CREDIT CRUNCH

Credit crunch begins to bite

Derek Soper

Last month I wrote about ongoing industry worries concerning the deepening credit crunch which has highlighted the necessity for adequate risk mitigation and business controls (see *Leasing Life*, February 2008). Other effects of the credit crunch are now starting to come through, as my firm is repeatedly hearing; examples are asset financiers reviewing their strategy and the impact on people.

There is a strong consensus among economic forecasters, the markets and policymakers that the UK economy is set to slow significantly as 2008 progresses. The question that cannot be answered is by how much? What is also unclear is how long this downturn will last and what will be its main features. We should, however, take note of the Bank of England warning of a prolonged period of discomfort for individual banks and the financial system as a whole.

It is not surprising in this prevailing uncertainty that some asset financiers (and some of the "seniors" are amongst them) are drawing breath and considering whether their future lies in this industry or, less drastically, in certain sectors, for example, financing IT.

So what should we expect? Will we see the cautious batten down the hatches and look to cut costs where possible? Will the entrepreneurs be opportunistic and have the confidence to gamble?

Business investment rebounded in Q3 of 2007 but investment intentions eased towards the end of last year. Will investment plans now be scaled back? The last significant downturn adversely affected the IT sector but, today, given the significance of technology to businesses -indeed their increasing reliance on it-IT investment may hold up relatively well. We are already seeing a number of mid-size players struggling to maintain satisfactory funding lines and the appetite for following 'new investment' in people or 'teams' is on the wane.

> *"Will we see the cautious batten down the hatches and look to cut costs where possible?"*

One authoritative barometer of sentiment among financial services businesses is the quarterly Financial Services Survey by the CBI and PricewaterhouseCoopers LLP. One of the January survey results surprised some people when it was reported that planned increases in capital investment were higher than three months earlier and above their long-run averages. Moreover, this was particularly the case for IT, where plans were at their strongest since September 1997. The main spur to invest is to increase efficiency, rather than to expand capacity.

However, the Bank of England's February Inflation Report contained further warnings – it cautioned that the weaker and more uncertain outlook for demand, reduced access to external finance and falling commercial property prices are all likely to weigh on capital spending over the coming year.

Crunching the numbers

Unemployment is still at historically low levels and fell in Q4 of 2007, according to government statistics. But, history reminds us that any economic downturn takes time to feed through to official data.

The sharp rises in costs, such as energy, are feeding through into CPI inflation – the government's target measure – which is nudging up and they are an imperative to contain or cut costs elsewhere.

A number of quarters of weak economic growth could prompt asset financiers to squeeze their HR budgets, trim headcounts and place increased emphasis on the retention of core personnel. Decisions may be shaped by their expectations of the magnitude of the slowdown and how long it might persist, or they may wait to see what happens. Another factor will be asset financiers' willingness, or ability, to hoard staff.

Forward-looking companies will recognise that a tougher market can be an opportunity to strengthen their talent pool as their competitors address cost pressures, and they will seek to emerge even stronger from a downturn.

When the economic climate improves, asset financiers need to have the right people in place to seize the business opportunities. If people do not find the job they are seeking in the industry, or if they are made redundant, their perceptions of the industry mood could prompt them to look elsewhere, leading to an even greater talent shortage when conditions improve – not an encouraging scenario.

We do not, of course, know whether there is more bad news to come. If there is, investment intentions could nosedive with investment taking a hammering in 2008. For now, some asset financiers are reviewing their options while others are waiting to see what transpires. The economic climate is volatile and we can expect to see further repercussions for asset finance in the weeks and months ahead.

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