

A review of Scottish Business Surveys January – May 2008

Current trends in Scottish Business are regularly reported by a number of business surveys. We draw on the following:

1. The Bank of Scotland's Quarterly Labour Market Report for the first quarter of 2008;
2. The Confederation of British Industries Scottish Industrial Trends Survey for the quarter to April;
3. Lloyds TSB Business Monitor for the quarter to February 2008;
4. Scottish Engineering's Quarterly Review for first quarter 2008;
5. The Royal Bank of Scotland's Monthly Purchasing Managers' Index for April 2008 & May 2008;
6. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor for April 2008;
7. The Scottish Retail Consortium - Nielsen Shop Price Index for May 2008;
8. The Scottish Chambers of Commerce Quarterly Business Survey, latest report for the first quarter of 2008.

Overall

Surveys conducted earlier in the year and the Scottish Engineering's Quarterly Review generally report more positive trends. All surveys suggest, to varying degrees a slowing down in orders and activity, although export trends remain positive. The common themes include rising prices, cost pressures and some easing in the demand for labour, and these have been strengthening over the first five months of 2008. In construction and retail smaller firms are reported to be more affected than larger firms. Scottish Chambers survey data indicated average pay increases in the first quarter ranged from 3.53% in retail, 3.66% in manufacturing, 4.0% in construction to 5.38% in tourism.

Manufacturing

Of the main surveys the Scottish Chambers' Business Survey for the first quarter of 2008 was the least optimistic, reporting

a net decline in business confidence reflecting declining orders and concerns over increased costs. In contrast, the Scottish Engineering Quarterly Review for the same period noted, that with the exception of fabricators, all sectors and size of company are either positive or are maintaining their optimism and that against the predictions of the economic forecasters, the manufacturing engineering sector continues to perform well for a further quarter, albeit with a weakening in the net trend in output volumes – for the first time after 17 positive quarters.

The CBI Scottish Industrial Trends Survey covering the same period likewise reported that business sentiment was broadly stable amongst manufacturing firms relative to three months ago, and, Scottish firms were the most upbeat about their export prospects for the next twelve months since April last year.

The Lloyds TSB Business Monitor (February) suggested the Scottish economy was slowing but still growing at the start of 2008. In the three months ending February 2008, 36% of the firms surveyed had increased turnover, 36% experienced static turnover and 28% reported a decrease. The overall net balance (those reporting an increase minus those reporting a decrease) is +8%. This is down on the +16% of the previous quarter and on the +28% of the same quarter one year ago, reaching the lowest level for two and a quarter years. The implication is that growth in the Scottish economy has slowed from the latest, underlying annual rate of 2.1% in autumn of last year. The net balance on turnover of production businesses was +5%. This is well down on the +14% of the previous quarter and the +36% of the same quarter one year ago. The net balance on turnover for production businesses has now fallen for five consecutive quarters.

Orders

The Scottish Chambers' Business Survey for the first quarter of 2008 reported that the rising trends in orders/sales in manufacturing had weakened, and the outturn in the first quarter was weaker than had been expected.

In contrast the CBI survey showed that total new order volumes registered moderate growth in the three months to April. Export demand was the driver of this increase, with solid growth reported for the first time since July 2007. Domestic demand remained weak, contracting for the second successive survey. Manufacturers expect no change in total orders over the next quarter, with a modest rise in export orders set to be offset by declining domestic demand.

The Royal Bank of Scotland PMI Scotland Report found that manufacturing output in Scotland declined for the second month running in April. Moreover, the seasonally adjusted Output Index fell to 47.7, from 49.8, indicating a sharper rate of contraction which continued in May. In their April report almost one quarter of firms reported lower output volumes

compared to one month earlier, mainly attributing the declines to reduced intakes of new orders.

The Scottish Engineering Quarterly Review found that with respect to orders, medium and large companies remain positive but small companies were 'struggling' to maintain order levels.

Costs/Prices

Both the Scottish Chambers' Business and CBI surveys noted rising costs. Manufacturers in the Scottish Chambers' Business Survey reported more extensive price pressures (the highest figures recorded since 1997), and pressures to raise prices due to raw material costs are at their highest since the question was introduced to the Survey in 1997.

The CBI noted that over the three months to April, average unit costs increased at the fastest rate for two years, and costs have continued to grow at an above average rate since October 2004 and are expected to rise significantly in the three months to July 2008. The rate of growth in domestic prices has accelerated, with the balance of firms reporting an increase over the past three months the highest for seventeen years. Similarly, export prices increased rapidly this quarter - at the fastest pace since October 2004. Looking forward, firms expect domestic prices to continue to rise, albeit less sharply than in the three months to April, while export prices are expected to be broadly stable.

The Scottish Chambers' survey noted expectations among manufacturers as to the trends in orders, turnover and profitability for the next twelve months are stronger than in the previous quarter, suggesting firms, especially exporters, expect some benefits from the declining value of the pound.

The Lloyds TSB Business Monitor respondents showed that concern for the general rate of inflation increased in production businesses, there is a definite expectation amongst all types of businesses of a substantial increase in costs in the next six months.

The Scottish Engineering Review noted that UK prices have risen for a net of small and medium companies over the last three months but have fallen in large companies. In the various sectors, prices have risen in mechanical equipment fabricators metal manufacturing and non-metal products.

Manufacturing employment

The Scottish Chamber' Business Survey for the first quarter of 2008 showed a net decline in employment and in total hours worked within manufacturing. The CBI survey likewise found that over the three months to April, firms modestly reduced their headcount, ending a year of expansion. Manufacturers had broadly expected this and next quarter, firms anticipate that employment will be unchanged.

The Royal Bank of Scotland PMI report found that average workforces expanded for the eleventh month running in April. However, the seasonally adjusted Employment Index eased to 50.6, indicating only a marginal rise. It noted anecdotal evidence highlighted the non-replacement of leavers and redundancies as a result of efficiency measures (in the light of lower workloads) as key factors behind weak overall jobs growth.

Construction

The Scottish Chambers' Business Survey noted business confidence continued to decline for a net of smaller and larger construction firms, again reflecting concerns as to credit issues, declining levels of enquiries were more widely reported by smaller contractors.

The declining trend in new contracts strengthened in the first quarter and 69% (71% and 86% in the previous two quarters) expect level or rising trends in the level of work through the next six months.

Average capacity used eased to 86.9%. The rising trends in work in progress were more modest for larger, but fell quite sharply for smaller firms in the first quarter. Over the six months to September 2007 a net of larger firms anticipate a rising trend in work in progress, whilst a net of smaller firms anticipate a declining trend.

Respondents remain confident (a net of 3% compared to 10% and 29% in the previous two quarters) as to rising trends in turnover, and a net of -3% anticipate declining profitability over the next twelve months. Expectations as to turnover and profitability remained positive amongst larger construction firms, but were negative for smaller construction firms. 53% of smaller and 46% of larger construction firms anticipate declining tender margins over the next twelve months.

Services

The Lloyds TSB Business Monitor indicated that service businesses were affected by the slowdown. During the three months to the end of February, 39% reported an increase in turnover, 31% a level trend and 30% a decline giving a net balance of +9%. This is again a significant fall from the +18% of the previous quarter and the +24% of the same quarter one year ago. Both the Lloyds TSB monitor and Royal Bank PMI Scotland reported rising trends in business activity in the service sector in February, and the later Royal Bank PMI reports suggested a continuation of this trend. The Lloyds TSB expected the slow down to continue and the Royal Bank PMI reports for April and May endorsed this view, noting the impact of energy costs and credit concerns.

The Scottish Chambers Business Survey noted rising costs in retail and the Royal Bank PMI Report for April echoed these concerns, both noted input price increases accelerating to

record highs. The Royal Bank PMI noting the strongest rises in average prices being recorded in those sectors where fuel costs are a higher proportion of total costs (transport and tourism/leisure) whereas the weakest increases were reported in financial services.

Retail

The Scottish Retail Consortium – Nielsen Shop Price Index reported shop price inflation for the year to May 2008 running at 2.4% (up from 1.6% per annum in March and 2.0% per annum in April). Retail sales for the year to April were up 5.3% for the year, but the annual rate of increase has declined each month from January 2008.

Data from the Scottish Chambers' Business Survey reported declining business confidence in the first quarter of 2008 and whilst a net of national/multiple retailers reported rising sales trends, and expect a rising trend in sales over the second quarter of 2008, a net of independent retailers reported declining trends in both the volume and value of retail sales and expect these declining trends to continue through the second quarter.

The Scottish Chambers' Business Survey also noted rising trends in the percentages of retail respondents reporting being under pressure to raise prices due to input and utility costs, these were both at the highest levels recorded. Overall 66% of independent retailers and 62% of multiple/national retailers anticipate price increases over the three months to end June 2008. Expectations of rising trends in turnover over the next twelve months have progressively weakened since the first quarter of 2007, and expectations for profitability have weakened since the third quarter of 2007, and whilst national/multiple retailers are still anticipating rising trends in profitability more than 50% of independent retailers anticipate declining trends in profitability over the twelve months to March 2009.

Tourism

The trends in visitor numbers/demand reported by the Scottish Chambers' Business Survey for the first quarter of 2008 were more modest than for the first quarters of the previous three years, and the expectations for the second quarter more modest than for the previous two years. Nevertheless, the percentages reporting and expecting to discount room rates remain low and average occupancy for the first quarter was only slightly down compared to the first quarter of 2007. Overall a net of respondents reported slightly declining trends for accommodation, bar and restaurant facilities and a very slight decline in the use of conference and function facilities. Overall, although with major regional variations, local trade accounted for 35.5%, tourist trade for 33.8% and business trade 30.7% of total demand.

Expectations

The outlook among Scottish Chambers' respondents is that signs of a slowdown in the economy were more evident at the end of March 2008 than at the end of 2007, with demand weakening and cost pressures increasing. The trends in expected orders, levels of work in progress and turnover are at their lowest for more than three years in manufacturing and construction. National/multiple retailers anticipate the rising sales trends to continue, but at more modest levels, whereas a net of independent retailers anticipate sales, turnover and profitability trends to weaken further in 2008.

The CBI Survey asks respondents to look one year ahead and the broad conclusions are that uncertainty about demand remains the most likely constraint to capital investment, followed by inadequate net return. However, for both factors the percentage of respondents citing them is below their respective long-run averages. There was also a modest increase in the proportion of firms citing inability to raise external finance as a barrier to investment. The SCBS survey noted that manufacturing respondents anticipate modestly rising trends in orders over the next twelve months, although expectations as to turnover and profitability over the year are more modest than the average for 2007. Construction respondents anticipate some deterioration in profit margins and more modest increases in turnover over the next year. In contrast retail respondents anticipate no improvements in the trends in turnover and profitability over the year.

Respondents in the LloydsTSB Business Monitor reported increasing expectations are shared by both production and service sectors. The net balance for production businesses for turnover for six months to August 2008 is +26% compared to the +21% of service business indicating a higher level of optimism among production businesses. Expectations among both production and service businesses are now close to the long-term 10 year trend of the Business Monitor. The increase in expectations is certainly more pronounced among production businesses.

The Bank of Scotland's Index of Leading Economic Indicators latest report (February 2008) indicated that Scottish economic growth is set to moderate during 2008, reflecting the expected slowdown in both UK and global economic growth this year. Labour market conditions in Scotland are expected to remain firm, and this should contribute to limited growth in 2008. However, the Bank of Scotland noted the recent declines in new housing starts, increased food and energy costs, reduced business and consumer confidence and sharp share price falls, indicate that an economic slowdown is likely over the coming months.

The Bank of Scotland Labour Market Report in March, based on responses from recruitment agencies and consultants, suggested that Scottish job market conditions continued to ease through the first quarter of 2008, with permanent staff placements rising at their slowest pace for eighteen months in

March and weakening permanent salary growth reflecting a further softening of demand for staff.

The report's labour market barometer fell for the ninth successive month to 53.4, from 54.2 in February, its lowest level for four-and-a-half years. The index was broadly in line with the equivalent barometer for the wider UK job market. At a sector level, Nursing/Medical/Care workers were the most sought-after category for both permanent and temporary employees.

Permanent staff placements rose only marginally in March and at the slowest pace for one-and-a-half years in March. Agency billings from the employment of temp staff fell for the first time in sixty-one months in March, although the contraction was only slight. The expansion of demand for permanent staff in Scotland was maintained for a fifty-eighth consecutive month in March. However, the rate of growth eased slightly to its weakest since January 2005. Demand for temporary/contract staff in Scotland improved for sixty-first successive month during March. Furthermore, the rate of expansion quickened to the sharpest in 2008 so far.

Data from the Scottish Chambers' survey suggests that recruitment activity by employers remains broadly based, 22% of retailers, 24% of manufacturers, 49% of construction and 64% of tourism respondents sought staff in the first quarter.

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