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Review of Scottish Business Surveys

Overall

Recent business surveys, in the main, have been optimistic and many indicate that the Scottish economy is at last moving in the right direction and that the worst of the recession is over. Most surveys show growing confidence and rising expectations for the coming quarters.

Oil and gas services

The revival of the oil and gas sector in the UKCS continued with rising confidence, investment and activity. The UKCS continues to benefit from record investment in new developments and improvement to existing assets and infrastructure, the strongest for more than three decades' (OGUK 2013:3).

The latest Aberdeen Chamber Oil and Gas Survey (No 19 Spring 2013) reported that with the latest projections for oil & gas output being for 'flat out' production to 2017; record levels of investment in new fields are forecast for 2013. A net balance of both operators and contractors reported working at or above optimum levels. Firms, on balance, continued to work above planned levels and a record 97.8% of contractors were seeking to recruit staff. More than half of contractors and operators reported increases in the total number of staff with a strong demand for permanent staff.

Oil and Gas UK, in their latest index reported that business confidence in the UK offshore oil and gas industry in the first quarter of this year remained unchanged from the Q4 2012. The index remained static at 60, indicating the continuing general positive outlook of the industry. Contractors were more positive while confidence among operators eased.

Private sector

The Bank of Scotland's latest PMI for September 2013 showed 'survey-record equalling' rates of growth in both output and new business in Scotland's private sector economy. Donald MacRae, Chief Economist at Bank of Scotland, said: "September's PMI showed the private sector of the Scottish economy continuing to expand across both manufacturing and service sectors providing further evidence of the strengthening of the recovery. Output and new business rose at survey-record equalling rates accompanied by growing employment and rising new export orders. The PMIs of the last six months suggest the Scottish economy not only grew in quarter two this year but saw that growth accelerate in quarter three. The recovery is gaining momentum."

The June PMI reported that growth in the private sector in Scotland had accelerated sharply and the July survey showed a further strong expansion in business activity. The August PMI reported that growth had consolidated further and gained momentum.

The September PMI reported sustained strong growth in business activity and in the level of new business. Employment in Scotland's private sector also rose during September, most notably among service sector firms. The report noted that backlogs of work had accumulated at businesses during September and that the latest increase was more marked than in previous months.

Production

The Bank of Scotland Scottish Business Monitor (SBM) reported a rise in turnover in the production sector, the overall net balance in the three months to end August 2013 was +24%, in stark contrast to the -5% of the previous quarter and the -2% of the same quarter of 2012. Expectations for turnover in the next six months were positive with a net of +21% of respondents expecting a rise. The SBM reported that total

volumes of business showed the second largest rise of any indicator in the Monitor with a net balance of +24%, a large improvement on the -4% of the previous quarter and the -6% of the same quarter one year previously.

The SBM reported that concerns over credit availability increased and concerns over credit costs fell. The Monitor also noted that the importance attached to the exchange rate increased dramatically for production businesses at the end of 2008 but fell back to the levels of four and a half years ago; however there was a slight increase in the level of importance attached to the exchange rate in the latest quarter.

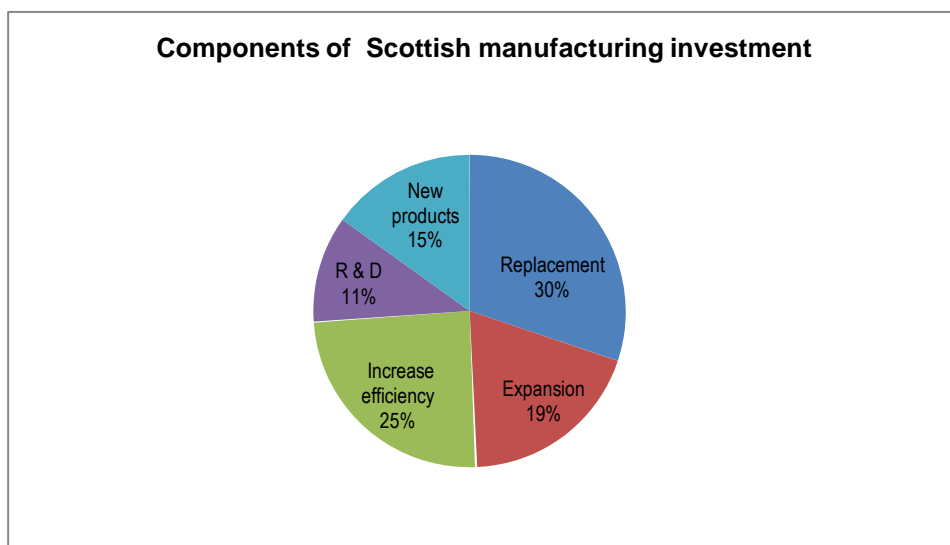
Manufacturing

During the third quarter of 2013 business confidence continued to improve for a net of 18% of Scottish Chambers' Business Survey (SCBS) respondents, a significant improvement from the -21.8% for the same quarter of 2012. Only 12% of SCBS firms were less confident compared to Q2 2013. Scottish Engineering respondents reported that business optimism generally improved during Q3 2013.

During the three months to the end of September a net balance of 16.7% of SCBS respondents reported a rise in total orders (the highest net balance since the third quarter of 2007); more than a third of firms reported a rise in total new orders and fewer than a fifth reported a decline. SCBS respondents remain optimistic as to the trends in orders for Q4 2013 (+19.1%). Average capacity utilisation rose by one percentage point over the quarter and was more than two percentage points higher than during the third quarter of 2012. The number of firms reporting working below optimum levels continued to decline. Expectations for both turnover and profitability over the coming 12 month period remain positive for a net balance of SCBS firms.

Scottish Engineering firms reported that the total order intake increased during the third quarter. Within the sectors only non-metal products experienced a negative trend and all other sectors (notably mechanical equipment and fabricators) were positive. Engineering respondents reported that UK orders maintained a healthy level and expectations are that orders will generally remain positive. Export orders in general improved in Q3 and predictions for the next quarter, in general remain positive. Scottish Engineering firms reported that for the vast majority of companies, prices were unchanged but a net balance reported an increase.

The trends in investment in plant/machinery improved during Q3 for a net balance of SCBS manufacturing respondents (+8%). New investment continues to be directed towards replacement (53%) or to improve efficiency (33%). Capital investment plans were more positive than in the previous quarter for Scottish Engineering firms and training investment plans also continue to grow.



Source: Scottish Chambers' Business Survey Q3 2013

During the three months to the end of September a net balance of SCBS firms reported a rise in total employment levels (+13%), the highest net balance in two years. A fifth of firms increased pay during the three months to the end of September and the average increase was marginally up from the previous quarter at 3%. A third of SCBS reported seeking to recruit staff compared to 39% in Q2, and slightly fewer than a third of these recruiting firms reported difficulties. Staffing levels remained positive for a net balance of Scottish Engineering firms and forecasts for Q4 are that the upward trends will generally continue.

Construction

The decline in business optimism among SCBS firms continued (-3.7%) compared to the previous quarter although once again, at least 80% of firms reported a rise/no change to optimism levels. The Scottish Construction Monitor recorded the first overall positive rating since the Survey began in 2008 reporting that industry confidence had improved by 31 points in Q3, (a fifth consecutive period of improving confidence since the Q2 2012 survey). Half of Construction Monitor respondents were more confident about their future prospects compared to just over one fifth remaining less confident.

As forecast by respondents from the previous Survey, the trend in total new orders/contracts declined for SCBS firms in Q3, although the net balance (-18.5%) was better than in Q3 2012 (-33.3%). A net of 14.8% expect a further decline in Q4. Capacity utilisation eased marginally from 81.4% to 80.8% and despite the marginal decline this was higher compared to the same period a year ago (74.6%). Public sector orders continued to decline (although the decline is expected to ease marginally towards the end of the year) and domestic/house build orders (-26.1%) also continued to decline. The upward trend in private commercial orders (+8.3%) continued.

The Scottish Construction Monitor focused their investment question on the training and development of managerial and supervisory staff and reported that just under one third of respondents reported that investment levels were adequate to meet their business needs. Whereas slightly more than one third of respondents reported that investment in this area was not currently a priority for their business and the remaining one third of respondents said a lack of confidence in their future work pipeline and/or a lack of finance was restricting the amount they were able to invest in training and development of managers / supervisors.

Cash flow trends deteriorated for SCBS construction respondents (-22.2%) and the decline worsened from the previous quarter (-3.6%). Turnover (-7.4%) and profitability (-18.5%) are still expected to be weak over the next 12 months together with continued pressure on margins. More than half of responding firms continue to expect tender margins to worsen during the coming year.

There was a net rise in total employment levels in Q3 and a net balance of SCBS firms (-7.7%) expect a further rise in Q4. Recruitment activity strengthened (from 29% to 38%) as did recruitment difficulties (from 19% to 23%). Average pay increases decreased marginally from 3.3% in Q2 to 3.2%.

Services

According to the SBM, service businesses showed an improvement in turnover in the three months to August 2013 and the survey reported a significant rise in the total volume of business. Expectations for turnover in the next six months are showing an overall net balance of +18%. Concerns over credit availability and credit costs were unchanged for firms in the services sector. The importance attached to late payment increased slightly among service firms in the latest Business Monitor and concerns over cash flow were unchanged.

Since late 2008 there has been a widespread fall in the importance attached to staff availability according to the SBM this is widely thought to reflect a lower rate of staff recruitment and a low level of business confidence. In the latest Business Monitor, the importance attached to staff availability over the next three months increased significantly for service firms.

Wholesale/logistics

The downward trend in business optimism amongst SCBS wholesalers eased further from -43.7% in Q1, -21.4% in Q2 to -13.3% in Q3. The downward trend in sales eased from 42.9% in Q2 to -6.7% in the current quarter and the net balance in sales was better than expected. A net balance expect the decline to worsen (-15.4%) in the fourth quarter.

More than three-quarters of SCBS wholesalers (78.6%) continued to report increased pressures from transport costs and to a lesser extent, firms also remain under pressure from raw material costs (40%) and pay settlements (40%). More than half of firms (60%) expect to increase prices over the next three months. The downward trends in both turnover and profitability continued in Q3. Two thirds of firms reported no change to investment plans; and for the first time since 2011 the trend was upward (+6.7%).

SCBS wholesale respondents, as expected, continued to report a net decrease in overall employment levels during Q3 although the decline was not as steep as forecast. More than half sought to recruit staff (60%) and 42% of these firms reported recruitment difficulties. The average pay increase in Q3 was 2.3% compared to 2.0% in Q2.

Retail distribution

Business confidence among SCBS retailers improved from -24.5% to +2.1% (the first positive net balance since Q4 2006). This is also a marked improvement compared to Q3 2012 (-42.4%). The recent negative trend in overall sales ended, with a net of 4.3% of SCBS firms reporting an increase compared to a net of -36% reporting a decline in Q2. Encouragingly, a further rise is anticipated for Q4 (+2.3%).

Retail figures from the Scottish Retail Sales Monitor conducted by the Scottish Retail Consortium (SRC) reported that after a strong summer, sales slowed in September when compared to recent months but the three-month average (3.1%) was up compared the twelve-month average (1.2%). The figures in August had been the strongest for four years and the July figures showed an increase of 4%. The SRC concluded that despite consumer confidence holding up in September the slowdown in sales may indicate that consumers are saving for Christmas.

Cost pressures for SCBS firms remain historically high and continued to increase in the three months to the end of June. Utility costs and raw material prices continued to be of particular concern. Pressures on margins eased considerably in Q3. A net balance of 15% expect a rise in turnover (compared to -13.6% in the previous quarter) and a net of -10.4% expect a decline in profitability (compared to -17.8% previously) – the highest net balances since Q3 2007.

The trend in total employment levels unexpectedly rose in Q3 and almost 80% of SCBS retailers expect no change in Q4. Fewer than a quarter of firms reported increasing pay, and the average increase rose from 2.8% in Q2 to 5.3% in the current quarter.

Tourism

The good summer weather had a positive impact on Scottish hotels as business confidence rose for a net balance of SCBS firms (+27.8%) in the three months to September 2013. This was the highest balance of optimism since 2006. As expected a net balance of SCBS hotels reported a rise in visitors and a net balance of 15% anticipate a further rise in Q4.

Average occupancy improved from 69% to 75%, up 7 percentage points compared to Q3 2012 (68%). During the third quarter of 2013 trends in bar/restaurant trade and conference/ function facilities declined although firms expect a small net rise in bar/restaurant use. A net balance (+20.4%) reported a rise in the average daily room rate, although a fall is expected (-3.6%) in the three months to the end of December. The Scottish Accommodation Occupancy Survey (SAOS) is commissioned by VisitScotland and carried out by research agency TNS, found that in the period January to August 2013 average occupancy increased by 5 percentage points compared the same period of 2012.

63% of SCBS hotel respondents (compared to 74% previously) reported the lack of tourist demand as the primary business constraint. Competition, poor transport infrastructure, high fuel costs and weak marketing of the area also remained a concern to hotels.

Over 60% of SCBS hotels sought to recruit staff and only 14% of these hotels reported recruitment difficulties. Employment trends improved, although the decline is set to resume in Q4.

Outlook

Many of the surveys conducted over the summer have reported the best set of results since the start of the recession – and many of the surveys showed better results than had been anticipated. Nevertheless the outlook remains challenging and doubts remain as to how sustainable or fragile this recovery is, and can the good results be maintained or even consolidated or are these figures an aberration?

According to the Bank of Scotland the PMI surveys for the last six months the Scottish economy grew in quarter two this year, and growth accelerated in quarter three. The latest Bank of Scotland Business Monitor (SBM) showed a turnaround in performance of the Scottish economy with an acceleration into growth in the summer months of June, July and August and expectations are high for this surge in growth to continue for the next six months.

One of the main drivers of the Scottish economy is consumer spending and whilst retail figures improved over the summer (partly buoyed by the good weather), there has been no real rise in household incomes for some time and the September retail figures showed a slowdown. Rising energy bills and limited wage increases resulting in a lack of disposable income could add to the fears that the recovery to lose some of its momentum.

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Fraser of Allander Institute

October 2013

Current trends in Scottish Business are regularly reported by a number of business surveys. This report draws on:

1. *Oil & Gas UK Index Q 1 2013*
2. *Lloyds TSB Business Monitor Issue August 2013 –November 2013;*
3. *Scottish Chambers' Business Survey Q3 2013*
4. *Scottish Engineering's Quarterly Review Q3;*
5. *The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for June – September 2013;*
6. *The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors for August and September 2013.*