UK Quarterly Industry Report

QUARTER 3 2017

November 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.

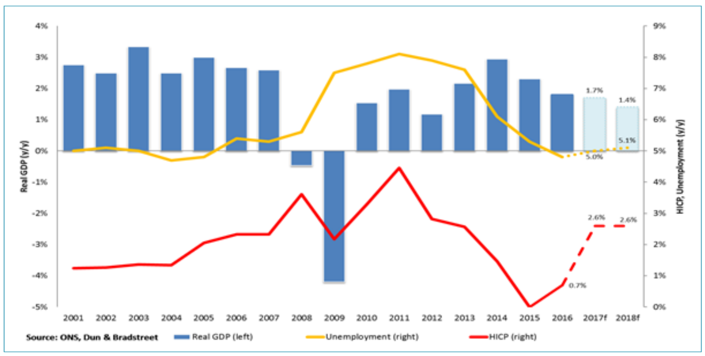
*Companies included in this report are those registered at Companies House.

1.0 UK ECONOMIC OUTLOOK

THE GOVERNMENT WANTS A TRANSITION PHASE

In a long-awaited speech in Florence, Italy, on 22 September, Prime Minister Theresa May shed some light on her government's post-Brexit planning. While the long-term future of EU-UK trade and investment regulations is still unclear, May announced that she wants a transition phase of around two years after the UK has left the EU in March 2019.

This will leave much, if not all, of the current legislation in place until 2021, thereby reducing uncertainty for companies operating in the UK. That said, May reiterated that after this transition phase the UK wants to be free of EU regulations while still maintaining close trade and investment ties with the Union, something EU leaders are currently objecting to, as they perceive the UK's position as 'cherry-picking'. Dun & Bradstreet recommends that companies continuously monitor developments to gain up-to-date insight on the UK government's Brexit-consensus.

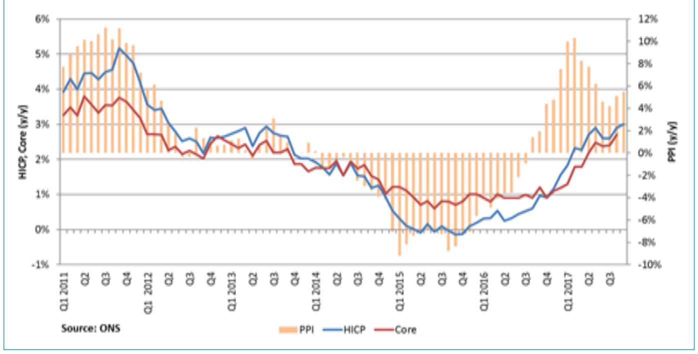


LABOUR MARKET CONDITIONS IMPROVE

Despite the elevated level of political risk, uncertainty about the long-term attractiveness of the UK as a business hub amid Brexit, and poor growth in the first half of 2017, labour market conditions continue to improve. With a harmonised unemployment rate of 4.3% in June (down from 4.9% a year earlier), the country is almost at full-employment (which economists define as an unemployment rate of around 3%). However, as high inflation continues to outstrip wage growth, households' disposable incomes are falling, weighing on economic growth.

Meanwhile, Purchasing Managers' Index (PMI) data for the service, manufacturing and construction sectors shows that all three sectors are still growing; however, worryingly, headwinds in the service sector (which accounts for around 80% of the British economy) are increasing. In August, the PMI came in at 53.2 (above the neutral 50-points line for the 13th month in a row), down from July's 53.8 and the lowest reading in 11 months. Dun & Bradstreet forecasts real GDP growth to slow to 1.3% in 2018, down from 1.8% in 2016 and a projected 1.6% in 2017.

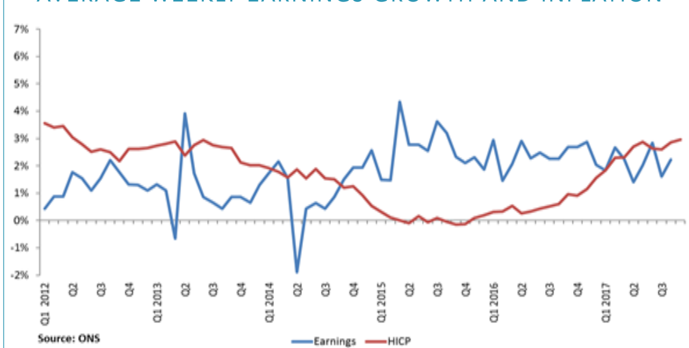
INFLATION



INTEREST RATE HIKE IMMINENT

Inflationary pressures have built up over the past year as a consequence of the weak pound and global commodity trends. At 2.9% in August, inflation is significantly overshooting the Bank of England's (BoE) 2% target. Although rate setters have so far been reluctant to return to a more restrictive policy - in order to stimulate the economy after the Brexit vote - recent remarks by BoE officials point towards an imminent interest rate increase. While this should have a supportive effect on the pound (which has already regained some ground against both euro and dollar throughout September), and reduce inflation, it could create a problem for the UK's heavily-indebted consumers - in turn endangering the stability of the banking system. That said, Dun & Bradstreet does not expect an imminent crisis in the UK's sizeable financial sector, but recommends monitoring the BoE's monetary tightening cycle closely.

AVERAGE WEEKLY EARNINGS GROWTH AND INFLATION



2.0 GLOBAL ECONOMIC OUTLOOK: GLOBAL GROWTH OUTLOOK IMPROVING INTO 2018

Global growth for 2017 is set to come in at 2.9%, the highest level since 2011, and will improve further to 3.1% in both 2018 and 2019. Our positive view is supported by the IMF's October upgrade of its forecasts. Furthermore, the WTO also sharply revised upwards its forecasts for world trade in 2017 on the back of a strong H1 performance. More generally, employment data is strong and commodity prices have rebounded from their 2016 lows, improving the outlook for commodity-exporting countries. Markets also appear to have built in expectations around the normalisation of central bank policy as quantitative easing is wound down and interest rates rise.

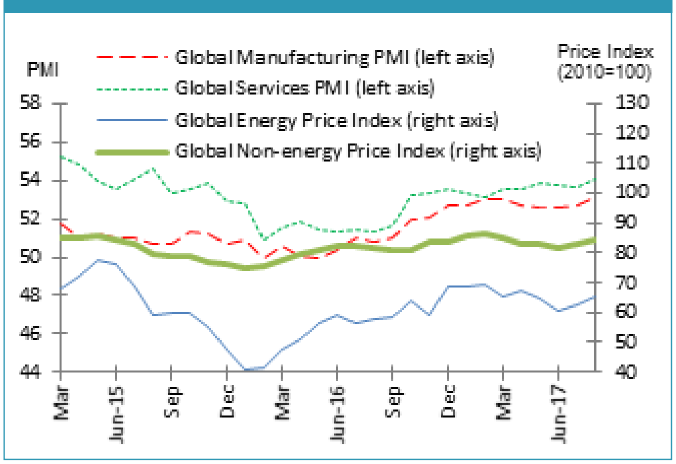
Meanwhile, political risk, although remaining elevated, has eased to a degree since the start of 2017. In particular, the checks and balances of the US political system have ensured greater policy certainty than initially predicted following the election of President Trump. In addition, although the Brexit negotiations are proving inconclusive at present, businesses continue to operate under the existing EU rules, ensuring short-term stability in our forecast period.

KEY RISK: PAUSE IN INFLATION QUESTIONS CREDIBILITY OF CENTRAL BANK MODELS

The intense hurricane season of 2017 did manage to force up US gasoline prices and even global liquefied natural gas spot cargo prices. However, inflation has otherwise continued to trail policymakers' expectations even as job markets have firmed across the OECD economies, with US core inflation easing to 1.4%. The lull in inflation puts paid to the idea that the worlds' leading central banks' models will be able to accurately predict and calibrate policy optimally for the next few years. Even if global growth conditions are the best in the decade so far, there are still profound uncertainties for policymakers as conventional assumptions about wages, inflation and policy rates are increasingly doubted as guides for policy. The OECD itself warned in September that "strong and sustained medium-term global growth is not yet secured".

Our global growth forecasts for 2018 and beyond, at close to 3.1%, are actually below those of the OECD. However, most of the world's large economies will accelerate slightly in 2017-18, with prominent exceptions in the economies of India and the UK, which are both exposed to policy shocks, and which will decelerate in 2017-18. In any case, the pause in inflation is slowing the monetary policy normalisation that could expose asset bubbles in high-income country housing markets outside the US, and in emerging market debt.

KEY GLOBAL GROWTH INDICATORS

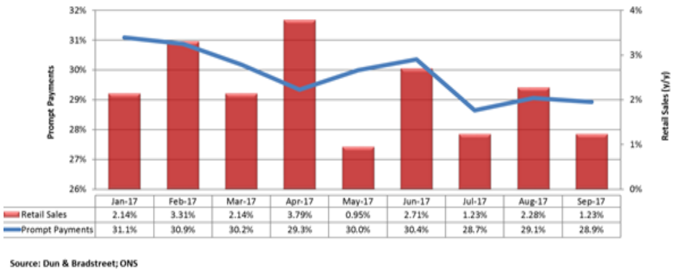


REAL GDP GROWTH (%)

	2016	2017f	2018f
World	2.3	2.9	3.1
Advanced economies	1.7	2.1	2.2
US	1.6	2.0	2.3
Euroland	1.8	2.1	2.1
Japan	1.0	1.3	1.3
UK	1.8	1.6	1.3
Emerging economies	3.6	4.3	4.7
Brazil	-3.6	0.3	1.8
Russia	-0.2	1.4	1.6
India	7.1	6.5	8.2
China	6.7	6.6	6.2

3.0 PAYMENT SNAPSHOT

PROMPT PAYMENTS TRENDLINE
JANUARY 2017 TO SEPTEMBER 2017

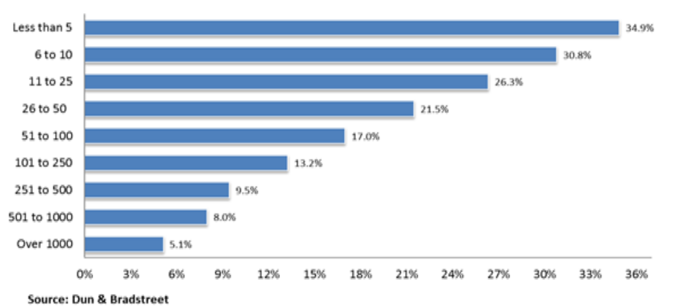


The chart above depicts how promptly all UK businesses have been paying their bills over the past nine months (blue line). Prompt payments deteriorated slightly in the three months to September, according to Dun & Bradstreet's latest data: an average of 30.7% of payments were made on time in Q1 versus 29.9% in Q2 and 28.9% in Q3. Disappointing retail sales data, as well as the uncertainty triggered by Brexit (which might have affected UK businesses' capacity – and/or willingness – to pay promptly) is likely to have contributed to the deterioration of payment habits. Looking ahead, we expect a further deterioration in prompt payments due to rising headwinds triggered by the Brexit vote.

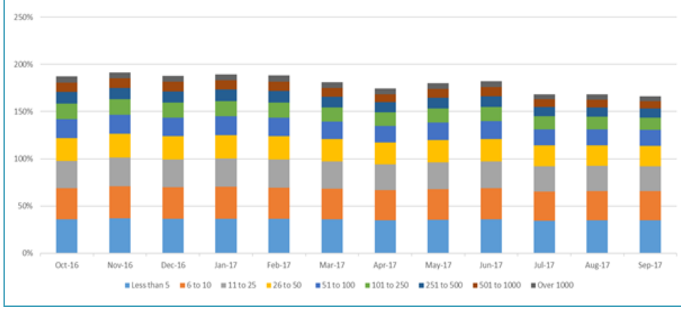
PROMPT PAYMENT, BY EMPLOYEE NUMBERS

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: 5.1% (it was 6.0% in Q2 2017) as opposed to some 34.9% (from 35.8% in Q1).

PROMPT PAYMENT BY EMPLOYEE SIZE FOR Q3 2017



PROMPT PAYMENT BY EMPLOYEE BAND

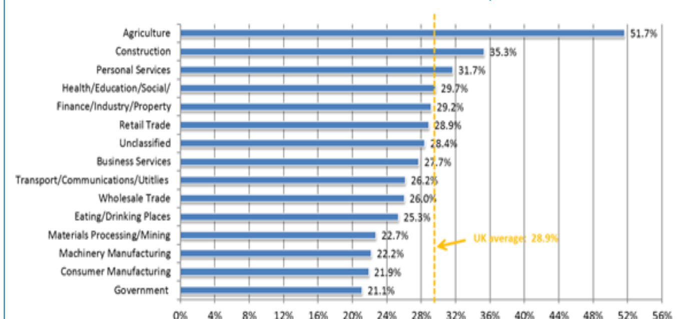


Indeed, late payments remain a major problem for UK-based small and medium-sized enterprises (SMEs). While legislation is in place to assist small businesses with their struggle against late payments, most businesses, especially SMEs, elect to take no action for fear of alienating their larger customers. 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.

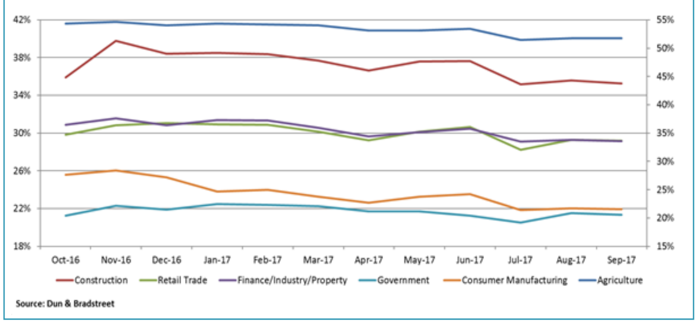
PROMPT PAYMENT, BY INDUSTRY

As Dun & Bradstreet data shows, average payment habits by industry deteriorated further across the board on a quarter-on-quarter (q/q) basis in Q3 2017. The data, broken down by industrial sector, reveals that between Q2 and Q3 2017 the largest deterioration in payment habits was recorded in the 'Materials Processing/Mining' sector, followed by the 'Construction' and 'Agriculture' sectors.

PROMPT PAYMENTS BY INDUSTRY, Q3 2017

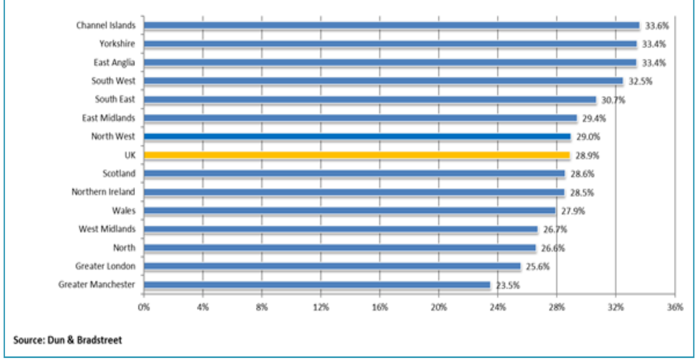


PROMPT PAYMENT EVOLUTION IN CRITICAL SECTORS (AGRICULTURE, RIGHT AXIS)



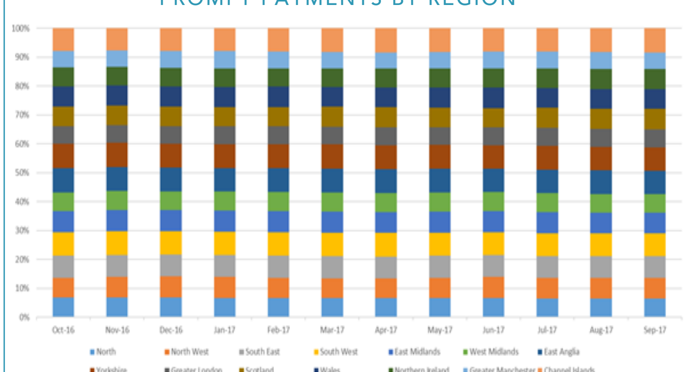
PROMPT PAYMENT BY REGION

PROMPT PAYMENT BY REGION, Q3 2017



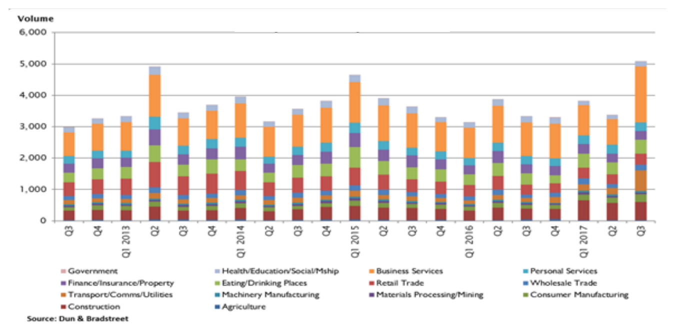
Dun & Bradstreet's Q3 data reveal that overall payment performance deteriorated by an average of 1.0 percentage point (pp) between Q2 and Q3 2017 across the regions. The East Midlands area and Wales recorded the largest deterioration in average prompt payments (as a percentage of total payments), falling by 1.6 pp to an average of 29.4% and 27.9%, respectively. The Greater Manchester area, whose average of prompt payments dropped by 0.8 pp, continues to lag behind all the other regions (only 23.5% of payments were made promptly, compared to a UK average of 30%). The Yorkshire and the Channel Islands areas exhibit the best prompt payment performance times (33.4% and 33.6%, respectively).

PROMPT PAYMENTS BY REGION



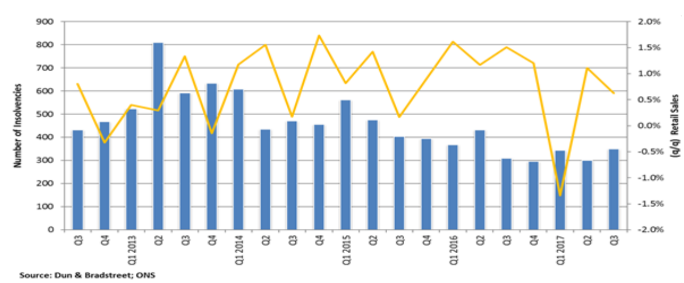
4.0 CORPORATE LIQUIDATIONS

CORPORATE LIQUIDATIONS



The number of corporate insolvencies spiked in Q3 (up by 51% q/q, or 52% y/y), according to Dun & Bradstreet data: 5,088 companies liquidated in the three months to September, compared to 3,372 in the previous quarter. Between Q2 and Q3 2017, corporate insolvencies rose in almost all sectors of the economy, with decreases of 242% q/q in 'Transport/Comms/ Utilities' and 116% q/q in 'Business Services'. Meanwhile, 'Agriculture', 'Machinery Manufacturing', 'Finance/Insurance/ Property' and 'Personal Services' were the only sectors recording a decrease in the amount of liquidations, down by 14.3% q/q, 3.7% q/q, 0.7% q/q, and 2.1% q/q respectively.

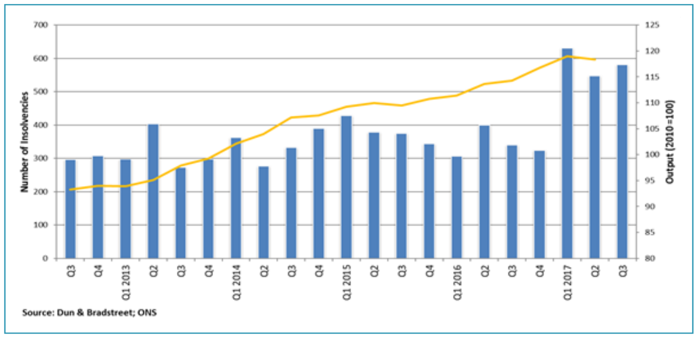
CORPORATE LIQUIDATIONS : RETAIL TRADE



The Office of National Statistics' (ONS) data reveals that retail sales growth decelerated in Q3 2017: retail sales volumes rose by 0.6% q/q in Q3, after expanding by 1.1% q/q in Q2. Tallying with disappointing retail trade data, Dun & Bradstreet's proprietary data shows a rise in corporate insolvencies in the retail sector – which accounts for almost 6% of the UK economy – in Q3 (up by 16.7% q/q and by 13.2% y/y).

Looking ahead, 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.

CORPORATE LIQUIDATIONS: CONSTRUCTION



Dun & Bradstreet's data shows a small rise in the number of construction companies liquidating in Q3: 581 companies failed in Q3, while 547 liquidated in Q2. 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 seasonally adjusted IHS Markit/CIPS UK Construction Purchasing Managers' Index stood at 48.1 in September, down from 51.1 in August and below the crucial 50.0 no-change threshold for the first time in a year. The latest reading signalled the fastest decline in overall construction output since July 2016, according to Markit. The report also reveals that lower volumes of construction work reflected marked falls in both commercial and civil engineering activity during September; house building was the only area of construction activity to expand - but even here growth momentum eased to a six-month low amid reports citing worries about less favourable market conditions ahead.

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 <=10)	CASH VULTURES UK AVERAGE – 19% RETAIL – 11% CONSTRUCTION – 17% 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
	RISK Minimal to above average risk (Delinquency Score >=11)	IDEAL CUSTOMERS – CULTIVATE UK AVERAGE – 76% RETAIL – 85% CONSTRUCTION – 78% 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 77% 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 19% 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

- In this light, firms should adopt a wait-and-see approach; it will be many more months before uncertainty about post-Brexit trade relations is lifted.
- As a baseline scenario, expect the UK to lose full access to the EU's common market once the two-year transition period following Brexit (which will happen in March 2019) is over.
- However, expect the EU and the UK to also sign a free-trade arrangement, which will give companies preferential access to each others' markets.
- Assume that the economy will grow by just 1.6% in 2017 and 1.4% in 2018 - the slowest pace since 2012.
- Be aware that there are still huge differences in payments performance between sectors; prompt payments range from 23.0% in machinery manufacturing to 53.2% in agriculture.
- Assume that payments performance in the UK will remain below average in a European comparison in 2017-18.
- In this context, remember that the average payment delay in the UK in Q2 2017 stood at 14.7 days, compared with a European average of 13.2 days.
- Count on interest rates rising in the coming quarters, but assume that the adverse impact on insolvency figures will remain minimal.

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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.
Classification: Commercial in Confidence