

3 Review of Scottish Business Surveys

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Abstract

Business surveys provide a useful barometer of the investment and business intentions across the economy. The business surveys reviewed in this section provide an overview of key recent evidence of the Scottish economy. Business Surveys are primarily conducted to provide data needed for calculating key economic indicators that monitor the economy over time and for constructing official statistics. The rapid rate of change in economic data creates a demand for quick estimators/indicators of these changes ideally 'as they are happening'. Survey data have the advantages of essentially being instantaneously accessible, never being revised and furthermore having little or no measurement errors. The latest set of Scottish Business Surveys are not particularly strong and show that many of the key benchmark indicators continued to slow in the most recent quarters, perhaps highlighting the impacts of the continuing low oil price and the low value of the pound on the Scottish economy.

The Bank of Scotland Purchasing Managers' Index (PMI)

The seasonally adjusted headline Bank of Scotland PMI - a single-figure measure of the month-on-month change in combined manufacturing and services output - scored 50.3 again in January 2016, unchanged from December's 2015 reading and up from the 49.8 recorded in November. The Scottish private sector grew marginally in the first month of 2016. The survey showed that the service sector reported growth but the production sector reported a contraction. The survey indicated a fall in employment as firms continued to reduce employee numbers, indeed the rate of job shedding accelerated to its fastest level since July 2015.

The January data showed a modest rise in total new orders in Scotland's private sector, as the rate of growth accelerated to a five-month high. Also, service sector respondents have reported a rise in incoming new business in every survey period since March 2015.

The Scottish Business Monitor (SBM)

The latest Scottish Business Monitor (SBM) for Q4 2015 produced by The Fraser of Allander Institute shows that the Scottish economy slowed in the final quarter of 2015. The rate of recovery is being constrained by companies in the North East. New business levels eased during the three months to the end of November with an overall net balance of +3% compared to +17% in the previous quarter and also down on the +18% of the same quarter one year ago. Expectations are that this slowdown in the rate of recovery will end and that the pace of the recovery will improve/strengthen.

The Business Monitor showed that the Scottish economy started to slow in the second half of 2008, following the global financial crash. Following the worst ever result at the end of that year, there was a

gradual improvement until the early part of 2010. From 2010 to mid-2012 the Monitor showed an economy that was largely stagnating. Last summer's Monitor showed an economy accelerating into growth. The recovery continued in spring, summer and autumn 2014 but paused at the start of 2015 before picking up again in spring and continuing throughout summer 2015. The latest Business Monitor shows this pick-up has eased in the latter part of 2015.

Firms' assessments of their immediate prospects in the next six months were on a rising trend throughout 2013 and reached highs in the first two quarters of 2014. The remainder of 2014 and into 2015 showed lower but still positive levels of expectations. Despite a fall compared to the last quarter, expectations remain positive but are lower than the high levels evident pre-recession. This is the twelfth successive Business Monitor showing a positive net balance for turnover expectations.

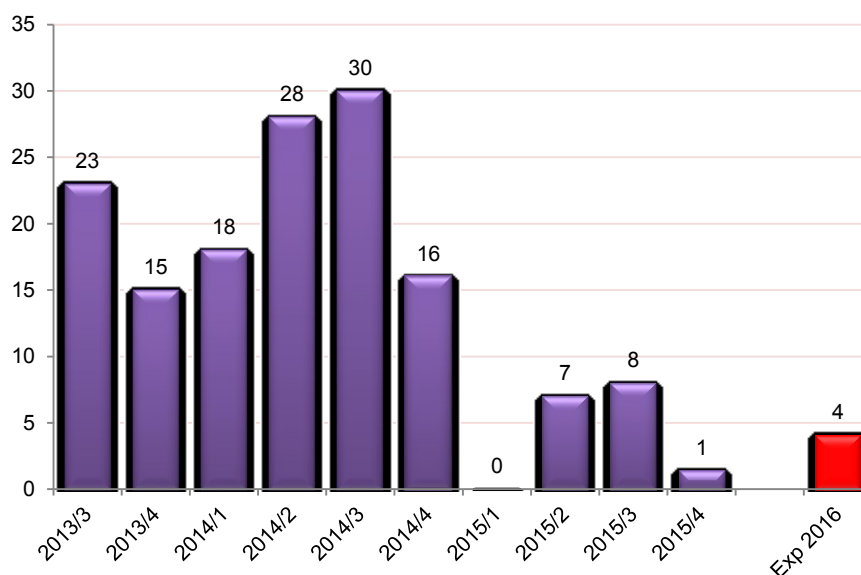
The expectation levels recorded by respondents in this latest survey suggest the private sector of the Scottish economy will show growth below trend level in the fourth quarter of 2015.

These expectation levels suggest that the private sector of the Scottish economy will show growth close to but below trend level in the first quarter of 2016, and suggests slower growth in the three months to February 2016 compared to the period to November 2015. Growth in Scottish economy slowed in the final quarter of 2015. Expectations of growth have remained broadly positive and suggest that current growth rates will be maintained in the final quarter of the year. We await the GDP figures for the 3rd quarter of 2015, and following only slight growth of 0.1% in Q2, we will then learn whether growth through last year was at moderate levels, as forecast earlier in the year. Internationally, the US Federal Reserve's decision to increase interest rates in December 2015 suggests its confidence in the embeddedness of the US recovery, however it remains to be seen how the US economy responds to this decision. Concerns about a slowdown in Chinese growth as we begin 2016 suggests ongoing weaknesses in the global economy. This will feed back into Scottish activity both through lower exports and the continuing low price of oil affecting activity across the country, and particularly in the North East of Scotland.

- Total volumes of business had previously been showing a slowly improving trend however in the latest quarter a net of -3% of companies reported a decline, well down on the +11% of the previous quarter and also down on the +19% of the same quarter one year ago.
- The overall net balance of turnover (those reporting an increase minus those reporting a decrease) is +1%, this is down from the +8% of the previous quarter and from the +16% of the same quarter one year ago.
- Export activity is continuing, on balance, to fall. The overall net balance for export activity at -10% marginally down on the -9% of the previous quarter and also worse than the -4% of the same quarter one year ago.
- Firms are significantly more concerned over weakening demand compared to the previous quarter with the percentage of firms citing it as 'very important' increasing from 46% to 53%.

- Concerns over credit costs and more notably credit availability increased slightly for both production and service firms.
- Firms located in the North East are performing significantly worse than those located elsewhere.
- Firms with a turnover of between £5 million and £10 million are reporting the most positive trends with those with a turnover of up to £5 million and those with a turnover of more than £10 million reporting more negative trends. Firms with a turnover of more than £10 million are expecting an increase in the total volume of new business.
- Expectations are that this slowdown in the rate of recovery will stop and that the pace will step up.

Figure 1: What is the trend in your turnover? (% net balance)



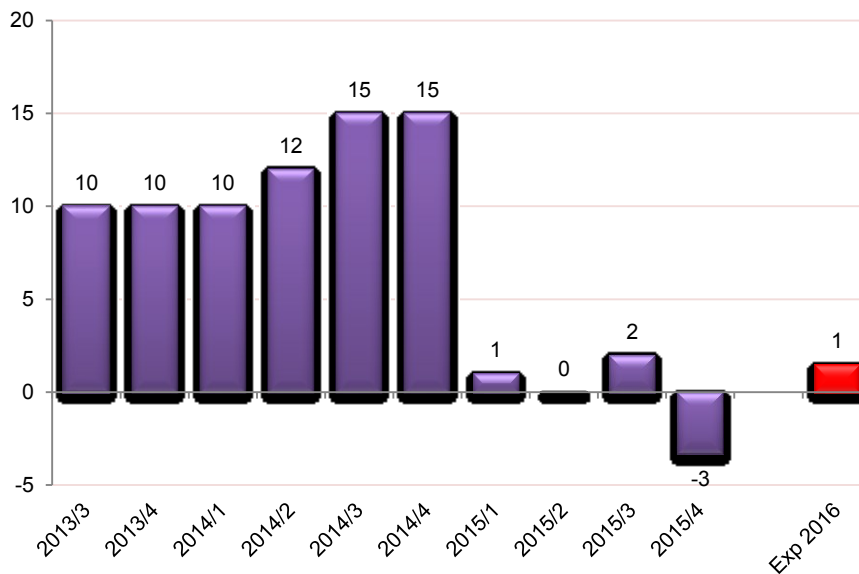
Source: Fraser of Allander Scottish Business Monitor

In the three months ending November 2015, 34% of the firms surveyed increased turnover, 33% experienced static turnover and 33% experienced a decrease. The overall net balance (those reporting an increase minus those reporting a decrease) is +1%, down from the +8% of the previous quarter and from the +16% of the same quarter one year ago. This latest result indicates a slowing in the pace of the improving trend identified in spring 2015.

The overall net balance of turnover for firms in the production sector in the three months to end November 2015 was 0%. This has eased from the +3% of the previous quarter but is down on the +12% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending November of +2%, down on the +11% of the previous quarter and also from the +19% of the same quarter one year ago.

Expectations for turnover in the next six months ending February 2016 show an overall net balance of +4%. Although positive this is down on the +15% of the previous quarter and also down on the +19% of the same quarter one year ago. Whilst 50% expect turnover to be static in the next six months, 27% expect turnover to increase against 23% who expect a decrease. Services firms remain more optimistic than production firms, with service firms showing an overall net balance for turnover for the next six months at +6% (+22% in the previous quarter) compared to +1% (+8% in the previous quarter) for production firms.

Figure 2: What is your trend in the volume of repeat business? (% net balance)



Source: Fraser of Allander Scottish Business Monitor

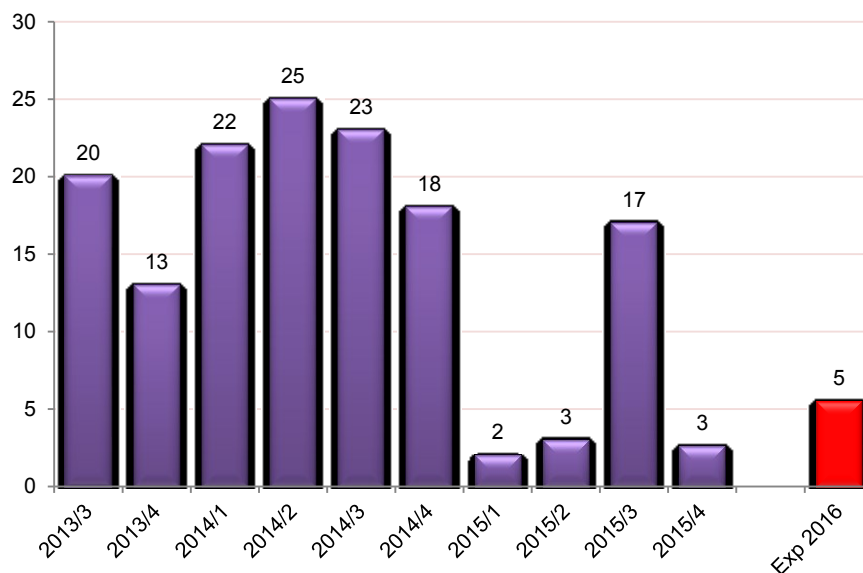
Volumes of repeat business are showing a slight decline in the latest quarter. In the three months ending November 2015, 19.3% of the firms surveyed increased repeat business, 58% experienced static new business and 22.7% experienced a decrease. The overall net balance of -3% is marginally worse than the +2% of the previous quarter and significantly worse than the +15% of the same quarter one year ago.

The overall net balance of repeat business for firms in the production sector in the three months to end November 2015 was -1.3%. This has eased from the -2.6% of the previous quarter but down on the +20% of the same quarter one year ago. Services firms showed an overall net balance for turnover for

the three months ending November of -4.7% , down on the $+5\%$ of the previous quarter and also from the $+11\%$ of the same quarter one year ago.

Expectations for the volume of repeat business were, once again, marginally down on the levels of the last quarter with an overall net balance of $+2\%$ for this quarter compared to $+4\%$ for the previous quarter; significantly down on $+13\%$ for the same quarter one year ago. Production firms are more optimistic than service firms, with service firms showing an overall net balance for repeat business for the next six months at $+0.5\%$ ($+10\%$ in the previous quarter) compared to $+3\%$ (-7% in the previous quarter) for production firms.

Figure 3: What is the trend in your volume of new business? (% net balance)



Source: Fraser of Allander Scottish Business Monitor

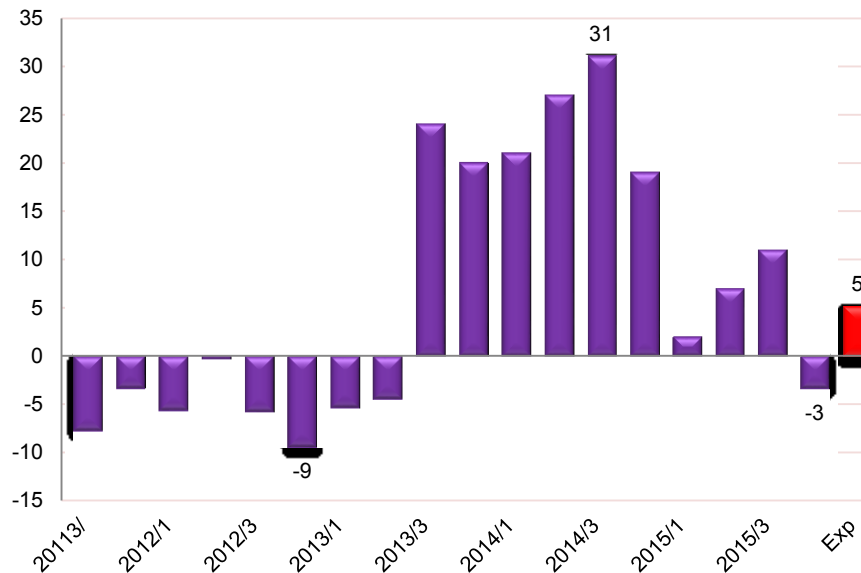
Trends in the volume of new business eased during the three months to the end of November with an overall net balance of $+3\%$ compared to $+17\%$ of the previous quarter and also down on the $+18\%$ of the same quarter one year ago.

The overall net balance of new business for firms in the production sector in the three months to end November 2015 was -3.4% . This is significantly down from the $+18\%$ of the previous quarter and also down on the $+12\%$ of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending November of $+7\%$, down on the $+17\%$ of the previous quarter and also from the $+23\%$ of the same quarter one year ago.

Expectations for the volume of new business in the next six months have eased with the latest net balance at $+6\%$ – down on the $+18\%$ of the previous quarter and also down on the $+19\%$ of the same quarter one year ago. Service firms are more optimistic than production firms, with service firms

showing an overall net balance for new business for the next six months at +8% (+21% in the previous quarter) compared to +1% (+14% in the previous quarter) for production firms.

Figure 4: What is the trend in your total volume of business? (% net balance)

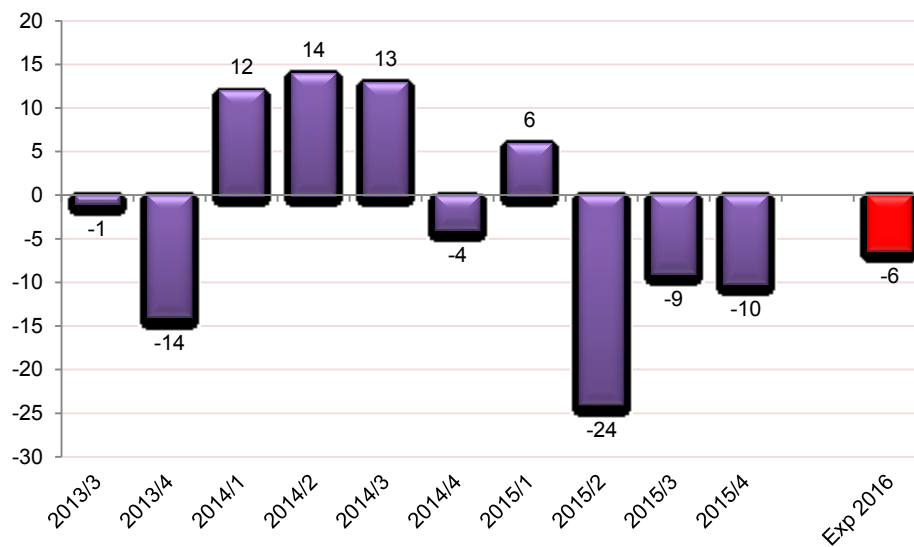


Source: Fraser of Allander Scottish Business Monitor

Total volumes of business had been showing a slowly improving trend however in the latest quarter a net of -3% reported a decline, down on the +11% of the previous quarter and also down on the +19% of the same quarter one year ago. These downward trends are evident across both production (-1%) and services firms but remain less positive among production firms (-5%).

The overall net balance of the total volume of business for firms in the production sector in the three months to end November 2015 was -1%. This is significantly down from the +6% of the previous quarter and also down on the +16% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending November of -5%, significantly down on the +13% of the previous quarter and also from the +21% of the same quarter one year ago.

Expectations for the total volume of business in the next six months have eased with the latest net balance at +5% down on the +10% of the previous quarter and also down on the +20% of the same quarter one year ago. Service firms are more optimistic than production firms, with service firms showing an overall net balance for new business for the next six months at +7% (+16% in the previous quarter) compared to +3% (+3% in the previous quarter) for production firms.

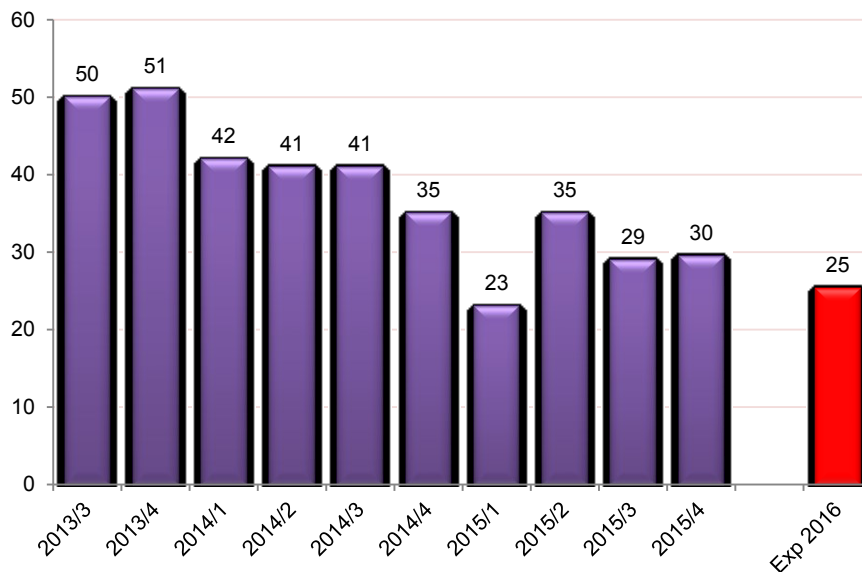
Figure 5: What is the trend in your export activity? (% net balance)

Source: Fraser of Allander Scottish Business Monitor

Export activity is continuing, on balance, to fall. The overall net balance for export activity at -10% marginally down on the -9% of the previous quarter and also worse than the -4% of the same quarter one year ago. The US Federal Reserve's decision to increase interest rates during December 2015 suggests their confidence in the embeddedness of recovery, however it remains to be seen how the US economy responds to this decision. Concerns about a slowdown in Chinese growth as we begin 2016 suggests ongoing weakness in the global economy. This feeds back to Scottish activity both through lower exports and a low price of oil affecting activity across the country, and particularly in the North East of Scotland.

The net balance for expected export activity for the next six months has eased. The net balance reached -6% – better than the -13% of the previous quarter but worse than the +5% of the same quarter one year ago.

Expectations for export activity in the next six months have fallen with the latest net balance at -6% – this has eased from the -13% of the previous quarter but is down on the +4% of the same quarter one year ago. Service firms are more pessimistic than production firms, with service firms showing an overall net balance for export activity for the next six months at -10% (-14% in the previous quarter) compared to -2% (-13% in the previous quarter) for production firms.

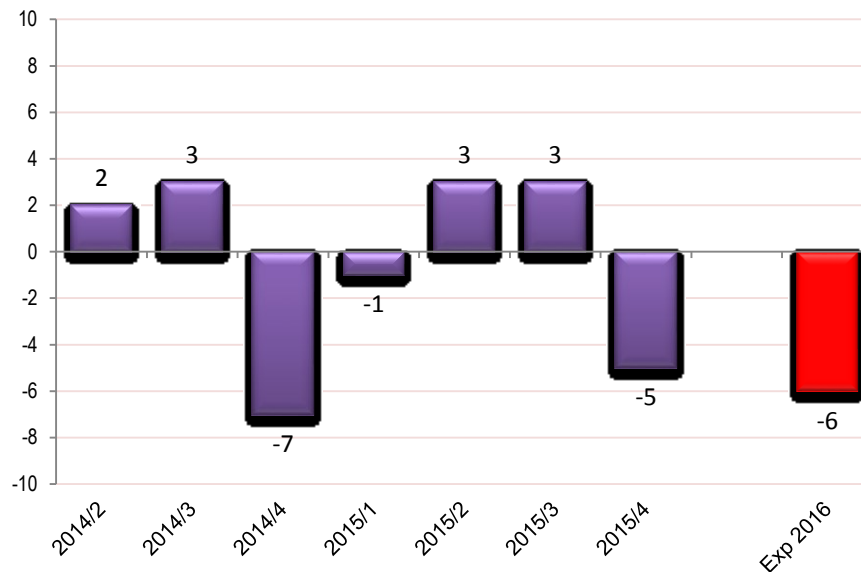
Figure 6: What is the trend in your costs? (% net balance)

Source: Fraser of Allander Scottish Business Monitor

Cost pressures were broadly unchanged in the latest quarter. The overall net balance of firms experiencing cost increases in the last three months was +30% – largely comparable to the +29% of the previous quarter but less than the +35% of the same quarter one year ago.

The overall net balance of costs for firms in the production sector in the three months to end November 2015 was +31%. This has increased from the +20% of the previous quarter but marginally down on the +36% of the same quarter one year ago. Services firms showed an overall net balance of costs for the three months ending November of +28%, down on the +34% of the previous quarter and also from the +35% of the same quarter one year ago.

Expectations for future cost increases have fallen slightly. The overall net balance for cost expectations is +25% – down from the previous quarter's +28% and lower than the +34% of the same quarter one year ago. Whilst 60% expect their costs to remain static, 33% expect an increase as opposed to 8% who expect a decrease in the next six months. Production firms are facing a larger increase in costs than service firms, with service firms showing an overall net balance for the trend in costs for the next six months at +3% (+27% in the previous quarter) compared to +22% (+30% in the previous quarter) for production firms.

Figure 7: What is the trend in your capital investment? (% net balance)

Source: Fraser of Allander Scottish Business Monitor

As forecast by firms from the previous survey, the rate of capital investment declined in Q4. For the three months to November 2015, 44% of firms reported static levels of capital investment, 30% a decrease while 25% reported an increase giving a net balance of -5%, down on both the levels last quarter +3% and also compared to the same quarter one year ago +7%.

The overall net balance of the rate of capital investment for firms in the production sector in the three months to end November 2015 was -11%. This has decreased from the +2% of the previous quarter and also from the +7% of the same quarter one year ago. Services firms showed an overall net balance of capital investment for the three months ending November of 0%, down on the +4% of the previous quarter and also from the +8% of the same quarter one year ago.

Expectations for new capital investment the next six months ending February 2016 are showing an overall net balance of -6%; down on the -3% of the previous quarter and marginally down on the -5.5% of the same quarter one year ago. Services firms remain less pessimistic than production firms, with service firms showing an overall net balance for new capital investment for the next six months at -1% (-2% in the previous quarter) compared to -13% (-4% in the previous quarter) for production firms

Scottish Chambers of Commerce Quarterly Economic Indicator

The Scottish Chambers of Commerce Quarterly Economic Indicator (QEI) is produced in collaboration with the Fraser of Allander Institute, University of Strathclyde. The results for the latest survey for Q4 2015 showed that there was a mixed performance across Scotland's key business sectors. The construction and manufacturing sectors reported strong results, indicating continued growth following

positive results in Q3 2015. However the tourism sector showed a somewhat mixed picture and the retail & wholesale sector experienced a decline with many of the indicators entering into negative territory. Both the retail & wholesale and tourism sectors, returned poorer results in Q4 2015 compared to the same quarter the year previously. Furthermore, the survey indicated a further contraction in the financial & business services sector. Overall, the survey showed that business optimism was lower in Q4 for the majority of sectors, compared to the same quarter one year previously.

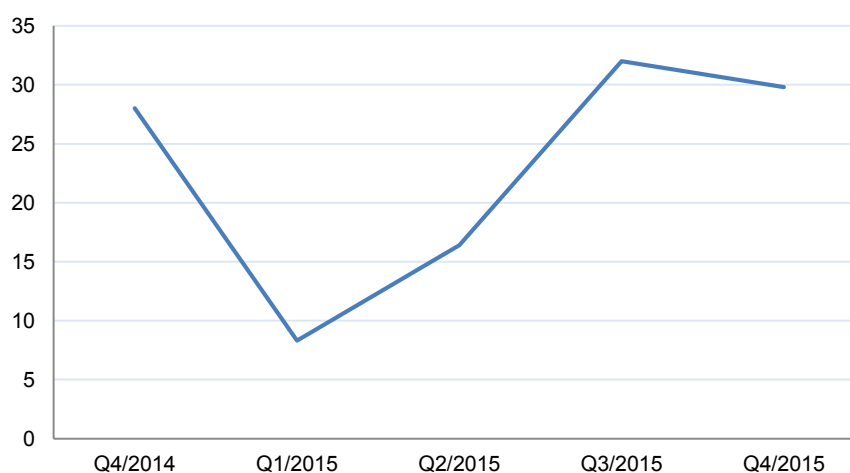
Construction

55.3% of construction businesses reported an increase in total sales revenue in Q4 2015, (a net balance of +38%). The increase can largely be attributed to domestic (Scotland) sales with just under half (47.8%) of firms reporting an increase. Almost 79% of respondents indicated that sales revenue will either be maintained or increased.

Construction Investment expenditure was positive during Q4 2015 with a net balance of 30% reporting a rise. Growth was recorded for both capital and training investment with net balances of +22% and +40% respectively. A net of +23% anticipate a further increase. A net balance of +24% reported a rise in profits during Q4 2015 marking the third consecutive quarter that construction businesses have, on balance, reported a rise in profits.

Almost half (48.9%) of all firms reported an increase in employment during the final quarter of 2015 (a net balance of +34%); the highest net balance since Q2 2007. Employment levels are expected to remain buoyant in Q1 2016 with 91.5% of businesses either expecting no change or anticipating an increase. Almost 70% of firms reported attempting to recruit staff over the quarter - the highest figure recorded since Q3 2007. Of these firms 64.5% experienced recruitment difficulties.

Figure 8: Trend in profit – Construction (% net balance)



Source: *Scottish Chambers of Commerce*

Financial and Business Services

The results recorded for the financial & business services sector was almost uniformly negative / subdued and continued to show the impact of the low oil price. Oil prices were a commonly cited concern for businesses throughout the year. Following disappointing figures in Q3 2015; results for Q4 2015 suggest a further contraction in the Financial & Business Services sector. Optimism declined for a net balance of -12% of firms - the lowest net balance since Q3 2014.

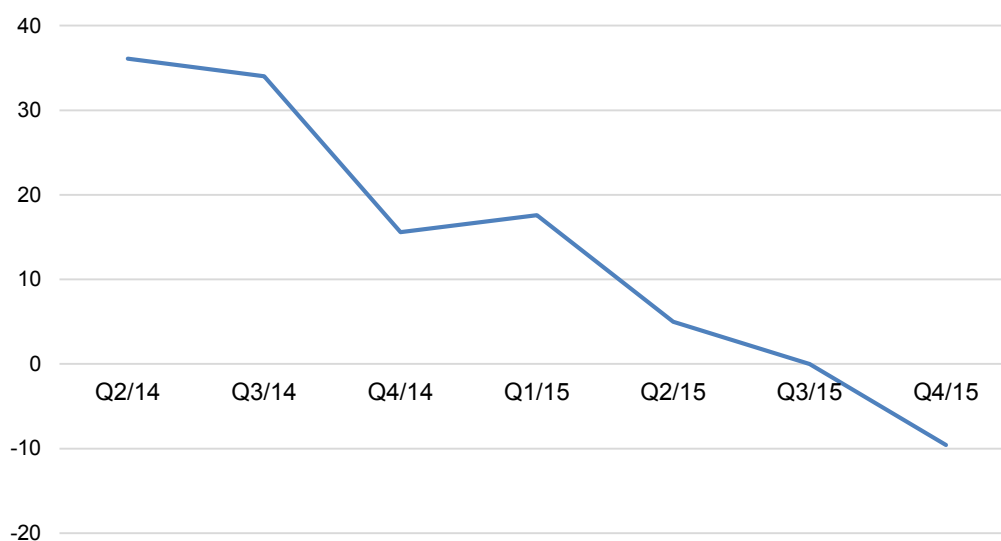
Following four quarters of positive trends for sales revenue, a negative net balance of -15.6% was recorded during Q4 2015. This is the first time that the trend balance for sales revenue has been in negative territory since this sector was introduced to the survey in Q4 2014. Cash-flow for businesses within the sector, declined for a net balance of -22.5%, also the lowest figure recorded since the sector was introduced.

A net balance of -10% reported a decline in expenditure on investment, this is first time a negative net balance has been reported since the sector was introduced to the indicator in Q1 2014. Moreover, with a net balance of -3% anticipate a further decline in Q1 2016.

Profits declined over the quarter for 46.7% of all businesses resulting in a net balance of -25%, the lowest recorded figure since Q1/14.

Employment levels decreased for a net balance of -12% of firms, the third consecutive quarter that employment levels were in negative territory. However a net balance of 7% expect a rise in Q1 2016.

Figure 9: Investment intentions in Financial and Business Services (% net balance)



Source: Scottish Chambers of Commerce

Manufacturing

Orders increased for a net balance of +18% of manufacturing firms in Q4 2015. While net balances of +6% and +14% were reported for orders from Scotland and the Rest of the UK respectively, growth eased for exports with a net balance of +12%.

Sales also, on balance, improved with a net of +13.7% reporting a rise; this is the fifth consecutive quarter that sales revenue has been positive. Growth was reported throughout the sector in terms of sales from Scotland (+8), rest of UK (+16) and exports (+8). These trends are expected to continue in Q1 2016 with 41.2% of all firms expecting sales to increase. Almost half (47.1%) of businesses reported an increase in the level of work in progress in Q4, (a net balance of +29%), the highest net % balance recorded in 2015.

A net balance of 33% reported a rise in investment expenditure over the quarter and a net of 14% expect a rise in Q1 2016.

Total employment levels rose for a net balance of +24% of firms during Q4 2015 and total employment levels are expected to be maintained or increased in Q4 with 56% of businesses expecting no change and 34% anticipating an increase. Almost 70% of firms reported attempting to recruit staff in Q4 2015 and almost one third of these firms reported facing recruitment difficulties.

Tourism

Tourism firms reported that the total number of guests and customers grew in comparison to the same time last year for a net balance of +26% of firms. Firms reported positive trends in guests coming from Scotland (+15%) and rest of UK (+15%), however, a net balance of business reported experiencing a fall in the number of guests from the rest of EU (-4%) and out with the EU (-11%).

Positive balances were reported for domestic (Scotland) sales and online sales, with net balances of 9% and 2% respectively however there was a negative trend balance for sales from the rest of UK (-11%).

Profits were down over the quarter for a net balance of -15% of firms and 53.2% of firms expect to increase their prices in Q1 2016 in order to increase profit margins.

Investment expenditure was positive during Q4 2015, with a net balance of +25% of firms reporting increased investment expenditure. Positive trends were recorded for both training and capital investment with net balances of +17% and +29% respectively. Investment expenditure is expected to continue to grow in Q1 2016 for a net balance of +17%. Downward trends are expected for both sales revenue and employment levels in Q1 2016.

Retail and wholesale

There was a decline in business optimism as a net balance of -17% reported a decline in business optimism in the final quarter of 2015 – this is the first negative net balance since Q4 2012.

A net balance of -23% reported a decline in sales in Q4 2014, with 44% of all firms experiencing a fall in sales - the lowest net balance since Q2 2013. However, a net balance of +19% expect sales to grow in Q1 2016. Total investment expenditure declined over the quarter for a net balance of -2%. A net balance of -26% reported a decline in profits during the final quarter of 2015.

Over the quarter, a net balance of -5% of retail and wholesale firms reported a decline in total employment levels. However, 41.9% of businesses in the sector reported attempting to recruit and a positive net balance of +9% expect a rise in Q1 2016. Expectations for the start of 2016 are encouraging as a net of 19% expect a rise in sales revenue and a net of +12% expect a rise in investment.

The Scottish Construction Monitor

Widely viewed as an important barometer of confidence within the Scottish construction sector, the Scottish Construction Monitor is a quarterly business confidence survey of the membership of the Scottish Building Federation (SBF). The latest survey covers Q4 2015 and in addition to its regular questions it also included a short series of questions to measure members' views concerning areas of policy including procurement, skills, planning and building control, capital investment, energy efficiency and consumer protection. The main findings of the latest survey are detailed below.

The overall confidence rating of the Scottish construction sector has been positive for ten consecutive quarters although in Q3 2015 confidence fell by 14 points and then fell a further 13 points in Q4 to sit broadly where it was during the final quarter of 2013 at +8. The percentage of respondents more confident about their prospects for the next 12 months compared to the past year has fallen from 51% last quarter to 33% this quarter and conversely, the percentage of respondents less confident about their firm's future prospects has risen from 16% in Q3 2015 to 25% this quarter.

More than half of responding firms did not believe that the recent procurement reforms by the Scottish Government improved procurement in Scotland compared to only 11% who did. Forty-four percent of respondents dislike current tendering practices claiming that they cannot afford not to take part in tenders and almost a quarter of firms reported negative experiences of procurement making them more selective in tendering for projects. The survey found that 16% actively avoid procurement opportunities due to cost and complexity compared to 14% who are content to tender and have generally positive experiences. The main issues surrounding tendering are cost and complexity, tight profit margins on projects, use of guarantee bonds and the delayed payment of tender fees.

Shortages of skills and labour were a concern with more than three quarters of respondents either moderately or extremely concerned about the impact on future growth and profitability, whereas only 7% reported having no concerns about this issue.

Most respondents were moderately satisfied with the performance of local authority planning and building control departments, while a third were not satisfied and 8% were very satisfied. 13% of respondents rate the Scottish Government's performance in prioritising public funding for investment in construction projects as good, 35% rate it as fair and 24% rate it as poor. Respondents to the latest survey ranked housing as the top priority for public investment in construction projects whereas investment in transport, energy and communications infrastructure is ranked lowest. Just over a third of firms did not think that the Scottish Government does enough to support improved energy efficiency in Scotland's existing built environment compared to 26% who do.

Scottish Engineering Quarterly Review

The latest Scottish Engineering Quarterly Review for the fourth quarter of 2015 showed that the engineering industry is being adversely affected by the strength of the pound and the impact of the slowing economy in China. The review noted that many trading areas are suffering although some companies serving more niche markets continue to thrive.

Optimism overall continued to fall but remained positive for large companies; however it continued to decline, on balance, for small and medium sized firms. Total order intake continued to fall for a net balance of 20% of firms. Falls in orders were more noticeable in small and medium sized firms. Prices, on balance, declined for a net of 30% of firms and a net of 19% of firms are forecasting a further decline for Q1 2016. Capital investment plans continued to decline for a net balance of firms. Training investment plans on the other hand continued to be positive. A net balance of 8% of Scottish engineering firms reported a decline in total employment levels and a net of 7% expect a decline in Q1 2016.

Conclusions

Overall, the pace of the recovery has slowed and this easing in the economy was identified by many Scottish business surveys last year. Despite the slowing in the rate of increase for many of the key balances, expectations in many of the surveys remained buoyant showing that many businesses are trying to be optimistic about the year ahead, however they face a number of challenges. Many forecasters have revised their forecasts downwards including the Bank of England whose forecast for GDP growth for 2015(?) has been revised down from 2.5% to 2.2%. The economy appears to be settling into a pattern of lower and slower for longer growth; with the economy still growing, but growing less strongly. Worldwide markets have been volatile despite many of the fundamentals in the economy remaining fairly good. The main concern is that if this turbulence and nervousness continues then business confidence could begin to suffer.

References

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