KPMG UK Tech Monitor

Tech sector slowdown continues in Q3

PMI® By IHS Markit

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KPMG UK Tech Monitor

Key findings

Weakest UK tech sector growth for nearly four years

Employment levels stagnate in response to reduced order books

Competitive pressures and higher costs place a greater squeeze on margins

"The latest KPMG UK Tech Monitor showed that UK tech firms felt the strain of a wider economic slowdown in the third quarter, as uncertainty and signs of weaker global economic growth weighed on performance. Underlying data adds to the gloomy picture, with tech companies recording the steepest drop in sales since 2011 amid reports of cancelled or delayed spending on projects due to worries over the outlook. At the same time, business confidence remains relatively subdued, and even positive growth forecasts for the year ahead were often dependent on a clearer path to Brexit in the coming months.

"If uncertainty does begin to fade from the horizon, the UK tech sector certainly has plenty of avenues from which to rediscover growth. Research from KPMG shows that the majority of UK Chief Information Officers are implementing or planning measures to boost performance through AI or automation, which will create huge opportunities for innovative tech companies to scale up and attract new sources of business investment."

Bernard Brown, Vice Chair,

KPMG in the UK

Welcome to the KPMG UK Tech Monitor Index

We have compiled the quarterly UK Tech Monitor Index by taking a representative sample of tech companies from IHS Markit's widely-watched Purchasing Managers' Index® (PMI®) surveys. The tech sector is defined in this report as technology software, technology services and manufacturing of technology equipment. Historical data is available since Q1 2003 and full details are in the methodology section.

Our panel of tech sector executives are asked about actual changes in business activity, new work, backlogs, employment, costs and charges. The headline UK Tech Monitor Index measures changes in business activity on average over the most recent quarter. Results are seasonally adjusted. Index numbers vary between 0 and 100, with readings above 50 indicating an overall increase and below 50 a decrease.

UK tech sector hit by fall in new work for first time since 2012

The latest KPMG UK Tech Monitor survey reveals a downturn in new work across the tech sector for the first time since the middle of 2012. Softer global economic conditions and ongoing domestic political uncertainty were the two key factors that contributed to the change of direction for incoming new orders.

Tech firms record slowest output growth for nearly four years

Subdued business and consumer spending meant that UK tech companies experienced another slowdown in business activity growth during the third quarter of 2019. The loss of momentum was widely attributed to delayed decision-making among clients.

The headline KPMG UK Tech Monitor Index registered 51.9 in the third quarter of 2019, to remain higher than the crucial 50.0 value that separates expansion from contraction. However, the latest reading was down from 52.9 in the previous quarter and signalled the slowest rate of UK tech sector growth since Q4 2015.

While tech firms are finding growth more difficult to achieve, their performance remains stronger than elsewhere in the UK private sector.

In fact, higher levels of business activity at tech companies stood in sharp contrast to flatlining UK private sector output, as signalled by the equivalent index posting 50.1 in Q3.

Global economic slowdown and Brexit worries hold back demand

Latest data revealed a drop in new orders received by UK tech sector companies, and the rate of decline was the steepest since Q4 2011.

Anecdotal evidence suggested that Brexit-related uncertainty remained a key headwind to sales volumes, alongside a dent to business confidence from US-China trade frictions. Survey respondents also noted a corresponding drop in business investment spending.

A lack of new orders to replace completed projects also led to a sharp and accelerated drop in backlogs of work.

Staff recruitment placed on hold

Reduced capacity pressure and concerns about the near-term business outlook contributed to more cautious staff hiring policies in Q3. The latest survey pointed to unchanged employment across the tech sector, which ended a ten-year period of workforce expansion.

Business expectations for the next 12 months remained subdued in the third quarter of 2019, which survey respondents linked in part to worries about the path to Brexit.

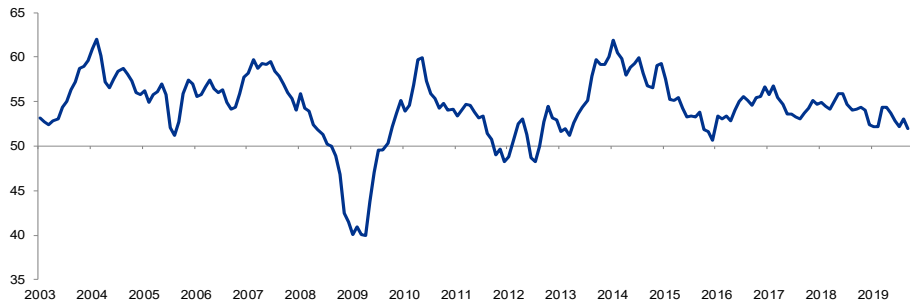
Companies anticipating growth cited the roll-out of new products and technologies, alongside hopes of a rebound in export sales.

Weaker pound pushes up costs

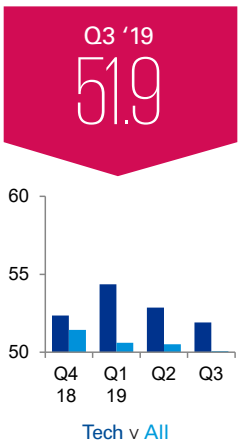
There were signs of greater pressure on margins in Q3. Input cost inflation accelerated to its highest for one year, while average prices charged rose at a slower pace. Exchange rate depreciation against the US dollar was widely reported as a key factor pushing up business expenses.

KPMG UK Tech Monitor Index

Above 50 = business activity growth, seasonally adjusted



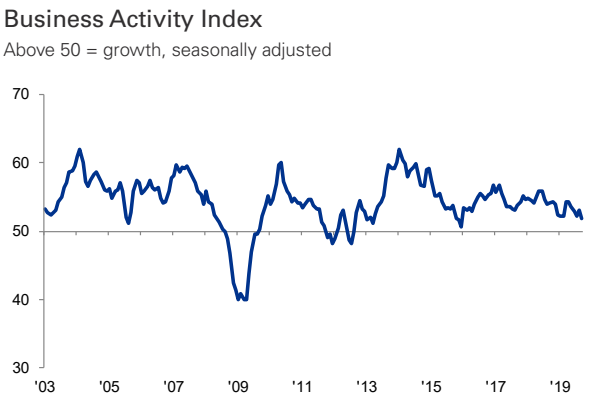
Tech Sector Output: Business Activity Index



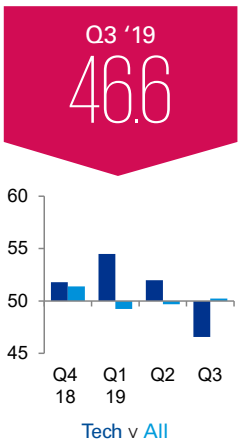
Tech firms struggle in face of wider economic slowdown

At 51.9 in Q3, the seasonally adjusted Business Activity Index fell from 52.9 in Q2 to indicate only a modest expansion of tech sector output. Notably, the reading was the lowest recorded since Q4 2015. Weakness was also seen across the UK private sector as a whole, which saw activity stagnate in Q3.

The softer upturn in activity was widely linked by tech companies to reduced client demand amid ongoing uncertainty around Brexit and the fallout from US-China trade frictions.



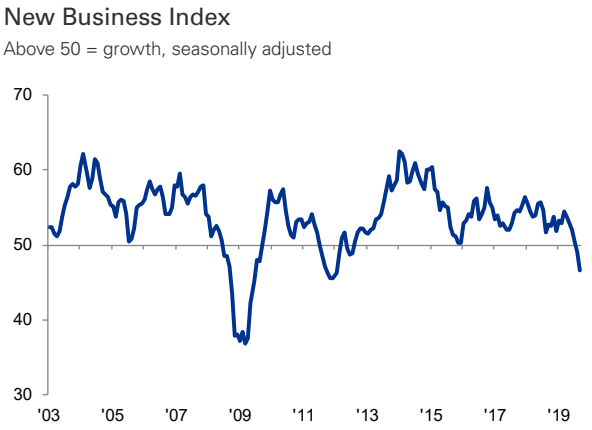
Tech Sector Sales: New Business Index



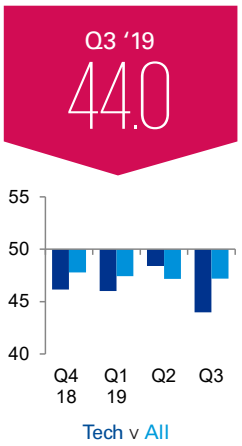
New orders decline for first time in over seven years

The New Business Index slipped from 52.0 in Q2 to 46.6 in Q3, which was below the neutral 50.0 level and signalled a drop in sales received by tech companies. This marked the first reduction seen since the Q2 2012. Across the UK as a whole, however, new orders remained broadly stable.

Lingering uncertainty around Brexit, global trade and the domestic economy had reportedly led a number of clients to delay or pare back expenditure in Q3.



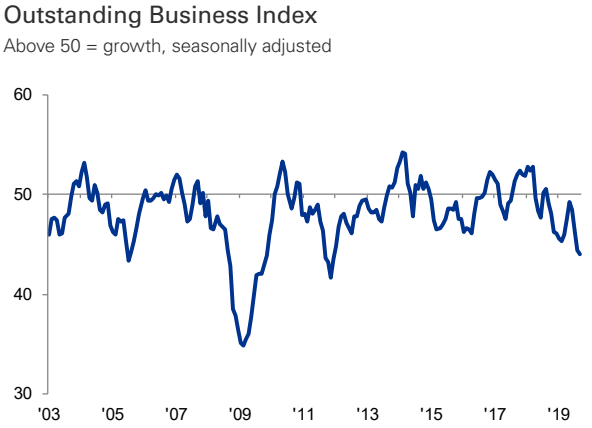
Tech Sector Capacity: Outstanding Business Index



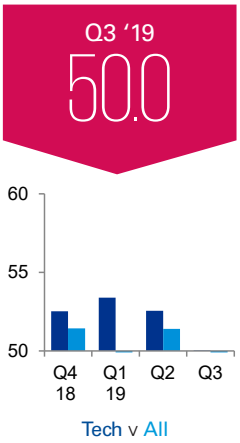
Backlogs of work fall at steepest pace since Q4 2011

Tech companies continued to signal little pressure on their business capacity, as highlighted by a sustained drop in the level of unfinished work in Q3. At 44.0, the respective index was down from 48.4 in Q2 to indicate the steepest rate of depletion since Q4 2011. The fall was also quicker than the wider UK trend.

Tech companies often noted that weaker inflows of new work had freed up capacity to complete orders in a more timely manner, while others commented on increased efficiency.



Tech Sector Jobs: Employment Index



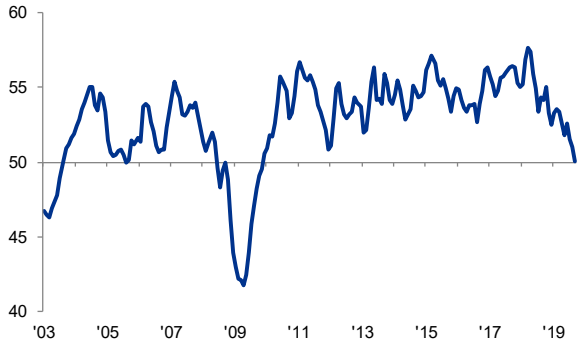
Tech sector employment stagnates

Staffing level at tech companies were unchanged in third quarter, thereby ending a run of job creation that began a decade ago. This was shown by the Employment Index posting at the neutral value of 50.0, which was down from 52.6 in Q2. Across the UK as a whole, payroll numbers were also unchanged in Q3.

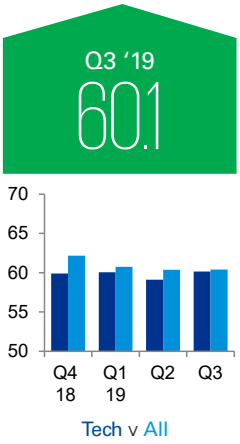
More cautious hiring policies were linked to subdued client demand, though there were also reports of difficulties in finding suitably skilled workers to fill vacancies.

Employment Index

Above 50 = growth, seasonally adjusted



Tech Sector Costs: Input Prices Index



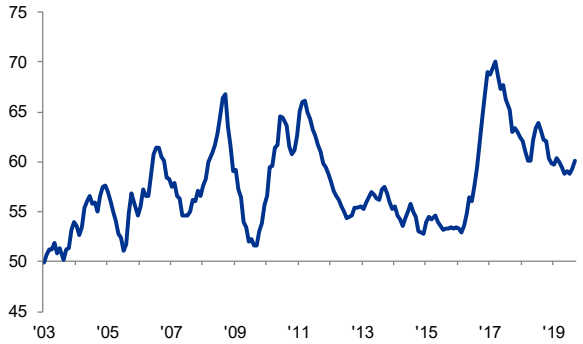
Steeper increase in input costs

The seasonally adjusted Input Prices Index picked up from 59.1 in Q2 to 60.1 in Q3 to signal a sharper rise in operating expenses. That said, the increase remained much softer than the peak seen in 2017. Cost burdens rose at a similarly sharp rate across the UK as a whole during the latest survey period.

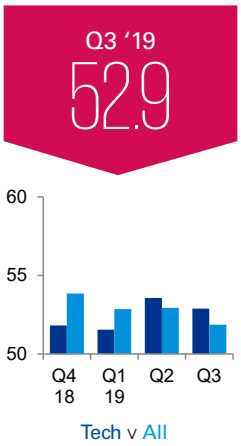
Anecdotal evidence indicated that a drop in the exchange rate against the US dollar had driven up input costs. Some companies also blamed rising expenses on trade tariffs and greater staffing costs.

Input Prices Index

Above 50 = growth, seasonally adjusted



Tech Sector Margins: Prices Charged Index



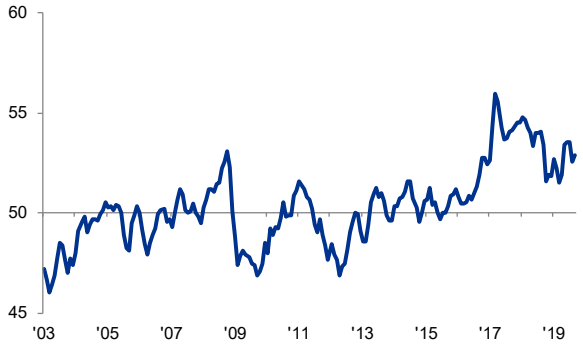
Selling prices rise at a softer pace

Reflective of the trend for input costs, tech firms increased their selling prices again in Q3. However, the Prices Charged Index slipped from 53.4 in Q2 to 52.9 and signalled only a modest slowest pace of inflation.

Some firms commented that they had raised their charges in order to maintain margins, although there were also reports that intense competitive pressures had held back pricing power in the third quarter.

Prices Charged Index

Above 50 = growth, seasonally adjusted



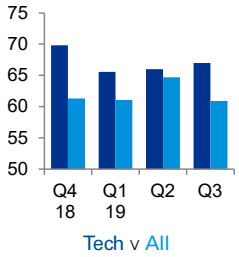
Tech sector outlook

Optimism towards the outlook remains weak

Business confidence at tech sector companies picked up slightly in Q3, but the overall degree of positive sentiment remained close to a decade-low. At 67.0, the Business Activity Expectations Index edged up from 66.0 in Q2 and still showed that optimism remained historically subdued. Expectations in the tech sector nonetheless are much more upbeat than the average for the UK economy as a whole.

Tech firms that are optimistic towards business activity over the year ahead linked this to new marketing strategies, investment in new product lines and expansion into overseas markets (particularly outside of the EU).

At the same time, uncertainty regarding the path to Brexit, signs of a wider global economic slowdown and reduced business expenditure on investment projects were cited as factors dampening business confidence in the third quarter.



Business Activity Expectations Index

Above 50 = growth in the next 12 months

Brexit concerns and global economic uncertainty hit the business outlook in Q3

The pattern of subdued business optimism recorded by UK tech companies has also been seen across the rest of the private sector so far in 2019. Softer business activity expectations have largely reflected rising Brexit-related concerns and greater global economic uncertainty in the third quarter, according to survey respondents.

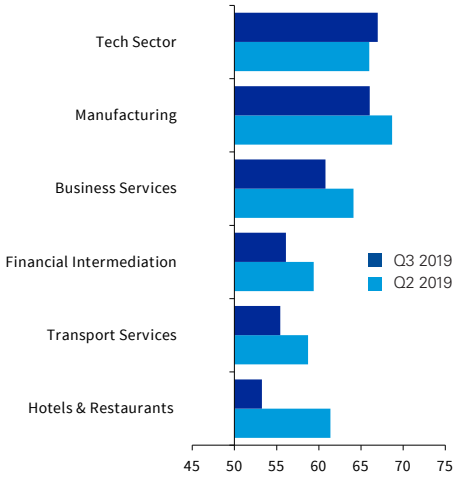
Latest data reveals that tech sector growth expectations remain stronger than in all other parts of the economy monitored by IHS Markit's UK PMI surveys. In fact, the slight improvement in business optimism among tech companies compared to the second quarter stood in contrast with weaker expectations across the manufacturing sector and in large parts of the service economy.

Companies operating in the Financial Intermediation category reported the lowest degree of optimism since the final quarter of 2008. Transport & Storage service providers are also the least optimistic about the business outlook for over a decade.

Meanwhile, Hotels & Restaurants remain the least confident overall about their prospects for the year ahead, reflecting intense competitive pressures and a sharp squeeze on margins from rising cost burdens.

Business Activity Expectations Index, by sector

Above 50 = growth in next 12 months



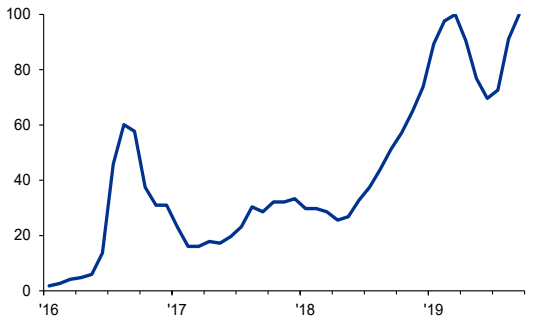
There was a sharp rise in the number of UK businesses citing Brexit as a negative influence on their business activity expectations during Q3 2019.

By tracking the frequency of words or phrases mentioned in qualitative replies supplied by respondents to IHS Markit's PMI surveys, we find that the degree of concern regarding domestic political uncertainty has now risen back to the peaks seen towards the beginning of this year. This index has accelerated sharply since mid-2018 and is much higher than seen in the aftermath of the EU referendum.

In the third quarter of 2019, reports of economic uncertainty increased worldwide, led by worries about US-China trade frictions. Moreover, a spike in trade-related concerns highlights a risk that softer global economic growth will amplify the challenges faced by UK tech firms from subdued business and consumer demand in domestic markets.

Business expectations: Brexit

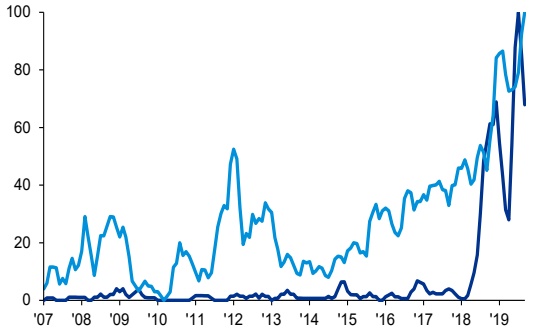
Index where 100 = maximum number of negative business outlook comments citing 'Brexit'



Brexit Comments (United Kingdom)

Business expectations: Trade & Uncertainty

Index where 100 = maximum number of negative business outlook comments citing 'Trade' and 'Uncertainty'



Trade / Uncertainty Comments (Worldwide)

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About KPMG

KPMG LLP, a UK limited liability partnership, operates from 22 offices across the UK with approximately 16,300 partners and staff. The UK firm recorded a revenue of £2.338 billion in the year ended 30 September 2018. KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 153 countries and territories and have 207,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

About IHS Markit

IHS Markit (NYSE: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions.

UK Tech Sector Purchasing Managers' Index® (PMI®) survey data

UK Tech Monitor Index data is derived from a representative sub-category of approximately 150 tech companies within IHS Markit's regular PMI® surveys of UK manufacturers and service providers. Tech is defined in this report as technology software, technology services and manufacturing of technology equipment. All figures are seasonally adjusted and smoothed using a three-month moving average, to better highlight underlying trends in the data.

UK Tech Sector Business Outlook data

Business activity expectations data are drawn from the monthly PMI® surveys question on companies' expectations for their activity/output over the next 12 months. Prior to July 2012, only service sector companies were asked this question. Employment, capex, profits and input cost expectations data are based on responses from UK services and manufacturing firms participating in IHS Markit's tri-annual Global Business Outlook survey, which is based on the same panel of companies as the PMI® surveys.

Technology Sector industry groups:

Software publishing (SIC 582), Computer programming, consultancy and related activities (SIC 620), Data processing, hosting and related activities; web portals (SIC 631), manufacture of computer, electronic and optical products (SIC 26), manufacture of electrical equipment (SIC 27).

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