

Review of Scottish Business Surveys

Overall

The publication of better than anticipated figures for UK growth for the third quarter of 2010 suggests that the UK economy appears to be recovering from recession at a faster rate than in previous recessions, although the rate of growth eased between the second and third quarter, and there is widespread concern that the deep cuts in government expenditure will impact on the recovery in 2011.

Since the comparable figures of growth in the Scottish economy are published later there is more interest in the results and forecasts of recent surveys covering the Scottish economy. However, there is considerable disagreement as to recent trends and three differing interpretations as to the current state of the economy are evident in recent Scottish business surveys:

1. Two surveys - the Oil & Gas UK and Scottish Engineering's Quarterly Report - are more optimistic than other surveys and suggest a continuing and strengthening recovery of the Scottish economy. The Oil & Gas UK index for the second quarter noted 'a sustained positive outlook across the UK oil and gas industry', although this was slightly less evident amongst exploration and production companies. Scottish Engineering noted in its quarterly review for q2 2010, orders, output volume and employee numbers 'returning to positive territory for the first time in three years'. In its report for q3 2010 it reported increasing optimism 'the latest results from ...show a further improvement on the return to positive territory', and 'represent some of the most positive figures we have seen for some time'. Coincidentally, engineering had the strongest growth in the latest Government figures;
2. The majority of surveys are more cautious as to trends in the third quarter, but differ in their views as to the outturn for the fourth quarter. The latest Lloyds TSB survey (June – August 2010) noted the 'results indicate that although growth may have been restored it remains weak and muted. Both consumer and business confidence remain at low levels'. The Bank of Scotland PMI for September 2010 reported that both output and activity declined for both manufacturing and services following four months of growth although recovery continued with respect to new orders and employment.

The CBI Industrial Trends (q3 2010) likewise noted a dip in manufacturing output following four quarters of growth – but predicted a stronger rise in orders and activity for the fourth quarter.

The SCBS (q3 2010) is the least confident of this group. It noted confidence weakening amongst its members in the third quarter of 2010, with the positive signs of recovery evident earlier in the year fading and respondents in all sectors revising downwards their expectations for the fourth quarter and for the year ahead. The SCBS captured more concerns that firms were factoring in the forthcoming significant reductions in public sector expenditure and consequent reduced consumer demand are increasingly concerned these will adversely influence turnover, profitability and demand over the next year.

3. The Scottish Construction Monitor and SCBS for the construction sector are the least optimistic of the range of business surveys over the summer months. Commenting on the results for the q3 2010 survey, the Scottish Building Federation noted 'confidence in the Scottish construction sector is now worse than it was at the beginning of 2009' and prompting the Scottish Building Federation's chief executive to raise fears of a 'dam of insolvencies fit to burst' in the Scottish construction sector. Likewise the SCBS in its construction sector noted a sharp deterioration in business confidence.

Oil and gas services

The latest available Oil & Gas UK Index (q2 2010) indicated a sustained positive outlook across the UK oil and gas industry, although there were differences between contractors being more confident than exploration and production companies. The report noted 'While business confidence for the industry as a whole shows signs of caution, some segments of the supply chain community have been experiencing reasonably high levels of activity, which gives some scope for optimism in the industry. It will be important to monitor the Q3 and Q4 results closely, especially in the light of the drop in confidence by exploration and production companies in Q2'. The impact of international events, most notably the Gulf of Mexico incident, may be a factor affecting business confidence amongst exploration and production companies.

Production

In a reversal of the trends from the previous Lloyds TSB Scotland Business Monitor, the latest survey, covering the three months to end August, reported a slowing down in business

performance. The overall net balance for turnover for firms in the production sector was -14% - a fall from the -2% of the previous quarter but much improved from the -24% of the same quarter one year ago. All main trends, except export trends, continued to decline. Nevertheless looking forward the Lloyds TSB anticipates a muted improvement in both turnover and export activity.

Manufacturing

The Scottish Engineering Review reported the most optimistic figures and most positive growth in both the second and third quarters. In the last survey (q3 2010) it noted the total order intake and output volume were the highest recorded for 12 years and across all sectors and company sizes the order intake was positive. In contrast to other surveys of manufacturing it reported rising export orders, capacity used, employment and investment. Looking forward to the fourth quarter it anticipates these rising trends continuing.

The CBI Industrial Trends for the third quarter noted a dip in manufacturing output following four quarters of growth. It reported and expects moderately rising domestic orders but more strongly rising export orders for the fourth quarter, although at the same time noted stocks rising faster than expected. It is unclear from the survey the extent to which the rising output noted in earlier quarters reflects more extensive stock rebuilding rather than a sustained increase in demand. Nevertheless, for the first time the survey noted increased investment over the next 12 months. The BoS-PMI noted firms running down their backlogs of work linked in part to a weak flow of new orders as well as evidence of spare capacity.

Chamber of Commerce respondents reported being less confident than a year ago and also less optimistic compared to the third quarter of last year whereas firms responding to the Scottish Engineering Quarterly Review Survey (q3 2010) reported positive and rising trends in optimism amongst all size bands.

In contrast both the Bank of Scotland PMI and the SCBS reported a weaker than anticipated outturn amongst manufacturing firms in the third quarter. The BoS-PMI noted a decline in activity levels in September. It noted a weakening in actual and expected orders, weakening employment and investment. Amongst SCBS respondents average capacity utilisation declined by almost 5 percentage points, previous positive trends in work in progress and were reversed in quarter three with a net balance of firms reporting a decline (firms in the second quarter survey had expected a weakening in these trends). SCBS respondents anticipate some further weakening in these trends in the fourth quarter, with the net trend in total orders and sales remaining negative.

In both the CBI and SCBS surveys rising trends in cost pressures were reported. The CBI survey noted 'average unit cost grew strongly in the quarter' and a further, although more modest, increase is forecast for the fourth quarter. Amongst SCBS respondents raw material and to a lesser extent transport costs, continued to cause most concern to firms during quarter three.

For SCBS firms, trends in investment of equipment declined with remaining investment mainly directed towards replacement. Investment for R & D and introducing new products/developing new markets remained low.

Declining trends in employment and hours worked were reported by a net balance of SCBS firms, and expenditure on training continued to ease. Conversely Scottish Engineering respondents reported and expect upward trends in total employment levels. Recruitment activity remained subdued among SCBS firms and few recruitment difficulties were reported.

Construction

The Scottish Building Federation (SBF) responded cautiously to the official output figures for the Scottish construction industry for the second quarter of 2010, noting 'private commercial activity is down 46% compared to where it was at its peak. Quarterly private house building activity is down 40% on the level of output at the peak of the housing boom. Public sector construction activity was up again this quarter but, with significant budget cuts starting to bite, this trend will not last.'

The Scottish Construction Monitor reported business confidence in the third quarter as being weaker than earlier in the year and weaker than it was at the beginning of 2009. It reported that only one third of construction firms seeking bank finance for their business over the past year had been able to secure it on satisfactory terms with almost a quarter reported their requests for finance being turned down.

Three quarters of employers responding to the survey described their finances as 'secure' but said that the outlook for their business remains difficult. However, 14% said that without additional bank finance, their business would be forced to restructure or to lay off workers or could even struggle to survive. It concluded the 'outlook for many Scottish construction firms remains extremely tough'.

SCBS respondents reported similar findings, business confidence declined sharply among Chamber of Commerce construction respondents in the three months to the end of September (the lowest net balance since Q1 2009).

Demand remained weak among SCBS construction firms with orders from all areas declining further during the third quarter.

83% of firms reported working below optimum levels, but the decline in the level of work in progress eased significantly. Expectations as to contracts over the next three months and turnover, tender margins and profitability over the next twelve months remain weak. There is much to suggest that expectations influenced by continued speculation concerning announcements as to reductions in public sector capital projects expected in the Comprehensive Spending Review. Average capacity rose marginally to 75%, similar to levels one year ago, but remains some 14 percentage points lower than in 2007. Employment levels continued to decline and further declines are anticipated during quarter four. Recruitment activity and average pay increases remain at historically low levels, few recruitment difficulties are reported.

The service sector

The Lloyds TSB Scotland Business Monitor reported service businesses noting an improvement in turnover during June – August with the overall net balance on turnover rising to -4% in the latest quarter from -10% in the previous quarter and -7% in the same quarter one year ago. However, more firms responding to the Business Monitor reported a fall in turnover (36%) in the latest three months compared to those reporting an increase of 32%.

The latest BoS-PMI noted a decline in activity levels in the service sector, although there were signs of rising new orders.

Retail distribution

Trends in business confidence in the retail sector reflect both factors within the sector as well as trends in consumer confidence and spending levels. Rising on line sales and sales amongst the major multiple retailers in a period of limited growth in consumer spending implies increased pressures on the smaller and independent store. The SRC-KPMG Scottish Retail Sales Monitor for September noted like-for-like sales in September were 0.4% lower than in September 2009, with non food sales down 2.2%. The overall rise of 2.3% in sales over the year largely reflected growth in floorspace rather than increased demand.

Amongst SCBS retail respondents the trend in sales remained weak with more than 60% of SCBS firms reporting and expecting a decline in the total value of sales. Only 12% reported increased sales, and once again continued concerns over consumer confidence are moderating sales expectations for the fourth quarter.

Both SCBS and SRC-KPMG retail respondents noted rising costs pressures. Rising suppliers' prices remain a concern, and as the SRC-KPMG monitor noted the inflationary pressures as cost increases felt in commodities such as wheat and cotton and in Chinese manufacturing work through shop prices. Pressures on margins look set to increase with two-thirds of

firms anticipating weakening trends in both turnover and profitability over the next year. Labour market activity remains at low levels with 70% of retailers reporting and almost 90% 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. Fewer than 10% of SCBS respondents reported increasing pay.

Tourism

SCBS respondents reported that overall business confidence weakened in the third quarter, whilst occupancy figures remained little changed from previous years, average daily spend eased and demand from abroad remained flat. SCBS respondents reported average occupancy declining marginally to 70.3% in q3 2010, slightly lower than a year ago, whereas the Scottish hotel occupancy survey (August) showed no change to either room or bed occupancy compared to the same month in 2009. Results from the SCBS survey suggests weakening trends in visitors from all areas with further weakening expected in the fourth quarter. Trends in bar/restaurant trade and most notably in conference/function facilities remained weak. Overall local and business demand accounted for 47% of total demand and tourist demand accounted for 53% of total demand in the third quarter. Average duration of stay rose slightly for seaside/coastal but eased for cities and town based hotels.

More than a third of SCBS respondents reported reducing average room rates and the discounting of rates is set to continue for 40% of hotels in the three months to the end of December. More than 80% reported that the lack of tourist demand remained the primary business constraint but once again almost a third felt that their area had suffered due to poor marketing. Fewer than half (compared to two thirds in quarter two) sought to recruit staff. Net declining trends in employment continued and are expected to accelerate in quarter four. Once again, notwithstanding the weak demand for staff difficulties in recruiting suitable chefs were evident.

Logistics and wholesale

Data from the SCBS for the third quarter of 2010 indicated a rise in business confidence amongst logistics respondents with a net of respondents reporting an increase in activity, especially local deliveries and storage. 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 no respondents reporting a rise in business confidence. Overall net sales trends weakened during the three months to September although 19% reported rising and 44% level sales; however almost two thirds anticipated a decline during quarter four.

Almost all SCBS wholesale respondents reported pressures to raise prices, as respondents report rising transport costs and

supplier prices. Wholesalers have revised their expectations downwards for both turnover and profitability over the coming year; more than half of respondents now expect both to decline. Wholesale respondents reported no change to investment intentions plans, nevertheless there was a net decline. Fewer than 20% sought to recruit staff, compared to more than 50% in the previous quarter. No responding firms increased pay during quarter three.

Cost pressures

Whilst there are marked differences between the surveys in terms the latest trends in optimism, orders, investment and employment there is much more agreement in terms of rising cost pressures. In the latest SCBS survey manufacturing and service firms reported rising raw material/suppliers prices and transport costs and construction firms reported pressures on tender margins and rising costs. In the SCBS survey more than 80% of manufacturing, 94% of wholesale and 78% of retail respondents reported pressures to raise prices due to rising raw material/suppliers' prices. 94% of wholesale, 42% of manufacturing and 42% of retail respondents reported rising transport costs.

The September PMI report and CBI survey likewise noted that higher raw material, wage and wholesale food costs were all reported to have contributed to another monthly rise in average input prices. Despite the increase, the latest figures indicated an easing in cost inflation to a nine-month low. Scottish firms raised their average charges during September in response to higher input prices, as has been the case in seven of the past eight months.

Pay and employment

Generally over the last 6 months labour market activity has remained subdued, in even the Scottish Engineering's quarterly review, the most optimistic of surveys, less than a third reported changing employment levels. The CBI likewise reported a modest increase in employment but expects no change in the fourth quarter.

Pay increases ranged from 1.5% in construction to 3.2% in manufacturing, and generally wage increases remain at historically low levels. The September PMI reported that despite recording a fall in activity, Scotland's private sector firms raised employee numbers. Job creation in Scotland was only marginal although it was sharper than the rise recorded at the UK-wide level. According to the PMI rising employment has now been recorded in nine months of the past year. In September, it noted that rising flows of new business had driven the increase in employment, although anecdotal evidence indicated that this may have reflected rising demand for temporary workers.

Latest data from the Bank of Scotland Report on Jobs has indicated that conditions in the Scottish labour market remained challenging in August. The number of workers placed in permanent job roles fell for the second successive month, whilst growth of temp billings weakened to the lowest level since September 2009. This was due to weaker trends in demand for workers for both long- and short-term jobs.

Outlook

The SCBS, Scottish Construction monitor and SRC-KPMG drew attention to the impact of the forthcoming public sector spending cuts as contributing to a decline in business confidence and leading firms to expect a further weakening in demand and activity. They note that the decline in capacity utilisation and trends in work in progress is slight but respondents fear, in the current uncertain climate, a further deterioration in the fourth quarter and in 2011. Activity in construction is set to remain weak, but the expectations for the year ahead are more depressed than in previous quarters. In the service sector consumer confidence continues to remain weak and retail sales trends remain flat. Activity and occupancy in tourism was only slight down on the averages for the third quarters of previous years, but there are some signs of weakening demand for conference/function as well as bar/restaurant facilities.

In construction and in the service sector the trends for the fourth quarter of 2010 and for the next two to three years are seen to be shaped by the reductions in public sector expenditure, employment, rising cost pressures, energy prices and VAT increases. In contrast the CBI and Scottish Engineering see export orders rising and leading a more general growth in manufacturing demand. However, disentangling this growth from an evident period of restocking leads to some uncertainties as does the extent to which there will be sustained growth in international markets.

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

The Confederation of British Industries Scottish Industrial Trends Survey for the third quarter 2010;

Lloyds TSB Business Monitor 51 for the quarter June – August 2010 and expectations to February 2011;

Scottish Engineering's Quarterly Reviews for the second and quarters of 2010;

The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Index for July, August and September 2010;

The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitor for August and September 2010;

The Scottish Chambers of Commerce Quarterly Business Survey, reports for the second and third quarters of 2010; Oil & Gas UK quarterly Index quarter 2 2010;

Visit Scotland Occupancy Survey July and August 2010; The Scottish Construction Monitor quarters 2 and 3 2010.