3 Review of Scottish Business Surveys

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Abstract

Business surveys are a useful tool to provide accurate and timely data and are extremely helpful in pinpointing subtle movements and also turning points in the economy. The business surveys reviewed here provide an overview of key recent evidence of the Scottish economy. Once again the latest set of Scottish Business Surveys are not particularly strong and show that many of the key benchmark indicators continued to slow in the most recent quarters. For business the economic outlook remains muted, perhaps reflecting the oil price fall and its onshore impact in Scotland, especially in the North East and on the supply chain, as well as uncertainty surrounding the EU referendum. This sense of uncertainty is most tangible for the business optimism and investment key balances and it is concerning that many of the forward-looking indicators indicate an easing of trends.

The Bank of Scotland Purchasing Managers' Index (PMI)

The seasonally adjusted headline Bank of Scotland PMI - a single-figure measure of the month-on-month change in combined manufacturing and services output - scored 48.5 in March 2016, falling from February's 49.2 which in turn was down on the January figure of 50.3. The January PMI showed a further deterioration in the Scottish private sector. The survey showed that both the service sector and, more significantly, the manufacturing sector contracted in March. The survey indicated that output, new business and employment all continued to decline.

RBS (Scottish) Business Monitor

The latest RBS (Scottish) Business Monitor produced in conjunction with The Fraser of Allander Institute (results for December 2015, January 2016 and February 2016, and expectations to August 2016) shows the Scottish economy slowed further during this period. The outturn this quarter for many key balances was significantly worse than the previous survey and down on expectations expressed in the previous survey. The rate of recovery is still being constrained by companies in the North East. New business levels declined during the three months to the end of February with an overall net balance of -8% compared to +3% of the previous quarter and also down on the +2% of the same quarter one year ago. Expectations are that this slowdown in the rate of recovery will continue and growth in Scotland is set to slow further with the fall in oil prices having a net negative impact on Scotland compared to the rest of the UK.

Firms' assessments of their immediate prospects in the next six months were on a rising trend throughout 2013 and reached highs in the first two quarters of 2014. The remainder of 2014 and into 2015 showed lower but still positive levels of expectations. Last quarter, expectation levels eased but largely remained positive whereas this quarter many declined to become negative. This is the thirteenth successive Business Monitor showing a positive net balance for turnover expectations although the balance has eased to +2%; down from +4% last quarter and down from +14% compared to Q1 2015. The expectation levels recorded by respondents in this latest survey suggest the private sector of the Scottish economy will show growth below trend level in the first quarter of 2016.

These expectation levels suggest the private sector of the Scottish economy will show growth below trend level in the first quarter of 2016, and suggests slower growth in the six months to August 2016, compared to the period to November 2015. Expectations of growth have generally eased or fallen and suggest that current growth rates will be maintained in the early part of 2016.

On a positive note domestic demand is still growing, inflation remains low, earnings/income growth is picking up slowly, interest rates remain low, and external demand for goods and services is being boosted by the continued resilience of the US economy and a gradual pick-up in growth in the Eurozone. However some threats to Scotland's economic growth remain namely the lower price of oil, unbalanced growth as household spending remains the key driver - fueled largely by rising household debt - net trade continues to be strongly negative – with exports weak - fiscal austerity and finally the current uncertainty surrounding the referendum on the UK's membership of the EU.

Total volumes of business had, up until the previous quarter, been showing a slowly improving trend however in the latest quarter a net of -19% reported a decline, further down on the -3% of the previous quarter and also down on the +7% of the same quarter one year ago. This is the lowest net balance since the first quarter of 2011.

- The overall net balance of turnover (those reporting an increase minus those reporting a decrease) fell significantly to -21%, this is down from the +1% of the previous quarter and from the 0% of the same quarter one year ago. This is the lowest net balance since the first quarter of 2011.

- Export activity is continuing, on balance, to fall. The overall net balance for export activity at −22% down on the −10% of the previous quarter and also significantly worse than the +6% of the same quarter one year ago.

- Firms are significantly more concerned over weakening demand compared to the previous quarter with the percentage of firms citing it as 'very important' or 'important' increasing from 81% to 84%.

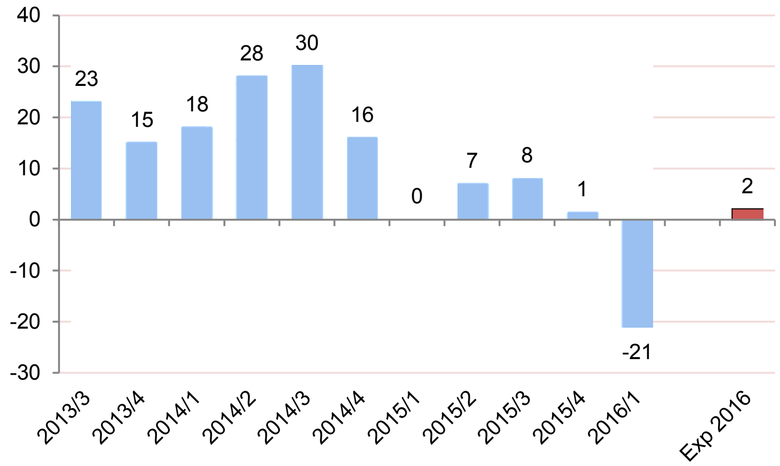
- Concerns over credit costs and more notably credit availability remain relatively low for both production and service firms.

- Firms located in the North East continue to perform worse than those located elsewhere.

- Firms with a turnover of between £5 million and £10 million are reporting the most positive trends with those with a turnover of up to £5 million and those with a turnover of more than £10 million reporting more negative trends. Firms with a turnover of more than £500,000 are expecting an increase in the total volume of new business.

- Expectations are that this slowdown in the rate of recovery will continue and growth in Scotland is set to slow further with falling oil prices having a net negative impact on Scotland compared to the rest of the UK.

Figure 1: Trend in business turnover, % net balance of respondents



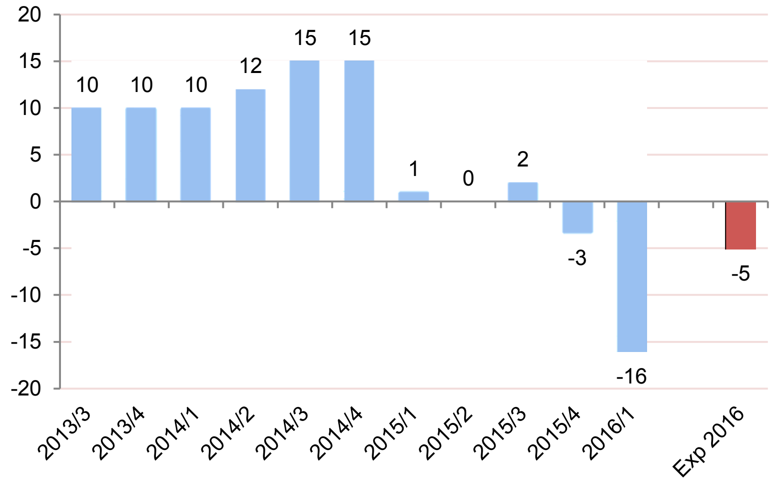
Source RBS Scottish Business Monitor

In the three months ending February 2016, 22% of the firms surveyed increased turnover, 35% experienced static turnover and 43% experienced a decrease. The overall net balance (those reporting an increase minus those reporting a decrease) is -21.5%, down from the +1% of the previous quarter and from the zero balance of the same quarter one year ago. This latest result is the lowest net balance since the first quarter of 2011.

The overall net balance of turnover for firms in the production sector in the three months to end February 2016 was -27%. This is significantly down from 0% of the previous quarter and also on the -5% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending February 2016 of -18%, well down on the +2% of the previous quarter and also from the +4% of the same quarter one year ago. Expectations for turnover in the next six months ending February 2016 are showing an overall net balance of +2%. Although still positive this is down on the +4% of the previous quarter and also down on the +15% of the same quarter one year ago. Whilst 49% expect turnover to be static in the next six months, 27% expect turnover to increase against 24% who expect a decrease. Services firms remain more optimistic than production firms, with service firms showing an overall net balance for turnover for the next six months at +3% (+6% in the previous quarter) compared to +2% (+1% in the previous quarter) for production firms.

Volumes of repeat business are showing a decline in the latest quarter. In the three months ending February 2016, 12.1% of the firms surveyed increased repeat business, 59.9% experienced static new business and 28.0% experienced a decrease. The overall net balance of -16% is significantly worse than the -3% of the previous quarter and also markedly worse than the +1% of the same quarter one year ago.

Figure 2: Trend in the volume of repeat business, % net balance of respondents



Source RBS Scottish Business Monitor

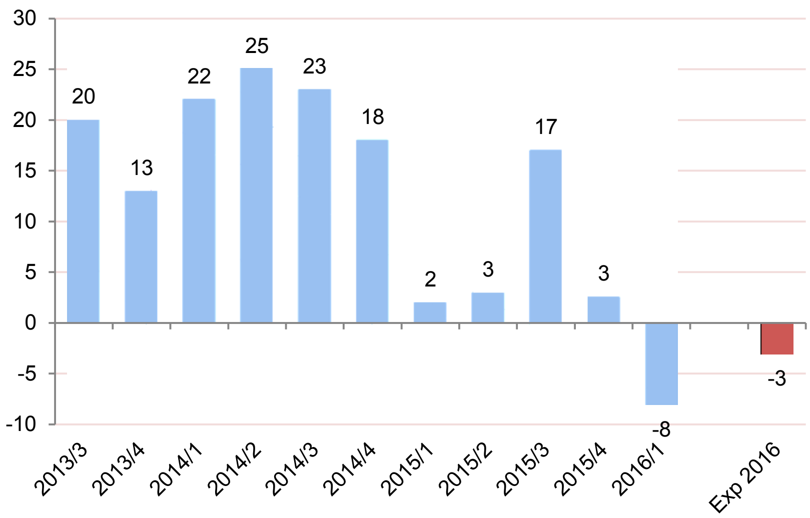
The overall net balance of repeat business for firms in the production sector in the three months to end February 2016 was –14.3%. This has down from the –1.3% of the previous quarter and also down on the -2% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending February of –16.8%, down on the -4.7% of the previous quarter and also from the +1% of the same quarter one year ago. Expectations for the volume of repeat business were, once again, down on the levels of the last quarter with an overall net balance of-5% for this quarter compared to +2% for the previous quarter; significantly down on +10% for the same quarter one year ago.

Production firms are marginally less pessimistic than service firms, with service firms showing an overall net balance for repeat business for the next six months at -4% (+0.5% in the previous quarter) compared to -6% (+3% in the previous quarter) for production firms.

Trends in the volume of new business declined during the three months to the end of February 2016 with an overall net balance of -8% compared to +3% of the previous quarter, down also on the +2% of the same quarter one year ago. During the summer new business volumes appeared to have recovered to the levels seen in 2014 after a poor six month period at the end of 2014 and the beginning of 2015 but this appears to have been a temporary position as the levels have declined.

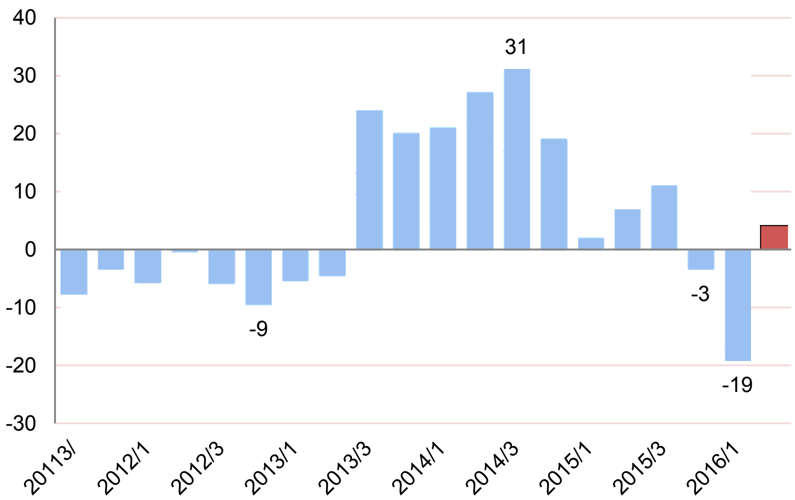
The overall net balance of new business for firms in the production sector in the three months to end February 2016 was –21.7%. This is significantly down from the -3.4% of the previous quarter and also down on the +6% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending February of +0.5%, down on the +7% of the previous quarter and also from the 0% of the same quarter one year ago. Expectations for the volume of new business in the next six months have declined with the latest net balance at -3% – down on the +6% of the previous quarter and also down on the +14% of the same quarter one year ago. Service firms are showing an overall net balance for expectations of new business for the next six months at -2.8% (+8% in the previous quarter) compared to -2.5% (+1% in the previous quarter) for production firms.

Figure 3: Trend in the volume of new business, % net balance of respondents



Source RBS Scottish Business Monitor

Figure 4: Trend in the total volume of business, % net balance of respondents



Source RBS Scottish Business Monitor

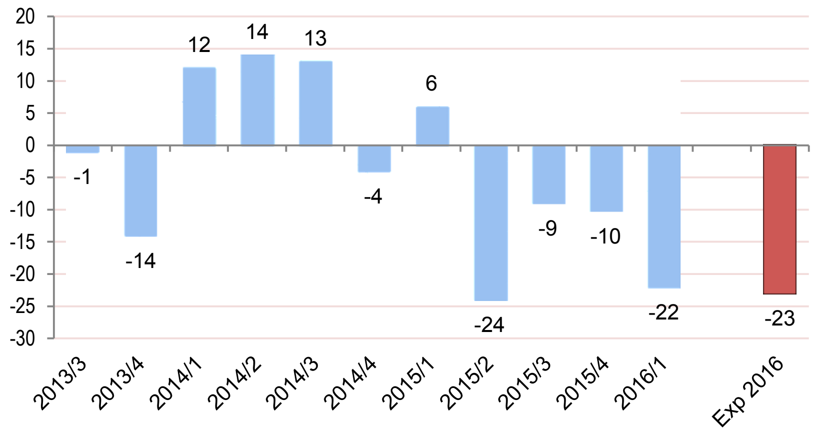
During 2015 total volumes of business had been showing a slowly improving trend however in the latest quarter a net of -18.9% reported a decline, down on the -3% of the previous quarter and also down on the +2% of the same quarter one year ago. These downward trends are evident across both production

(-19.0%) and services firms (-18.9%).

The overall net balance of the total volume of business for firms in the production sector in the three months to end February 2016 was –19%. This is significantly down from the -1% of the previous quarter and also down on the -5% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending February of –18.9%, significantly down on the -5% of the previous quarter and also from the +7% of the same quarter one year ago.

Expectations for the total volume of business in the next six months have remained broadly unchanged with the latest net balance at +4.5% – very marginally down on the +5% of the previous quarter but down further from the +15% of the same quarter one year ago. Service firms are now slightly less optimistic than production firms, with service firms showing an overall net balance for new business for the next six months at +3.8% (+7% in the previous quarter) compared to +5.6% (+3% in the previous quarter) for production firms.

Figure 5: Trend in export activity, % net balance of respondents



Source RBS Scottish Business Monitor

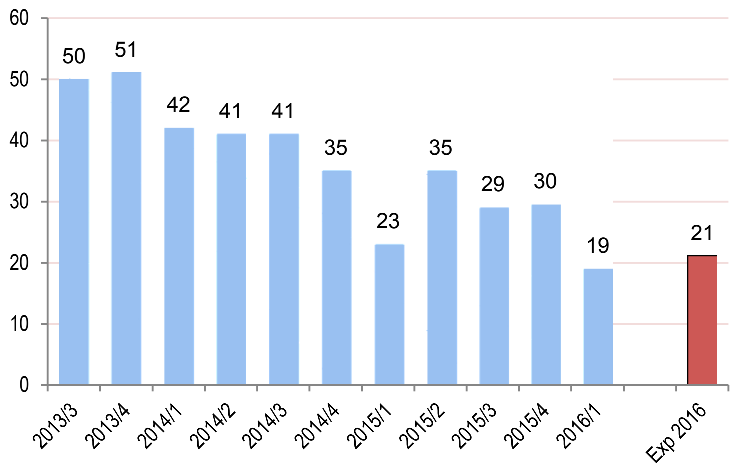
Export activity is continuing, on balance, to fall. The overall net balance for export activity at −22% is marginally down on the −10% of the previous quarter and also worse than the +6% of the same quarter one year ago. Net trade (exports minus imports) continues to be strongly negative, exacerbated by slowdown in China and a slowing of the growth of world trade. This feeds back to Scottish activity both through lower exports and a low price of oil affecting activity across the country, and particularly in the North East of Scotland.

The net balance for expected export activity for the next six months has worsened. The net balance reached −22% – well down on the −6% of last quarter and also worse than the +2% of the same quarter one year ago.

The overall net balance of the total volume of business for firms in the production sector in the three months to end February 2016 was –24.4%. This is significantly down from the -10.6% of the previous quarter and also down on the +6% of the same quarter one year ago. Services firms showed an overall net balance for turnover for the three months ending February of –20.0%, significantly down on the -9.8% of the previous quarter and also from the +6% of the same quarter one year ago.

Expectations for export activity in the next six months have fallen with the latest net balance at –23.3% – this down on the –6% of the previous quarter and is also down on the +2% of the same quarter one year ago. Service firms are less pessimistic than production firms, with service firms showing an overall net balance for export activity for the next six months at –17.8% (-10% in the previous quarter) compared to –29.3% (-2% in the previous quarter) for production firms.

Figure 6: Trend in costs, % net balance of respondents



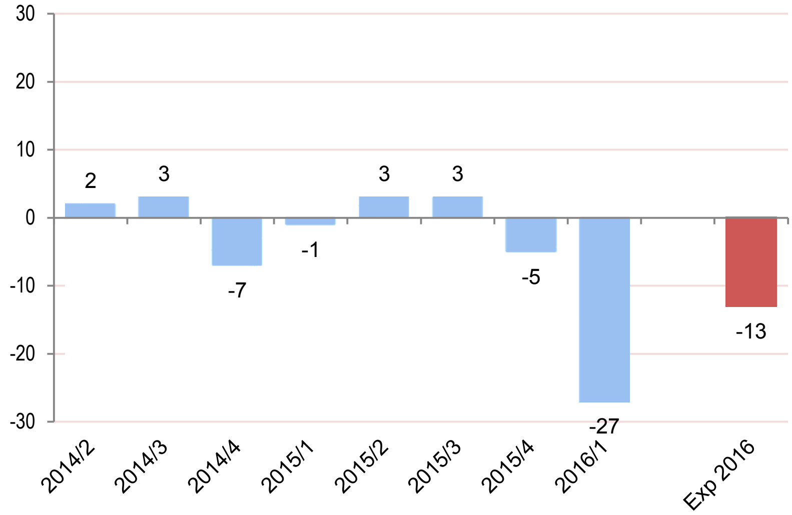
Source RBS Scottish Business Monitor

Cost pressures were broadly unchanged in the latest quarter. The overall net balance of firms experiencing cost increases in the last three months was +19% – this has eased from the +30% of the previous quarter and also from the +23% of the same quarter one year ago.

The overall net balance of costs for firms in the production sector in the three months to end February 2015 was +18.4%. This has eased from the +31% of the previous quarter and is also marginally down on the +19% of the same quarter one year ago. Services firms showed an overall net balance of costs for the three months ending February of +20%, down on the +28% of the previous quarter and also from the +25% of the same quarter one year ago.

Expectations for future cost increases have fallen slightly. The overall net balance for cost expectations is +21% – down from the previous quarter's +25% and lower than the +26% of the same quarter one year ago. Whilst 61% expect their costs to remain static, 30% expect an increase as opposed to 9% who expect a decrease in the next six months. Production firms are facing a larger increase in costs than service firms, with service firms showing an overall net balance for the trend in costs for the next six months at +18% (+3% in the previous quarter) compared to +23% (+22% in the previous quarter) for production firms.

Figure 7: Trend in capital investment, % net balance of respondents



Source RBS Scottish Business Monitor

As forecast by firms from the previous survey the rate of capital investment declined in Q1. For the last three months, 48% of firms reported static levels of capital investment, 30% a decrease while 21% reported an increase giving a net balance of -8.8%, down on both the levels last quarter -5% and also compared to the same quarter one year ago -1%.

The overall net balance of the rate of capital investment for firms in the production sector in the three months to end February 2015 was –9.5%. This has eased marginally from the -11% of the previous quarter but is down from the +1% of the same quarter one year ago. Services firms showed an overall net balance of capital investment for the three months ending February of -8.4%, down on the 0% of the previous quarter and also from the -2% of the same quarter one year ago.

Expectations for new capital investment the next six months ending February 2016 are showing an overall net balance of –12.9%; down on the –6% of the previous quarter and also down on the -1% of the same quarter one year ago. Services firms remain marginally less pessimistic than production firms, with service firms showing an overall net balance for new capital investment for the next six months at –9.1% (-1% in the previous quarter) compared to –18.3% (-13% in the previous quarter) for production firms.

Scottish Chambers of Commerce Quarterly Economic Indicator Quarter 1 2016

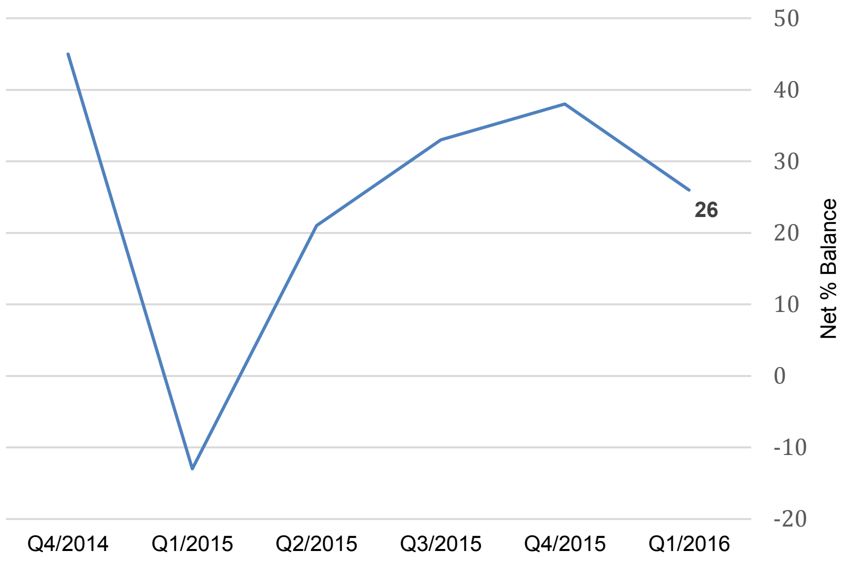
Construction

Construction respondents to the QEI were fairly buoyant, business confidence rose from +4% in Q4 2015 to +20% in Q1. Sales revenues, on balance remained positive for a net of 26% of firms and positive trends in sales revenue are expected to continue in Q2 with 61% of businesses predicting a rise.

Almost half of all respondents reported an increase in the volume of total new contracts, with a net balance of +24%, the highest net % balance reported since Q4 2014.

Generally pressure to raise prices appears to have increased as 49% of firms reported an increase in prices and only 3% reported a fall. Almost 40% of construction firms reported that wages increased over the quarter. On balance firms reported a positive net balance of +7% for total investment although a net balance of 3% reported a fall in capital investment.

Figure 8: Scottish Construction Sales Revenue, 2014q4 – 2016q1



Source: Scottish Chambers of Commerce Economic Intelligence Unit

Financial & business services

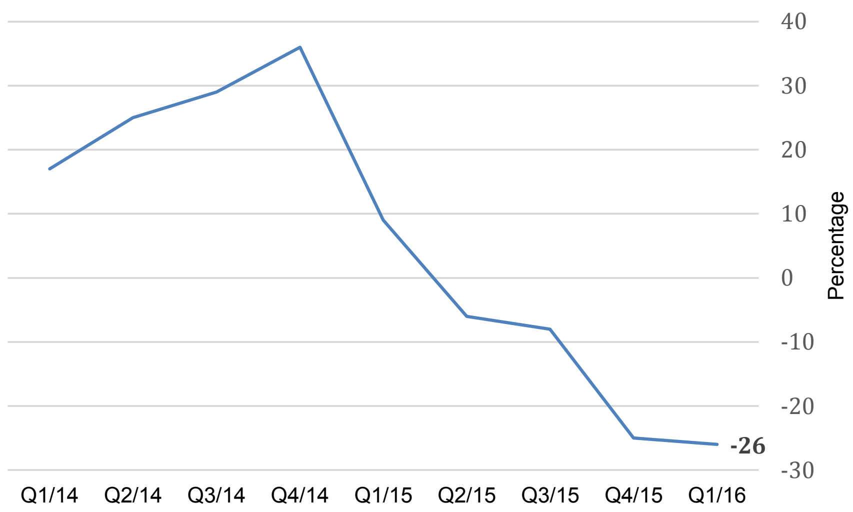
Following a disappointing quarter in terms of sales revenue in Q4 of 2015, businesses in the sector experienced another quarter of declining growth with a 43.2% of firms reporting a decrease in total sales revenue over Q1 2016 the quarter. Negative net balances were reported for domestic sales (-18), sales revenue from the rest of the UK (-12), and revenue generated by exports (-22). Profits declined for the fourth consecutive quarter with a net balance of -26% reporting a decline. A decline in cashflow was reported by a net balance of -23% the lowest figure recorded since Q1 2014.

Employment levels decreased for a net balance of -6% of firms although the majority of businesses (52.1%) reported that employment levels remained the unchanged Q1 and 59.5% of businesses expect employment over the next quarter to remain stable.

The financial and business services sector has experienced negative growth since the second half of 2015. A net balance of businesses have indicated that they expect both investment (-8%) and employment (-1%) to remain in negative territory in Q2 although a net balance of 7% expect a rise in sales revenue.

Business optimism dipped to the lowest net balance since Q3 2012 with a net balance of -10% reporting a fall. Despite the decline in business optimism levels of investment remained buoyant with over 80% of businesses indicating that total investment had either increased or remained unchanged over the quarter.

Figure 9: Financial and business services profit, 2014q4 – 2016q1



Source: Scottish Chambers of Commerce Economic Intelligence Unit

Manufacturing

A net balance of -17% of manufacturers reported a fall in total orders, the lowest figure recorded since Q3 2012. There were net declines in Scottish orders (-19), rest of UK orders (-13) and export orders (-15). Despite the trends in orders falling into negative territory, more than half (54.3%) of businesses expect total new orders to increase in Q2 2016. The majority of businesses expected orders to increase or remain level in Q2.

A net balance of +15% of firms reported a rise in employment and employment levels are expected to rise or remain unchanged by 81.3% of businesses during Q2 2016. Also 72.9% of business indicated that they were currently recruiting and around a third of firms currently indicated that they were experiencing recruitment difficulties.

Retail and wholesale

Business optimism improved for a net balance of 10% of distribution firms during the three months to the end of March 2016. A net balance of +10% reported a rise in total sales with firms reporting net rises in export (+4%) and online sales (+19%); however, domestic sales were, on balance unchanged and rest of UK sales declined for a net of 7% of respondents.

Total investment expenditure improved for a net of 8% of firms with net increases in both capital (+2%) and training investment (+2%). Investment is expected to continue to increase in Q2 2016 for 22.2% of retail and wholesale firms. Profitability declined for a net of 4% of firms. Employment levels changed for fewer than half of firms and 72.9% of firms expect no change to their staff numbers during the three months to June 2016.

Tourism

Sales revenue rose for a net balance of 28% of firms over the quarter, with sales from Scotland increasing for a net of 25% of firms. Sales revenue is expected to continue to rise in Q2, with 60% of firms anticipating an increase. However despite positive trend balances for the number of total guests, sales revenue and investment a negative net balance was recorded for profits (-10%). The total number of Guests/ Customers grew in comparison with the same time last year for a net balance of +17%, with net rises in coming from Scotland (+23%). Although a net balance of 0 was reported for guests coming from the rest of the UK, and business experienced a net fall in the number of guests from the rest of EU (-10%) and from outside the EU (-3%).

Investment levels continued to increase albeit at a slower rate than in the previous quarter with a net balance of +13% reporting a rise compared to +25% reported in Q4 of 2015, and also lower than the +21% reported for the same time last year. However, investment is expected to increase or remain unchanged in Q2 of 2016 for 80% of businesses. Most businesses in the tourism sector expect to increase prices in Q2 of 2016 as and only 7.1% expected their prices to fall.

Employment levels increased for a net balance of +17%. Firms expect positive trends in employment to continue in Q2 with 93.1% of firms stating that they expect employment levels to rise or remain the unchanged. Recruitment problems persist throughout the sector, with 41% of firms facing difficulties recruiting during Q1 2016.

Scottish Engineering Quarterly Review

The Scottish Engineering Quarterly Review for the first quarter of 2016 showed little change from the survey of Q4 2015 in that orders and output remained negative, optimism remained low however employment once again, was to some degree stronger. Optimism was broadly unchanged with small and medium firms reporting negative trends whereas larger firms were more confident.

The trend in total order intake improved compared to last quarter but the trend remained negative (-11%); once again small and medium sized companies reported negative trends but large companies remained positive. Forecasts for the next three months of UK orders in show that the trend is expected to ease slightly but remain, on balance, negative. A net balance of firms predict that export trends will remain negative during Q2 2016 – though only for small and medium sized firms. Overall, output volumes in general remained negative for small and medium sized firms whereas large companies reported a rise and predictions for the next three months in general are slightly better with both medium and large firms expecting a rise.

Respondents on balance reported a slight rise in prices and in Q2 2016 small and medium companies are forecasting a further fall although large companies are predicting a positive balance. Capital investment plans, in general, remained negative whereas training investment plans remained positive.

Employment trends remain broadly unchanged with similar numbers of firms recruiting staff as reported shedding staff however forecasts for the next quarter predict that small and medium sized firms will, on balance, shed staff.

Scottish Construction Monitor

For the eleventh consecutive quarter the overall confidence rating of the Scottish construction sector remained positive at +3 although the rating dropped 5 points during Q1 2016. The percentage of respondents more confident about their prospects for the next 12 months compared to the past year rose marginally from 33% last quarter to 35% this quarter. The percentage of respondents less confident about their firm's future prospects has also risen marginally from 25% in Q4 2015 to 26% this quarter

In anticipation of referendum on the UK's membership of the European Union, the latest Construction Monitor asked a series of questions about Scottish construction companies' level of exposure to the European Union in terms of labour, supplies and exports. Participants were asked questions about the impact on their business if the UK were to leave the European Union. The survey found that almost one quarter of respondents employ labour from EU countries and a third of respondents procure goods and/or services from other EU countries. Only 6% of Scottish construction respondents export to other EU countries. Thirty one percent of all respondents reported that there would be a negative impact on the Scottish construction sector if the UK were to leave the EU compared to 7% who believe the impact would be positive.

Conclusions

The economy appears to be settling into a pattern of 'lower and slower for longer' growth; with the economy still growing, but growing less strongly. This latest round of Scottish Business Surveys indicated that there are some signs of growth in the economy although many show that Scottish firms are continuing to face considerable challenges. Uncertaintly surrounding a number of issues including the EU referendum is affecting optimism and investment and if capital investment plans fall then this will affect growth into the future. Growth in the UK is still, to an extent, reliant on household spending and in order to sustain growth over the longer term, an increase in investment and net exports as well as manufacturing and construction activity is needed. Confidence levels among Scottish businesses need to reach and maintain a point where firms have the confidence to invest for the longer term.

Eleanor Malloy
7 June 2016

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