

Q3 2022



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INTRODUCTION

**THIS REPORT SUMMARISES THE
KEY RESULTS FROM OUR LATEST
FRASER OF ALLANDER INSTITUTE
(FAI) SCOTTISH BUSINESS MONITOR,
PUBLISHED IN PARTNERSHIP WITH
ADDLESHAW GODDARD**

The survey sampled 450 firms in October from across the Scottish economy.

The survey examined business sentiment in the third quarter of 2022 and the outlook and expectations for the year ahead.

Our survey results show that business sentiment is now negative for the first time since the end of 2020, with over **7 in 10** firms in Scotland now expecting growth in the Scottish economy to be weak or very weak over the coming year.

OUR SURVEY RESULTS ALSO SHOW THAT:

- Energy costs continue to loom large in business decision-making, with just **under half** of Scottish firms surveyed this quarter expecting to reduce their operations this year due to higher energy bills, up from **40%** last quarter.
- However, over **3/5** of firms reported that the ongoing energy crisis had increased their focus on adopting energy-efficient processes.
- In terms of overall business costs, **90%** of firms in Scotland surveyed have experienced higher business costs over the past year, with the majority (**77%**) experiencing increased costs of up to **50%**.
- **10%** of hospitality firms have seen their costs more than double in a year.
- Businesses expect energy bills and wages to drive costs in the coming 6 months.
- Our latest results indicate that businesses will continue to pass these increased costs on to their consumers, with **85%** of responding businesses reporting that they expect their prices to increase by more than normal, or a lot more than normal, in the next 12 months.
- However, the share of Scottish firms experiencing supply chain issues continues to fall, which may ease some inflationary pressures.
- Finally, in the latest quarter, **half** of responding businesses had vacancies to hire new staff members, down from **56%** in the previous quarter, suggesting the labour market might be cooling slightly.
- However, increasingly, firms are finding it challenging to fill these job posts, with **9 in 10** struggling to hire the staff they need. This is predominantly due to a lack of skills, applications, and, increasingly, wage expectations.



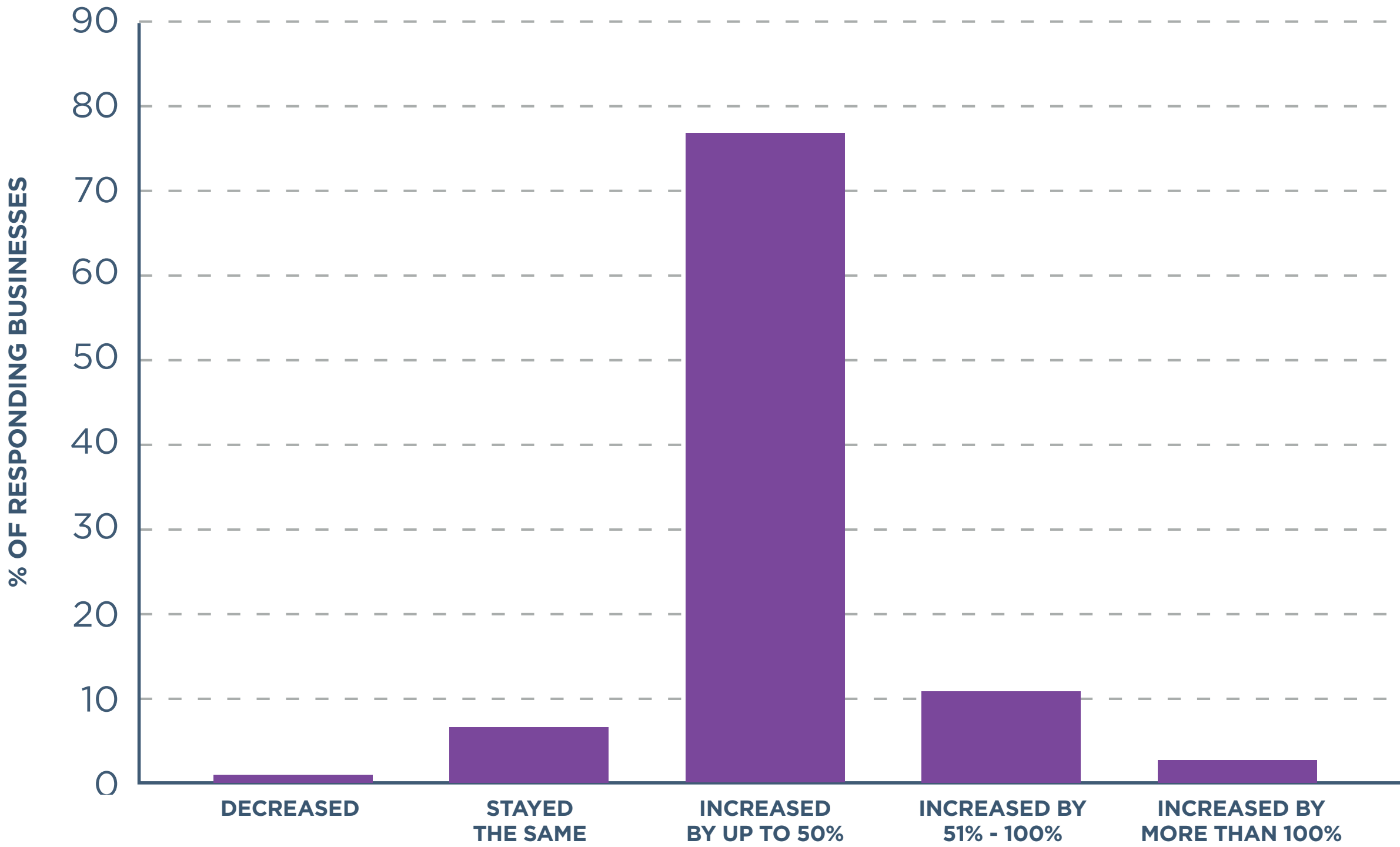
KEY RESULTS

BUSINESS COSTS

- This quarter we asked businesses across Scotland how their costs have changed over the past year.
- **90%** of firms in Scotland surveyed had experienced increased business costs, with the majority (**77%**) experiencing increased costs of up to **50%**.
- Just **7%** of Scottish firms have seen their business costs stay the same, or decrease, over the year, while **2%** have seen their costs more than double.
- Just under **10%** of hospitality firms in Scotland have seen their business costs increase by more than **100%**.

Chart 1:

Over the past year, roughly how have your business costs changed?



*3% of businesses responded N/A; therefore, percentages will not sum to 100%

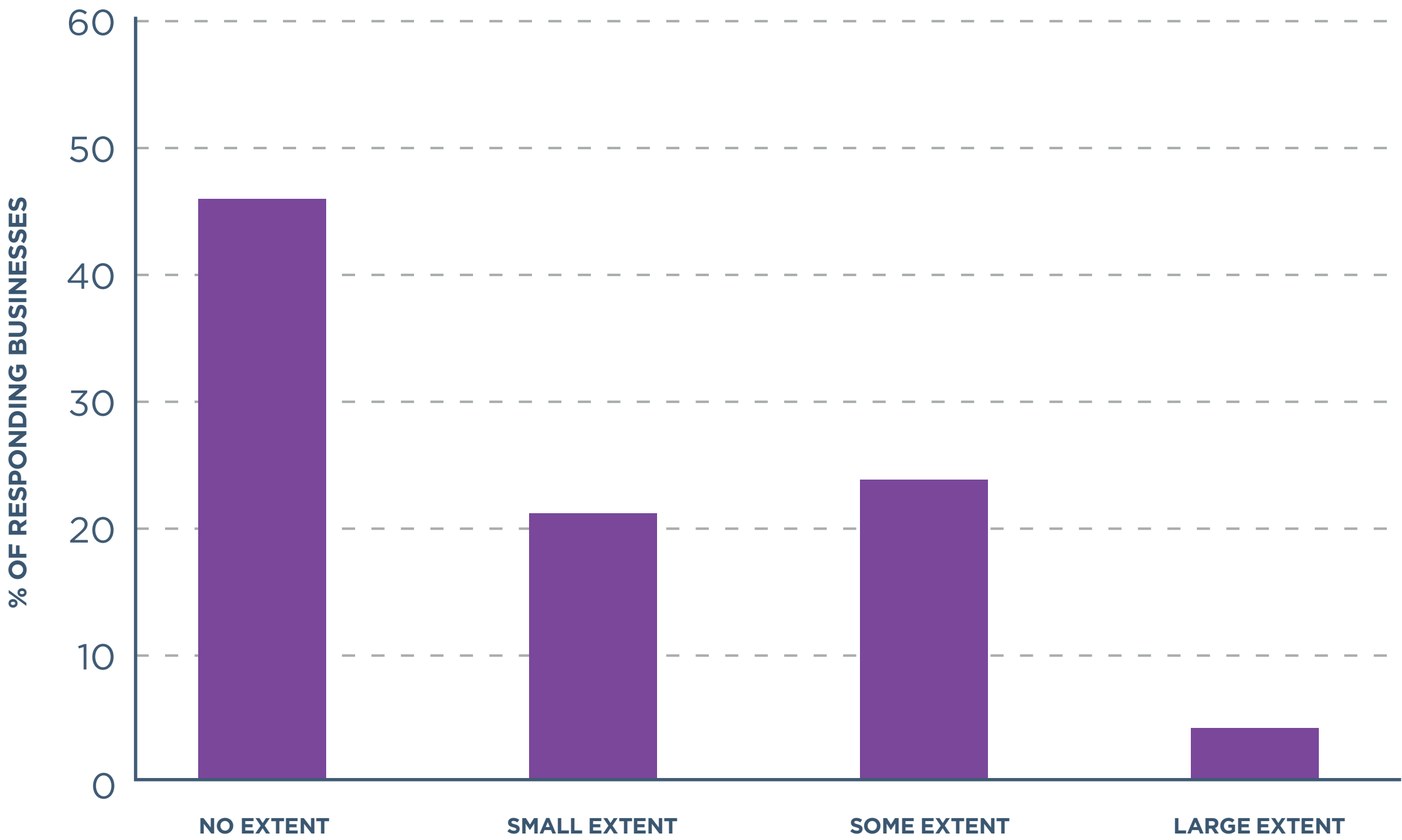
KEY RESULTS

ENERGY COSTS

- We continued to ask businesses about rising prices in the energy sector and how this is expected to impact their operations.
- Just **under half** of the businesses surveyed this quarter expect to reduce their operations this year due to higher energy prices, with the majority anticipating this reduction to be small or moderate.
- This is a **9%** increase relative to the previous quarter.
- **46%** of businesses reported that they do not expect to reduce operations in the year ahead, down from **55%** in the previous quarter.
- The accommodation and food services sector had the highest share of firms (**74%**) expecting to reduce operations due to rising energy bills.

Chart 2:

To what extent do you expect to reduce operations this year due to increases in energy (electricity, gas, or fuel) prices?



*5% of businesses responded N/A; therefore, percentages will not sum to 100%

KEY RESULTS

ENERGY EFFICIENCY

- Given the impact rising energy costs continue to have on firms, we asked businesses if the energy crisis has sped up considerations to make energy-efficient improvements.
- Over **3/5** of firms reported that the ongoing energy crisis had increased their focus on adopting energy-efficient processes.
- More than **70%** of manufacturing, hospitality, finance, and info & comms firms reported that the energy crisis had increased their focus, while the equivalent figure for transport and storage was just under a third.
- Of those firms with an increased focus on energy efficiency, the majority plan to revise their energy processes (**57%**). This was followed by those that plan to invest in solar panelling (**28%**), invest in draughtproofing and/or double/triple glazed windows (**25%**), invest in green heating technologies (**13%**), and adopt hydrogen (**1%**).



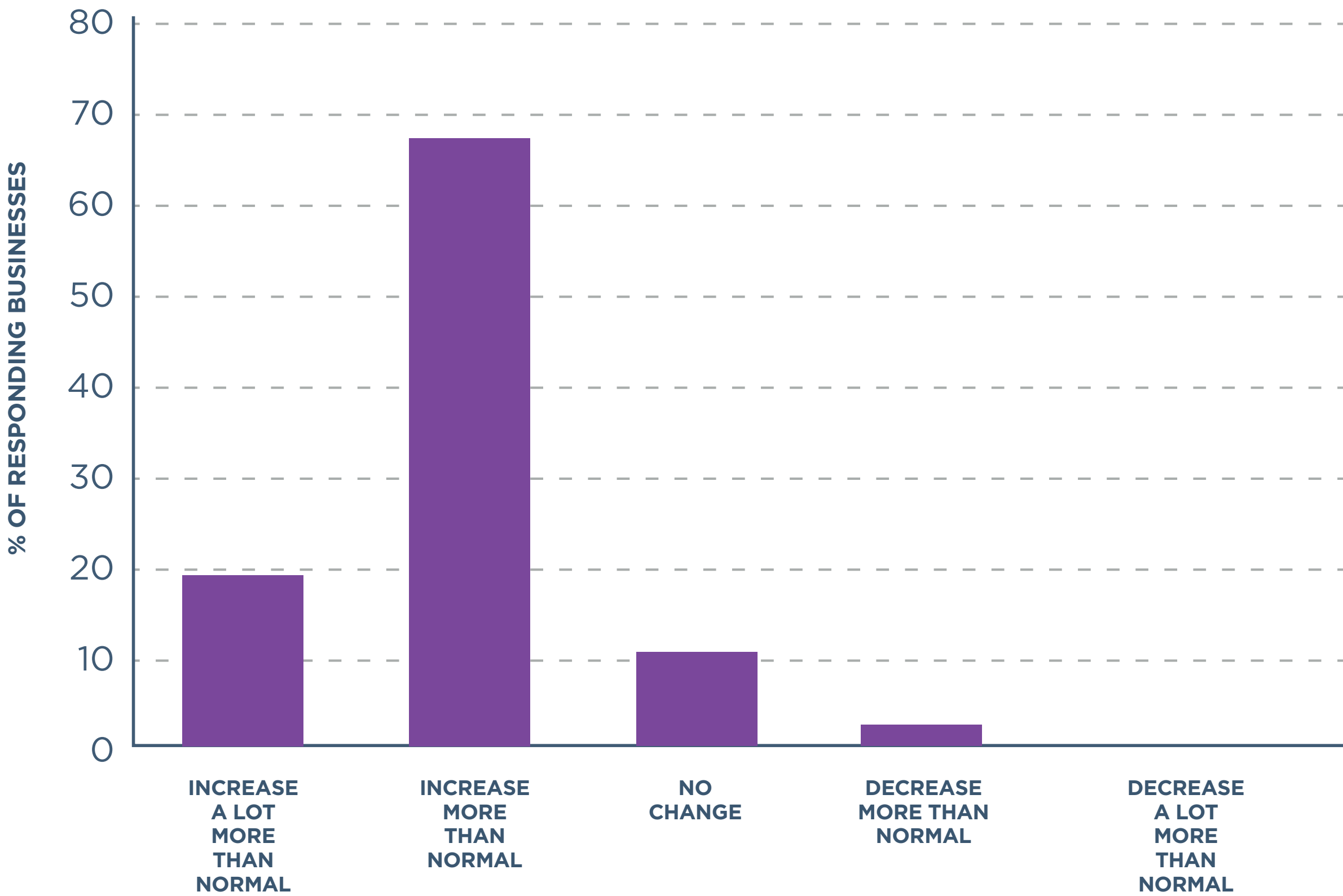
KEY RESULTS

INFLATIONARY PRESSURES

- Inflationary pressures continue to impact firms, with **85%** of firms expecting to increase their prices by more than, or a lot more than normal, over the next 12 months.
- Relative to the last quarter, there has been a marginal decrease in the number of businesses expecting to raise their prices significantly over the next 12 months - made up by an increase in the number of businesses expecting moderate price rises.
- Only **2%** of firms expect their prices to decrease by more than normal, and **10%** expect no price changes at all over the next 12 months.
- No firms this quarter reported that they expect their prices to decrease by a lot more than normal over the next 12 months, down from the **1%** reported in Q2.
- **93%** of firms in the administration and support services expect the price of their goods and services to increase, as do **91%** of firms in the accommodation and food services sector.

Chart 3:

Over the next 12 months, how do you expect the prices of your goods and services to change compared to normal?



*2% of businesses responded N/A; therefore, percentages will not sum to 100%

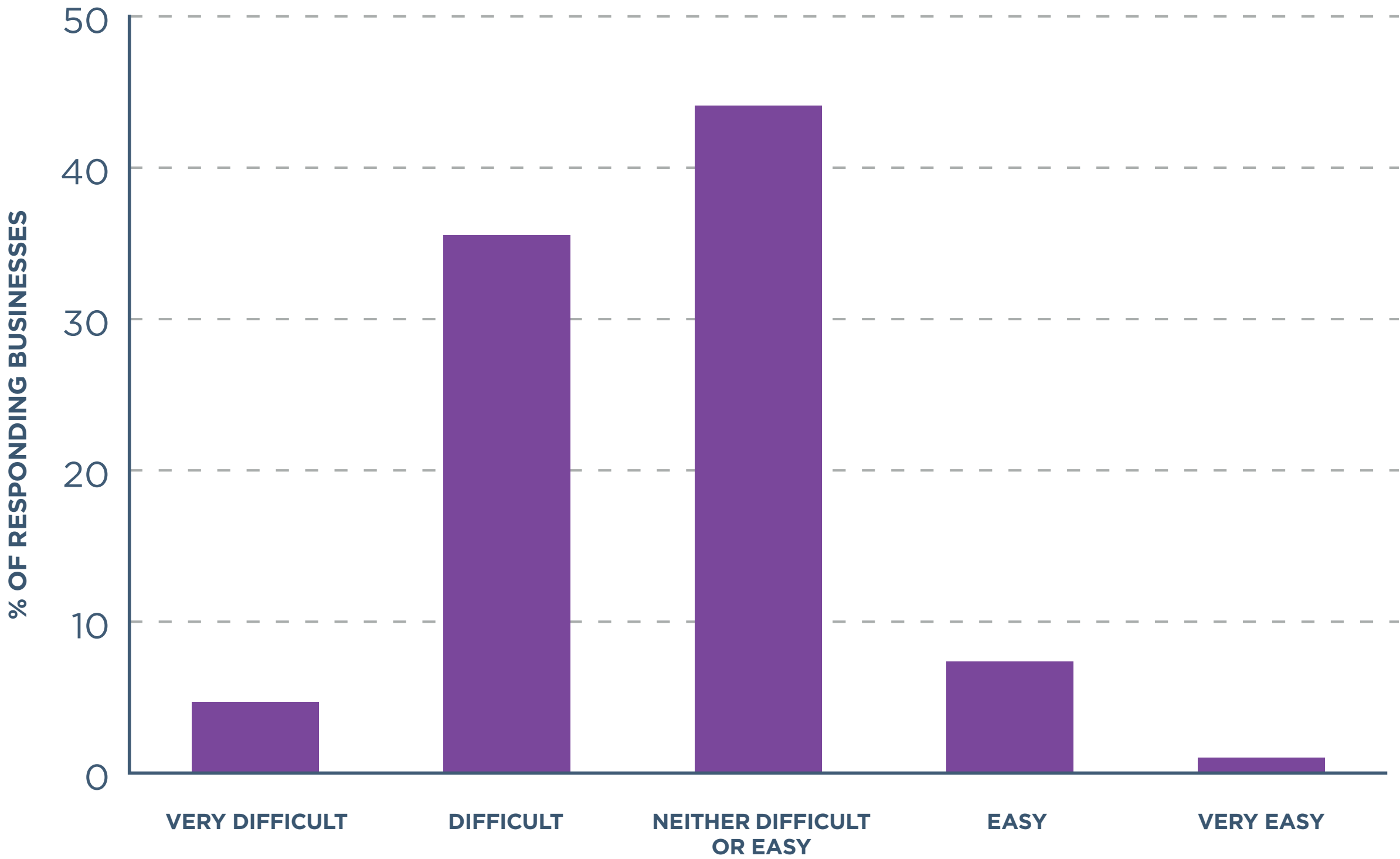
KEY RESULTS

SUPPLY CHAIN ISSUES

- Given ongoing supply chain challenges, we continued to ask firms about their experience sourcing goods and services.
- 40%** of businesses reported that they were finding it difficult, or very difficult, to purchase goods and services – down 7-percentage points relative to the last quarter.
- 7%** reported that they were finding it easy to source goods and services, with only **1%** reporting that they were finding it very easy to source goods and services.
- Businesses in the accommodation and food services sector were finding it hardest to source goods and services, with over **3/5** of firms reporting difficulties.
- The most common factor affecting firms’ ability to source goods and services was a lack of supply in the UK (**73%**), followed by the price of goods and services (**71%**).
- Other common factors hampering businesses’ procurement were the availability of freight and potential delays (**46%**), as well as the cost of freight (**41%**).

Chart 4:

How easy or difficult are you finding it to source available goods and services your business purchases?



7% of businesses responded N/A; therefore, percentages will not sum to 100%

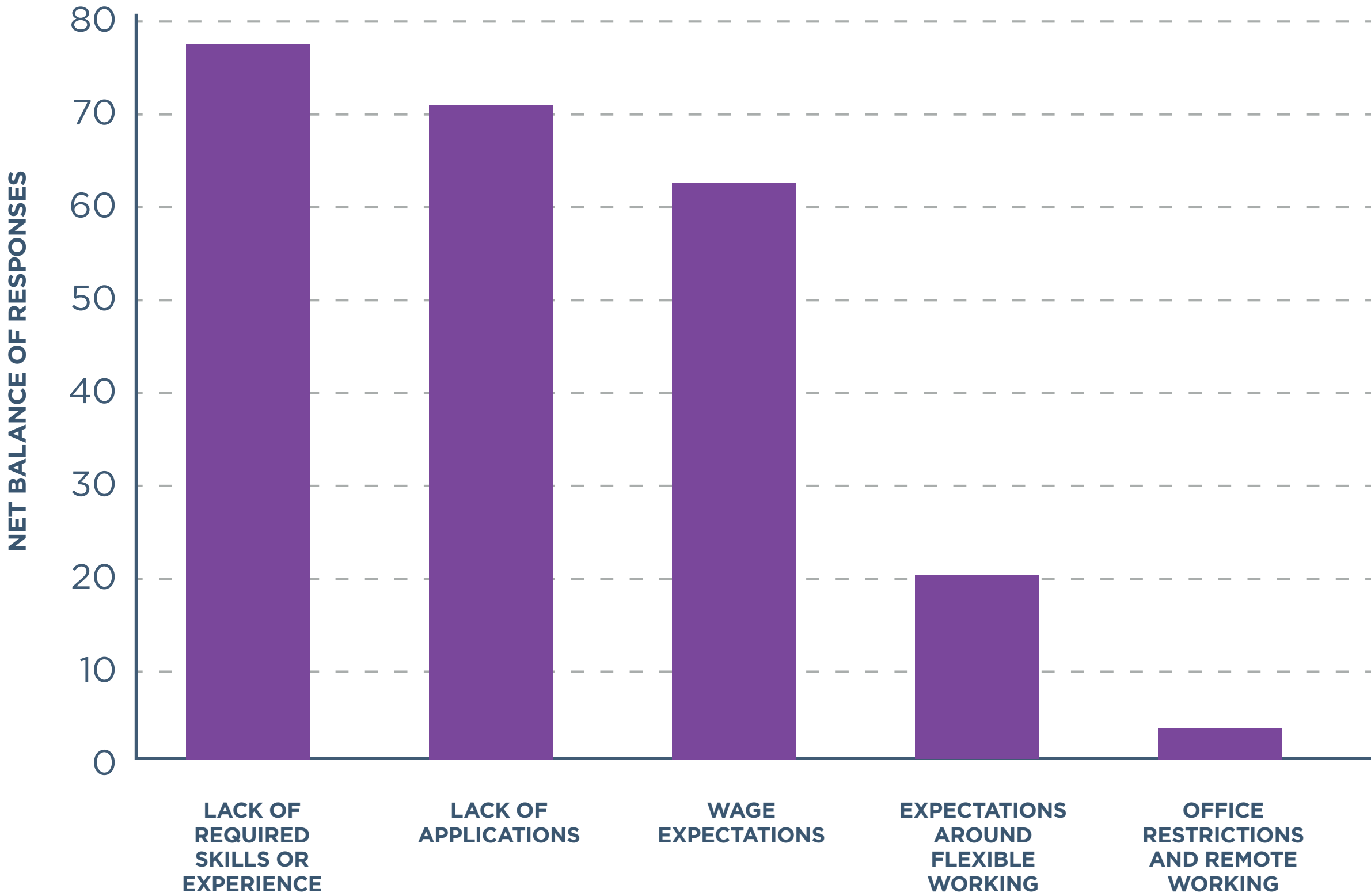
KEY RESULTS

VACANCIES

- In the most recent quarter, half of responding businesses had vacancies to hire new staff members, down from **56%** in the previous quarter, suggesting the labour market might be cooling slightly.
- Of the firms that reported vacancies, just under **9 in 10** reported that they were finding it difficult, or very difficult, to fill these vacancies. This is up 3-percentage points from the last quarter.
- A lack of required skills or experience continued to be the greatest challenge in filling these vacancies (**77%**).
- A lack of applications was also identified as a significant barrier (**71%**), and increasingly wage expectations (**62%**) are making it difficult for Scottish firms to hire the required staff.
- Compared to the last quarter, firms are finding it more challenging to retain their current workforce, with over a third of firms reporting difficulties retaining existing staff.

Chart 5:

What factors have made filling vacancies difficult?



CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS ACTIVITY

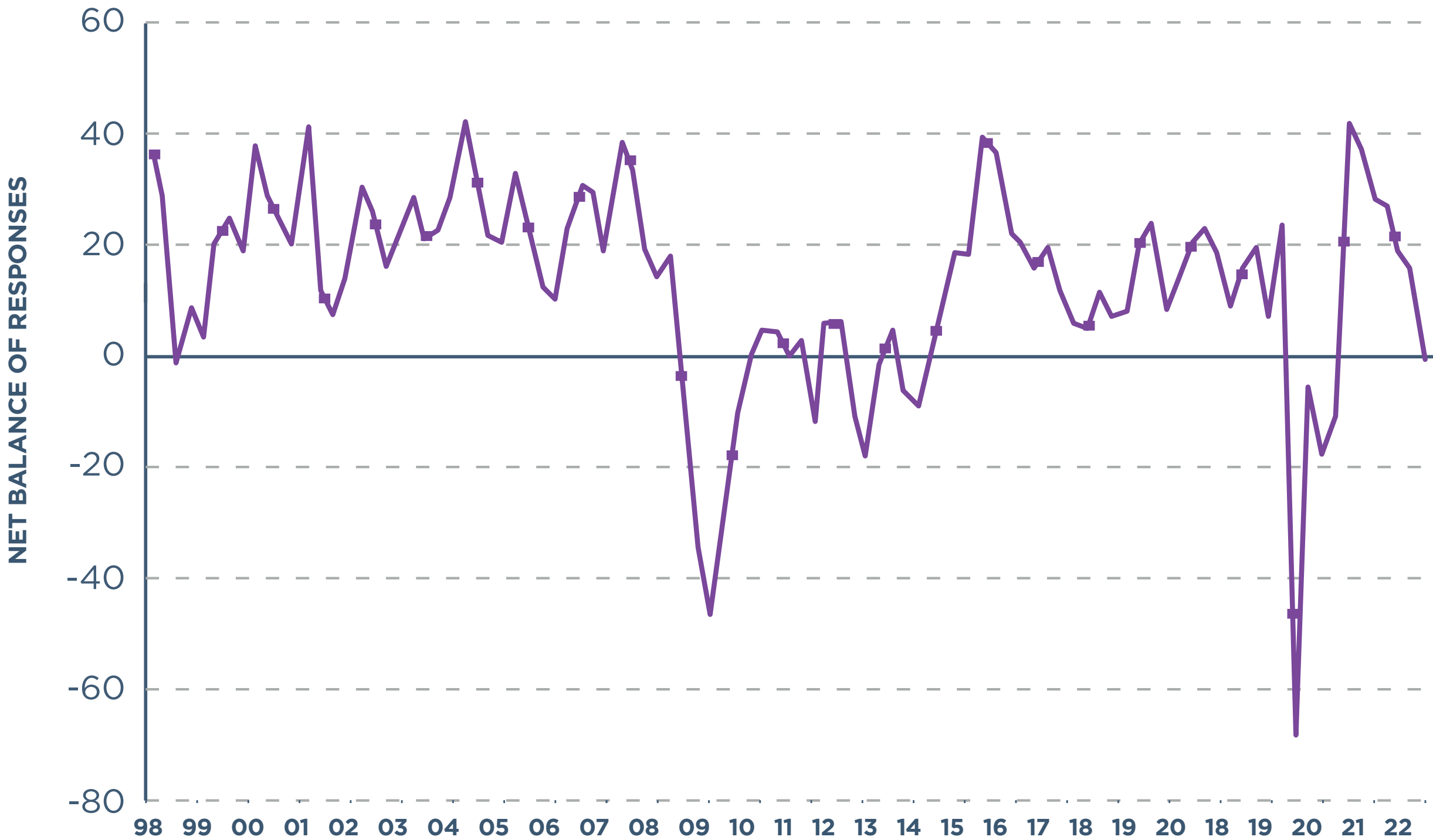
- The net balance of firms reporting an increase in their volume¹ of business over the third quarter² of 2022 remained above zero. However, it has fallen significantly compared to last quarter.
- The net balance of firms expecting an increase in their volume of business over the next six months was negative for the first time since Q4 2020.
- While there were positive net balances in expectations for the level of employment and turnover in the coming six months, there continued to be negative net balances for expected capital investment and export activity, with all measures worsening in the latest quarter.

¹ i.e. business sales.

² Q3 2022 compared to Q2 2022.

Chart 6:

Net balance (%) of firms expecting an increase in their volume of business over the next six months, Q1 1998 – Q3 2022



*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS ACTIVITY – SECTORAL ANALYSIS

- While most sectors reported a positive net balance for the volume of business in the third quarter of 2022, retail, professional services, and admin services all reported negative net balances.
- Only manufacturing experienced an improvement in business volume in the latest quarter.
- There were positive net balances for all sectors, except admin services and professional services, for the value of business activity (turnover).
- There were also positive net balances for all sectors, except admin and professional services, for the level of employment.

Table 1:

Net balance (%) of firms experiencing an increase in their volume of business over the past three months, Q1 2021 – Q3 2022

	2021				2022		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
MANUFACTURING	5	45	36	4	22	2	24
ACCOMMODATION & FOOD SERVICES	-77	46	31	18	14	17	17
CONSTRUCTION	14	55	40	3	29	26	16
TRANSPORT & STORAGE	-36	32	15	25	41	21	9
IT & COMMS	3	44	29	33	27	14	7
RETAIL & WHOLESALE	-11	18	17	39	30	17	-1
PROFESSIONAL, SCIENTIFIC, AND TECHNICAL	15	24	32	14	31	14	-5
ADMIN & SUPPORT SERVICES	-13	26	7	0	31	3	-14

*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

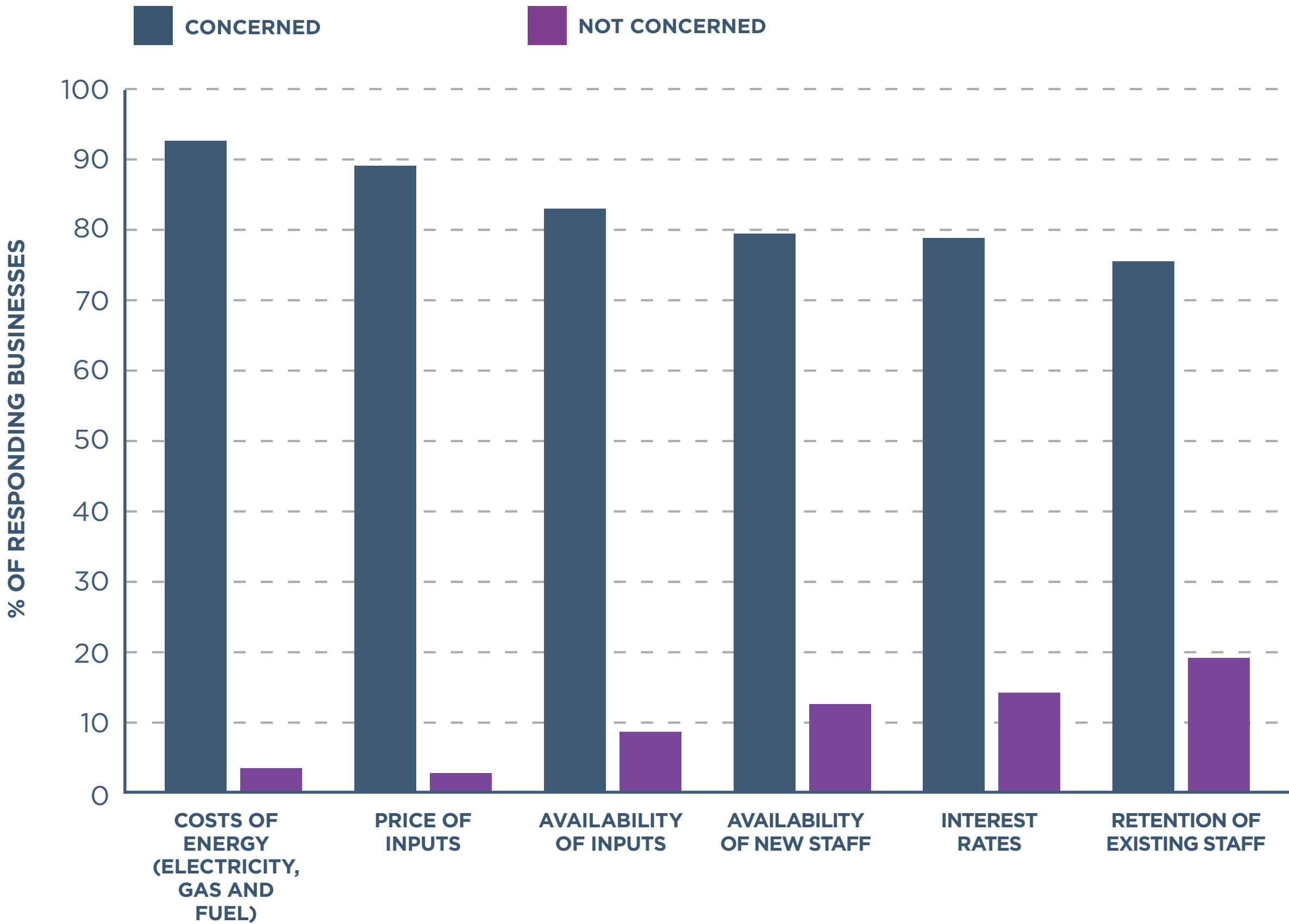
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

BUSINESS CONCERNS

- In the latest quarter, we asked Scottish firms what they expect to be important to their business over the coming quarter.
- The majority of firms expect economic and business uncertainty (**88%**), staff availability (**84%**), and policy uncertainty (**83%**) to be important, or very important, to their business over the next 3 months.
- Additionally, firms were asked what the biggest concerns for their business were likely to be over the next quarter.
- Consistent with the first half of the year, the most common concerns reported by businesses were the cost of energy (**93%**), the price of inputs (**90%**), and the availability of inputs (**84%**).

Chart 7:

Compared to normal, how concerned is your business about the following factors?



*Some businesses responded N/A; therefore, percentages may not sum to 100%

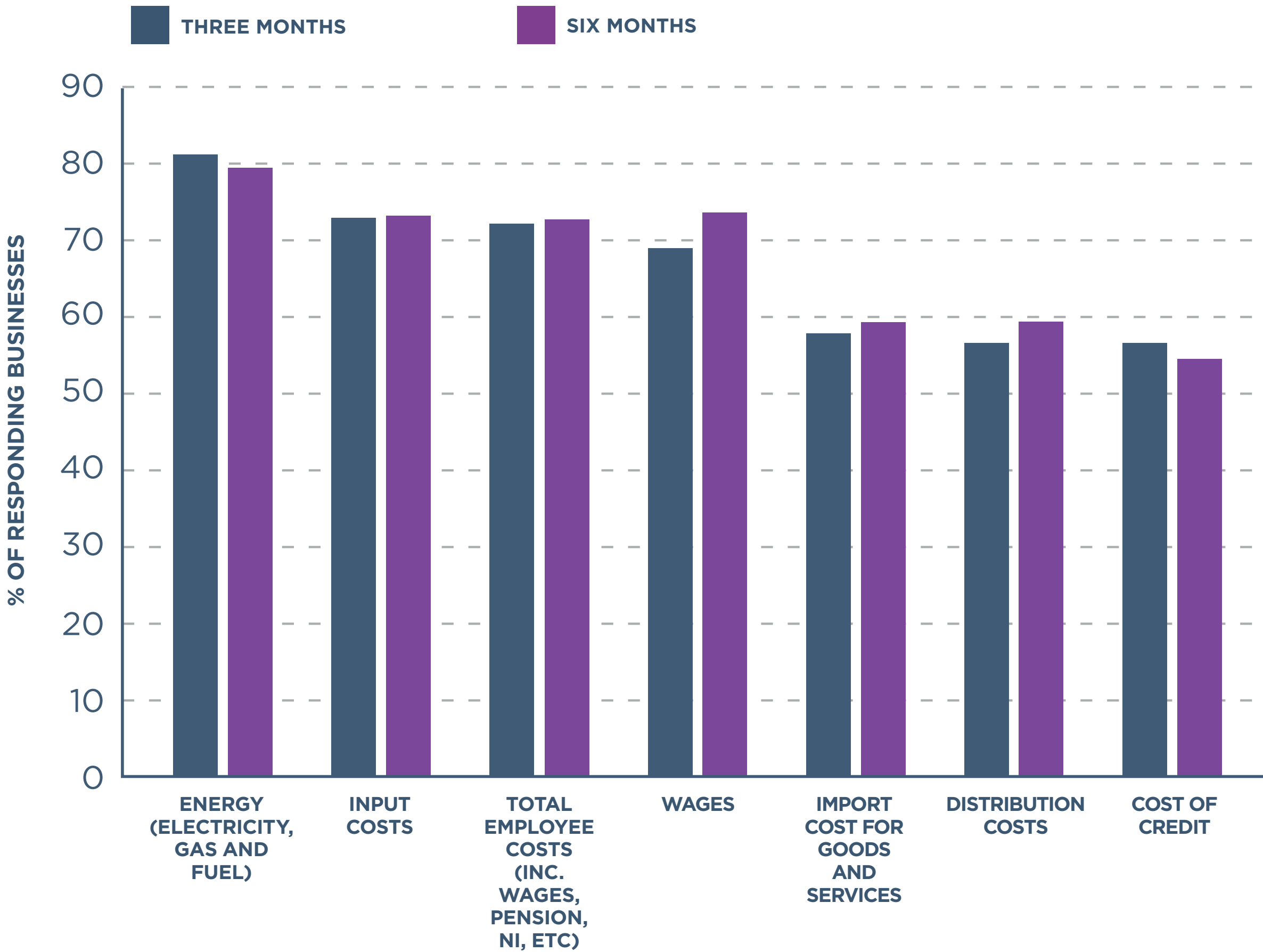
CURRENT AND EXPECTED SCOTTISH BUSINESS ACTIVITY

THE OUTLOOK FOR THE NEXT YEAR...

- We also asked businesses what the main cost drivers have been over the last quarter, and what effect they might have over the next 6 months.
- Over the latest quarter, energy was the most common cost driver reported by businesses (**83%**), followed by input costs (**81%**).
- In the upcoming 6 months, businesses expect energy (**80%**) and wages (**74%**) to act as significant cost drivers for their business.
- Finally, we asked businesses about their outlook for growth in the Scottish economy over the next 12 months.
- Over **7 in 10** firms expect growth to be weak or very weak, up from **65%** of firms in the previous quarter.
- Just **1%** expect strong or very strong growth over the next year, down from the **5%** reported in Q2.

Chart 8:

Thinking about the key cost drivers for businesses, what is your business' assessment of the following cost pressures over the past 3 months and the next 6 months?



*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

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