UK Quarterly Industry Report

QUARTER 1 2017

May 2017

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WITHIN THIS REPORT YOU CAN FIND ANALYSIS OF THE FOLLOWING KEY TOPIC AREAS:

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GLOSSARY OF TERMS

Business failure - A 'Failed Business' means any business that seeks legal relief from its creditors or ceases operations without paying all its creditors in full.

Company* - A legal entity, made up of an association of people (be they natural, legal, or a mixture of both), for carrying on a commercial or industrial enterprise.

Corporations - A 'Corporation' is a company or group of people authorised to act as a single entity (legally a person) and recognised as such in law.

Non-registered business - A business that is not recognised as a separate legal entity and not registered at that country's official companies registry (e.g. Companies House in the UK).

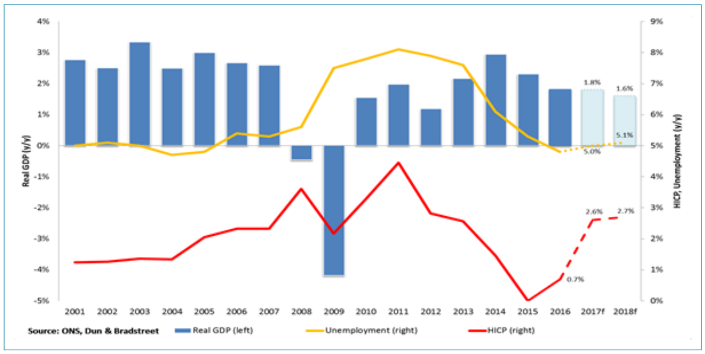
Firm - A business organisation that sells goods or services to make a profit, regardless of registration status.

*Companies included in this report are those registered at Companies House.

1.0 UK ECONOMIC OUTLOOK

FORWARD-LOOKING INDICATORS STILL ROBUST

On the economic front the picture still looks reasonably good, with forward-looking indicators continuing to show robust readings. Eurostat's Industrial Confidence Indicator stood at 9.1 in Q1 2017, the highest reading since Q2 2014. Despite a modest appreciation after the news of a snap election, the pound is still down significantly against pre-referendum values, especially against the US dollar. This means that British manufacturers have gained price competitiveness on global markets over the past three quarters, a trend we expect to last until the Brexit negotiations are completed. Meanwhile, consumer confidence is flat, coming in at -4.3 in March (meaning that more people are pessimistic about the economic outlook than are optimistic). While the current economic situation is not universally seen as a problem, concerns about the macroeconomic outlook created by Brexit are weighing on confidence levels. Taking all factors into account, we expect the economy to grow by 1.8% in 2017, unchanged from last year.



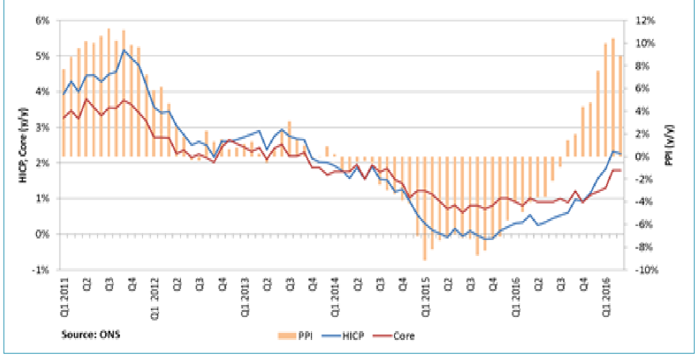
SNAP ELECTION CALLED

In a surprise move, Prime Minister Theresa May called a snap election for 8 June. Parliament overwhelmingly approved her request on 19 April, which means that the country is heading for its second general election in just over two years. Dun & Bradstreet expects May's centre-right Conservative Party to win the vote, given the reasonably good state of the economy and, more importantly, the disarray in the centre-left Labour Party, the main opposition party. If, as expected, the government increases its working majority from the currently meagre 17 seats, the passage of controversial laws around Brexit will become easier. This will improve May's position in domestic politics, but not necessarily in the upcoming negotiations with the EU. Worryingly, separatist forces in Scotland and Northern Ireland are expected to achieve a good result as well, thereby endangering the structural integrity of the country over the medium to long term (especially in Scotland).

Regardless of May's surprising decision to call an election, our Brexit baseline scenario remains unchanged: Dun & Bradstreet expects the UK to exit the EU in March 2019. An interim arrangement will come into force until a free-trade agreement (FTA) is negotiated, with the British government certainly pushing for a completion date before the 2022 elections.

During the period that the interim arrangement is in place, the UK might have to accept the supremacy of the European Court of Justice over British courts, and the free movement of labour in exchange for ongoing market access. However, in the yet-to-be-started negotiations about the FTA, it seems very likely that the British government will sacrifice access to the EU's market in order to regain control over its immigration policy, thereby creating significant risks to supply chains involving the UK. We recommend monitoring the situation continuously, as the frequency of events remains high.

INFLATION



In the background to this, the UK fell by one position in the World Bank's recent *Doing Business 2017* report, slipping from 6th to 7th, thereby still outperforming most of its peers. Overall, seven out of ten sub-indices deteriorated and two stagnated. The only sub-ranking where the UK saw an improvement was 'paying tax'; the country rose from an already high 11th spot to 10th. Compared with the OECD average, it takes fewer payments (8.0 versus 10.9) and less time (110.0 hours versus 163.4 hours) to settle tax bills, with the total tax rate (as a percentage of profits) in the UK also comparing very favourably against the OECD average (30.9% versus 40.9%).

AVERAGE WEEKLY EARNINGS GROWTH AND INFLATION

2.0 GLOBAL ECONOMIC OUTLOOK: BUSINESS OUTLOOK IS STRENGTHENING

The global economy continues to record solid expansion, as measured by various PMIs. The euro-zone's IHS Markit PMI reached 56.7 in March; its highest level in six-years. Meanwhile, the US manufacturing Markit PMI weakened slightly in February from its 22-month high in January, a pattern followed by the J.P. Morgan Global Manufacturing & Services PMI. The forward-looking indicators suggest stronger global growth in 2017 on the back of improved business conditions. We are currently forecasting global output growth to improve from an estimated 2.3% in 2016 to 2.7% in 2017.

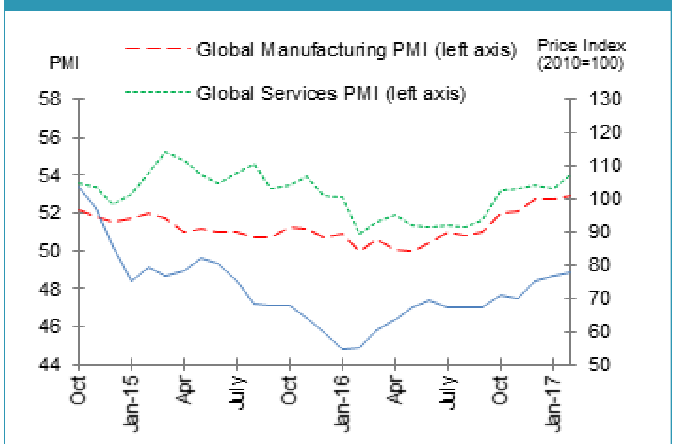
Although the parliamentary election in The Netherlands saw the populist candidate defeated, political uncertainty continues to weigh on the outlook in a number of advanced countries. The overall policy direction of the Trump administration still lacks clarity, and markets in the US have weakened as the initial euphoria over the result has faded and splits within the Republican party over healthcare deepen. Other concerns revolve around the outcome of the Brexit negotiations between the UK and the EU and other elections in some major European countries, which could affect the future of the euro zone and the EU.

KEY RISK: EMERGING MARKET RESILIENCE TO FED RATE RISE

Investors were generally reassured by an adequately dovish Federal Reserve statement in March. The feared repeat of the 'taper tantrum' of 2013-14 hitting emerging markets is absent, with carry trades back in vogue, and the lack of a clear political path to a strong fiscal stimulus in the US is helping to abate US dollar strength. Most stock markets, in both the advanced and developing world, saw their main board indexes up year on year (y/y) as of late March, and the MSCI emerging markets index was up almost 19% y/y (and 12% in the past 12 weeks). It is a minority of emerging markets that have current account deficits of over 2.0% of GDP, and indeed the UK's current account deficit looks more exposed than prominent G20 emerging markets'.

The difficulties the Trump White House will face in advancing legislation that pleases both its core electorate and House Republicans are likely to temper inflation expectations and the US dollar, giving space for emerging markets to adjust to commodities' volatility and the Federal Reserve's well-telegraphed interest rate rise schedule. While we expect at least three policy rate rises from the US central bank in 2017, fiscal stimulus is rather unlikely before 2018, and in any case we do not expect it to be highly effective, given that the economy is much closer to full employment. Meanwhile, political risks from the euro-zone election cycle and Brexit negotiations appeared manageable, with the price of gold largely stable as macroeconomic factors on the demand side offset each other.

KEY GLOBAL GROWTH INDICATORS

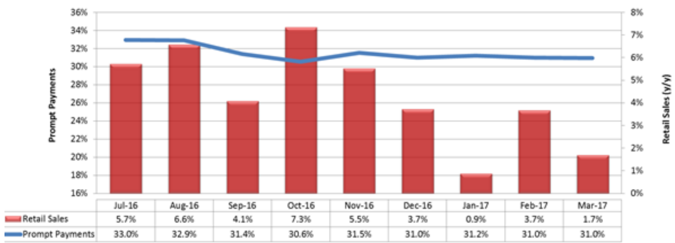


REAL GDP GROWTH (%)

	2016	2017f	2018f
World	2.3	2.7	3.0
Advanced economies	1.7	1.9	2.2
US	1.6	2.2	2.6
Euroland	1.7	1.6	1.9
Japan	1.0	1.0	1.5
UK	1.8	1.5	1.5
Emerging economies	3.4	4.2	4.5
Brazil	-3.6	0.2	1.5
Russia	-0.2	1.2	1.4
India	7.1	7.5	8.0
China	6.7	6.3	5.8

3.0 PAYMENT SNAPSHOT

PROMPT PAYMENTS TRENDLINE, JULY 2016 TO MARCH 2017



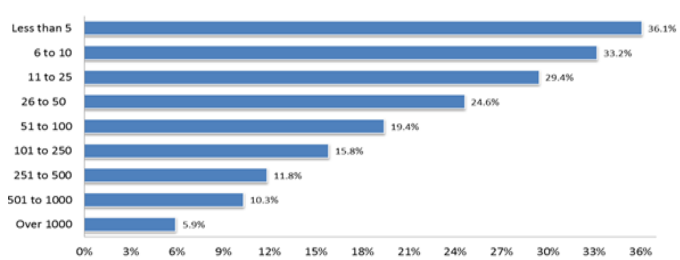
Source: Dun & Bradstreet; ONS

The chart above depicts how promptly all UK businesses have been paying their bills over the past nine months (blue line). Robust growth in Q3 and Q4 2016, and the boost to exports from a weaker pound, have not fed through into improved prompt payments, which have remained broadly stable over the past six months, according to Dun & Bradstreet's latest data. This could be partly explained by the uncertainty triggered by Brexit, which might have affected UK businesses' capacity (and/or willingness) to pay promptly, as well as by lower retail sales volumes (red bars). Looking ahead, we expect a further deterioration in prompt payments due to rising headwinds triggered by the Brexit vote.

PROMPT PAYMENT BY EMPLOYEES

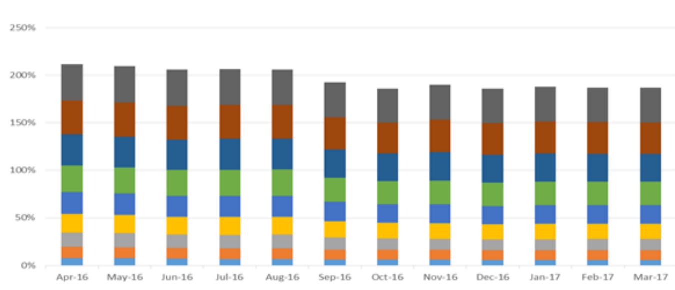
As the data in the charts below reflect, larger businesses continue to squeeze their suppliers by paying in a much slower manner than their smaller counterparts. The differential in payment habits between those companies employing 1,000 workers or more and those employing fewer than five is significant: 5.9% (it was 6.3% in Q4 2016) as opposed to some 36.1% (from 33.8% in Q4).

PROMPT PAYMENT BY EMPLOYEE SIZE FOR Q1 2017



Source: Dun & Bradstreet

PROMPT PAYMENT BY EMPLOYEE BAND

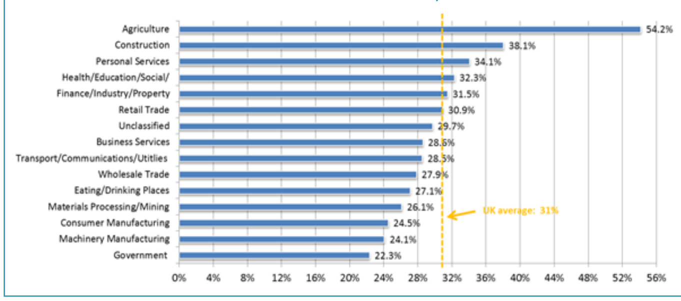


Indeed, late payments remain a major problem for UK-based small and medium-sized enterprises (SMEs). While legislation is in place to assist small businesses with their struggle against late payments, most businesses, especially SMEs, elect to take no action for fear of alienating their larger customers. Indeed, according to the Association of Chartered Certified Accountants (ACCA), firms with fewer than 50 employees are typically twice as likely as larger businesses to experience late payment issues. Besides giving rise to tighter financial conditions and higher administrative, transaction and financial costs (external financing may be necessary to manage cash flows), late payments can cause insolvency and ultimately lead to bankruptcy.

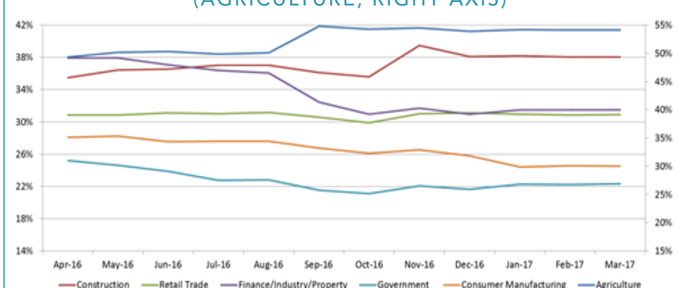
PROMPT PAYMENT BY INDUSTRY

As Dun & Bradstreet data show, payment habits by industry remained substantially stable on a quarter-on-quarter (q/q) basis in Q1 2017. The data, broken down by industrial sector, reveal that between Q4 2016 and Q1 2017 the largest deterioration in payment habits was recorded in the 'Consumer Manufacturing' sector, followed by the 'Eating/Drinking Places' and 'Personal Services' sectors. 'Health and Education', 'Government', and 'Machinery Manufacturing' sectors recorded the largest improvement in prompt payments (up by 0.8%, 0.7% and 0.4%, respectively).

PROMPT PAYMENT BY INDUSTRY, Q1 2017



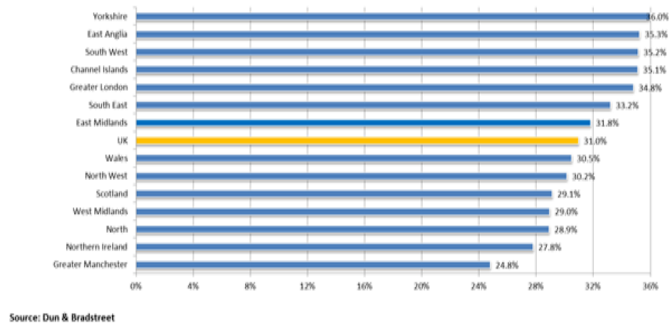
PROMPT PAYMENT EVOLUTION IN CRITICAL SECTORS (AGRICULTURE, RIGHT AXIS)



Source: Dun & Bradstreet

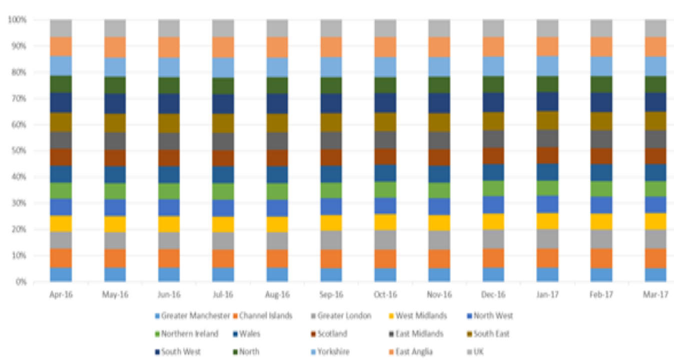
PROMPT PAYMENT BY REGION

PROMPT PAYMENT BY REGION, Q1 2017

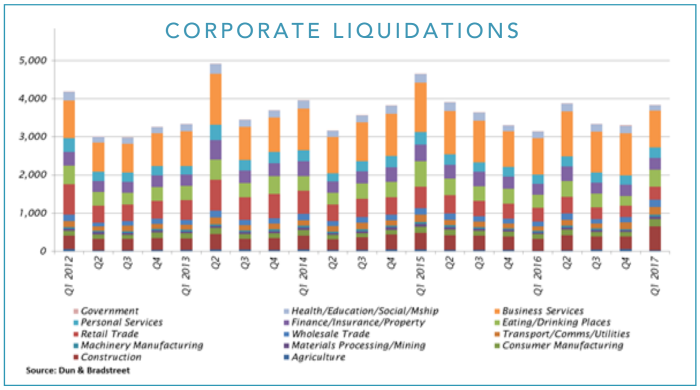


Dun & Bradstreet's Q1 data reveal that overall payment performance has remained stable in almost all regions. The West Midlands' average prompt payments (as a percentage of total payments) edged slightly up to 29%, from 28.8% in Q4 (although it remains one of the worst performers). The Greater Manchester area continues to lag behind all the other regions (only 24.8% of payments were made promptly, compared to a UK average of 31%), while the East Anglia and the Yorkshire areas exhibit the best payment performance times (35.3% and 36%, respectively).

PROMPT PAYMENTS BY REGION

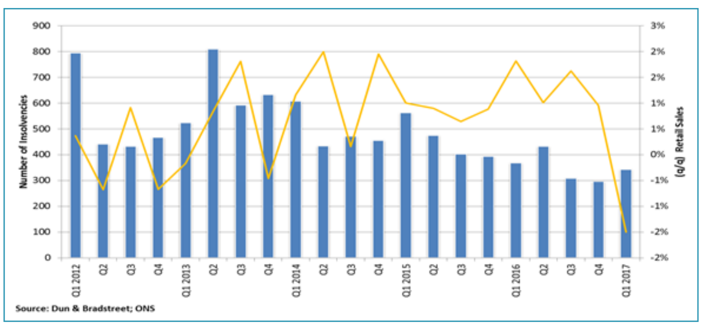


4.0 CORPORATE LIQUIDATIONS



The number of corporate insolvencies edged up in Q1, according to Dun & Bradstreet data: 3,824 companies liquidated in the three months to March, compared to 3,307 the previous quarter. Between Q4 2016 and Q1 2017, corporate insolvencies were up in almost all the sectors of the economy, with increases of 94.8% q/q in 'Construction' and 93.3% q/q in 'Machinery Manufacturing'. Meanwhile, 'Government', 'Agriculture' and 'Health and Education' were among the sectors recording the highest decrease in the amount of liquidations, down by 87.5% q/q, 53.3% q/q, and 28.3% q/q, respectively.

CORPORATE LIQUIDATIONS : RETAIL TRADE



The Office of National Statistics' (ONS) data reveal a slump in retail sales volume in Q1: retail sales volumes fell by 1.5% y/y in Q1, after expanding by 0.9% y/y in Q4 2016. Tallying with disappointing retail trade data, Dun & Bradstreet's proprietary data show a significant rise in corporate insolvencies in the retail sector – which accounts for almost 6% of the UK economy – in Q1 (up by 15.8% q/q).

Looking forward, we expect a slight increase in the unemployment rate on account of slower GDP growth, and so we expect retail sales growth to decelerate in the quarters ahead. Lower sales growth could lead to a small rise in the number of liquidations in the coming quarters. Against this backdrop, the uncertainty surrounding the retail sales outlook remains high, with risks tilted to the downside. On the upside, the still-low unemployment rate will continue to provide a boost to domestic sales volumes. On the downside, a slowdown in overall economic growth, Brexit, and lower real wage growth (on account of rising inflation) could weigh on consumer spending.

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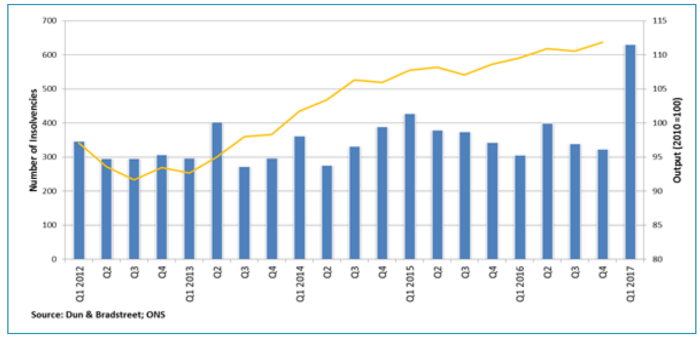
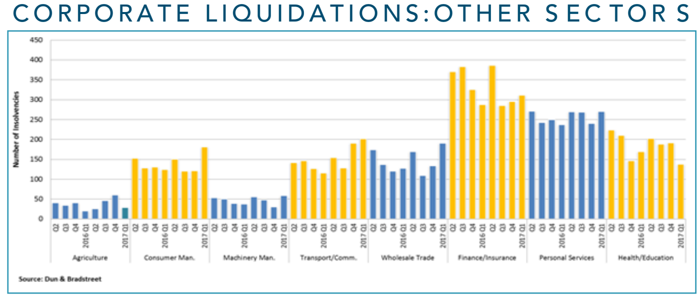
CORPORATE LIQUIDATIONS: CONSTRUCTION



The number of construction companies liquidating in the first quarter of 2017 nearly doubled with respect to the previous quarter: 631 companies failed in Q1, while 324 liquidated in Q4 2016. The construction industry plays an important role in the UK economy; the entire sector contributes some £90bn in gross value added to the UK economy and supports 2.9m jobs. Lower momentum in this sector is likely to weigh on real GDP growth in the quarters ahead.

The latest seasonally adjusted Markit/CIPS UK Construction Purchasing Managers' Index (PMI) tallies with the implied weakening of momentum in the sector, with the rate of expansion of sectorial activity easing between February and March. Although it remained above the 50-point expansion threshold, the PMI posted a reading of 52.2 in March, down from 52.5 in February. March's data revealed a slowdown in growth across the UK construction sector, led by a weaker rise in residential building activity. The latest survey also pointed to only a marginal increase in new work, which contributed to slower employment growth and a slight decline in input buying. However, construction companies remain relatively upbeat about their near-term growth prospects, partly reflecting a stabilisation of client confidence from the post-referendum lows seen in 2016. Optimism regarding year-ahead business activity picked up in March to its second-highest since December 2015, according to Markit.

CORPORATE LIQUIDATIONS:OTHER SECTORS



The chart above shows the number of corporate liquidations in several critical sectors. Insolvencies rose by some 49.5% q/q in 'Consumer Manufacturing' and by 42.8% q/q in 'Wholesale Trade'. Liquidations dropped in the 'Business Services' sector by 13.1% q/q.

5.0 RISK OF FAILURE AND PAYMENT DELINQUENCY – INDUSTRY SECTOR COMPARISON

		RISK OF FAILURE	
		RISK (Rating 1,2,3) Minimal to above average risk	**HIGH RISK** (Rating 4)
RISK OF VERY SLOW PAYMENT	**HIGH RISK** (Delinquency Score <=11)	**CASH VULTURES** UK AVERAGE – 21% RETAIL – 11% CONSTRUCTION – 15% Offer discount for prompt payment Charge interest on late payments Reset payment terms accordingly Improve relationship with client to induce prompt payment	**TROUBLE – LET YOUR COMPETITORS HAVE THEM** UK AVERAGE –3% RETAIL – 3% CONSTRUCTION – 4% Increase prices to cover risk Reduce exposure - stop orders until paid Take guarantees Monitor vigorously Avoid new clients with this profile Up-front payment
	RISK Minimal to above average risk (Delinquency Score >=10)	**IDEAL CUSTOMERS – CULTIVATE** UK AVERAGE – 75% RETAIL – 85% CONSTRUCTION – 80% Push for more sales Strengthen relationship with client	**MONITOR CLOSELY** UK AVERAGE – 1% RETAIL – 1% CONSTRUCTION – 1% Reduce exposure – minimise outstanding orders Monitor vigorously Take guarantees

Dun & Bradstreet's statistical analysis reveals that some 3% of UK businesses are deemed to be at high risk of liquidation and are highly likely to pay in a severely delinquent manner, while 75% offer a low risk of failure and of slow payment. Sales emphasis towards these latter businesses will enhance opportunities and enable suppliers to reduce risks of non-payment.

Additionally, some 21% of UK businesses fall within the lower risk categories and are thus less likely to fail; however, the payment habits they exhibit are somewhat slow, and while suppliers can be fairly secure in the knowledge that the business will not fail, payment may be somewhat protracted.

DUN & BRADSTREET'S OVERALL RECOMMENDATIONS

– Monitor negotiations between the UK and the EU; the outcome will have an immense impact on the UK's country risk rating in general and market access conditions in particular.

– Firms should adopt a wait-and-see approach; it will be many more quarters before uncertainty about post-Brexit trade relations is lifted.

– Expect the UK to lose full access to the EU's common market – although certain sectors should be able to trade more easily than others.

– Count on the economy growing by just 1.5% in 2017 – the lowest rate since 2012.

– Monitor the government's plans for increased infrastructure spending (such as a new runway for Heathrow airport).

– We expect a deterioration in the share of prompt payments in the quarters ahead on the back of lower GDP growth.

– Keep in mind that the UK was one of only nine countries in our Global Bankruptcy Report 2016 (out of a total 38) that saw an increase in business failures last year.

– Monitor developments in the banking sector; support from the central bank will have a stabilising impact, but further turmoil cannot be ruled out, especially if passporting rights are lost.

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ABOUT COUNTRY INSIGHT

Dun and Bradstreet also have a team of economists dedicated to analysing the risks and opportunities of doing business across the world, monitoring 132 countries on a daily basis. For further details please contact Country Risk Services on 01628 492595 or email CountryRisk@dnb.com.