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

1.0 UK Economic Outlook: Uncertainty about Brexit persists as government loses parliamentary vote
2.0 Global Economic Outlook: China headwinds will weigh on growth in 2019
3.0 Payment Snapshot: Payments performance improves considerably
4.0 Corporate Liquidations: Quarterly corporate liquidations rise sharply
5.0 Risk of Failure and Payment Delinquency: Industry Sector Comparison

We hope you find this report of use – please feel free to share it with others within your own organisation.

If you would like further information on the range of Dun and Bradstreet products and services that can provide an analysis of your own customer or supplier data, please see the final page in this document for more details.

GLOSSARY OF TERMS

Dun & Bradstreet defines specific terms as follows:

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.
We have kept the UK’s political environment outlook at ‘rapidly deteriorating’ in order to reflect the immense degree of uncertainty stemming from the Brexit issue. As a baseline scenario, we expect Brexit to be delayed by several months, with a cross-party deal on a form of ‘soft’ Brexit to be negotiated in the meantime (keeping the UK in the EU’s customs union). However, other scenarios (including another snap election) are also possible. Positively in this light, the risk of a no-deal Brexit – which would see the UK leaving the EU on 29 March 2019 on WTO trade terms – seems low at this stage, which reduces some risks for cross-border traders and international investors.

EMPLOYMENT IS RISING

Despite the ongoing political risks created by Brexit, the British labour market continues to produce good news. Latest data from the Office for National Statistics shows that the number of employed people was 32.5m in November, the highest rate since the start of the data series in 1971. Unemployment stood at a very low 1.4m in the same period, only marginally up from the summer months. From a business perspective, the low unemployment rate creates opportunities, but also risks.

Worryingly, companies are increasingly struggling to find employees, as highlighted by a rise in the number of vacancies (£53,000 in November). At the same time, wage growth is sound – easily outstripping inflation – thereby adding to companies’ costs. Positively, however, the buoyant labour market conditions and solid wage growth could create additional domestic demand, which could also help exporters to the UK. But with political developments dominating the headlines, any significant improvement will likely require a solution of the Brexit issue.
Meanwhile, forward-looking indicators have deteriorated markedly in recent quarters. While this is a trend that can also be seen in most of the UK’s European peers, the downturn in the UK is especially worrying as it coincides with elevated levels of political risks. Eurostat’s Economic Sentiment Indicator (which combines industrial, services, retail, construction and consumer confidence indicators) dropped to 103.7 in January, the lowest reading since July 2016 (the month after the Brexit referendum) and significantly below the EU-28 average of 106.1. Despite the sound performance of real wages over the past few months, consumer confidence has been falling for seven consecutive months, and the January 2019 reading is the lowest since November 2013.

At the same time, Purchasing Managers’ Indices for the manufacturing and service sectors have also fallen in recent months, and the construction industry PMI fell to 50.6 in January, a ten-month low and only marginally above the neutral 50-points line that divides expansion in sectoral activity from contraction. Taking all figures into account and assuming some form of managed Brexit, Dun & Bradstreet predicts real GDP growth to come in at 1.6% p.a. in 2019-20. However, given the political uncertainty, this figure would have to be revised downwards should the UK leave the EU without any deal in place.
Our forecast for global growth in 2019 remains solid at 2.9%, but a number of interrelated factors are due to weigh on global growth prospects in 2019 and into 2020. These factors are: slowing Chinese growth (including recessions in some sectors); protectionist headwinds; general policy uncertainty; and concerns over global financing conditions – driven in part by uncertainty over the speed of monetary normalisation in the context of the heavy accrual of debt in both OECD and emerging economies in the past decade.

Corporate earnings do not always have macroeconomic significance. However, Samsung reported lower y/y earnings in Q4 2018, Ford reported y/y falls in Asia-Pacific revenue due to the China market, Caterpillar’s construction industry sales for Asia-Pacific fell by 4% y/y, and Apple’s guidance for the current quarter was disappointing. The common denominator may be China, where the shift in consumer sentiment has been swift. By contrast, wage income growth has been strong in most of the OECD, although this has not translated evenly into spending, and we expect it to peak in 2019. A further concern is that the asset price inflation over the past couple of years has driven many streams of household and business spending and investment. As asset prices come under pressure from interest rates, uncertainty and growth prospects, the wealth effects which drove key variables – from housing prices to discretionary consumer spending – will disappear.

KEY RISK: CHINA SNEEZES, EUROPE CATCHES A COLD?

In January, Dun & Bradstreet downgraded China’s country risk rating from DB4b to DB4c, maintaining a ‘deteriorating’ outlook. Chinese exports fell 4.4% y/y in December and imports by 7.6% y/y. However, the trade war with the US is only one of several factors that have triggered a credit crunch for the private sector and a rapid souring of consumer sentiment in China; a 15% y/y drop in vehicle sales in Q4 was illustrative. The impact on international trade is already emerging. Of 66 economies reporting quarterly GDP data, 28 experienced y/y falls in shipments to China that held back their nominal GDP growth, up from an average of 14 in the previous four quarters. Shipments to China from Singapore and Switzerland fell by over 1.0 percentage point (pp) of their GDP. The drop was almost 0.5pp for Hungary, and over 0.2pp for South Korea and Taiwan. Exports to China from Germany barely told on its y/y growth, compared to a boost of 0.4pp in Q3 2018.

There is a view that China’s GDP can grow at the official target rate regardless of the business cycle, as autonomous investment by the state can always substitute for the private sector. However, we believe that China’s long debt-fuelled growth phase (when investment was ploughed into non-productive uses – ironically, to boost reported GDP) is ending. The result will be a prolonged downturn in China-related global trade that will last into 2020, even if the trade war with the US resolves. While the obvious casualties will be in Asian countries that export high-tech components and raw materials, it may be that the threat to Europe has been underestimated. Europe’s economy has become more linked to China’s in the past decade, with Germany’s export sector constituting almost half of its GDP.

However, the steady global growth forecast will conceal real differences. As the tide of central bank-provided global liquidity recedes and financial conditions tighten, they will show up the differences in fundamentals. In the US, although the Chicago Fed National Financial Conditions Index is still close to a 25-year low, the Goldman Sachs Financial Conditions Index has hit an 18-month high. Portfolio flows have anticipated the direction of global credit flows. US dollar credit to non-bank borrowers outside the US, according to the Bank for International Settlements, reached USD11.4trn at end-Q2, up from USD5.8trn at end-2008, but banks have already started to pull back, with total lending to emerging countries falling by USD20bn in Q2, led by falls in loans to Brazil, India, and Mexico; such loans contracted by USD130bn overall. In OECD countries, demographic pressures will support wage inflation. As long-term interest rates rise, in line, this will expose global stocks and property prices in New York and London to further corrections.

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**KEY GLOBAL GROWTH INDICATORS**

**REAL GDP GROWTH (%)**

<table>
<thead>
<tr>
<th></th>
<th>2018e</th>
<th>2019f</th>
<th>2020f</th>
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<tbody>
<tr>
<td>World</td>
<td>2.9</td>
<td>2.9</td>
<td>2.9</td>
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<tr>
<td>Advanced economies</td>
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<td>2.0</td>
<td>1.9</td>
</tr>
<tr>
<td>US</td>
<td>2.9</td>
<td>2.5</td>
<td>1.9</td>
</tr>
<tr>
<td>Euroland</td>
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<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
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<td>0.8</td>
<td>1.2</td>
<td>1.0</td>
</tr>
<tr>
<td>UK</td>
<td>1.4</td>
<td>1.6</td>
<td>1.6</td>
</tr>
<tr>
<td>Emerging economies</td>
<td>4.1</td>
<td>4.4</td>
<td>4.6</td>
</tr>
<tr>
<td>Brazil</td>
<td>1.2</td>
<td>2.3</td>
<td>2.4</td>
</tr>
<tr>
<td>Russia</td>
<td>1.7</td>
<td>1.5</td>
<td>1.6</td>
</tr>
<tr>
<td>India</td>
<td>7.5</td>
<td>7.7</td>
<td>8.0</td>
</tr>
<tr>
<td>China</td>
<td>6.6</td>
<td>6.0</td>
<td>5.8</td>
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</table>
As Dun & Bradstreet data shows, all 14 sectors covered in our Industry Report saw improvements in the share of prompt payments in October-December when compared with July-September. The smallest improvement was recorded in machinery manufacturing, where the share of prompt payments rose by 0.8 percentage points (pp). At the top of the league are transport/communication/utilities (up by 4.1pp) and business services (+5.5pp). Despite the rise of prompt payments in all sectors, significant differences across industries remain clearly visible: while only 26.1% of all bills get paid on time in the machinery manufacturing sector, this percentage rises to 42.3% in the construction sector and an even higher 57.2% in agriculture. Meanwhile, the public sector remains bottom of the league: only 23.1% of all bills were settled in a timely manner in Q4, up from 20.2% in Q3.

The chart above depicts how promptly all UK businesses have been paying their bills over the past nine months (blue line). Prompt payments improved significantly in the three months to December, according to Dun & Bradstreet’s latest data: 35.7% of payments were made on time in December versus 31.3% in September. This is somewhat surprising, as general macroeconomic conditions had deteriorated in the final quarter of the year. And the delay in the adoption of Theresa May’s Brexit deal in parliament is a worry: should the UK leave the EU with no deal in place, a recession (and hence a significant deterioration in payments performance) is likely.

**PROMPT PAYMENT (CATEGORISED BY NUMBER OF EMPLOYEES)**

As the data in the charts below reflects, 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: 7.4% in Q4 (it was 5.7% in Q1 2018) as opposed to some 42.7% (compared with 37.7% in early 2018). 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.
Positively, all 14 regions covered in this report showed a higher share of prompt payments in Q4, with improvements ranging from 2.0pp in the Channel Islands and the South West to 5.4pp in Northern Ireland (a region that had already moved up the table over the last few quarters, and which now displays the third-best payments performance in the UK). In a European comparison, proprietary data from Dun & Bradstreet and our World Wide Network confirms the UK’s below-average position: in Q3 (latest available data for this comparison), the average payment delay in the UK was 15.0 days (up from 14.7 days in Q2), compared with the European average of 13.3 days (13.1 days in Q2). The UK lags some of its neighbours considerably, most notably the Netherlands (where the average payment delay stood at 4.2 days in Q3) and Germany (6.7 days). Positively, the UK outperforms Italy (18.5 days) and Portugal (26.3 days).
While payments performance improved in the final quarter of 2018, painting a picture of microeconomic strength, the number of corporate liquidations increased sharply in the same period. In October-December, Dun & Bradstreet recorded 4,993 business failures, up a sizeable 23.1% q/q and a still significant 10.3% y/y. The Q4 outturn brings an end to five consecutive quarters of falling numbers of corporate liquidations, and the reading is also just shy of the multi-year high of 5,088 business failures recorded in Q3 2017.

Out of fourteen sectors surveyed, nine recorded an increase in the number of business failures in Q4 compared with Q3 2018. The worst performer was the business services sector, where the number of corporate liquidations reached 1,746 in Q4, up by a very high 90.6% q/q. While machinery manufacturing recorded a stagnation in Q4 (52 business failures, the same as in Q3), four sectors saw a drop in the number of corporate liquidations, ranging from a 0.9% q/q fall in finance/insurance/property to a 13.1% q/q reduction in retail trade.

CORPORATE LIQUIDATIONS: RETAIL TRADE

In the retail space, the number of business failures dropped by 13.1% q/q in Q4. However, in a year-on-year comparison, figures continued to rise (+8.9%) in October-December. Although retail business failures currently account for less than 7% of all business failures in the UK (344 out of 4,993), they tend to attract a large amount of media attention. After House of Fraser and Debenhams reported significant financial problems in the autumn, HMV (a public entertainment retailing company) went into administration on 28 December, as the Christmas period did not generate enough revenue to keep the business afloat. This development put 2,200 jobs in 120+ stores at risk in an environment where consumers are switching from CDs/DVDs to online streaming. Although a buyer for HMV was eventually found in early February (which will keep around 100 shops open), it remains to be seen if this strategy will be successful, given the long-term challenges facing the business model.

Latest sales figures show the problem most retailers are currently facing: while John Lewis stores’ sales figures remained almost stagnant in 2018 (up 0.3% for the year as a whole, but down in the last three quarters after a very strong Q1), online sales in the UK continue to expand rapidly, putting pressure on ‘bricks-and-mortar’ shops. According to the Office for National Statistics (ONS), online retail sales (excluding fuel) rose by 14.5% in 2018, having already expanded by 21.1% in 2016 and 16.0% in 2017.

Since the start of the ONS data series in 2008, online retail sales (as a percentage of total retail sales in the UK) have increased from 4.2% in January 2008 to 18.1% in December 2018. It seems likely that this trend will continue over the next few years, adding to the problematic operating conditions the sector is facing. Also worryingly, rising wages, higher fuel costs and more difficult access to credit also create problems for retailers, with consumer confidence dented by the political uncertainty around Brexit. At the same time, the number of personal insolvencies in England and Wales hit a seven-year high in 2018 – reaching 115,299 – also impacting on consumer spending.

CORPORATE LIQUIDATIONS: CONSTRUCTION

Dun & Bradstreet business failure data for the construction sector shows a similar trend to retail: Q4 saw an improvement in q/q terms (down 1.6%), but in a year-on-year comparison the number of corporate liquidations in the sector rose by 11.4%. Overall, 666 companies filed for insolvency in October-December. The sector is of importance for the UK economy as it contributes some £90bn in gross value added and supports 2.9m jobs.

Problematically, latest high-frequency indicators point towards a cooling in the construction sector. The Purchasing Managers’ Index dropped to 50.6 in January, a ten-month low and only marginally above the neutral 50-points line that divides expansion in sectoral activity from contraction. All three sub-categories (residential, civil engineering, and construction) were down from their December readings, and work on commercial projects (including shops and offices) fell for the first time since March 2018. ONS data shows that new orders in the construction sector fell in Q1-Q3 2018, with July-September (the latest-available data point) recording a 30.2% y/y drop, the sharpest deterioration since the financial crisis.
5.0 RISK OF FAILURE AND PAYMENT DELINQUENCY – INDUSTRY SECTOR COMPARISON

<table>
<thead>
<tr>
<th>RISK OF FAILURE</th>
<th>RISK</th>
<th>HIGH RISK</th>
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<tbody>
<tr>
<td>(Rating 1,2,3)</td>
<td>Minimal to above average risk</td>
<td>(Rating 4)</td>
</tr>
</tbody>
</table>

**CASH VULTURES**
- UK AVERAGE – 13%
- RETAIL – 7%
- CONSTRUCTION – 13%

- 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 – 4%
- RETAIL – 4%
- 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

**IDEAL CUSTOMERS – CULTIVATE**
- UK AVERAGE – 83%
- RETAIL – 88%
- CONSTRUCTION – 82%

- 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 4% of UK businesses are deemed to be at high risk of liquidation and are highly likely to pay in a severely delinquent manner, while 83% offer a low risk both 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 13% 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 the number of business failures carefully: the latest data shows a significant rise, following five quarters of continuous improvement.
- Follow Brexit developments in parliament closely, as the UK’s economic performance (including payments performance and insolvency risk) will suffer significantly should the country leave the EU without a deal.
- Remember that Dun & Bradstreet’s baseline scenario foresees the delay of Brexit by a few months, during which a ‘soft’ Brexit will be approved by parliament.
- Keep in mind that average payment delays in the UK vary largely between sectors but that, on average, the country performs poorly in a European comparison.
- Even in the case of a Brexit deal, assume that real GDP growth will come in between 1.5% and 2.0% over the next five years – rather low figures by historical standards.
- Assuming a successful end to the Brexit negotiations, expect interest rates in the UK to rise (albeit at a very slow pace) over the coming quarters.
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