The Association of
Accountants and
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The global
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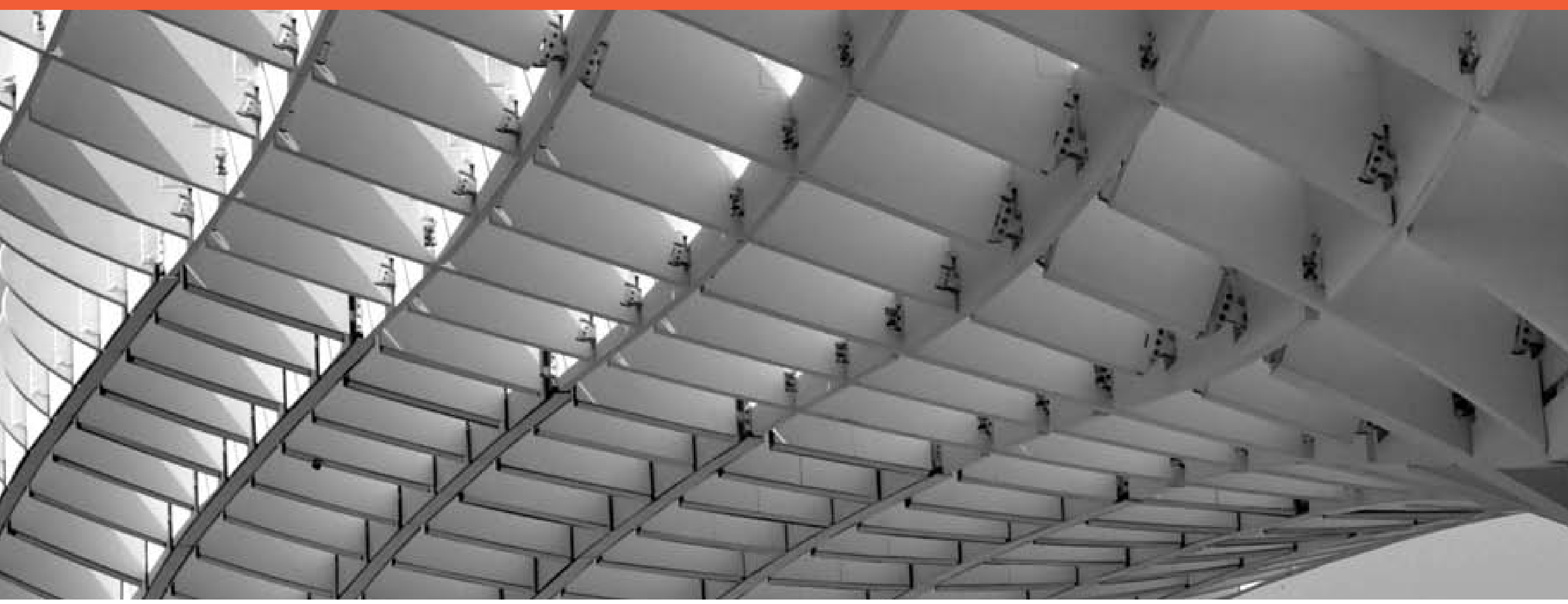
Five years of the global economic recovery



ACCA AND **IMA**: GLOBAL BODIES EMPOWERING ACCOUNTANTS AND FINANCIAL PROFESSIONALS TO DRIVE BUSINESS PERFORMANCE

About ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

We support our 162,000 members and 428,000 students in 173 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of over 89 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

About IMA®

IMA® (Institute of Management Accountants), the association for accountants and financial professionals in business, is one of the largest and most respected associations focused exclusively on advancing the management accounting profession. Globally, IMA supports the profession through research, the CMA® (Certified Management Accountant) program, continuing education, networking, and advocacy of the highest ethical business practices. IMA has a global network of more than 65,000 members in 120 countries and 200 local chapter communities. IMA provides localised services through its offices in Montvale, N.J., USA; Zurich, Switzerland; Dubai, UAE; and Beijing, China.

This report marks the fifth anniversary of the ACCA/IMA Global Economic Conditions Survey. It explores the major trends that have driven the global economy between 2009 and 2014 and considers what they might mean for the future of the recovery.

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A note from the editor

When ACCA's Global Economic Conditions Survey (GECS) was first conceived in late 2008, my colleagues and I were not modest in our ambitions – we wanted to create a trusted, widely-followed barometer for the state of the global economy.

Five years, more than 40,000 responses and nearly 6,300 press mentions later, we can't resist patting ourselves on the back a little. The survey has grown into ACCA's (and now IMA's) most cited publication, and possibly the world's most complete record of the global economic recovery. But it's also clear that our regular reports have only begun to scratch the surface of the survey's insights. With the worst of the financial crisis behind us, now is a good time to reflect on what the first five years of the GECS have taught us and dig deeper into the long-term drivers of the global economy.

But why continue to run the survey in the first place? ACCA and IMA are not, after all, economic consultancies. Though both bodies are active in advocacy circles, we have no macroeconomic policy agenda other than a commitment to the public good. Very few of our members make their living from economic forecasting. And besides, aren't the financial crisis and the global recession over by now?

As this report demonstrates, the health of the economic recovery is by no means assured. But in GECS' case, the medium is very much the message. This survey is our opportunity to showcase our members' wealth of expertise, celebrate their global outlook, and remind the world that finance professionals are at the heart of business.

Our members in practice are some of the business world's most trusted advisers; those in finance functions help run some of the world's biggest companies, its fastest-growing small firms, and its most critically-important government agencies. Moreover, they are all part of an international network of colleagues who feel they have a direct stake in the global economy, as a source of opportunities as well as risk.

It is their insights that make the GECS the trusted barometer that it is. For this reason, I am personally grateful to ACCA and IMA members for their continued support for the GECS. Here's to another five years!

Manos Schizas
Senior Economic Analyst, ACCA

1. Introduction to the GECS

When the credit crunch and economic downturn of 2007–8 turned into a full-fledged global financial crisis in the second half of 2008, analysts and economic journalists scrambled for economic indicators that would provide an accurate, up-to-date dashboard on the prospects of the global economy.

Official statistics took a long time to finalise and were subject to very substantial revisions. Gold-standard private sector estimates such as the Purchasing Managers' Index (PMI) were proving unreliable, missing the precise timing of both recessions and recoveries. An ailing financial sector meant that assumptions about the relationship between output, employment and investment could not be made easily, while stock market indices lost what little connection they had once had with their domestic economies. Economic forecasts were increasingly treated with contempt by both analysts and the public.

Developments in the small and medium enterprise (SME) sector, which accounts for half of all private sector output, were much less transparent than those among listed firms and would often go unremarked. The substantial informal sectors making up much of the emerging markets' economies were even harder to model.

It was in this environment that GECS came into existence, as a quarterly online survey of ACCA (and later IMA) members. Its key advantage was, and remains, the breadth of its coverage – finance professionals work across industries, in businesses large and small, but are also over-represented in accountancy practice and the financial sector, where members have hands-on experience of some of the most problematic areas of the world economy. Some 40% of its respondents work with, for or in SMEs. ACCA's global reach, later augmented by the international footprint of the IMA, also means that emerging markets in Asia and Africa can be appropriately represented.

Like many surveys of its kind, GECS records respondents' macro-economic outlook and business confidence; it also covers perceptions of government policies, including fiscal policy. But it also includes a much broader set of questions about the economic and investment environment, from input price inflation and the incidence of late payment to export opportunities and innovation, as well as organisations' responses through investment, headcount decisions and changes to the finance function. To take full advantage of the experience of members in practice or consultancy, members are asked these questions with regards to their clients as well as their own organisations.

As of Q1 2014, GECS allowed year on year comparisons over five consecutive years, gathering just over 40,000 responses from ACCA and IMA members over 21 waves of the survey. Its business confidence and macro outlook indicators have proven to be good predictors of both macro-economic variables and short-term economic sentiment.

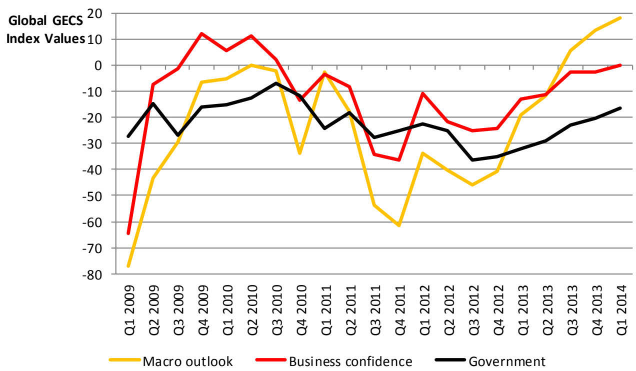
Table 1: Anatomy of the GECS

Demographics	Sector Years of ACCA/IMA membership Role Size of employer Scope of employer (countries and offices) Country + Region (UK, China, Malaysia and Pakistan only)
Indices	Macro outlook index Confidence index Government approval index
Impacts and opportunities	Income and new orders Access to finance Operating costs Hiring decisions (general) Late payment FX rates volatility Supplier/customer viability Investment (capital and staff) Innovation opportunities Cost-cutting opportunities Opportunities in new markets Opportunities to invest in quality Opportunities to invest in supply chain relationships Opportunities in Niche markets Opportunities from changing buyer behaviour
State of finance	Redundancies (voluntary/compulsory) Recruitment (full time/part time) Training Restructuring: out/insourcing, use of shared services
Investment climate	Access to growth capital Profitable opportunities Government support
Government spending	Medium-term trend (expected) Medium-term trend (desirable)
Ad-hoc quantitative questions	Personal involvement in accessing finance Personal involvement in small business advice Personal involvement with the micro-finance industry Personal involvement with business angels Rating of specific areas of government response to recession
Ad-hoc qualitative questions	Advice to a generic small business trading in the new year Medium-term trends in the global economy Details on specific high-impact government policies
Regular qualitative questions	Details on impacts of current economic conditions Details on opportunities pursued by the business
Privacy	Would like to be contacted for future surveys Would like to be contacted for other policy/research work Would like to be featured in ACCA/IMA publication

2. A history of the recovery according to the GECS

The five-year long GECS time series to date provides a fascinating record of the global economic recovery. As Figure 1 demonstrates, the recovery itself has been uneven, progressing through five stages lasting around twelve months each.

Figure 1: A brief history of the global GECS indices



Q1 2009 TO EARLY Q4 2009: THE GREEN SHOOTS PERIOD

When the first GECS was launched in February 2009, the world was already fully engaged in responding to the financial crisis, with bank bailouts and sector-wide recapitalisation packages already complete in many jurisdictions. In the UK and the US, central banks were months into their respective Quantitative Easing programmes.

The first editions of the survey found that businesses expected, on average, just under two more years of the downturn, followed by a recovery. At the time, Africa and Asia-Pacific were leading the recovery and still recording high output growth, with some commentators continuing to insist that their economies had de-coupled from those of the ailing West. Western Europe, South Asia and the Caribbean lagged behind.

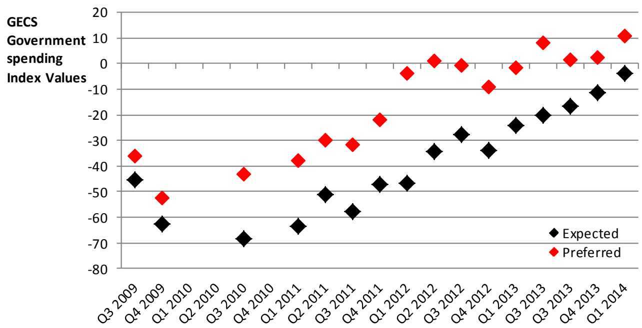
The early editions of the GECS registered the impact of a co-ordinated global stimulus package. In April, the G-20 summit in London agreed a $5 trillion global fiscal stimulus by end 2010, including $1.1 trillion through the IMF and the Multilateral Development Banks, to restore the flow of trade finance and international capital flows. The resulting rebound in business confidence was substantial - by the summer of 2009, global output was growing fast and some optimistic commentators were quick to call the end of the crisis. By the end of the year, the GECS business confidence index had crossed very convincingly into positive territory, but the confidence levels seen during the Green Shoots period have never since been repeated (See Figure 1).

LATE Q4 2009 TO Q4 2010: THE SOVEREIGN DEBT CRISIS

The first outbreak of sovereign contagion came with Dubai's debt crisis in November and the bailout by Abu Dhabi in December 2009. With investors looking hard at their sovereign exposures, the dominoes soon began to fall. April 2010 saw the EU, ECB and IMF bail out Greece; Ireland followed in November.

As a result of these alarming changes in the fiscal landscape, Europe's finance professionals turned hawkish, only to gradually lose their appetite for austerity as the first fiscal adjustment programmes came into play. In late 2009, 72% of respondents in the region wanted government spending in their countries to fall over the next five years, up from 62% only three months earlier; by Q3 2010, this percentage was back down to 66%, and has fallen ever since.

Figure 2: Medium-term government spending expectations and preferences in Western Europe

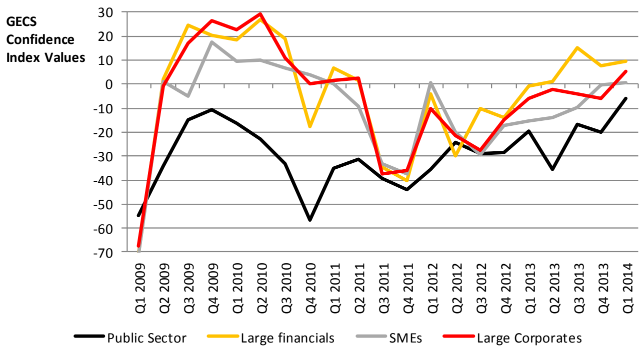


A key weakness of front-loaded fiscal adjustment was the reliance on cuts to public investment rather than consumption: government support for investment began to fall sharply in early 2010, and ACCA members in the public sector became increasingly pessimistic. By the end of the year, their confidence levels had fallen below even the record lows of early 2009 (see Figure 3).

The second half of 2010 was an important period for the global financial sector, as central banks and regulators intervened dramatically to ensure its viability. Results of the second stress test of European banks were published in July, followed by the new Basel III framework for bank capital requirements in December; both added a new sense of urgency to the global drive for bank recapitalisation. Banks were also boosted directly by monetary stimulus, as in November 2010, the Federal Reserve launched its second round of Quantitative Easing (QE2), pledging to buy $600bn worth of securities; the Bank of England pledged to add another £25bn to its own asset purchase programme.

As Figure 3 demonstrates, however, the financial sector was in a state of shock – trailing significantly behind the real economy in terms of business confidence. It would be another two years before it would truly begin to recover.

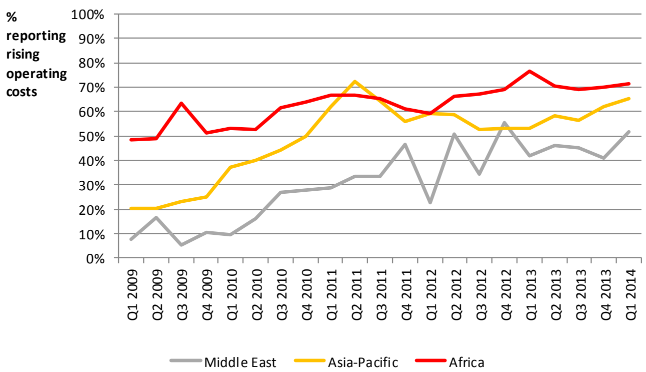
Figure 3: Global GECS Confidence Indices for major sectors



Q1 2011 TO Q4 2011: TURMOIL

2011 was easily the most eventful year of the recovery to date. In response to loose monetary policy, growing uncertainty and supply constraints, a dramatic spike in input price inflation across almost all regions came to a head in the first half of the year, with Asia bearing the brunt. At its peak in Q2 2011, nearly three quarters (72%) of all GECS respondents in Asia reported adverse impact from rising input costs, and inflation briefly became the most-cited business challenge globally (see Figure 4).

Figure 4: Inflation proxies in selected emerging markets

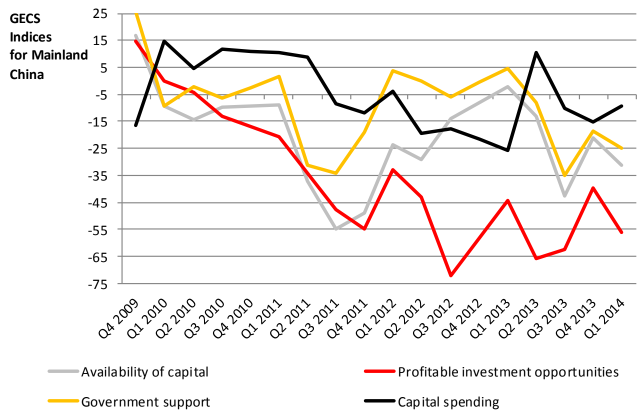


Elsewhere in the world, rising commodity and food prices sparked unrest and riots, and played a role in destabilising already fragile regions, even adding fuel to the broad wave of upheaval now known as the Arab Spring. By the end of 2011, as the Libyan civil war seemed to come to an end, business confidence in the Middle East was at its lowest (-17) since Q2 2009; it has never approached such low levels since. In developed countries, the rise of the Occupy movement and the London riots also underscored the potentially explosive mix of falling real incomes, youth unemployment and income inequality that was the New Normal.

Meanwhile, Portugal's bailout was agreed in May, and European leaders' first effort in July 2011 to defuse the Greek debt crisis through Private Sector Involvement (PSI), ie voluntary creditors' haircuts, proved unsuccessful, casting doubt on Europe's ability to control contagion. In August, a political impasse in Congress led to a watered-down compromise on fiscal policy and a downgrade of the US' credit rating by S&P. Later in the year, the ECB was forced to provide European banks with additional liquidity through its Long Term Refinancing Operations (LTRO). By the end of 2011, GECS respondents in large financials were once again less confident than any other professionals in the private sector (-36) (see Figure 3).

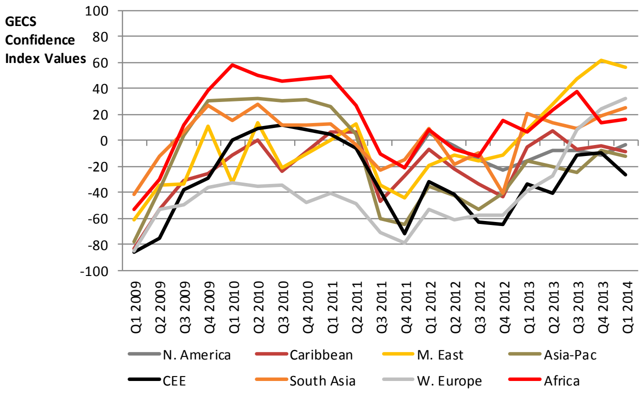
But perhaps the most significant trend in 2011 was the steep slowdown in the Chinese economy. Worn down by sluggish Western demand as well as tightening credit throughout 2010, Chinese businesses grew increasingly pessimistic and cash-strapped, but this trend intensified in mid-2011 as policymakers explicitly targeted slower growth in order to combat inflation and contain the growth in property prices. In May, UBS's George Magnus gave the first of many warnings to follow of a looming 'Minsky Moment' in China, when private sector debt would spark financial instability. And throughout this period, the supply chain disruption and falling demand caused by the Fukushima Daiichi nuclear disaster in Japan was adding pressure to an already tense situation (see Figure 5).

Figure 5: Mainland China investment environment indices



By early 2012, new orders in Hong Kong were weaker than they had been even in early 2009, and the mainland was not performing much better. The combination of slowing industrial production in China and the end of the Fed's QE2 programme broke the trend for rising commodity prices and the global rise of inflation, sending shockwaves through the economies of commodity-producing countries, especially in Africa. Confidence levels in Africa have never since returned to their Q2 2011 reading (10) (see Figure 6).

Figure 6: Business confidence across the regions



Q1 2012 TO Q1 2013: THE TRIUMPH OF POLITICS

Unlike 2011, which saw global economic uncertainty peak, the period between early 2012 and the first quarter of 2013 was dominated by new certainties forged by political solutions and changes of the guard, and perceptions of government policies started to become more positive for the first time since 2009. The US presidential election in November, the election of China's 18th Politburo and December's general election in Japan saw new policy mandates emerge in the world's three largest economies; while heavily contested elections also took place in Malaysia and Pakistan.

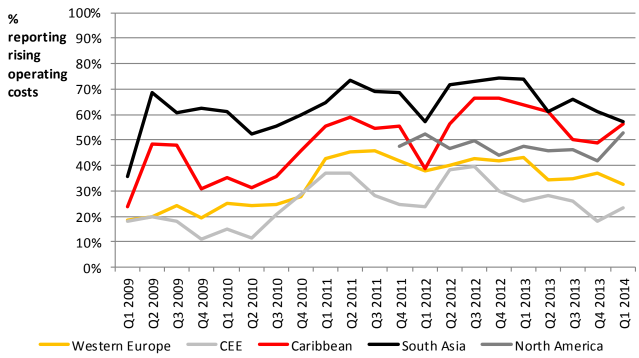
This period marked the beginning of the end of the European debt crisis. The second deal to reduce Greece's government debt through Private Sector Involvement (PSI 2) effectively ended contagion from the European periphery to the core of the Eurozone. The European Stability Mechanism (ESM) was established in September, breaking the feedback loop between bank and government balance sheets, and November saw the European Commission propose a Single Supervisory Mechanism for the region's banks. By the time Spain sought a long-expected bail-out in November, it was able to limit assistance only to its most troubled banks, rather than the government itself.

Other fiscal crises, however, intensified. Business confidence in the Caribbean remained low throughout most of 2012 as concerns grew about the lack of a financing agreement between Jamaica and the IMF. The resulting uncertainty reversed the previous upward trend in capital spending, until May 2013 when an agreement was finally reached.

In the US, the new Obama administration faced fierce opposition over, among other things, the proposed Patient Protection and Affordable Care Act, and the resulting political impasse culminated in the Fiscal Cliff and Debt Ceiling crises. While both dominated headlines and the latter even briefly threatened a US default, policymakers managed to avert both crises without permanent damage to the US economy.

With systemic risk abating and inflation on the retreat, this period saw gold crash repeatedly against major reserve currencies (see Figure 7). More importantly, falling inflation emboldened central banks to take more aggressive action: in July 2012, the Bank of England launched Funding for Lending, a targeted bank liquidity support programme, and Mario Draghi's vow to do 'whatever it takes' to save the Eurozone dramatically altered the dynamics in the banking sector in favour of greater stability. In September, the Federal Reserve also launched QE3, an open-ended programme of asset purchases. By the end of this period, large financials had moved from being the least-confident part of the private sector globally to being the most confident (see Figure 3). Worryingly, the gap in confidence between financials and the real economy has been growing ever since.

Figure 7: Costs in developed and selected emerging markets



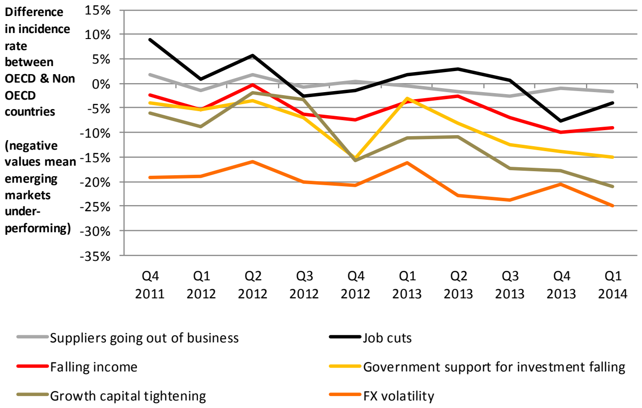
Q1 2013 TO Q1 2014: THE BOOM AND TAPER

This period of extremes began with the US economy bracing against the impact of automatic spending cuts due in March 2013 – the budget sequestration. US business confidence continued to rise regardless, but was dented again in October, when a further political impasse led to a 16-day federal government shutdown.

In late March 2013, the Cyprus bail-in put the new-found confidence in the financial sector to the test, as an unprecedented intervention saw the overnight imposition of capital controls and part of the claims of depositors and creditors in failed banks turned to equity. Despite this, the European and global financial sectors continued to recover, aided by a global surge of monetary stimulus, and even Cyprus' crisis-hit economy performed better than forecast over the following year.

But the defining moment of this period came in late May 2013. Then-Chairman of the Federal Reserve Ben Bernanke shook financial markets by telling Congress that the Fed was considering 'tapering' its asset purchasing programme. By the time the Taper was formally announced in December 2013, much of the market reaction was already underway. Investors stampeded out of riskier assets, including emerging market debt and equities, and left policymakers in Asia and Africa grappling with a loss of liquidity and volatile exchange rates. Since then, GECS figures have documented a continuing divergence in the fortunes of developed and developing countries (see Figure 8).

Figure 8: The changing fortunes of emerging markets

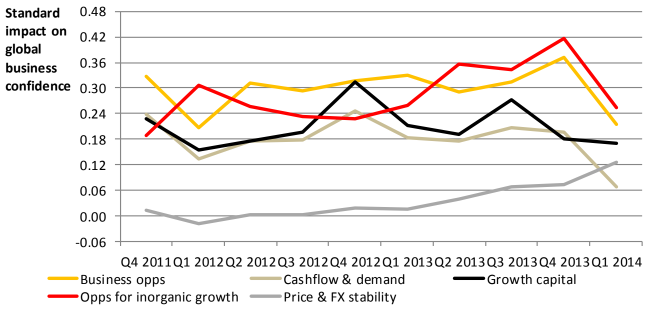


Elsewhere in the world, the first results from Japan's 'Abenomics' policy platform – one of fiscal and monetary stimulus coupled with structural reforms – started to come in in early 2013, with analysts giving the measures a cautious thumbs-up after signs of robust output growth. But China entered a period of uncertainty in the summer of 2013, and again at the end of the year, as a tough regulatory response to the rise of shadow banks led to a dangerous liquidity crunch. While the real economy did suffer from the liquidity crunch, GECS responses as of early 2014 suggested that its impact had mostly receded and financing conditions were on the mend.

Finally, November 2013 saw the seeds of future turmoil sown in the Ukraine, where the rejection of an agreement for closer economic ties with the European Union was followed by a series of intensifying protests. This came to a head in February 2014, with the protesters eventually forcing a change of government and prompting a vigorous response from neighbouring Russia, shaking business confidence throughout the region.

Despite numerous sources of uncertainty, a global growth consensus took hold by the end of 2013, and by Q3 2013 the macro-economic outlook of GECS respondents had comfortably exceeded the previous record set in mid-2010 (see Figure 1). Perceptions continued to improve throughout this period, but business confidence was unable to keep up, and ACCA and IMA continued to warn of an unbalanced and flawed recovery. Clearly, most of the rise in business confidence in 2013 appears to have come from inorganic growth opportunities, and the rising influence of price and exchange rate stability on business confidence suggests that the recovery is confined to relatively few pockets of stability.

Figure 9: Impact of fundamentals on global business confidence, by quarter



WHAT WENT WRONG?

Following a broadly-successful policy response to the global financial crisis, the global economy went through three full years of stagnation between 2010 and 2012. The early recovery was weighted down by a combination of factors:

- **Bank capitalisation and liquidity**
  The world's, and especially Europe's, banks entered the recovery in a bad shape. They were quickly faced with new demanding standards for capital and liquidity, but policymakers were also faced with a dilemma between financial stability and continued access to finance, especially for households and smaller businesses.

- **Deleveraging and underinvestment**
  As access to finance remained tight and future prospects remained uncertain, households and businesses focused on paying down debt and demand for credit remained subdued in much of the world. Similarly, with the immediate need for stimulus behind them, governments turned to tight fiscal discipline. In both cases, this resulted in under-investment, which in turn kept productivity growth artificially low.

- **Inflation and asset bubbles**
  The combination of growing demand for commodities in the early recovery, money in search of safe havens, and the use of specific asset classes as inflation hedges created a perfect storm of inflation and asset price growth. While these dealt a direct blow to businesses, fear of further stoking inflation or inflating asset bubbles also made it very difficult for central banks to intervene in the manner and at the scale that would restore confidence, and even forced some countries to curtail credit.

- **Policy firefighting and polarisation**
  Solving a lot of the policy challenges that emerged during the recovery involved unprecedented cross-subsidies that did not enjoy universal support. The political process of achieving these has been highly controversial, while the crisis-response mode in which they were often pursued limited constructive debate and ended up stretching many people's notion of legitimacy. The result, paradoxically, was not rapid but slow decision-making which sometimes resulted in unpalatable compromises and undermined both voters' and investors' faith in institutions.

- **International economic linkages**
  Increasingly interconnected financial and real sectors between regions meant that regional economies could not decouple from less healthy ones, however dynamic they were in their own right. In particular, weak demand in the Western countries continued to weigh down the recovery in emerging markets.

A NOTE ON THE 5-YEAR TIME SERIES

IMA's involvement in the Global Economic Conditions Survey began in Q4 2011. Prior to this, the survey included no responses from IMA members and samples from the US, Canada and North America as a whole were too small for reliable quarterly figures to be produced. Due to the substantially different characteristics of the ACCA and IMA memberships, Q4 2011 represents a break in the GECS time series.

In order to ensure comparability, all time series covering the full period from Q1 2009 to Q1 2014 are based on the responses of ACCA members only. The same is true of the factor and regression analyses discussed in Sections 3 and 4.

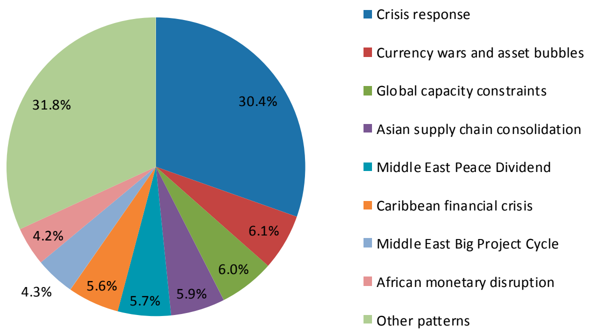
Any time series covering only the period from Q4 2011 to Q1 2014 (including the N. America time series in figures 6, 7 and 14) represent the responses of both ACCA and IMA members. The same is true of the inductive analysis discussed in Section 5.

3. Eight recovery narratives

The global reach of the GECS, the wide range of economic variables it monitors, and the long time series of its headline indices make it possible to study economic conditions in different markets as parts of wider regional and global economic patterns.

Factor analysis[1] reveals eight distinct and significant patterns that have driven the changing fortunes of businesses around the world. Together they account for just over two thirds of all observed quarter on quarter variance in regional economic conditions, as captured by the GECS (see Figure 10).

Figure 10: The eight narratives' share of variance in economic conditions, 2009–14



PATTERN 1: CRISIS RESPONSE

At the height of the global recession, poor cashflow and access to finance, financial instability and declining revenues world-wide led to changing buyer behaviour and relentless cost-cutting at the expense of capital spending and business' innovative capacity. However, forward-thinking corporates also worked out deals with their suppliers around the world to ensure their mutual continued survival, particularly by investing in quality controls that also delivered cost savings. This worldwide 'crisis response' pattern, which dominated economic developments in 2009 but has mostly disappeared since, accounted for 30% of the variance in business conditions on the ground over the first five years of the GECS.

For finance professionals in particular, the crisis response pattern was accompanied by widespread redundancies across sectors, led by the Big Four and the finance functions of large corporates, which also made significant use of voluntary redundancy schemes.

The opposite was true in the public sector, where a combination of policy and operational needs forced departments and agencies to maintain their finance headcounts during the crisis. Finance job creation stalled across the real economy and among the Big Four, while large financials mostly cut back on temporary hires.

Training for finance staff was less affected than finance headcount by the Crisis Response pattern, and among small practices and public sector finance teams the impact was particularly mild. Corporates, on the other hand, cut finance training considerably. Almost across all sectors, the incidence of finance function outsourcing fell significantly, as the crisis made major finance transformation initiatives much riskier and pundits predicted a political backlash against offshoring in 2009.

Finance functions in Western Europe and the Asia-Pacific region were the most exposed to this pattern, while those in Africa were mostly unaffected.

PATTERN 2: CURRENCY WARS, HOT MONEY AND ASSET BUBBLES

This pattern, which peaked in early 2009 and mid-2011, emerged in the depth of financial crisis episodes, as monetary authorities pursued competitive devaluation and investors rushed to buy inflation hedges, fuelling commodity and other asset bubbles. In many emerging markets this will have registered in the form of 'hot money' – rapid inflows of capital that can be easily reversed. The impact of exchange rate volatility was most keenly felt in Asia-Pacific and Central and Eastern Europe, but overall it was Africa's businesses that appeared to lose out the most as their economies became exposed to inflation and loss of demand. Their access to global supply chains was eroded, along with the ability to pursue niche strategies and innovate. Eastern European businesses, on the other hand, tended to benefit on balance. It was a simultaneous surge in this pattern and tightening capacity constraints that fuelled the runaway inflation of mid-2011.

For employers of finance professionals, this pattern focused attention on managing headcount costs in the face of a rise in living costs. In the financial services sector and among smaller practices, employers turned away from voluntary redundancy schemes, while public sector employers cut training in order to avoid real wage cuts. So did employers in the financial sector, despite systemic risks on the rise. Finally, runaway inflation strengthened the business case for outsourced finance functions and offshore shared service centres, with large financials in particular taking notice. South Asia benefited substantially from this reversal.

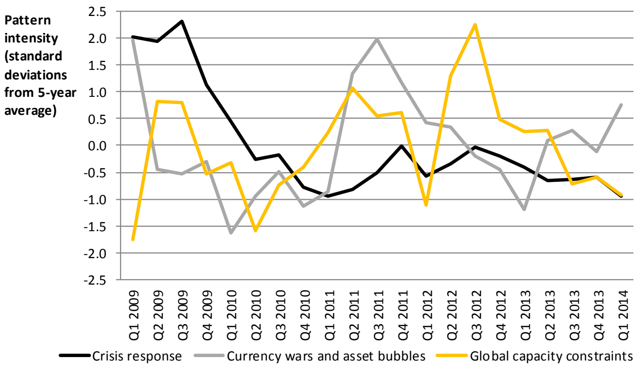
1. The analysis used the full set of quarterly readings on business impacts and opportunities for each of the major GECS regions (See Impacts and Opportunities in Figure 1). Thus each datapoint in the analysis corresponded to the share of participants in a given region reporting a specific problem or opportunity in a given quarter. This analysis does not include North America, as a full five year series is not available. Varimax rotation was used in order to ensure the factors were distinct and uncorrelated.

PATTERN 3: GLOBAL CAPACITY CONSTRAINTS

Although currency wars and asset bubbles have had a role in fuelling inflation during the recovery, price increases resulting from supply shortages and demand growth have also had a significant impact. GECS figures suggest that the long-term trend in capacity constraints peaked in mid-2011 and mid-2012, but has eased significantly since. As the recovery becomes entrenched, however, capacity will once again become an issue. The usual response to increasing capacity utilisation has been higher capital spending and stronger job creation, especially in Central and Eastern Europe and the Asia-Pacific region. But tightening capacity has proven problematic where the financial sector has been unable to respond adequately due to structural problems or poor balance sheets. For example, in the Caribbean, capacity constraints have more often translated into cashflow problems and insolvencies. Rising input costs have also steadily forced African businesses to pursue niche strategies in order to maintain competitiveness without increasing capital spending.

This pattern has not directly affected finance employment for the most part, but in the long run it affects wage differentials between developed and developing countries, and thus the business case for outsourcing finance functions. It is also associated with less finance training among the Big Four, but increased training in the public sector. In regions facing acute financing constraints, such as Africa and the Caribbean, capacity constraints tended to make finance teams less flexible, discouraging staff redeployment.

Figure 11: Business environment patterns no. 1 through 3



PATTERN 4: ASIAN SUPPLY CHAIN CONSOLIDATION

In early 2010 and early 2011, the more forward-thinking businesses in the Asia-Pacific region prepared for slowing growth and adjusted to the changing preferences of newly cautious customers. To achieve this, they were forced to either carve out and defend profitable niches or diversify into new markets. Either way, part of the solution was to work closely with their supply chain partners in order to control costs. Businesses in the Middle East bore the brunt of the cost-cutting, while activity was moved to South Asia, where capital spending grew accordingly. The resulting inflow of currency additionally eased pressure on South Asian countries' capital accounts. As the recovery wore on, this pattern has progressively reversed.

Within finance functions, this pattern led to a significant fall in recruitment and a rise in redundancies in the Middle East, while large financials brought previously outsourced functions back in house and limited their use of shared service centres. In Asia-Pacific, the source of the trend, finance functions were much less affected, although businesses became increasingly reluctant to redeploy finance staff elsewhere in the business in order to ensure ownership of supplier relationships within finance.

PATTERN 5: THE MIDDLE-EAST PEACE DIVIDEND

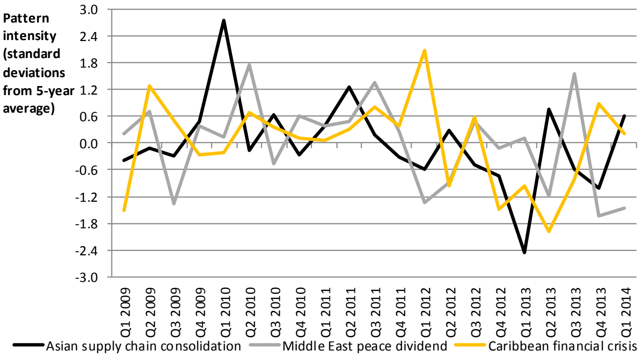
Windows of financial stability, easing access to finance and rising business revenues in the Middle East have tended to generate demand for high value-added, high-quality, innovative goods and services in niche sectors from Western Europe. In turn, Western businesses seeking opportunities in the region would generate new demand, which would then cascade to new investments in quality management among sub-contractors in Africa and investments in innovation by sub-contractors in the Asia–Pacific region.

This pattern strengthened substantially as the early impact of the Arab Spring started to taper out, but receded again in late 2013 and early 2014 as geopolitical risks returned.

PATTERN 6: THE CARIBBEAN FINANCIAL CRISIS

This pattern peaked in early 2012, and has been the consequence of Jamaica's sovereign debt crisis as well as fiscal challenges in Belize, St. Kitts & Nevis, and more recently Barbados. Its impact throughout the region has been widespread, as businesses in the Caribbean found themselves unable to finance innovative projects, respond to changing customer preferences, strengthen supply chain links and invest in quality management. This pattern saw some demand redirected to South Asia and Africa, with customers in Central and Eastern Europe leading the way.

Figure 12: Business environment patterns no. 4 through 6



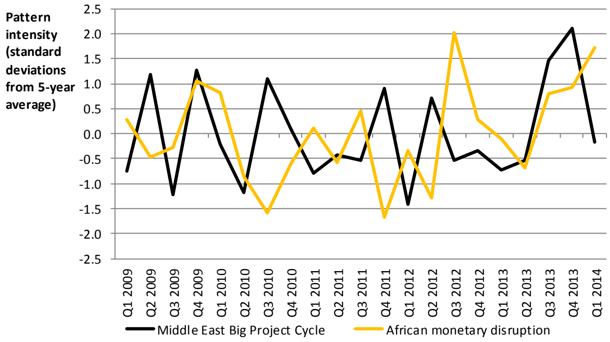
PATTERN 7: THE MIDDLE EAST BIG PROJECT CYCLE

Major infrastructure projects in the Middle East are international affairs. Within the region, they force businesses to invest in quality, innovation and supply chain relationships. This demand for high quality inputs then prompts suppliers in Africa and South Asia to invest in quality standards and finance skills, incurring higher operating costs in the process. While this element of the recovery, which accounts of 4.2% of variance in business conditions, had been in decline between 2009 and 2013, the awarding of the Expo 2020 to Dubai in late 2013 helped re-ignite it, at least momentarily.

PATTERN 8: AFRICAN MONETARY DISRUPTION

This pattern corresponds to a period of growing instability, focused on South Africa, Ghana, Kenya, Nigeria, Tanzania, Uganda, Burundi and Rwanda. It is characterised by tightening access to finance, significant exchange rate volatility and rapid cost-cutting among Africa's businesses, along with significant changes to buyer behaviour in the region. Although African exchange rate volatility is always high by the standards of other regions, it became increasingly so since late 2011, and reached a peak in Q3 2012. Within the finance functions of African businesses, this pattern led to a renewed emphasis on savings and flexibility, but the need to tightly control cashflow in response to it meant that this pressure did not translate to a loss of capacity – with the exception of training cuts in finance.

Figure 13: Business environment patterns no. 7 and 8

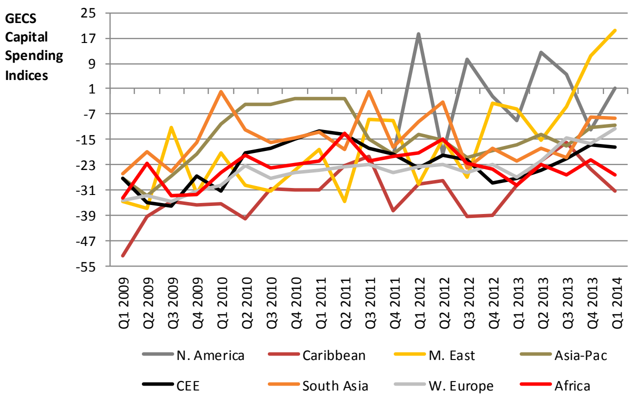


4. Ten observations on business investment

In recessions, it is common for economic agents to put off some of their most important long-term plans for better days: couples put off having children; legacy-building government strategies are put on hold; and businesses put off capital spending. ACCA and IMA have therefore often pointed to the return of long-term commitments as the ultimate measure of economic recovery.

In the early days of the recovery, the dynamic economies of the Asia-Pacific region were driving much of the world's capital spending, with expenditure rising throughout 2009 and plateauing at a high level in 2010. But the rest of the world saw only the slightest uptick in investment. Eventually, Asia's investment surge came to an abrupt end as China's economy began to slow in early 2010 (see Figure 14).

Figure 14: Capital spending across the regions



The two years of turmoil and political tension that followed kept global capital spending subdued, and it wasn't until late 2012, with contagion contained in Europe and the drama of multiple elections in key world economies out of the way, that spending started to return again, across regions. Africa still stands out as an exception, as an inefficient financial sector has continued to hold back the region's fast-growing champions and their investment.

ACCA's analysis of the last three periods of the recovery, from early 2011 to early 2014[2] suggests the following (see Table 2).

NOT ALL BUSINESS OPPORTUNITIES GENERATE SIMILAR LEVELS OF CAPITAL SPENDING

Business investment is drawn to concrete opportunities. Throughout the recovery, new orders were a stronger determinant of investment than any other class of business opportunity. Among long-term planners, businesses hoping to exploit opportunities in new markets were the most reliable drivers of capex, investing significantly regardless of macroeconomic and political conditions. On the other hand, businesses taking refuge in niches typically don't have to make large commitments. This is a chicken-and-egg situation, as the need to avoid large capital commitments is often the main motivation for such strategies – which, in turn, have been more common among credit-rationed small businesses.

ANIMAL SPIRITS (USUALLY) MATTER

Even after controlling for the full range of business challenges and opportunities monitored by GECS, as well as the state of the investment environment, business confidence and macro-economic expectations were significant predictors of capital spending. Ironically though, very high confidence levels can sometimes hold back investment, as businesses hope that a rising tide will lift all boats.

BUSINESS IS CATCHING UP ON A LOT OF OVERDUE INVESTMENT

GECS data show that, since early 2013, capital spending decisions have largely decoupled from business confidence and macro-economic sentiment. This surprising behaviour is due to the fact that businesses have been putting off investment since as far back as 2008, when indiscriminate (or desperate) cost-cutting led to a reduction in business capacity. To this day, cost-cutting has a disproportionate effect on capital spending.

AS CONDITIONS IMPROVE, THE SHORTAGE OF GROWTH CAPITAL BECOMES MORE SIGNIFICANT

Investment can be hampered by a lack of short-term or long-term financing. As economic conditions improve, however, shortages of long-term financing are becoming the greater influence. This is shifting debates on business financing towards structural, rather than cyclical, problems. GECS figures also show that the healthier a region's banking sector and investment environment, the more closely linked capital spending is to employment. This link can be broken by dysfunctional finance systems, skewed economic incentives and skills shortages, which force businesses to combine resources in sub-optimal ways. When long-term business decisions are made on this basis, they can be hard to reverse in future, leading to a legacy of poor productivity.

2. The analysis is limited to these three years in order to ensure that a uniform set of business and investment environment variables can be used as determinants of investment.

SUPPLY CHAIN DISRUPTION HOLDS BACK INVESTMENT

While insolvencies of any kind are a signal of poor liquidity which tends to discourage investment, businesses with suppliers at risk of going out of business were much more likely to cancel or refrain from investment plans than those without, even if the latter had customers at risk of going out of business.

GOVERNMENTS GENERALLY STRUGGLE TO SPUR CAPITAL SPENDING…

After allowing for the effects of other variables, including respondents' macroeconomic outlook, the effect of Government support on capital spending was significant, but negative. One explanation for this phenomenon is that Government incentives target sectors for which conditions are particularly adverse, creating the illusion of negative returns. If that is the case, then this explanation would also suggest that government intervention has rarely been able to restore capital spending to its original levels during the downturn.

… BUT HAVE BEEN RUTHLESS WHEN IT COMES TO CUTTING THEIR OWN INVESTMENT

After controlling for other factors, the public sector stood out throughout the recovery for its low levels of capital spending. Countries' decisions to cut investment ahead of public consumption not only weighed down the recovery, but will also have implications for public services and productivity in the medium-term.

RELAXED BUSINESS DOESN'T MIND A BIG SPENDER IN POWER

After controlling for the expected medium-term trend in Government spending, expectations of government over-spending in the medium term were positively correlated with increased capital spending. This was, however, not true during periods of intense uncertainty and turmoil, such as 2011. And while businesses might be reassured by governments that err on the side of overspending when in power, they may not look so favourably on politicians who err on the side of overspending pre-election: during the period referred to in this report as 'The Triumph of Politics' the relationship between expected public spending and businesses' capital spending turned negative.

THE WAITING IS THE WORST

Election periods have a chilling effect on capital spending, and paradoxically this is more likely if businesses are expecting better times ahead.

Throughout 2012, capital spending decisions in many countries were typically put off until after elections or a change of leadership. However, it seems that it was only the less confident businesses that behaved in this way – business confidence generally had the expected effect on investment across all three periods.

NEVER UNDERESTIMATE THE POWER OF CENTRAL BANKERS

The GECS demonstrates, for instance, that Mario Draghi's 'whatever it takes' statement in late July 2012, whereby the ECB pledged to provide whatever stimulus is needed to save the Eurozone, had a massive effect on the health of the banking sector throughout the Western world, which in turn kick-started a recovery in business investment. The period described in this report as 'the triumph of politics' was the only one that saw capital spending rise from quarter to quarter even after controlling for the observed improvement in access to finance.

Table 2: Determinants of capital spending, 2011 to 2013

Recovery period:		The turmoil			The triumph of politics			The boom and taper		
Theme	**Explanatory variables in the analysis**	**Sign**	**Sig**	**Standard effect**	**Sign**	**Sig**	**Standard effect**	**Sign**	**Sig**	**Standard effect**
Government policy factors	Expected medium-term trend in government spending	Negative		.039	Negative	*	2.857	Negative		.087
	Expected medium-term government overspending	Positive		.001	Positive	***	10.413	Positive	***	8.526
	Increasing government support for investment	Negative	***	9.026	Negative	**	4.650	Negative	***	11.489
	Organisation is in the Public sector	Negative	***	32.440	Negative	***	12.649	Positive		.013
Business challenges	Poor access to finance	Negative	***	59.654	Negative	***	26.652	Negative	***	25.291
	Falling revenues	Negative	***	35.609	Negative	***	25.266	Negative	***	20.888
	FX rate volatility	Negative	***	24.876	Negative	***	17.735	Negative		.071
	Late payment	Negative	*	3.229	Negative		1.006	Negative	***	12.315
	Suppliers going out of business	Negative	***	40.397	Negative	***	16.700	Negative	***	11.056
	Customer going out of business	Negative	**	4.211	Negative		1.738	Negative	***	9.436
	Declining orders	Negative	***	41.782	Negative	***	10.601	Negative	***	22.389
Business opportunities	Opportunities through innovation	Positive		.375	Positive	**	5.911	Positive		1.906
	Opportunities in niche markets	Negative		1.727	Negative	**	5.178	Negative		2.351
	Opportunities in new markets	Positive	**	4.331	Positive	***	15.578	Positive	***	11.650
	Cost-cutting opportunities	Negative	***	63.487	Negative	***	56.291	Negative	***	43.265
	Opportunities through investment in quality	Positive	***	8.643	Positive		2.627	Positive	***	19.756
	Opportunities to increase orders	Positive	***	35.292	Positive	***	11.451	Positive	***	17.756
Investment environment	Falling availability of growth capital	Negative	***	21.594	Negative	***	33.331	Negative	***	34.135
	Increasing availability of growth capital	Positive		.087	Negative		.538	Positive	**	5.152
	Fewer investment opportunities	Negative	***	28.242	Negative	***	22.377	Negative	**	6.262
	More investment opportunities	Positive		1.269	Negative		.545	Positive	***	17.310
Macro-economic outlook	Getting worse	Negative	*	2.769	Negative	**	6.291	Positive		.208
	Getting better	Positive		.021	Negative		.044	Positive		.610
	Bottom and will remain	Negative	**	5.758	Negative		2.277	Negative		.456
	Bottom and will improve	Negative	*	3.188	Negative	**	6.122	Negative		.313
Business confidence	Much less confident	Negative	***	13.095	Negative	***	13.142	Negative		2.633
	Less confident	Negative	***	7.433	Negative	***	12.982	Negative		1.959
	As confident	Negative	**	4.363	Negative	***	8.527	Negative		1.210
	More confident	Negative	**	5.412	Negative	**	5.468	Negative		2.044

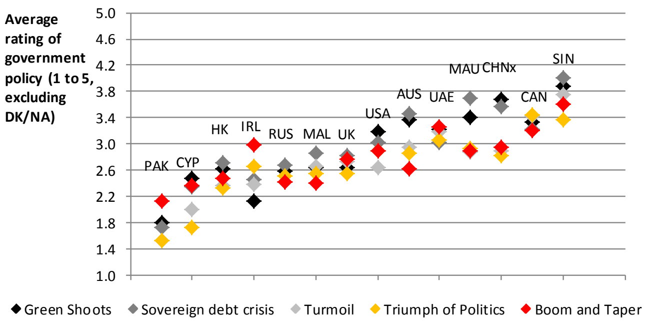
Notes: Sample are all responses from ACCA members, from Q1 2011 to Q1 2014. Coefficients obtained through ordinal regression analysis. The dependent variable (capital spending) was coded as follows. –1: net reduction in capital spending; 0: capital spending unchanged; 1: net increase in capital spending). The analysis controlled for region, business size and sector, level of international activity, macro-economic outlook, business confidence, business challenges and opportunities, investment environment, ratings of government policy, expectations of government spending. Not all coefficients are shown *** $p < 0.01$; ** $p < 0.05$; * $p < 0.1$

5. How effective is government policy?

Government policy is a key driver of the global economy, but disentangling its influence from that of other factors can often be difficult. Throughout almost all of its five-year history, GECS has monitored finance professionals' perceptions of economic and fiscal policies and allows a level of analysis across periods and countries that is unparalleled among surveys of its kind.

As Figure 15 demonstrates, few countries' economic policies got passing grades consistently throughout the recovery, with Singapore, Canada and the UAE standing out as high performers. In emerging markets, governments were generally rated higher during the early days of the recovery, when growth was still brisk, while the opposite pattern emerged in more developed countries. Elections have also generally been followed by a rise in approval ratings, giving the incoming governments a brief 'grace period', while financial and fiscal crises have directed criticism towards policymakers. Ireland and Australia have provided the GECS' most striking reversals, the former as a result of its recovery from the financial crisis of 2009 and the latter as a result of a high dependence on falling commodity prices and a slowing Chinese economy.

Figure 15: Ratings of government policy by jurisdiction and stage of the recovery



It will come as no surprise that ratings of government tend to be higher when finance professionals are feeling more confident about the economy and their own organisations, although some of the more specific influences on government ratings are interesting. ACCA's analysis suggests that finance professionals tend to hold governments accountable for many pressures on their organisations – with inflation, in particular, ranking higher than any other area that wasn't under the government's direct control.

But overall the strongest influence on perceptions of government is fiscal policy. In Europe, fiscal consolidation became a priority following the financial crisis, but in emerging markets governments remained engaged in major investment programmes and increased public consumption (see Figure 16). Finance professionals typically became more tolerant of high levels of government spending when business confidence dipped, but less so during the sovereign debt crisis (see Figure 17).

Figure 16: Medium-term spending indices for selected markets, by stage of the recovery

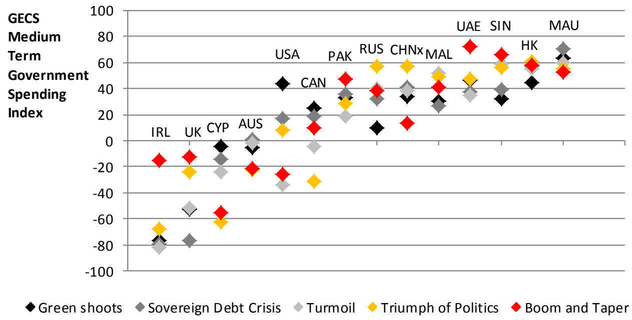
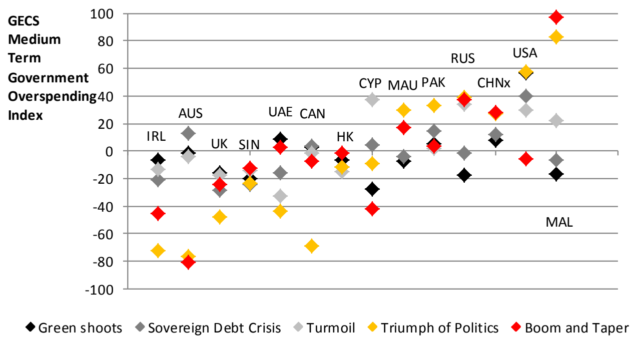


Figure 17: Medium-term overspending expectations for selected markets, by stage of the recovery



Over the whole period, countries can be grouped into four quadrants:

- a group of 'carefree big spenders', including major markets such as the US, China, Russia, Malaysia and Pakistan, where fiscal policy was loose and finance professionals worried about its sustainability throughout most of the recovery. It is worth noting, though, that almost all of the 'carefree big spenders' appeared to be tightening their fiscal stances during the final period of the recovery (the Boom and Taper).

- a group of 'prudent big spenders', including Singapore, the UAE and Hong Kong, where fiscal policy was loose but generally seen as sustainable. The prudent big spenders typically increased their levels of spending as the recovery progressed.

- a group of 'prudent savers', including Canada and Australia, where fiscal policy was relatively tight but austerity was not seen as likely to hurt growth.

- a group of 'extreme savers', including the UK and Ireland, where fiscal policy was very tight and respondents expected austerity to hurt the recovery. The extreme savers generally relaxed their tight fiscal stance during the final stages of the recovery, as growth boosted tax revenues.

More detailed analysis at the global level reveals that the influence of actual political direction is significant and growing. The influence of government spending is cyclical but generally positive, while the influence of fiscal sustainability, which was extremely high in 2011 (and presumably earlier), has been falling ever since – by early 2014, with a 'recovery consensus' on the rise, this was no longer a significant influence on global business confidence at all.

6. Conclusions

The five-year review of the Global Economic Conditions Survey reveals some fascinating patterns underlying the recovery. ACCA and IMA analysis suggest the following.

THE CRISIS IS OVER, LONG LIVE THE CRISES!

Judging from the responses of businesses, the global recession that began in 2008 was already over by the end of 2009. But its legacy of damaged bank and government balance sheets, unconventional economic policies and political tensions set off a number of more specific or localised failures, from the sovereign debt crisis and a series of asset price bubbles to political showdowns such as the US debt ceiling crisis and massive capital flow reversals such as the Taper. This fragmentation of the original crisis into multiple ones raises questions over the supposed global 'recovery consensus', which appears to be limited for now to a few islands of financial stability.

REGIONAL ECONOMIC LINKAGES ARE AS STRONG AS EVER

One pattern that emerges clearly from the GECS data is that economic sentiment and business confidence across regions are inextricably linked – particularly among emerging markets. Not only are the GECS macro-economic sentiment and business confidence readings for Asia-Pacific, Africa, and Central and Eastern Europe very strongly correlated; clear linkages also emerge between specific business impacts, decisions and opportunities across the regions. This means that global supply chains have continued to drive the recovery as they did the growth period that preceded it; despite predictions to the contrary, the trend towards greater globalisation has not gone into reverse.

EUROPE IS FIXED, FOR NOW

The Eurozone sovereign debt crisis was a profound shock to the global financial system and the global economy. But since late 2012, many of the institutional gaps that gave rise to the crisis have been addressed, and Europe's financial sector was even able to absorb profound shocks such as the Cyprus bail-in without renewed turmoil. In Western European economies, finance professionals believe that the worst of the austerity drive is behind them, and with it the constant drag on business confidence. Of course, European countries, and indeed most of the developed world, continue to labour under a significant debt burden, and it would be foolish to dismiss this threat in the long run.

CHINA'S HARD LANDING HAS BEEN AVERTED, BUT THE SLOWDOWN WILL CONTINUE

Despite repeated doomsday warnings, China's slowing growth has so far remained manageable and policymakers' efforts to rein in the shadow banking sector have not caused a widespread financial crisis. In the long-run, however, China's investment environment is becoming increasingly adverse and the country is pivoting, slowly and awkwardly, from an investment-driven to a consumption-driven economy. For Chinese policymakers, and for the many countries in the wider region that have tied their economic growth to commodity exports and Chinese demand, this transition will present a significant challenge for years to come.

IT'S TIME TO GET REAL

Since as early as mid-2011, confidence gains in the financial sector have outstripped those in the real economy, and since the ECB's 'whatever it takes' moment in July 2012 the gap between large financials and large corporates (to say nothing of SMEs) has widened considerably. It is hard to ascertain purely on the basis of GECS data what the source of this discrepancy is; however, the timing of the divergence and its correlation with the eight patterns identified in Section 2 (particularly financial disruption in Africa), suggest that is closely tied to monetary policy at the global level. A recovery that is confined to the financial sector is ultimately unsustainable and must be treated as such by policymakers – who must now start asking hard questions about the underlying trends in consumer spending, business investment, and indebtedness.

Generally speaking, unconventional monetary policy during the recovery caused international spillovers that Western policymakers have generally failed to take fully into account. Emerging markets in Asia and Africa in particular have had to contend with the effects of 'hot money' as a result of policies they had no choice about and rarely benefited from, while businesses in these regions have often lacked access to the kinds of financial infrastructure that would ideally have softened the blow. As calls for more rigorous global economic governance and financial regulation intensify, a greater appreciation of such spillovers is necessary.

INFLATION ISN'T DEAD!

In developed countries, 'inflation is dead' became a rallying cry between 2011 and 2012, supporting calls for more accommodative monetary and fiscal policy in particular. In emerging markets, however, operating costs are now once again on the rise. In Africa and the Middle East inflation never really fell, while in Asia-Pacific input prices have rebounded since late 2012, and even the Chinese mainland, which has driven much of the fall in inflation, saw a rebound from mid-2013 onwards.

It's important to realise that there are two components influencing businesses' operating costs – capacity constraints, which take time to propagate across regions, and growth in asset and commodity prices, which propagates almost immediately. As this report has demonstrated, the fact that these two are not synchronised can lead to inflation readings that do not seem to be justified by other economic trends. Treating these two elements separately can help central banks to better judge the necessity and impact of their interventions.

ACCESS TO FINANCE HAS RETURNED, BRINGING STRUCTURAL PROBLEMS TO THE FORE

Across almost all major regions, access to finance for businesses has improved consistently over the last five years. However, in Africa, the Caribbean and the Asia-Pacific region, financing problems have re-emerged as the recovery progressed. More generally, as the recovery boosts the demand for long-term funding along with banks' balance sheets, the underlying reasons for financing problems are increasingly structural ones, and they are driving a global misallocation of resources.

Such structural weaknesses may include inefficient banking sectors, under-developed capital markets, flawed regulation or low financial capability among smaller businesses – all areas in which the accountancy profession has a stake and indeed significant influence. Promoting structural change now can improve not only the timing but also the quality of the recovery.

THE RETURN OF INVESTMENT WILL BE THE MAJOR ECONOMIC STORY OF 2014/5.

As the GECS figures demonstrate, businesses around the world have been holding back on long-overdue investment for years. Austerity-hit public sectors in Europe and beyond have sacrificed public investment in order to maintain government consumption levels. Finally, political uncertainty in many of the world's major economies has made long-term planning problematic for business leaders. These three trends have now been reversed, and business investment has rebounded across many regions in response. This surge of investment will shape industries for years to come; policymakers around the world with plans for long-term industrial policy must ensure their policy toolkits are complete and ready for deployment by the end of this year.

ACCA, IMA and the global economy

Global economic conditions continue to dominate business life. They are at the top of the world's political agenda, and updates and debates on economic issues are almost constantly the focus of media attention. While most national economies are now growing once again, it is far from clear how sustainable this growth is or how long it will be before a sense of normalcy returns to the global economy.

ACCA and IMA have been prominent voices on what the accounting profession can do to help turn the global economy around. Both bodies have published extensively on a range of topics from the regulation of financial markets or the prevention of fraud and money laundering, to fair value or the role of international accounting standards, to talent management and the development of an ethical business culture.

ACCA and IMA aim to demonstrate how an effective global accountancy profession contributes to sustainable global economic development; to champion the role of accountants as agents of value in business; and to support their members in challenging times. Both professional bodies believe that accountants add considerable value to business, and never more so than in the current environment.

Accountants are particularly instrumental in supporting the small business sector. Small and medium-sized enterprises (SMEs) account for more than half of the world's private sector output and about two thirds of all employment. Both ACCA and IMA focus much of their research and advocacy efforts on articulating the benefits to SMEs of solid financial management and reliable financial information.

WHERE NEXT?

As countries around the world once again consider strategies to promote stability and stimulate growth, the interconnectedness of our economies, and how they are managed and regulated, is now firmly in the spotlight. The development of the global accountancy profession has benefited from, and in turn contributed greatly to, the development of this interconnected global economy. The fortunes of the two are tied. ACCA and IMA will, therefore, continue to consider the challenges ahead for the global economy, and focus on equipping professional accountants for the uncertain future.

To find out more visit

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