



Recent trends in the middle corporate market

Main performance indicators continue to improve

Chart 1 shows the strong upturn currently being reported in company sales and order balances. The survey last December showed encouraging signs of growth and good expectations of business performance for the first half of 2004. These expectations have been met and the survey results are encouraging. The balance of firms reporting higher rather than lower sales in the first half of 2004 rose to a third of all companies questioned in this survey, significantly up from 25% of companies in December 2003 and from 13% a year ago. 54% of firms reported higher sales and 20% of firms reported lower sales in the first half of 2004, compared with 49% of firms reporting higher sales and 24% reporting lower sales during the second half of 2003. The sales balance result in this survey is now well above the average sales balance achieved over the 12-year life of the survey, a quarter of companies reporting higher rather than lower sales. The orders balance rose to 29% in June 2004 from 21% in December 2003 and from 7% a year ago; 49% of respondents reported higher orders and 20% reported lower orders in June compared with 43% of respondents reporting higher orders and 22% reporting lower orders last December. The order book level in this survey is also stronger than the average of 20% of companies reporting higher rather than lower order books over the life of the survey.

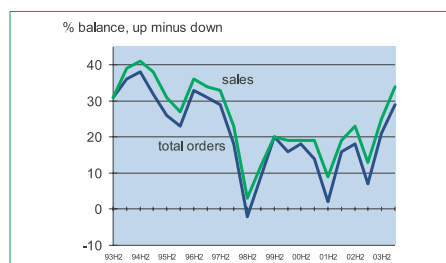


Chart 1 Sales and orders, last 6 months

The survey results show that companies' export balances continued to strengthen in the first half of this year, reaching the strongest position since 1996. The balance of companies reporting higher rather than lower exports rose to 27% in June 2004 from 18% in December 2003 and from 10% a year ago (see Chart 2). In this survey, 45% of companies reported higher exports and 18% reported lower exports, compared with 41% and 23% of companies, respectively, in December 2003. Export balances to both European and non-European destinations continued to improve; export balances to Europe rose from 11% of companies increasing rather

than decreasing exports six months ago to 18% of companies in June 2004. During the first half of 2004, 36% of companies exporting to Europe reported higher exports and 18% of companies reported lower exports and 31% of companies exporting to non-European destinations reported higher exports and 18% reported lower exports. These results suggest that despite the strong pound, UK exporters are benefiting from stronger global economic growth.

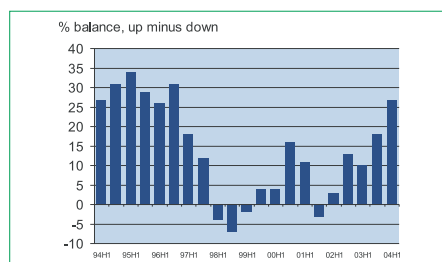


Chart 2 Export sales, last 6 months

UK imports have also strengthened according to the survey. In December 2003, the positive balance of companies increasing rather than decreasing imports amounted to a quarter of companies responding to the survey. By June 2004, this share had increased to over a third. Almost half of the companies surveyed reported having increased imports in the last six months, a reflection of the strength of UK demand for foreign goods and services. Following the conversion within the euro-zone to euro notes and coins on 1 January 2002, the majority of UK companies exporting to the euro-zone now receive invoices and issue payment in euros. The number of exporting firms issuing invoices in euros rose from 24% in December 1999 to 59% in this survey. Companies being invoiced in euros amounted to 36% in December 1999 and amount to 79% in this survey. The breakdown of data by industry sector shows that 83% of manufacturing companies are being invoiced in euros and 66% are issuing invoices in euros, 84% of transport & communication companies and 81% of wholesale companies' payments are issued in euros, but the highest share is taken by the hotel & catering industry with 100% of companies receiving invoices in euros.

Business optimism continues

The good news is that UK companies continue to be optimistic about their business conditions for the rest of the year, seeming undeterred by rising UK interest rates and higher oil-related costs. Euro-zone GDP growth is still weak, but improving, and this has helped UK exports to the region and robust US GDP growth is increasing demand for UK goods and services there. The balance of companies expecting higher rather than lower orders for six months ahead in the June survey strengthened to 33% compared with 28% in the December 2003 survey and 19% in the survey a year ago. This survey reports that 44% of companies expect higher orders and 11% expect lower orders in the second half of 2004, compared with 41% of companies expecting higher orders and 13% expecting lower orders in the first six months of 2004 as reported in the December 2003 survey.

The balance of companies expecting higher rather than lower sales over the next six months strengthened to 41% in this survey compared with 33% in December 2003 and 22% in June 2003. Over half of companies responding to the survey expect higher sales and just 12% of companies expect lower sales, an improved result on 48% and 15%, respectively, in the previous survey. Also, companies responding to the survey continue to be more optimistic about raising exports during the remainder of the year. The balance of companies expecting to increase rather than decrease total exports rose from 34% in December 2003 to 41% in June 2004, the balance of companies expecting to increase rather than decrease exports to Europe rose from 27% in December 2003 to 28% in June 2004 and to non-European destinations from 21% to 28% over the same period.

The profit balance continues to improve this year

Chart 3 shows the relationship between prices and profits. The improvement in the profit balance that began in the last survey has continued due to higher sales and prices charged for goods and services, although the positive balance is small compared with balances achieved during the earlier part of the 1990s when the survey began.

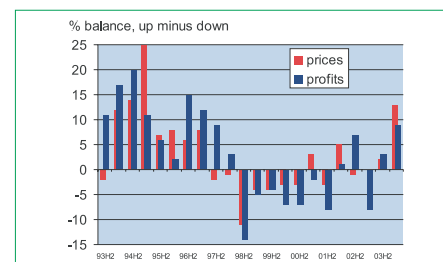


Chart 3 Prices and profits, last 6 months

The balance of companies reporting higher rather than lower profits strengthened to 9% in this survey from 3% in December 2003 and from minus 8% in June 2003, therefore showing considerable improvement. 38% of companies reported higher profits during the first half of 2004 and 29% of companies reported lower profits over the same period, compared with 34% of companies reporting higher profits and 31% of companies reporting lower profits in the survey in December 2003. The balance of companies reporting higher rather than lower prices increased from zero in June 2003 to 2% in December 2003 and to 13% in this survey, suggesting that some pricing power may be returning to companies. The highest positive pricing balances were recorded by companies operating in the South West and Scotland and in the hotel & catering, construction and retail sectors. The transport & communications industry was the only sector to report more companies experiencing declining profits rather than increasing profits. London, the South West, South Wales & the Welsh borders and the Eastern region have shown good profit balances, as have the construction, wholesale, hotel & catering and business services sectors. Profit expectations for the first half of 2004 are



encouraging as 22% of companies responding to the survey expect higher rather than lower profits in the next six months compared with 15% of companies in the December 2003 survey. This is the strongest result since 1997. 39% of companies responding to the current survey expect higher profits in the second half of 2004 and 17% of companies expect profits to fall over the same period. This compares with 35% of companies expecting higher profits and 20% expecting lower profits reported in December 2003. London followed by Scotland are the regions most optimistic about profits for the remainder of the year – 50% of companies responding in London expect higher profits in the second half of 2004 and 46% of Scottish companies expect higher profits over the same period. Business services and hotels & catering are the most optimistic industry sectors in terms of raising profits next year. Companies with turnover over £50m have the most encouraging profit expectations. Improved profitability is reflected in the fact that the share of companies reporting cash flow pressures remains low, at 17%, well below the peak level of 56% of reporting companies in the early 1990s.

Survey suggests higher prices

In addition to the improvement in pricing power in the first half of this year, companies responding to the survey expect to be able to increase prices in the second half of the year – in the December survey a balance of 10% of companies expected higher rather than lower prices in the first six months of 2004 and this balance increased further to 12% in the June survey for the second half of 2004 (see Chart 4). In this survey, a quarter of companies expect to increase prices and 12% expect to lower prices compared with 22% of firms reporting higher price expectations and 12% lower expectations in the last survey. The largest and the smallest companies reporting to the survey are the most optimistic about raising their prices. For the regions, the South West and Scotland report the most favourable price balances in the survey. Companies reporting in the hotel & catering, construction and retail sectors show the strongest balances.

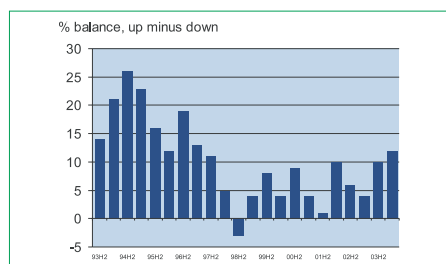


Chart 4 Prices, expectations for next 6 months

The share of companies operating below full capacity is fairly large at 62%, see Chart 5, which indicates that the output gap in the UK is still ample. However, the share of companies reporting difficulties in recruiting skilled labour has risen from 47% in December 2003 to 52% in June 2004 and the share of companies reporting difficulties in recruiting unskilled labour has risen from 26% to 29% over the same

period. Given companies' recruitment intentions for the remainder of the year this could put upward pressure on pay.

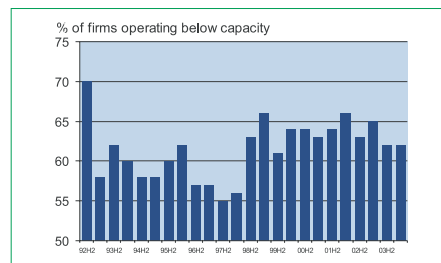


Chart 5 Surplus capacity

Encouraging investment and employment results

Chart 6 shows investment and employment trends over the 12-year life of the survey. The balance of companies increasing rather than decreasing investment in the last six months rose from 9% in the December survey to 17% in the current survey. 33% of companies reported increasing investment compared with 16% of companies lowering investment in the first half of 2004. This compares with 29% of companies increasing investment and 20% lowering investment spending during the second half of 2003. Encouragingly, the investment balance is higher than the average balance of 13% of companies reporting higher rather than lower investment spending over the 12-year life of the survey. Larger companies reported the strongest investment balances as did companies in South Wales & the Welsh borders and the South East regions and in the retail, hotel & catering and business services industries.

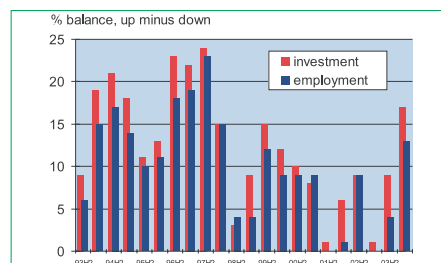


Chart 6 Investment and employment, last 6 months

Companies also have more optimistic intentions about investment spending for the remainder of the year. The survey shows that more companies expect to increase rather than to decrease investment spending during the second half of 2004 with the balance up from 6% in December to 13% in this survey. Again this is higher than the average of 7% over the life of the survey. 27% of companies expect to increase investment over this period and 14% of companies expect to decrease investment over the same period. This compares with 25% of companies planning to raise investment and 19% of companies planning to lower investment in the December 2003 survey. Also, the balance of companies reporting higher rather than lower employment improved from zero in the first half of 2003 to 4% in the second half of 2003, to 13% at present. 31% of companies increased staff numbers and 18% of companies decreased staff numbers in

the first half of the year. In the last survey, 25% of companies increased staff numbers and 21% decreased staff numbers in the second half of 2003. For the rest of the year, the balance of firms planning to increase rather than decrease staff numbers has risen sharply to 17% from 8% in the last survey. 28% of companies report intentions to increase employment in the second half of 2004 and 11% of companies plan to decrease employment over the same period. In the December survey, 21% of companies expected to raise employment and 13% to lower employment over the first half of 2004.

Business confidence strongest since 1997

Chart 7 shows our index of business confidence, which measures companies' expectations of orders, sales and profitability for the coming six months. In this survey, the business confidence index has strengthened considerably from 25 in December 2003, the same level as the average of 25 reported over the 12-year life of the survey, to 32 at present. All components of the index are higher – the order books index has increased from 28 to 33, the sales index has increased from 33 to 41 and the profitability index from 15 to 22. The industry sectors reporting the greatest confidence going forward are hotel & catering, showing recovery following several difficult years, wholesale and business services. The Thames Valley, London and Scotland are the regions showing the most optimistic intentions.

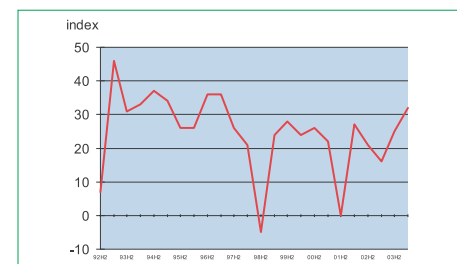


Chart 7 Business confidence

Summary

The results of the June survey are encouraging and all of the main performance indicators have continued to improve – order books, sales, exports, profits, investment and employment, supporting strong UK economic growth for the whole of 2004. 53% of companies responding to the survey expect to increase sales over the next six months. However, with faster growth there is also a rise in inflation and a quarter of companies expect to be able to raise prices. 39% of companies expect higher profits, the strongest result since June 1997. Despite the strong pound, half of companies plan to increase exports, probably explained by strong growth of global markets. Given the more attractive business environment, 27% of companies are planning to increase capital expenditure in the next six months and 28% of companies are planning on increased staff numbers. Higher recruitment intentions, combined with further tightness in labour markets – over half of companies surveyed were experiencing difficulty in recruiting skilled labour – could translate into upward pressure on pay.