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A review of Scottish Business Surveys July – October 2008

Overall

Negative trends were widely reported in most surveys. The PMI Scotland Report for September noted a 'further marked deterioration in operating conditions in the Scottish private sector. Output, new business and backlogs of work all declined during September'. The Lloyds TSB Scotland Business Monitor noted 'growth in the Scottish economy grinding to a halt in the summer of 2008'. The Scottish Chambers of Commerce, commenting on their latest survey, talked of the 'looming recession' and 'harsh trading conditions'. Scottish Engineering and CBI trends reported falling order intake for the first time for four years. The SRC Scottish Retail Sales Monitor reported the flat trend (0.0%) in the year on year trend in like for like sales and commented on the 'worst Scottish sales since March 2006' (the previous Monitor had noted the worst August sales since 2005).

Whilst record weak trends were reported as indicative of the impact of the recession in the 'real economy' it is important to consider the methodology adopted by most business surveys. Most national surveys, seek evidence as to changing trends, and use net balances as the key survey statistic. Typically surveys ask their respondents to indicate whether the trend, over the past three months, and expected for the next three months, is either 'up', 'level' or 'down'. The net balance for such survey questions is defined as the number of 'up' responses minus the number of 'down' responses to each survey question. Hence a positive net balance indicates a rising trend, and a negative net balance a declining trend. The current strong negative trends in business confidence, for example, widely reported in recent months, can be interpreted as either evidence of more strongly declining falls in business confidence, or as weakening trends in business confidence being more broadly reported. It is important to look behind the headline trends to understand more clearly the experiences and expectations amongst Scottish business as to the severity of the likely recession. There is clear evidence of reduced levels of activity in manufacturing, construction and tourism compared to a year ago, and sales trends are likewise weaker than for some time. Recruitment activity and total hours worked are likewise weaker than in 2007. Nevertheless, the alarmist interpretations of these results should be treated with some caution.

Production

The Lloyds TSB Scotland Monitor (to end August 2008) reported modestly rising trends, but noted these were markedly weaker than a year ago. Looking forward (to end February 2009) 40% of respondents anticipate a decline in the volume of business, although modestly rising trends in export activity are forecast; however costs pressures are expected to remain widespread with 71% anticipate rising costs over the next six months.

Manufacturing

Confidence and Orders

Business confidence, where reported, was widely depressed, more so than trends in business activity. The Scottish Chambers' Business Survey and PMI Scotland Report, both to the end September, noted a slight improvement (although within the context of continuing weakening trends) in manufacturing output, new orders and backlogs of work. Nevertheless, the accompanying commentary focussed on 'faltering market conditions', a 'sharp contraction in new orders' and 'a significant contraction in the level-of-work in hand'. A slight downturn in manufacturing orders was also noted in the third quarter results for Scottish Engineering, The CBI manufacturing survey asks if order books are above, at or below normal levels, their latest surveys suggest declining current and future order book trends becoming more broadly based.

The Scottish Chambers' Business Survey noted a net of small, medium and larger firms reporting declining trends in the level of work in progress. Unlike other surveys the Scottish Chambers' Business Survey seeks evidence as to average capacity used and noted this had eased further to 73.6%, some five percentage points lower than a year ago, and the percentage reporting capacity used being below preferred levels had risen to 65%, some fifteen percentage higher than a year ago.

Costs/Prices

The PMI report noted input prices 'rose at a considerable pace during September.' Rising costs prices remain evident. In the Scottish Chambers' Business Survey the proportion reporting being under pressure to raise prices due to raw material costs has averaged over 80% in 2008, the proportion reporting increased pressures due to other overheads (utility, insurance and other charges) has increased by some thirteen percentage points and transport costs by twenty one percentage points in 2008, and was widely reported by panel members of the PMI Report. Both the PMI Report and the Scottish Chambers' Business Survey noted a slight easing in the rate of increases in prices charged.

Employment

Scottish Engineering reported modestly rising trends in employment, although weaker than in previous quarters, 'overall demand for staff is being maintained particularly for small companies'. In contrast the PMI Report noted 'job losses in manufacturing were considerable' as it reported the third month of declining trends. The Scottish Chambers' Business Survey noted a slight decline. A closer examination of the results in the three surveys show strongly similar patterns, the majority of respondents (74% in the PMI Report, 64% in Scottish Engineering and 71% in the Scottish Chambers' Business Survey) reported no change and the percentages reporting increasing levels in employment in the third quarter ranged from 7% in the PMI Report, 11% in the Scottish Chambers' Business Survey to 22% in the Scottish Engineering Quarterly Review). Both the Scottish Engineering and Scottish Chambers' quarterly surveys reported slightly more respondents reporting a weakening in total hours worked.

Average pay increases in manufacturing have remained around 3.66% through the year.

Construction

Confidence and Orders

The Scottish Chambers' Business Survey noted the percentage of firms reporting declining business confidence was the highest ever reported. Eighty per cent reported being less confident than a year ago, again reflecting concerns as to credit issues and the sharply declining trends in domestic/house build contracts.

The declining trend in new contracts strengthened in the third quarter, with a sharp downturn in the trends in private commercial and domestic/ house build contracts, and more modestly declining trends in public sector work. Now only 41% (52%, 69%, 71% and 86% in the previous four quarters) expect level or rising trends in the level of work through the next six months.

Expectations as to turnover trends over the next year have weakened significantly over the past two quarters. In the third quarter a net of 37% (25% in quarter two) anticipate declining turnover trends over the next year (in contrast rising net trends of 3%, 10% and 29% were reported in the preceding three quarters). A net of -54% (-49% and -3% in the previous two quarters) anticipate declining profitability over the next twelve months. Seventy-four per cent of construction firms anticipate declining tender margins over the next twelve months.

Average capacity declined to 79%, down nine percentage points over the year, and 43% reported and 59% expect a declining trend in the level of work in progress, again the weakest trends in the history of the survey.

Costs/Prices

Expectations of lower trends in turnover and tender margins in 2009 were widely reported in the Scottish Chambers' Business Survey for the third quarter as were rising trends in building and other costs.

Employment

The Scottish Chambers' Business Survey notes a slight weakening trend in employment in the third quarter, although rising trends in overtime were noted; looking ahead to the fourth quarter, expectations of staff and overtime reductions are more broadly based. Possibly more significant is the declining proportions of firms seeking to recruit, down fifty-one percentage points over the year.

Average pay increase in quarter three eased slightly to an average of 4.11%.

The Service Sector

Both the PMI Report and The Lloyds TSB Monitor noted a decline in service sector activity. The PMI noted declining trends being reported in business, financial services and tourism. The Lloyds TSB Monitor noted 'service businesses are affected more than manufacturing', with service sector turnover now having fallen for five consecutive quarters. The PMI and Lloyds TSB Monitor both noted declining trends in volumes of repeat and new business. Expectations for the six months to February 2009 remain depressed. All the main surveys noted strongly rising cost pressures.

Retail distribution

Optimism and Sales

The Scottish Chambers' Business Survey reported that the widespread deterioration in business confidence continued, reflecting continued concerns as to declining consumer confidence, credit restrictions and spending. The Chambers' survey noted declining business confidence in 2008 has consistently been the most broadly based ever recorded by the survey.

The Scottish Retail Consortium – Nielson Shop Price Index (September) noted year on year price inflation in Scotland at 4.3%, but with some signs of easing prices as some of the earlier cost price increase in food start to annualise. However like-for-like sales were flat in September (a combination of rising food and falling non-food sales), and total sales in September were 4.6% higher than a year ago, but this rise was only due to rising food sales, non food sales fell slightly in September.

Both the CBI and Scottish Chambers' Business Surveys reported declining sales trends. Half of the retailers in the

October CBI survey, and 59% of retailers in the Scottish Chambers Survey (three months to end September) reported declining sales trends.

Costs/Prices

The Scottish Chambers' Business Survey noted cost pressures were again more evident in the third quarter with over 70% citing raw material and utility costs, and over 65% citing transport costs. Cost pressures were again more widely reported by independent retailers.

Employment

The Scottish Chambers' Business Survey noted changes in employment levels were by less than a quarter of respondents, nevertheless, declining trends in full time, temporary and permanent employment and overtime working were reported. In common with other sectors the proportion seeking to recruit staff in the third quarter was significantly lower than a year ago. Average pay increases in the third quarter were reported at 4.32%, slightly higher than earlier in the year.

Tourism

Optimism and Demand

Weaker trends in business confidence were widely reported in the third quarter by the Scottish Chambers' Business Survey. Visit Scotland noted bed and room occupancy some 3% lower in August 2008 compared to same month in 2007, whilst the Scottish Chambers' Survey data for the three months to end September reported occupancy some five percentage points lower than a year ago.

Weak trends in demand were more widely reported than in previous third quarters for the past ten years of the Scottish Chambers survey, with weaker trends in demand for restaurants and function/conference facilities.

A net of -33% reported declining turnover trends (compared to a decline of -8% and increases of 10% and 38% in the previous quarters) and a net of -43.5% (-22.4%, -34% and -5% in the previous three quarters) reported falling trends in margins. Overall tourist demand accounted for 54.2% of total demand with local trade generating 25.5% and the balance was business demand.

Underlying these trends was a lack of demand, reported by 90% of respondents to the Scottish Chambers' Business Survey.

Employment

Changes in employment levels were reported by 38%, net declining trends in full time, part time, seasonal and overtime working were reported. In common with other sectors the proportion seeking to recruit staff in the third quarter of 2008 was more than ten percentage points lower than a year ago.

Outlook

All surveys note the slowing down in the Scottish economy becoming more evident over the third quarter, with the services sector being more affected than manufacturing. Manufacturing still expects better trends in export orders, but this will depend on developments in the main markets. Results in the construction sector remain dominated by the housing market; although the levels of public sector work appear less affected. Tender prices and margins are expected to remain depressed over the next year. In the services sector sales trends, and expectations for the next quarter, remain weak. Activity will be affected by continuing credit concerns, weakening demand and recession in major markets. Declining consumer confidence is widespread. Developments in the international economy will be the key factor over the next months.

Eleanor Malloy/Cliff Lockyer
28 October 2008

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

1. The Bank of Scotland's Leading Indicators published September 2008 and Quarterly Labour Market Report for the second quarter of 2008;
2. The Confederation of British Industries Scottish Industrial Trends Survey for the quarter to September 2008;
3. Lloyds TSB Business Monitor for the quarter to August 2008 and expectations to February 2009;
4. Scottish Engineering's Quarterly Review for the third quarter 2008;
5. The Royal Bank of Scotland's Monthly Purchasing Managers' Index to end September 2008;
6. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor to October 2008;
7. The Scottish Retail Consortium - Nielsen Shop Price Index for September 2008;
8. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the second and third quarters of 2008;
9. BRC-KPMG Retail sales monitor September 2008;
10. Halifax House Price Index October 2008;
11. Visit Scotland Occupancy Index to August 2008.