

Scottish Chambers' Business Survey

Expectations for the next twelve months

For a further quarter both manufacturing and construction respondents are more cautious in their expectations as to trends in turnover and profitability over the next twelve months, and price pressures appear stronger;

Retail respondents, excluding large retailers, are less confident as to the forthcoming year, and now expect easing trends in turnover and profitability. For the smaller retailers the pressures on margins have increased. In contrast the expectations amongst tourism respondents are strong for the second quarter.

Business Performance

Recent past and next three months

Business confidence rose in construction and tourism, remained level in wholesale and eased in logistics, manufacturing and retail. Nevertheless, business optimism rose amongst larger firms in manufacturing, logistics and retail.

Rising trends in demand were reported by small and large manufacturing firms, and amongst larger construction firms. In the service sector demand rose in wholesale and logistics. For a further quarter tourist respondents reported rising and better than anticipated trends in visitor numbers. In contrast sales remained weak in retail, although rising sales trends were reported for a net of retailers employing more than 25 staff;

Manufacturing respondents again reported a modest rise in the volume of work in progress; and whilst average capacity used remained at 79%, the percentage reporting working below optimum levels eased further to 43%. Construction firms reported a rise in average capacity used, and a slight easing in the level of work in progress, but expect rising trends to re emerge over the next six months;

In the service sector wholesale respondents reported a rising trend in sales. In retail larger firms reported rising sales trends and national retailers reported better trends than independent stores; rural respondents again reported weak sales trends. Overall 50% of retail respondents (compared to 62% in the fourth quarter) reported rising or level trends in sales. Tourism respondents reported good first quarter results, with rising business demand and rising Scottish, and rest of UK visitor numbers;

Concerns over raw material and transport costs were again widely cited by manufacturing respondents, 70% of construction firms anticipate rising material costs in 2006 and transport costs were widely cited in wholesale and retail distribution. Rising fuel costs and regulation costs were widely cited by logistics firms;

Pay increases in the first quarter ranged from 3.2% in retail to 5.2% in construction. Recruitment activity was generally lower than in the previous quarter in construction, wholesale and retail, but was higher in manufacturing and tourism.

Manufacturing

Optimism

Business confidence remained weak, although optimism rose for a net of small (under 50 employees) and large firms (250 plus employees).

Orders and Sales

Rising trends in total orders were reported by a net of small and large firms, but remained depressed amongst medium sized firms. Overall respondents continue to expect a slight strengthening of trends in demand in the second quarter. Average capacity used remained at 79%, nevertheless, rising trends in the level of work and hours worked were reported for a net of firms in all size bands, Expectations for the next twelve months, are stronger than three months ago.

Finance

For a further quarter firms downgraded their expectations as to profitability trends over the next year. Cost pressures increased as concerns as to raw material costs, transport costs and other overheads strengthened in the first quarter.

Investment

48% reported revising investment plans for the coming year, and rising trends in investment were again reported. Investment in the current quarter was again mainly for the replacement of equipment. Investment for R & D remained weak, although investment to develop new products and processes was more evident amongst medium and larger sized firms.

Employment

Employment rose marginally, and 53% sought to recruit staff, mainly skilled and technical employees.

Table 1 Manufacturing – key results

| | Q1 2006 | | |
|---------------------------------------|-------------|-------------|-------------|
| | Up | Level | Down |
| Business Optimism | 25.2 | 47.8 | 27.1 |
| Trends in actual orders | | | |
| Total new orders | 34.5 | 39.5 | 26.0 |
| Scottish orders | 26.4 | 46.5 | 27.1 |
| Rest of UK orders | 24.1 | 44.0 | 31.8 |
| Export orders [42.6% = N/A] | 21.0 | 24.6 | 11.9 |
| Trends in expected orders | | | |
| Total new orders | 34.0 | 51.2 | 14.9 |
| Scottish orders | 21.0 | 57.6 | 21.4 |
| Rest of UK orders | 28.9 | 50.0 | 21.1 |
| Export orders [45.1%= N/A] | 21.6 | 25.3 | 8.0 |
| Av Capacity used | 79 | | |
| Invest in plant/equip. | 27.4 | 50.2 | 22.4 |
| Cash flow past 3 moths | 16.9 | 48.8 | 34.3 |
| Turnover next 12 moths | 43.3 | 35.2 | 21.4 |
| Profitability next 12 moths | 34.9 | 35.4 | 29.8 |
| Price change next 3 moths | 39.2 | 56.7 | 4.2 |
| Pressures to raise prices from | | | |
| Pay settlements | 29 | | |
| Raw material costs | 72 | | |
| Finance costs | 21 | | |
| Other overheads | 56 | | |
| Transport costs | 62 | | |
| Employment trends | | | |
| Total actual employment | 16.9 | 68.2 | 14.9 |
| Total expected next 3 months | 22.8 | 63.2 | 14.0 |
| Average pay increase | 3.67 | | |

Construction

Optimism

Business confidence strengthened in the first quarter, due to widespread rising confidence amongst firms employing more than 100.

Contracts

Larger firms reported rising trends in new contracts, whilst smaller firms (those employing under 100) reported slightly

easing trends in new contracts. Rising trends in the level of work are expected over the next six months, suggesting that seasonal factors may have been an issue affecting activity levels in the first quarter. Rising trends in work in all areas were again more evident amongst larger firms.

49% (56% in the previous quarter) reported operating at or above optimum rates in the first quarter, and average capacity used rose to 87%.

For a further quarter respondents remain confident as to rising trends in turnover over the next twelve months, but now anticipate a level trend in profitability. Smaller firms, unlike large construction firms, expect tender margins to be under more pressure over the next year.

The levels of contracts and new work and shortages of skilled labour were again seen as the two factors most likely to restrict activity over the next quarter.

Investment

Rising trends in investment and in the leasing of plant and equipment were reported. Investment authorised in the first quarter was mainly for the replacement of equipment.

Employment

The rising trend in employment continued, with more use of sub contractors anticipated over the next three months.

Table 2 Construction – key result

| | Q1 2006 | | |
|-------------------------------------|-------------|-------------|-------------|
| | Up | Level | Down |
| Business Optimism | 24.3 | 59.5 | 13.2 |
| Trends in actual contracts | | | |
| Total new contracts | 29.7 | 37.8 | 32.4 |
| Public sector orders | 13.8 | 62.1 | 24.1 |
| Private commercial | 21.2 | 51.5 | 27.3 |
| Domestic/house build | 21.9 | 50.0 | 28.1 |
| Trends in expected contracts | | | |
| Total new orders | 26.5 | 55.9 | 17.6 |
| Public sector orders | 7.7 | 80.8 | 11.5 |
| Private commercial | 18.5 | 70.4 | 11.1 |
| Domestic/house build | 10.7 | 71.4 | 17.9 |
| Trends in work in progress | | | |
| Actual | 24.3 | 45.9 | 29.7 |
| Expected | 29.4 | 55.9 | 14.7 |
| Capacity used | 87 | | |

| | | | |
|-----------------------------|------|------|------|
| Invest in plant/equip. | 27.8 | 55.6 | 16.7 |
| Leasing in plant/equipment. | 17.6 | 67.6 | 14.7 |

Employment trends

| | | | |
|------------------------------|------|------|------|
| Total actual employment | 16.7 | 69.4 | 13.9 |
| Total expected next 3 months | 14.7 | 70.6 | 14.7 |

Average pay increase 5.17

Percent recruiting staff 40

Recruitment difficulties increasing 11.1

Wholesale distribution

Optimism

Business confidence although weak was the strongest for the past 15 months.

Sales

The outturn in sales was better than had been anticipated, and a further improvement is expected in the second quarter.

Once again the level of competition, along with business rates were seen as the factors most likely to restrict sales over the next quarter.

Expectations of price increases remained widespread but were slightly lower than in the previous three quarters. Respondents were more confident as to rising trends in turnover over the next twelve months, and concerns as to profitability, although weak, were less than in previous quarters. Pressures on margins are still evident, but less acute than in the fourth quarter.

Concerns as to transport costs together with raw material costs were again the most widely cited pressure on prices.

Investment

Changes to investment plans were more widespread, affecting 48% of respondents.

Finance

A rising trend in cash flow was reported.

Employment

A level trend in employment was reported. Overall 39% sought to recruit staff, and 30% increased pay by an average of 3.23%.

Table 3 Wholesale distribution – key result

| | Q1 2006 | | |
|------------------------------|---------|-------|------|
| | Up | Level | Down |
| Business Optimism | 21.7 | 56.5 | 21.7 |
| Trend in actual sales | 47.8 | 17.4 | 34.8 |
| Trend in expected sales | 41.2 | 41.2 | 17.6 |
| Investment plans | 26.1 | 52.2 | 21.7 |
| Cash flow past 3 months | 30.4 | 60.9 | 8.7 |
| Turnover next 12 months | 47.8 | 26.1 | 26.1 |
| Profitability next 12 months | 28.6 | 28.6 | 42.9 |
| Price change next 3 Months | 47.8 | 34.8 | 17.4 |

Pressures to raise prices from

| | |
|--------------------|----|
| Pay settlements | 39 |
| Raw material costs | 48 |
| Finance costs | 17 |
| Other overheads | 44 |
| Transport costs | 61 |

Employment trends

| | | | |
|-------------------------|------|------|------|
| Total actual employment | 17.4 | 65.2 | 17.4 |
| Expected next 3 months | 14.3 | 76.2 | 9.5 |

Average pay increase 3.23

Percent recruiting staff 39.1

Recruitment difficulties 23.5

Logistics

Optimism

Business confidence, although weak, rose amongst larger logistics firms.

Business trends

Rising business trends across the range of logistics work were more evident amongst larger logistics firms.

Fuel and regulation costs were most widely cited cost pressures; and legislation, competition and the transport

infrastructure were the most widely cited concerns. Concerns as to the availability of drivers were less than in the previous quarter, and were more apparent amongst smaller logistics firms.

Investment

Investment trends in vehicles and equipment remained weak.

Finance

A rising trend in cash flow was reported by both smaller and larger logistics firms. Smaller firms anticipate more difficulties in sustaining turnover and profitability over the next year. In contrast, larger firms anticipate both rising trends in profitability and turnover.

Employment

A level trend in employment was reported. 58% sought to recruit staff, and 26% increased pay by an average of 4.15%.

Table 4 Logistics – key results

| | Q1 2006 | | |
|---------------------------------------|-------------|-------------|-------------|
| | Up | Level | Down |
| Business Optimism | 25.0 | 45.0 | 30.0 |
| Trend in actual business | 40.0 | 40.0 | 20.0 |
| Trend in expected business | 55.6 | 22.2 | 22.2 |
| Trend in long distance | 20.0 | 60.0 | 20.0 |
| Trend in local deliveries | 26.7 | 53.3 | 20.0 |
| Trend in storage | 23.1 | 53.8 | 23.1 |
| Trend in couriering | 28.6 | 57.1 | 14.3 |
| Trend in other work | 36.4 | 36.4 | 27.3 |
| Cash flow past 3 months | 31.6 | 68.4 | 0.0 |
| Turnover next 12 months | 50.0 | 35.0 | 15.0 |
| Profitability next 12 months | 55.0 | 20.0 | 25.0 |
| Price change next 3 Months | 40.0 | 60.0 | 0.0 |
| Pressures to raise prices from | | | |
| Pay settlements | 45 | | |
| Fuel costs | 95 | | |
| Finance costs | 25 | | |
| Utility costs | 40 | | |
| Road charging etc | 20 | | |
| Regulation costs | 55 | | |

Employment trends

| | | | |
|--------------------------------|-------------|-------------|-------------|
| Total actual employment | 16.7 | 66.7 | 16.7 |
| Expected next 3 months | 11.8 | 88.2 | 0.0 |

Average pay increase **4.15**

Retail distribution

Optimism

Overall business confidence remained weak, although rising confidence was reported by those retailers employing more than 25 staff.

Sales

The weak outturn in the value of sales reflected declining trends being reported by retailers employing less than 25 but rising trends by those employing more than 25 staff. National retailers reported better trends than independent stores, and rural shops reported weak sales trends.

For a further quarter competition, legislation/regulation and business rates were again identified as the three factors most likely to inhibit sales. Utility, transport and regulation costs were widely reported.

Investment

Changes in investment plans were limited, being reported by 25% of respondents; and a slight decrease in investment plans was noted.

Finance

Retailers employing 5 or less staff reported declining cash flow trends, whereas rising trend were reported by larger firms

Respondents now anticipate weaker turnover trends over the next 12 months; although firms employing more than 25 anticipate rising turnover and profitability trends over the next year.

Employment

The decline in employment ended, and a slight increase in full time and temporary staffs was reported. 14% increased pay by an average of 3.21%.

Table 5 Retail – key result

| | Q1 2006 | | |
|------------------------------|-------------|-------------|-------------|
| | Level | Up | Down |
| Business Optimism | 3.9 | 62.7 | 33.3 |
| Trend in actual sales | 11.5 | 38.5 | 50.0 |

QUARTERLY ECONOMIC COMMENTARY

| | | | |
|------------------------------|-------------|-------------|-------------|
| Trend in expected sales | 12.8 | 44.7 | 42.6 |
| Investment plans | 15.4 | 67.3 | 17.3 |
| Cash flow past 3 months | 13.7 | 76.5 | 9.8 |
| Turnover next 12 months | 13.5 | 50.0 | 36.5 |
| Profitability next 12 months | 20.0 | 30.0 | 50.0 |
| Price change next 3 months | 55.8 | 40.4 | 3.8 |

Pressures to raise prices from

| | | | |
|--------------------|-----------|--|--|
| Pay settlements | 25 | | |
| Raw material costs | 44 | | |
| Finance costs | 15 | | |
| Other overheads | 10 | | |
| Transport costs | 48 | | |
| Utility costs | 58 | | |
| Regulation costs | 42 | | |

Employment trends

| | | | |
|-------------------------|------------|-------------|------------|
| Total actual employment | 6.1 | 89.8 | 4.1 |
| Expected next 3 months | 5.3 | 92.1 | 2.6 |

Average pay increase **3.21**

Percent recruiting staff **27**

Recruitment difficulties inc **18.2**

Tourism

Optimism

The rising trend in business confidence continued through the first quarter, reflecting a better than anticipated outturn.

Demand

For a further quarter the outturn in demand was stronger than anticipated, and rising trends in total, rest of UK and Scottish demand were reported. Average occupancy, at 57%, was broadly the same as for the first quarter of 2005.

Overall 30% of business was local trade, 34% tourist trade and 36% business trade.

Finance

A fifth reported discounting room rates in the first quarter and 13% anticipate some discounting of room rates in the second quarter of the year.

Employment

Changes in employment levels were again limited, being reported by 31% of respondents, and the downward seasonal trend was the same as in the first quarter of 2005.

Recruitment

79% sought to recruit staff, and 50% of those recruiting reported difficulties in recruiting suitable staffs, most notably in the recruitment of chefs/cooks. 36% increased pay by an average of 4.01%.

Table 5 Tourism – key result

| | Q1 2006 | | |
|-----------------------------|-------------|-------------|-------------|
| | Up | Level | Down |
| Business Optimism | 32.6 | 56.5 | 10.9 |
| Trends in demand/visitors | | | |
| Total demand/visitors | 33.3 | 40.0 | 26.7 |
| Demand from Scotland | 33.3 | 45.2 | 21.4 |
| Demand from Rest of UK | 31.7 | 56.1 | 12.2 |
| Demand from abroad | 17.9 | 56.4 | 25.6 |
| Business Trade | 30.0 | 57.5 | 12.5 |
| Trends in expected demand | | | |
| Total demand/visitors | 39.5 | 55.8 | 4.7 |
| Demand from Scotland | 24.4 | 63.4 | 12.2 |
| Demand from Rest of UK | 39.0 | 53.7 | 7.3 |
| Demand from abroad | 35.0 | 50.0 | 15.0 |
| Business Trade | 33.3 | 61.5 | 5.1 |
| Capacity used | 57.2 | | |
| Investment | 45.7 | 47.8 | 6.5 |
| Turnover past 3 months | 52.0 | 32.0 | 16.0 |
| Average daily rate | 31.8 | 45.5 | 22.7 |
| Expected average daily rate | 32.6 | 54.3 | 13.0 |
| Employment trends | | | |
| Total actual employment | 9.5 | 69.0 | 21.4 |
| Expected next 3 months | 28.6 | 66.7 | 4.8 |
| Average pay increase | 4.01 | | |
| Percent recruiting staff | 79.2 | | |
| Recruitment difficulties | 50.0 | | |

