ACCA

Global economic conditions survey report: Q1, 2011

The ninth edition of the ACCA Global Economic Conditions Survey featured a unique section on the diverse characteristics and life/career paths of our membership, as well as ad-hoc questions on the outlook for government spending. Fieldwork was carried out between 24 February and 18 March 2011 and with over 2,360 professional accountants responding this has been our largest survey to date.

RECOVERY TEMPORARILY PICKS UP SPEED, FANS FLAMES OF INFLATION

After briefly going into reverse at the end of 2010, the global economic recovery picked up speed again in early 2011 – but conditions remain fragile and new challenges have emerged. This is the outlook from the latest version of ACCA's Global Economic Conditions Survey, drawing on the views of 2,367 professional accountants around the world.

ACCA's Confidence Index reached relatively safe levels (-3) this quarter (Fig. 1), up from a dangerous reading of -13 in the previous one,[1] as both demand and cashflow conditions have continued to improve around the world for the time being. While this has generally led to a stabilization of the outlook for employment and investment in developed countries, accountants in the developing world report slightly less investment in staff and more layoffs as businesses continue to come to terms with the weaker-than-expected recovery.

Possibly the most worrying development during the last quarter was the explosive rise of operating costs (Fig. 2), following a steady build-up over the last year. For the first time since the survey began, more than half (51%) of the professionals responding to the survey reported problems with input inflation, making this the most commonly cited business challenge. Although the worst problems were reported in Malaysia and Singapore, this trend was not confined to the faster-growing markets in the East but was reported with only marginally lesser intensity even in the most sluggish of the developed economies.

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[1] ACCA's confidence index correlates very strongly with economic growth globally. A balance of below -13.4 tends to suggest that the economies of the developed world are contracting and the global economy is slowing to a halt.

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The outlook for business opportunities has remained broadly constant, but with productivity gains slowing down and input prices on the rise, accountants have steadily become less likely to spot opportunities for both growth *and* cost-cutting. In the developing world, members cited export opportunities relying mostly on strong supply chain relationships, investments in quality, and innovation. Accountants in developed markets, however, reported fewer opportunities in all of these areas compared to previous quarters.

With the global economic recovery still far from assured and Europe still in the throes of a fiscal crisis, ACCA once again asked members how they thought government spending in their countries was going to change in the medium-term (five years) (see Fig. 3). Although rich nations are expected to face further austerity, respondents in emerging markets and the developing world now felt that their Governments were more likely to increase spending in order to prop up the recovery. Overall, members around the world feel that fiscal policy is now more of a balancing act than before, especially in fast-growing markets where rising inflation has limited policymakers' options. As a result, almost one in six respondents expects their government to get spending dangerously wrong over the next five years.

Figure 1: ACCA Business Confidence Index

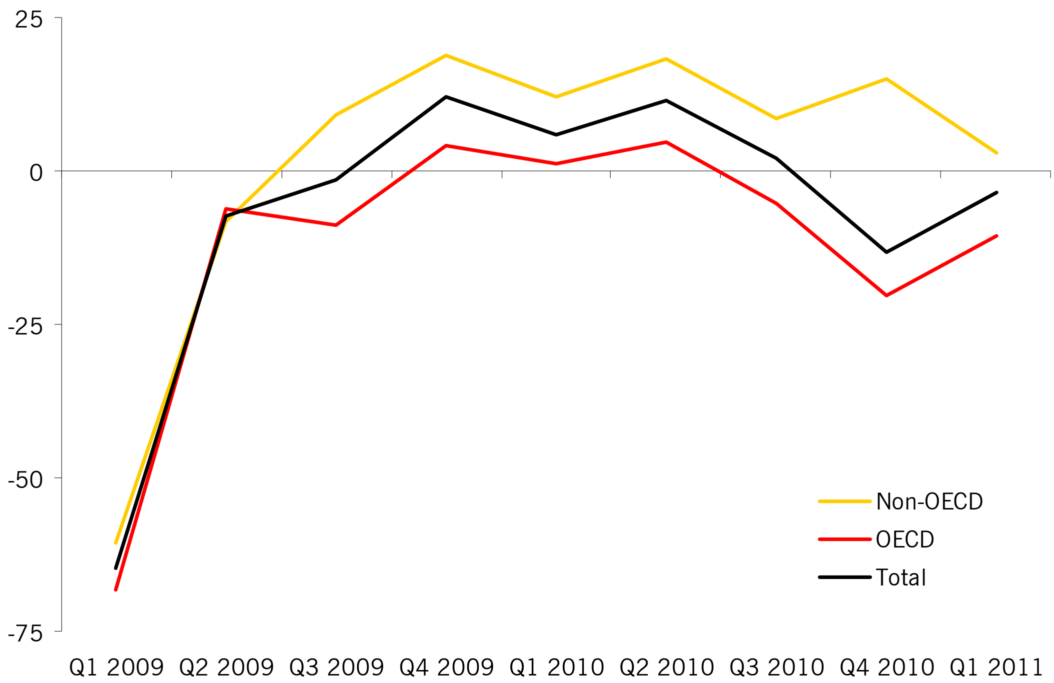

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Figure 2: Respondents citing rising operating costs as a problem for their businesses and clients

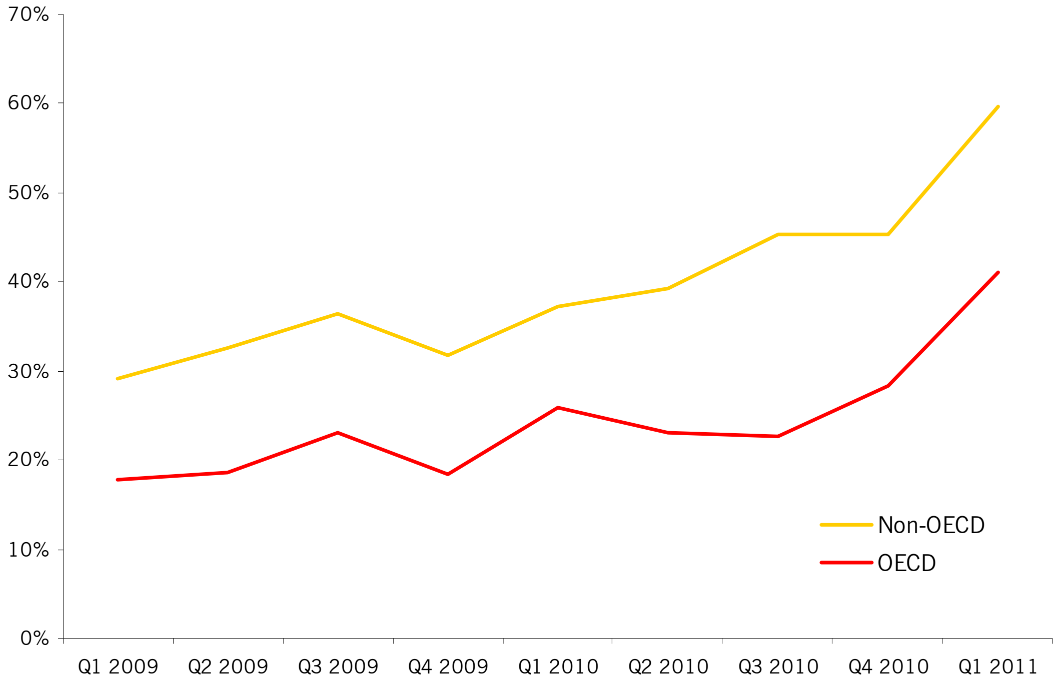
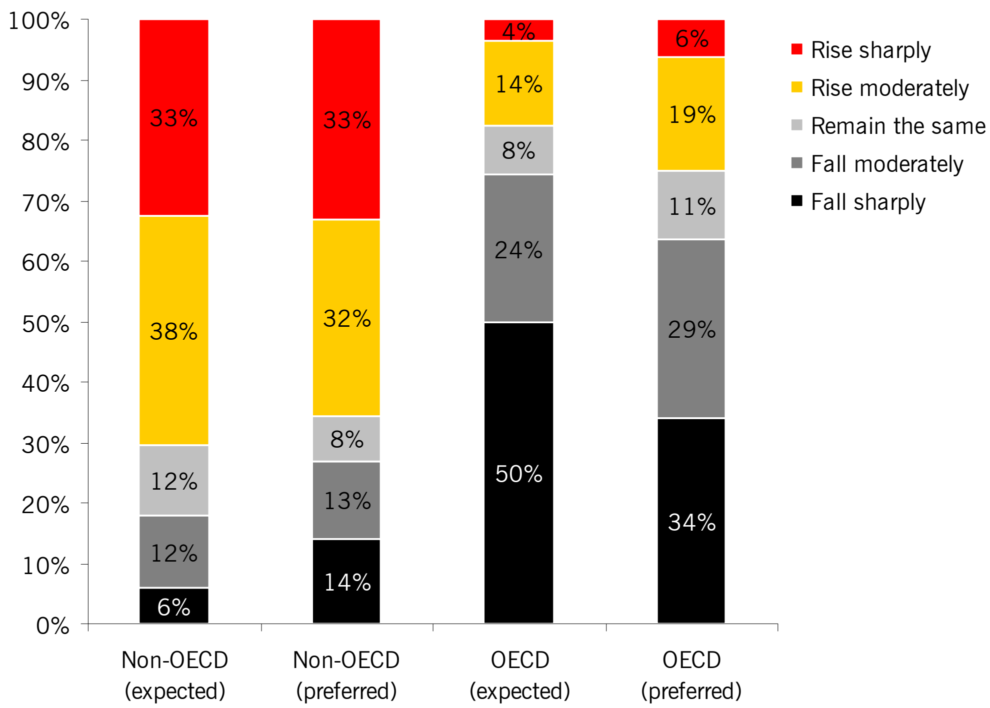


Figure 3: Expected and preferred changes in government spending over the next five years



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REGIONAL VIEWS

The Americas
The third quarter of 2010 marked a turning point for confidence in the broader region. Since then, and although accountants in the region have similar levels of faith in the strength of the global recovery, confidence has been rising in North America, where 45% of respondents reported gains in the last quarter, and falling in the Caribbean, where only 31% did.

This is mostly due to the fact that demand in North America is recovering faster, while in the Caribbean it is still subdued and could deteriorate further. Access to finance is also improving faster in North America, while cashflow pressures are on the rise in the Caribbean. The result is a more subdued outlook for employment and investment in the Caribbean, both relative to the North and to the region's performance in 2010. Operating costs are on the rise in the region, with the Caribbean hit substantially harder than North America.

Respondents in both sub-regions reported more value-added opportunities for their organisations than in previous quarters, citing more opportunities than in the last quarter for their firms to capitalise on innovation and niche markets. Those in the Caribbean also see an increasing number of opportunities for exports, while in North America there is a growing emphasis on quality as a source of advantage.

Asia Pacific
The region's front-row seats to the recovery are once again proving uncomfortable; although about 42% of respondents in the region believe things are getting better, this is the lowest percentage in a year, and down sharply from three months ago. Confidence rose faster in mainland China and fell the fastest in Malaysia, while remaining constant in Singapore. Small financials and small practices appear to have been particularly hard hit, while large financials and corporates are only barely in positive territory. While business incomes continued to rise in the last quarter, new orders did not – suggesting the region's economic recovery is facing headwinds. These, combined with soaring inflation and a mild rise in the incidence of cashflow problems (represented by late payment and customer failures), has set back job creation and the employment outlook in general. That said, investment has remained resilient and spending on staff training and development appears to have held constant.

Africa
Respondents in Africa have consistently been the most optimistic about the state of the global economy and for the past year they have been the most confident among ACCA's global sample. With 47% of respondents reporting gains in

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confidence and 48% believing the global economy is improving, these trends have persisted into early 2011, but confidence is clearly leveling out. Operating costs are on the rise, throughout Africa, which has, however, faced consistently worse inflation than any other region over the past two years. While demand continued to stabilise, the combination of inflation and tightening access to finance has given accountants reason to expect a rise in business failures and caused more business to lay off staff. In fact, the outlook for employment and investment in staff has been deteriorating for most of the last 12 months, even though capital spending is slowly recovering.

Central and Eastern Europe

Respondents' confidence in the prospects of their own organizations has remained steady even as they begin to question the strength of the global economic recovery. Just over one quarter of the sample (27%) reported confidence gains in the last quarter, while 48% report reported no change.

The reason for this is that fundamentals for the region have steadily improved for the last twelve months; demand has rebounded strongly and with it the outlook for employment and capital spending. There is even evidence of an export boom in the region, as more respondents report increasing opportunities in new and niche markets, or opportunities to strengthen supply chain relationships. Operating costs, however, have also risen sharply, with the share of respondents citing this as a problem more than tripling in the last nine months.

The Middle East

Business confidence among respondents in the Middle East has improved only marginally in the last three months, with about one quarter now reporting a loss of confidence and just under one third reporting confidence gains. This marginal rise in confidence may be due to a more upbeat assessment of the global economy: half of the respondents in the region now believe that conditions are improving or about to improve.

Stabilising demand and access to finance is no doubt responsible for some of this optimism, while cashflow conditions also appear to be improving. As a result the outlook for employment and capital spending has improved.

Although cost-cutting remains the most commonly cited type of business opportunity, respondents also cited entering new markets, strengthening relationships along the supply chain and investing in quality (in that order) as potential opportunities. Of these however, only exports appear to be on the rise.

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South Asia
Respondents here reported the lowest level of confidence in any of ACCA's major regions and have in fact been very pessimistic for the past nine months. Although 55% of them are still confident that globally things are getting better or at least about to, 43% also reported a loss of confidence in the prospects of their organizations – the worst performance in almost two years.

Operating costs are on the rise in the region, with nearly two thirds of the sample reporting rising inflation. Although demand appears to have stabilised and the outlook for investment and employment has improved steadily in the past nine months, a weakening pipeline of new orders could spell trouble ahead. Already finance professionals are reporting that access to finance and cashflow conditions are tightening and some (probably small) suppliers are coming under pressure.

Western Europe
Late 2010 was a difficult time for respondents in Western Europe as the sovereign debt crisis claimed another victim. Since then, both respondents' confidence and their overall assessment of global economic conditions have improved without making up for much lost ground. With only 21% reporting confidence gains and 29% believing economic conditions are improving or about to improve, Western Europe hasn't been this gloomy in at least 18 months.

For the time being cashflow conditions are stable and business insolvencies are down, but with demand and access to finance tightening, this may not last. Moreover, a spectacular rise in operating costs now means that this is the most commonly cited business problem even in this region (43%).

The outlook for capital spending has improved only marginally, while that for employment has remained unchanged, with increases in both job creation and layoffs cancelling each other out.

As the effects of austerity continue to be felt across Western Europe, fatigue appears to be setting in with a small but growing number expecting governments to change course in the face of a renewed downturn. So far, however, only 12% of respondents expect truly dangerous levels of fiscal retrenchment – a marginal rise from the last reading in Q3 2010.

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VIEWS FROM THE COALFACE

Robert D. Pearce
CFO, Davis Langdon & Seah Asia Company Ltd.

The last quarter in Asia has been a very interesting one. News surrounding potential merger activity between stock markets, continuing economic growth, corporations exploring ways to list on stock markets and the associated problems and of course the continuing news surrounding currencies and inflation.

Employment in Asia is still very much on the rise; however changes in the market place are creating the need for new types of skills along with corporations concerning themselves with how to address the requirement for staff retention in a more competitive environment. Many Asian organizations (particularly major cities in China) are offering staff higher incentives. Staff training and development also appears to be high on the agenda. Consumer demand for products and business seems ever increasing. However, as certain countries in Asia fail to strengthen their currencies inflation also appears to be following a similar trend.

There is increasing interest from Asian owned corporations to list on the stock exchange in order to compete globally. Such corporations will be required to meet listing requirements such as having a sufficient group structure, sufficient capital and sufficient controls surrounding financial reporting. That said, the majority of successful corporations in Asia grew organically, predominantly owned by large family names. There have been news in the media regarding succession of ownership and concerns surrounding strategic growth which in some cases could open the way towards a different kind of stewardship. Historically, corporate governance has always been an area of topical discussion. However, as corporations look to list, key staff and responsibilities (such as a corporate governance committee) will need to be facilitated to manage change and take responsibility.

As more and more money continues to flow into Asia, access to finance does not appear to be an issue. What may however be an issue for corporations that desire to list is that not all their capital may be held in one place. It is common for Asian groups to have finance spread out over group companies, possibly as a result of historical rules surrounding foreign ownership. Corporations requiring to list could be challenged with restructuring their group/ownership or possibly merging or acquiring other corporations.

In terms of government policy making Singapore seems to attract most of the recent attention. Singapore is ever popular for its strong performing education system but most of all how it recovered from the recent global credit crunch at such a remarkable pace. In recent weeks key officials from China have visited Singapore with interest to see how China could adapt a similar government model. Overall Asia is experiencing rapid change and new challenges. So far the challenges appear to have been dealt with extremely well. Interest surrounding business in Asia continues to grow and countries such as India are expected to make an even bigger impact on the world stage. It will be interesting to see how the future develops.

Vince Hodgson
Consultant, private retail consultancy, Japan

Vince's report was received prior to the tragic events in Japan; he has since been in touch to confirm that he and his family are well.

There has been little change in the overall economy in the last three months. Unemployment is currently 4.9%, and domestic capital investment is not in growth mode. The retailing sector and other major industries are respectively in cut-back or consolidation mode. The outlook for the next three months remains the same and will be dependent for improvement on maintaining export volumes to China and other Asian countries, especially Singapore, and a full resolution of budget and debt issues following the recent downgrade of Japanese debt.

The major problem for the Japanese Economy so far has been the huge increase in commodity prices including oil for business and food prices for consumers, despite a relatively strong Yen. Deflation and a strong yen remain issues for the long term economic outlook, while at the annual "shunto" or Union wage negotiations. average demand is for a 1% increase, which is being resisted by the employers. Employment is slightly improving from the previous 3 months, but remains an issue as graduates continue to be unplaced.

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Government attempts to stimulate domestic investment are not proving effective, and there have been cross-border moves to Asia from many sectors such as Electronics and Automobiles. The major retailers are also saying growth in 2011/2012 will come from investment in overseas markets, especially China, and the upmarket retailers are consolidating or closing stores.

Finance is available but it is also expensive and banks are very risk averse in their selection of borrowers. The damage done to the credit industry by interest charge reduction and repayment regulations has also caused problems beyond the mortgage and property market decline.

Consumer spending with businesses remained flat in the last three months and shows no signs of growth until possibly the third quarter. The increases in food prices over the last few months and for the next few months do not in any case augur well for improved consumer demand. This remains 60% of the economy and until it recovers this economy will remain stagnant.

Government policy direction is weak especially for the business community where tax breaks are still demanded, but the recent budget takes many away. Also the consumption tax, corporate tax, income tax and debt issues are not being addressed despite frequent promises to this effect.

Eric Verheijden
Finance manager, Air Products

We still see a slow recovery in Europe, with GDP growing but only by 0.3% in the last quarter. Conditions vary by country and we see some rumbling between Eurozone and non-Eurozone countries. Germany and France are looking at competitiveness for the Euro zone, which is not welcomed by the non-Euro countries.

Following their respective bailouts, Greece and Ireland are still working towards economic recovery and this seems still to be challenging. Portugal is also in difficulty and it looks like they will need to be bailed out by the EU as well. [Ed: Eric's report was received prior to Portugal's formal request for assistance.] The government is taking measures but they are very unpopular with the people.

Spain is still on the brink as well. They have promised to cut their deficit by 6% for 2011 but there are great fears that this cannot be achieved. An additional worry now is that 12 banks need to boost their capital by around €15 billion, as it appears they have a high number of impaired loans on their books. The EU fund available for bailouts is now around €500 billion strong and the markets fear that if Portugal and Spain need to be bailed out this might not be enough. From a business perspective we see improvements in most countries but the outlook differs from business to business. Northern and Central Europe sees most of the improvement but we are still behind in Poland. In Southern Europe we still see issues in our markets and not really much improvement. There are several large investments underway in Northern Europe, and production volumes will increase from Q3 2011 onwards, based on these investments.

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Table 1: ACCA Confidence and Recovery Indices for selected markets

		Country (robust samples only)										
		Australia	**China, (including Hong Kong and Macau)**	**Cyprus**	**Republic of Ireland**	**Malaysia**	**Pakistan**	**Singapore**	**UK**	**Canada**	**Mauritius**	**Total**
Business confidence	Much less confident	4%	5%	3%	15%	11%	16%	6%	14%	6%	4%	10%
	Less confident	18%	19%	33%	23%	20%	32%	21%	27%	19%	19%	22%
	No change	53%	47%	51%	36%	45%	34%	45%	41%	30%	48%	40%
	More confident	23%	23%	13%	24%	20%	15%	20%	15%	43%	27%	23%
	Much more confident	4%	5%		2%	4%	3%	8%	3%	4%	3%	5%
Distance from recovery	It's getting better	40%	49%	16%	6%	31%	26%	52%	11%	37%	47%	28%
	We're at the bottom and things will now start to improve	23%	14%	15%	19%	18%	24%	14%	14%	17%	28%	18%
	We're at the bottom and will remain here for a while yet	25%	11%	37%	41%	16%	16%	18%	39%	37%	12%	29%
	It's getting worse	11%	14%	28%	32%	24%	28%	11%	32%	7%	12%	21%
	Don't know / Not sure	2%	11%	3%	3%	11%	6%	5%	3%	2%	1%	4%