

# Review of Scottish Business Surveys

## Overall

Well into January 2012 surveys of Scottish business, in common with UK and European surveys, continued to highlight ongoing and deepening concerns as to the sovereign debt crisis in the eurozone. These, together with continuing fears of recession, with more signs of a slowdown both in the UK and internationally, forecasts of lower rates of growth in 2012, continuing consumer insecurity and pressures on household spending continued to dampen business confidence and activity. However, amongst the latest UK wide surveys there are some tentative suggestions that activity, outside the construction and retail sectors, was lowest in October/November, as reflected in the fourth quarter UK results, but has picked up since then. The latest UK PMI for January reported an increase in the service sector, at the fastest rate since March 2011. But it remains unclear if this echoes last year, with good survey figures for the first quarter, but fading later in the year as the headwinds facing the UK economy remain, or represents the first signs of a more permanent upward trend.

Both the Lloyds TSB Scotland Business Monitor (Q4 2011) and the Scottish Chambers' Business Survey (Q4 2011) noted the signs of the fragile recovery in the first half of 2011 were less evident by the end of 2011. The Business Monitor indicated that the already muted recovery in the Scottish economy had stalled. 'There is every indication of an already low recovery slowing further to the point where growth is negligible or non-existent.' The Scottish Chambers' survey noted 'demand remains weak as a combination of uncertainty, limited access to capital, reduced household income limits business activity and restricts plans for the future. The continuing concerns as to the future of the eurozone, the impact of government spending cuts and reorganisation of public services continue to adversely influence both activity and sentiment in Scotland and in the rest of the United Kingdom.' It concluded, at the beginning of 2011 we noted 'Rising price pressures and

weak demand seem set to continue in the service sector, for many Scottish businesses the combination of limited improvements in turnover, rising costs, pressures on margins and declining trends in profitability will pose real problems in 2011' at the end of 2011 we see little evidence in the results to change this view, if anything, our concerns for 2012 are greater and threat of recession more apparent.

## Oil and Gas services

Through much of 2011 international prospects remained positive with expectations of increased capital spending on both exploration and production with continued expansion of deep water reserves and unconventional sources. However, the International Energy Agency noted that oil demand fell for the first time since the 2008 – 2009 global financial crises, a reflection of the slowing down in the major economies and a relatively mild winter. Once again expectations as to demand is affected by political uncertainties in the gulf, most notably the threat by Tehran to close the Strait of Hormuz, the EU ban on Iranian imports and the downside risks to the global economy and hence to oil demand.

UK Government data suggest that the number of exploration and appraisal wells started in Q3 2011 declined to 12 compared to 21 in Q3 2010, and Deloitte reported offshore drilling levels falling to the lowest level since 2003, however, these figures masked the approval of a larger number of significant development projects in 2011. A number of longer term reviews remain positive as to the level of activity in the UKCS.

Within the UK confidence amongst operators and contractors remained stagnant, with little change evident in the first three quarters of 2011 (Oil and Gas UK Index Q3 2011). Both the Oil and Gas UK Index and Aberdeen & Grampian Chambers' 15th Oil and Gas Survey (November 2011) reported respondents' concerns focussing on wage rate escalation (higher than the UK average), cost inflation and staff shortages.

## Production

Respondents from the Lloyds TSB Business Monitor (Q4 2011) reported that export activity appeared to have been severely affected by the global slowdown and the sovereign debt crisis in the eurozone economies and, as a consequence, their assessment of prospects

over the next six months has deteriorated. Production firms were marginally less pessimistic than services with a net balance of -12% compared to services with a net balance of -14%. Expectations for the volume of repeat business over the next quarter fell to an overall net balance of -11% compared to -5% of the previous quarter and the -4% of the same quarter one year ago. Expectations for the volume of new business are slightly better at -7%. This is only marginally worse than the -6% of the previous quarter and the -5% of the same quarter one year ago.

## **Manufacturing**

The Index of Manufactured exports for the third quarter of 2011 indicated that exports grew by only 0.2% (compared to 1.1% over the second quarter) and on an annual basis grew by 2.7%. Drink, Metal Products, Other Manufacturing and Mechanical Engineering registered rises over the quarter. Whilst most business surveys differed in their interpretation of trends, there was more agreement in surveys in the final quarter of 2011 of a slowing down in activity. The Purchasing Managers Index (PMI) conducted by The Bank of Scotland concluded that the Scottish economy witnessed a slowdown in December and a pickup in the services sector compensated for falling output and export orders from a manufacturing sector affected by the slowdown in eurozone economies. Employment prospects in manufacturing continued to look favourable during September. However, surveys for the first two months of 2012 have been slightly more positive.

Scottish Chamber of Commerce Business Survey (SCBS) firms reported that business confidence remained low and weakened throughout the second half of 2011; and similarly the Scottish Engineering Review in its fourth quarter survey outlined that business confidence has now become negative. Similarly the CBI Industrial Trends Survey for Q4 2011 reported that business optimism had 'withered' to its lowest level for three years.

Trends in total new orders became negative for respondents to The Scottish Engineering Review and SCBS firms reported that the trend in total new orders again eased in quarter four and the upward trend in total new sales ended. The trends in orders remained negative for the third consecutive quarter for CBI respondents. For SCBS firms the outturn

in total orders was worse than had been expected, the rising trend in export orders, a feature of the past four quarters, ended and respondents now anticipate a slight easing in export orders over quarter one 2012. The Scottish Engineering review also reported a downward trend in export orders although in general exports held up amongst larger companies.

The CBI reported that for the first time in three years most firms intend to reduce expenditure across all four investment indicators. SCBS firms claimed that although continuing to rise, trends in investment in plant/machinery remained weak during quarter four for a net balance of firms. New investment was again mainly directed towards replacement or to improve. Capital investment plans among respondents to the Scottish Engineering Review rose for the sixth consecutive quarter. Small and medium companies remained more positive whereas large companies reported a flat trend.

Employment trends eased among SCBS and CBI firms, although two thirds reported no change and remained upbeat for respondents to the Scottish Engineering Review.

## **Construction**

Scottish Chambers' construction respondents noted that for the fourth quarter of 2011 business confidence remained weak compared to a year ago although, given the harsh weather conditions at the ends of both 2010 and 2011, comparisons are difficult. The latest Scottish Construction Monitor conducted by the Scottish Building Federation members (SBF) for Q3 2011 reported that the general confidence rating declined by 13 points following a period of rising confidence, and a further decline was reported in Q4 together with weak trends expected for 2012. They are attributing the decline to the prospects of significant cuts in public sector spending coupled with a stagnating private sector. Similarly the Construction Industry Training Board in their report, Construction Skills concluded that the strong recovery seen in the Scottish construction industry in 2010 has proved to be short-lived, with an estimated decline of 3% in output for 2011 in real terms.' The reason cited for this is the lower than anticipated activity in the private sector combined with the depressed public sector brought about by problems in the eurozone countries and the levels of debt. The report

argued that given the scale of public expenditure cuts the public construction sectors held up in 2011 better than might have been expected.

Scottish Chamber respondents reported that strong downward trends in orders had been anticipated for the fourth quarter of 2011, but worryingly the outturn was worse than had been expected. The decline in new contracts is expected to ease in Q1 2012, but it is unclear as to whether this is a pickup of work emanating from the series of winter storms or the beginnings of a recovery in activity. Over 80% of Chamber respondents reported working below capacity, and cash flow trends, turnover and profitability are all expected to be weak over the next 12 months together with continued pressure on margins. Average capacity used, at 75% was marginally lower than Q3 although was higher compared to a year ago, when activity was disrupted due to the adverse weather. The Construction Industry Training Board indicate that the concerns over prospective growth in the UK and Scotland will affect levels of private investment, therefore stunting growth in the private housing, industrial and commercial sectors in the short term. This, combined with likely public expenditure cuts will hit the public housing and public non-housing sectors hard, and the outlook for the house building sector is muted. The Construction Skills report is forecasting 2012 as another year of declining output overall with growth not expected to return to the sector until 2013.

Scottish Chamber firms reported that the downward trend in employment accelerated in Q4 and that once again no recruitment difficulties were evident. The Scottish Construction Monitor focused on the recruitment of apprentices and concluded that firms are anticipating recruiting few apprentices over the course of 2012. Construction Skills, on the other hand, forecast that construction employment in Scotland is expected to grow at an annual average rate of 1.1%.

### **The service sector**

The Lloyds TSB Scottish Business Monitor (Q 4 2011), reported continued weak trends in terms of the volume of new business (both new and repeat business) and expect little change to these trends over the next six months.

### **Retail distribution**

As we have noted in earlier Commentaries recognition of the structural changes affecting the sector is critical in understanding the trends reported in retail surveys. A combination of a continued rise of internet sales (both with delivery and or collection at store bases), drift towards out of town centres and away from secondary city areas and increased price competition between the major retailers have contributed to changes in the high street shopping landscape, with slower growth in some areas but declines in others. Whilst the Retail Sales Index for Scotland Q4 2011 noted the volume of retail sales grew by 0.7% in Q4 2011 and by 0.7% annually (seasonally adjusted). The value grew by 0.8% in Q 4 2011 and by 3.5% annually (both at constant prices), both the Scottish Retail Consortium and retail respondents to the Scottish Chambers' survey reported harsh trading conditions. The Finance Secretary, in commenting on the Retail Sales index figures, suggested this reflected stronger consumer confidence in Scotland compared to Great Britain, rather than the ongoing structural changes.

In contrast both the Scottish Retail Consortium and Scottish Chambers' retail respondents reported poor sales trends through the fourth quarter. Weak sales trends had been reported by the Scottish Retail Sales Monitor through much of 2011. Sales in November 2011 were 1.3% down on November 2010 (when they had increased by 3.4%) The Scottish Retail Consortium noted 'This was the worst fall in total sales for any month since the survey began in 1999. Like-for-like sales were 2.1% lower than a year ago, the worst since August and the sixth decline in the past seven months'. Evidence of considerable discounting and extensive promotions was evident in November and concerns as to weak sales trends in December were widespread with harsh retail conditions widely forecast.

Comparisons between December's 2011 and 2010 sales reported by the Scottish Retail Sales Monitor were problematic given the marked differences in the weather. Sales in December 2011 whilst up 1.6% on December 2010 were reported as the worst December figures since the monitor began in 1999. Once again aggressive discounting, clearance sales and promotions were widespread. The SRC noted 'Sales growth revived to its highest since July but this still represented a real terms fall

once inflation is allowed for. The Christmas boost was well below both what Scottish retailers hoped for and the UK-wide figures. It came largely from a last-minute surge in the week before Christmas, helped by discounts and the shopping opportunity presented by the Saturday Christmas Eve' although profits warnings and cost cutting plans have been announced by a number of major retailers. More recent analysis by the Scottish retail Consortium suggest there was an 8.5% drop in foot fall (numbers shopping) in the three months to January.

Concerns were raised as to the impact of sales growth lower than inflation on cash management, stock control and on jobs and investment. Both commentators and industry bodies have noted that margins have been hit so hard that retail health is considered now to be in a worse state than at the depths of the 2008 recession and 2012 will be a difficult year for retailers. GVA Grimley (November 2011) noted that up to a sixth of retail spaces in some Scottish towns are now empty, notwithstanding reductions in rental charges. They noted that traditional town centres as being less able to withstand the effects of economic decline – compared to out of town centres (quoted in the Herald 24.11.2011). The annual shop vacancy report echoed these trends. The average national UK vacancy rate has risen from 3% in 2008 to 14.3% in 2011, with much higher levels in some Scottish towns reflecting a combination of insolvencies and national chains moving to out of town locations. There is much to suggest that vacancy rates will continue to rise, notwithstanding reductions in rental rates.

Conditions in the retail sector among SCBS firms did not improved during the crucial fourth quarter with declining consumer confidence and sales trends, increasing competition, rising costs and declining margins. Sales trends weakened further with more than 80% reporting, and more than three quarters expecting a decline in the total value of sales. Fewer than 10% of SCBS respondents reported or expect increased sales, as continuing concerns over consumer confidence remain evident. Cost pressures remain intense with transport costs and pay settlements being more of a concern. Pressures on margins remain widespread with over two thirds expecting declining profitability and turnover over the next year. Labour market activity continues to remain at

historically low levels with no firms reporting or expecting to increase overall staff levels. The CBI's Distributive Trades survey (UK wide) for January likewise noted retail sales down sharply on January 2011, with 44% reporting sales lower than in January 2011 and a net of 10% anticipating lower sales in February compared to February 2011. Continued pressures on family budgets and low confidence amongst consumers were seen to be the factors underpinning these results. The Scottish Retail consortium (January 2012 sales) reported, notwithstanding widespread discounting, the worst monthly figures for a decade, down 1.5% on last year, and like for like figures 2.6% lower than a year ago. Modestly rising food sales were offset by weaker non food sales.

### **Tourism**

Business confidence declined further in Q4 for SCBS hotels and was significantly lower compared to Q4 2010 and to the lowest level since Q4 2008. The rising trend in total visitor numbers continued although weakened further and was better than had been anticipated.

PKF reported (November) declining room yields in Scottish hotels and only a modest rise in occupancy rates to 69.8% - but with marked differences between the major Scottish cities, with Aberdeen and Inverness both recording increases in occupancy and room yields, whereas both Glasgow and Edinburgh reported declining trends. In common with other surveys the PKF report noted rate cutting to sustain occupancy levels, and increased concerns for those currently running high debt levels. Whitbread whilst reporting 'stalling growth' in the UK hotel sector nevertheless reported increased like for like sales with its Premier Inn group reporting occupancy at 80.3%, well above the industry average. The rise of the budget hotel sector in recent years, with Premier Inn's capacity of over 40,000 rooms (and with a growth target of 4000 rooms and 13 restaurants in 2011) and Travelodge with over 32,000 rooms indicates the scale of change in the hotel sector and the increasing pressure on smaller and traditional hotels.

Average occupancy declined for SCBS hotels (from 75.4% to 56.8%) although was marginally better compared to the same quarter a year ago. The Scottish Guest House and B&B Occupancy Survey for November 2011 showed that both room and bed occupancy declined over the year. The

Scottish Self-catering Occupancy Survey also reported a decline. The accountants PKF reported occupancy rates rose by 0.6% in Scotland compared to 1% in England. Their report noted that whilst room yields and occupancy declined in three and four star hotels in Glasgow and Edinburgh, Aberdeen hotels, possibly reflecting the more buoyant oil and gas sector, reported improved occupancy and yields.

During the three months to the end of December, trends in bar/restaurant trade and for conference/function facilities continued to decline among SCBS hotels. Half of hotels reported reducing average room rates and the widespread pattern of 'special offers' seems set to continue with more than half expecting to reduce room rates in Q1 2012. Three-quarters, compared to 84% in the previous quarter, reported that the lack of tourist demand remained the primary business constraint and almost a third noted competition. Poor transport infrastructure also remained a concern to hotels. 48% (compared to 56% in the third quarter) sought to recruit staff. Employment trends, as forecast declined in quarter four but the declines were not as steep as had been expected. A net balance of 201% expect a further decline in quarter one 2012.

### **Logistics and Wholesale**

Data from the Scottish Chambers' Business Survey showed that the problems in the Scottish wholesale distribution sector continued. Business confidence amongst SCBS wholesale respondents eased marginally although again more than half of firms reported a decline in business confidence. Business confidence was once again considerably lower compared to one year ago. Firms in the third quarter survey had expected a decline in sales however the downward trend in sales trends eased in Q4. More than 90% of SCBS wholesalers reported increased pressures from transport costs. Cost pressures generally increased during the three months to the end of December and remained historically high. More than 70% expect to increase prices over the next three months, and cash flow trends remain weak. Once again concerns over turnover eased slightly however profitability remains low. Once again most firms reported no change to investment plans; nevertheless there appears to have been a marginal improvement. Wholesale respondents continued to shed staff during Q4

although the rate of decline eased further. Fewer than a third sought to recruit staff; largely for replacement.

### **Outlook**

The slowing down of the weak recovery in the UK and eurozone economies, coupled with continuing consumer insecurity and reduced domestic spending, and with the impact of government spending cuts again dampened business confidence and activity. The pickup in activity in construction in Q2 2011 appeared short lived and continuing consumer uncertainty and reduced spending contributed to weaker results in retail and the closure of a number of retail groups. For a further quarter tourism benefited from some increase in the numbers of home visitors, but these have been sustained by widespread discounting. The corrosive effects of uncertainty both in Europe and at home coupled with weak consumer confidence will combine to make 2012 a difficult year for Scotland.

At the end of 2011 the trends in demand and activity in construction were largely unchanged from a year ago, with widespread declining trends and pressures on margins being widely reported, once again the exceptional weather conditions are likely to impact on trends, especially in the first quarter given the need for repair and renewal following the winter storms. In tourism the outturn was weaker than anticipated and little changed from a year ago.

Structural changes continue to affect both the retail and tourism sectors and compound the difficulties in assessing the impact of the slowdown in economic activity on consumer spending. It is clear that the migration of retail outlets and consumers from traditional city and town high streets to out of town centres and internet based retailing is affecting retail activity, as is the widespread discounting and competition between the major supermarket groups. Equally the continued expansion of the number of budget hotel room numbers has contributed to more intense discounting of room rates in tourism. The impact of the Olympics on overall tourism numbers in the UK remains unclear, as is the impact on the Scottish tourism sector. However, there is much to suggest that weak consumer confidence and spending will continue to adversely affect these sectors through 2012.

Bank of Scotland PMI data for January reported a moderate improvement in business

conditions, with rates of growth marginally faster than in the previous survey period. However, export orders weakened, albeit at the lowest rate for four months. The Scottish economy was seen as 'struggling to maintain growth momentum in the face of a global slowdown, but is, so far, avoiding a return to recession.' The Lloyds TSB English Regional PMIs noted that Scotland's growth in December was lower than all of the English regions, but unlike Wales and Nn. Ireland reported growth. In January Scottish growth was again better than Wales and Nn. Ireland, but again lower than all English regions except the South West.

There is much to suggest in the surveys that labour market activity remained limited with the majority of respondents not varying overall employment levels, nevertheless, SCBS respondents reported declining employment trends in all sectors and all sectors expect these weak employment trends to continue. Recruitment difficulties remained at low levels in all sectors. Pay increases in 2011 were at historically low levels and well below the rate of inflation, implying real declines in household income. In Q4 2011 pay increases amongst SCBS respondents ranged from 1.8% in manufacturing and construction, to 2.5% in retail and 3.5% in tourism, although were higher in the Scottish oil and gas sector.

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

1. Aberdeen & Grampian Chamber of Commerce Survey no 15 November 2011;
2. The Confederation of British Industries Scottish Industrial Trends Survey for the fourth quarter 2011;
3. Lloyds TSB Business Monitor for the quarter September 2011 – November 2011 and expectations to May 2012;
4. Lloyds TSB Commercial, England Regional PMIs for January 2012;
5. Scottish Engineering's Quarterly Reviews for the fourth quarter of 2011;

6. The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices for November, December 2011 and January 2012;
7. The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitors October, November and December 2011 and January 2012;
8. The Scottish Chambers of Commerce Quarterly Business Survey report for the fourth quarter of 2011;
9. Oil & Gas UK quarterly Index Q3 2011;
10. Oil & Gas UK Economic Report 2011;
11. ONS Retail sales Q 4 2011;
12. Visit Scotland Occupancy Survey for October and November 2011;
13. The Scottish Construction Monitor October 2011;
14. 2012-2016 Construction Skills Network Scotland.

PKF Hotel Occupancy Report 2011