



SCOTTISH CHAMBERS  
OF COMMERCE

## **MEDIA RELEASE**

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# **SCOTTISH BUSINESSES FACE DECLINING DEMAND AND RISING COST PRESSURES**

The Scottish Chambers of Commerce today released its Business Survey results for the second quarter of 2008. The twin problems of a broadly based slowing down in the economy and rising price inflation have resulted in the sense of an economic slowdown being much more evident than three months ago.

Commenting on today's survey, Liz Cameron, Chief Executive of Scottish Chambers of Commerce, said:

"This survey clearly demonstrates that the lack of business confidence apparent in the early part of this year is now being translated into a general slowing down of the Scottish economy. It is clear that the domestic housebuilding market is suffering particularly acutely, whilst the pinch being felt by independent retailers is now spreading to larger chains. Declining consumer confidence and spending is also appearing to be hitting tourism demand.

"However it is important to put these results into perspective. Scotland still has a positive rate of growth, employment remains robust and wage demands are steady for the moment. Our manufacturing sector has seen export sales holding up, with domestic orders being reported as level or rising by a majority of businesses.

"The underlying pressures on the Scottish economy are well known and are largely internationally based. The survey reveals clearly that factors such as high energy and transportation costs are having a major impact on business across a variety of sectors.

"At this time we are looking for the UK and Scottish Governments to back Scottish business and act to address cost pressures where possible. Westminster must look to alleviate fuel taxes which are having a disproportionate effect in Scotland, and particularly in rural areas, where transport costs are often higher. The Scottish Government must accelerate public procurement opportunities for small and medium sized businesses and utilise its Scottish Futures Trust to open up new construction possibilities in the public sector.

"This survey shows that opportunities do exist for Scottish businesses, but they are having to fight harder and think smarter in order to seize them."

## **BUSINESS PERFORMANCE**

### ***Summary Points***

Business confidence	Over 60% of construction, retail and tourism; over 50% of wholesale and over 45% of manufacturing respondents reported lower levels of business optimism in the second quarter. The trends in business confidence declined further in manufacturing, declined sharply in construction, wholesale distribution, retail and tourism. The trends in business confidence were at their lowest for more than ten years in manufacturing, construction, retail and tourism;
Demand/sales	<p>Declining trends in orders/sales were reported in manufacturing, construction, retail and tourism. In these sectors the outturn in the second quarter was weaker than had been expected and no improvement is forecast for the third quarter. In retail declining net sales trends were reported by both national and independent retailers;</p> <p>Declining trends in demand (the weakest trends since 2001) were reported by a net of manufacturing firms. The declining trend in new work/contracts in construction, due mainly to the sharp deterioration in the level of orders in domestic/house build contracts, eased to the lowest for more than ten years. In retail declining trends in both the volume and value of sales were reported by both independent and national/multiple retailers.</p> <p>In the tourism sector strongly declining trends in visitor numbers/demand were again reported;</p>
Capacity/work in progress	Trends in work in progress remained slightly positive for a net of manufacturing respondents, but are expected to decline in the third quarter. Declining trends in the level of work in progress were reported by a net of construction firms;
Cost pressures	Concerns over raw material costs were again evident in the second quarter, being cited by 77% of manufacturing and 72% retail respondents. Expectations of price increases in the third quarter of 2008 were more broadly based than in previous surveys, and range from a net of 53% of manufacturing, a net of 78% of wholesale and a net of 81% of retail respondents;
Pay	Pay pressures remain relatively subdued, average pay increases in the second quarter ranged from 3.7% in manufacturing retail to 5.58% in tourism;
Outlook	The signs of a slowdown in the economy are far more evident than at the end of March, demand is expected to continue to weaken and cost pressures are expected to continue to increase. Activity in construction will continue to be depressed due to the decline in the housing market, although public sector work appears to be less affected. Declining consumer confidence and spend is clearly evident in the service sector and little improvement is anticipated in either retail or tourism.

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 June 2008 to early July 2008, almost 300 firms responded to the questionnaire.

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## MANUFACTURING

### Optimism

Business confidence again deteriorated for a net of firms in all size bands in the second quarter. The net trend for the second quarter, and expected trend in total orders for the third quarter are the lowest reported since q1 1999.

### Orders and Sales

Weakening trends in orders were again reported by a net of firms and these trends are expected to continue through to September. However, a net of firms employing more than 100 continue to report and expect modestly rising export orders and sales. Rising trends in the level of work in progress were reported by a net of firms employing more than 25 staff. Average capacity eased to 76%, and 55% reported capacity used was below preferred levels. Expectations as to the trends in orders, turnover and profitability for the next twelve months are much weaker than in the previous quarter and firms continue to report extensive price pressures. The percentages expecting prices to change over the next three months is the highest recorded in the survey.

### Investment

Overall investment trends eased and only 20% reported an increase in investment and 2% an increase in leasing equipment over the coming year.

### Employment

A slight net increase in employment and a level trend in total hours worked were reported and 55% sought to recruit staffs.

	Q2.2008			Net Balances		
	Up	Level	Down	Q2/08	Q1/08	Q4/07
<b>Business Optimism</b>	9.2	44.4	46.4	-37.2	-22.9	-8.7
<b>Trends in actual orders</b>						
Total new orders	20.1	38.9	41	-20.9	0.7	7.9
Scottish orders	11.9	48.4	39.8	-27.9	-23.4	-16.2
Rest of UK orders	10.7	49.1	40.3	-29.6	-19.4	0.7
Export orders [43.9% = N/A]	11.6	27.2	17.3	-5.7	-10.9	9.0
<b>Trends in expected orders</b>						
Total new orders	18.1	40	41.8	-23.7	-6.8	3.8
Scottish orders	8.1	48.7	43.2	-35.3	-24.5	-6.5
Rest of UK orders	9.7	44.9	45.4	-35.6	-13.3	-4.2
Export orders [44.2% = N/A]	14.6	25.5	15.7	-1	-1	13.2
Av Capacity used	76.1			76.1	78.6	78.3
Invest in plant/equip.	19.8	53.3	26.9	-7.1	1.6	20.1
Cash flow past 3 moths	22.1	52.3	25.6	-3.5	-5.9	-18.9
Turnover next 12 moths	25.4	35.2	39.4	-14	23.9	5.3
Profitability next 12 moths	20.1	20.4	59.5	-39.4	5.3	-7.4
Price change next 3 moths	54.6	43.5	1.9	52.7	46.9	43.3
<b>Pressures to raise prices from</b>						
Pay settlements	40.4			40.4	45.4	38.3
Raw material costs	77.1			77.1	84.8	80.0
Finance costs	11.4			11.4	14.3	19.4
Other overheads	54.4			54.4	45.2	44
Transport costs	78.2			78.2	50.3	41.8
<b>Employment trends</b>						
Total actual employment	17.3	66.9	15.9	1.4	-6.6	3.3
Total expected next 3 months	15.9	69.1	15	0.9	-0.6	-3.8
Average pay increase	3.7			3.7	3.66	4.05

## CONSTRUCTION

### *Optimism*

Business confidence deteriorated further for both a net of smaller and larger construction firms, again reflecting concerns as to credit issues and the sharply declining trends in domestic/house build contracts.

### *Contracts*

The declining trend in new contracts strengthened in the second quarter, with a sharp downturn in the trends in domestic/house build contracts, although the trends in public sector work are relatively unchanged. Now only 52% (69%, 71% and 86% in the previous three quarters) expect level or rising trends in the level of work through the next six months.

Declining trends in work in progress were reported by both nets of smaller and larger firms. Over the next six months a net of both smaller and larger firms anticipate a declining trend in work in progress.

A net of respondents now anticipate declining turnover trends over the next year (in contrast to rising net trends of 3%, 10% and 29% in the previous three quarters), and a net of -49% (-3% in the previous quarter) anticipate declining profitability over the next twelve months. Expectations as to turnover and profitability are now negative for both smaller and larger construction firms. 73% (53% in the previous quarter) of smaller and 62% (46% in the previous quarter) of larger construction firms anticipate declining tender margins over the next twelve months.

87% reported the level of contracts and new work as being the main factor most likely to limit output over the next year.

### *Employment*

The rising trend in employment ended, 31% reported increasing pay by an average of 4.6%.

	Q2.2008			Net Balances		
	Up	Level	Down	Q2/08	Q1/08	Q4/07
<b>Business Optimism</b>	4.8	26.2	69	-64.3	-38.5	-23.3
<b>Trends in actual contracts</b>						
Total new contracts	20.5	31.8	47.7	-27.3	-23.1	-6.5
Public sector orders	19.4	50	30.6	-11.1	-23.3	-28.0
Private commercial	12.8	43.6	43.6	-30.8	-8.6	0.0
Domestic/house build	7.7	25.6	66.7	-59	-22.9	-23.1
<b>Trends in expected contracts</b>						
Total new orders	7	39.5	53.5	-46.5	-2.6	-10.7
Public sector orders	5.6	52.8	41.7	-36.1	-3.4	-17.4
Private commercial	5.1	41	53.8	-48.7	-14.9	8.3
Domestic/house build	5.1	23.1	71.8	-66.7	-20.6	-37.5
<b>Trends in work in progress</b>						
Actual	15.9	50.0	34.1	-18.2	-15.4	16.1
Expected	11.4	40.9	47.7	-36.4	-2.6	-3.3
<b>Capacity used</b>	87.8			87.8	86.9	89.6
<b>Invest in plant/equip.</b>					8.1	
<b>Leasing in plant/equipment.</b>					-16.2	
<b>Employment trends</b>						
Total actual employment	20.5	59.1	20.5	0	10.3	22.5
Total expected next 3 months	4.8	71.4	23.8	-19	17.9	13.3
<b>Average pay increase</b>	4.6			4.6	4.00	4.04
Percent recruiting staff	47.7			47.7	48.7	58.1
Recruitment difficulties increasing	17.2			17.2	17.9	27.3

## WHOLESALE DISTRIBUTION

### Optimism

In common with other sectors a broadly based declining trend in business confidence was reported.

### Sales

The outturn in sales was anticipated, and, following the retail sector, firms are anticipating a deterioration in sales trends in the third quarter of 2008.

Expectations of price increases in the next quarter remained widespread and the highest ever recorded. The percentages of respondents reporting pressures to raise prices due to raw material and transport costs are also the highest recorded by the survey.

A level trend in turnover is expected for the forthcoming year but 50% (a net trend of -22%) are expecting profitability to decline over the year. 78%, the highest proportion ever recorded, expect prices to increase over the next quarter.

### Finance

Changes to investment plans were reported by 44% and the rising trend in investment intentions continued.

### Employment

Changes in employment levels were again reported by a third of respondents and the modestly rising trend in employment continued for a further quarter, and is expected to continue through the third quarter of 2008. 44% sought to recruit staff, and 50% increased pay by an average of 3.94%.

	Q2.2008			Net Balances		
	Up	Level	Down	Q2/08	Q1/08	Q4/07
<b>Business Optimism</b>	11.8	35.3	52.9	-41.2	5.3	-23.5
<b>Trend in actual sales</b>	38.9	33.3	27.8	11.1	5.3	0.0
<b>Trend in expected sales</b>	25	37.5	37.5	-12.5	11.8	0.0
<b>Investment plans</b>	27.8	66.7	5.6	22.2	31.5	29.4
<b>Cash flow past 3 months</b>	11.1	55.6	33.3	-22.2	-10.5	0.0
Turnover next 12 months	38.9	22.2	38.9	0	31.6	29.4
Profitability next 12 months	27.8	22.2	50	-22.2	5.3	11.8
Price change next 3 months	77.8	22	0	77.8	52.6	62.5
<b>Pressures to raise prices from</b>						
<b>Pay settlements</b>	22.2			22.2	31.6	41.2
<b>Raw material costs</b>	61.1			61.1	57.9	64.7
<b>Finance costs</b>	5.6			5.6	15.8	17.6
<b>Other overheads</b>	33.3			33.3	31.8	29.4
<b>Transport costs</b>	88.9			88.9	78.9	70.6
<b>Employment trends</b>						
Total actual employment	17.6	70.6	11.8	5.9	11.1	11.7
Expected next 3 months	12.5	81.3	6.3	6.3	23.5	12.5
<b>Average pay increase</b>	3.94			3.94	4.9	4.1
Percent recruiting staff	44.4				52.6	47.1
Recruitment difficulties inc	0			0	33.3	33.3

## RETAIL DISTRIBUTION

### Optimism

For a further quarter the sharp deterioration in business confidence continued, reflecting heightened concerns as to declining consumer confidence, credit restrictions and spending.

### Sales

For the first time a net declining trend in sales was reported both by independent and national/multiple retailers. Both groups reported declining net trends in both the volume and value of sales in the second quarter, and expect these declining trends to continue through the third quarter.

Cost pressures were again more evident in the second quarter with the percentages citing raw material, transport and energy costs at the highest recorded in the survey. Cost pressures were again more widely reported by independent retailers. The percentage anticipating price increases is the highest recorded in the survey.

### Finance

A net of -49% of independent retailers anticipate declining turnover, and a net of -56% (-49% in the previous quarter) anticipate declining profitability over the next year, suggesting significantly increased pressures on margins in 2008. In contrast a net of -25% of the national retailers anticipate declining turnover over the next year (compared to a net increase of +25% in the previous quarter) and a net of -13% expect declining profitability over the next year (in contrast to a net of 38% in the previous quarter expecting rising profitability over the year).

### Employment

Changes in employment levels were reported by 14%. The overall trends in employment indicated continuing declining trends in full time, temporary and permanent employment.

	Q2.2008			Net Balances		
	Up	Level	Down	Q2/08	Q1/08	Q4/07
<b>Business Optimism</b>	5.2	32.8	62.1	-56.9	-53.8	-41.6
<b>Trend in actual sales</b>	17.2	27.6	55.2	-37.9	-23.1	-12.8
<b>Trend in expected sales</b>	10.7	37.5	51.8	-41.1	-32.7	-20.9
<b>Cash flow past 3 months</b>	3.6	66.1	30.4	-26.8	-11.8	-2.0
Turnover next 12 months	13.8	31	55.2	-41.4	-32.7	-20.8
Profitability next 12 months	15.8	21.1	63.2	-47.4	-41.2	-33.6
Price change next 3 months	84.5	12.1	3.4	81.1	61.5	54.2
<b>Pressures to raise prices from</b>						
<b>Pay settlements</b>	24.1			24.1	32.7	25.0
<b>Raw material costs</b>	72.4			72.4	65.4	50.0
<b>Finance costs</b>	34.5			34.5	28.8	33.3
<b>Other overheads</b>	13.8			13.8	13.5	12.5
<b>Transport costs</b>	69			69	48.1	50.0
<b>Utility costs</b>	69			69	67.3	47.9
<b>Regulation costs</b>	25.9			25.9	34.6	37.5
<b>Employment trends</b>						
Total actual employment	3.4	75.9	20.7	-17.2	-9.8	-12.5
Expected next 3 months	7.8	72.5	19.6	-11.8	-17.4	-4.5
<b>Average pay increase</b>	3.77			3.77	3.53	3.11
Percent recruiting staff	39.7			39.7	21.6	39.6
Recruitment difficulties inc	35.1			35.1	19.2	40.0

## TOURISM

### **Optimism**

Over 60% reported lower levels of business confidence in the second quarter, the most widely reported figure since 2001. The current declining trend in business confidence emerged in 2007 q4, but the decline more than doubled in the second quarter. The trends in visitor demand are the lowest for five years.

### **Demand**

The net trends in demand were weaker than in the previous second quarters of 2002 - 2007. Whilst 21% reported increased demand for accommodation, 10% increased numbers in restaurants and 14% increased demand for function/conference facilities, the net trends were negative. Average occupancy at 67% was lower than in the second quarters of 2004 - 2007, but broadly similar to that of q2 2003.

Overall 44% of business in the second quarter was tourist trade, 27.7% local trade, and 2.3% business trade. A net of -8.2% reported declining turnover trends (compared to a 10% and 38% in the previous quarters reported rising turnover) and a net of -22.4% (-34% and -5% in the previous two quarters) reported falling trends in margins.

### **Business constraints**

75% (60% in 2007 q2) reported the lack of demand as the main business constraint in the second quarter, 43% the high exchange rates, 26% poor transport infrastructure and 24% the weak marketing of their area.

### **Employment**

Changes in employment levels were again limited, being reported by 30%.

### **Recruitment**

76% sought to recruit staff; difficulties in recruiting chefs and front of house staff were widely reported.

	Q2.2008			Net Balances		
	Up	Level	Down	Q2/08	Q1/08	Q4/07
<b>Business Optimism</b>	3.9	35.3	60.8	-56.9	-24.4	-20.9
<b>Trends in demand/visitors</b>						
Total demand/visitors	22	40	38	-16	-9.8	30.9
Demand from Scotland	12.5	64.6	22.9	-10.4	-5	23.8
Demand from Rest of UK	14.9	51.1	34	-19.1	-12.2	12.5
Demand from abroad	19.1	36.2	44.7	-25.5	-37.5	4.8
Business Trade	18.8	41.7	39.6	-20.8	-7.5	25.0
<b>Trends in expected demand</b>						
Total demand/visitors	17	34	48.9	-31.9	7.7	2.6
Demand from Scotland	0	63.6	36.4	-36.4	-5.4	-7.9
Demand from Rest of UK	13.3	46.7	40	-26.7	-2.6	-10.6
Demand from abroad	15.2	32.6	52.2	-37	-2.6	-23.7
Business Trade	11.4	47.7	40.9	-29.5	10.8	5.5
<b>Occupancy</b>	97			67	54.6	63.1
Average daily rate	28	56	16	12	25.6	21.9
Expected average daily rate	16	64	20	-4	4.9	5.3
<b>Employment trends</b>						
Total actual employment	8.2	71.4	20.4	-12.2	2.6	-5.1
Expected next 3 months	12.2	63.3	24.5	-12.2	5.3	-5.6
<b>Average pay increase</b>	5.58			5.58	5.38	4.01
Percent recruiting staff	77.6			77.6	64.3	72.1
Recruitment difficulties	24			24	30	29.7



**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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