The Association of Accountants and Financial Professionals in Business

The global body for professional accountants

Global economic conditions survey report: Q2, 2014

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 170,000 members and 436,000 students in 180 countries, helping them to develop successful careers in accounting and business, with the skills needed by employers. We work through a network of 91 offices and centres and more than 8,500 Approved Employers worldwide, who provide high standards of employee learning and development.

www.accaglobal.com

About IMA®

IMA®, the association of 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 70,000 members in 140 countries and 300 professional and student chapters. Headquartered in Montvale, N.J., USA, IMA provides localized services through its four global regions: The Americas, Asia/Pacific, Europe, and Middle East/Africa.

www.imanet.org

CONTACTS

For further information about the Global Economic Conditions Survey and the series of quarterly reports, please contact:

Emmanouil Schizas
Senior Economic Analyst , ACCA
+44 (0)20 7059 5619
emmanouil.schizas@accaglobal.com

Dr Raef Lawson
Professor-in-Residence and Vice President of Research
Institute of Management Accountants
+1 201 474 1532
rlawson@imanet.org

Global economic conditions survey report: Q2, 2014

INTRODUCTION

The Global Economic Conditions Survey (GECS), carried out jointly by ACCA and IMA, is the largest regular economic survey of accountants in the world, in terms of both the number of respondents and the range of economic variables it monitors. Its main indices are good predictors of GDP growth in the OECD countries and daily trend deviations correlate well with the VIX or 'fear' index, which measures expected stock price volatility.

This is the 22nd edition of the survey, and the 11th since ACCA and IMA first joined forces to conduct this research. Over the years, GECS has been covered in the international, national and local press about 6,500 times, and its combined dataset now includes more than 41,000 responses. A review of the first five years of the survey, *Five Years of the Global Economic Recovery,* was published by ACCA and IMA in July 2014.[1]

Fieldwork for the Q2 2014 GECS took place between 29 May and 25 June 2014, and attracted just under 1,100 responses from ACCA and IMA members around the world; 430 of those were senior finance professionals, including 86 CFOs.

As always, ACCA and IMA are deeply grateful to all members who gave up their time to respond to the survey. Finance professionals have front-row seats to the recovery, and it is their first-hand accounts of business conditions on the ground that make the GECS a trusted barometer for the global economy.

1. *Five Years of the Economic Recovery,* ACCA and IMA, 2014. http://www.accaglobal.com/lk/en/technical-activities/technical-resources-search/2014/july/five-years-of-the-global-economic-recovery.html

GLOBAL RECOVERY LOSES MOMENTUM IN MID-2014, AS MAJOR MARKETS RELY ON EASIER FINANCE AND SHORT-TERM BOOSTS TO SHORE UP CONFIDENCE

At first glance (see Figure 1), the second quarter of 2014 appears to have been a time of relative calm for the global economy. At the global level, the survey registered only a marginal loss of confidence compared to early 2014, as 30% of respondents reported confidence gains (unchanged on last quarter) and 32% reported a loss of confidence (up marginally from 31%).

Similarly, respondents' macro-economic outlook remained mostly unchanged, with a steady 58% believing that conditions were improving or about to do so, and 38% believing that conditions were deteriorating.

This apparent stability is, however, a complex outcome, resulting from the combination of lacklustre expectations of business performance going forward and an improved investment environment. Business opportunities grew only marginally in the second quarter of 2014, while demand and cashflow conditions weakened, following eighteen months of more or less steady improvement. However, access to growth capital continued to improve, and opportunities for asset purchases and non-organic growth continued to proliferate. As a result, business capacity building, including recruitment and capital spending, continued to grow, albeit at a slower pace than over the last year.

These aggregate global figures disguise significant variation at the regional and sector level. As Figure 2 demonstrates, business confidence was down throughout Western Europe, Asia-Pacific, Africa and the Middle East, while most of the confidence gains have come from North America, South Asia, the Caribbean and a temporary rebound in Central and Eastern Europe.

Figure 1: Major GECS Indices, Q4 2011 to Q2 2014

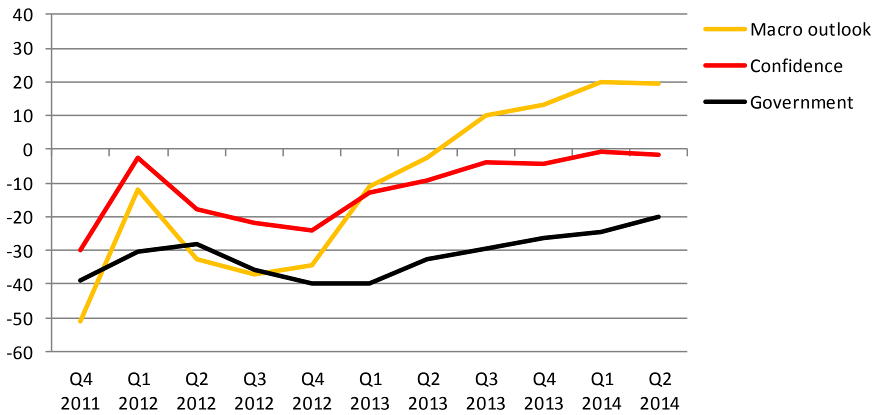


Figure 2: GECS business confidence indices by region

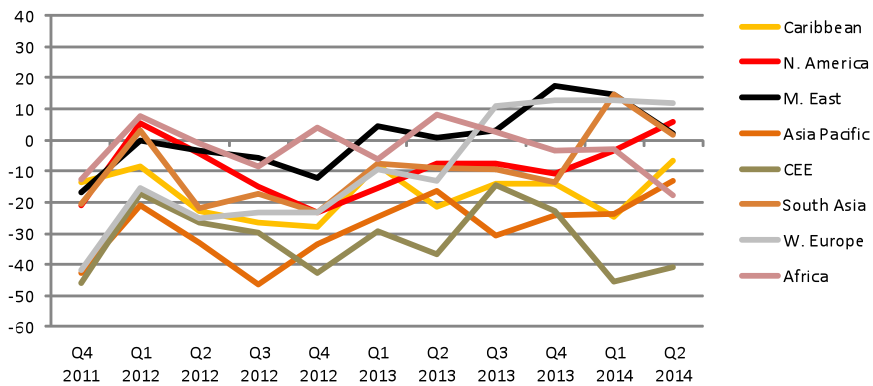
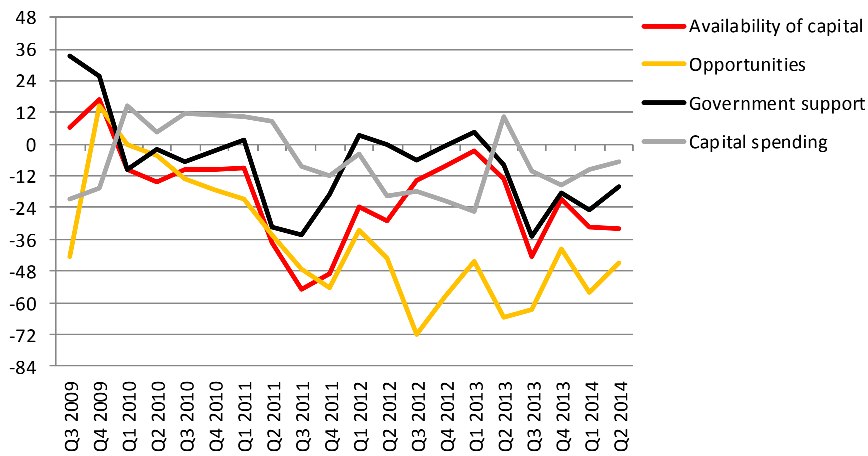


Figure 3: The investment environment in mainland China



Among the larger ACCA and IMA markets, only Malaysia stands out as a clear winner over the last quarter, building further on confidence gains made earlier in the year. In others, including the US, Russia and China, respondents also reported confidence gains, but these were not enough to reverse the general downward trend over the first half of 2014. Finally, business confidence fell for a second consecutive quarter in major European markets such as the UK and Ireland, which had staged a dramatic recovery throughout 2013.

Many of the confidence gains in individual markets will almost certainly prove temporary. The Russian and Chinese figures, in particular, may owe much to the success of a range of far-reaching economic negotiations, including a $400bn deal for the supply of natural gas to the latter, completed just ahead of GECS fieldwork. While undoubtedly significant, these will not impact conditions on the ground for years to come. Moreover, confidence figures throughout Central and Eastern Europe do not yet reflect the renewed geopolitical risks stemming from the controversial crash of flight MH17 and its aftermath.

That said, it's also worth noting that the ongoing trend of China's slowdown (Figure 3), which has driven much of the development of the global economy over the last five years, is showing signs of coming to an end, or at least settling into a 'new normal.'

SUBSTANTIAL RISKS AND IMBALANCES REMAIN

As Figure 4 demonstrates, global business confidence has once again become more contingent on financial stability. The persistence, for a second year running, of this worrying trend suggests that the recovery is becoming increasingly confined to small pockets of stability within the global economy, as ACCA and IMA have repeatedly warned. At the same time, the impact of non-organic growth opportunities on business confidence has recovered, while that of organic business opportunities and access to growth capital has remained low after falling significantly in early 2014. This combination casts further doubts on the health of the global recovery; but in some parts of the world, particularly sub-Saharan Africa, such patterns are more pronounced, hinting at the risk of a significant crisis to come.

Meanwhile, emerging markets have fallen further behind the OECD countries in terms of business performance, matching the record confidence gap last seen in late 2013. Although this post-Taper performance gap is narrowing in terms of access to growth capital, government support, and investment in skills, it is widening in terms of revenue and capital spending (see Figure 5). Even if these findings can be taken as evidence that the impact of the Taper is beginning to fade, there is no doubt it will remain relevant for some time.

Figure 4: Impact of fundamentals on global business confidence

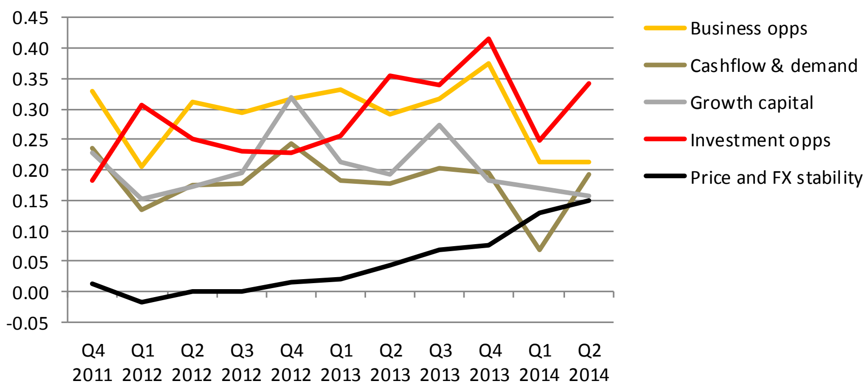
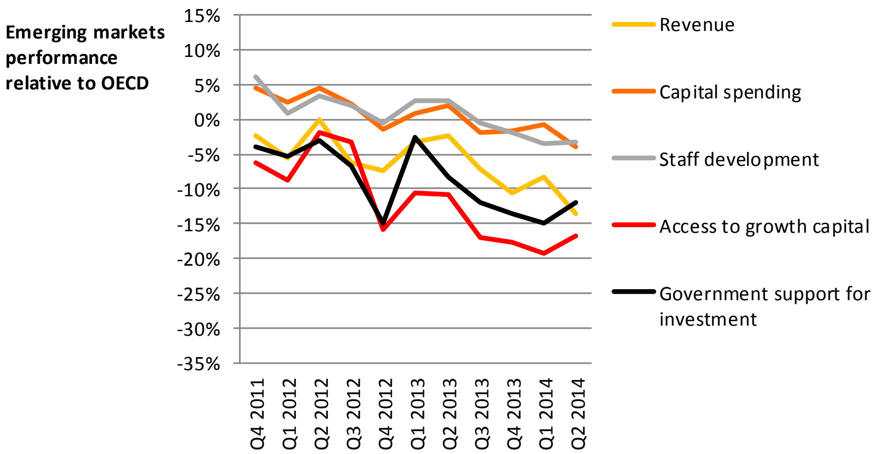


Figure 5: The legacy of the taper



LEADING FINANCIALS WAKE UP TO TOUGH TIMES AHEAD

In analysing the dynamics of the recovery in Q2 2014, the sector perspective is possibly even more important than the regional one. Confidence among large financials around the world fell significantly, and in the case of developed countries the change since late 2013 has been particularly stark (see Figure 6). This stands in contrast to the OECD countries' real economies, which have built up steady confidence gains.

Some of this loss of confidence is likely to be down to geopolitical risks such as the threat of sanctions against Russia. Some is also likely to be down to a mix of cyclical factors, including expectations of easing property prices and rising interest rates in major markets such as the US, Ireland and the UK. Finally, some is undoubtedly due to regulatory pressures. The upcoming EU-wide stress testing exercise, whose details were announced in late May, as well as news of tighter stress testing rules in the US will have caused concern. Similarly, financial services firms will have noted the negotiations leading up to BNP Paribas' record-breaking $8.9bn sanction-busting fine, and registered a clear change of course in regulatory enforcement.

RISING BUSINESS DYNAMISM LEAVES AFRICA TRAILING BEHIND

As Figure 7 demonstrates, indicators of business dynamism continued to rise in the second quarter of 2014 in both developed and emerging markets. As a rule, developed markets proved slightly more dynamic, but there were significant regional variations underlying this picture that cut across the OECD/non-OECD country divide.

All three dynamic indicators – capital spending, new orders and headcount – were up in North America and south Asia. Africa and the Middle East fared worst, with all three indicators either falling or stable. A more mixed picture appeared throughout Europe and the Asia-Pacific region, where capital

Figure 6: GECS Confidence Index by sector and developed country status

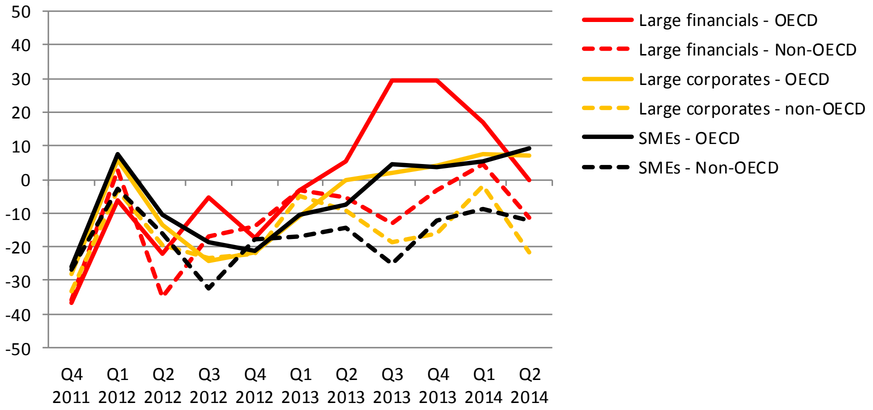


Figure 7: GECS dynamic indicators in developed and emerging markets.

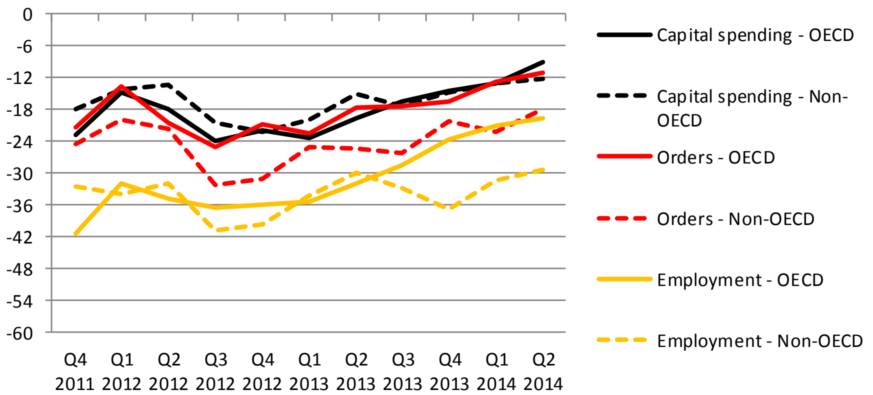
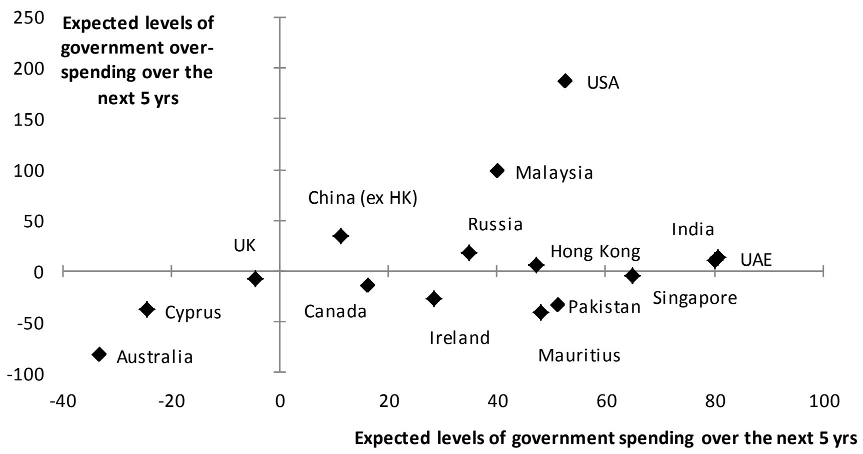


Figure 8: Medium-term public spending indicators for selected markets – H1 2014



spending fell and net job creation rose, while new orders were stable or rose only marginally. Finally, after a long period of under-investment, capital spending and job creation rose in the Caribbean, despite falling new orders.

BIG SPENDERS' BELT TIGHTENING CONTINUES INTO Q2, BUT SPENDING EXPECTATIONS RISE THROUGHOUT SOUTH ASIA

As Figure 8 shows, the GECS' traditional map of world fiscal policy has changed somewhat over the past year. Comparing the first halves of 2013 and 2014, countries such as Canada and Ireland appear to have moved out of their respective periods of austerity, while expectations of public spending have fallen substantially in Malaysia and China. Other countries, such as the UK and crisis-hit Cyprus, appear to be making an extraordinarily fast transition out of their respective fiscal adjustment programmes but their scope for increasing spending is extremely limited.

During the second quarter of 2014, expectations of public spending fell in the US, mainland China, Russia and the UAE, some of the survey's traditional Big Spenders, but rose further in others, such as Malaysia, Pakistan and (particularly) post-election India. Malaysia and the US remain the countries with the most controversial fiscal policies, with the majority of US respondents almost certainly believing that their government's fiscal policies are unsustainable.

Views from the coalface

IMPRESSIONS AND COMMENTARY FROM SELECTED MARKETS

'Increased competition has led to unprecedented exploitation and use of both ethical and unethical tactics to win contracts and engagements.'

Supervisor, Big Four accountancy firm, Bahrain

'Loss of international business has reduced the number of professionals on the island and has resulted in lower consumer spending. Professionals spend an estimated $4,000 on average per month on rent, food, entertainment, transport. Therefore, if 2,000 persons have been lost, that results in $8 million monthly spending lost along with its multiplier effect.'

Controller, medium-sized airport, Bermuda

'Our economy has seen a significant increase in mining, prospecting and explorations for base metals, and this has added lots of optimism in the future of the country. Some mining operations that have previously shut due to decline in metal prices and operating challenges are resuming their operations. There is a slight hope that in the not-so-distant future, the economy will be back to full throttle.'

Manager, Large mining company, Botswana

'Our company protects the trucking sector through insurance. Decreased manufacturing has led to decreased demand for logistics, in turn decreasing the number of trucks/lorries on the road. Meanwhile, we're facing increased re-insurance costs, increasing compliance requirements, and unethical competitors.'

Controller, small insurer, Canada

'With a budget deficit of over 3% and public debt above 60% of GDP, both above EU standards, the government is cutting spending in an effort to bring those numbers down. This has had a negative effect on spending in the entire economy, the willingness of banks to provide loans, and customers' willingness to increase their orders.'

Manager, private equity, Croatia

'Huge infrastructure development has attracted foreign firms and consultancy projects have soared, with engagements ranging from tax to finance and company set-up.'

Consultant, Big Four accountancy firm, Ethiopia

'The major economic development has been the depreciation of the local Ghanaian currency, coupled with strict regulations from the Bank of Ghana to freeze and close all foreign accounts owned by individuals and businesses. Barring individuals and businesses from trading in foreign currency has affected businesses and economic performance.'

Accountant, small financial, Ghana

'Legislation regarding bad loans has been relaxed to the benefit of the banks. This has allowed the bank I work for more flexibility in exercising guarantees and making collections.'

Manager, large financial, Greece

'GST [General Sales Tax] implementation and adoption is our major challenge for the next financial year. Knowledge of GST is still very limited among users and companies; training and information from the government should be publicly available at all times to support these changes.'

Accountant, medium-sized business, Malaysia

'Many companies are looking for a quick-fix solution to their problems, resulting only in temporary contracts. Many US companies function on this basis. Dutch companies hire younger people who are cheaper, then have experienced hires prepare year-end reports and corrections to accounts. It's easier to start a business, for which you may obtain government funding, than to find employment.'

Self-employed book-keeper, the Netherlands

'We have diversified our business through a group of companies. We helped clients secure some mega-projects in the areas of construction, power and telecoms in our country. This definitely increased our business growth and the performance of the JVs and outsourcing deals we are currently engaged in.'

CFO, mid-market company, Pakistan

'The Government has decided to allow private capital to flow into the oil and gas industry, which has until now been dominated by state owned capital.'

Internal auditor, large state-owned enterprise, China (mainland)

'Local companies have problems with attracting financing from international IPOs, debt placement or borrowing from international financial institutions. Therefore they scale down investment projects and seek loans from government-owned banks, such as VTB or Sberbank. This results in a decrease of demand for audit services provided by the Big Four, and clients migrating to second tier or local auditors.'

Senior manager, Big Four accountancy firm, Russia

'The increased budgets of major brands for Internet advertising have allowed us to capture more contracts, but the clients do not pay on time.'

Controller, online advertising agency, US

The fundamentals

NORTH AMERICA

Confidence boost to the US as investment powers on; retailers' confidence hints at consumer recovery

US respondents' macro-economic outlook brightened considerably in Q2 2014, with two thirds (67%, up from 60%) believing that things are getting better or are about to do so. The pessimists made up only 28% of the US sample, down from 37% previously.

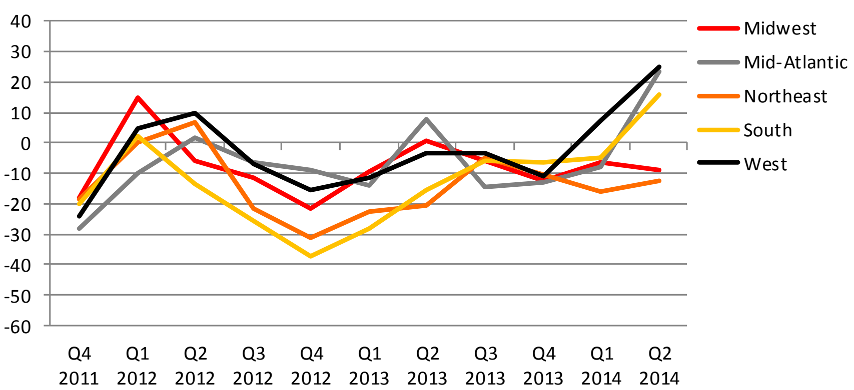
For businesses, the most notable change since early 2014 was a significant further easing of access to growth capital, prompting an increase in capacity building – both capital spending and new hires. These developments in financing and investment are part of a longer trend, starting at least as far back the first quarter of 2013, which remains resilient.

Demand and cashflow conditions, however, once again struggled to keep up with business confidence, marking a full nine months of stagnation as consumers proved unable to prop up the recovery. As a result, business opportunities ticked up only marginally.

Overall, however, business confidence rose, and the US stood out as one of the few major markets where a genuine recovery is still underway. 32% of US respondents reported confidence gains over the last three months, up from 25% in early 2014. Only 23% reported a loss of confidence, down from 29%. High-tech sectors continued to lead the US recovery, although retailers have finally started to recover; this suggests that consumption is also ready to rebound, and should see an improvement in the third quarter. Regional convergence has continued in only part of the country, with business confidence rising in the south, west and mid-Atlantic, while the Northeast and Midwest have lagged behind (see Figure 9).

GECS has traditionally classified the US as one of the survey's 'Big Spenders', and US respondents to GECS have consistently felt that public spending is inappropriately high. However, with consumption softening, US respondents were more dove-ish in Q2 2014 than at any time in the past two and a half years, which still left 70% calling for lower spending. Accordingly, although approval of government policies remained very low by global standards, it grew to its most positive in two and a half years.

Figure 9: Business confidence in the US regions



Despite improving fundamentals, capital shortages and thoughts of austerity put the breaks on Canada's recovery

There is much to celebrate in the Canadian economy's performance during the first half of 2014. Cashflow and demand conditions continued to recover after bottoming out in late 2013 and inching upwards in early 2014. Business opportunities proliferated in the second quarter of 2014 and are up substantially year on year, although the first half of the year looks very likely to have been a short-term peak.

But dark clouds loom ahead for the Canadian economy. Despite a healthier outlook than what was on offer throughout 2013, a surprise tightening of business' access to growth capital forced business capacity building down in early 2014; this latest development, in fact, appears to be part of a generally downward trend that has lasted for just over a year. Meanwhile, expectations of medium-term government spending peaked in late 2013 as the economy slowed down, and now appear to be falling again, despite a modest recovery in the second quarter of 2014. On balance, Canadian respondents believe that fiscal policy is once again erring on the side of under-spending.

Even after accounting for the high level of seasonality in the Canadian GECS readings, the macro-economic outlook appears to have deteriorated in the second quarter of 2014. Although the optimists are still in the majority (55%), their numbers are down substantially from early 2014 (73%). The pessimists now make up 30% of the sample, up from 22%. Similarly, business confidence has fallen, with 25% of respondents reporting confidence gains, down from 29%, while 40% reported a loss of confidence, up from 26% in the first quarter. Both the macro outlook figures and the business confidence readings for Canada still represent significant year-on-year gains, however, and it is clear that the economy has put the most recent slowdown behind it.

Improving fundamentals support growing business confidence in the Caribbean

The balance of business confidence in the Caribbean grew in the second quarter, with 23% of respondents reporting confidence gains, up from 14% in the previous quarter, and another 29% reporting a loss of confidence, down from 39% previously.

The rise in business confidence has mostly been down to improving fundamentals. Cashflow and demand became significantly stronger, and are now at their healthiest in two years, while prices and exchange rates stabilised slightly and business opportunities remained resilient after falling for nine consecutive months. Access to growth capital rebounded slightly in the second quarter, even though it remains subdued after more than a year of slow decline, and opportunities for inorganic growth remained very rare. As a result, business capacity building rebounded in the second quarter of 2014.

Looking forward, the macro-economic outlook for Caribbean economies has also improved slightly, although it remains far from upbeat. 45% of respondents in the Caribbean are now optimistic about the shape of their national economies, up from 42% previously, while the pessimists make up 52% of the sample, down from 53% previously.

WESTERN EUROPE

UK business confidence dips despite improved fundamentals, end of austerity in sight

Respondents in the UK reported a very significant improvement in cashflow and demand conditions, including new orders, to easily the highest levels in the last two and a half years. With prices and exchange rates stabilising and – crucially- access to growth capital easing, the recovery in UK business capacity building continued, and shows no immediate signs of weakening.

There are, however, also signs of trouble ahead for individual businesses: reported opportunities for both organic and inorganic growth dwindled in the second quarter of 2014, and could indicate a soft patch for the economy in the months to come.

On balance, UK respondents' macro-economic outlook remained almost entirely unchanged, with 71% (up from 70%) believing that conditions were improving or about to do so. The pessimists only made up 27% of the UK sample (up from 26%).

Business confidence, on the other hand, dipped slightly in the second quarter of 2014, with 37% of UK respondents reporting confidence gains, down from 40% in the previous quarter. Only 22% (unchanged since Q1) reported a loss of confidence. Current independent forecasts for GDP growth in 2014 range from 2.4% to 3.5%; a forecast consistent with GECS readings would be at the very top of that range.

At the national/regional level, Scotland continued to outperform the rest of the UK for business confidence, due to more favourable cashflow and demand conditions and a better supply of business opportunities, and business confidence there has been mostly stable over the past two quarters. Among the English regions only the South West and North East showed signs of robust confidence growth in the first half of 2014.

This quarter marked a turning point in expectations of fiscal policy, as, for the first time since the recession, UK respondents now believed that public spending was due to increase over the next five years. But this shift in expectations also came with a warning, as on balance respondents felt that spending should not rise, but rather remain flat. Still, approval of government policy rose significantly, heading comfortably into positive territory for the first time since the GECS began.

Post-bailout euphoria dies down in Ireland as macro outlook darkens

Ireland's strong bounce-back was one of the major economic stories of 2013, but it appears to have come to an end in early 2014. Following a significant correction in the first quarter of the year, the second quarter of 2014 saw a marginal uptick in business opportunities, but cashflow and demand conditions deteriorated and access to growth capital tightened. This led to a very marginal fall in business confidence, with 34% of respondents reporting confidence gains (up from 32%) and 22% reporting a loss of confidence (down from 23%).

But while Irish finance professionals remained relatively upbeat about their organisations' prospects, their views about the Irish economy have started to become more pessimistic. In the second quarter of 2014, 37% of Irish respondents (up from 28%) believed the economy was deteriorating or stagnating, while 61% (down from 69%) believed it was on the mend. More than two years of constant improvement in their expectations of public spending also came to an end, and on balance respondents saw a greater risk of government under-spending in the medium term. As a result of this more pessimistic macro outlook, business investment and capacity building, which have been recovering strongly over the past two years, fell. Approval of government policies also fell sharply, back to levels last seen in 2012.

CENTRAL AND EASTERN EUROPE

The region spirals into turmoil as Ukraine crisis intensifies

The second quarter of 2014 saw the unrest in Ukraine erupt into a full-fledged geopolitical crisis. GECS responses in the region were spread between 29 May and 18 June, incorporating the election of a new Ukrainian government and some of the first concrete negotiations between all involved parties. Crucially, fieldwork was closed before the loss of flight MH17.

During this time, cashflow and demand conditions deteriorated substantially throughout the region, which also saw a second consecutive quarter of increased financial instability, with FX rates and input prices fluctuating substantially. Business opportunities also fell for a second quarter, approaching a three-year low. That said, access to growth capital tightened only marginally, and instability created more opportunities for non-organic growth for a number of businesses.

Despite these numerous challenges, in relative terms business confidence in the region inched forward, with 14% of respondents reporting confidence gains (up from 11%) and 55% (down from 56%) reporting a loss of confidence. Part of this was due to an improving macro-economic outlook – 41% (up from 30%) of respondents felt that their national economies were improving or about to do, while the pessimists made up 57% of the CEE sample, down from 69% in early 2014.

Buffeted by financial turmoil, Russian businesses hold out hope for better days

In Russia, the business environment has changed substantially in the first half of 2014 and is proving extremely unpredictable. Business opportunities were on the rise before the Ukraine crisis erupted, but have fallen for two consecutive quarters since. More recently, demand and cashflow conditions deteriorated significantly in Q2 2014, ending a nine-month trend for steady growth. Access to growth capital tightened marginally, and is now below the global average, although it remains up year on year.

Opportunities for non-organic growth, on the other hand, soared in the second quarter of 2014 as businesses saw opportunities to buy assets or other companies. But the most dramatic change can be observed in terms of exchange rate volatility and input prices. FX volatility has been on the rise for just over two years in Russia, and was worse in Q2 2014 than it's been for many years.

Expectations of medium-term government spending fell in the second quarter of 2014, but the downward trend of the past two years has almost certainly been halted. If anything, for the first time in years GECS respondents in Russia seem to believe that government runs the risk of underspending in the medium term.

Despite discouraging fundamentals, the timing of GECS fieldwork (a generally hopeful time in the timeline of recent events) means that business confidence in Russia picked up in the second quarter, with business confidence rebounding after a nearly unbroken 18-month slump. 50% of respondents reported a loss of confidence, down from 66% previously. It is worth noting, however, than no respondents reported confidence gains (down from just 3% previously). Respondents' macro outlook also improved significantly, with 57% (up from just 17%) believing that things were getting better and 43% (down from 79%) believing the economy was deteriorating or stagnating.

ASIA PACIFIC

New business opportunities prop up business confidence in China, despite a darkening macro outlook

Business confidence recovered in the mainland, returning to levels last seen a year ago. 30% of respondents reported confidence gains, up from 25% in the first quarter of 2014, while 43% reported a loss of confidence, down from 53% previously. In Hong Kong, confidence also rose marginally, suggesting that the lows of late 2013 have been mostly overcome, but business performance has become much more volatile. 23% of respondents reported confidence gains, up from 10% previously, while 46% reported a loss of confidence, also up from 36%.

The relative buoyance in China was mostly due to greater opportunities for organic growth. In the mainland, readings in this respect were better than at any time in 2013, and in Hong Kong they were better than they've been in at least two and a half years. Despite this, access to growth capital tightened throughout the country.

The recovery in the mainland is clearly more robust. Opportunities for non-organic growth ticked up and a second consecutive quarter of improving cashflow and demand conditions helped keep spirits high. The opposite was true in Hong Kong, where cashflow and demand deteriorated in the second quarter and opportunities for non-organic growth – already very low by global standards – fell sharply.

Marginal confidence gains stand in contrast to a deteriorating macro-economic outlook throughout the country. In mainland China, this change has been mild: 61% of respondents (down from 62%) believe conditions are getting worse or stagnating, against 35% who believe they are improving or about to do so (down from 38%). But in Hong Kong, the macro outlook has darkened significantly: the share of pessimists among the GECS sample has soared from 35% in early 2014 to 62%. Only 35% (down from 52%) are optimistic.

Finally, respondents' expectations of government spending in mainland China fell once again in the second quarter of 2014, suggesting that public investment is not about to stabilise yet. But the overall investment environment appears to be stabilising, and China's slowdown could soon bottom out into a stable 'new normal.'

Good fundamentals and strong government spending send Malaysian business confidence back to post-election highs

Malaysia has been one of the few major ACCA and IMA markets to have genuinely recovered this quarter. Access to growth capital improved substantially in the second quarter of 2014, reaching its best levels in at least two and a half years, and there were signs of a slow return to financial stability, with inflation and exchange rate volatility falling. Additionally, cashflow and demand conditions improved, in line with the broad trend of the last fifteen months. The result was a strong rebound in business capacity building and a smaller uptick in opportunities for inorganic growth, but with growth in the rest of the region facing strong headwinds, opportunities for organic growth fell. Although this development would normally tend to depress business confidence, it has been balanced out by expectations of stronger medium-term growth in government expenditures.

In response to these broadly benign readings, business confidence rose to the highest levels in a year – rivalling the post-election highs of Q2 2013. 18% of respondents reported confidence gains (up from 12%), while 28% reported a loss of confidence – down from 49%. The macro-economic outlook has also returned to post-election levels of euphoria: 37% of GECS respondents in Malaysia believe conditions are improving or about to do so (up from 27% previously), while the pessimists made up 55% of the Malaysian sample, down from 63%.

Poor macro outlook and subdued business opportunities in Singapore hold down business confidence, capacity building.

The second quarter of 2014 was a difficult time for the economic recovery in Singapore. Although access to growth capital was more favourable than at any time in the last two and a half years and cashflow and demand conditions improved marginally, business opportunities remained flat. This combination meant that a surge of funding was directed into asset purchases and inorganic growth while net capacity building by Singaporean businesses fell.

Although these fundamentals might not appear terribly discouraging on their own, they must be seen in the context of a darkening macro-economic outlook for Singapore. Although 42% of respondents (up from 40%) were optimistic, 54% of respondents (up from 40%) believed that conditions were deteriorating or stagnating. As a result, business confidence fell in Q2 2014, ending a two-year trend of confidence gains. Only 15% of respondents reported confidence gains in Q2, down from 29% in early 2014. Singapore's traditionally robust fiscal policies do, however, provide finance professionals with some reassurance. After a whole year of adjusting expectations, respondents in Singapore now appear to believe that government spending levels are just right.

SOUTH ASIA

Post-election euphoria completes India's investment recovery, but weak demand hints at trouble ahead

It is hard to overstate the impact on the regional economy of India's elections, conducted between April and May 2014; fortunately, the immediate aftermath of this is captured by GECS Q2 figures. Prior to Q2 2014, access to growth capital had been tightening for nearly two years, and business capacity building had stalled for a whole year. Both have now bounced back strongly despite fewer business opportunities, as businesses scramble to make up for overdue investment. A lot of funding is probably also being directed into non-organic growth (investments in new assets and acquisitions), for which opportunities shot up to unprecedented levels post-election. A correction is almost certainly due in the next few quarters, as it is not only business opportunities that have dwindled in Q2: cashflow and demand conditions have also tightened.

Business confidence, which soared ahead of the elections in Q1, remained at broadly the same levels, falling only marginally. While 55% of respondents reported confidence gains up from 53%. 27% (up from 21%) reported a loss of confidence. The pre-election boost to respondents' macro-economic outlook, on the other hand, proved more transitory with optimists making up 73% of the Indian sample in Q2, down from 84% previously, and pessimists making up 27% of the sample, up from 16%.

For now, India's new government is benefiting from the well-established 'honeymoon' effect, with government approval ratings among respondents in India swinging into positive territory for the first time in two years. Expectations appear to be of a significant increase in government spending, which respondents have largely welcomed after two years of what they saw as insufficient stimulus.

In Pakistan, financial stability and hopes of fiscal stimulus boost investment, but underwhelming fundamentals weigh down the recovery

The second quarter of 2014 was a period of reduced dynamism for Pakistan's economy. Access to growth capital tightened significantly in Q2, and business opportunities remained flat for the third quarter running. As a result, business confidence fell, with 31% reporting a loss of confidence (up from 30%) and 34% reporting confidence gains, down from 43% in early 2014.

However, cashflow and demand conditions improved and recent gains in financial and price stability were not reversed, while opportunities for inorganic growth were more limited than in early 2014. This allowed business capacity building to continue, extending an 18-month positive trend.

These factors provide hope for the medium-term, and ensured that respondents' macro-economic outlook remained positive on balance, changing only marginally from early 2014. Pessimists made up 41% of the sample in Q2 2014, up from 39% previously, and optimists made up 56% of the sample, up from 55% previously.

A lot of this optimism and confidence, however is premised on relatively aggressive fiscal policy. Expectations of medium-term government spending levels rose in Q2, continuing an 18-month trend towards higher spending. Yet since the turn of the year respondents' appetite for fiscal stimulus has increased even more significantly. Therefore on balance even the expected rapid increase in government spending has come to be seen as inadequate. Since the scope of fiscal policy is not without limits, this development suggests a correction in business confidence and economic outlook may be due relatively soon.

The Middle East's moment is over, but the recovery is still healthy

In the Middle East, finance professionals' outlook for their companies and the wider regional economy became less rosy, as the last echoes of the Expo2020 euphoria died down and the recovery resumed its normal course. Business confidence fell significantly in the second quarter of 2014, but remains up year-on-year. 36% of respondents reported confidence gains, down from 41% previously, while 33% reported a loss of confidence, up from 27% in early 2014. The macro-economic outlook for the region's economy followed the same pattern, falling slightly while remaining up year-on-year. Of the total Middle East sample, 32% were pessimistic about the state of their national economies, up from 29% in early 2014, while 62% were optimistic, down from 63% earlier.

It is easy to explain this trajectory of confidence and economic sentiment because it directly reflects all economic fundamentals in the region. Having soared throughout 2013, and in early 2014, business capacity building slowed substantially, although it is still up year-on-year. Similarly, cashflow and demand conditions tightened in the latest quarter, following nine months of solid improvement, and business opportunities fell after six months of gains. Opportunities for inorganic growth through asset or company acquisitions appeared to have peaked a little earlier, but nonetheless they too fell in Q2. Only access to growth capital continued to ease for a second consecutive quarter, a trend which should translate to more investment if business opportunities recover.

Note: The GECS fieldwork period included the fall of Tikrit, Iraq to the ISIS militant group and the group's widespread media coverage, but not the renewed conflict in Gaza.

African business confidence reaches five-year low as crisis mentality takes hold

The second quarter of 2014 was a particularly difficult time for many African economies, with GECS recording the worst business confidence levels in five years. 45% of respondents in Africa reported a loss of confidence, up from 36% in early 2014, while only 28% (down from 33%) reported confidence gains. Confidence was down throughout the real economy, among large financials and in the public sector.

This level of pessimism wasn't down to a poor macro-economic outlook among respondents in Africa. This became only marginally more negative since early 2014, with 42% of respondents (up from 41%) believing that conditions were deteriorating or stagnating. The majority remain optimistic: 55% (down from 57%) believe that conditions are improving or about to do so.

Fundamentals can explain some of the fall in business confidence. Access to growth capital became more difficult, cashflow and demand conditions deteriorated, and input prices and exchange rate volatility remained elevated. However, business opportunities rose marginally and opportunities for inorganic growth through business acquisitions or asset purchases remained stable. As a result, business capacity building rose in the second quarter of 2014.

But most importantly, it appears as though a crisis mentality has taken hold among respondents in Africa. Further analysis by ACCA and IMA reveals that business confidence has steadily become decoupled from business opportunities since Q2 2013, and increasingly tied to government spending. Over the last two quarters, business confidence has also become unresponsive to the supply of growth capital. Finally, in the latest quarter business confidence has become more sensitive to fears of unsustainable government finances as well as cashflow and demand. These are all signs of businesses worried about survival, and of a looming crisis.

Conclusions

The second quarter of 2014 has been a very difficult time for the global economy, and it is important not to mistake the relative calm of GECS' aggregate global indices for a sign of growing stability. In Eastern Europe and the Middle East, geopolitical risk is on the rise; in Africa, GECS readings suggest a new downturn or worse might be brewing. Members in large (Western) financials are losing confidence rapidly.

This is probably the first time that a GECS report has had to include so many caveats regarding the timing of the underlying fieldwork. This is a measure of the density of political and economic developments in the second quarter of 2014, and the difficulty more generally of capturing a representative picture of the global economy.

Even with real-time information to hand, the job of economic forecasters and decision-makers is not enviable at the moment. With few major markets genuinely pulling their weight in the recovery and significant downside risks on the horizon, it is almost certain that the year 2014 is unlikely to ever live up to early growth forecasts. This would suggest that the much-anticipated round of monetary policy tightening among developed economies may have to wait even longer. Yet measures of economic dynamism across regions are, broadly speaking, on the rise. Businesses may be building capacity faster than they are using it up at the moment, but this cannot be the case for long.

The last few quarters of GECS have also demonstrated how far-reaching the impact of one-off economic events can be, from the US Government shutdown to the awarding of Expo 2020 or the recent Sino-Russian gas deal. The power of elections to fire economic sentiment is also plain to see in the case of India, as it was previously in the case of Malaysia or Pakistan in 2013. As with all such cases, sentiment eventually returns to normal but if a change in the economic narrative can be used to encourage investment, then such episodes can be growth-enhancing.

ACCA and IMA will continue to monitor economic developments in 2014, with an eye to the emerging risks around the world. What we know for certain is that, in times like these, having access to the kinds of complete professionals that can help steer businesses through economic turbulence is more important than ever.

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

www.accaglobal.com

www.imanet.org

TECH-MS-GEC22

ACCA 29 Lincoln's Inn Fields London WC2A 3EE United Kingdom / +44 (0)20 7059 5000 / www.accaglobal.com