The BDO Monthly Business Trends Indices

December 2009

Introduction

The BDO Monthly Trends Indices are 'polls of polls' that pull together the results of all the main business surveys. The December Monthly Indices update the results in the *'BDO Business Trends Report'* produced in November 2009. The latest results include new business surveys carried out between the 1st December and the 1st January 2010.

The report covers four indices:

- The BDO Output Index, which collates the results of surveys of turnover or output expectations
- The BDO Optimism Index, which collates the results of surveys of business confidence
- The BDO Inflation Index, which collates the results of surveys of business price expectations
- The BDO Employment Index, which collates the results of surveys of employment expectations

Summary and key findings

Index	**Current confidence**	**Movement in month**	**Index level** **– *December 2009 compared to November 2009***
BDO Output Index	✓	⬆⬆	The output index leaped to 99.7 thus suggesting a strong return to growth in the short term.
BDO Optimism Index	✗	⬆⬆	The optimism index also increased robustly to 100.5 as businesses finally have become more optimistic about orders growth and revenue expectations.
BDO Inflation Index	✗	⬆	The inflation index rose to 98.3 in December indicating increasing short term inflationary pressures.
BDO Employment Index	✗	⬆	The employment index remained largely unchanged at 94.9 pointing to a bottoming out of unemployment.

One tick = above 100; two ticks = highest in 12 months; one cross = below 100; two crosses = lowest for 12 months
One arrow = movement; two arrows = largest movements in 12 months

Report commentary

- The December BDO business trends report paints a more optimistic picture after confidence paused over the previous two months. Both output and optimism index rose buoyantly in December on the back of a bounce in business confidence. Indeed, businesses have become more upbeat about the short and medium term prospects for output and revenues as well as reporting robust increases in order numbers.
- However, increasing business confidence is only slowly becoming evident in the official data. The Office for National Statistics reported that economic activity declined by 0.2 per cent in the three months to September compared to the 0.7 per cent decline seen in the second quarter. More recent data for the largest sub sectors shows that industrial production was flat in October, following a 1.3 per cent increase in September. The wider services sector increased by 0.1 per cent in October, after a 0.5 per cent rise in September.

BDO output and optimism indices suggest short term bounce

- **The BDO output index**, increased significantly in December to 99.7 – up from 96.3 in November. It thus suggests a strong bounce in activity in over the next three months. The manufacturing sub index rose to 99.3, from 95.8 amidst a marked improvement in new orders growth and improved output expectations.

- The BDO services index also improved to 99.8 in December, from 96.4 in November. The latest official statistics showed a return to growth with the wider services sector with output increasing by 0.5 in September and 0.1 per cent in October.

- The more forward looking **BDO optimism index** also increased robustly in December. The index which measures output expectations two quarters ahead rose to 100.5, from 96.3 in November.

- Judging from the latest rise in confidence we expect a significant short term bounce, particularly in the manufacturing industry. This recession has been characterised by a particularly pronounced inventory decline so production is likely to increase to top up depleting stock levels.

BDO inflation expectations shows increasing price pressures amidst VAT reversal and dearer commodities

- **The BDO inflation index** rose markedly by 3.0 points to 98.3 points between November and December indicating that price pressures are likely to pick up following a period of declining annual inflation. A value above 95.0 indicates rising annual inflation. Increasing price expectations follow a sharp decline at the turn of 2008 - 2009 on the back of falling input prices and heavy discounting amidst collapsing demand.

- Overall, the story is one of a steady increase in the annual rate of inflation due to base effects comparing with a period a year earlier when prices were falling steeply. The annual rate of inflation rose to 1.9 per cent in November, up from 1.5 per cent in October. Short term inflationary pressures edged up as prices grew by 0.3 per cent month-on-month in November following 0.1 per cent growth in October.

- Yet, the reversal of the VAT cut is likely to lead to a short term spike in inflation. The Office for National Statistics calculated that prices excluding the impact of indirect taxes – of which VAT is the largest chunk - were on average 1.2 percentage points higher than those including VAT and other indirect taxes. Thus we expect inflation to peak around 3.0 per cent in January as the VAT cut is reversed and could force Bank of England Governor Mervyn King to write to the Chancellor. But thereafter inflation should start to fall back towards a steadier level as considerable spare capacity remains.

Unemployment likely to stabilise in the medium term

- This spare capacity is also illustrated in the **BDO employment index** which showed little change and stood at 94.9 in December compared to a reading of 94.6 in November.

- As such the index broadly consistent with a stabilisation in unemployment but an otherwise jobless recovery. Indeed, vacancy levels remain historically low with 423,000 positions offered on average in the three month to October, down by 23.9 per cent compared to the same period one year ago.

- The unemployment rate remained stable at 7.9 per cent in October although the number of unemployed according to the internationally comparable ILO measure rose by 21,000 and now stands at 2.49 million.

- Claimant count unemployment, however, a narrower indicator for unemployment which measures the number of people on unemployment benefits surprisingly declined by 6,300 in November.

Expect robust growth in the fourth quarter but weak prospects thereafter

- On the whole the latest BDO business trends report suggest a significant bounce in economic activity in the fourth quarter and in early 2010.

- The main driver behind this effect will be the end of de-stocking. The decline in stock levels reduced gross domestic product by £4.6 billion in the third quarter – the equivalent of 1.5 per cent of total economic output over this period. Hence, slowing de-stocking or indeed increasing inventory levels are likely to provide a boost to growth in the fourth quarter.

- Secondly, early evidence suggests that retail spending in the run up to Christmas and on Boxing Day has been buoyant. John Lewis – a bell-weather for the high street – even posted a 16 per cent rise in sales over the five weeks to January the 2nd compared to one year ago.

- Additionally, the fall in the claimant count, typically a lagging indicator also suggests that the recovery is underway.

- However, further weakness later on in 2010 following this mini-bounce as the rise in VAT and political uncertainty, along with a stuttering global recovery; provide a reminder that the upturn is unlikely to be smooth or rapid.

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The BDO Indices to December 2009

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec
The BDO optimism index	**Total**	90.5	90	91.2	91.5	92	94.2	96	95.8	96	96.3	96	**100.5**
	Small	89.5	89	90.2	90.6	91	93.2	94.9	94.8	95	95.3	95	**99.4**
	Large	91.3	90.7	91.9	92.3	92.7	95	96.8	96.6	96.8	97.1	96.8	**101.3**
	Manuf.	81.9	79.4	86.4	87.4	88.3	92	95.4	95.6	95.9	96.2	95.9	**99.7**
	Service	92.8	92.8	92.4	92.6	92.9	94.7	96.1	95.8	96.1	96.3	96.1	**100.7**
The BDO output index	**Total**	88.3	88.6	90	92	92.3	95.1	96.3	95.8	95.8	96.3	95.8	**99.7**
	Small	86.8	87.1	88.5	90.4	90.8	93.5	94.7	94.1	94.2	94.7	94.2	**98.0**
	Large	89.5	89.8	91.2	93.2	93.6	96.4	97.6	97.1	97.1	97.6	97.1	**101.0**
	Manuf.	80.7	82	83.6	86	88.3	92.4	94.3	93.6	93.5	95.8	93.5	**99.3**
	Service	90.3	90.3	91.7	93.5	93.4	95.8	96.8	96.4	96.4	96.4	96.4	**99.8**
The BDO inflation index	**Total**	85.9	87.7	91.5	93.5	92.8	91	92	92.6	93.8	95.3	93.8	**98.3**
	Manuf.	82.8	82.2	83.9	87.5	86.8	85.8	90	90.0	89.9	89.9	89.9	**93.6**
	Service	87.8	90.7	96.3	97.3	96.6	94.3	93.2	94.3	98.8	98.8	98.8	**101.3**
The BDO employment index	**Total**	91.7	91.2	88.5	89.8	90	92.9	93.5	93.4	93.6	94.6	93.6	**94.9**

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Methodological Notes

The BDO Monthly Business Trends Indices are prepared on behalf of BDO Stoy Hayward by the centre for economics and business research ltd., a leading independent economics consultancy. **cebr** has particular strengths in all forms of macroeconomic and market forecasting for the UK and European economies and in the use of business survey techniques.

The indices are calculated by taking a weighted average of the results of the UK's main business surveys. It incorporates the results of the quarterly CBI Industrial Trends Survey (and the CBI Monthly Trends Enquiry which is carried out in the intervening months); the CBI Distributive Trades Survey; the CBI/PriceWaterhouseCoopers Financial Services Survey; the British Chambers of Commerce Quarterly Economic Survey; the Institute of Directors Business Opinion Survey; the 3i Enterprise Barometer; and the Chartered Institute of Purchasing and Supply's Surveys of Manufacturing and of Services.

Taken together the surveys cover over 11,000 different respondents from companies employing approximately five million employees. The respondents cover a range of different industries and a range of different business functions. Together they make up the most representative measure of business trends available.

The surveys are weighted together by a three-stage process. First, the results of each individual survey are correlated against the relevant economic cycles for manufacturing and services. This determines the extent of the correlations between each set of survey results and the relevant timing relationships. Then the surveys are weighted together based on their scaling, on the extent of these correlations and the timing of their relationships with the relevant reference cycles. Finally, the weighted total is scaled into an index with 100 as the mean, the average of the past two cyclical peaks as 110 and the average of the past two cyclical troughs as 90.

The results can not only be used as indicators of turning points in the economy but also, because of their method of construction, be seen as leading indicators of the rates of inflation and growth.