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Malloy, Eleanor and Lockyer, Cliff (2009) *Review of Scottish business surveys [February 2009]*. Fraser of Allander Economic Commentary, 32 (3). pp. 27-30. ISSN 2046-5378

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Review of Scottish Business Surveys

Overall

All of the major Scottish Business Surveys showed a further sharp deterioration in the private sector economy during the latter part of 2008 and into 2009. The latest Lloyds TSB Scotland Business Monitor (Issue 44 September – November 2008) reported the downturn in the Scottish economy intensified in late summer and winter 2008. “The implication is that growth in the private sector of the Scottish economy has not only slowed dramatically but has reversed into a contraction. This is the most negative result in eleven years of the Business Monitor.” The PMI Scotland Report (Royal Bank of Scotland (January 2009) found that “Output and new business both contracted at near –record rates and, despite backlogs of work being reduced at the fastest pace in the eleven-year history, staff were shed at the strongest rate on record.” The Scottish Chambers’ Business Survey noted “The results for the fourth quarter 2008 are the most depressed results recorded since the survey commenced in 1984. This is the first time that negative trends have been recorded for the key indicators in all sectors.” According to the fourth quarter 2008 Quarterly Review of the engineering industry in Scotland; “The global financial crisis has finally caught up with the Scottish manufacturing engineering sector. For the first time in five years output volume and recruitment figures are negative” The latest Scottish Industrial Trends Survey published by CBI Scotland (Quarter 4 2008 date) pointed to “sharp deterioration in the trends of new orders and output among Scottish manufacturers, bringing the picture here back in line with the UK average. “

Oil and Gas Sector

Activity in the UK oil and gas sector slowed in slightly in 2008 after a period of increased investment, activity and employment. Underpinning these trends has been the relentless increase in oil prices, which had risen from an average of \$54 per barrel in January 2007 to an average of over \$90 per barrel by January 2008 peaking at \$147 in July 2008. In early 2008 a number of institutions were confidently predicting that prices would reach over \$200 per barrel by the end of 2008. In reality average oil prices tumbled to \$34 per barrel in December 2008 and current central predictions are for oil prices to be in the region of \$30 – 45 per barrel in 2009.

The Oil and Gas UK Activity Survey (published February 2009) noted a slight reduction (6%) in investment levels in 2008 compared to 2007, and expects reduced investment and a reduction in the number and scope of sanctioned investment in 2009, reflecting the declining price of oil and the availability of credit, and called for measures to prevent the effects of the global recession combined with the banking crisis from dampening new investment in the recovery of the UK’s oil and gas reserves.

Upstream and downstream capital costs have risen substantially in the global oil industry. The IHS Cambridge Energy Research Associates (IHS CERA) Upstream Capital Costs Index (UCCI) reported new record highs, with the index at 210 (base 100 in 2000). However, IHS CERA noted some moderation in September and October which ‘points to a precursor to a downward turn in the direction of the UCCI’ (CERA press release Dec 2008).

Evidence from the 10th Oil and Gas Survey (Aberdeen & Grampian Chamber of Commerce, February 2009) noted that the majority of contractors engaged in UKCS activity continued to report working at or above optimum levels, but there are expectations that these trends will weaken in 2009 and that the majority of operators expect to reduce total employment levels in 2009, with some reduction in the use of contract and temporary staffs. A net balance of contractors expect to increase total and permanent employment in 2009, but likewise expect to make less use of temporary and contract staffs.

The 10th Oil and Gas Survey also noted that the business strategy for some smaller exploration and production companies that relied on raising capital to finance exploration spending is likely to be less sustainable in the current climate of substantially reduced oil prices and a reduction in capital availability, or increased costs of capital. This problem is likely to be more acute in those areas where costs and lift costs are high. Additionally the survey concluded that the resulting decline in share prices has increased the probability of a wave of consolidation in the sector and of new overseas companies purchasing North Sea assets and contractors. All operators and 87% of contractors shared the view that the current credit issues would lead to more mergers and consolidation in the UKCS and all believe it will have an adverse effect on working capital and activity. In addition whilst the economic downturn will lead to spare capacity in the short term; the combination of financial constraints, sector consolidation and low prices will hinder new investment and oil markets will tighten in the medium term and a new upward price cycle is likely to emerge in a context of reduced investment levels in the UKCS.

Production

The Lloyds TSB Scotland Business Monitor - Issue 44 to November 2008, showed that production businesses showed a marked decline, displaying a worsening performance. In the latest quarter, 20% of firms experienced an increase in turnover, 37% a static position and 43% a decline giving a net balance of -23%. This compared unfavourably to the +6% of the previous quarter and was significantly down on the +14% of the same quarter one year ago.

Manufacturing

The surveys differed in terms of when in 2008 orders turned down and the rate of decline accelerated. The Scottish Chambers' Business Survey noted a sharp drop in the level of total orders in q2 2008 and a further sharp drop in quarter 4 2008. The PMI data (not seasonally adjusted) likewise indicated a drop in orders in q2, a sharper drop in q3 and then a similar drop in q4 2008. In contrast Scottish Engineering recorded rising trends in new orders in q1 and q2 (although the rate of increase eased in q2), followed by a decline in q3 and a sharper decline in q4 2008.

Confidence and Orders

The Scottish Chambers' Business Survey reported that during the fourth quarter business confidence continued to deteriorate for a net of firms in all size bands. The proportion of firms reporting declining levels of business confidence in the fourth quarter is the highest reported in the history of the survey. The actual and expected trends in total orders in the second half of 2008 are the weakest ever recorded. Weakening trends in orders were again reported by a net of firms in all size bands and these trends are expected to continue through the next year.

Scottish Chambers reported that declining trends in the level of work in progress continued and are expected to deepen further in the first quarter of 2009. Average capacity remained at 73.6%, some 5 percentage points lower than a year ago, and once again 65% reported capacity used was below preferred levels. In both the 3rd and 4th quarters of 2008 the expectations as to the trends in orders and turnover for the next twelve months are the weakest reported in the history of the survey. However, pressures to raise prices eased significantly.

The latest Scottish Industrial Trends Survey by CBI Scotland (Quarter 4 2008) pointed to sharp deterioration in the trends of new orders and output among Scottish manufacturers. Output continued to fall and the contraction intensified. The proportion of respondents reporting sales/orders as a constraint on output almost doubled during the past two surveys. Total new order volumes fell at their sharpest rate since October 2001 – a notable deterioration from the

comparatively modest decline seen in the previous survey. A slightly weaker fall is anticipated next quarter, with expectations for domestic orders appearing to have stabilised somewhat. It was in export markets that the trend in orders deteriorated most noticeably, and this is expected to continue as the global recession deepens. The CBI reported that export prospects for Scottish firms appear to be deteriorating faster than across the UK as a whole.

The Royal Bank of Scotland PMI Scotland (January 2009) report noted the sharpest fall in manufacturing production in eleven years of data collection. The main reason given for the decline was a fall in new business with the report highlighting the steepest decline in new order books in the history of the survey. The survey also showed a continued downturn in export orders albeit at a slower rate of decline than in the previous survey.

Costs/Prices

For Scottish Chambers' respondents pressure to raise prices eased significantly from more than 80% anticipating price increases in quarter 3 2008 to 29% in quarter 4. PMI Scotland report indicated that prices had broadly remained unchanged with firms claiming that rising costs had left them unable to lower charges due to rising competition.

Scottish Engineering Quarterly review noted that prices were holding up well in UK markets but export prices were slightly down although margins remained negative in both UK and export markets. Prices are expected to fall for a net of firms in the latest Scottish Industrial Trends Survey by CBI Scotland. Firms reported that costs had continued to rise albeit at a slower rate than in previous surveys.

Employment

Amongst Scottish Chambers' manufacturing respondents changes to employment levels were reported by 33% of which 23% reported declining employment; 23.3% reported reductions in total hours worked. Scottish Engineering reported that staffing levels in general, but notably in small companies, were negative. PMI Scotland noted that 27% of manufacturing firms recorded a fall in employment. CBI Industrial Trends Survey on the other hand reported that employment had remained broadly unchanged for almost a year despite expectations in the past two surveys that marked reductions would be seen.

Construction

Confidence and Orders

The Scottish Chambers' Business Survey noted that for a further quarter 80% of construction firms reported being less confident than a year ago, and the net trend in business

confidence was the lowest recorded in the history of the survey. The declining trend in new contracts accelerated further in the fourth quarter, with a sharp downturn in the trends in public sector, in private commercial and domestic/house build contracts. Now only 28% (41%, 52%, 69%, and 71% in the previous four quarters) expect level or rising trends in the level of work through the next six months. Average capacity declined to 72%, the lowest figure recorded, a decline of 18 percentage points over the year. 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. The UK PMI Construction index (January 2009) likewise noted continued contraction in the sector, but suggested the rate of slowdown was easing and that confidence, although falling, was easing at a more modest rate than in preceding months, although it would be premature to interpret these signs as heralding a recovery of the sector.

Costs/Prices

For respondents to the Scottish Chambers Business Survey, expectations as to turnover trends over the next year have weakened significantly over the past three quarters. In the fourth quarter a net of 65% (37% and 25% in the previous two quarters two) anticipate declining turnover trends over the next year (in contrast rising net trends of 3%, 10% and 29% in the preceding three quarters). A net of -78% (-54%, -49% and -3% in the previous three quarters) anticipate declining profitability over the next twelve months. 83% of construction firms anticipate declining tender margins over the next twelve months.

Employment

Almost two thirds of Scottish Chambers' construction firms reported reducing employment and 73% reducing overtime in the fourth quarter. Recruitment was at the lowest level since the start of the survey.

The Service Sector

The PMI Scotland Report indicated that service sector activity declined for the tenth consecutive month although the rate of decline eased in January. The Lloyds TSB Scotland Business Monitor to November 2008 noted that Service businesses were more severely affected by the downturn than production businesses. For the last three months, the net balance on turnover of service businesses was -35%. This is significantly down on the -20% of the previous quarter and the +18% of the same quarter one year ago. The net balance on turnover for service businesses has now fallen for six consecutive quarters to the lowest level ever recorded in the 11 years of the Business Monitor. Compared to production firms service businesses were again more pessimistic with the overall net balance for increasing turnover in the next six months at -50% compared to the -34% of the previous quarter and the +13%

of the same quarter one year ago. Only 10% of service business expect turnover to increase in the next six months compared to 60% who expect a decline.

Retail Distribution

Optimism and Sales

Business confidence among Scottish Chambers respondents fell to unprecedented levels in the fourth quarter. The proportion reporting and expecting declining sales was the highest ever reported in the history of the survey. Over two thirds of respondents reported declining sales trends and over 80% expect sales to ease in the first quarter of 2009.

The SRC Scottish Retail Sales Monitor (December 2008) reported that like-for-like sales in December were 0.8% higher than in December 2007, when they had risen 0.4%. Total sales in December were 3.4% up on a year ago. The small like-for-like increase was the best since June, but was largely driven by food sales, discounts and clearance sales. Food sales showed stronger growth but non-food sales recorded their largest decline since 1999, despite increased discounting.

Costs/Prices

Scottish Chamber of Commerce retail respondents reported that cost pressures were less evident in the fourth quarter. A net of -69% of retailers anticipate declining turnover, and a net of -72% (-49% in the previous quarter) anticipate declining profitability over the next year, suggesting rising pressures on margins in 2009. This was echoed in the Scottish Retail sales Monitor (December 2008) which noted "Widespread promotions and discounts for all goods put immense pressure on margins. With mounting fears about jobs and plummeting consumer confidence these figures provide little reassurance about Scottish retail's prospects for 2009".

Employment

Changes in employment levels were reported by 44% of Scottish Chamber respondents (13% in the previous quarter) and the proportion reducing employment was the highest recorded. The trends in employment indicated continuing declining trends in full time, temporary and permanent employment, overtime working was sharply down.

Tourism

Optimism and Demand

For a further quarter concerns as to the business situation were widely reported by respondents in the Scottish Chambers' Business Survey. Over 70% reported lower levels of business confidence, the most widely reported figure since 2001. The current declining trend in business confidence

emerged in 2007 q4, and the proportions reporting declining trends more than doubled in the fourth quarter. The net trends in demand were weaker than in the previous fourth quarters of 1997 - 2007. Only 12.5% reported increased demand for accommodation, 7% increased numbers in restaurants and 9% increased demand for function/conference facilities. Average occupancy at 58% was lower than in the fourth quarters of 2006 - 2007, but broadly similar to that of q4 2005 and above that for q4 2001. Overall tourist demand accounted for 38.5% of total demand with business trade generating 27.3% and the balance was local demand.

A net of -37% Scottish Chamber of Commerce firms reported declining turnover trends (compared to a decline of -33%, -8% and increases of 10% and 38% in the previous quarters) and a net of -48% (-43.5%, -22.4%, -34% and -5% in the previous four quarters) reported falling trends in margins. Discounting of room rates was more widespread than expected and 47% expect to discount room rates in the first quarter.

Employment

Changes in employment levels were reported by 52% of Scottish Chamber respondents. Net declining trends in full time, part time, seasonal and overtime working were reported, and the proportions recruiting staff was lower than for the past ten years.

Outlook

All surveys continue to note the slowing down in the Scottish economy becoming more evident over the fourth quarter, with the services sector continuing to be more affected than manufacturing.

Eleanor Malloy/Cliff Lockyer
February 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 quarter to December 2008;
2. Lloyds TSB Business Monitor for the quarter to November 2008 and expectations to May 2009;
3. Scottish Engineering's Quarterly Review for the fourth quarter 2008;
4. The Royal Bank of Scotland's Monthly Purchasing Managers' Index to end January 2009;
5. The Scottish Retail Consortium's Monthly Scottish Retail Sales Monitor for December 2008;
6. The Scottish Chambers of Commerce Quarterly Business Survey, reports for the fourth quarter of 2008;
7. Oil & Gas UK 2008 Activity Survey;
8. 10th Oil and Gas Survey (Aberdeen & Grampian Chamber of Commerce, February 2009).