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Review of Scottish Business Surveys

Overall

A sense of rising confidence and improving business activity was increasingly evident in business surveys over the summer months, although this did not apply to all sectors. In July Scottish Engineering, commenting on the results for the second quarter, noted that 'manufacturing remains in the doldrums' and whilst there was a marginal improvement in orders the 'green shoots of recovery have yet to appear.' In October it noted, in response to the survey results for the third quarter, 'manufacturing looks to be turning the corner', and 'capacity utilisation creeps up'. The CBI Scottish Industrial Trends in the second quarter noted the rate of decline in domestic and export orders eased, but there were 'few signs of export improvement'. The Scottish CBI noted the continuing concerns as to finance and the deflation in both export and domestic prices. By September the Markit UK Regional PMI (the Scottish version is no longer published) reported an improvement in business activity in Scotland, although the rate of improvement was slower than in other UK regions. The Lloyds TSB monitor (September 2009) indicated 'the Scottish economy is on track to exit recession later this year', although noted that the Scottish economy has not yet returned to growth 'but is nearer to the point of turnaround between decline and growth'.

The Scottish Chambers' Business Survey reported in July that there was much clearer evidence in the results for the second quarter that the first stage of the recession, a period of sharp decline in confidence, orders, sales and activity, is coming to an end, and there are more signs of both an easing in the rate of decline, and signs of some pick up in orders and activity and recruitment, although pressures on margins remain at high levels. At the end of the third quarter it reported 'clear signs of an emerging recovery in manufacturing and a 'good summer' in tourism, with rising confidence in manufacturing, wholesale distribution and tourism, together with a lessening in the decline in confidence in construction and retail.'

Data from the Scottish Chambers' Business Survey illustrates well the trends in business confidence since 2006. Across most sectors rising net trends in business confidence were reported in the first half of 2007. These were followed by sharp and ferocious declines in 2008 and the first quarter of 2009, with net trends of over 60% of manufacturing and 70% of construction, wholesale, retail and tourism respondents reporting declining confidence. Rising net trends re-emerged in manufacturing in Q2 2009 and strengthened significantly in Q3 2009. In contrast

confidence remained negative in construction and rose only marginally in tourism.

Data from the Scottish Chambers' Business Survey suggests pay pressures remained subdued through the summer. The percentages of respondents increasing pay in the third quarter ranged from 3% of construction to 21% of manufacturing, and average pay increases ranged from 2.1% in manufacturing to 4.5% in retail. Average pay increases in manufacturing and construction remain at historically low levels. Recruitment activity in all sectors remained low ranging from 19% in construction, 23% in retail to 37% in manufacturing and 59% in tourism;

Oil and Gas

The severe downturn in oil and gas prices continued to impact on activity and investment plans. The leading organisation in the sector, Oil and Gas UK, reported that capital investment in 2008 was some 6% lower than in 2007 and is anticipated to ease through 2009 and 2010. More recently Subsea UK noted 'the short term outlook remains tough' as operators sought to cut costs and reduce activity, and only forecasts an improvement in activity in 2010.

Production

The latest Lloyds TSB reported production businesses still experiencing difficult conditions, 'although the rate of decline has been arrested'. It noted the recession in production is deeper and longer lasting than in services, and the production sector is further away from a return to growth. According to Markit UK Regional PMI Scotland recorded only a marginal increase in private sector output during October.

Manufacturing

Optimism

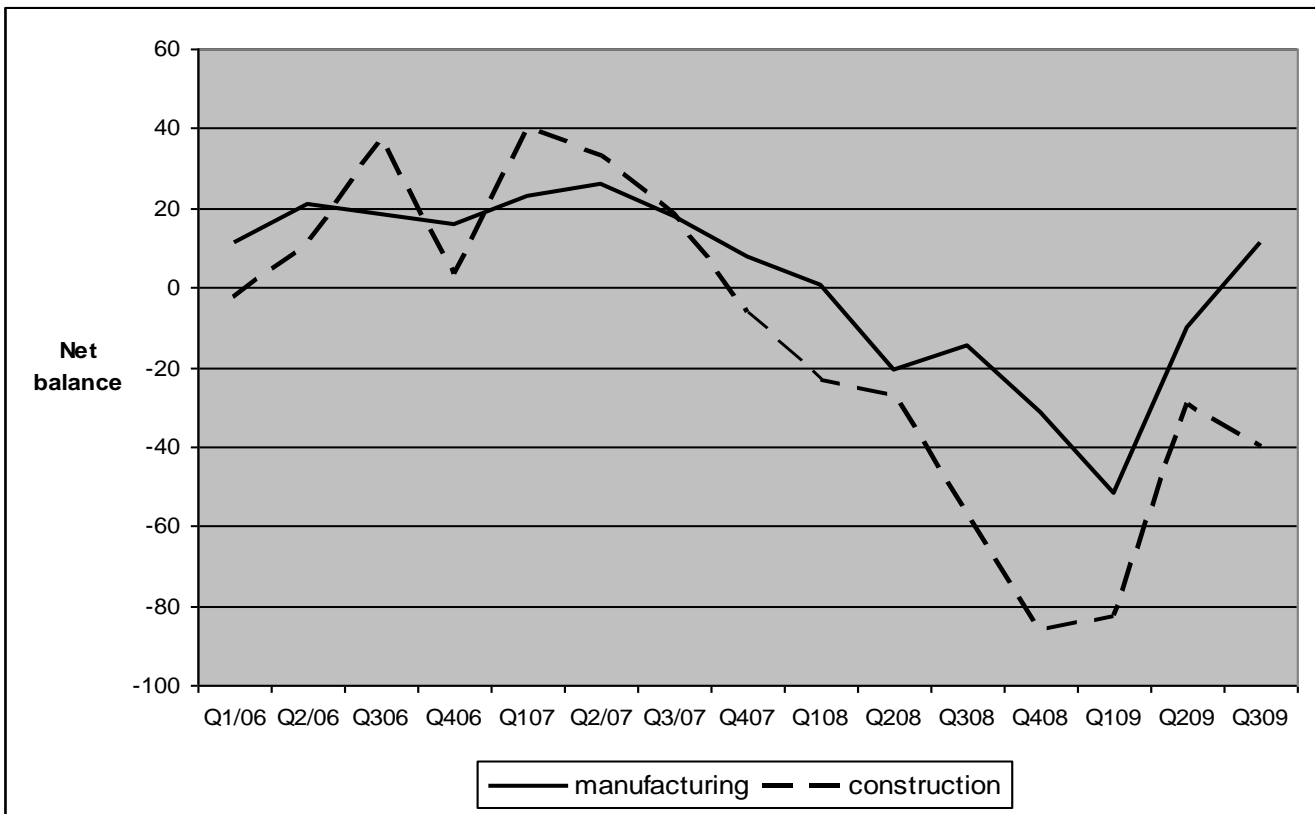
Both Scottish Engineering and Scottish Chambers reported rising confidence trends in business confidence in the third quarter. Scottish Chambers noted business confidence improved further in the third quarter rising strongly from a net balance of 9% in Q2 to 32%, whilst Scottish Engineering reported a net balance of 20% for the same quarter. Declining confidence was only reported by 10% of Scottish Chambers manufacturing and 14% respondents of Scottish Engineering respondents.

Orders and Sales

Scottish Chamber and CBI respondents reported the outturn in total new orders and export orders was marginally better than expected and the actual trends in total, Scottish and rest of UK orders, whilst remain weak, are better than in previous quarters. There was a further improvement in export orders. In contrast Scottish Engineering reported continuing net declines in orders,

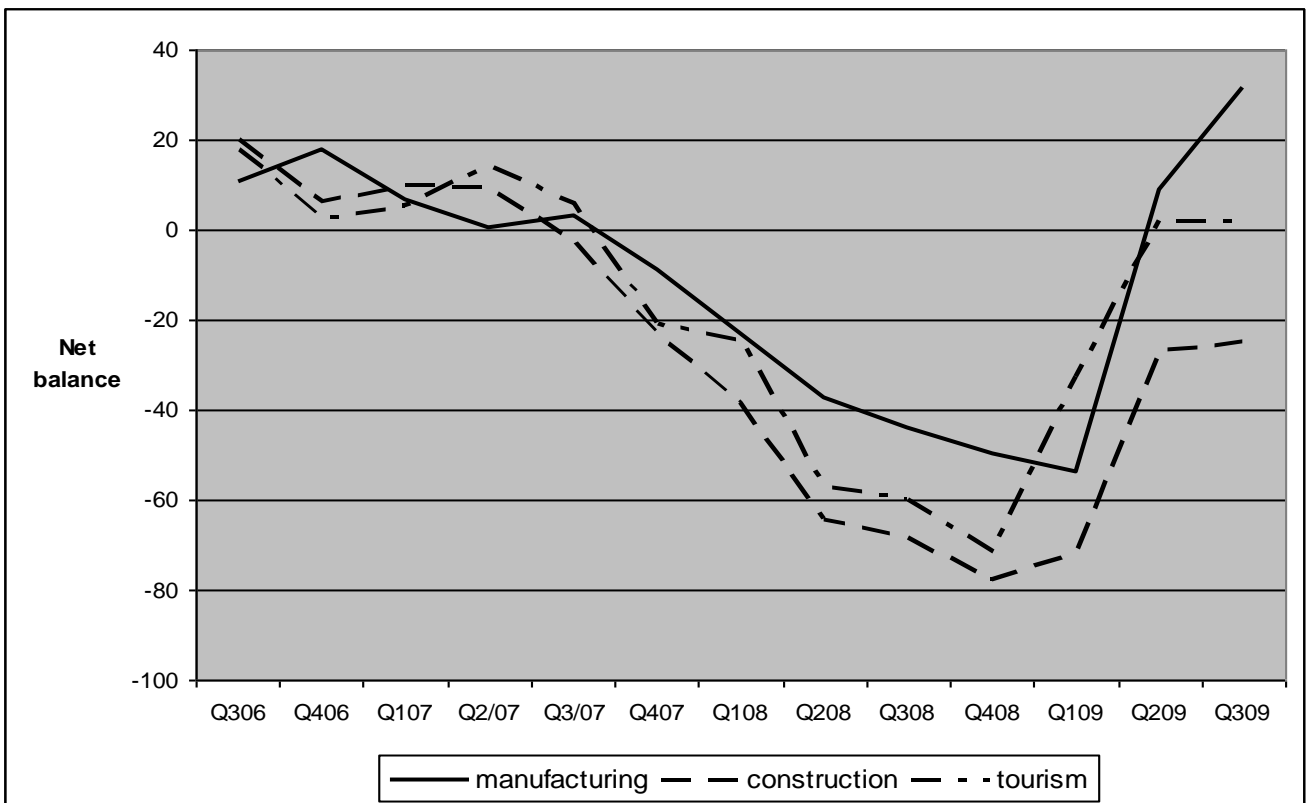
Total orders/contracts (net balances)

Source: Scottish Chambers' Business Survey



Business confidence (net balances)

Source: Scottish Chambers' Business Survey



although at reduced rates over the previous two quarters. Both Scottish Chambers and Scottish Engineering respondents reported an improvement in the trend in export demand, although this was stronger amongst Scottish Chamber respondents

Scottish Chamber respondents reported a continuation of the declining trend in the level of work in progress, but the rate of decline was slower than in the second quarter. Average capacity used rose marginally by 0.8 percentage points to 71.6%, although 57% (71% in quarter 2) reported capacity used was below preferred levels. Pressures to raise prices continued to moderate.

Investment

Both Scottish Engineering and Scottish Chambers reported negative trends in investment. Overall investment trends eased and only 16% expect to increase investment and 5% anticipate increasing their leasing of equipment over the coming year. Cash flow trends continued to ease, but at a more modest rate than in the past four quarters. The anticipated trends in turnover and profitability improved with 40% and 34% of respondents respectively reporting an increase over the twelve months to September 2010; although once again Scottish Engineering respondents are more cautious as to price trends.

Employment

Two thirds of Scottish Chamber respondents reported and expect no change in total employment levels with a small net balance reporting a decline. Scottish Engineering respondents likewise reported a decline in both employment and hours worked and expect the decline to continue through the fourth quarter. The CBI respondents were more confident and anticipate a slight rise in employment in the fourth quarter.

Construction

Optimism

Data from the Scottish Chambers' Business Survey suggested that business confidence remained weak through the third quarter, with only 11% reporting being more confident compared to the previous quarter. Thirty-six per cent, compared to over 42% of respondents in quarter two, reported being less confident. The net trend in business optimism remained negative, only improving marginally from -27% in quarter 2 to -25% in quarter three.

Contracts

The rate of decline in the net trend in new contracts increased from -30% in the second quarter to -40%. The trends in orders from all sectors continued to decline although the rate of decline in public sector orders eased. Demand remained depressed with 50% reporting downward trends in total new orders and 72% declining levels of domestic/house build contracts. The

proportion reporting working below optimum levels rose slightly to a net of 75%.

Expectations as to turnover trends over the next year remained depressed, although did not deteriorate further in the third quarter. A net of -31% (-37%, -64%, -65%, and -37% in the previous four quarters) anticipate declining turnover trends over the next year. A net of -44% (-59% -78%, -78% and -54% in the previous four quarters) anticipate declining profitability over the next twelve months. And a net of 64% of construction firms anticipate declining tender margins over the next twelve months.

Average capacity rose by two percentage points to 74% but 50% (44% in the previous survey) expect a declining trend in the level of work in progress.

Employment

A third of firms reduced total employment levels with only 6% reporting an increase in employment and recruitment again remained at very low levels. Only 3% of respondents reported increasing pay in the third quarter by an average of 3.5%.

The service sector

The latest Lloyds TSB Business Monitor noted a marked easing in the rate of decline in turnover in new and repeat business in the service sector, and suggested the Scottish service sector is close to where growth will be resumed. Expectations for the next six months are more positive than in previous quarters, and a net of 3% of service firms anticipate increasing turnover in the six months to February 2010.

Retail distribution

The Scottish Retail Consortium's Monitor for September reported increased sales 'Customers' mood improving' as like for like sales were 1.5% higher than in September 2008 and total sales were up 4.3% on a year ago. Underpinning these figures was the increase in food sales (up 2.4% on a like for like basis). However, firms remain cautious and discounting of prices remains widespread.

Optimism

The Scottish Chambers survey for the third quarter reported that the long running negative trend in business confidence eased further from -27% to -8% (the least depressed figure since quarter 4 2007). However, more than half of firms were less confident compared to the same quarter one year ago.

Sales

Scottish Chambers survey data for the retail sector reports unweighted sales trends, as such the trends reflect the trends reported by independent retailers as well as the major multiple retailers, this tends to understate the overall trends in sales. The proportion of respondents reporting and expecting declining sales in the third and fourth quarters remains

historically high. Nevertheless the rate of decline in actual and expected sales has continued to ease. Almost half of respondents reported and expect declining sales trends.

The value of total new sales declined for 45% (64% in quarter two) of firms and 41% (68% in quarter two) expect a further decline during the three months to the end of December 2009.

Finance

A net of -15% of retailers anticipate declining turnover (compared to -49% in the previous quarter), and a net of -36% (-51% in the previous quarter) anticipate declining profitability over the next year, suggesting continued pressures on margins, although perhaps beginning to ease.

Employment

For a further quarter no responding retail firms increased total employment levels and only a small number expect to increase total employment levels during the three months to the end of December. Only 23% of firms attempted to recruit, although historically low it was an improvement compared to quarter two (18%). Nineteen percent of firms increased wages by 4.51%.

Tourism

Optimism

According to the Scottish Chambers' Business Survey the overall level of business confidence remained positive in the third quarter and unchanged from the previous quarter, and was stronger than in the same quarter in 2008. A net balance of firms also reported being more confident compared to one year ago.

Demand

Both Visit Scotland and Scottish Chambers reported better trends in the summer than in the previous year. Visit Scotland data for June indicated a two percentage point increase over the June 2008, July indicated a five percentage point increase in bed occupancy compared to July 2008 and the August 2009 suggests a two percentage point rise in room occupancy over the same month in 2008. Scottish Chambers reported the outturn in the third quarter was better than anticipated. Forty-four percent, compared to 21% in quarter two reported increased demand for accommodation. The trends in demand from Scotland and RUK improved for the first time since quarter four 2007. Demand from abroad and business trade continued to decline but the rates of decline eased. Average occupancy rose from 54% to 72.7% (marginally higher than in Q3 2008, but lower than in Q3 2007).

Data from Visit Scotland indicated average hotel bed occupancy for August 2009 was 66% and for 80% room occupancy. Visit Scotland data noted that whilst nationally the average length of stay has dropped slightly over the past year, this has not been the case in all regions, with Edinburgh and

Dumfries & Galloway reporting the larger increased duration of stays. Additionally Visit Scotland data suggested less evidence of visitors moving to lower graded hotels.

Looking forward to the fourth quarter, Scottish Chambers noted respondents expecting to reduce room rates and the discounting of prices were anticipated to be widespread.

Employment

Scottish Chambers data for the third quarter noted changes in employment levels were reported by fewer than half of firms. Net declining trends in full time (-21%), part time (-18%), seasonal (-51%) and overtime working (-56%) were reported.

Outlook

Scottish Chambers data suggest manufacturing trends in the third quarter offer the clearest signs of an emerging recovery, tourism has benefitted from a good summer, but pressures on margins may cause problems in the fourth quarter. However, uncertainty, fears of the recovery stagnating, and limited capital spending remain concerns. Generally for Scottish firms working levels remain well below optimum levels in manufacturing and construction, and competition for demand/sales remains widespread in retail and tourism leading to widespread and early seasonal discounting of prices. Pressures on margins and likely pressures on raw material and other costs highlight the fragility of the recovery. The labour market remains weak with few signs of an improvement for the fourth quarter.

Eleanor Malloy/Cliff Lockyer
November 2009

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

1. The Confederation of British Industries Scottish Industrial Trends Survey for the second and third quarters of 2009;
2. Lloyds TSB Business Monitor 47 for the quarters June – August 2009 and expectations to February 2010;
3. Scottish Engineering's Quarterly Reviews for the second and third quarters 2009;
4. The Markit Economics Regional Monthly Purchasing Managers' Index to end September 2009 and Markit UK Regional PMI Nov 2009;
5. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor for September 2009;
6. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the second and third quarters of 2009;
7. Oil & Gas UK 2008 Activity Survey;
8. Visit Scotland Occupancy Survey August 2009.