# Review of Scottish Business Surveys

## Overall

Signs of a modest improvement in the Scottish economy were evident in the more recent PMI reports, and in the Scottish Engineering report for Q 4 2012, and were more strongly evident in the Oil & Gas UK index (and commercial surveys as to UKCS drilling activity) but were less evident in other surveys. Whether or not the more recent monthly surveys are picking up signs of a recovery, whilst the quarterly surveys tend to reflect the weaker conditions through the fourth quarter, is uncertain. Nevertheless, the quarterly surveys suggest some signs of a slight improvement looking forward to Q1 2013. However, there is more agreement as to the increased activity in oil and gas sectors and it is likely that this is having a spill over effect into Scottish engineering.

Quarterly surveys (Lloyds TSB and Scottish Chambers) reported the Scottish economy remaining essentially weak during the final quarter of 2012 although there was an unexpected rise in manufacturing optimism for Scottish Chamber of Commerce (SCBS) respondents (and this echoes Scottish Engineering's report for Q4 2012, but would suggest some improvement in Q4 on the latest official export data). The outturn in all SCBS sectors in Q4 remained weak and the trends, although remained negative, generally eased. Business sentiment remained historically weak with only 19% of manufacturing, 13% of tourism, 10% of construction and 6% of retail respondents reporting being more confident than in the third quarter. In contrast 18% of manufacturing, 36% of construction, 47% of retail and 36% of tourism respondents reported being less confident as to the general business situation. In all sectors the main trends in activity remain negative although the downward trends eased slightly, more so in manufacturing and construction, prolonging the sense of weak, stagnating demand and continuing negative growth continuing into 2013.

The latest Lloyds TSB Scotland Business Monitor showed the Scottish economy stagnating in the three months ending November 2012. The Business Monitor noted the Scottish economy starting to slow in the second half of 2008. Following the worst ever result at the end of 2008, there had been a gradual improvement until the early part of 2010 leading to a recovery in the middle of the year but this was followed by a relapse in growth in early 2011 largely attributed to severe winter weather. The spring 2011 Business Monitor suggested a return to growth but the summer and autumn Monitors suggested the economy stagnating, with neither an improvement in the rate of recovery nor a return to recession. The summer and autumn 2012 Monitors again showed the economy stagnating. This latest Monitor shows this trend continuing in the three months ending November 2012, but expectations improving for the next six months. The latest survey showed that the overall net balance for turnover was -10%; a deterioration from the -3% of the previous quarter and the -3% of the same quarter one year ago.

## Oil and gas services

Both internationally and domestically the outlook for the oil and gas sector in 2013 remains positive. The on-going interest and potential of shale reserves continues to influence both national energy policies and the global oil market, and interest in potential shale gas reserves continues to grow in a number of European countries, with signs of more interest as to the possibilities in the UK.

The latest available Oil & Gas UK quarterly index (Q3 2012) together with PwC and Deloitte's review of drilling activity (Q4 2012) all indicated rising drilling activity (up by a third) reflecting the 2012 tax changes, continuing demand and high oil prices. However, Oil & Gas UK noted concerns as to continuing skill shortages and rising costs limiting increases in business confidence. Nevertheless, M & A activity remains at a high level and a number of major investments have been announced by both major and independents. The 2013 Activity Survey (published 25$^{th}$ February) reported investment at the highest levels for thirty years, reflecting UK tax changes aimed at encouraging growth in the sector. Investment rose to an estimated £11.4 billion in 2012 and is expected to rise to £13 billion in 2013. Production fell to 1.55 billion boe per day in 2012, down by 30% from 2010, but some upturn is anticipated over the next three to four years, given a continuation of the current fiscal and regulatory regime.

## Private Sector

The Bank of Scotland Purchasing Managers Index (PMI) for the period November – January reported consistently rising trends. The index fell in November to 50.3, but rose in December to 51.2 and rose again in January to 52.3. Trading conditions were described as 'challenging' in November, on a 'sound footing' at the end of 2012, and 'gaining momentum' in January 2013. There were some signs that the upward pressures on costs abated slightly in January, when output and new work increased at a faster rate than previously in the Scottish private sector. Once again the growth in new business and employment was concentrated in the service sector, and the rate of decline in manufacturing was modest and declining. The rise in manufacturing export activity, noted in the PMI for December, has yet to be reflected in any significant signs of growth.

In comparison to the rest of the UK the Lloyds TSB England Regional PMIs for December 2012 and January 2013 indicated that activity was slightly higher than the English average, stronger than the north of England regions, and on a par with London. Significantly the index improved for all regions in January, with the exception of West Midlands.

## Production

The Lloyds TSB Business Monitor for the three months to the end of November 2012 showed the net balance of turnover for production firms at +1%; a slight improvement on the -2% of the previous quarter but significantly down on the +9% of the same quarter one year ago. Production firms were generally more optimistic than service firms with production firms showing an overall net balance for turnover for the next six months at -2% compared to -8% for service firms. The Business Monitor reported concerns over credit availability particularly for production firms however the importance of credit costs fell for production firms. The Monitor also indicated that the sterling exchange rate continued to be of more concern to production businesses than service businesses.

## Manufacturing

Business confidence improved during the final quarter of 2012 with a net balance of 1.1% of SCBS firms reporting increased confidence levels compared to -22% in the third quarter; business optimism also improved compared to the same period of 2011. Likewise Scottish Engineering members overall reported a rise in business optimism although negative trends were reported by large and medium sized firms.

During the three months to the end of December a net of 1.2% SCBS firms reported a decline in orders compared to -18% in Q3, the trend in total new orders declined by much less than had been forecast in the previous survey. Respondents are also less cautious as to the trends in orders in the first quarter of 2013. Average capacity utilisation improved although was down on the same quarter of 2011. Around half of SCBS manufacturing firms reporting working below optimum levels. Turnover is expected to rise for a net balance of firms in 2013. The net trend in profitability is also expected to rise over the coming year.

An improvement in orders in Q4 2012 was reported by Scottish Engineering firms, small and medium companies reported positive results while large companies showed equal numbers of companies reporting a drop in orders as reporting an increase. Within the sectors, electronics and mechanical equipment were buoyant in contrast to metal manufacturing and fabricators, although the trends remained weak.

The trends in investment in plant/machinery improved slightly during quarter four for a net balance of manufacturing firms in the SCBS although new investment continued to be directed towards replacement or to improve efficiency. Scottish Engineering firms also reported positive investment trends in the final quarter of 2012.

A net balance of SCBS firms reported a rise in total employment levels although around two thirds continued to report no change to overall levels. A quarter of firms increased pay during the three months to December and the average increase was 3.4%. 48% reported seeking to recruit staff, and difficulties remained limited. Scottish Engineering respondents also reported positive employment trends (notably for small and medium sized firms) and respondents to this survey also noted a rise in overtime working during the three months to the end of December 2012.

## Construction

Business confidence weakened further in the fourth quarter for SCBS firms with more than 90% of construction firms reported no change or a decline in confidence levels and only 9.7% reporting a rise.

The latest Scottish Construction Monitor, a quarterly survey of employers in the Scottish construction industry carried out by Scottish Building Federation reported that confidence had subsided for the fourth consecutive survey period to -40%. Confidence fell by 34 points in 2012 to three points below where it was in the third quarter of 2010. More than two-thirds of all respondents were less confident about the prospects for their business in the year ahead compared to the preceding 12 months.

The trend in total new orders/contracts unexpectedly eased in the final quarter of 2012 for a net balance of SCBS firms; capacity utilisation rose to 79.4% to the highest average level since the second quarter of 2008. The downward trend in new SCBS orders eased from all sources although the stronger downward trends are forecast to resume early in 2013 and of any new orders/contracts awarded in recent months, two thirds reported that tender margins had worsened.

Cash flow trends continued to decline with only 3% of SCBS firms reporting an improvement. Turnover and profitability are still expected to be weak over the next 12 months together with continued pressure on margins. Almost 90% reported a desire for new orders/contracts.

The downward trend in employment continued in Q4 for a net of SCBS firms and although the downward trend eased it is forecast to be a temporary improvement. Recruitment activity among SCBS respondents rose as did recruitment difficulties; average pay increases rose from 2.0% in Q3 to 2.3%.

Problems with the current public procurement policies were highlighted in the Scottish Construction Monitor survey which asked a series of questions around public procurement and found that Scottish construction firms are spending considerable sums on unsuccessful public procurement bids. They reported that each pre-qualification questionnaire completed had only a one in thirty-six chance of securing new work. Another key finding was that almost two thirds of small construction firms say they have opted out of public procurement entirely over the past three years because the costs are so prohibitively high, anecdotal evidence from professional firms allied to construction echoes this trend. The survey found an average of more than three out of every four pre-qualification questionnaires completed by construction firms for public tenders failed to secure them a place on the tender shortlist. Even when shortlisted, an average of seven out of every eight tender submissions was unsuccessful.

UK construction firms reported a continuing fall in output levels in January (Markit/CIPS Construction PMI), reflecting weakening volumes in housing and civil engineering activity, although improved business confidence as to the outlook for business activity over the next twelve months was noted, although this may reflect hopes of an upturn in public sector investment spending.

## Logistics and wholesale

Once again, business optimism amongst SCBS wholesalers continued to decline with slightly fewer than 12% of firms reporting an increase in business confidence; business confidence also remained more depressed compared to one year ago. The downward trend in sales was worse than expected from the previous SCBS with fewer than a fifth reporting an increase in sales; a net balance expect the decline to continue, though ease, in the first quarter of 2013.

Around 80% of SCBS wholesalers continued to report increased pressures from transport costs and more firms are now under pressure from raw material costs compared to previous quarters. Pay settlements were cited as a pressure for almost 30% of firms. Fewer than half of firms expect to increase prices over the next three months. A net balance of 5% of firms expect an improvement in turnover. Once again most firms reported no change to investment plans; nevertheless the decline continued. SCBS Wholesale respondents, as expected, reported a net decrease in overall employment levels during the fourth quarter of 2012 and a net balance expected to shed staff in the first three months of 2013. Over a third sought to recruit staff; largely for replacement.

## Retail distribution

Official data (ONS Retail sales - UK wide) and Scottish household expenditure suggest little improvement in retail activity. UK data indicates the rise of internet based sales now accounts for 3.7% of all food sales and 10.1% of all retail spending excluding fuel. Overall food stores saw a decline of 2.6% in the quantity purchased and an increase of 0.9% in the amount spent. Predominately non food stores saw a 1.7% increase in the quantity of goods bought and a 0.8% increase in spend compared to January 2012. In contrast department stores witnessed an 8.8% increase in the quantity bought and a 6.5% increase in spend.

Weak business confidence was widely reported by SCBS retail respondents in Q4 2012, although the trends were not as weak as in Q4 2011. Only 13% of SCBS respondents expect increased sales, as continuing concerns over consumer confidence remain evident, and in common with the ONS data the SCBS data reported smaller retail firms reporting weaker trends than larger ones.

Like the Bank of Scotland PMI, The Scottish Retail Sales Monitor (SRSM) conducted by the Scottish Retail Consortium and KPMG reported improving trends through November 2012 to January 2013. In December total Scottish sales increased by 1.5% compared with December 2011, when they had risen by 1.6%. The 1.5% increase was driven by non-food sales, which recorded their best performance since March 2011. Like-for-like sales also increased, by 0.3% on last December, when they had increased by 0.4%. But when taking account of shop price inflation at 1.5%, December total sales were flat in real terms. The SRSM reported January sales as being 2.1% higher than a year ago, but recognised that sales were particularly low in January 2011. Given continuing pressures on household budgets reports the retail sector continues to face continuing problems with more distressed sales and closures featuring through the year.

Further evidence of the changing retail landscape is highlighted in the latest PwC and Local Data Company analysis. This reported 353 store closures and 276 store openings in Scotland in 2012, with discounters, charity, payday loan and coffee shops increasing in numbers and declines in the numbers of card, computer, clothes and sports shops, together with reduced numbers of banks and travel agencies. Cost pressures remain historically high in the SCBS survey and generally increased in the final quarter of 2012. Transport costs and utility costs continued to be of particular concern. Pressures on margins remain widespread with around half of firms forecasting declining profitability and turnover during 2013.

Labour market activity continued to decline among SCBS firms with only 4% reporting or expecting an increase in overall employment levels. A quarter of firms reported increasing pay, and the average increase declined from 3.4% to 2.3%.

## Tourism

Among SCBS tourism respondents the decline in business confidence continued during the final quarter of 2012 (-23%) although optimism levels were not as depressed compared to Q4 2011 (-45%). Slightly fewer than half of hotels reported a fall in visitors during the three months to the end of December; and a similar number anticipate a further decline in the first quarter of 2013. The trend was not as depressed as had been expected by respondents from the previous survey.

Average occupancy declined from 68% in Q3 to 60% for SCBS hotels although was slightly up on the same quarters of 2011 (57%) and 2010 (56%). In Q4 2012 the trends in demand for bar/ restaurant trade and conference/ function facilities continued to decline. In the three months to the end of December the pattern was one of extensive discounts and seasonal closures. These ‘special offers’ seem set to continue with a net balance of 22% expecting to decrease room rates in Q1 2013. The Visit Scotland Scottish Occupancy Survey for November 2012 showed that occupancy rates remained unchanged from

November 2011 with bed occupancy remaining at 42% and room occupancy remaining at 60%, although the overall figures concealed better room occupancy rates in 2012 compared to 2011 in Aberdeen/Grampian, Edinburgh/Lothians, Borders, Ayrshire and Glasgow/Clyde and weaker trends elsewhere.

More than 80% of SCBS hotels reported that the lack of tourist demand remained the primary business constraint. Competition, poor transport infrastructure, high fuel costs and weak marketing of the area also remained a concern to hotels. Only 12% of hotels sought to recruit staff and employment trends, as forecast, continued to decline. Little change is expected through the first quarter.

## Outlook

Scottish manufactured exports rose by 0.8% in Q3 2012, after three quarters of negative growth, and export levels remain around 10% below their pre-recession level. The decline in engineering exports ended (Scottish Engineering Q 4 2012), although no real improvement is forecast for Q1 2013, apart from large firms. Likewise SCBS manufacturing respondents remain cautious as to improvements in export orders in the first quarter of 2013. SCBS construction respondents reported better than anticipated trends, and again there is some anecdotal evidence of rising activity amongst smaller firms at the front end of the sector. However the trends in retail and tourism remain generally weak, with widespread price cutting and discounts coupled with closures. The SCBS Q4 2012 survey concluded that the downward trends are beginning to ease with fewer firms now reporting or forecasting further declines, and the majority are now reporting either no change or an increase. However, the trends, with some exceptions, most notably oil and gas related manufacturing, are largely unchanged from a year ago, and are indicative of below trend growth continuing and of an economy bumping along the bottom of a recession rather than any substantial sense of a real recovery. The 'age of austerity' seems set to continue for a further year.

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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 September – November 2012;*
6. *Markit/CIPS UK Construction PMI for January 2013;*
7. *Scottish Engineering's Quarterly Review Q4 2012;*
8. *The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for November, and December 2012 and January 2013;*
9. *Lloyds TSB England Regional PMI for December 2012 and January 2013;*
10. *The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors for November, and December 2012 and January 2013.*