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IoD Business Opinion Survey  
March 2001

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**Price: £10.00**  
**Annual Subscription: £40.00**

## Summary

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### Demand, output and profits

Given the uncertainty surrounding the global economic outlook it is not surprising that company optimism has deteriorated in the latest March 2001 Business Opinion Survey. The balance of company directors, more or less optimistic about their company prospects, compared with three months ago, stood at 28% in the latest survey. Whilst the latest decline is only small, it continues a downward path exhibited throughout 2000. In the December 2000 survey the balance stood at 35%, in September 39%, in June 49% and in March last year it was 57%.

Company performance levels continued 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 78%. In the previous survey the performance balance recorded 75%. The performance balance has been essentially flat over the past year.

The latest Business Opinion Survey provides mixed messages as to the economic outlook. The signals from the survey are not all negative. Capacity utilisation, reported order books, reported output and reported employment suggest a slight weakening in economic activity. In contrast, expected order books, expected employment and expected output suggest a small pick-up in economic activity. Similarly, despite much media attention at present regarding profit warnings, the evidence from our survey is more optimistic.

These results are difficult to interpret since they differ with the results of the optimism and performance balances above - expectations (akin to optimism) exceed reported (akin to performance) activity.

The balance on capacity utilisation deteriorated in the latest Business Opinion Survey. In the previous December 2000 survey the balance had risen to minus 6% - the highest level for three years - but in March 2001 the balance fell back to -13%.

The order books balance slipped back in the latest Business Opinion Survey. The balance of those company directors reporting above normal order books, compared with those reporting below normal order books, stood at 20% in the latest March survey. In December this balance was recorded at 27% and in September at 24%.

Expected order books improved in the latest survey. The latest March survey shows that the balance of those company directors expecting above normal order books, versus those expecting below normal order books, rose to 7%. In the previous survey this balance was zero.

Compared with the previous two surveys both reported and expected employment balances have only changed a small amount. The balance of those company directors reporting employment numbers up, versus those reporting employment numbers down, stood at 22% in the latest March survey. This was down slightly on the 25% balance recorded in December and the 22% balance recorded in September of last year.

The expected employment outlook has improved marginally since the previous survey. In the latest March survey the balance of company directors expecting numbers employed to be up, versus those expecting employment numbers to be down, stood at 35%. This compared with a balance of 31% in the previous survey.

The balance of those company directors reporting output up, versus those reporting it down, stood at 40% in the latest March Business Opinion Survey. The latest figure was down slightly on the 43% recording in December of last year.

The balance of those company directors expecting output to be up, versus those expecting it to be down, rose to 55% in the latest survey. In the previous survey the expected output balance stood at 48%.

Both reported profits and profit expectations edged up in the latest survey. The balance of those company directors reporting profits up, versus those reporting profits down, rose to 23% in March 2001 from 18% in December 2000.

The balance of those company directors expecting profits to be up, versus those expecting them to be down, edged higher to 37% in March 2001 from 34% in December 2000. The rise was attributable to a higher proportion of company directors expecting profits to be up.

## Costs, prices and pay

Inflationary pressures remain benign in the latest Business Opinion Survey. The balances on both reported and expected costs have fallen in the latest survey. The balance of those company directors reporting costs up, versus those reporting costs down, slipped from 38% to 35% in the latest survey. Two thirds of this small decline was attributable to fewer company directors reporting a rise in costs.

The balance of those company directors expecting costs to be up, versus those expecting them to be down, declined from 39% to 32% in the latest survey. The primary explanation for the fall in the expected costs balance was a 7% point fall in the proportion of company directors expecting future cost increases.

The balance on reported prices was essentially unchanged between the December 2000 and March 2001 Business Opinion Surveys. The balance of company directors reporting prices up, versus those reporting prices down, stood at 9% in the latest survey. In the December survey this balance stood at 8% and in September it was 7%.

The balance on expected prices fell back in the latest survey to 14% compared with 23% previously. This series has been more volatile, jumping from 10% to 23% between September and December of last year.

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 from 16% in December 2000 to 12% in the latest March 2001 survey. In September 2000 this balance stood at 23%, in June it was 14% and in March it was zero.

The average pay settlement has fallen back to 4.1% in the latest survey. This compares to a figure of 4.5% in December and 4.1% in September of last year.

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## Survey Method

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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 26 February - 9 March. 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

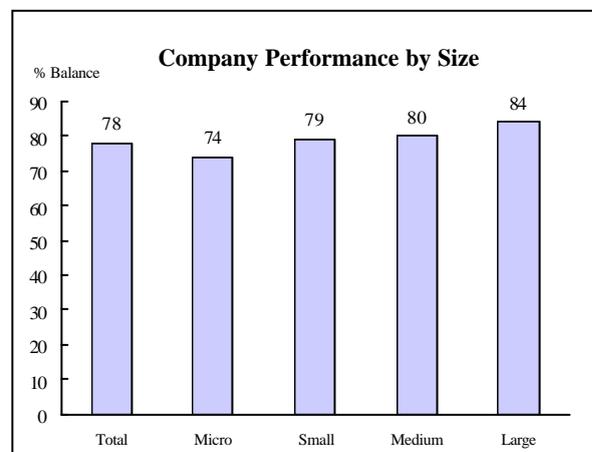
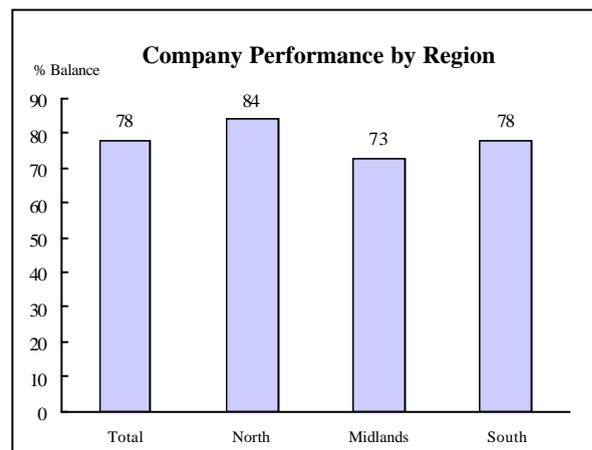
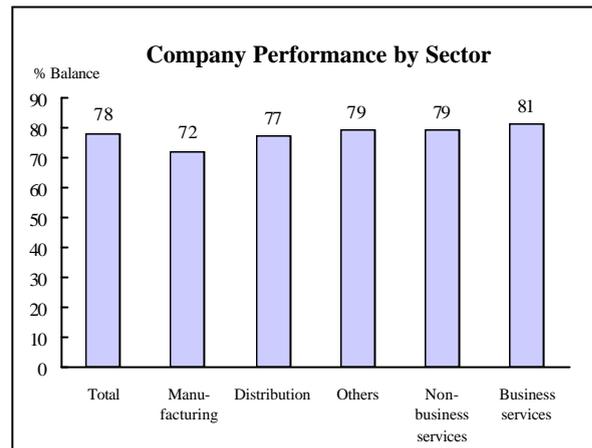
Manufacturing	
Distribution	
Others including construction/mining/transport	“Others (including construction)”
Government/Educational/Medical/Personal services	“Non-business services”
Business/Finance/Professional services	“Business services”

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.

# Company Performance

<i>How well is your company performing overall?</i>	
Well	84%
Neither well nor badly	11%
Badly	5%
Balance	+78

- **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 78%. In the previous survey the performance balance recorded 75%. The performance balance has been essentially flat over the past year.**
- **There are only small differences in the performance balance across different sectors. The performance balance in manufacturing is lowest (72%) and that in business services highest (81%), but the levels in both sectors are similar to the previous survey.**
- **Company performance by region shows the highest performance balance in the North (84%) and the lowest performance balance in the Midlands (73%). Whilst the regional rankings shifted in the latest survey, the actual differential between highest and lowest performers remains small.**

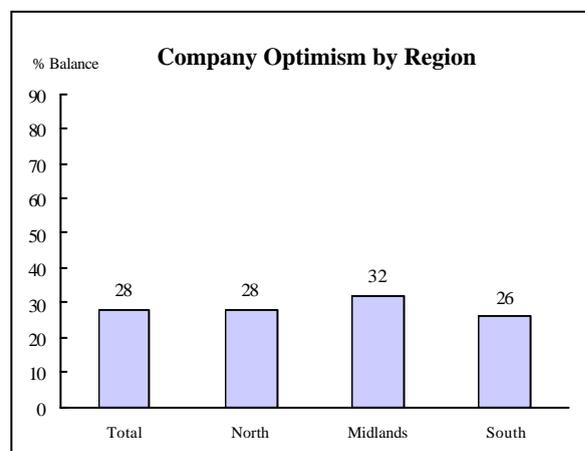
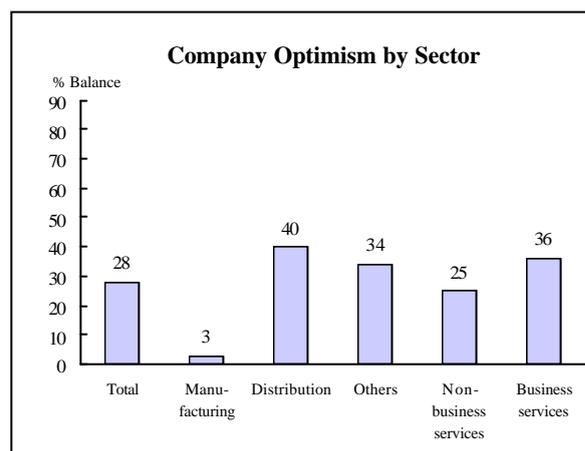


## Company Optimism

- **Company optimism has deteriorated in the latest Business Opinion Survey. The balance of company directors more or less optimistic about their company prospects, compared with three months ago, stood at 28% in the latest survey. Whilst the latest decline is only small, it continues a downward path exhibited throughout 2000. In the previous December 2000 survey the balance stood at 35%, in September 39%, in June 49% and in March last year it was 57%.**
- **Analysis by sector shows a sharp decline in optimism for the manufacturing, others and non-business services sectors.**
- **Company optimism by region remains fairly evenly distributed**

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

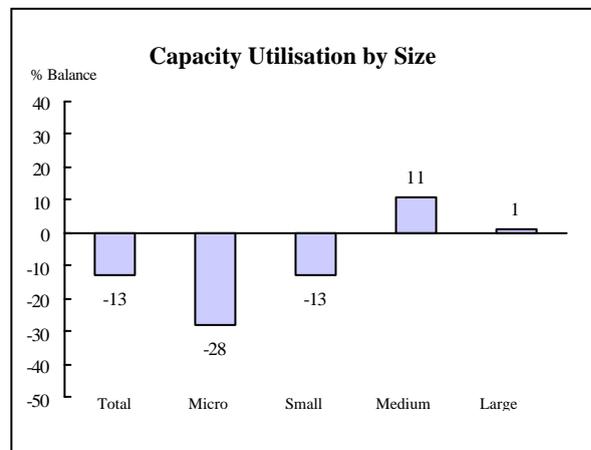
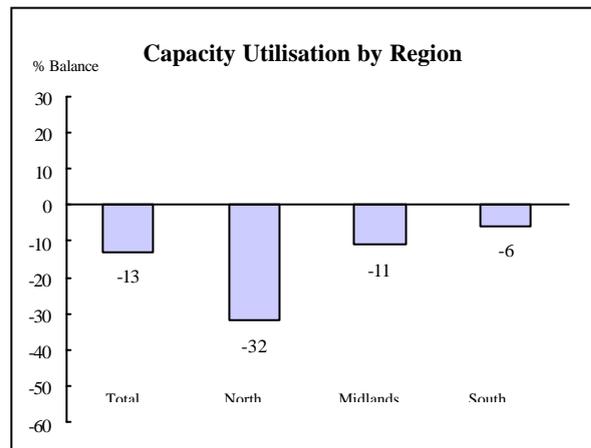
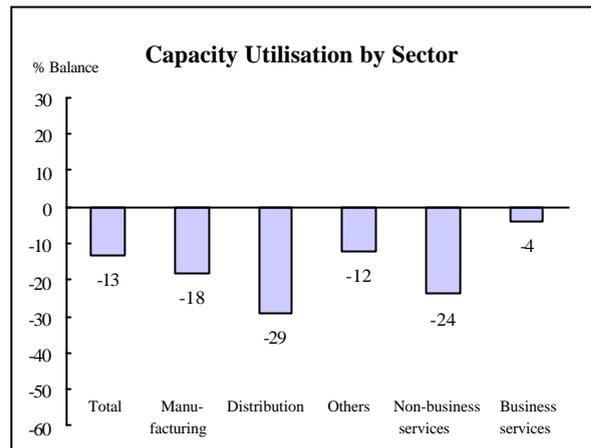
More	52%
Same	24%
Less	24%
Balance	+28



# Capacity Utilisation

<i>Are you currently operating at full capacity?</i>	
Yes	44%
No	56%
Balance	-13

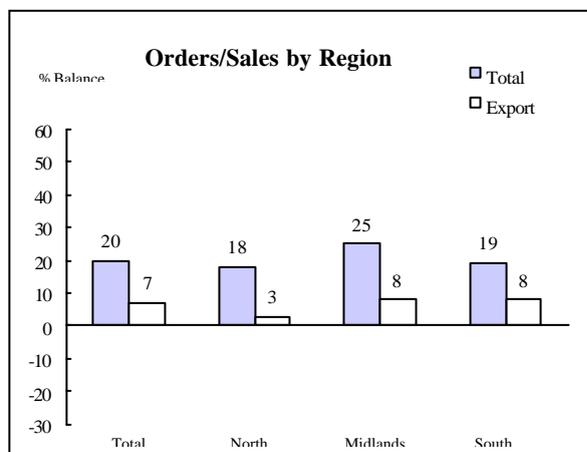
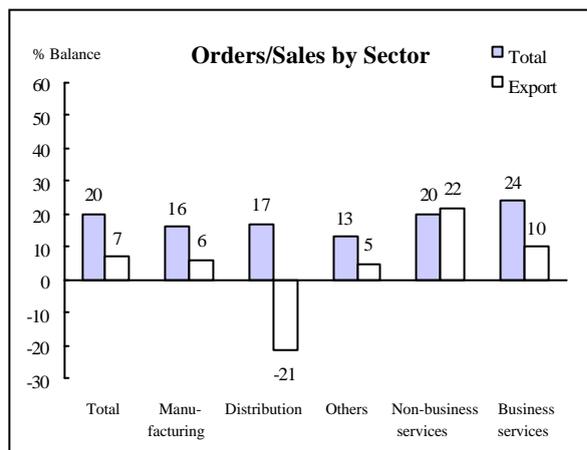
- The balance on capacity utilisation deteriorated in the latest Business Opinion Survey. In the previous survey the balance had risen to minus 6% - the highest level for three years - but in March 2001 the balance fell back to minus 13%.
- Clear sectoral differences are seen in the capacity utilisation balance, with the distribution sector displaying the worst levels of capacity utilisation. However, in the latest survey the capacity utilisation balance for manufacturing has notably improved from minus 31% in December to minus 18% now.



# Order Books

- The balance on order books slipped back in the latest Business Opinion Survey. The balance of those company directors reporting above normal order books, compared with those reporting below normal order books stood at 20% in the latest March survey. In December this balance was recorded at 27% and in September at 24%.
- The balance on expected order books has improved in the latest survey. The latest March survey shows that the balance of those company directors expecting above normal order books, versus those expecting below normal order books, rose to 7%. In the previous survey this balance was zero.

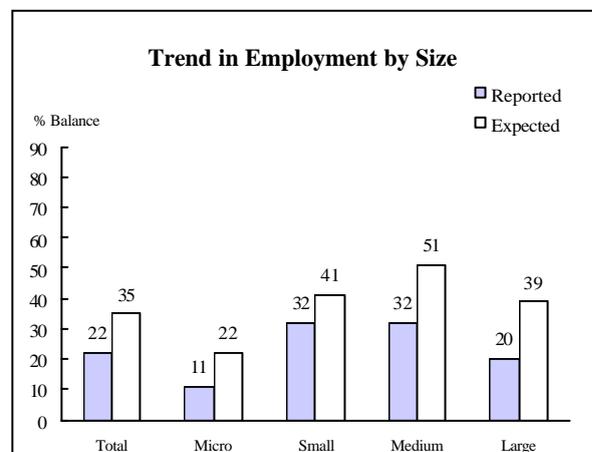
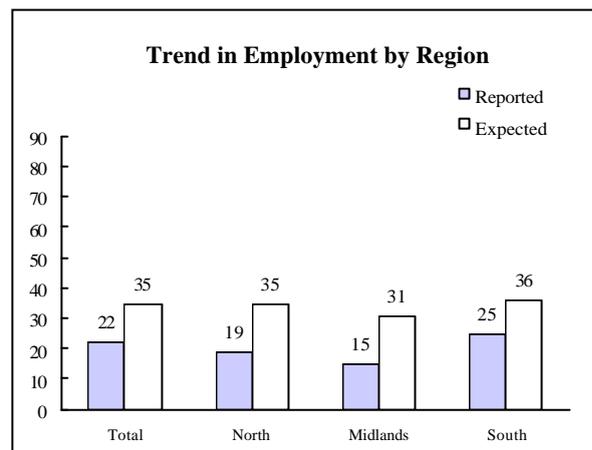
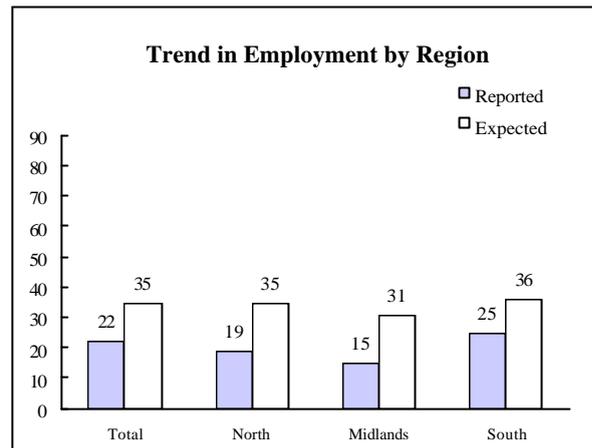
<i>Order books</i>	
Above normal	39%
Normal	42%
Below normal	19%
Balance	+20
<i>Export order books</i>	
Above normal	34%
Normal	39%
Below normal	27%
Balance	+7



# Employment

	Reported	Expected
Up	36%	43%
Same	50%	48%
Down	14%	8%
Balance	+22	+35

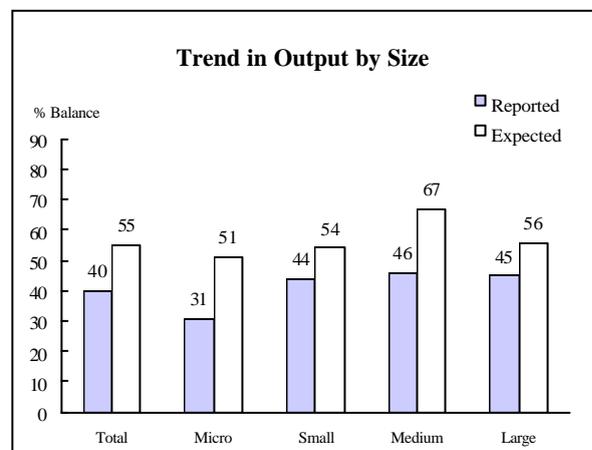
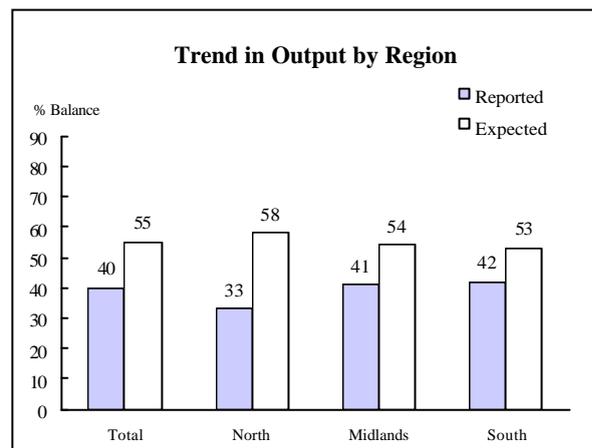
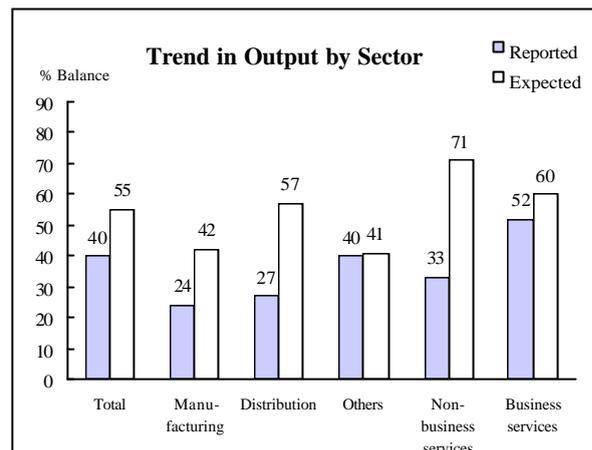
- Compared with the previous two surveys both reported and expected employment balances have only changed a small amount. The balance of those company directors reporting employment numbers up, versus those reporting employment numbers down, stood at 22% in the latest March Business Opinion Survey. This was down slightly on the 25% balance recorded in December and 22% balance recorded in September of last year.
- The expected employment outlook has improved marginally since the previous survey. In the latest March survey the balance of company directors expecting the number employed to be up, versus those expecting employment numbers to be down, stood at 35%. This compared with a balance of 31% in the previous survey.



# Output

<i>Trend in Output</i>		
	Reported	Expected
Up	55%	62%
Same	29%	31%
Down	16%	7%
Balance	+40	+55

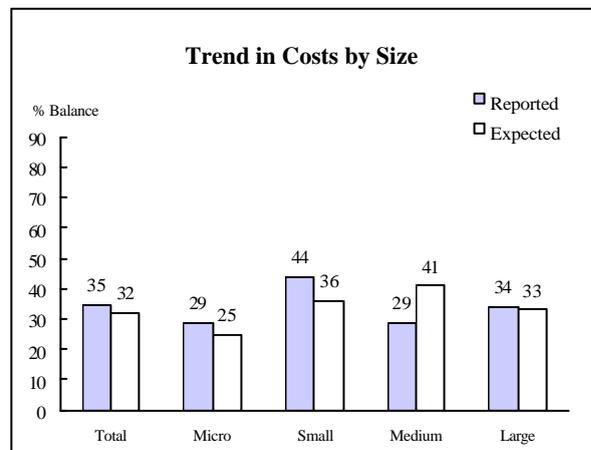
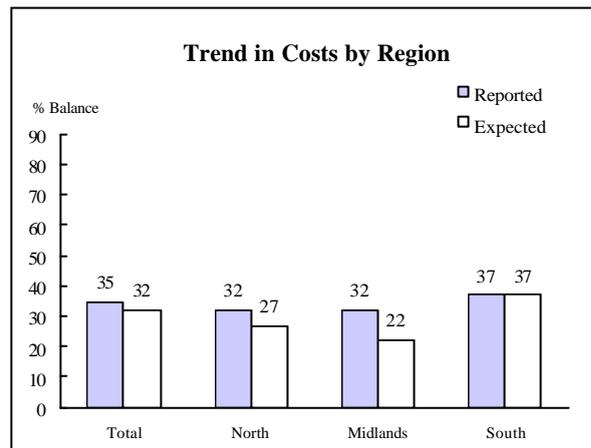
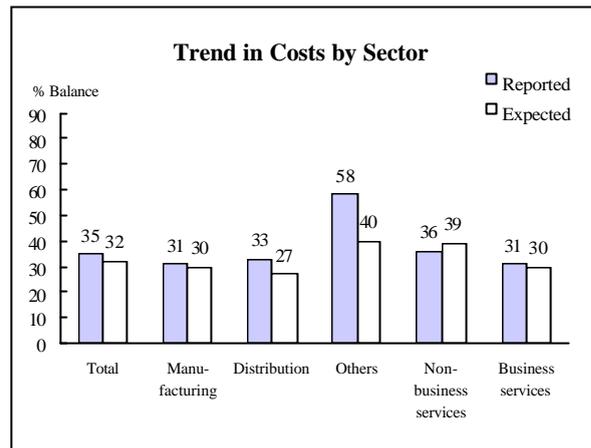
- The balance of those company directors reporting output up, versus those reporting it down, stood at 40% in the latest March Business Opinion Survey. The latest figure was down slightly on the 43% recording in December of last year.
- The balance of those company directors expecting output to be up, versus those expecting it to be down, rose to 55% in the latest survey. In the previous survey the expected output balance stood at 48%.



# Costs

	Reported	Expected
Up	45%	41%
Same	44%	49%
Down	11%	9%
Balance	+35	+32

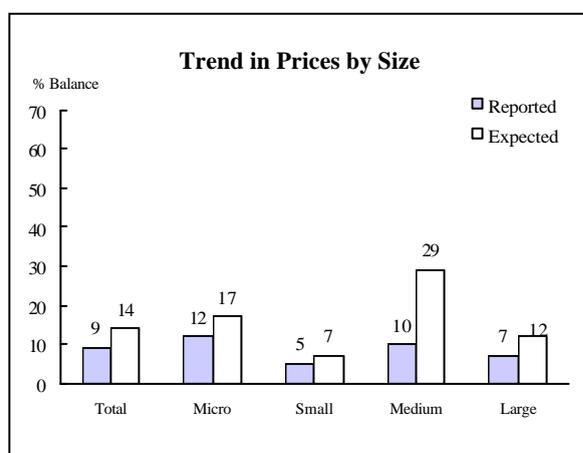
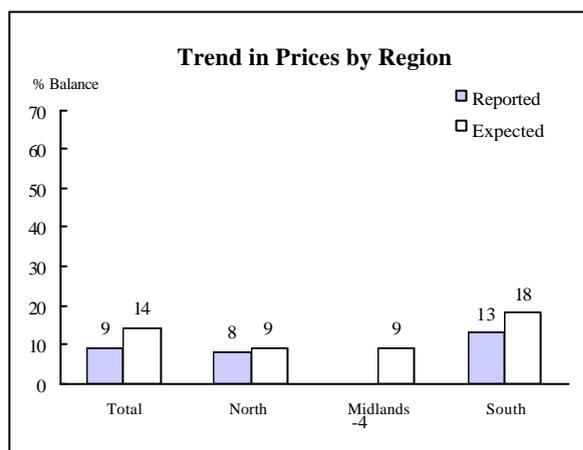
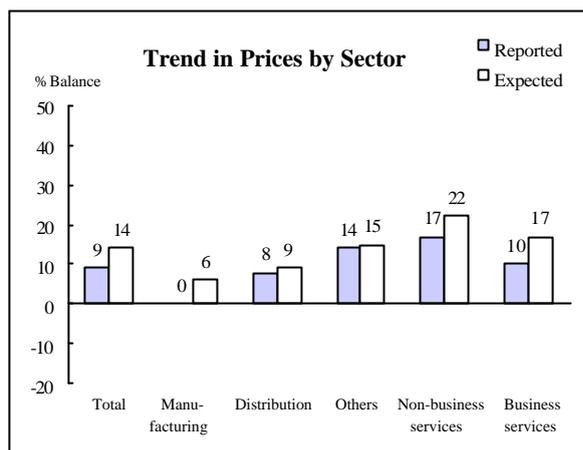
- The balances on both reported and expected costs have fallen in the latest survey. The balance of those company directors reporting costs up, versus those reporting costs down, slipped from 38% to 35% in the latest survey. Two thirds of this small decline was attributable to fewer company directors reporting a rise in costs.
- The balance of those company directors expecting costs to be up, versus those expecting them to be down, declined from 39% to 32% in the latest survey. The primary explanation for the fall in the expected costs balance was a 7% point fall in the proportion of company directors expecting future cost increases.



# Prices

	Reported	Expected
Up	21%	23%
Same	67%	68%
Down	12%	9%
Balance	+9	+14

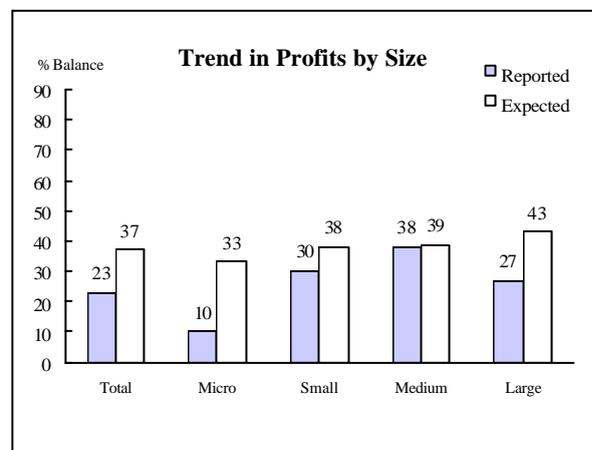
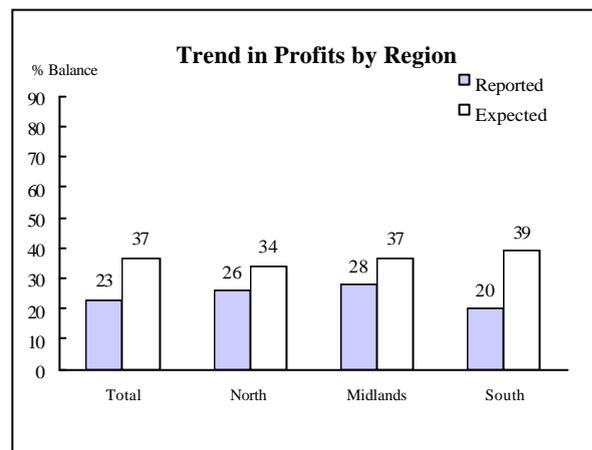
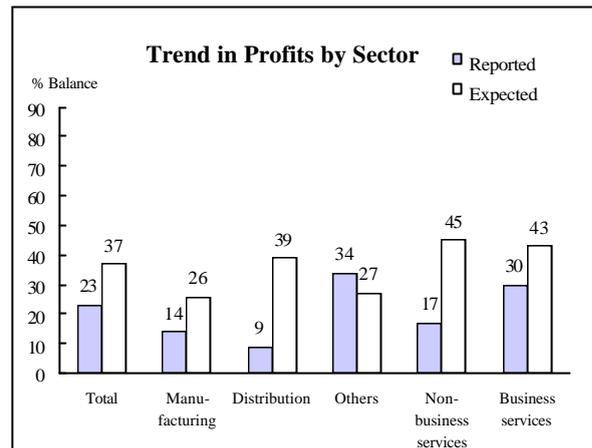
- The balance on reported prices was essentially unchanged between the December 2000 and March 2001 Business Opinion Surveys. The balance of company directors reporting prices up, versus those reporting prices down, stood at 9% in the latest survey. In the December survey this balance stood at 8% and in September it was 7%.
- The balance on expected prices fell back in the latest survey to 14% compared with 23% previously. This series has been more volatile, jumping from 10% to 23% between September and December of last year.



# Profits

	Reported	Expected
Up	43%	50%
Same	37%	38%
Down	20%	12%
Balance	+23	+37

- Both reported profits and profit expectations edged up in the latest survey. The balance of those company directors reporting profits up, versus those reporting profits down, rose to 23% in March 2001 from 18% in December 2000.
- The balance of those company directors expecting profits to be up, versus those expecting them to be down, edged higher to 37% in March 2001 from 34% in December 2000. The rise was attributable to a higher proportion of company directors expecting profits to be up.

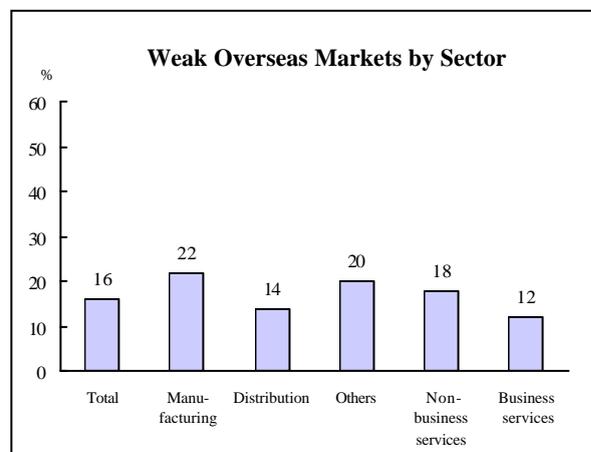
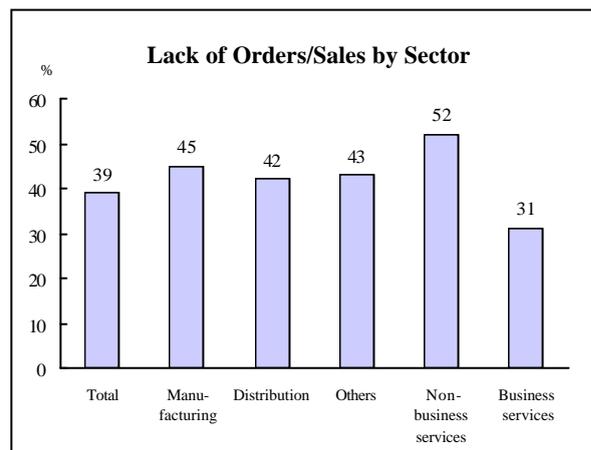
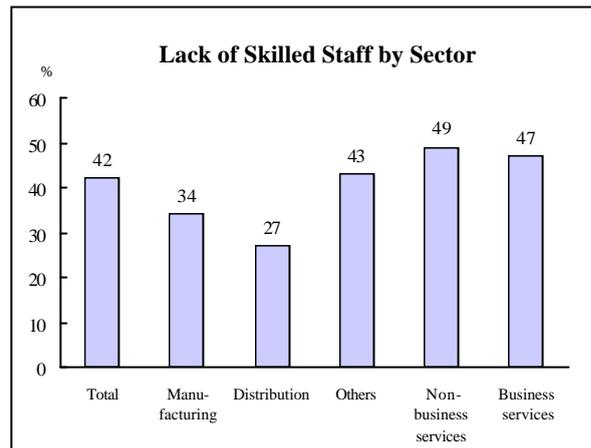


# Factors limiting output

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

Lack of skilled staff	42%
Lack of orders/sales	39%
Other staffing problems	18%
Weak overseas markets	16%
Credit or finance	16%
Plant capacity	7%
Lack of materials or components	7%

- The two most significant factors limiting output over the next three months show very little change in the latest survey. Lack of skilled staff remains the number one factor, followed by a lack of orders/sales.
- Weak overseas markets has fallen from third to fourth place in the rankings, but the proportion of company directors citing this factor has increased from 12% to 16% 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 from 16% in December 2000 to 12% in the latest March 2001 survey. In September 2000 this balance stood at 23%, in June it was 14% and in March it was zero.
- The average pay settlement has fallen back to 4.1% in the latest survey. This compares to a figure of 4.5% in December and 4.1% in September of last year.

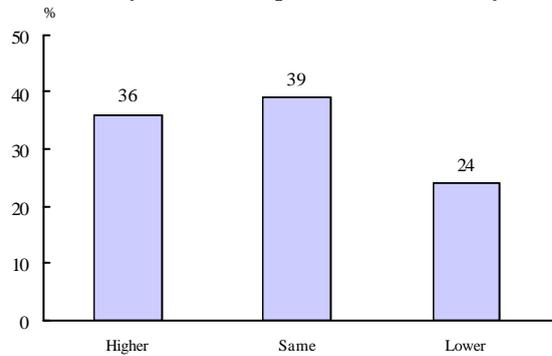
*If you made a pay award in the last 3 months, what was the average percentage increase?*

2% or less	7%
2-3%	30%
3-4%	26%
4-5%	15%
5-7.5%	8%
7.5% or more	15%

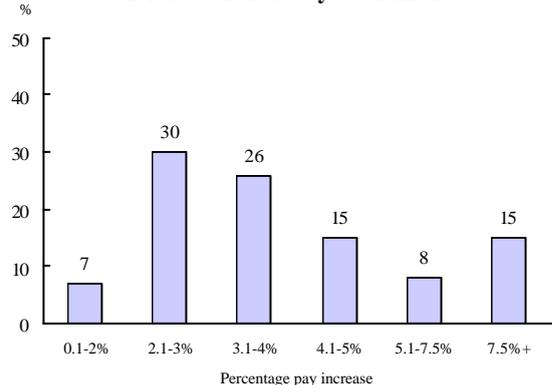
*How did it compare with the previous pay award?*

Higher	36%
Same	39%
Lower	24%
Balance	+12

**Current Pay Award Compared to Previous Pay Award**



**Distribution of Pay Settlements**



## Investment

- Investment intentions in buildings, training, plant, machinery & equipment are almost identical in the latest survey, as compared with the previous one.
- Investment intentions in product and process innovation/R&D have reduced, with a rise from 23% to 30% in the proportion of company directors expecting no investment in this category.

*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	15%
None in either period	40%

### **Plant, machinery and equipment**

More	49%
Same	28%
Less	15%
None in either period	7%

### **Product and process innovation/R&D**

More	36%
Same	29%
Less	5%
None in either period	30%

### **Training**

More	52%
Same	36%
Less	4%
None in either period	8%

# UK Economic Update: Recent Developments and Prospects

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## Latest statistics

Recently a number of commentators have downgraded their GDP forecasts for the UK economy in 2001. Pricewaterhouse Coopers have reported that a US hard landing could shave GDP growth from 2.5% to 1.8% in 2001, whilst the knock-on effects of the foot and mouth crisis could reduce growth by a further 0.3 to 0.8% points. This suggests UK GDP growth might fall to just 1% in 2001. CEBR estimate that stock market weakness and the economic impact of foot & mouth will reduce UK GDP growth to around 2% in 2001.

Latest figures show that the UK economy expanded by 0.4% (qtr-on-qtr) and 2.6% (yr-on-yr) in the final quarter of 2000. For 2000 as a whole GDP is estimated to have increased by 3.0% (yr-on-yr). Analysis of the various expenditure components shows that UK domestic demand was relatively robust, as was the demand for imports and exports. In the final quarter of 2000 household consumption increased by 3.4% (yr-on-yr), gross fixed capital formation by 3.2% (yr-on-yr), general government expenditure by 2.9% (yr-on-yr), exports by 8.7% (yr-on-yr) and imports by 8.8% (yr-on-yr). However, the quarter on quarter profile did display signs of weakening activity. First, household consumption rose by 0.6% (qtr-on-qtr), an annualised rate of 2.5%. Second, the household savings ratio jumped from 3.4% to 5.5% of disposable income between the third and fourth quarters. However, more recent indicators suggest consumers remain confident - the volume of retail sales jumped from 3.4% (yr-on-yr) growth in January to 5.8% (yr-on-yr) in February.

Unemployment - claimant count measure - fell by 10,600 in February to 0.996 million, a rate of just 3.4%. In the South east of England the claimant count rate is just 1.7%. The ILO unemployment measure fell to 1.535 million over the November-January period, a rate of 5.2%. Employment rose by 102,000 to 28.086 million over the same period.

Inflationary pressures remain relatively weak. RPIX rose by 0.5% (mth-on-mth) and 1.9% (yr-on-yr) in February. However, despite the latest monthly increase, the overall index is still less than in December, owing to a 0.7% (mth-on-mth) fall in January. International comparisons using the HICP measure show that the UK has the lowest inflation rate in the EU. In February the HICP measured UK inflation at 0.8% (yr-on-yr), compared with an EU average of 2.3% (yr-on-yr).

Producer price pressures are also weak. Producer output prices fell 0.1% (mth-on-mth) to rise by only 1.6% (yr-on-yr) in February - the lowest rate of growth since August 1999. Excluding food, beverages, tobacco and petroleum products, core output prices rose by just 0.5% (yr-on-yr) in February. Producer input prices rose by 6.1% (yr-on-yr) in February, around half the rate of growth seen last Autumn in the wake of the spike in oil prices. Core input prices rose by 4.9% (yr-on-yr) in February.

Average earnings growth for the whole economy has picked up from a low of 4% last August to a provisional 4.4% in January. This was split between a private sector rate of 4.5% and a public sector rate of 3.8%. In addition to steady income growth, wealth effects from the housing market are still positive. The most recent RICS survey shows the house price-balance returning to the level seen in the second quarter of last year. The latest Nationwide index shows UK house price inflation of 7.2% (yr-on-yr) in March.

The uncertainty at present is whether positive wealth effects from the housing market will maintain the savings ratio at the low level seen in the final quarter of last year, or whether negative wealth

effects from the equity market will contribute towards driving the savings ratio upwards, and to what extent.

Survey data for the UK does not as yet display any serious weakening in the economy. The headline CIPS services survey remained unchanged at 57.1 in February. The latest CIPS manufacturing survey did however show orders and output falling for the first time in two years.

The latest NTC Leading Indicator has risen for the fourth successive month in February. This signals an upturn in the UK business cycle during the second half of 2001. The Leading Indicator declined for ten successive months to hit a ten-year low in October 2000.

The NTC Coincident Indicator fell for the twelfth consecutive month in January. NTC report that this index is now below the 100 mark for the first time since April 1992, and suggests a rate of economic growth fractionally below the long-term trend in early 2001. NTC report that the overall pace of economic growth in the UK is likely to continue to deteriorate in the second quarter, although the likelihood of growth picking up in the second half of 2001 has improved.

**Should interest rates fall further or stay on hold?**

Hold at 5.5%	Reduce from 5.75%
Unemployment rate at 3.4%	RPIX 1.9% (yr-on-yr) in February
Employment increased by 102,000 to 28.086 mn	Stock market fall and reverse wealth effects
RPIX up 0.5% (mth-on-mth) in February	Impact of US downturn on the global economy
Retail sales volumes 5.8% (yr-on-yr) in February	Real interest rates at 4%
Private sector earnings growth 4.5% in January	RPIX below target for the past 22 months
Broad money M4 up almost 10% (yr-on-yr)	
NMW increase to £4.10 in October 2001	
CSR expenditure kicks-in in 2001	

The latest March 2001 Financial Statement and Budget Report provides a fiscal boost of around 0.5% of GDP in 2001-02 - as compared with the Pre-Budget Report in November 2000. The main fiscal measures included the over-indexation of the starting rate band for income tax, together with measures supporting families with children and extra departmental spending on health and education. Whilst certain of the Budget measures might re-distribute income towards lower income families with a higher marginal propensity to consume, other petrol related measures could work in the opposite direction.

One of the most significant economic developments in 2001 could be a turnaround in the lead sectors of GDP growth. In the final quarter of 2000 the leading sources of GDP growth were in transport and communication (5.1% yr-on-yr) and business services and finance (4.1% yr-on-yr). Government services rose by just 1.8% (yr-on-yr) over the period. There is a likelihood that planned expenditure under the CSR, including a catch-up on underspend in the 2000-2001 financial year, might see strong growth in Government spending over the 2001-2002 period.

## The US economic outlook

What impact will the downturn in the US have on the UK economy, given that around 17% of our total exports of goods and services are accounted for by trade with the largest economy in the world? Expectations for US GDP growth in 2001 have fallen sharply. In October 2000 Consensus Economics reported a consensus forecast of 3.5% in 2001, but by March of this year expectations had halved to 1.8% growth.

There can be little doubt as to the seriousness of the downturn in the US economy. A year ago the US economy was expanding at an annualised rate of close to 6%, but twelve months later this growth rate may have fallen to zero. In a \$10 trillion economy that's a difference in output of \$600 billion.

Over \$4.5 trillion has been wiped off equity markets in the intervening period - although bond holders have made capital gains over the period - with the NASDAQ down in value by almost two-thirds. In 2000 the net worth of US households fell for the first time in 55 years. Moreover, on a number of key indicators US equity markets remain significantly overvalued:

- Price-earnings ratio - The price earnings ratio in late March stood at 22, having fallen from 33 last Autumn. However, the long term average is around 15. Given that the long term average includes the 1990s boom years, and that markets can undershoot just as easily as they overshoot, current levels suggest US equity markets could fall another 10%, 20% or even 30% or more.
- Equity market-GDP ratio - The stock market to GDP ratio peaked at 150% and is presently around 130%. Before the second half of the 1990s the ratio stood around 50%.
- Tobin's Q ratio - Following the equity market falls of the past year, Tobin's Q has moved back from three times to twice its long term average. After recent falls it is still only back to the peak levels seen in 1929 and 1967.

In the second half of 2000 the private sector in the US was running a zero savings ratio and a financial deficit close to 6% of GDP. This deficit is 11% points of GDP less than the position reached in the last recession and 8% points less than the historic average.

All of a sudden there is no more talk of the death of the business cycle, indeed much of the previous positive talk has been completely turned around. During the 1990s three factors were often flagged as extending the length of the business cycle - greater vigilance by central banks, investment in extra capacity and global competition - by suppressing inflationary pressures. As a result, the latest economic cycle has not been brought to an end by rising inflation. The latest US upswing ground to a halt because of a classic investment boom which boosted capacity to the point where expected returns on investments were hopelessly optimistic. The contractionary forces are expected to unwind in two ways:

- Companies scale back investment plans and reduce inventories.
- Consumers scale back consumption plans and increase savings.

In response to this threat the Federal Reserve has acted swiftly by reducing interest rates, with expectations of further cuts to come. We expect further cuts in US interest rates - of at least 100 basis points by the end of 2001 - as the Federal Reserve acts to stem the economic downturn.

Early indications are that consumer confidence in the US has stabilised - helped by interest rate expectations and prospective tax cuts of \$1.6 trillion over the next decade. At the end of March 2001 the jury is still out as to whether the US economy will achieve a soft or hard landing in 2001. Our forecasts assume that the US economy achieves a soft landing in 2001, but we readily acknowledge that the risk of a far more serious downturn is very real.

## UK economic forecasts

The IoD has reduced its GDP forecasts over the 2001-2002 period (see table) in the wake of stock market uncertainty and the foot & mouth crisis. Whilst the agricultural sector accounts for less than 1.5% of GDP, the knock-on effects on tourism and other elements of the rural economy will be serious. Compared with our previous forecasts we have made three key changes. First, GDP growth in 2001-2002 has been reduced. Second, end-year unemployment has been revised upwards. Third, end-year interest rate projections have been reduced. Following the reduction in interest rates to 5.5% in April we now expect rates to fall to 4.75% by the end of 2001. This revision is primarily due to the worsening situation in the US and the weakening economy in the EU.

### IoD Economic Forecasts

Indicator	2001	2002
GDP	2.1	2.4
Household consumption	2.2	2.4
Government expenditure	4.0	4.3
Fixed investment	2.2	2.5
RPIX (end Q4)	2.1	2.3
Unemployment, millions, end Q4	0.98	1.0
Unemployment, rate, end Q4	3.5	3.6
Base rate, % end Q4	4.75	5.0