



## **MEDIA RELEASE**

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### **THE SCOTTISH ECONOMY IN 2010 – A SLOW AND FRAGILE RECOVERY**

Scottish Chambers of Commerce have today (Thursday) released their Business Survey results for the fourth quarter of 2009. The survey, conducted in conjunction with the University of Strathclyde's Fraser of Allander Institute, suggests that despite an improvement in the position from a year ago, there is still an uncertain year ahead for the Scottish economy and a fragile and tenuous economic recovery.

Garry Clark, Head of Policy and Public Affairs at Scottish Chambers of Commerce, said:

"Scottish business is clearly in a better position at the start of 2010 than it was twelve months ago, but our latest survey reveals that we cannot take the recovery for granted and that this year is likely to pose further challenges to our fragile economy.

"Already businesses have had to contend with the costs of a harsh winter, the re-imposition of VAT at 17.5% and the continued threat of industrial action in the postal and airline industries. Pressures on national, devolved and local Government budgets are likely to increase in 2010, and together with a possible weakening in consumer spending, coupled with increased pressures on margins as a result of rising raw material and energy costs, these could threaten the emerging and fragile recovery.

"On the positive side, there is further evidence that the first signs of recovery, led by manufacturing, and which we first reported in our July survey, have been supported by a better year in tourism. We have also seen signs of a return to positive investment trends in manufacturing for the first time in nearly two years, and evidence of improving employment levels in the sector may be linked to the Scottish Government's positive action to promote the recruitment and retention of apprentices. This would be a timely reminder of the ability of the Scottish Parliament to influence the direction of Government policy to help our economy.

"However with few signs of any sustained improvement in activity across other sectors, it is clear that our recovery is likely to be slow and fragile and that, in a UK General Election year, politicians of all parties must recognise that if economic growth is to be sustained, increased tax revenue must come from economic growth and widening the tax base rather than increasing rates of tax on already hard pressed businesses.

"It is time to re-assess the planned increases in National Insurance Contributions and in fuel duty, as rising costs will have an adverse effect on business and the Scottish economy."

## BUSINESS PERFORMANCE

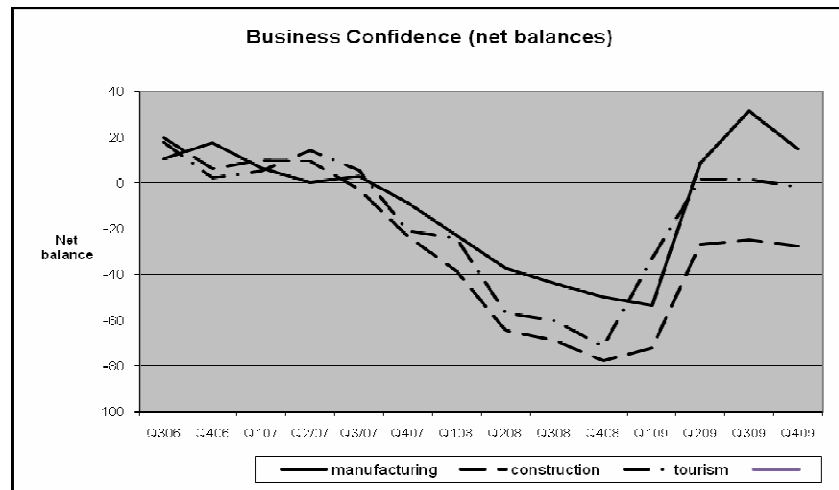
### Summary Points

#### Overall

Fewer signs of a sustained recovery in manufacturing but the trends in tourism were better than a year ago, however there were few indications of increased activity in construction. There were more signs that cost pressures are increasing, especially raw material costs;

#### Business confidence

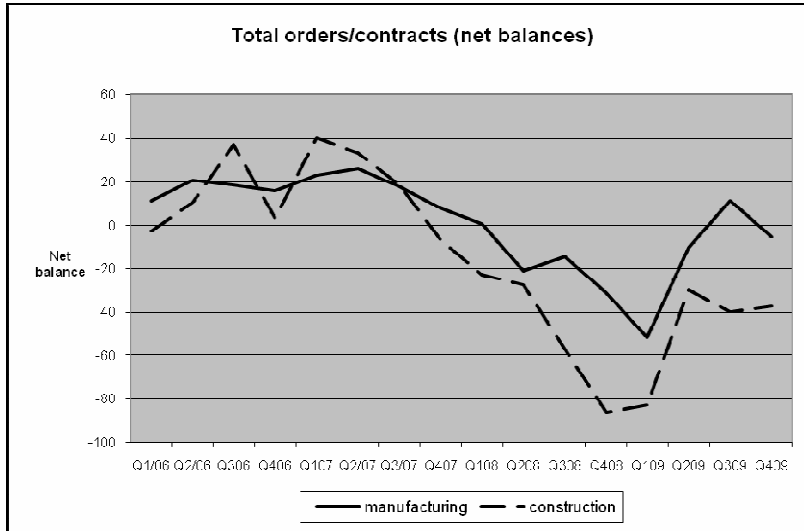
Net rising trends in business confidence were reported in manufacturing, but at reduced rates. In construction net declining trends have remained largely unchanged for the past three quarters. Confidence in wholesale distribution has fluctuated widely, but the underlying declining trend eased in the second half of 2009. In retail confidence, especially in the non multiple retail sector, remains negative, whilst in tourism confidence remains weak, but the fourth quarter trends are better than in Q4 2008 and 2007;



#### Demand/sales

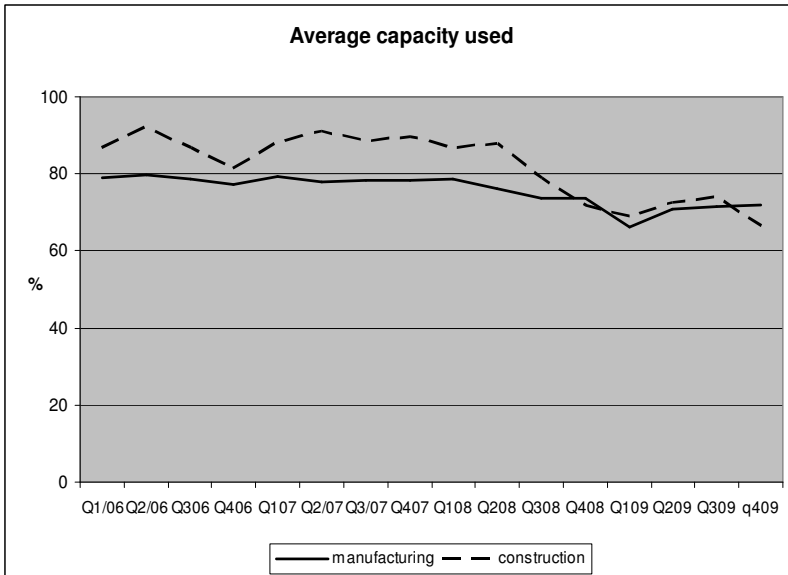
Overall orders were weaker than the previous quarter and weaker than expected in manufacturing, although the rising trend in export orders continued. The trends in the levels of work in progress remained weak. In construction demand remained depressed with 50% again reporting downward trends in total new orders and 59% declining levels of domestic/house build contracts.

In the retail sector the outturn in sales were again weak, and weaker than anticipated. Once again underpinning these results were the weakening net trends reported by independent stores. In tourism the outturn for Q4 was again better than anticipated and rising net trends in the numbers of guests were reported, although the trend in business demand remained weak;



Capacity/work in progress

Average capacity used in manufacturing rose by 0.3 percentage points and in construction fell by 7.5 percentage points over the past quarter. In construction the proportion reporting working below optimum levels rose slightly to a net of 88%. In tourism occupancy in Q4 remained a little higher than in Q4 in 2008, and once again, occupancy has been sustained only by discounting;



Cost pressures

There are more signs of increasing cost pressures, fuelled by increasing raw material costs in manufacturing, wholesale and retail. As yet the effects of rising transport costs have not been reported. In retail and wholesale distribution finance costs are evident. Pressures to raise prices are more evident in manufacturing and retail, but in a climate of weak demand recovering increased costs may be problematic;

Pay and employment

The percentages of respondents increasing pay in the fourth quarter ranged from 5% of construction to 19% of manufacturing, and average pay increases ranged from 1.5% in wholesale to 2.8% in manufacturing.

Average pay increases in manufacturing and construction continue to remain at historically low levels.

#### Outlook

Manufacturing trends continue to offer the clearest signs of an emerging, but weak and fragile recovery, tourism continues to report better trends than a year ago. The trends for 2010 remain uncertain; the fragile recovery will have to contend with a possible weakening in consumer spending, the costs of a harsh winter, the re-imposition of VAT, and pressures on Government expenditure. Pressures on margins and likely pressures on raw material and other costs highlight the fragility of the recovery. The labour market continues to remain weak with few signs of an improvement.

Strathclyde University's Fraser of Allander Institute in collaboration with the Scottish Chambers' of Commerce conducts the quarterly Chambers' Business Survey. In the present survey, which was conducted in December 2009 and early January 2010, almost 300 firms responded to the questionnaire.

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## MANUFACTURING

### Optimism

The rising trend in business confidence noted in the third quarter eased from a net balance of 32% in Q3 to 15%.

### Orders and Sales

The outturn in total new orders and export orders was weaker than expected. The actual trends in total, Scottish and rest of UK orders, remained weak, and weaker than in the third quarter, moreover, respondents are more cautious as to trends in orders in the Q1 2010.

A declining trend in the level of work in progress was again reported, and the net decline is expected to end over the next twelve months. Average capacity used rose marginally by 0.3 percentage points to 71.9%, although 61% (57% in Q3 and 71% in Q2) reported capacity used was below preferred levels. Pressures to raise prices due to raw material costs and other overheads increased.

### Investment

Investment trends improved as 29% expect to increase investment and 5% anticipate increasing their leasing of equipment over the coming year. Cash flow trends improved compared to the past eight quarters. Respondents are more confident as to rising turnover over 2010, and the net trends are the most positive for eight quarters, in contrast expectations as to rising profitability eased.

### Employment

Once again thirty-seven percent of firms attempted to recruit and there was some evidence of a temporary rise in employment trends.

	Up	Q4 2009		Net Balances		
		Level	Down	Q409	Q3/09	Q2/09
<b>Business Optimism</b>	34.3	46.1	19.5	14.9	31.6	8.7
<b>Trends in actual orders</b>						
Total new orders	27.3	39.8	32.9	-5.6	11.2	-10.3
Scottish orders	27.7	42.6	29.8	-2.1	-0.2	-12.3
Rest of UK orders	30.8	31.9	37.3	-6.5	4.2	-18.0
Export orders [30.4% = N/A]	16.0	41.2	12.4	3.6	16.6	1.6
<b>Trends in expected orders</b>						
Total new orders	33.4	41.5	25.1	8.3	9.8	7.1
Scottish orders	18.6	63.7	17.8	0.8	1.3	6.0
Rest of UK orders	21.9	54.0	24.0	-2.1	9.4	5.5
Export orders (30.9% = N/A)	17.0	45.2	6.8	10.2	19.6	12.2
Av Capacity used	71.9			71.9	71.6	70.79
Invest in plant/equip.	28.6	47.0	24.4	4.2	-16.3	-23.5
Cash flow past 3 moths	26.4	47.8	25.9	0.5	-11.5	-16.7
Turnover next 12 moths	43.7	29.4	26.9	16.8	11.5	-0.7
Profitability next 12 moths	38.6	25.6	35.7	2.9	4.7	-19.2
Price change next 3 moths	41.4	50.3	8.3	33.1	7.1	-10.0
<b>Pressures to raise prices from</b>						
Pay settlements	29.8			29.8	28.2	22.9
Raw material costs	72.9			72.9	63.8	52.5
Finance costs	10.5			10.5	18.1	17.5
Other overheads	46.6			46.6	31.1	27.0
Transport costs	27.9			27.9	34.2	22.6
<b>Employment trends</b>						
Total actual employment	29.2	56.2	14.6	14.6	-5.7	-4.4
Total expected next 3 months	8.3	82.7	9.0	-0.7	-15.2	-9.5
Average pay increase	2.8			2.8	2.1	2.52

## CONSTRUCTION

### Optimism

Business confidence remained weak with only 15% reporting being more confident compared to the previous quarter. The net balance of optimism at -28% was less depressed compared to Q4 2008 at -78%

### Contracts

The rate of decline in the net trend in new contracts eased marginally from -40% in the third quarter to -38%. The trends in orders from all sectors continued to decline although the rate of decline in domestic/house building orders eased.

Expectations as to turnover trends over the next year remain depressed, and are forecast to deteriorate further in 2010. A net of -48% (-31%, -37%, -64%, and -65% in the previous four quarters) anticipate declining turnover trends. A net of -60% (-44%, -59% -78% and -78% in the previous four quarters) anticipate declining profitability over the next twelve months. A net of 72% of construction firms anticipate declining tender margins over the next twelve months.

Average capacity declined by eight percentage points to 66% and almost 50% expect a declining trend in the level of work in progress.

### Employment

More than half of firms reduced total employment levels with only 13% reporting an increase in employment and recruitment again remained at very low levels. Only 5% of respondents reported increasing pay in the fourth quarter by an average of 2%.

	Q4 2009			Net Balances		
	Up	Level	Down	Q4/09	Q3/09	Q2/09
<b>Business Optimism</b>	15.0	42.5	42.5	-27.5	-25.0	-26.9
<b>Trends in actual contracts</b>						
Total new contracts	12.5	37.5	50.0	-37.5	-40.0	-29.6
Public sector orders	16.1	41.9	41.9	-25.8	-14.8	-38.4
Private commercial	5.9	26.5	67.6	-61.8	-57.1	-60.0
Domestic/house build	8.8	32.4	58.8	-50.0	-62.5	-78.3
<b>Trends in expected contracts</b>						
Total new orders	10.5	39.5	50.0	-39.5	-37.1	-37.0
Public sector orders	6.7	43.3	50.0	-43.3	-37.0	-37.5
Private commercial	3.2	32.3	64.5	-61.3	-50.0	-52.0
Domestic/house build	12.1	30.3	57.6	-45.5	-33.3	-47.8
<b>Trends in work in progress</b>						
Actual	5.0	35.0	60.0	-55.0	-42.9	-51.9
Expected	17.5	35.0	47.5	-30.0	-41.2	-33.3
<b>Capacity used</b>	66.5			66.5	74.0	72.5
<b>Invest in plant/equip.</b>					-36.4	
<b>Leasing in plant/equipment.</b>					-34.4	
<b>Employment trends</b>						
Total actual employment	12.8	33.3	53.8	-41.0	-27.8	-29.6
Total expected next 3 months	5.3	47.4	47.4	-42.1	-11.8	-28.0
<b>Average pay increase</b>	2.0			2.0	3.5	N/a
Percent recruiting staff	15.0			15.0	19.4	14.8
Recruitment difficulties increasing	0.0			0.0	0.0	0.0

## WHOLESALE DISTRIBUTION

### Optimism

Business optimism amongst Scottish wholesale respondents declined during quarter four falling from a net balance of 5% to -24%. Although the comparable figure for 2008 was a net balance of -75%.

### Sales

The declining trend in sales continued during the three months to the end of December with almost half of firms reporting declining sales and this downward trend is expected to continue in quarter one.

Almost two-thirds of responding firms expect price increases in the three months to the end of March 2010, mainly under pressures from raw material prices and transport costs.

Over the next twelve months wholesale firms now expect turnover to improve, moreover a net balance continue to expect profitability to decline although the rates of decline are set to ease.

### Finance

Changes to investment plans were widespread and the declining trend in investment intentions continued.

### Employment

Changes in employment levels were reported by more than 40% with a net of 35% reporting a downward trend in employment. A net of 13% anticipate a further decline in quarter one. Only 6% of firms increased pay during quarter four by an average of 1.5%.

	Q4 2009			Net Balances		
	Up	Level	Down	Q4/09	Q3/09	Q2/09
<b>Business Optimism</b>	17.6	41.2	41.2	-23.5	5.3	7.2
<b>Trend in actual sales</b>	11.8	41.2	47.1	-35.3	-31.6	-42.8
<b>Trend in expected sales</b>	12.5	37.5	50.0	-37.5	-22.2	-21.4
<b>Investment plans</b>	5.9	52.9	41.2	-35.3	-31.6	-28.6
<b>Cash flow past 3 months</b>	0.0	64.7	35.3	-35.3	-5.3	7.2
Turnover next 12 months	47.1	17.6	35.3	11.8	-21.1	-38.7
Profitability next 12 months	35.3	17.6	47.1	-11.8	-26.3	-35.7
Price change next 3 months	64.7	29.4	5.9	58.8	57.9	21.4
<b>Pressures to raise prices from</b>						
Pay settlements	11.8			11.8	5.3	7.1
Raw material costs	64.7			64.7	68.4	28.6
Finance costs	35.3			35.3	21.1	7.1
Other overheads	41.2			41.2	36.8	42.9
Transport costs	64.7			64.7	63.2	42.9
<b>Employment trends</b>						
Total actual employment	5.9	52.9	41.2	-35.3	-16.7	0.0
Expected next 3 months	20.0	46.7	33.3	-13.3	-23.5	-15.4
<b>Average pay increase</b>	1.5			1.5	3.1	10.0
Percent recruiting staff	29.4			29.4	21.1	21.4
Recruitment difficulties inc	0.0			0.0	13.3	0.0

## RETAIL DISTRIBUTION

### *Optimism*

The trend in business confidence declined during the fourth quarter falling from -8% to -35%. Despite the decline the overall trend was less depressed than Q4 2008 (-91%) and Q4 2007 (-42%).

### *Sales*

At least half of retailers reported and expect declining sales in the fourth and first quarters. The rate of decline in actual and expected sales accelerated during quarter four although remained less depressed compared to Q4 2008.

The value of total new sales declined and is expected to decline further for more than half of firms.

### *Finance*

Both turnover and profitability are expected to decline further for a net of retailers over 2010, although the rate of decline is less than that anticipated by firms during quarter three 2009. Two-thirds of retail respondents expect price increases during Q1 2010.

### *Employment*

Most firms reported and expect no change to overall employment levels with fewer than 5% increasing or expecting to increase total employment levels. During the three months to the end of December the percentage of firms actively recruiting rose from 23% to 33%. Nine percent of firms increased wages by 2.43%.

	Q4 2009			Net Balances		
	Up	Level	Down	Q4/09	Q3/09	Q2/09
<b>Business Optimism</b>	9.3	46.5	44.2	-34.9	-7.7	-27.4
<b>Trend in actual sales</b>	20.5	25.0	54.5	-34.1	-25.0	-35.3
<b>Trend in expected sales</b>	14.3	35.7	50.0	-35.7	-22.9	-58.4
<b>Cash flow past 3 months</b>	24.4	48.8	26.8	-2.4	-7.5	-23.6
Turnover next 12 months	16.3	48.8	34.9	-18.6	-15.1	-49.2
Profitability next 12 months	11.9	28.6	59.5	-47.6	-36.5	-51.0
Price change next 3 months	67.4	27.9	4.7	62.8	37.7	-54.1
<b>Pressures to raise prices from</b>						
<b>Pay settlements</b>	22.7			22.7	18.9	17.6
<b>Raw material costs</b>	72.7			72.7	47.2	72.5
<b>Finance costs</b>	29.5			29.5	22.6	19.6
<b>Other overheads</b>	13.6			13.6	17.0	19.6
<b>Transport costs</b>	36.4			36.4	47.2	37.3
<b>Utility costs</b>	31.8			31.8	41.5	45.1
<b>Regulation costs</b>	31.8			31.8	47.2	21.6
<b>Employment trends</b>						
Total actual employment	4.8	78.6	16.7	-11.9	-15.4	-30.0
Expected next 3 months	2.9	91.4	5.7	-2.9	-16.3	-24.5
<b>Average pay increase</b>	2.43			2.43	4.51	3.39
Percent recruiting staff	32.6			32.6	22.6	18.0
Recruitment difficulties inc	33.3			33.3	23.1	7.1



## TOURISM

### **Optimism**

The overall level of business confidence became negative for a small net balance of responding firms although trends remained broadly unchanged from the previous quarter, and was significantly less depressed than in the same quarter of 2008.

### **Demand**

The net trend in total demand remained positive in quarter four. The rate of increase slowed although the overall trend was better than anticipated. Domestic demand continued to exhibit stronger trends than demand from abroad and business demand. Average occupancy declined from 72% to 62% (higher than in Q4 2008, but marginally lower than in Q4 2007).

Respondents report continuing to reduce room rates and the discounting of prices is more marked than during the same quarter a year ago and is set to continue in the first quarter.

### **Business constraints**

An overall lack of demand remained the primary business constraint although hotels were also concerned with competition, exchange rates and poor transport infrastructure.

### **Employment**

Changes in employment levels were reported by half of firms. Net declining trends in full time (-19%), part time (-17%), seasonal (-31%) and overtime working (-52%) were reported.

	Q4 2009			Net Balances		
	Up	Level	Down	Q4/09	Q3/09	Q2/09
<b>Business Optimism</b>	27.9	42.6	29.5	-1.6	1.7	1.7
<b>Trends in demand/visitors</b>						
Total demand/visitors	40.0	28.3	31.7	8.3	11.9	-31.0
Demand from Scotland	29.3	50.0	20.7	8.6	23.7	-12.1
Demand from Rest of UK	32.2	44.1	23.7	8.5	27.6	-12.3
Demand from abroad	26.3	31.6	42.1	-15.8	-5.2	-33.9
Business Trade	13.8	41.4	44.8	-31.0	-32.7	-49.1
<b>Trends in expected demand</b>						
Total demand/visitors	18.8	43.8	37.5	-18.8	-29.6	-17.0
Demand from Scotland	18.8	54.2	27.1	-8.3	-13.5	-3.8
Demand from Rest of UK	17.4	52.2	30.4	-13.0	-9.8	0.0
Demand from abroad	13.0	43.5	43.5	-30.4	-35.3	-26.9
Business Trade	17.0	42.6	40.4	-23.4	-44.9	-40.0
<b>Occupancy</b>	61.7			61.7	72.7	71.45
Average daily rate	15.8	35.1	49.1	-33.3	-21.1	-34.4
Expected average daily rate	18.2	40.0	41.8	-23.6	-42.3	-17.3
<b>Employment trends</b>						
Total actual employment	10.5	50.9	38.6	-28.1	-20.0	-25.9
Expected next 3 months	5.5	61.8	32.7	-27.3	-41.5	-9.2
<b>Average pay increase</b>	2.6				4.3	3.83
Percent recruiting staff	59.3				58.6	64.9
Recruitment difficulties	21.8				27.3	26.4

**Methodology**

The Scottish Chambers' Business survey, in common with most national surveys, seeks evidence as to changing trends, and uses net balances as the key survey statistic. Most questions ask the respondent 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. Net balances for the current quarter, together with those for the previous quarter and the quarter a year ago have been added to the usual results.

Size band analysis is based on the number of employees in manufacturing, construction and wholesale, on the number of rooms in tourism and on ownership and location patterns together with number of full time equivalents in retail.

This information is part of the data collected by the quarterly surveys, further information can be provided, but a charge will be made, depending on the time to organise and present the data.

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