Review of Scottish Business Surveys

Overall

Increasingly surveys of Scottish business, in common with UK and European surveys, have highlighted the continuing and deepening concerns as to the sovereign debt crisis in the Euro zone. These, together with growing fears of recession coupled with more signs of a slow down both in the UK and internationally, forecasts of lower rates of growth in 2012, consumer insecurity, pressures on household spending, rising energy costs and continued difficulties in obtaining finance have all contributed to a dampening of business confidence and activity.

However, the Scottish Engineering Review (Q3) retained a positive outlook, as did the Oil and Gas UK Quarterly Index (Q2), albeit more modestly and with more reservations it noted the announcement of a substantial investment and 'the Government's apparent willingness to engage with companies to lessen the negative impacts may have reassured companies and resulted in a slightly more positive outlook'.

Notwithstanding the deepening economic concerns the most recent occupancy rates as reported by Visit Scotland Scottish hotel occupancy surveys (July and August 2011) suggest average bed and occupancy rates were slightly better than in the same months in 2010 and 2009, and business remained quite confident. In contrast whilst Scottish Chambers hotel respondents reported declining business confidence, demand was still rising and occupancy rates better than in the previous year.

A sense of a slowdown in activity, noted earlier in other business surveys, was more evident in the latest CBI Industrial Trends (Q3), Bank of Scotland Scottish Job market (September) and PMI report (for September 2011) which reported a further moderation in Scottish private sector growth due to a fall in new business. It reported a fall in employment levels for the second consecutive month in the private sector, due mainly to job shedding in the service sector offsetting rising employment in manufacturing. As the Scottish Engineering Quarterly Review (q3) noted ' whilst our level of optimism remains high, our sector realises that in the longer term we are not immune to the effects of uncertainty associated not only with the Euro zone but also with the USA'.

Cost inflation continues to feature as an increasing business pressure, being noted by the PMI, Scottish Chambers, and Scottish Retail Consortium surveys.

Oil and gas services

Internationally prospects are positive with expectations of increased capital spending on both exploration and production with continued expansion of deep water reserves and unconventional sources. Whilst the outlook for operators and for oilfield services is much brighter than other sectors in the current international economic difficulties, macro economic uncertainties continue to pose major uncertainties as to demand and the level of activity in both the short term and medium term.

In the UKCS and elsewhere volatility in stock exchange values have been seen by some analysts as adversely affecting smaller exploration and production companies' access to capital, and this may well encourage some consolidation of smaller E & P companies in the short to medium term.

In the UK positive news as to major investments, and signs of some resilience in investment levels, contributed to a positive view of the UKCS, and one which the Government took advantage of in support of its view that the recent tax increase, announced in the 2011 Budget, would only have a marginal effect on investment trends and activity in the industry. However, in a climate of limited resources it is likely that the unannounced 'raid' on the industry together with the increase in taxation levels will, in general terms, lower the attractiveness in investment in the UKCS compared to other regions, a review endorsed in the recent report of the House of Commons Energy and Climate Change Select Committee's report noted 'It is not sensible to make opportunistic raids on UKCS producers. The Government must build a more constructive relationship if it is to restore industry confidence and maximise the benefits gained from the UKCS.'

Production

Respondents from the LloydsTSB Business Monitor (June-August 2011) reported that the overall net balance of turnover for firms in the production sector was 0%. This was worse than the +3% from the previous survey but better than the -14% reported by firms in the same quarter last year. The Business Monitor noted that expectations differ widely between sectors with production firms more

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pessimistic, although the degree of pessimism declined from the previous quarter.

Manufacturing

The Index of Manufactured exports for the second quarter of 2011 indicated that exports grew by 1.1% over the quarter and on an annual basis grew by 2%. Textiles, engineering and chemicals registered the largest rise over the quarter. Business surveys differed in their interpretation of trends, but there was more agreement in recent surveys of a slowing down in activity. The Purchasing Managers Index (PMI) conducted by The Bank of Scotland concluded that the overall growth of manufacturing output in September was better than for the service sector, although the trends new orders were weaker. More recent UK data (Markit/CIPS October) reported a substantial reduction in new order inflows with declining output, new orders and employment, this may herald weaker trends in Scottish surveys for the fourth quarter. Cost pressures for manufacturers remained similar to August levels with firms reporting sharper increases than their counterparts in the service sector. Employment prospects in manufacturing continued to look favourable during September.

The Scottish Engineering Review in its upbeat survey in September noted that 'for the first three quarters of 2011, the manufacturing engineering sector has shown remarkable resilience in the face of global economic disruption'. By and large firms in the survey remained optimistic and maintained their strong growth levels with respect to orders and output, although non metal products returned negative trends. Export trends, whilst positive, were again weaker and down from the peak reported in Q1 2011, and the rising trend in order intake remains on the positive trend for the sixth quarter, albeit at slightly lower levels. Staffing levels remain positive for the sixth quarter. But recognised that the sector is not immune in the longer term from the uncertainty in the Eurozone economies.

Similarly the CBI Industrial Trends Survey for Q3 2011 was that 'following seven consecutive quarters of growth, export orders are expected to contract in the coming three months and at their fastest pace for four and a half years. It comes as firms report that concerns over political and economic conditions overseas have risen, and which are now at their fifth highest quarterly level in 10 years'. The Survey concluded that manufacturing orders, employment and employment were all down whereas costs had increased during the third quarter.

The SCBS reported that manufacturing firms were, on balance, more pessimistic compared to three months ago. The rising trend in total new orders ended in quarter three although the upward trend in total new sales continued. The outturn in total orders was worse than had been expected however export orders continued to improve. Average capacity utilisation rose marginally to 77.7%, a little higher than a year ago. The rising trend in orders is expected to resume during the fourth quarter. Cost pressures eased marginally with half of respondents expecting prices to stabilize. Once again the net trend in turnover is expected to remain positive over the coming twelve months. Profitability, on balance, is expected to decline although the decline is set to ease with a net balance of 5% (compared to 10% in Q2) expecting a decline over the coming year.

Plans to invest in plant/machinery improved during quarter three for a net balance of SCBS manufacturing firms. New investment mainly directed towards replacement or to improve efficiency whereas R&D/expansion investment intentions remained low. Employment trends continued to rise modestly. Fewer than 15% of firms increased pay during the three months to October and the average increase was 3.3%. Recruitment activity increased further with 40% attempting to recruit compared to 23% in Q2.

Construction

The latest Scottish Construction Monitor conducted by the Scottish Building Federation members (SBF) for Q2 2011 reported an improving picture of overall confidence, but with at best a fragile recovery within the Scottish construction industry, with their latest confidence rating having risen by 16 percentage points from -22% to -6%. The survey noted however that, 70% of those completing the survey described themselves as less confident or as neither more nor less confident about the prospects for their business over the next 12 months compared to the past year. The Scottish Building Federation remain concerned over the prospects for sustainable long-term recovery in the industry.

Scottish Chambers' construction respondents noted that the strong downward trend in business confidence resumed in Q3 with business optimism as low as in Q3 2010; suggesting that the easing in the downward trend during Q2 was temporary. The outturn, in terms of new contracts, was significantly worse than had been anticipated by respondents in the previous survey. Trends in contracts from all areas declined with the most significant reduction being for public sector contracts. A net balance of firms from the previous survey had expected a rise in work in progress however the outturn was a net balance of -21%. 60% of firms reported working below optimum levels. Average capacity used, at 76.4% was two percentage points lower than Q2 although was marginally higher compared to a year ago. Turnover, tender margins and profitability over the next twelve months are expected to decline for more than half of respondents. The long-term downward trend in employment resumed in Q3, suggesting that the rise in Q2 was seasonal. Once again no recruitment difficulties were evident. Average pay increases declined from 3.9% in Q2 to 2.1%.

The service sector

The Lloyds TSB Scottish Business Monitor (June-August 2011) described the recovery in the service sector as 'muted and mild' with no overall improvement in turnover during the three months to the end of August. The survey reported that service sector respondents continue to expect a negative net balance for expectations in turnover in the six months to the end of February 2012.

Retail distribution

Recent UK retail figures from the ONS (August and September) provide a useful insight as to the issues confronting the sector. In the food sector sales values increased by 5.0% in August 2011 and continued to rise at similar rates in September, sales volumes decreased by 0.8% and prices rose by an estimated 5.7%. Interestingly in November 2006 approximately £1 in every £33 spent in retail (excluding automotive fuel) was spent on line, in August 2011 £1 in £10 spent in retail is spent on line. The implications for firms without an on line sales facility are clear. Moreover, non food sales decreased and sales fell for the smallest retail firms. The September Retail Sales Monitor saw a slight improvement over the August figures with a slight rise in non-food sales (mainly small home wares and electrical goods). However, there is much to suggest, as the Scottish Retail Consortium noted, that any growth in retail is being driven by inflation rather than an increase in sales. Widespread discounting is evident and set to continue for the remainder of the year.

The Scottish Retail Sales Monitor (August data) reported sales falling at the second fastest annual rate since 1999. Retail sales value fell by 0.7% compared to the same month a year ago and the value of non food sales was down 3.6% compared to August 2010. With food sales rising 1.4% year on year in a context of inflation of 4.5% in August suggests a decline in the volume of sales.

Scottish Chambers' retail respondents reported no improvement in conditions in the retail sector in recent quarters with weak/declining consumer confidence, flat sales trends, increasing competition, rising costs and declining margins were widely reported by SCBS respondents. The low levels of business confidence remained with more than half of firms reporting a decline. The trend in sales weakened further with 68% reporting and 72% expecting some decline in the total value of sales. Only 10% reported increased sales during Q3 2011, and once again continuing concerns over consumer confidence are moderating sales expectations for the coming quarter with only 10% of retailers expecting an overall increase. Cost pressures remain intense with over 80% reporting increased suppliers costs, 58% reporting increased transport costs. Pressure from utility costs increased from 50% to 73% of firms (reflecting recently announced price increases). Inflationary pressures remain widespread. Pressures on margins also remain widespread with two thirds expecting declining profitability and turnover over the next year. Labour market activity continues to remain at low levels with three quarters of retailers reporting no change to overall employment levels. Recruitment activity eased for the ninth consecutive quarter.

Tourism

Business confidence remained positive for respondents to the Visit Scotland Monthly Occupancy Survey (August 2011), but declined significantly in Q3 for Scottish Chambers' hotel respondents. Scottish Chambers' respondents reported increased occupancy levels (averaging 75.4% for Q3) and Visit Scotland's survey reported hotel occupancy up slightly compared to the previous two years, but a further decline in self catering occupancy. Increasing occupancy levels in the major city centres and in the islands adds support to those who see current visitor numbers bolstered by 'staycations' and shorter breaks.

During the three months to the end of September, trends in bar/restaurant trade and demand for conference/function facilities remained relatively weak. A third reported reducing average room rates and the widespread pattern of 'special offers' seems set to continue with almost half expecting to reduce room rates in Q4. Underpinning these weak trends is the lack of tourist demand, reported by 84% of Scottish Chambers' hotel respondents whilst almost a quarter noted competition and poor transport infrastructure. Recruitment activity remained widespread, but mainly seasonal staffs.

Logistics and wholesale

Data from the Scottish Chambers' Business Survey showed that business confidence amongst Scottish wholesale respondents deteriorated further in Q3 with no firms reporting an improvement in optimism. Business confidence was considerably lower compared to one year ago. Sales trends remained very weak during Q3 with the outturn worse than had been predicted by firms in Q2. Almost half of firms reported declining sales and more than half expect a further decrease. Cost pressures eased slightly during the three months to the end of September for SCBS responding firms although remained historically high. Three quarters of respondents cited transport costs and 62% cited increased suppliers costs and. Over 60% expect to increase prices over the next three months, but cash flow trends remain weak Concerns over turnover eased slightly however profitability remains low. Once again most firms reported no change to investment plans; nevertheless the net decline continued. Wholesale respondents continued to shed staff during Q3 although the rate of decline eased. Slightly fewer than a third sought to recruit staff; largely for replacement. The average pay increase in Q3 was 3.5% compared to 3.3% in Q2.

Outlook

Recent business surveys suggest a slowing down in the recovery and more concerns that the recovery may, to all intents and purposes, halt over the winter months. Continued consumer uncertainty and reduced living standards are evident in the trends in retail and tourism. Concerns as to likely events in both the Eurozone and American economies continue to adversely influence both activity and sentiment in Scotland and in the rest of the United Kingdom.

The Scottish Chambers' Business Survey for Q3 concluded 'As we noted in report for Q1 2011 'Rising price pressures and weak demand seem set to continue in the service sector, for many Scottish businesses the combination of limited improvements in turnover, rising costs, pressures on margins and declining trends in profitability will pose real problems in 2011 we see little evidence in the results for the third quarter to change this view, if anything, our concerns are greater'. Such sentiments are more widely evident although not universal in recent business surveys.

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November 2011

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 third quarter 2011;

2. Lloyds TSB Business Monitor for the quarter June 2011 – August 2011and expectations to February 2012;

3. Scottish Engineering's Quarterly Reviews for the third quarter of 2011;

4. The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for July, August and September 2011;

5. The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors August/September 2011;

6. The Scottish Chambers of Commerce Quarterly Business Survey report for the second and third quarters of 2011;

7. Oil & Gas UK quarterly Index Q1 and Q2 2011;

8. Oil & Gas UK Economic Report 2011;

9. ONS Retail sales August and September 2011;

10. Visit Scotland Occupancy Survey for July and August 2011;

11. The Scottish Construction Monitor October 2011

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