employment

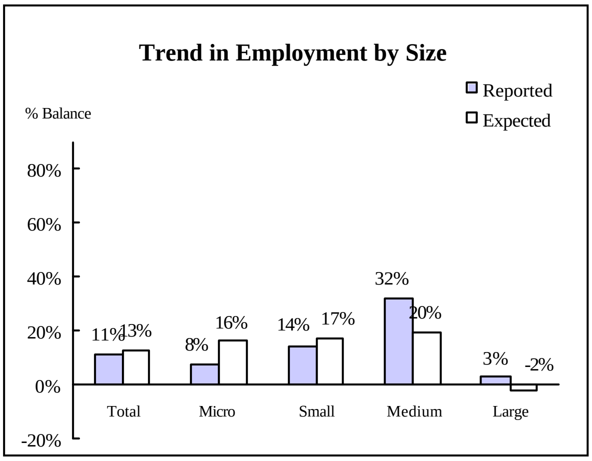
Trend in Numbers Employed

	Reported	Expected
Up	30%	29%
Same	51%	55%
Down	19%	16%
Balance	+11	+13

- The reported employment balance - of those reporting the trend in the number of employed up versus down - has fallen sharply to 11% from 28% in the previous September survey. In June 2001 the reported employment balance stood at 18%.
- The expected employment balance has also deteriorated significantly, from 24% in September to 13% in the latest December survey. In June 2001 the expected employment balance stood at 25%.





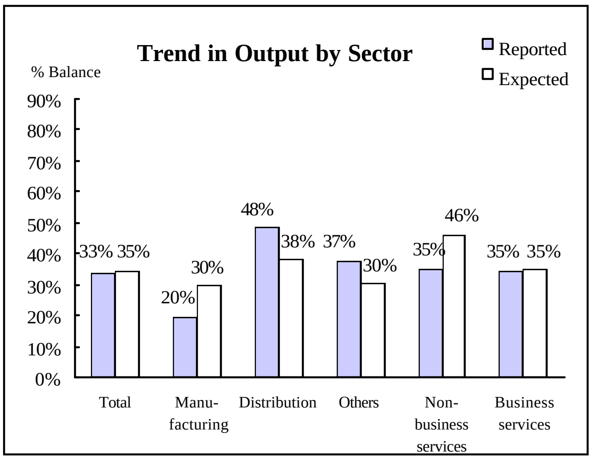


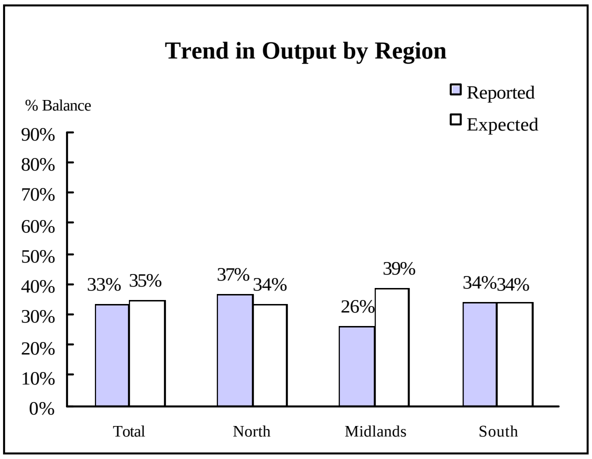
Output

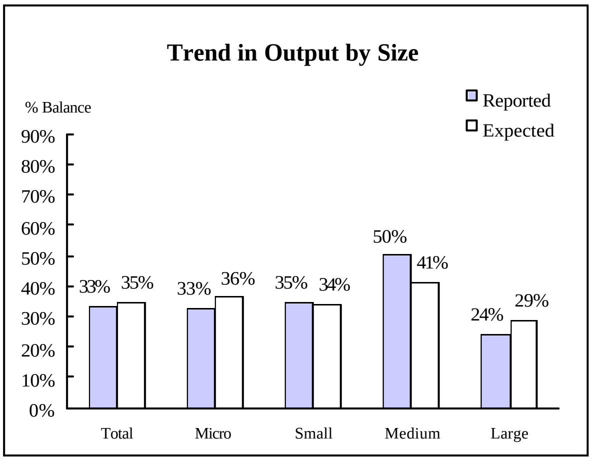
Trend in Output

	Reported	Expected
Up	50%	49%
Same	31%	37%
Down	18%	14%
Balance	+33	+35

- The balance of those company directors reporting output up, versus those reporting it down, slipped to 33% in the latest survey. This compares to a figure of 38% in September and 40% in June 2001.
- The balance of those company directors expecting output to be up, versus those expecting it to be down, stood at 35% in the latest survey, down from 48% in September and 45% in June 2001.





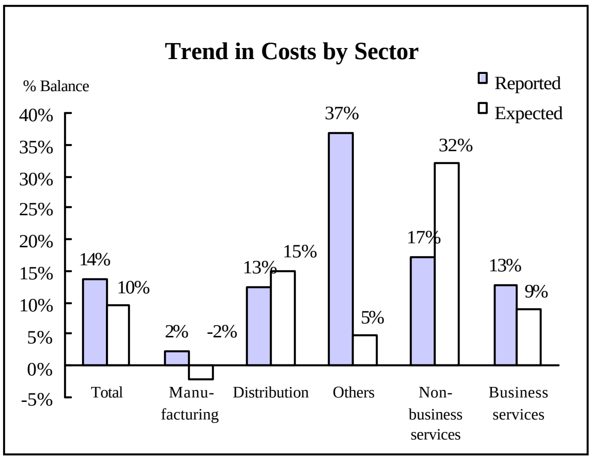


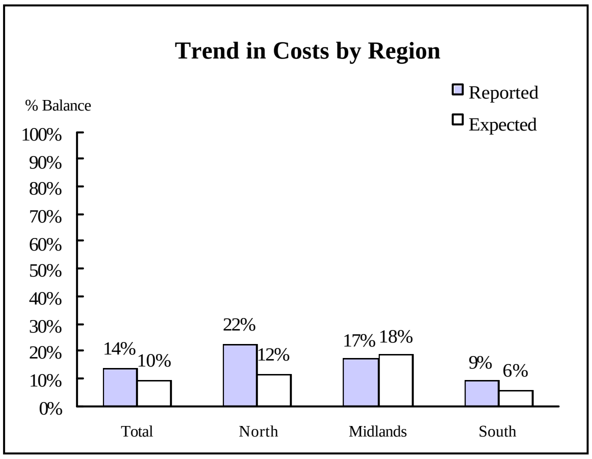
Costs

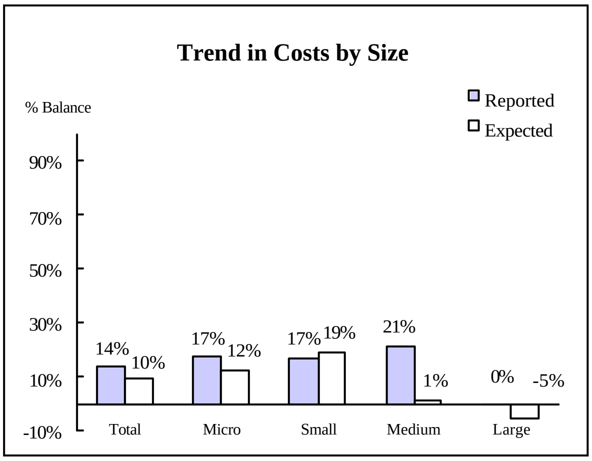
Trend in Costs

	Reported	Expected
Up	33%	29%
Same	48%	52%
Down	19%	19%
Balance	+14	+10

- The balance on both reported and expected costs has weakened significantly in the latest December survey, following on from the slide exhibited in the September survey. The balance of those company directors reporting costs up, versus those reporting costs down, fell from 31% to 26% between June and September. In December this balance plunged to 14%.
- The balance of those company directors expecting costs to be up, versus those expecting them to be down, fell sharply to 10% from 22% in September and 31% in June 2001.



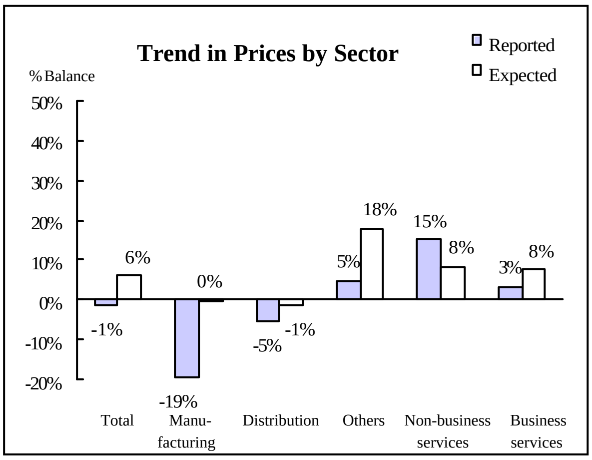


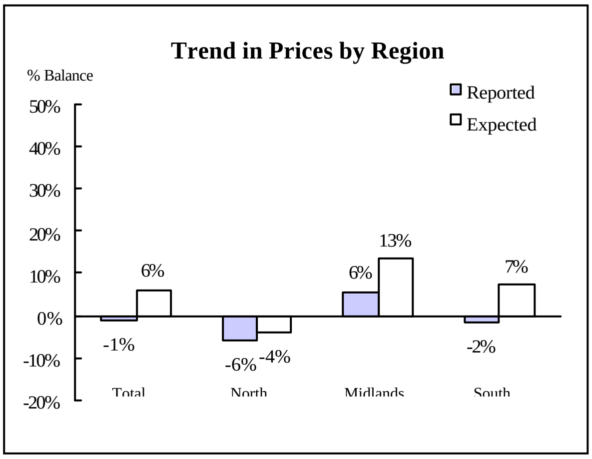


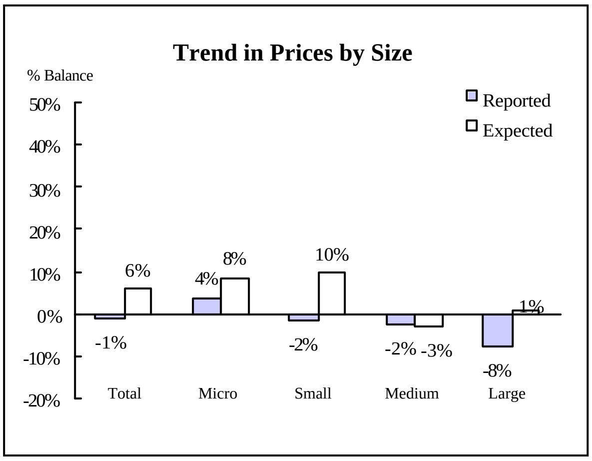
Prices

Trend in Prices	Reported	Expected
Up	15%	18%
Same	69%	69%
Down	16%	12%
Balance	-1	+6

- The balance of those company directors reporting prices up, versus those reporting them down, declined from 2% to -1% in the latest survey. In the June 2001 survey this balance stood at 8%.
- The balance of those company directors expecting prices to be up versus those expecting them to be down, stood at 6% in the latest survey compared with 4% previously. In the June 2001 survey this balance stood at 7%.





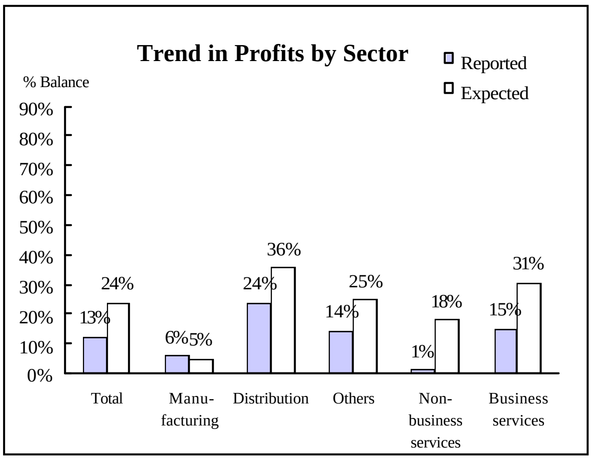


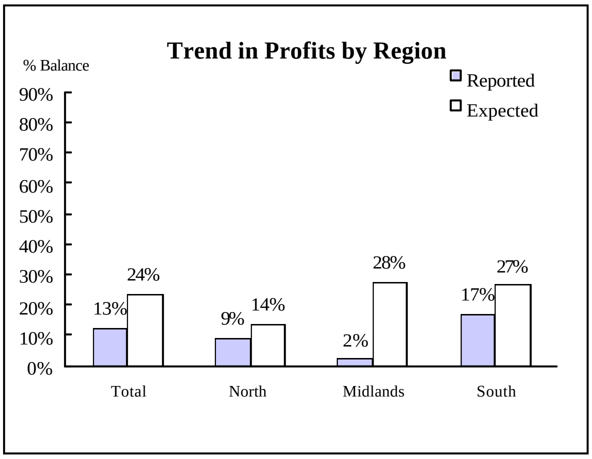
Profits

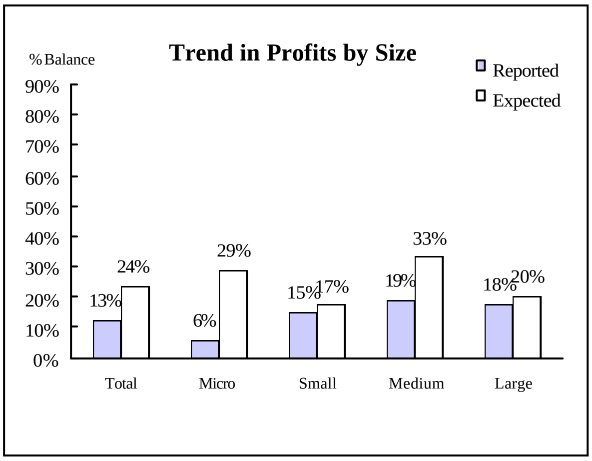
Trend in Profits

	Reported	Expected
Up	37%	42%
Same	38%	39%
Down	25%	19%
Balance	+13	+24

- The balances on both reported profits and profit expectations have deteriorated in the latest survey having improved between June and September 2001. The balance of company directors reporting profits up, versus those reporting profits down, fell to 13% in December, from 21% in September and 17% in June 2001.
- The balance of those company directors expecting profits to be up, versus those expecting them to be down, fell to 24% in December, from 36% in September and 30% in June 2001.





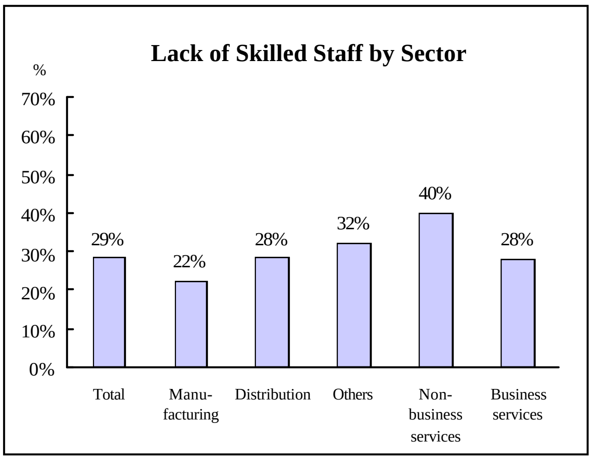


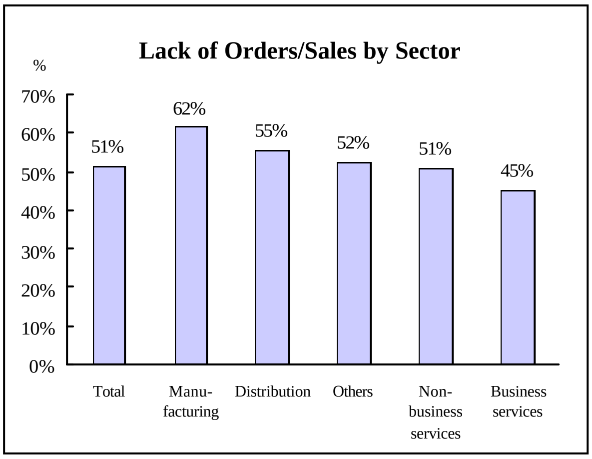
Factors limiting output

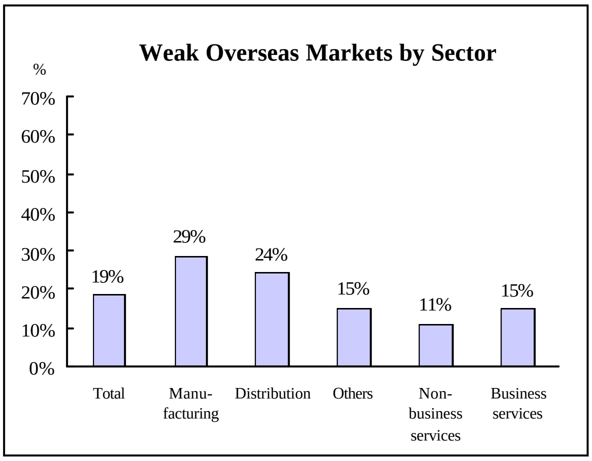
What factors are likely to limit output over the next three months?

Lack of orders/sales	51%
Lack of skilled staff	29%
Weak overseas markets	19%
Credit or finance	14%
Other staffing problems	13%
Plant capacity	6%
Lack of materials or components	6%

- As in previous surveys, lack of orders/sales and a shortage of skilled staff remain the primary constraints on output. In the latest survey, 51% of company directors cite a lack of orders/sales, compared with 52% previously. Whilst a shortage of skilled staff remains the second highest constraint on output, the proportion of directors citing this explanation has fallen from 37% to 29% in the latest survey.







Pay

- The balance of those company directors reporting a higher company pay award - compared with the previous pay award - versus those reporting a lower pay award, fell to 16% in December from 20% in September. In June 2001 this balance stood at 25%.
- In the latest survey the average pay settlement was 4.6%. This compares with a figure of 4.3% in September and 4.1% in June 2001.

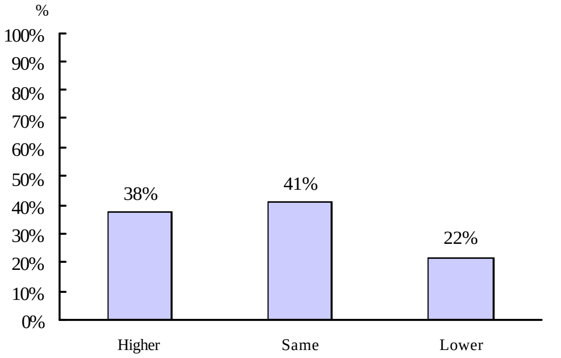
If you made a pay award in the last 3 months, what was the average percentage increase?

2% or less	4%
2-3%	29%
3-4%	22%
4-5%	9%
5-7.5%	12%
7.5% or more	24%

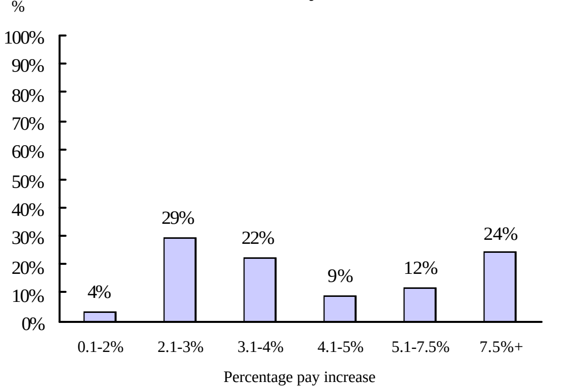
How did it compare with the previous pay award?

Higher	38%
Same	41%
Lower	22%
Balance	+16

Current Pay Award Compared to Previous Pay Award



Distribution of Pay Settlements



Investment

- Investment intentions are little changed from the previous survey (figures in parenthesis are for the previous survey). The balance of those intending to invest more versus less over the next 12 months stands at 13% (16%) for buildings, 25% (27%) for plant, machinery & equipment, 27% (31%) for product and process innovation/R&D and 39% (46%) for training.

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	29%
Same	15%
Less	16%
None in either period	40%

Plant, machinery and equipment

More	41%
Same	33%
Less	16%
None in either period	11%

Product and process innovation/R&D

More	34%
Same	28%
Less	7%
None in either period	30%

Training

More	45%
Same	41%
Less	6%
None in either period	8%

UK Economic Update: Recent Developments and Prospects

Despite the slowdown in the world economy the performance of the UK economy remains robust - outside of the manufacturing sector which is in recession. UK GDP growth was around 2.3% last year[1], helped by the reductions in interest rates in the wake of the US slowdown. Mortgage rates - in nominal terms - are now at their lowest level for nearly 50 years.

Recent statistical releases show that:

- The Nationwide reports that UK house prices surged by 1.9% (mth-on-mth) in December. In the final quarter of 2001 house price growth in the South east of England was around 16-18% (yr-on-yr). The Halifax reports an even stronger surge in prices in December. Halifax report that UK house prices jumped 2.9% (mth-on-mth) and by 15.5% (yr-on-yr).
- Retail sales volumes rose 7% (yr-on-yr) in November. The latest CBI Distributive Trades Survey showed the best Christmas on the high street since 1987. A balance of 48% of retailers said sales had risen. Retailers such as Marks & Spencer and Next have recently reported double digit growth in sales - year-on-year.
- The savings ratio fell to 4.2% in 2001Q3. Personal lending remains strong, with mortgage lending increasing around 10% (yr-on-yr) - the highest rate for 11 years. Latest figures also show consumer credit growing at double-digit levels as well. Despite this, income gearing and capital gearing ratios are less than a decade ago.
- Money supply growth remains firm. Broad money M4 growth stood at 8% (yr-on-yr) in November. M0 notes & coins growth increased from 7.8% (yr-on-yr) in November to 8.2% (yr-on-yr) in December.
- The latest December NTC UK Leading Indicators suggests that robust economic growth can be expected up to the third quarter of 2002.

The Governor of the Bank of England has recently remarked that UK GDP growth is unsustainable if the world economy recovers before domestic consumption slows. Deputy Governor of the Bank of England, Mervyn King, has also observed that we are probably experiencing the first period since the 1870s, when domestic demand growth has exceeded GDP growth for more than five years.

At the same time that the Governor was highlighting the upside risks to the economy, the Deputy Governor was pointing out that because consumer demand had been so strong for so long, one could not rule out the risk that it could fall away sharply in 2002.

Much of the New Year speculation regarding the economic outlook in the UK has focussed on the possibility that the next move in interest rates might be up, not down. However, the debate is not as clear cut as is suggested by retail sales growth. There are a number of other major influences which need to be factored into the equation:

1. Assuming no further GDP revisions and flat quarter-on-quarter growth in 2001Q4.

- Inflation - The all items RPI rose by just 0.9% (yr-on-yr) in November. The underlying RPIX index rose by 1.8% over the same period. It is quite plausible that that RPIX could fall below 1.5% over the coming months. The Chancellor has made it clear that the MPC's target rate of 2.5% inflation is symmetrical i.e. if the index undershoots the target rate, the MPC is expected to stimulate economic activity. If RPIX does fall further, the MPC might argue that there is sufficient stimulus in the pipeline already, which will accelerate the economy and inflation upwards on a two year horizon. The deployment of this argument could justify no further reductions in interest rates, but what would be more difficult would be to raise interest rates at the same time that inflation hits a record low. However, this possibility cannot be ruled out. As the table below shows, trend 0.2% (mth-on-mth) - giving an annualised rate of 2.5% - RPIX inflation results in a mid-year fall in inflation followed by a subsequent pick-up.

RPI & RPIX inflation scenarios

RPI with 0.2% month-on-month growth		RPIX with 0.2% month-on-month growth	
June 2002	December 2002	June 2002	December 2002
0.8%	2.4%	1.1%	2.4%

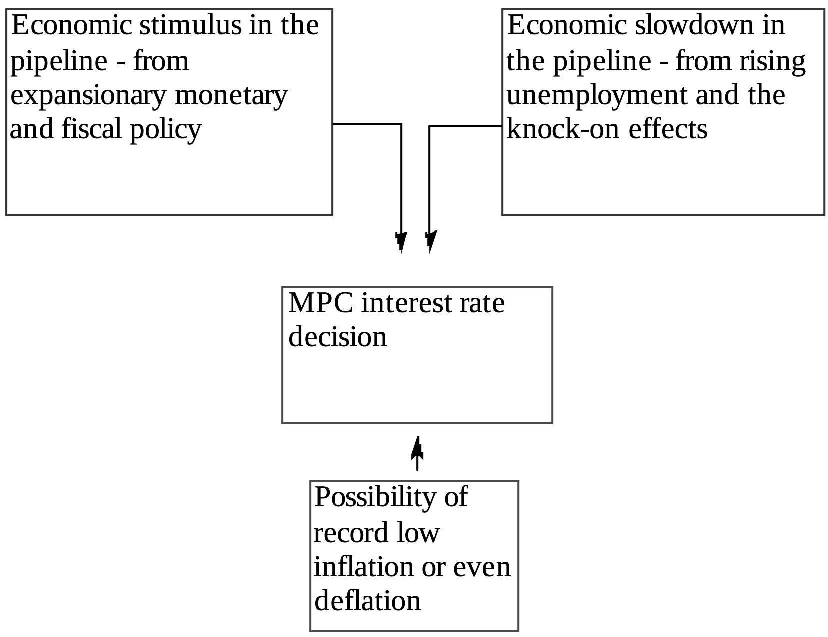
- Manufacturing - The manufacturing sector is in recession and any hopes that it might be about to turn the corner could be quashed by an interest rate rise. Moreover, at a time when the world economy is so weak and export markets may be contracting, there is a risk that a UK interest rate rise might push up sterling and reduce export competitiveness.
- Nominal interest rates - The UK base rate at 4% is very low by historic standards, but so too is inflation. As a result, real interest rates remain positive.
- Labour markets - The unemployment claimant count stood at 3.2% in November, having risen very slightly for two consecutive months. The ILO measure also edged up by 0.1% to 5.1%. In the latest three month period ILO unemployment rose by 29,000. What is uncertain at present is the scale and pace of any turnaround in the labour market. The latest Manpower Quarterly Survey of Employment Prospects suggests labour demand is easing and that unemployment will continue to rise in the first quarter of 2002. The latest REC/Andersen Report on Jobs shows the labour market weakening further in December with a further downturn in business for recruitment consultancies. In addition to the uncertainty as to the pace and scale of labour market retrenchment is the added uncertainty - exhibited in the remarks of Mervyn King - as to the knock-on effect on the savings ratio.
- Consumer psychology - In the wake of September 11th careful reflection is required in order to interpret consumer behaviour. It may/may not be the case that much of the recent strength in retail sales was the result of people cancelling holidays and spending the money at home. Alternatively, the terrorist attacks may have had the effect of making people depressed initially, but the knock-on effect was to make them go on a spending spree subsequently, to cheer themselves up. Will this result in a New Year hangover for the consumer? Will the spending momentum be maintained through January? Even if a decision to retrench has already been taken, will the consumer supertanker take a while to slowdown and turn around? As yet it is too early to know the answer to these questions.

The interest rate decision facing the MPC is particularly difficult at the present time. The MPC has to weigh the effects of the monetary (interest rate reductions) and fiscal (higher public expenditure) stimulus whilst at the same time assessing the possibility of record low headline inflation combining with some form of global shock to create a deflationary environment.

The IoD's forecasts assume no further global shocks and a US recovery during 2002. However, as we have previously noted, the risk of a deeper and longer global downturn - than consensus forecasts suggest - remains a serious threat. Global growth in 2002 is likely to be pedestrian at best. The US and the EU are likely to grow by just over 1% whilst the Japanese economy is likely to contract by the same amount. If the US economy were to remain stuck in recession throughout 2002 there is a real risk that capital could flow out of the dollar and into the euro. Sterling might also come under downward pressure if euro referendum fever intensified amid speculation that a yes vote was obtainable - sterling weakness might then become a self-fulfilling prophecy with regard to euro entry.

The IoD's forecasts show that the stimulus from monetary and fiscal policy prevents any sharp upward movement in unemployment. The domestic risk to this forecast is a scenario under which:

- The fiscal stimulus is delayed due to departmental underspending.
- The monetary stimulus is offset by precautionary consumer behaviour - possibly attributable to the knock-on effects of 11th September and/or rising personal debt burdens.



IoD Economic Forecasts - January 2002

Indicator	2001	2002	2003
GDP	2.3	1.6	2.5
Household consumption	2.5	1.8	2.4
Government expenditure	3.5	4.0	3.6
Fixed investment	2.0	1.6	2.4
RPIX (yr-on-yr, end Q4)	2.0	2.2	2.4
Unemployment (average, millions, end Q4)	1.0	1.3	1.4
Unemployment (average, %, end Q4)	3.3	4.0	4.1
Base rate (%, end Q4)	4.0	4.25	4.0