Review of Scottish Business Surveys

Overall

The effects of the harsh winter weather were a common theme in most business surveys covering the first quarter of 2011, with a number of surveys suggesting the Scottish economy to all intents stalled in the first quarter, although with some pick up in activity from February onwards.

Surveys covering manufacturing reported rising demand, activity and limited employment growth, although Oil & Gas UK noted a sharp downturn in longer term activity as a consequence of the increase in the Supplementary Tax charge in the sector.

A general theme in the surveys covering the first half of 2011 are the rising cost pressures, rising raw material and energy costs and, especially in retail and tourism the impact of inflation and consumer uncertainty on sales trends.

Surveys covering construction reported declining business optimism, pressures on margins and escalating cost pressures.

The Scottish Chambers' Business Survey (Q 1 2011) noted that once again for manufacturing firms raw material/suppliers prices (86%) and transport costs (65%) were the most widely reported cost pressures and for firms these pressures are now more evident than in previous quarters. More than three quarters of manufacturing, 93% of wholesale and 76% of retail respondents reported pressures to raise prices due to rising raw material/suppliers' prices. Firms are reporting increasing transport costs with 86% of wholesale, 65% of manufacturing and 67% of retail respondents reported rising costs.

Labour market activity remained largely subdued, although recruitment activity in construction improved. Recruitment difficulties remained at low levels. Pay increases ranged from 2.13% in wholesale to 5.4% in tourism, no construction firms reported increasing wages in the first three months of 2011.

Oil and gas services

The outlook for the UK oil and gas sector changed markedly in the first half of 2011. Without exception, all surveys published towards the end of 2010 and before 23rd March 2011 noted that oil prices were remaining on a slight upward trend and the signs were for a relatively stable continuation of the world economic recovery. Oil & Gas UK noted that the global growth in demand for energy was beginning to resume and 'every credible scenario shows further growth in demand for oil and gas over the next twenty years' (2010:4). Further evidence of rising confidence in the sector was noted in the Oil & Gas UK quarterly index (Q4 2010) which measures a combination of confidence, activity, revenue and investment. The overall index in Q4 2010 was the highest recorded since the survey began, and recorded increases across the sector, both amongst exploration and production companies and the supply chain.

In January a major report estimated that investment in the UKCS was expected to almost double, with spending expected to rise to £7.7 billion, compared with £4.4 billion in 2010 (Wood Mackenzie, quoted to the Herald 20.1.2011). Increasing recognition on the scale and value of decommissioning work, the longer term potential of offshore renewables and the application by oil and energy companies for European Union money to develop a carbon capture and storage facility (Shell UK, Petrofac and Scottish and Southern Energy) all reinforced the sense of optimism and increased activity.

The UK budget in March introduced an unexpected and potentially damaging tax increase on UKCS oil companies. Both the Chancellor and the OBR took the view that this increase would not impact adversely on either investment or activity in the UKCS. Claiming this measure was 'economically smart' the chancellor argued 'with the current oil price the prospects are for increased investment'. The OBR chairman likewise took the view 'we are assuming there is no significant effect on the investment and production profile from that change'. These views were not shared by Oil & Gas UK speaking on behalf of the industry, international and UK oil producers, investment companies, UK and international industry experts and international commentators.

The immediate reactions to the tax increase by Oil & Gas UK included seeking meetings with ministers and PILOT to outline that more frequent and unexpected tax changes potentially reduce the attractiveness of the UKCS as a location to companies choosing where to invest. It will lead to uncertainty and impact on the volume of work and long term competitiveness of the supply chain. The tax change was seen as hurried and ill informed and with little thought as to the potential impacts on

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investment and hence longer term energy supply and employment in the UK.

Evidence from the 14th Oil and Gas Survey (Aberdeen Chamber of Commerce) and OGUK oil and gas activity survey update (May 2011) indicates a significant decline in business confidence and investment plans for the future. OGUK suggest the impact of the increase in the Supplementary Charge has reduced the probability of some 60 projects proceeding. These projects have an estimated capital investment of £20 billion. 'In 20 instances decommissioning was likely to be accelerated by between 1 – 5 years' (OGUK May 2011:2). OGUK suggests this could mean a reduction in HM Treasury direct tax receipts of between £15 – 20 billion over time if the 25 most at risk projects did not proceed and employment will fall by some 15,000 over the decade. These conclusions were supported by Kemp and Stephen's analysis of the effects of the 2011 budget on fields and projects that could be developed over the next 30 years as well as on existing sanctioned fields in the UKCS concluded that there will be long term reductions in field investment and oil/gas production as a consequence of the tax increase, and that these changes will reduce incentives to pursue exploration projects and reduce the ability to finance exploration and development projects.

The additional consequences of the tax changes will be to reduce the value of assets and adversely influence decisions to commit capital, and as the North Sea becomes less attractive investment, staff and assets will increasingly flow to other regions.

However, at the time of writing this review rumours were emerging that the Government might review the Supplementary charge.

Production

The latest issues of the Lloyds TSB survey covering the period November 2010 to February 2011 and with expectations to the end of August 2011 suggested the recovery was severely interrupted and possibly stalled by the adverse winter weather. However, it suggested 'the recovery from recession is likely to resume with expectations for the next six months at their highest level for three years. Forward looking indicators in the Business Monitor show the economy growing in the first half of this year. For the six months to August 2011 there are more firms (32%) expecting an increase in turnover compared to those (26%) expecting a decrease, indicating a return to growth from the weather affected last three months of last year'.

The Business Monitor noted that cost pressures remained high and increasing in the Scottish economy. The overall net balance of production businesses experiencing cost increases in the last three months is +66%, up significantly from the previous quarter and from the same quarter one year ago. Expectations for cost increases remain stubbornly high among production businesses with a net balance of +77%.

Manufacturing

Once again a common theme of export led growth appears to be underpinning improvements in the sector. The Scottish Engineering's Quarterly Review (March and June), SCBS (Q1 2011) and the Bank of Scotland PMI noted an improvement in manufacturing activity. The BOS – PMI for February reported firms recovering from the adverse weather. It noted improved demand conditions and an increase in new orders levels, although the increase in Scotland was weaker than for the UK. The March data confirmed the continuing growth in Scottish manufacturing, although the rate was lower than in February, data for April indicated a continuation of the growth, and the rate increased back to that reported in January and with the growth rate for Scotland stronger than that recorded for the UK as a whole. The May 2011 PMI noted that manufacturing activity continued to rise for the fifth consecutive month, although the rate of increase slowed.

In common with other surveys the BOS – PMI (February, March and April) noted that input price inflation remained high, driven by rising fuel, energy, raw material and wage costs, with the pressures accelerating in April. Input price inflation eased in Scotland, although remained above the UK average.

Both Scottish Engineering and SBS manufacturing respondents anticipate an improvement in demand in the second half of 2011, with the net trends in total orders and sales expected to be positive, again fuelled by export demand.

SCBS respondents noted cost pressures increased further in quarter one, raw material and to a lesser extent transport costs, continued to cause most concern to firms. Nevertheless, the net trend in turnover is expected to remain positive over the coming twelve months however a net balance of 21% expect profitability to decline.

Construction

SCBS and Scottish Building Federation construction respondents continued to report weak and declining business confidence through the first quarter. The

Scottish Building Federation concluded that 'any recovery in the sector remains slow and bumpy'. Commenting on UK figures their chief executive commented ' these figures show precipitous falls in output from all sectors of the industry in the first quarter of this year, with the exception of infrastructure and non-housing repair and maintenance – most probably as a result of road and other repairs being undertaken following the sever weather.'

A major concern noted by both surveys was the rise in costs, the SBF noted that a third of respondents had been adversely affected by unexpected cost increases and one in 12 anticipated losing money as a result of underestimating the increase in raw material costs. Both surveys noted the increasing pressure on tender margins.

SCBS respondents reported weakening trends in demand with orders from all areas declining further during the first quarter. More than 70% of firms reported working below optimum levels, and, with the exception of orders from the public sector, expectations as to contracts over the next three months are still expected to ease. Turnover, tender margins and profitability over the next twelve months are expected to decline for more than half of responding firms. There is much to suggest that expectations continue to be influenced by continued speculation concerning reductions in public spending. Average capacity improved from 72% to 77%, an improvement over levels one year ago (65%).

Logistics and Wholesale

Business confidence amongst SCBS wholesale respondents remained weak as sales trends continued to weaken during the three months to March. More than half of firms reported increasing or level sales and the rate of decline is expected to ease in Q2. Cost pressures were widespread and significant, almost all firms reported pressures to raise prices, and more than 80% of respondents report rising transport costs and supplier prices. Although a net of firms anticipate an improvement in trading conditions over the coming year.

Retail distribution

Once again common themes in the surveys covering the Scottish retail sector, in addition to the longer term trends of the increase in on line sales and increasing competition amongst the major multiple retailers, have been the consequences of the harsh winter, food price inflation, cost pressures and a lack of consumer confidence dampening sales. The Scottish Retail Consortium reported a 0.9% decline in like for like sales in January. Sales trends in February were weaker with like for like sales down 1.3% on the year and trading conditions were described as getting 'steadily tougher' and weak sales were reported in March. Rising sales in April, like for like sales up 3.4% were seen as reflecting a combination of holidays and inflationary pressures. April, however was seen as a blip as The Scottish Retail Consortium reported that 'sales were down 1.1%, against a 2.4% increase in May 2010. This was the worst fall in total sales since the survey began in 1999. Like-for-like sales values were down 3.2% from May 2010, when sales had fallen 0.8%.'

SCBS respondents (mainly non major multiple retailers) reported weak trends in confidence in the first quarter, and the trend in sales remained weak with more than three-quarters reporting and 60% expecting a decline in the total value of sales. Only 7% reported increased sales during the first quarter of 2011, and once again continued concerns over consumer confidence are moderating sales expectations for the coming quarter with no firms expecting an overall increase in total sales.

SCBS respondents again reported rising cost pressures, especially suppliers' prices, and pressures to increase prices remain high. Firms are coming under more pressure from transport costs and regulation costs than in the previous quarter. Pressures on margins look set to continue with a net of 62% of firms anticipating a weakening trend in turnover and a net of 73% expect profitability to decline over the next year.

Tourism

SCBS firms noted a continued weakness in business confidence during Q1 2011 as occupancy levels weakened and demand declined sharply. Average occupancy declined from 56.4% to 46.2%, marginally better than a year ago (46.6%). Demand from Scotland, the rest of the UK, abroad and business trade all continued to decline, and the declines were greater than had been anticipated by respondents from the fourth quarter survey. Total demand and demand from the rest of the UK was lower compared to Q1 2010. Demand from all areas is expected to decline during the second quarter although the rate of decline is expected to ease. Trends in bar/restaurant trade and in conference/function facilities remained weak. Overall local and business demand accounted for 62% of total demand and tourist demand accounted for 38% of total demand in the first quarter. Visit Scotland data indicates hotel occupancy rates of 44% in January, 54% in February and 58% in March; these figures suggest little improvement in either room or bed occupancy for the past 4 years.

The March figures for self catering and guest house/B & B suggest no evidence of an improvement over the past three years.

Almost 50% of SCBS respondents reported reducing average room rates and the discounting of rates is set to continue for almost a third of hotels in the three months to the end of June 2011. Once again, 70% reported that the lack of tourist demand remained the primary business constraint and once again around a third felt that their area had suffered due to poor marketing.

Outlook

The underlying weaknesses in demand and consumer spending were again evident. Cost pressures continued to rise faster than anticipated and together with rising fuel and energy costs will be of increasing concern in the second half of 2011.

Manufacturing respondents continue to rely on export orders, activity in construction is set to remain weak, and much will depend on Government action to stimulate activity. In the service sector weak consumer confidence and inflation will continue to adversely impact on retail sales trends. Activity and occupancy in hotels is little changed from previous years, and demand for bar/restaurant facilities remains weak.

Rising price pressures and weak demand are expected to continue and for many Scottish businesses the combination of slow and patchy growth, limited improvements in turnover, rising costs, pressures on margins and declining trends in profitability will pose real problems in 2011.

Cliff Lockyer/Eleanor Malloy
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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 first quarter 2011;
2. Lloyds TSB Business Monitor for the quarter November 2010 – February 2011and expectations to August 2011;
3. Scottish Building Federation press releases;
4. Scottish Engineering's Quarterly Reviews for the first and second quarters of 2011;
5. The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for February - May 2011;
6. The Bank of Scotland Markit Economics Report on Jobs January 2011;
7. The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors for February – May 2011;
8. The Scottish Chambers of Commerce Quarterly Business Survey report for the first quarter of 2011;
9. Oil & Gas UK quarterly Index quarters 4 2010, Q1 2011;
10. Oil & Gas UK Activity Survey 2011;
11. Oil & Gas UK Activity Survey May 2011 Update;
12. Visit Scotland Occupancy Survey for February and March 2011;
13. The Scottish Construction Monitor quarter 4 2010
14. Jackson, P. (2009). The Future of Global Oil Supply: Understanding the Building Blocks (CERA);
15. Kemp, A & Stephen, L. (2011) The effects of Budget 2011 on Activity in the UK Continental Shelf. North Sea Study Occasional Paper no 120. April 2011. University of Aberdeen.

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