Corporate Banking

UK Business Services

Sector outlook

First quarter 2012

Summary

- Business services activity remained buoyant in 2011, following a strong recovery in 2010. However, demand may come under pressure from wider economic uncertainties.

- The recovery in private sector demand is being offset, in part, by the tightening of government contracts, as a result of wider fiscal retrenchment.

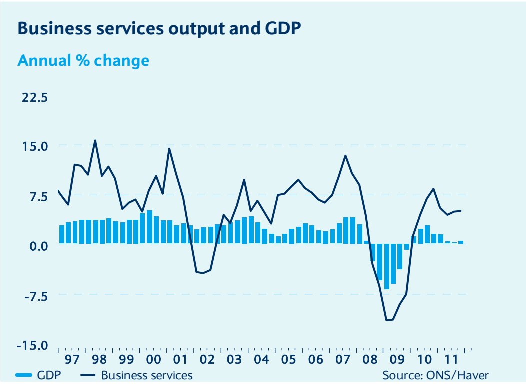
- While new outsourcing opportunities may arise from efficiency-seeking in both the public and private sectors, providers of business services can expect tighter margins on contracts, as clients seek to minimise costs.

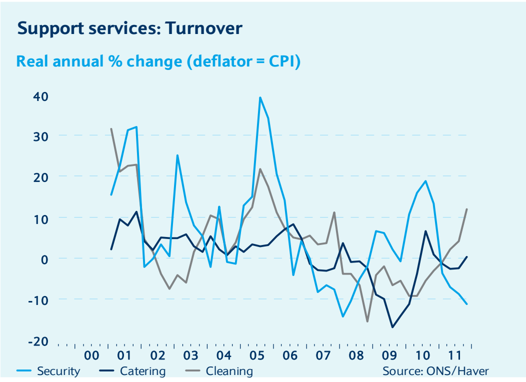
- Overall, the subdued economic environment suggests that activity in business services is likely to expand steadily in the medium term. However, activity in regions outside London and the South East is likely to be relatively weak.

UK Business Services overview

- The business services sector is highly diverse and includes facilities management support (FMS), recruitment and marketing, as well as engineering and management consultancy. The contraction in sector activity was deeper than that of the wider economy during the recession, but (partly as a result) it has experienced a stronger recovery. Indeed, business services activity was relatively buoyant during 2011, increasing by 5%, compared to 2010.

- However, the evident fragility of the wider economic recovery in recent quarters has undermined business confidence, with the government's fiscal austerity programme also likely to impact on business services activity (both directly and indirectly). Some providers face cutbacks on government contracts, which could offset the positive impact of recovery in private sector demand. Businesses will also be affected by both the direct and indirect impact of public spending cuts on consumer and corporate spending, which could see demand for advertising, marketing and other services decline. Whilst anecdotal evidence suggests that new outsourcing opportunities are arising, providers are facing tighter margins, as clients seek to minimise costs.



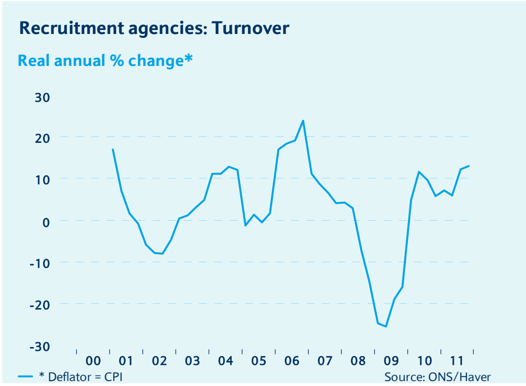


Facilities management and support (FMS) services

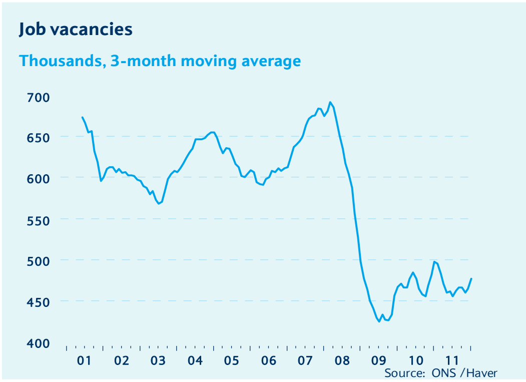
- Activity in FMS services was mixed in 2011, with weak occupier demand in non-prime, regional commercial property markets constraining growth. Although real turnover growth in cleaning services resumed (increasing by 4.3% y/y, following three years of decline), security and catering firms saw turnover contract by 7.8% and 1.6% respectively. A more competitive environment for contracts has created opportunities for integration and expansion of the services provided, as both public and private sector clients seek efficiency gains. Further consolidation in the industry is expected this year, which may ease the margin pressures providers are facing.

Unrestricted distribution

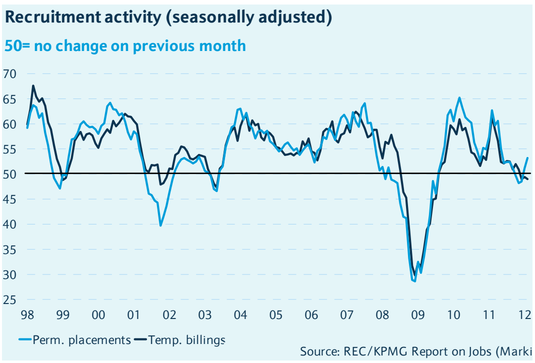
Recruitment



- Turnover in the recruitment sector increased by 9.6% in real terms during 2011, due to a strong performance in the second half of the year, despite a slowdown in the labour market. However, the number of job vacancies fell last year and remains well below pre-recession levels. REC/KPMG Report on Jobs data pointed to a deterioration in the labour market towards the end of last year, as the fragile economic environment constrained demand for staff. More recently, recruiters have reported an improvement in permanent staff placements, whilst the contraction in temporary billings has continued, in part due to changes in Agency Worker Regulations (see below). Activity was weakest in hospitality and finance, which remain under pressure from a weak consumer sector and wider concerns over the European sovereign debt crisis respectively. Demand for engineering, construction and IT staff remained relatively buoyant, however.



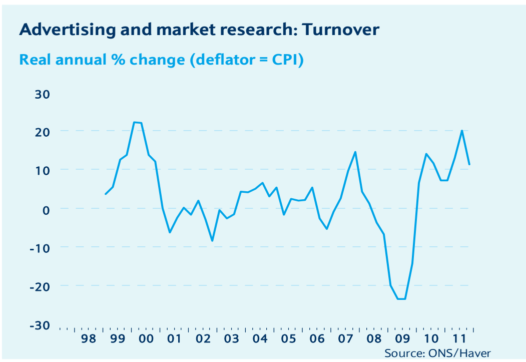
- The unemployment rate rose to a 16-year high of 8.4% in the three months to December 2011. Cuts in public sector employment accelerated further in the year to Q4 2011, offsetting a rise in private sector jobs. The labour market is likely to weaken further in the next few years, with fiscal tightening set to continue and the wider economic recovery expected to be protracted. The government now estimates that total public sector job losses could rise to 710,000 by 2017. The new estimate is much higher than the 400,000 previously forecast. Recent surveys also suggest that the on-going eurozone crisis and concerns over the wider global economy are causing greater uncertainty about hiring in the private sector.



- In its latest Labour Market Outlook, the Chartered Institute of Personnel and Development forecast weak employment prospects over the next year, continuing the trend that emerged in the second half of 2011. Survey data suggest that the private sector will continue to generate jobs, albeit at a slower pace. Manufacturing firms have reined in previously buoyant hiring intentions and companies generally remain cautious, amid a deteriorating economic outlook.

- New regulations granting equal rights to temporary employees were implemented in October 2011, which has created a further challenge for recruiters. However, anecdotal evidence from employment agencies and business groups suggests that the longer-term impact of the new regulations is likely to be mixed.

Marketing and advertising

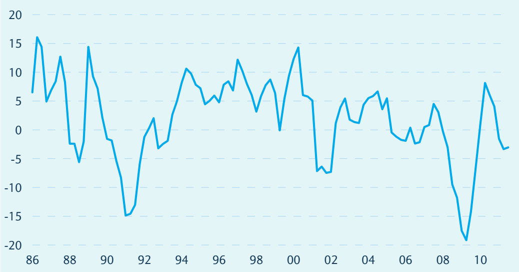


- Real turnover in the marketing and advertising sector increased by 12.8% in 2011, despite subdued corporate spending on advertising. Indeed, according to the latest WARC Expenditure Report, spending on advertising (adspend) was 2.6% lower in the first nine months of 2011, compared to the same period a year earlier, and is likely to remain subdued, due to weak consumer spending and cuts to public sector marketing budgets. Although the latest IPA/BDO

Bellwether survey suggests that firms increased their advertising expenditure in Q4 2011, in an attempt to improve sales, marketing executives' confidence remained extremely low, as the outlook for the wider economic environment deteriorated. The European football championships, Olympic Games and US presidential elections should provide a boost to activity in 2012, but this is likely to be offset by subdued economic growth. WARC forecasts growth in adspend of just 0.7% in real terms this year, following an estimated 2.9% decline in 2011.

Real advertising expenditure*

Annual % change



*Deflator = CPI

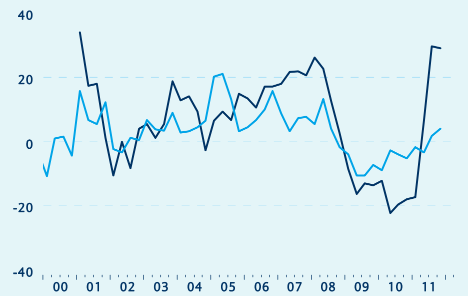
Source: Advertising Association/WARC, ONS

Management consultancy

- Management consultancy turnover growth accelerated in the second half of 2011 and increased by 10.7% in real terms during the year as a whole, following two years of decline. As a result, the level of turnover in the sector is approaching pre-recession levels. Although it remains to be seen whether the current momentum can be sustained, both the corporate and the public sectors continue to utilise consultancies for operational and improvement work, reflecting concerns over an expected slowdown in the economy and cuts in government spending.

Consultancy services: Turnover

Real annual % change (deflator = CPI)



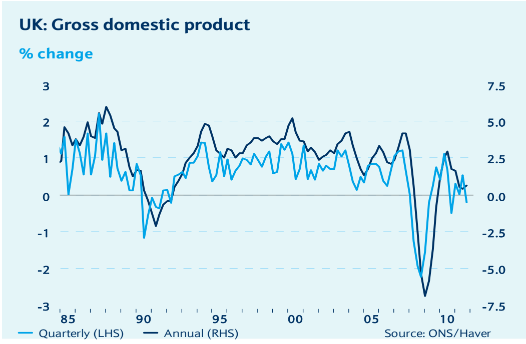
Source: ONS/Haver

Architecture and engineering services

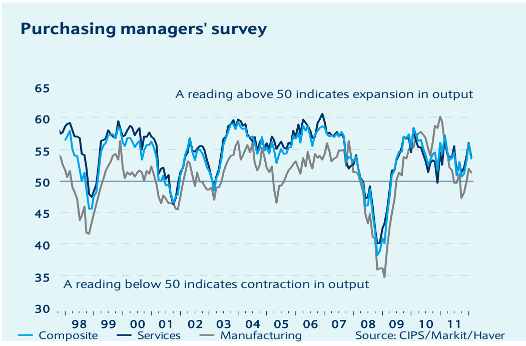
- Real turnover growth in engineering consultancy services was broadly unchanged in 2011. The sector has been impacted by the uneven recovery in construction output (which remains below pre-recession levels) and a weak housing market and planned cuts to public sector investment will continue to weigh on demand for engineering consultancy services in the medium term. However, demand for engineering services may improve in the long-term as a result of the government's infrastructure strategy.

- Overall, business services activity is likely to continue to expand steadily in 2012. However, the deteriorating economic outlook (both at home and abroad) will weigh on activity and the full impact of public spending cuts on the sector remains to be seen. Regional recovery is expected to be uneven, given the relative strength of economic activity in London and the greater dependence on public sector demand of regions outside the south east.

Appendix 1 – Summary of macroeconomic overview

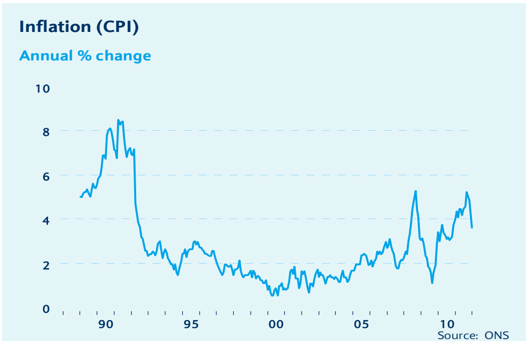


- Official data suggest that the UK economy contracted by 0.2% q/q in Q4 2011, following growth of 0.5% in Q3. The distortionary impact of events, such as the Japanese earthquake, the Royal Wedding and the associated extra bank holiday, resulted in an uneven pattern of quarterly GDP growth during 2011 (events, such as the Olympics and Diamond Jubilee holiday, will result in similar distortions in 2012). However, over the year as a whole, growth slowed to just 0.8%, compared to 2.1% in 2010, with concerns about the pace of the global economic recovery and the escalating eurozone sovereign debt crisis weighing heavily on activity and confidence in the UK (and across the advanced economies), particularly in the second half of the year.

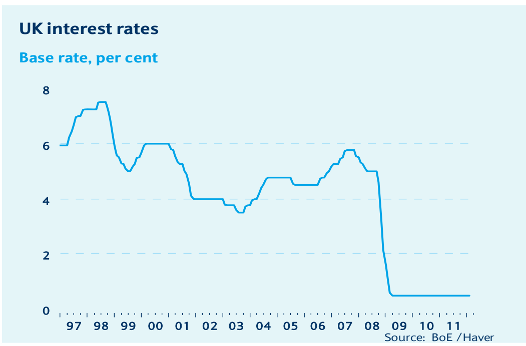


- Large-scale, long-term ECB liquidity provision and progress on a new support package for Greece appear to have eased eurozone tensions, for now, with the more positive tone of recent data from the US further bolstering confidence. Business surveys also suggest that UK economic activity has picked up once more (albeit modestly). However, whilst improving, confidence remains fragile and events in Europe continue to cast a shadow over both the UK and wider global economic outlook.

- The unemployment rate rose to 8.4%, with some 2.67 million people unemployed in the UK, in the three months to December 2011. Weak growth in private sector employment has failed to offset public sector job cuts over the past year and a continued rise in 'involuntary' part-time and temporary employment (by those seeking full-time, permanent posts) suggests that the degree of slack in the labour market is greater than the headline unemployment figures indicate.



- At 3.6%, inflation remains well above the 2% target rate, but has slowed markedly from its recent peak of 5.2%. With domestic inflationary pressures relatively subdued, and the temporary factors that contributed to high inflation last year (such as the increase in VAT and earlier rise in fuel and energy costs) set to fall out of the annual comparison, it is expected to continue to decline, although the recent rise in oil prices highlights the potential risks to this scenario.



- Allied to the weak prospects for the economy, the benign inflationary outlook has seen the MPC maintain interest rates at their historic low of 0.5%. In February, the MPC also sanctioned a further £50 billion of quantitative easing (QE), raising the limit on the Bank's asset purchase facility to £325 billion. Whilst financial markets now expect the MPC to pause QE, Bank Rate is expected to remain on hold during 2012-13.

- Despite a brief pick-up in the quarterly data in Q4, official figures show that consumers' expenditure declined by 0.8% during 2011. Falling inflation should gradually begin to ease some of the downward pressure on real disposable income (RDI). However, consumer spending is likely to remain weak over the next 12 months, as households remain heavily indebted, confidence remains weak and, with wage growth likely to remain below the rate of inflation, RDI is likely to continue to decline (albeit more slowly) in the near term.

- Fiscal tightening will also continue to bear down on the economy. Although official data suggest that the 2011-12 fiscal deficit will be lower than originally forecast, the Chancellor's Autumn Statement revealed significant downward revisions to the Office for Budget Responsibility's (OBR) medium-term economic forecasts. As a result, the Chancellor has stated that there will be no loosening of fiscal policy in the forthcoming Budget, which will be fiscally neutral. Indeed, the OBR's revised forecasts suggest that the austerity programme will likely have to be extended to 2016-17 to meet the government's medium-term fiscal targets.

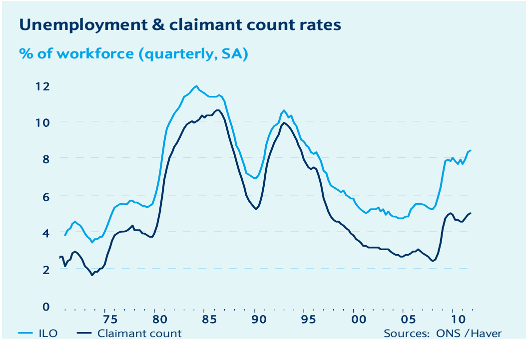
- Business investment was volatile last year, but declined once more in Q4 (by 5.6% q/q and by 2% y/y), resulting in growth of just 0.2% over the year as a whole. The corporate sector has been running a sizeable aggregate financial surplus, raising hopes that investment would provide a catalyst for both the recovery and the rebalancing of the UK economy. However, firms have adopted a more cautious approach as a result of spare capacity and/or the increasingly uncertain outlook.

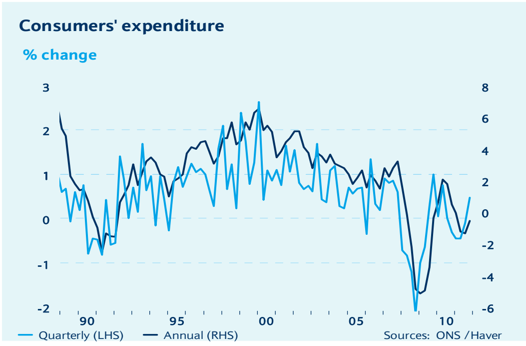
- Bolstered by the earlier sharp depreciation of sterling, the weak domestic UK performance was offset by a relatively strong contribution (1.2% points) to GDP growth from net trade last year. However, growth prospects for the UK's key European export partners have deteriorated markedly as a result of the eurozone sovereign debt crisis.

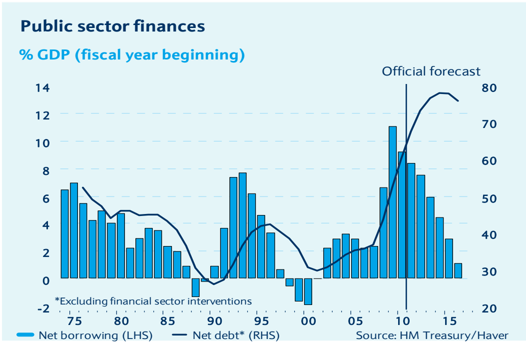
- Industrial production declined once more in 2011, with the pace of decline deepening as the year progressed. Following a period of robust annual growth at the beginning of the year, manufacturing activity stalled in Q4. Mining and oil extraction output also fell sharply (by 15.5%) in 2011, partly due to extra maintenance work in the North Sea, where production is now in long-term decline. Utilities output also declined last year, with relatively mild winter weather resulting in a particularly steep fall (10.9% y/y) in Q4. Annual growth in construction output also slowed markedly in the second half of 2011.

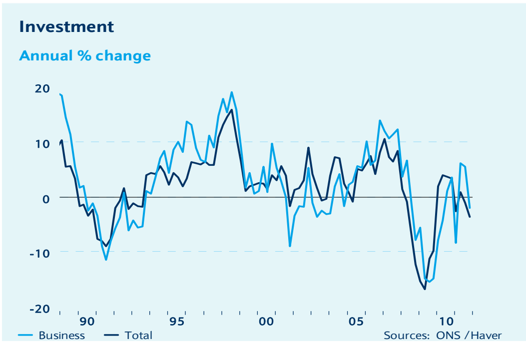
- Annual growth in services activity, which accounts for around 75% of UK GDP, proved more stable in 2011, although the quarterly pattern of growth was somewhat uneven. Growth in activity in this sector accelerated to 1.8% y/y in Q4, resulting in 1.6% growth during the year as a whole. However, performance was highly variable across the service industry's various sub-sectors, with business-oriented sub-sectors generally out-performing consumer-facing sub-sectors.

- UK economic forecasts have been revised downwards, with growth of just 0.5% expected this year and 1.8% next. As a result, recovery is likely to be protracted and weak, with risks weighted on the







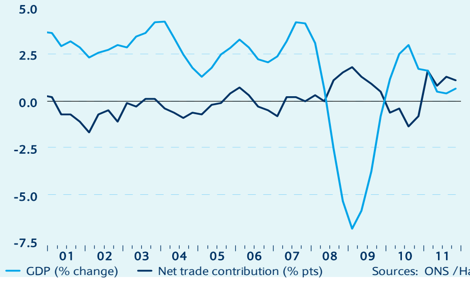


downside, given continued concerns over events in the eurozone, tensions in the Middle East(and the actual and potential impact of these tensions on oil prices) and signs of slowing growth in key Asian economies.

- Although expected to gradually pick up, as pressures on RDI gradually ease, consumer spending is forecast to remain subdued, from a longer-term perspective, during 2012-13, while fiscal tightening will see public sector activity and demand fall. Net trade is expected to continue to make a positive contribution to growth, but weak prospects for the eurozone are likely to see this diminish. However, investment should gradually pick up as economic growth accelerates.

- Unemployment is likely to continue to rise, as a result of further public sector job losses and cautious private sector job creation, but slowing inflation should, in the absence of unforeseen price shocks, enable the Bank of England to keep interest rates low.

Annual GDP growth and net trade contribution



Sources: ONS /Haver

UK consensus economic forecasts: February 2012

Annual % change (unless otherwise stated)	2009	2010	2011	2012f	2013f
Real GDP	-4.4	2.1	0.8	0.5	1.8
Consumer spending	-3.5	1.2	-0.8	0.2	1.6
Government consumption	-0.1	1.5	0.3	-0.4	-1.0
Investment (total GFCF)	-13.4	3.1	-1.7	0.9	4.0
Stockbuilding (contribution to GDP growth)	-1.0	1.3	-0.1	0.0	0.1
Net trade (contribution to GDP growth)	1.1	-0.8	1.2	0.3	0.3
Unemployment rate %	7.6	7.9	8.1	8.8	9.2
Consumer prices (CPI)	2.2	3.3	4.5	2.0	2.1
Base rate (end period)	0.50	0.50	0.50	0.50	0.50

Sources: HM Treasury; Bank of England; ONS; Barclays Corporate Economics

Prepared by Economics Team, Client Capital Management, Corporate Banking, Barclays Bank PLC.

All data and factual information referred to in this report were correct as of March 2012.

Source of ONS data: National Statistics website: www.statistics.gov.uk