IoD Business Opinion Survey
June 2001

The Business Opinion Survey report was written by Graeme Leach, Chief Economist.
The publication was designed and produced by Lucy Chard.

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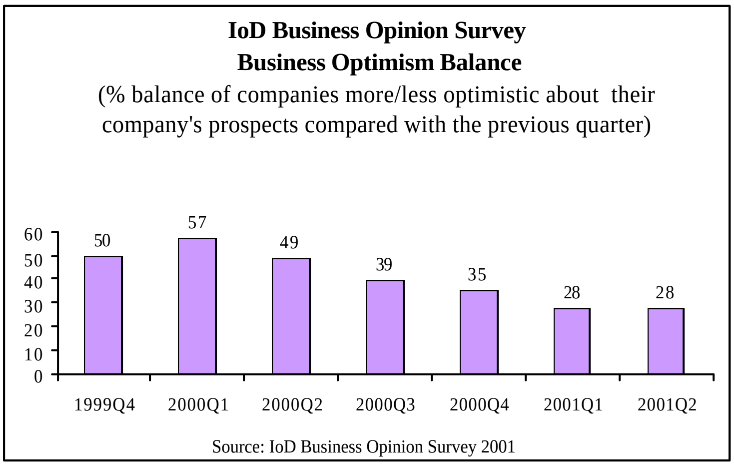
Summary

Demand, output and profits

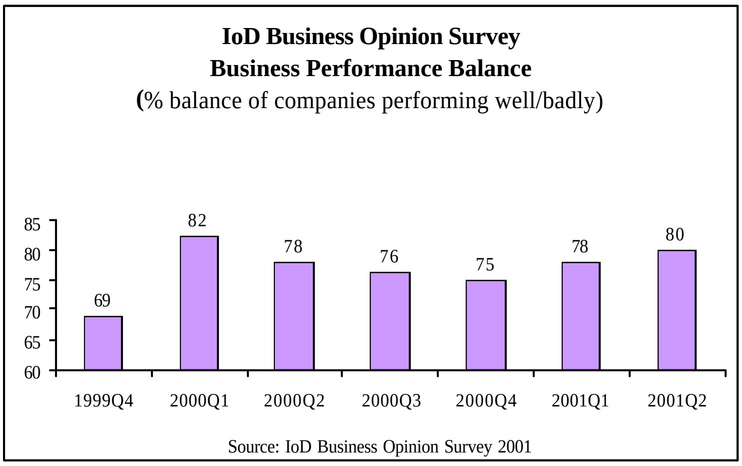
Company optimism and performance is little changed in the latest Business Opinion Survey (BOS) in June, compared with the previous survey in March. The latest BOS of company optimism shows an identical balance to that in the previous survey - a balance of 28% of company directors were more, rather than less optimistic about their company's prospects, compared with three months ago.

The latest survey result stops the downward trend exhibited throughout 2000 and early 2001. In the December 2000 survey the optimism balance measured 35%, in September 2000 it stood at 39%, in June 2000 it was 49% and in March 2000 it was 57%.



In the latest survey there has been a strong improvement in the optimism balance for manufacturers (from 3% to 19%), whereas in the distribution sector the optimism balance has deteriorated (from 40% to 17%). In the business services, non-business services and other sectors, the balances have changed very little.

Company performance levels continue to be maintained in the latest BOS. The latest BOS shows that the balance of those companies performing well, versus those performing badly, stood at 80%. In the previous survey the performance balance measured 78%. The performance balance has been essentially flat over the past 18 months. The performance balance is weakest in the distribution (65%) and manufacturing (72%) sectors and strongest in the non-business services (91%) sector. This pattern is very similar to that displayed in the previous survey.



The balance on capacity utilisation deteriorated in the latest BOS. In December 2000 the capacity utilisation balance had risen to -6%, its highest level for three years, but in March 2001 the balance fell back to -13% and has now slipped further to -22%.

The deterioration in capacity utilisation has been most notable in manufacturing (from -18% to -42% in the latest survey) and business services (-4% to -18% in the latest survey).

The balance on order books slipped back in the latest BOS. The latest balance of those company directors reporting above normal order books, compared with those reporting below normal order books, stood at 9% in the June survey. In the previous survey this balance stood at 20%. The fall in order books is particularly noticeable in the manufacturing sector where the balance has fallen from 16% to -10%.

Compared with the previous survey, the reported employment balance has slipped a little, while the expected employment balance has slipped a lot. In the latest survey the balance of those company directors reporting employment numbers up, versus those reporting employment numbers down, stood at 18%, compared with 22% previously. The deterioration in reported employment in the manufacturing sector is particularly bad, with the balance falling from 5% to -7% between March and June.

In the latest survey the balance of those company directors expecting employment to increase, versus those expecting it to decrease, fell to 25% from 35% previously.

The balance of those company directors reporting output up, versus those reporting it down, was unchanged at 40% in the June survey. This balance has been essentially flat over the past year. The output balance for manufacturers is lower, having remained unchanged at 25% in the latest survey.

The balances on both reported profits and profit expectations have fallen back. The balance of those company directors reporting profits up, versus those reporting profits down, fell to 17% in the June survey from 23% in March.

The balance of those company directors expecting profits to be up, versus those expecting them to be down, edged lower to 30% in June from 37% in March. Profit expectations have declined considerably over the past year. In March 2000 the profit expectations balance stood at 49%.

In the manufacturing sector profit expectations are very weak, with the balance at just 12% in the latest survey, compared with a recent peak of 43% in September of last year.

Costs, prices and pay

The balances on both reported and expected costs are little changed from the previous survey. The balance of those company directors reporting costs up, versus those reporting costs down, slipped to 31% in the latest survey from 35% previously. In the manufacturing sector the reported costs balance was much lower at 18%, having fallen from 31% in the previous survey.

The balance on reported prices continues to display the flat profile exhibited over the past year. The balance of those company directors reporting prices up, versus those reporting them down, stood at 8% in the latest survey, compared with 9% in the March survey. For the manufacturing sector the reported prices balance was -1% compared with zero in the previous survey.

The balance on expected prices continued the decline seen since the end of 2000. In December 2000 the expected prices balance stood at 23%, before falling to 14% in March and 7% in June of this year. Over the same period, the expected prices balance in manufacturing fell from 12% to 6% to -10% in the latest June survey.

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, rose to 25% in the latest survey, from 12% in March. This balance is now back to the level shown in September 2000 when it was recorded at 23%. In the latest survey the average pay settlement has remained unchanged at 4.1%. This compares to a figure of 4.5% in December and 4.1% in September of last year.

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 31 May-12 June 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"

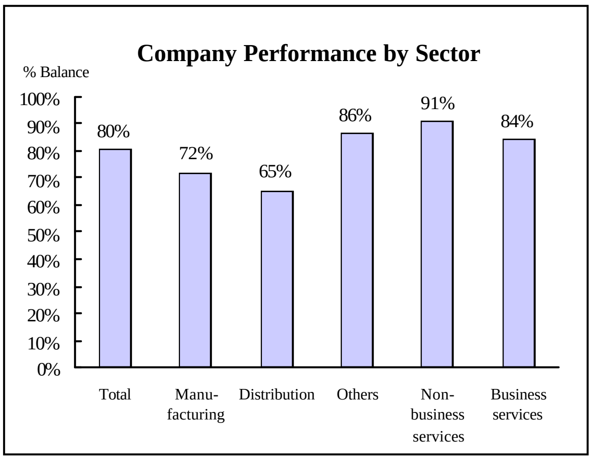
In order to give a simple, clear indication of the trend in any particular variable, the survey results are summarised throughout in terms of a positive or negative balance. The balance is computed by simply subtracting the number of respondents replying less/down/badly to a question from those replying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

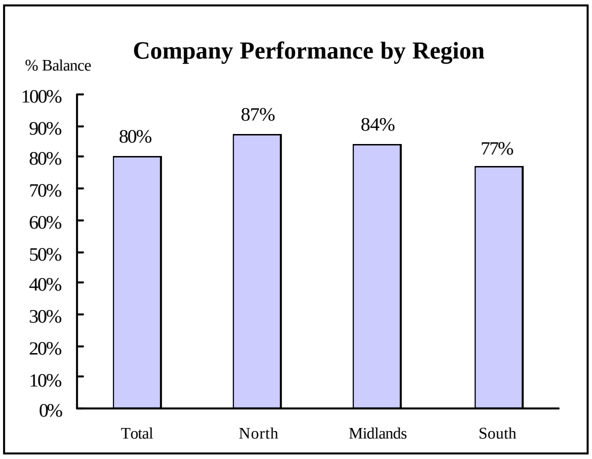
Survey Results
Company Performance

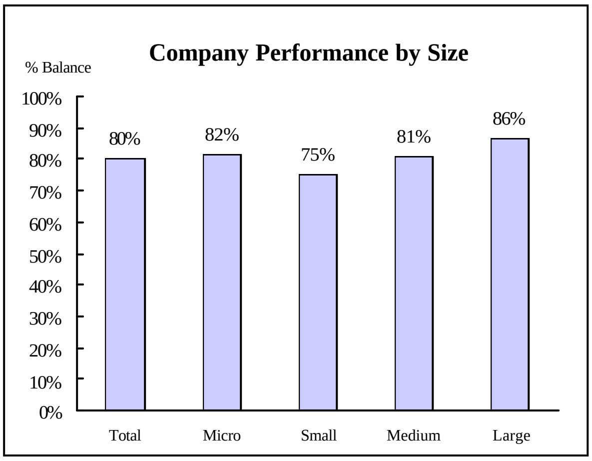
How well is your company performing overall?

Well	86%
Neither well nor badly	8%
Badly	6%
Balance	+80

- Company performance levels continue to be maintained in the latest Business Opinion Survey. The latest Business Opinion Survey shows that the balance of those companies performing well, versus those performing badly, stood at 80%. In the previous survey the performance balance measured 78%. The performance balance has been essentially flat over the past 18 months.
- The performance balance is weakest in the distribution (65%) and manufacturing (72%) sectors and strongest in the non-business services (91%) sector. This pattern is very similar to that displayed in the previous survey.
- As with the previous survey, the disparity in company performance across different regions is relatively small, ranging from 77% in the South to 87% in the North.





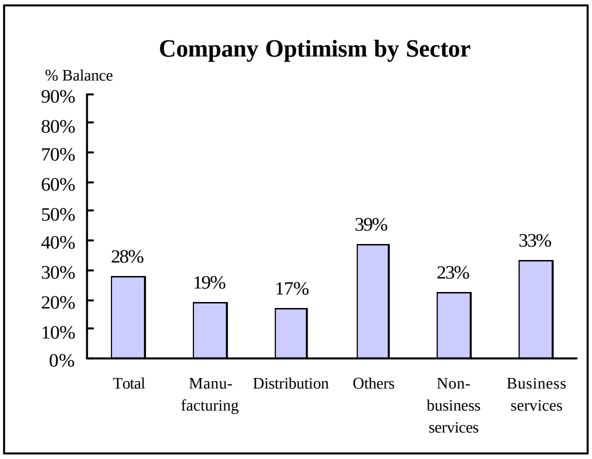


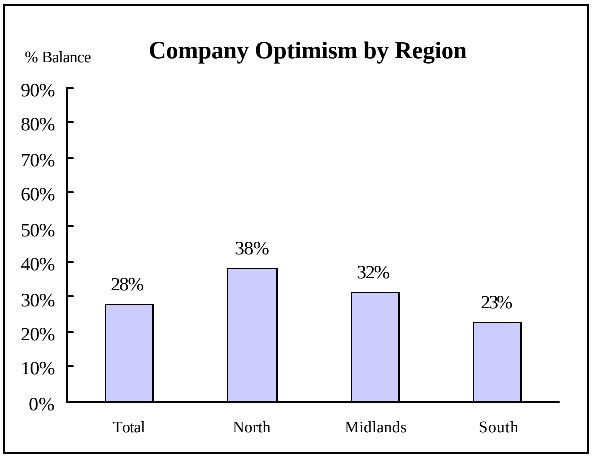
Company Optimism

- Company optimism is unchanged in the latest Business Opinion Survey, compared with previously. The latest survey results shows a balance of 28% of company directors who were more or less optimistic about their company prospects, compared with three months ago.
- The latest survey result stops a downward trend throughout 2000 and early 2001. In the December 2000 survey the optimism balance measured 35%, in September 2000 it stood at 39%, in June 2000 it was 49% and in March 2000 it was 57%.
- In the latest survey there has been a strong improvement in the optimism balance for manufacturers (from 3% to 19%), whereas in the distribution sector the optimism balance has deteriorated (from 40% to 17%). In the business services, non-business services and other sectors, the balances have changed very little.
- Company optimism is less in the South (23%) than in the North (38%) or Midlands (32%).

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

More	53%
Same	23%
Less	25%
Balance	+28



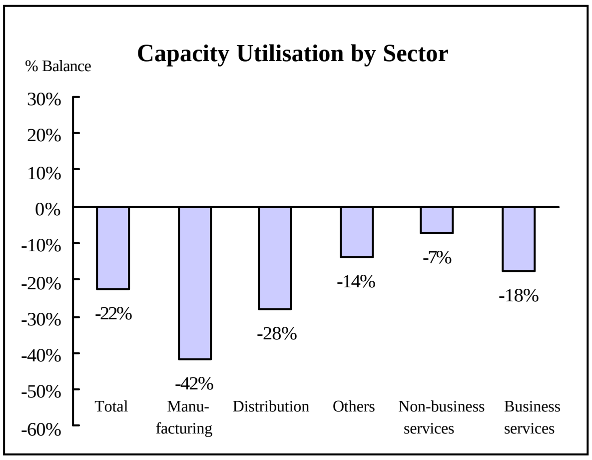


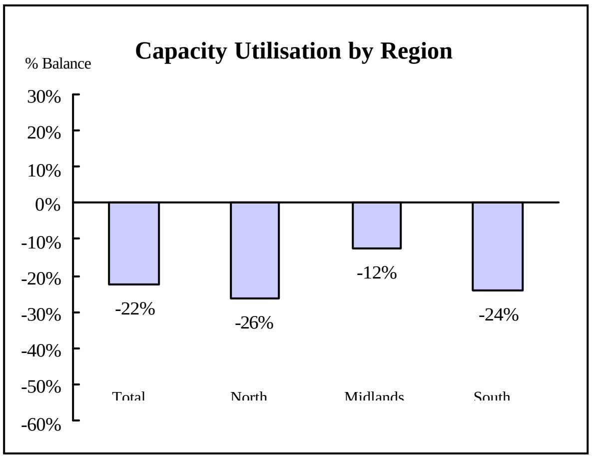
Capacity Utilisation

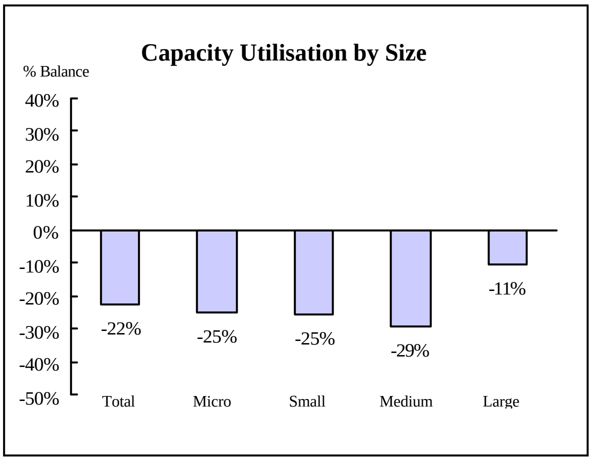
Are you currently operating at full capacity?

Yes	39%
No	61%
Balance	-22

- The balance on capacity utilisation deteriorated in the latest Business Opinion Survey. In December 2000 the capacity utilisation had risen to -6%, its highest level for three years, but in March 2001 the balance fell back to -13% and has now slipped further to -22%.
- The deterioration in capacity utilisation has been most notable in manufacturing (from -18% to -42% in the latest survey) and business services (-4% to -18% in the latest survey).



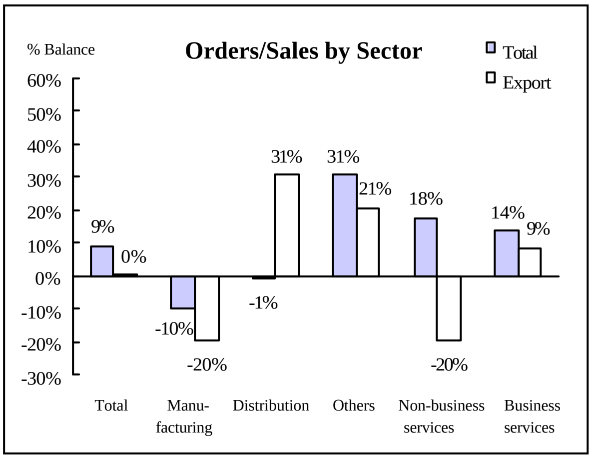


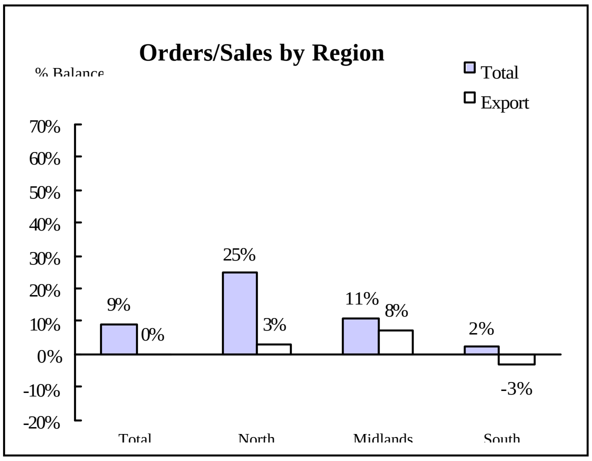


Order Books

- The balance on order books slipped back in the latest Business Opinion Survey. The latest balance of those company directors reporting above normal order books, compared with those reporting below normal order books, stood at 9% in the latest June survey. In the previous survey this balance stood at 20%.
- The fall in order books is particularly noticeable in the manufacturing sector where the balance has fallen from 16% to -10%.
- The balance on export order books has also deteriorated in the latest survey. The latest June survey shows that the balance of company directors expecting above normal export order books, versus those expecting below normal export order books, had fallen to zero, from 7% in the previous survey. This balance is now back to the level seen in December 2000.

Order books	
Above normal	34%
Normal	42%
Below normal	25%
Balance	+9
Export order books	
Above normal	32%
Normal	36%
Below normal	32%
Balance	0

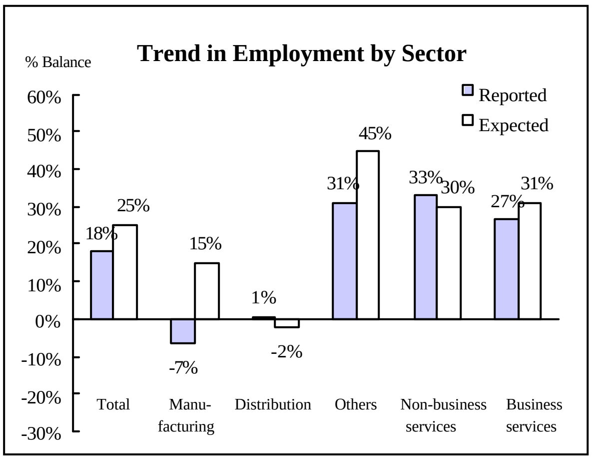


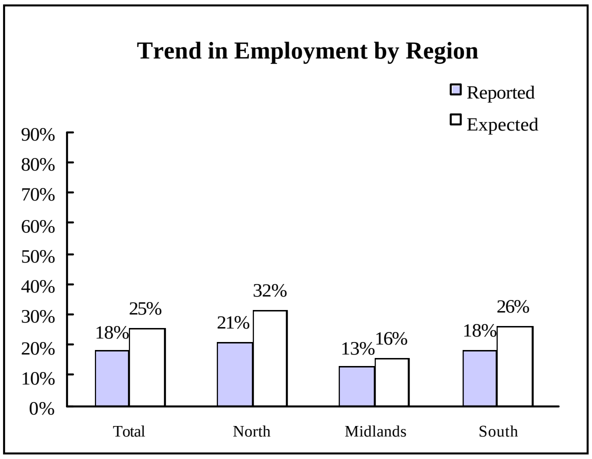


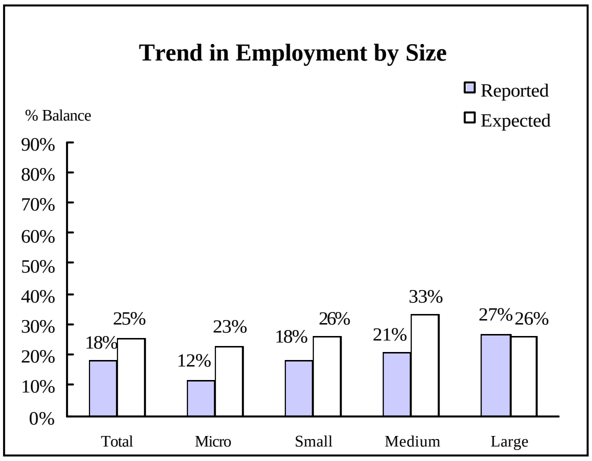
Employment

	Reported	Expected
Trend in Numbers Employed		
Up	33%	37%
Same	53%	52%
Down	15%	11%
Balance	+18	+25

- Compared with the previous survey, the reported employment balance has slipped a little, while the expected employment balance has slipped a lot. In the latest survey the balance of those company directors reporting employment numbers up, versus those reporting employment numbers down, stood at 18%, compared with 22% previously. The deterioration in reported employment in the manufacturing sector is particularly bad, with the balance falling from 5% to -7% in the latest survey.
- In the latest survey the balance of those company directors expecting employment to increase, versus those expecting it to decrease, fell to 25% from 35% previously.



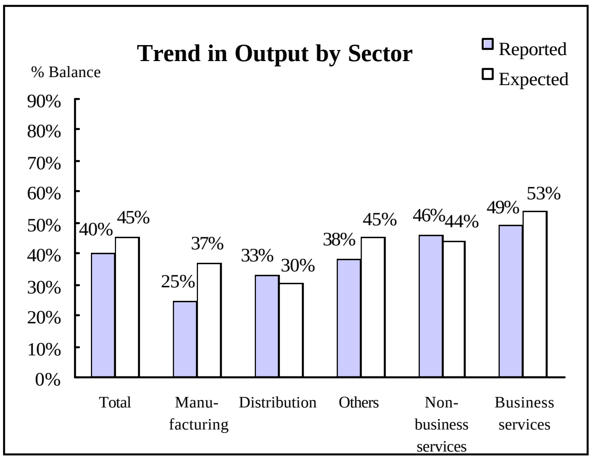


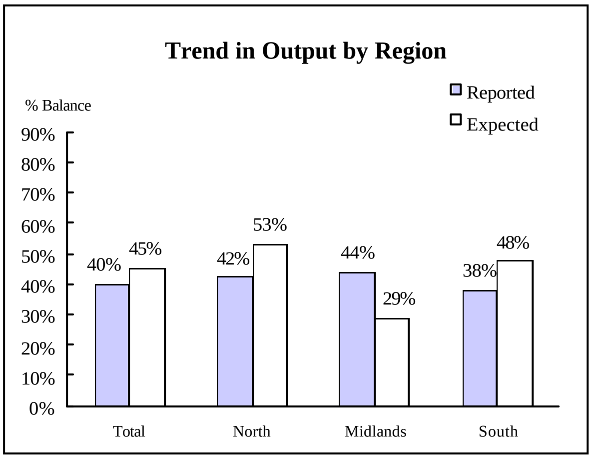


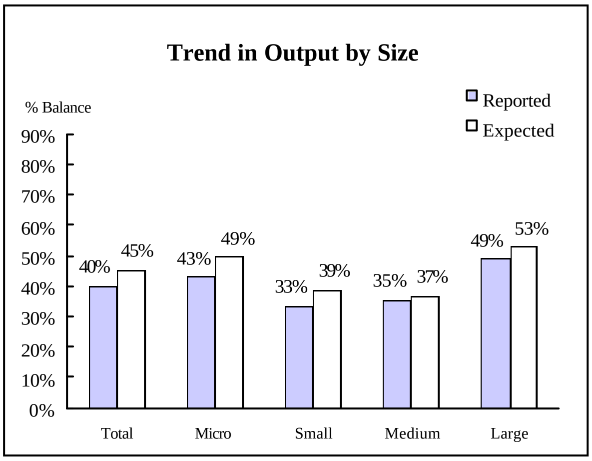
Output

Trend in Output	Reported	Expected
Up	56%	56%
Same	29%	34%
Down	15%	10%
Balance	+40	+45

- The balance of those company directors reporting output up, versus those reporting it down, was unchanged at 40% in the latest survey. This balance has been essentially flat over the past year. The output balance for manufacturers is lower, having remained unchanged at 25% in the latest survey.
- The balance of those company directors expecting output to be up, versus those expecting it to be down, fell back to 45% in the latest survey, from 55% previously.





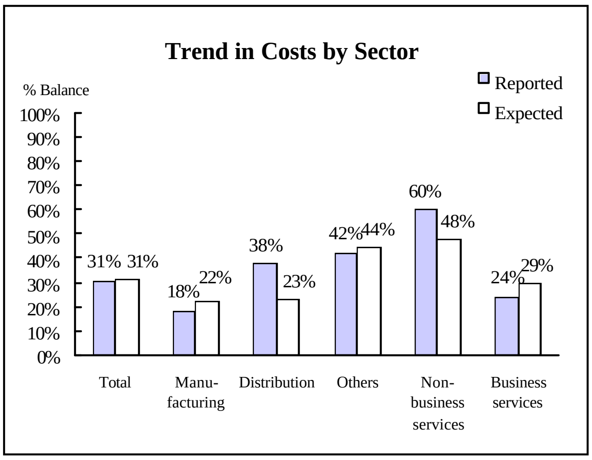


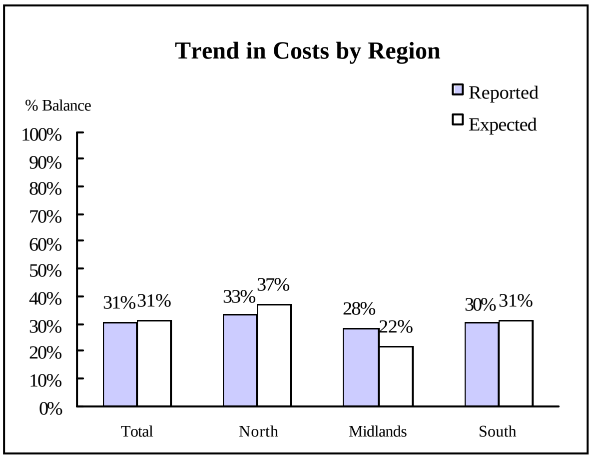
Costs

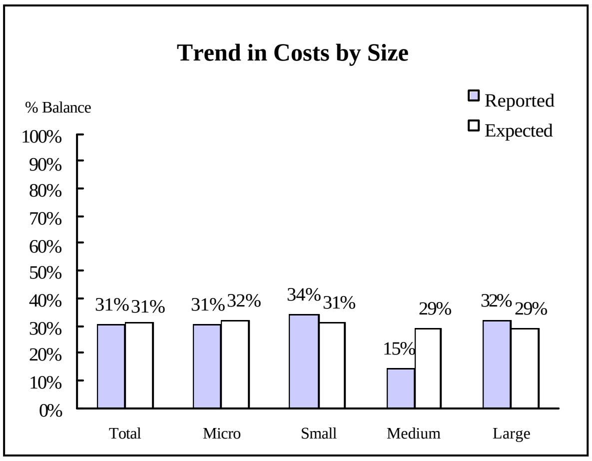
Trend in Costs

	Reported	Expected
Up	43%	43%
Same	44%	44%
Down	13%	12%
Balance	+31	+31

- The balances on both reported and expected costs are little changed from the previous survey. The balance of those company directors reporting costs up, versus those reporting costs down, slipped to 31% in the latest survey from 35% previously.
- In the manufacturing sector the reported costs balance was much lower at 18%, having fallen from 31% in the previous survey.
- The balance of those company directors expecting costs to be up, versus those expecting them to be down, was unchanged at 31% in the latest survey. Again, the balance was lower in the manufacturing sector. The expected costs balance fell to 22% in the manufacturing sector from 30% previously.





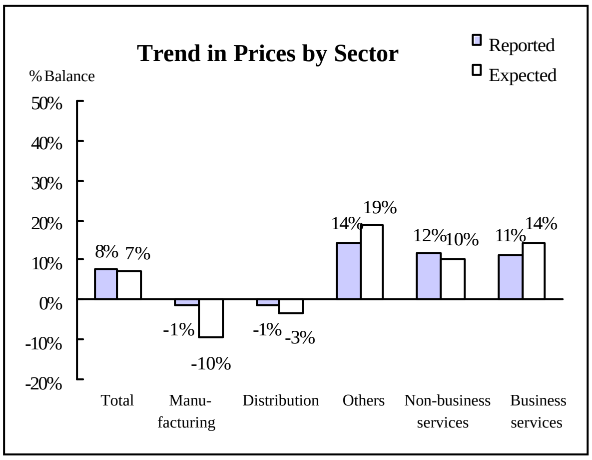


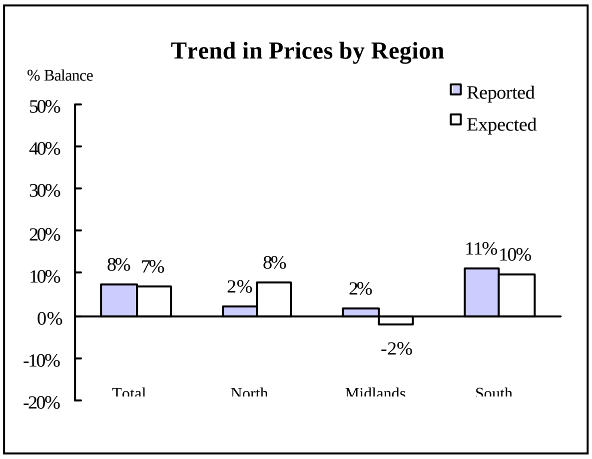
Prices

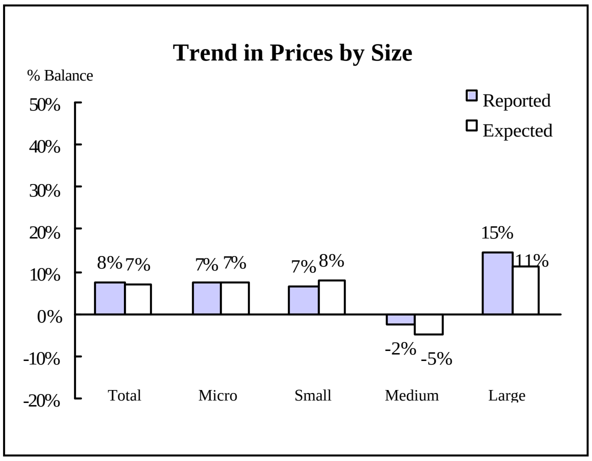
Trend in Prices

	Reported	Expected
Up	19%	17%
Same	69%	72%
Down	12%	10%
Balance	+8	+7

- The balance on reported prices continues to display the flat profile exhibited over the past year. The balance of those company directors reporting prices up, versus those reporting them down, stood at 8% in the latest survey, compared with 9% in the March 2001 survey. For the manufacturing sector the reported prices balance was -1% compared with zero in the previous survey.
- The balance on expected prices continued the decline seen since the end of 2000. In December 2000 the expected prices balance stood at 23%, before falling to 14% in March and 7% in June of this year. Over the same period, the expected prices balance in manufacturing fell from 12% to 6% to -10% in the latest June survey.





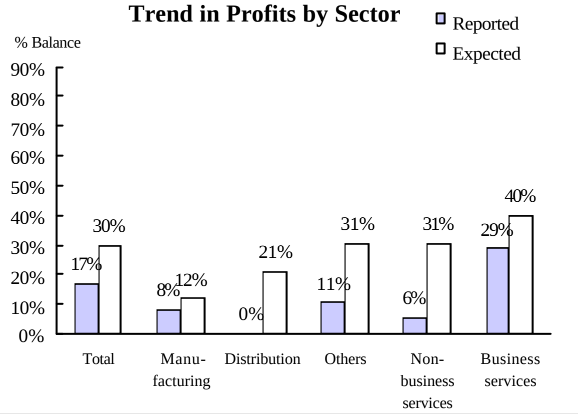


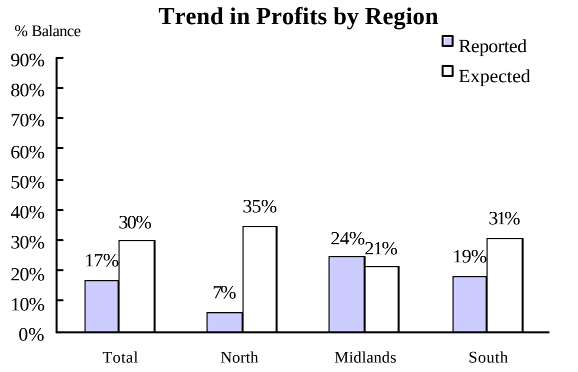
Profits

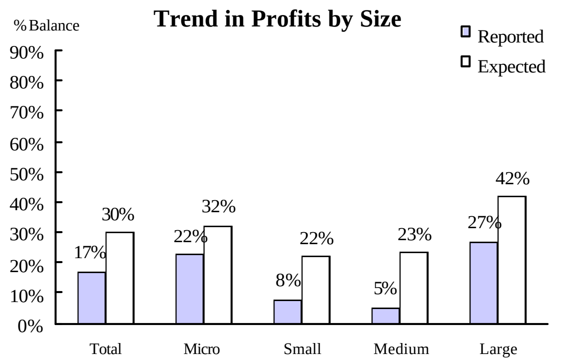
Trend in Profits

	Reported	Expected
Up	40%	44%
Same	37%	42%
Down	23%	14%
Balance	+17	+30

- The balances on both reported profits and profit expectations have fallen back in the latest survey. The balance of those company directors reporting profits up, versus those reporting profits down, fell to 17% in the June survey from 23% in March.
- The balance of those company directors expecting profits to be up, versus those expecting them to be down, edged lower to 30% in June from 37% in March. Profit expectations have declined considerably over the past year. In March 2000 the profit expectations balance stood at 49%.
- In the manufacturing sector profit expectations are very weak, with the balance at just 12% in the latest survey, compared with a recent peak of 43% in September of last year.





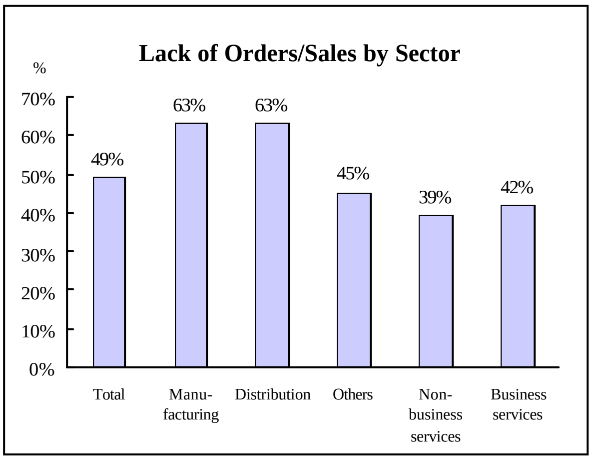


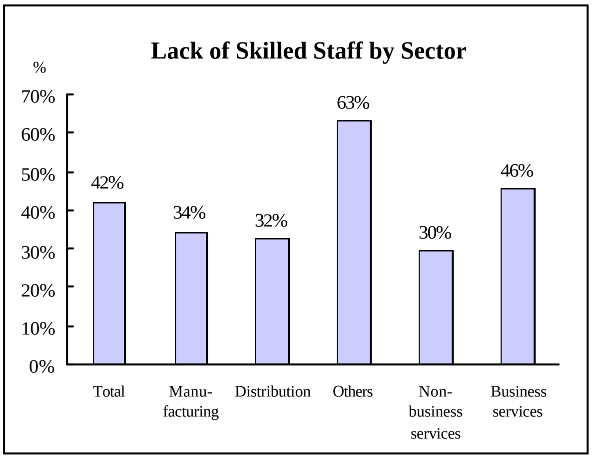
Factors limiting output

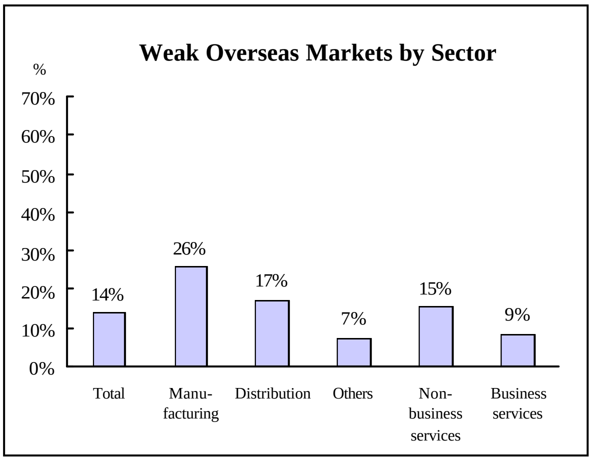
What factors are likely to limit output over the next three months?

Lack of orders/sales	49%
Lack of skilled staff	42%
Other staffing problems	17%
Weak overseas markets	14%
Credit or finance	11%
Plant capacity	8%
Lack of materials or components	6%

- There has been a small change - in the relative importance of different factors limiting output - in the latest survey. The first two factors limiting output have swapped places. In the latest survey 49% of company directors cited a lack of orders/sales as a limit on output over the next three months, whilst 42% cited a lack of skilled staff. In the previous survey 42% cited a lack of skilled staff as the most significant factor constraining output, with 39% citing a lack of orders sales. The other factors are little changed from the previous 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, rose to 25% in the latest survey, from 12% in March. This balance is now back to the level shown in September 2000 when it was recorded at 23%.
- In the latest survey the average pay settlement has remained unchanged at 4.1%. This compares to a figure of 4.5% in December and 4.1% in September of last year.
- In the latest survey the average pay settlement in manufacturing rose to 3.5% from 3.1% in March. The level of manufacturing settlement has now returned to the levels seen in December and September of last year.

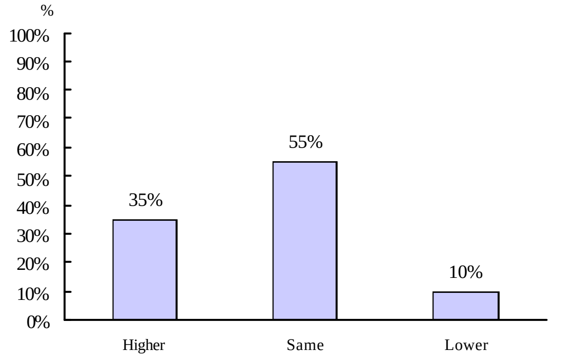
If you made a pay award in the last 3 months, what was the average percentage increase?

2% or less	1%
2-3%	33%
3-4%	25%
4-5%	19%
5-7.5%	13%
7.5% or more	10%

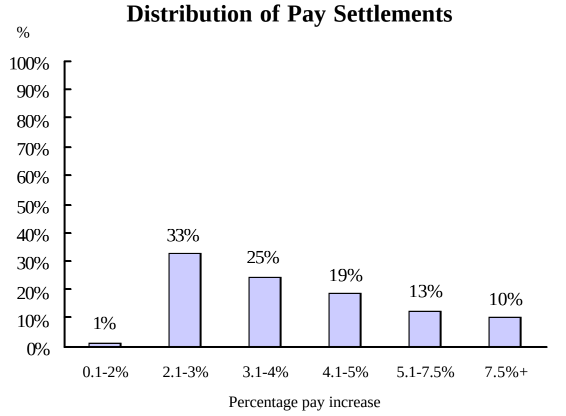
How did it compare with the previous pay award?

Higher	35%
Same	55%
Lower	10%
Balance	+25

Current Pay Award Compared to Previous Pay Award



Distribution of Pay Settlements



Investment

- Investment intentions in buildings are flat compared with the previous survey.
- Investment intentions in plant, machinery and equipment have edged lower in the latest survey, with 42% of company directors reporting plans for more investment, compared with 49% previously.
- Investment intentions in product and process innovation/R&D are flat compared with the previous survey.
- Investment intentions in training have edged lower in the latest survey, with 46% of company directors reporting plans for more investment in training, compared with 52% in the previous 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	17%
Less	16%
None in either period	39%

Plant, machinery and equipment

More	42%
Same	34%
Less	14%
None in either period	10%

Product and process innovation/R&D

More	35%
Same	30%
Less	4%
None in either period	31%

Training

More	46%
Same	38%
Less	6%
None in either period	10%

UK Economic Update: Recent Developments and Prospects

The decision of the Monetary Policy Committee (MPC) in June to leave the repo rate unchanged at 5.25%, was a sensible one. At the present time the performance of the UK economy is divided between:

- Domestic and overseas sectors.
- Manufacturing and services sectors.

Whilst the manufacturing and overseas sectors display signs of recession, the domestic economy and service sector continue to display above trend growth. Cumulatively, over the past five years, domestic demand has expanded by 20.8% whilst overall GDP has risen much less, by 14.8%.

The manufacturing sector in the UK has weakened further over recent months. The most recent purchasing manager's report from CIPS/Reuters showed manufacturing activity contracted for the fourth consecutive month in June. Net rates of return in manufacturing have fallen to just 3.7% compared with 14.6% in the service sector.

In the latest three-month period manufacturing output is down 1.6% on the previous three months and by 0.5% year-on-year. There can be little doubt that a malaise has settled over this sector of the economy, aided by the media focus on companies such as Marconi, gloomy assessments by the Engineering Employer's Federation and dwindling hopes of the Eurozone economy providing a locomotive effect for exports, because of a high pound and weakness in the German economy.

Economy wide surveys, such as the July NTC Report on Jobs, show that the demand for permanent staff has fallen for the first time since February 1999. NTC also report that press recruitment has dropped at the sharpest rate since January 1999. Analysis of the financial accounts of the UK's top 2000 companies, by Experian, show British business is experiencing its longest period of falling profitability since the recession of the early 1990s.

Against this background, why did the MPC leave interest rates unchanged? The answers are not difficult to find:

- Inflation - The all items RPI rose by 0.6% (mth-on-mth) and 2.1% (yr-on-yr) in May. RPIX, the MPC's target measure rose by 0.8% (mth-on-mth) and 2.4% (yr-on-yr) in May, up from 2% (yr-on-yr) in April. The primary explanation for the jump in inflation was a surge in seasonal food prices, which were up 24.5% (yr-on-yr) in May. Even allowing for the fact that bad autumn weather in 2000 helped cause the price surge in 2001, the MPC will have still felt the need for caution. The all goods RPI rose 0.7% (yr-on-yr) in May whilst the all services index rose by 4% (yr-on-yr).
- Labour market - The labour market remains tight. The claimant count of unemployment fell to under 977,000 in May, an unemployment rate of just 3.2%. The ILO measure fell to 1,478,000 - an unemployment rate of 5% - in the latest Labour Force Survey (LFS), covering the February-April period. In the latest LFS, total employment was up by 67,000 on the previous three-month period and by 261,000 year-on-year.
- Wages & earnings - The latest IRS survey suggests that the median pay settlement level has fallen back from 3.3% to 3.1%. However, of possibly greater impact on the MPC will have been the increase in the headline rate of growth in average earnings, which rose from 5% to

5.2% between March and April. Over the February-April period private sector earnings growth averaged 5.5%, compared with 4.5% over the November-January period. However, private sector earnings growth in services reached 6.1% in February, before falling back to 5.5% in April. As a rule of thumb, the MPC will assume that earnings growth in excess of 4.5% is likely to stimulate inflationary pressures above the 2.5% target for RPIX.

- First quarter GDP growth - In 2001Q1 GDP increased by 0.5% (qtr-on-qtr) and 2.7% (yr-on-yr). Domestic demand growth was strong, rising by 3.6% (yr-on-yr). Strong output growth was displayed in transport and communications, business services and finance together with the hotels and catering sectors.
- Consumers - Household consumption rose by 3.3% (yr-on-yr) in 2001Q1 and the savings ratio fell to 4.1%. Retail sales volumes rose by 6.4% (yr-on-yr) in May. If food sales are stripped out, then we see that clothing & footwear sales volumes were up by 10.5% (yr-on-yr) and household goods sale volumes were up by 8.1% (yr-on-yr). The latest CBI Distributive Trades Survey also reported that sales volumes grew significantly in June. This is not surprising given the stimulus to consumer confidence from falling interest rates, falling unemployment and rising house prices.
- Housing market - Both the Halifax and Nationwide house price indices indicate UK house price inflation around 8% (yr-on-yr) in June. Nationwide reported that UK house prices jumped 1.9% (mth-on-mth) in June. The housing market is therefore providing a boost to household wealth, some of which may result in equity release. Broad money M4 growth remains firm, growing 8% (yr-on-yr) in April.

Future outlook

The key question at present is whether the MPC will reduce interest rates further in the second half of 2001. The case for further cuts has various components:

(1) The recent inflation spike from seasonal food prices proves to be only temporary. The strong 'bonus' effect on earnings - in the financial services sector - is seen to have passed, because of weak stock markets, and is expected to reverse and become a source of downward pressure on earnings next year.

(2) Service sector inflationary pressures subside. The monthly survey on services from the Chartered Institute of Purchasing & Supply (CIPS) has revealed a significant weakening in both cost and price indices so far this year. The latest CBI/Deloitte & Touche service sector survey shows price expectations in consumer services at their lowest point since September 1999.

(3) Further weakening in the global economy and equity markets undermines UK exports and problems in the manufacturing sector then spread into the service sector.

(4) There is no significant depreciation of the pound against the euro and/or dollar.

(5) Consumers become more cautious and the savings ratio turns upward.

It is probably the case that all five components will need to be satisfied, at least to some degree, in order to bring about a further easing in interest rates. Merely satisfying (1) and (2) is unlikely to deliver further reductions in interest rates in 2001. The strength of domestic demand in the UK at present, implies that the MPC would need to see evidence of weakening here, before implementing further interest rate cuts.

This is because the MPC is all too aware of:

- The monetary stimulus 'in the pipeline' from previous rate cuts in 2001.

- The fiscal stimulus 'in the pipeline' from planned public expenditure rises under the Comprehensive Spending Review.

The table below shows the IoD's forecasts for the UK economy over the 2001-2002 period. Our forecasts have changed since the previous quarterly update. We now assume there will be only one further quarter-point interest rate reduction in 2001.

IoD Economic Forecasts - June 2001

Indicator	2001	2002
GDP	2.2	2.5
Household consumption	2.7	2.6
Government expenditure	3.7	4.1
Fixed investment	2.3	2.6
RPIX (yr-on-yr, end Q4)	2.3	2.5
Unemployment (average, millions end Q4)	1.0	1.1
Unemployment (average, % end Q4)	3.3	3.6
Base rate (%, end Q4)	5.0	5.25