Review of Scottish Business Surveys

Overall

Overall demand remains weak and a number of Q1 surveys took the view that the Scottish economy was stagnating and bumping along the bottom of the recession, however May survey data indicated that there was more of an emerging sense of a recovery and that that the worst of the recession is over, but that the recovery will be slow.

Once again activity in the oil and gas sector was the strongest. The Ernst & Young's review of the oilfield services sector suggested strongly rising orders, revenue and employment in 2012, and this was echoed by the Oil & Gas UK's quarterly index and annual Activity Survey 2013. The latest Scottish Engineering Survey (Q2 2013) reported slightly rising confidence and orders, more so for metal manufacturing, machining and transport; and the latest monthly hotel occupancy survey reported higher occupancy levels than a year ago. In contrast the first Scottish Chamber' Business Survey (SCBS) of 2013 showed that whilst the Scottish economy essentially remained weak, there was a further rise in manufacturing optimism. Confidence among SCBS construction firms was less downbeat than in previous quarters and there was an unexpected modest rise in tourism confidence. Retail remains problematic for the Scottish economy with like for like sales declining by 3.0% in April, according to the Scottish retail consortium. Business sentiment among SCBS wholesale and retail firms however failed to improve with the weakness in consumer demand threatening to delay any economic recovery. The latest Business Monitor from Lloyds TSB Scotland for the three months to February 2013 indicated a marginal improvement in the Scottish economy as 29% of the firms surveyed increased turnover, 37% experienced static turnover and 34% experienced a decrease; the resulting overall net balance of -5% was an improvement from the -10% of the previous quarter and the -6% of the same quarter one year earlier.

Oil and gas services

The revival of the oil and gas sector in the UKCS continued with rising confidence, investment and activity. The UKCS is now benefitting from record investment in new developments and improvement to existing assets and infrastructure, the strongest for more than three decades' (OGUK 2013:3). Strong prospects for the UKCS were also highlighted in the latest Scottish Enterprise's UKCS Spends and Trends and by most industry analysts. Underpinning the rising confidence and activity have been a series of tax changes.

The oilfield services sector likewise recorded growth in optimism, output and employment. Ernst & Young's Review of the Oilfield Services sector suggests an increase of 6,000 employees in 2011 and an increase of 17% in revenues.

Oil and gas production has declined considerably over the past two years, due in part to adverse tax changes in the mid-2000s. As Oil & Gas UK note, it would be wrong to expect any immediate upturn in production, but by 2017, production is expected to rise to approximately two million boepd. (Oil & Gas UK 2013:4).

The Aberdeen city and Aberdeenshire labour markets continue to outperform both the Scottish and UK figures, with unemployment in Aberdeenshire at 3.4% compared to 7.9% in Scotland. The activity rate in Aberdeenshire is 9.3 percentage points higher than the Scottish figure. In terms of job quality and income the North East continues to outperform the Scottish figures. (ONS Dec 2012)

The importance of the oil and gas sector to the UK and to Scotland was evident in the publication of two major strategy papers: (1) HM Government's UK Oil and Gas, Business and Government Action, and (2) Oil & Gas Industry Leadership Group, co-chaired by the Minister for Energy, Enterprise and Tourism, the Scottish Government and the chairman of the Imes Group.

The latest Aberdeen Chamber Oil and Gas Survey (No 18 Spring 2013) noted that recent changes to tax allowances coupled with rising international demand had contributed to operators reporting rising total activity in 2012. 60% of operators anticipate increased activity and 40% a level trend in total activity in 2013. In 2012 80% reported rising production related activity in 2012, and 40% anticipate increasing production related work in 2013. The extent of working at or above optimum levels provides further evidence of the rising levels of activity both in the UKCS and internationally. In the Spring 2013 survey all operators reported working at or above optimum levels in 2012 and 75% at or above optimum levels in respect of international based activities.

Private sector

The February PMI stated that ‘the health of the Scottish private sector economy continued to improve’. Results indicated growth in both business activity and inflows of new work, which in turn contributed to further job creation. There was a rise in costs pressures leading to a slight increase in average output prices over the month. The index climbed to an eight-month high of 52.5, from 52.3 in January. This indicated a further expansion in private sector business activity, and extended the sequence of growth to five months. As was the case in January, Scotland registered a sharper increase in output than the UK as a whole. The March PMI data from the Bank of Scotland showed that growth of private sector activity north of the border had slowed and that the level of new business rose at a slower rate. Job creation however, strengthened and was the most marked in eight months. Amid rising fuel costs and weakness in sterling, input price inflation was sharp, although firms generally absorbed these higher cost pressures as charges were virtually unchanged. The private sector economy expanded modestly in March, and at a slower rate than in each of the previous three months. The index for March was 51.1, down from 52.5 in February. Growth was underpinned by a further, albeit slower, rise in service sector business activity and factory output down marginally on the month. The April PMI data showed an increase in business activity and new work. Companies reported creating more jobs, with employment rising at the fastest pace in nine months. Input price inflation eased from the peak in March, although cost pressures remained high enough to lead to an increase in output prices. The index rose to a 12 month high of 53.1 in April, from 51.1 in March, suggesting a solid increase in private sector business activity in Scotland. The expansion was broad-based by sector, with a rise in growth in factory output and in service sector activity. The index showed that Scotland outperformed the UK as whole.

Production

Respondents to the LloydsTSB Scotland Business Monitor showed that the overall net balance of turnover for firms in the production sector in the three months to end of February 2013 was +2%. This was a slight improvement on the +1% of the previous quarter but identical to the +2% of the same quarter one year ago. Overall total volumes of business improved in the first quarter with a net balance of -6%, (a rise from -10% in the previous quarter); the improvement however, was less evident among production firms (+1%) compared to +3% of last quarter. Production firms appeared to be more optimistic than service firms and showed an overall net balance for turnover for the next six months at +10% compared to -4% for service firms. Expectations for cost increases showed a slight increase. Concerns over credit availability fell for all firms as did concerns for credit costs, however production firms were more concerned about credit availability and credit costs than service firms.

Manufacturing

During the first quarter of 2013 business confidence continued to improve for a net of 18.6% of SCBS manufacturing firms compared to a net balance of +1.1% in the previous quarter and to +14.3% in Q1 2012. Similarly respondents to the Scottish Engineering Quarterly Review for the three months to the end of March 2013 reported that optimism remained generally positive, but the level of optimism remained similar to the final quarter of 2012.

A net balance of 4.6% of SCBS firms reported a rise in total sales; better than the previous quarter (-1.2%) but down on the same quarter of 2012 (+14.3%). Respondents are fairly optimistic as to the trends in orders for the second quarter of 2013 (+16.7%). Scottish Engineering respondents reported that total orders declined following a rise in the final quarter in 2012. Within the engineering sectors only machine shops and transport reported positive trends. Average capacity utilisation declined by one percentage point for SCBS firms and was also down on the same quarter of 2012. More than half of firms reported working below optimum levels.

Turnover is expected to rise for a net balance of SCBS firms (+18.8%). The net trend in profitability (+5.9%) is also expected to rise over the coming year. The trends in investment in plant/machinery declined for a net balance of manufacturing respondents (-3.6%). New investment continues to be directed towards replacement (32.5%) or to improve efficiency (39%).

During the first quarter of 2013 a net balance of SCBS firms reported a decline in total employment levels (-8.3%) although around two thirds continued to report no change to overall levels. A third of firms increased pay during the three months to March and the average increase was 2.9%. 42% reported seeking to recruit staff compared to 48% in Q4 2012, and a third of recruiting firms reported difficulties. Employment levels continued to improve for small and medium Scottish Engineering companies but not for large companies; fabricators and metal manufacturing reported shedding staff while the oil & gas sector continued to grow.

Construction

The decline in business optimism among SCBS construction firms eased further during the first quarter of 2013 (-10.7%) compared to the previous quarter (-25.8%) although around two thirds of firms continued to reported a rise/no change to optimism levels. The trend in total new orders/contracts continued to ease for a net balance of -3.5% in the first quarter of 2013. No net change is forecast for Q2. Capacity utilisation rose from 79.4% to 83.7%, the highest average level since the second quarter of 2008. Public sector (-8.3%) and domestic/house build orders (-16.6%) continued to decline however there was an unexpected rise in private commercial orders (+7.4%). Cash flow trends continued to decline (-28.6%). Turnover (-7.1%) and profitability (-21.5%) are still expected to be weak over the next 12 months together with continued pressure on margins. Half of responding firms expect tender margins to worsen during the coming year.

The downward trend in employment unexpectedly ended with a net of 10.7% of SCBS firms reporting a rise in total employment levels in Q1, although the upward trend is expected to be a temporary one with a net of 4.5% forecasting a decline in Q2 2013. Recruitment activity rose (from 38% to 44%) as did recruitment difficulties (from 15% to 27%). Average pay increases rose from 2.3% in Q4 2012 to 2.6%. The latest figures from the Annual Population Survey indicate that the Scottish construction sector has lost an estimated 62,500 jobs since 2008, including 14,500 in 2012.

The main findings from the Scottish Construction Monitor conducted by the Scottish Building Federation indicated that Industry confidence eased four percentage points rising from -28% to -24%. Despite this rise, the overall level of confidence within the industry remained negative as just under half of firms reported being less confident about their future prospects compared to only one fifth who were more confident.

This latest survey focussed on the issue of late payments and found that almost four out of every five construction firms responding to the survey have been affected by late payments in the past year. The survey reported that late payments appeared to be an issue predominantly affecting private sector repair and maintenance, private sector house building, and private commercial activity although a quarter of firms also report problems with late payments from public sector repair and maintenance. The main findings were that 57% of construction firms had been forced to write off unpaid invoices over the past 12 months with the value of these invoices ranging from less than £500 up to £50,000 and the results indicate Scottish construction firms have written off invoices with an average value of £5,931.25 over the past 12 months.

Wholesale and logistics

Business optimism amongst Scottish Chamber of Commerce wholesalers declined (-43.7%) to the lowest level since the final quarter of 2011. Only 6% of firms reported an increase in business confidence. Once again the downward trend in sales (-18.7%) was worse than expected from the previous survey with fewer than a fifth reporting an increase in sales; a net balance expect the decline to continue (-14.3%) in the second quarter of 2013.

Three-quarters, compared to 80% in the previous Scottish Chambers' survey, of wholesalers continued to report increased pressures from transport costs. Firms remain under pressure from raw material costs (62.5%), pay settlements were cited as a pressure for 25% of firms. More than half of firms (62.5%) expect to increase prices over the next three months. A net balance of firms expect a fall in both turnover (-31.3%) and profitability (-31.2%) over 2013. Slightly fewer than half (43.8%) of firms reported no change to investment plans; nevertheless the decline continued (-18.7%).

SCBS wholesale respondents, as expected, reported a net decrease in overall employment levels during the first quarter of 2013 (-6.3%) and a net balance expected to shed staff in the second quarter (-12.5%). Over a third sought to recruit staff (37.5%); largely for replacement. The average pay increase in Q1 was 3% compared to 3.1% in Q4 2012.

Retail distribution

Sales trends remained relatively flat. The latest Scottish retail sales index (Q1 2013) noted that retail sales volumes grew by 2.0% (2012 Q1 on 2013 Q1). The value of Scottish retail sales, without adjusting for inflation, during the first quarter of 2013 increased by 0.6 per cent from the previous quarter, and grew by 2.5 per cent annually (2013 Q1 on 2012 Q1).

The low levels of business confidence among SCBS retailers continued through the first quarter of 2013 (-45.2%) but although the net balance remains negative it was less severe than the decline reported in Q1 2012 (-62.8%). The negative trend in overall sales continued, although eased marginally from -37.3% in Q4 2012 to -35.9%, however 60% of retailers reported a decline in the total value of sales during the first three months of 2013. Only 11.9% reported and only 5.1% expect increased sales, as continuing concerns over consumer confidence remain evident.

Cost pressures remain historically high and continued to increase in the first quarter of 2013 for SCBS firms. Utility costs and raw material prices continued to be of particular concern. Pressures on margins remain widespread with more than half of firms forecasting declining profitability (59%) and slightly fewer than half (47.6%) expect a decline in turnover during the coming year. Labour market activity continued to decline with only 4.9% reporting an increase and none expecting an increase in overall employment levels. A fifth of firms reported increasing pay, and the average increase rose marginally from 2.3% to 2.4%.

The Scottish Retail Consortium SCR reported that sales on the high street declined by 2.1% in April; like-for-like sales fell by 3%. The SRC blamed the cold weather and an early Easter for the decline. Food sales saw their biggest fall since January 1999 although retailers insisted this was due to the early Easter. The latest figures, from the SRC/KPMG retail sales monitor, showed total food sales were down 1.4% on 12 months ago, with like-for-like food sales down 2.7%. Non-food sales fell by 2.7% and like-for-like non-food sales declined by 3.3%.There was an increase in sales of clothing and footwear in Scotland during April compared with March, but not as much as in the rest of the UK where the weather was better at the end of the month.

Tourism

Business confidence rose for a net balance of SCBS hotels (+2%) in the first quarter of 2013 (the first rise for six quarters). Slightly fewer than half of firms reported no change (42%). A net balance of 14% reported a fall in visitors during the three months to the end of March; and a net balance of 6.7% anticipate a decline in the second quarter of 2013. The trend was not as depressed as had been expected by respondents from the previous survey.

Average occupancy declined from 60.4% to 59.6% amongst SCBS responding hotels although this average was up compared to Q1 2012 (53.0%). During the first quarter of 2013 trends in bar/restaurant trade and conference/function facilities declined and are expected to continue to decline. A net balance (-39.2%) reported a decline in the average daily room rate, although the downward trend is expected to ease with -8.9% expecting a further decrease in room rates in Q2 2013. 63% reported the lack of tourist demand as the primary business constraint. Competition, poor transport infrastructure, high fuel costs and weak marketing of the area also remained a concern to hotels.

The Scottish Hotel Occupancy Survey (February 2013) conducted by Visit Scotland reported a rise of 11 percentage points in room occupancy and a rise of 6 percentage points in bed occupancy. The only regions reporting a decline in room occupancy were Dundee & Angus and Forth Valley. Only the main urban centres of Aberdeen/Grampian, Edinburgh/Lothians and Glasgow & Clyde had above average occupancy rates.

More than half (56.3%), compared to only 12% in the previous quarter, of SCBS hotels sought to recruit staff. Although employment trends continued to decline, the decline was less steep than had been forecast. A net balance of 8.7% expect a rise in total employment levels in the second quarter of 2013.

Outlook

The most recent surveys suggest signs of an emerging but weak and tentative recovery together with some growth both in the UK and elsewhere. There are more positive signs of a recovery in the United States and more encouragement to focus less exclusively on austerity in the Eurozone, but at present these developments are reflected more in increased confidence than orders.

UK manufacturing (PMI trends for May) reported an improving situation, and the latest Scottish Engineering quarterly survey reported rising orders across a number, but not all, sectors and the continuing high levels of capital expenditure and activity in the UKCS will stimulate the UK oil and gas supply chain.

The latest PMI survey evidence for UK construction suggests signs of a pick-up in housing and anecdotal evidence in Scotland suggests signs of both modest increased house building activity and of increased architectural and design work.

Inevitably household consumption remains constrained, given continuing pay restraint and the widened sense of job insecurity and this continues to impact on the retail sector. Nevertheless, latest data from Visit Scotland's monthly occupancy survey suggests better trends than last year, albeit with widespread discounting together with some signs of an improvement in business and conference tourism.

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

1. *Oil & Gas UK Index Q 3 2012*
2. *Deloitte Petroleum Group Drilling Activity Q4 2012*
3. *PwC Drilling Activity*
4. *PwC Shale Oil: the next energy revolution*
5. *Lloyds TSB Business Monitor Issue December 2012 –February 2013;*
6. *Scottish Engineering's Quarterly Review Q1 and Q2 2013;*
7. *The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for February – May 2013;*
8. *Lloyds TSB England Regional PMI for February – April 2013;*
9. *The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors for February - April 2013.*