Review of Scottish Business Surveys

Overall

A common theme in quarterly business surveys covering the final quarter of 2010 and first quarter of 2011 has been the slowing of the economic recovery in the final quarter and relatively weak trends in the first quarter of 2011. As the Bank of Scotland Index of Leading Indicators noted 'Scotland's economic recovery is set to peak in Q3…. (with) a slowing of growth in Q4, continuing into the start of 2011'. Scottish Engineering's Quarterly Review and Oil & Gas UK's Quarterly Index largely followed this interpretation, albeit with more optimism and rising trends in orders and output. The latest Oil & Gas UK's Activity Survey for Q4 2010 (published 23rd Feb 2011) was more positive as to rising investment, activity and employment than other surveys.

Monthly surveys encountered more problems in interpreting the underlying trends. The exceptionally long spell of bad weather, continuing consumer uncertainty and weak consumer confidence, the increase in VAT to 20% in January and rising prices combined to increase the difficulties of disentangling short term effects from longer term trends in the Scottish economy and contributed to heighten interpretations as to the rate of recovery or slow down in the Scottish economy, especially in terms of the performance of the service sector. Nevertheless, evidence from the monthly Scottish Retail Monitor and Visit Scotland's Occupancy Survey and the quarterly SCBS retail sector results point to the continuing underlying weakness in consumer demand and confidence.

The overall weakness in demand was well captured in a number of surveys. The SCBS Q4 data for manufacturing noted that 65% of manufacturing and 83% of construction respondents reported working below optimum levels. In tourism occupancy levels fell and discounting of room rates was widespread, Visit Scotland data for December suggests occupancy rates at their lowest for five years, although the adverse weather was a clearly a contributing factor.

Rising cost pressures were widely cited in a number of surveys – the SRC – KPMG Retails Sales Monitor, Bank of Scotland PMI and Scottish Chambers Business Survey. The latest Bank of Scotland PMI noted a 'strong acceleration of average cost inflation…. Both Scottish manufacturers and service providers registered a considerable acceleration of cost inflation during the month with higher fuel, energy and food prices widely commented on'. This had been noted in the SCBS Q4 2010 survey which reported that more than three quarters of manufacturing, 92% of wholesale and 67% of retail respondents reported pressures to raise prices due to rising raw material/suppliers' prices. 92% of wholesale, 42% of manufacturing and 38% of retail respondents reported rising transport costs.

Once again the contrasts between official and survey data for the Scottish construction sector were the most pronounced. There is now more evidence that cuts in public sector expenditure are beginning to affect the private sector. The SCBS noted expectations for the first quarter remain very weak, generally weaker than a year ago, and there is more evidence, in both manufacturing and construction, that those firms with more exposure to public sector orders are less optimistic as to 2011 than those with lower exposure.

Oil and Gas services

Data from Oil & Gas UK Index (Q3 and Q4 2010) and Aberdeen & Grampian Oil and Gas survey (Autumn 2010) suggested continuing rising confidence across the sector, although the rate of increased eased amongst supply chain companies in the third quarter before rising strongly in the fourth quarter. The Aberdeen & Grampian Chamber Oil and Gas Survey (no 13 autumn 2010) likewise reported rising confidence and activity, noting that in a climate of global economic recovery, rising oil prices the global oil sector and the UKCS has returned to growth with signs of increasing investment, consolidation and acquisitions by both suppliers and countries to secure longer term supplies. Significantly the independent E & P companies registered the strongest increase in business confidence with expectations of increased activity investment being reported in the Oil & Gas UK's 2011 Activity Survey.

Drilling activity in the UKCS had eased in 2009, and whilst there were some signs of a pick up in the first half of 2010, this was less evident later in the year and this was reflected in the slight easing in the rate of increase in business confidence reported by operators, but not by contractors in the Oil & Gas UK index Q2 2010). The lingering impact of the recent financial crisis is still evident in terms of some limits in the access to capital and a more cautious approach to drilling schedules. Latest international data from IHS CERA's Downstream capital costs index (November 2010) suggests the costs for designing and constructing downstream refining and petrochemical projects rose 3 percent from Q1 2010 to Q3 2010. The index noted that costs are now just 4 percent below their 2008 peak with higher commodity prices and a weakening U.S. dollar again the driving force behind the steady rise of costs in the downstream sector.

Oil prices remained relatively stable and on a slight upward trend averaging with more widespread predictions that these prices will remain and increase slightly in 2011 and 2012, assuming a relatively stable continuation of the world economic recovery. As the industry notes the price for oil and gas is critical for long term investment, development and production. By autumn oil prices were in the range $74–$76 per barrel, but had risen to over $100 per barrel by January 2011.

The Aberdeen & Grampian survey noted signs of increasing demand for staff in terms of increased recruitment activity, demand for additional staffs, and in the rising trends in working hours being above planned levels. Recruitment and retention problems increased in 2010 and shortages of experienced engineering and specialist skills were reported by both the Aberdeen & Grampian Oil & Gas survey and by the Bank of Scotland Report on Jobs (December 2010). Further indications of continued growth in the sector were evident in the Oil and Gas UK and the recent Douglas Westwood UKCS Offshore Decommissioning Market Report 2010 – 2040 which highlighted the infrastructure development and work volumes over the next thirty years associated with decommissioning and considerable potential and value of such work for contractors.

Production

The latest issue of the Lloyds TSB Scotland Business Monitor covering the three months to the end of November noted that the production sector showed a robust recovery compared to the three months to the end of August. The overall net balance for turnover for firms in the production sector was -1% - a significant improvement from the -14% of the previous quarter and very similar to the -2% of the same quarter one year ago. Respondents reported an overall net balance for turnover in the next six months of -2%. Although this was worse than the +6% of the previous quarter and the +7% of the same quarter one year ago, production firms remain more optimistic for the next six months than their service counterparts. Expectations for export activity continued to be positive, 33% of firms expect export activity to increase in the next six months compared to only 11% who expect a decrease. This overall net balance of +22% was the most positive in two and a half years.

Manufacturing

A common theme in the surveys covering Scottish manufacturing was one of export led growth cushioning the sector as the domestic economy remained weak.

Once again the most optimistic views were those in Scottish Engineering's Quarterly Review. Their Quarterly Review (Q3 2010) reported rising optimism, orders, output, investment and employment, with the total order intake the highest for 12 years. This eased in Q4 and the index noted 'The Scottish manufacturing sector has managed to maintain a lot of positive features in this final Review of 2010. While order intake, staffing levels and output have slipped slightly, they remain positive'.

The Scottish Chambers' Business Survey (SCBS) for quarter 4 2010 found that respondents continued to report a downward trend in business confidence, but noted firms reported a resumption in rising trends in orders and sales in quarter four following a temporary decline in quarter three. Average capacity utilisation declined by one percentage point, although was up by 5 percentage points on the year. Respondents anticipate some further weakening in these trends in the first three months of 2011, with the net trends in total orders and sales expected to be negative. Cost pressures, especially raw material and to a lesser extent transport costs, continued to cause most concern to firms during quarter four. Nevertheless, the net trend in turnover is expected to remain positive over the coming twelve months and a small net balance of firms expect profitability to increase (1.8%).

The CBI Industrial Trends Survey reported that the volume of total new orders contracted in the three months to January, despite expectations that it would grow strongly. As anticipated new domestic orders fell sharply. Meanwhile, export order growth continued, albeit at a slower pace. It was the third consecutive quarter in which export orders have risen while domestic orders have fallen. Expectations for the three months to April 2011 are that export orders are expected to grow again, while domestic orders are expected to be broadly flat.

The Bank of Scotland PMI for November highlighted the first monthly rise in new order levels received by Scottish manufacturers since August. The New Orders Index indicated a marginal expansion mainly due to new business wins from export markets. However the December PMI noted that new orders and output contracted as the adverse weather dampened domestic demand although further export growth lessened the blow for manufacturers. The headline Bank of Scotland PMI index indicated a contraction of Scotland's manufacturing sector in the final month of 2010.

SCBS firms reported that the downward trends in investment of equipment eased with new investment mainly directed towards replacement. Investment for R & D and expansion remained low. Scottish Engineering Quarterly Survey firms reported that capital investment plans in general remained unchanged. Respondents from the CBI Industrial Trends Survey claimed that investment intentions for the next twelve months compared to the last twelve had generally fallen compared to the previous quarter.

Construction

According to the Scottish Building Federation a majority of Scottish construction firms expect their workloads to decline during 2011. The Scottish Construction Monitor, for the three months to the end of December showed overall confidence within the sector declining for the fifth consecutive quarter. More than 60% of firms responding to the survey report a reduced order book compared to the same time last year, while 80% predict that industry activity will decline in the course of 2011.

Business confidence amongst SCBS firms continued on its downward trend in the three months to the end of December (the lowest net balance since Q4 2008). Almost two thirds reported a decline in business confidence. Average capacity declined from 75% to 72%, an improvement over levels one year ago (66%), and similar to the level of the same quarter two years ago. Once again the trends in demand weakened among construction firms with orders from all areas declining further during the fourth quarter. 88% of firms reported working below optimum levels.

The service sector

Service businesses in the latest issue of the Lloyds TSB Scotland Business Monitor showed an improvement in turnover with an overall net balance rising to +2% in the three months to the end of November 2010 compared to -4% in the preceding quarter and showing a significant improvement on the -11% of the same quarter one year ago.

The Bank of Scotland PMI for November noted that Scottish service providers recorded a third straight monthly decline in activity levels at their business units during November. Respondents noted that lower new order volumes was the key reason for reduced activity levels. Output was reported to have fallen by 31% of survey respondents. In December it noted the impact of harsh weather conditions and a weak final quarter to 2010. However in January it reported rising activity for both manufacturing and service providers.

Logistics and Wholesale

Data from the SCBS for the fourth quarter of 2010 indicated a levelling off in business confidence amongst logistics respondents with a net of respondents reporting no net change in activity. Over the next year pressures on margins are expected to ease with turnover and profitability set to improve. In contrast, business confidence amongst SCBS wholesale respondents remained weak, with few respondents reporting a rise in business confidence. Sales trends weakened during the three months to December although more than half of firms reported increasing or level sales; however fewer respondents are now forecasting a decline in sales in the coming quarter. Almost all firms reported pressures to raise prices, as respondents report rising transport costs and supplier prices. Wholesalers are no longer revising their expectations downwards for both turnover and profitability over the coming year though are not yet forecasting a rise. Once again most firms reported that their investment intentions remained unchanged; nevertheless there was a net decline. A quarter of wholesale firms sought to recruit staff, mainly for replacement as no firms reported that actual total employment levels had increased.

Retail distribution

A common theme in the surveys covering the Scottish retail sector has been the adverse impact of the harsh weather conditions, weak consumer confidence and demand, the impact of the VAT increase in January on sales in both December and January, rising costs, price pressures and increased competition amongst the major multiple retailers and the continued drift to on line sales. Not unsurprisingly the net trends in retail confidence among SCBS firms in the fourth quarter remained and weak and also remained weaker than during the same quarter one year ago. The trend in sales remained weak with almost 60% of SCBS firms reporting and more than 60% expecting a decline in the total value of sales, notwithstanding extensive price cutting. Only 11% reported increased sales during the final quarter of 2010, and once again continued concerns over consumer confidence are moderating sales expectations for the coming quarter.

The Scottish Retail Sales Monitor, published by the Scottish Retail Consortium reported that like-for-like sales in November were unchanged from a year ago; in December like for like figures were 0.7% better than a year ago and the comparable figures for January 2011 were 0.9% lower than in January 2010. Over the three months non food sales fell in each month and the increase in food sales in November and December was driven mainly by inflation in prices. Footfall was reported as being below average in January 2011 and 2011 is forecast to be a challenging year for the sector, with Scottish consumer confidence being weaker than in the UK.

Tourism

SCBS firms noted that overall business confidence and occupancy weakened, whilst visitor numbers and demand remained flat. The trend in visitors from Scotland improved for a small net balance of hotels during quarter four 2010. Demand from the rest of the UK, abroad and business trade all continued to decline. Demand from all areas is expected to decline during the first quarter of 2011. Trends in bar/restaurant trade and in conference/function facilities remained weak, and weaker than a year ago. Overall local and business demand accounted for 54% of total demand and tourist demand accounted for 46% of total demand in the fourth quarter. More than a third reported reducing average room rates and the discounting of rates is set to continue for a third of hotels in the three months to the end of March 2011. 70%, compared to more than 80% in the previous quarter, reported that the lack of tourist demand remained the primary business constraint but once again around a third felt that their area had suffered due to poor marketing.

Both the SCBS Q4 2010 and Visit Scotland surveys for November and December suggested a weakening in demand in tourism and demand for bar/restaurant and conference facilities in the final quarter of 2010. Average occupancy among SCBS hotels over the three months to December 2010 declined from 70.3% to 56.4%, slightly lower than a year ago (61.7%). The Scottish Hotel Occupancy Survey reported that room occupancy in November was 58% but fell in December to 32% (five percentage points lower than a year ago), moreover in December average length of stay (nights) and bed occupancy were lower than a year earlier. The average bed occupancy in December was the lowest average bed occupancy rate recorded in December over the five previous years.

The Scottish Self-Catering Occupancy Survey reported an average unit occupancy rate for self-catering properties throughout Scotland of 27% in November and 28% in December 2010 (the lowest average unit occupancy rates recorded for these two months over the past five years). The Scottish Guest House and Bed & Breakfast Occupancy Survey reported an average unit occupancy rate 20% in November and 15% in December. Again the figures for these two months were lower than for previous years.

Cost pressures

A common theme across most business surveys was rising cost pressures For SCBS construction firms tender margins and profitability over coming year weakened further during the final quarter of 2010. Cost pressures, especially suppliers' prices, remain significant for SCBS retail respondents and pressures to increase prices remain high. More than half of firms reported that utility costs were also putting pressure on prices. Pressures on margins look set to continue (though ease marginally) with almost two-thirds of firms anticipating weakening trends in both turnover and profitability over the next year.

Pay and Employment

According to the latest Bank of Scotland Report on Jobs (January 2011) the Scottish labour market improved further in December, led by faster vacancy growth, although this was strongest in the North East and the oil and related sectors. The number of people placed in both permanent and temporary job roles increased during the latest survey period, whilst candidate availability tightened since November. The report noted that permanent staff placements increased for the third month and the number of people placed into temporary or contract jobs rose at a strong rate in December. However, in the Bank of Scotland PMI report covering January job losses in the Scottish private economy extended to a third straight month.

SCBS manufacturing firms found that declining trends in employment eased, and expenditure on training continued to ease, nevertheless recruitment activity increased with manufacturing firms reporting difficulties in attracting suitable technical staff. In contrast Scottish Engineering respondents reported positive trends in staffing levels across all size bands.

More than 60% of firms surveyed in the Scottish Building Federation Survey expect that they will have to reduce the size of their workforce next year, with only 5% of respondents expecting to be in a position to take on additional workers. The latest survey suggests that the construction industry's reported recovery is at risk of faltering or that output and employment could slip back into decline.

Similarly amongst SCBS construction firms employment levels continued to decline and further declines are anticipated during the first quarter of 2011. Recruitment activity and average pay increases remain at historically low levels, few recruitment difficulties are reported.

Labour market activity remains at low levels in the retail sector with almost 70% of SCBS retailers reporting and expecting no change to overall employment levels. Recruitment activity in the third quarter, whilst just as strong as a year ago, remains at historically low levels. More than 20% reported increasing pay, and the average increase in for quarter 4 2010 was 2.3%.

SCBS hotel respondents noted that 54% (compared to 45% in quarter three) sought to recruit staff, mainly for replacement. Net declining trends in employment continued and are expected to accelerate in quarter one. Once again, notwithstanding the weak demand for staff difficulties in recruiting suitable chefs were evident.

Outlook

The trends for 2011 will reflect adjustments to higher levels of VAT, increased fuel and utility charges and continuing weak consumer confidence. Over the year the pace and scale of public sector job cuts and reductions in expenditure will contribute to weak levels of demand coupled with increased cost pressures. Recruitment activity, apart from the oil and gas sector is likely to remain at historically low levels and signs of rising private sector employment remain elusive.

Cliff Lockyer/Eleanor Malloy
February 2011

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Current trends in Scottish Business are regularly reported by a number of business surveys. This report draws on:

1. The Confederation of British Industries Scottish Industrial Trends Survey for the fourth quarter 2010;

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2. Lloyds TSB Business Monitor 53 for the quarter September - November 2010 and expectations to May 2011;
3. Scottish Engineering's Quarterly Reviews for the third and fourth quarters of 2010;
4. The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Index for November and December 2010 and January 2011;
5. The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitor for November and December 2010 and January 2011;
6. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the fourth quarter of 2010;
7. Oil & Gas UK quarterly Index quarters 3 and 4 2010;
8. Visit Scotland Occupancy Survey for November and December 2010;
9. The Scottish Construction Monitor quarter 4 2010.