

Scottish
Chambers of
Commerce
The Ultimate Business Network

MEDIA RELEASE

Embargoed until 0001 hours on Thursday 14th July 2011

THE SCOTTISH RECOVERY CONTINUES BUT MAJOR CHALLENGES LIE AHEAD

Scottish Chambers of Commerce (SCC) have today (Thursday) released their Business Survey results for the second quarter of 2011. The survey, conducted in conjunction with the University of Strathclyde's Fraser of Allander Institute, suggests the fragile recovery continues, but business uncertainties, weak consumer confidence and rising costs threaten to undermine the recovery.

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

“Our latest survey has shown that several sectors of the economy have performed well over the last three months, particularly manufacturing and tourism. It is also pleasing, if somewhat surprising, that the construction sector is reporting a much improved position and it is to be hoped that this improvement will continue. However, underlying this positive image remains the continuing impact of rising material and transport costs and the impending rising energy costs which will take their toll later in the year and these, together with the impact of government spending cuts, will continue to threaten the fragile economic recovery in 2011 and beyond. The combination of weak consumer confidence, rising costs and tightening margins is already well evident in our high streets as retailers struggle to cope with these pressures.

“The strong performance in manufacturing has been well documented in recent months and this has continued throughout the second quarter. It is clear that this growth is in large measure down to strong performance in export markets and we are therefore reliant on continued strong demand in these markets in order to maintain our excellent results in this sector. This means focusing on the growth economies and lessening exposure to some of the more pressured Eurozone economies.

“The tourism sector has reported some of its best figures for three years but occupancy rates are a little lower than in previous years and business demand shows little sign of improvement. Fortunately domestic demand remains buoyant and there is clearly still some life in the ‘staycation’ market. Interestingly 30% of businesses blamed a lack of effective transport infrastructure as a barrier to growth and this must remain a key priority of the Scottish Government, despite cuts to capital budgets. The need to focus on our tourism sector is one of the reasons why Scottish Chambers of Commerce are calling for the UK Government to devolve Air Passenger Duty to the Scottish Parliament and for the Scottish Government to use this, and a new Air Route Development Fund, to boost international visitor numbers to Scotland.

“Many of Scotland's businesses are performing as well as they can against a challenging background of rising energy costs, inflationary pressures, weak consumer demand and a decline in living standards. With the impact of government spending cuts and reductions in capital expenditure still to be felt, it remains a difficult environment for business, but our hope is that the encouraging start to the year can be maintained.”

BUSINESS PERFORMANCE

Summary Points

Overall

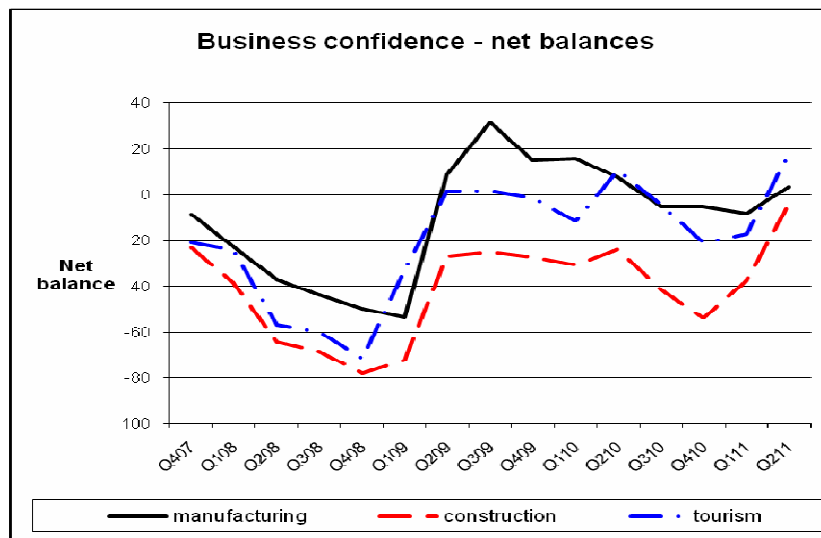
The uncertain business climate was again evident in the results for the second quarter of this year. Manufacturing continues to improve with an export led recovery, but continuing uncertainties in Europe and our major markets pose some continuing concerns. The consequences of the harsh winter and the completion of delayed work probably underpin the improvements in construction. Tourism has benefitted from increased numbers of home visitors, a reflection of the weak consumer confidence that affects the retail sector. Uncertainty, weak consumer confidence and rising costs and price pressures seem set to be the main features affecting the Scottish economy.

Within manufacturing export led demand again continued to improve, and confidence improved as the outturn was better than anticipated. Expectations for the year ahead suggest a slow and gradual improvement, but concerns as to rising raw material and transport costs remain and pressures to raise prices in manufacturing are widespread.

Trends in both construction and tourism were better than expected and better than the past three years, but it would be premature to see these as signs of a permanent and sustained recovery in these sectors.

Business confidence

Business optimism rose in manufacturing and tourism, and the extent of the decline was much less in construction. In contrast declining optimism was widely reported in wholesale and retail distribution. To an extent an improvement in confidence in the second quarter is a regular feature in both construction and tourism, reflecting seasonal factors, but the improvement was strong.

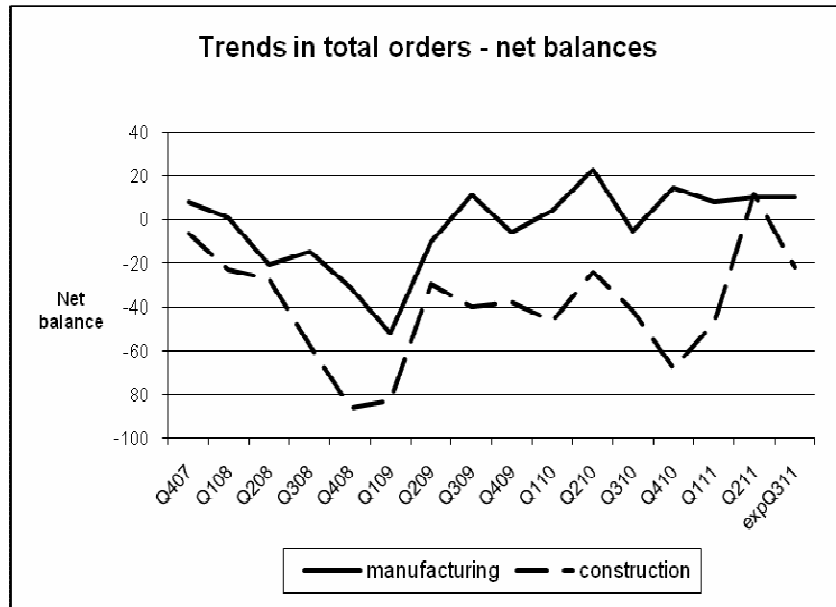


Demand/sales

For manufacturing firms export orders/sales remained the only positive aspect of demand in the second quarter of 2011, nevertheless, the net decline in Scottish and rest of UK demand was weaker than in previous quarters. A rising trend in the levels of work in progress was reported, but respondents are uncertain as to whether this will continue. In construction private commercial demand improved and the downward

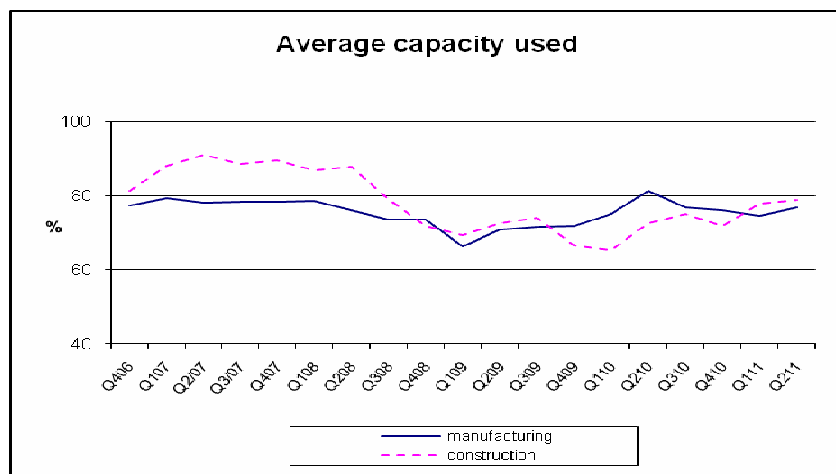
trends in domestic/house building orders eased. However, in common with manufacturing, construction respondents are uncertain as to whether this improvement will continue through the third quarter.

Retail sales trends again remained weak, and the continuing combination of low consumer confidence, price inflation and rising costs contributed to 61% of firms reporting a decline, only a slight easing in the downward trends reported in the first quarter. In tourism the outturn in demand for Q2 2011 was the best figure since 2007, reflecting rising trends from Scottish, rest of UK and overseas visitors. However, business demand remained weak.



Capacity/work in progress

Average capacity used in manufacturing rose by 2.3 percentage points (down 3.8 points compared to a year ago) and in construction by 1.1 percentage points (up 6.4 points compared to a year ago) over the past quarter.



In construction the proportion reporting working below optimum levels decreased from 71% in quarter 1 to 60% in Q2 2011. In tourism occupancy was some three percentage points lower than in the second quarters of 2010 and 2009.

Cost pressures Once again for manufacturing firms raw material/suppliers prices (84%) and transport costs (57%) were the most widely reported cost pressures and for firms these pressures are now more evident than in previous quarters. Almost 50% of manufacturing, 72% of wholesale and 66% of retail respondents reported pressures to raise prices due to rising raw material/suppliers' prices. Firms are coming under increasing energy related costs, and these will continue to escalate in the third quarter, given announcements of increased energy prices.

Pay and employment Once again labour market activity remained largely subdued, although recruitment activity in construction and tourism improved (partly a function of seasonal factors). Net rising trends in employment were reported in manufacturing and construction, the extent of decline eased in tourism, but remained weak in wholesale and retail distribution. Recruitment difficulties remained at low levels. Pay increases ranged from 2.9% in tourism to 3.1% in retail, 3.6% in manufacturing and 3.9% in construction firms.

Outlook There are some signs of the fragile recovery improving, however the improvements in construction and tourism, whilst welcome, may reflect more weaknesses rather than strengths in the Scottish economy. Overall demand remains weak, consumer uncertainties, reduced living standards and inflation continue to impact on retail and tourism. Rising cost pressures and uncertainties in our major markets pose concerns for the remainder of the year and the medium term.

Manufacturing respondents expect very modest improvements over the year. Activity in construction, notwithstanding the results for the current quarter, is set to remain weak, and much will depend on Government action to stimulate activity. In the service sector weak consumer confidence, reduced living standards and inflation will continue to adversely impact on retail sales trends. Activity and occupancy in hotels has improved compared to the second quarters of previous years, and this is expected to continue through the third quarter.

As we noted in our last survey report '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' this is again evident in the results for the second quarter.

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 2011 and early July 2011, almost 200 firms responded to the questionnaire.

© University of Strathclyde, Fraser of Allander Institute 2011. Use, storage and distribution by any means is freely given provided full citation is given.

For further information contact:

On the survey results Cliff Lockyer 0141 548 3198 (c.j.lockyer@strath.ac.uk)
Eleanor Malloy 0141 548 3967

On Chamber policy Garry Clark 0141 204 8337 or 07795 158137 (gclark@scottishchambers.org.uk)
Liz Cameron 0141 204 8316

MANUFACTURING

Optimism

Manufacturing firms reported a modest rising trend in business confidence in Q2, the first rising trend since Q2 2010.

Orders and Sales

Rising trends in orders and sales continued in quarter two, again sustained by export orders/sales. The outturn was better than expected in all areas, except export demand. Average capacity utilisation rose marginally from 74.5% to 76.8%, a little lower than a year ago. The current rising trend in orders is expected to continue through the third quarter.

Cost pressures remained substantial and almost a half of respondents expect to raise prices in the next quarter. Once again the net trend in turnover is expected to remain positive over the coming twelve months however a net balance of 10% (compared to 21% in Q1) expects profitability to decline over the year.

Investment

Investment trends remained weak with any new investment mainly directed towards replacement or to improve efficiency. Once again investment for R & D and expansion remained low.

Employment

Modestly rising trends in employment strengthened. Pay increases appear to be increasingly slightly, in the current quarter 23% reported increasing pay by an average of 3.6%. Recruitment activity increased further as almost 25% reported increasing staff numbers and a fifth reported increased hours of work.

	Up	Q2 2011		Net Balances		
		Level	Down	Q2/11	Q1/11	Q4/10
Business Optimism	21.3	60.7	18.0	3.3	-8.2	-5.4
Trends in actual orders						
Total new orders	38.3	33.3	28.3	10.0	8.2	14.8
Scottish orders	19.3	57.9	22.8	-3.5	-8.6	-3.9
Rest of UK orders	23.6	50.9	25.5	-1.8	-15.6	0.0
Export orders [27.9% = N/A]	26.2	24.6	21.3	4.9	13.7	12.5
Trends in expected orders						
Total new orders	26.7	56.7	16.7	10.0	2.8	-8.9
Scottish orders	6.9	81.0	12.1	-5.2	-11.6	11.5
Rest of UK orders	14.8	74.1	11.1	3.7	-11.1	-14.0
Export orders (28.3% = N/A)	21.7	40.0	10.0	11.7	17.8	7.0
Av Capacity used	76.8			76.8	74.5	76.04
Invest in plant/equip.	16.9	62.7	20.3	-3.6	-8.6	0.0
Cash flow past 3 moths	23.3	48.3	28.3	-5.0	-5.6	0.0
Turnover next 12 moths	36.1	42.6	21.3	14.8	6.9	14.3
Profitability next 12 moths	24.6	41.0	34.4	-9.8	-20.8	1.9
Price change next 3 moths	47.5	47.5	4.9	42.6	0.0	37.5
Pressures to raise prices from						
Pay settlements	21.3			21.3	26.4	22.8
Raw material costs	83.6			83.6	86.1	77.2
Finance costs	14.8			14.8	12.5	7.0
Other overheads	50.8			50.8	44.4	50.0
Transport costs	57.4			57.4	65.3	42.1
Employment trends						
Total actual employment	24.6	63.9	11.5	13.1	5.6	0.0
Total expected next 3 months	17.5	77.2	5.3	12.3	2.8	-14.0
Average pay increase	3.6			3.6	3.3	3.1

CONSTRUCTION

Optimism

The strong downward trend in business confidence, a feature of the past fourteen quarters, was much weaker in Q2. Typically business confidence improves in Q2 compared to Q1, reflecting seasonal factors, and in Q2 changes were at the margin, with 72% reporting no change in business confidence and 43% were still less confident than a year ago.

Contracts

Respondents had anticipated an improvement in business conditions in Q2, nevertheless, the outturn was better than anticipated and a rising trend in new contracts reported, possibly a reflection of work held back from previous quarters. 60% of firms (compared to 70% in the previous quarter) reported working below optimum levels. However, respondents remain cautious as to the level of work in Q3 and a slight weakening is anticipated.

A modest rise in the level of work in progress was reported and this is expected to continue. Average capacity used, at 78.8% was one percentage point higher than Q1 and four points higher than a year ago. For a further quarter turnover, tender margins and profitability over the next twelve months are expected to decline. Lack of demand still remains the main constraint on business, but a third mentioned credit and finance issues.

Employment

A modest upward trend in employment was recorded, the first for 12 quarters, although this rising trend is expected to level out in Q3. Recruitment activity increased further in Q2 although again few recruitment difficulties were reported. Average pay increases in Q2 were 3.9%.

	Q2 2011			Net Balances		
	Up	Level	Down	Q2/11	Q1/11	Q4/10
Business Optimism	12.0	72.0	16.0	-4	-37.5	-58.3
Trends in actual contracts						
Total new contracts	32.0	48.0	20.0	12.0	-47.1	-68.0
Public sector orders	16.7	33.3	50.0	-33.3	-57.1	-77.8
Private commercial	36.8	42.1	21.1	15.7	-31.3	-63.6
Domestic/house build	16.7	66.7	26.7	-10.0	-61.5	-60.0
Trends in expected contracts						
Total new orders	13.0	52.2	34.8	-21.8	-11.8	-72.0
Public sector orders	13.3	46.7	40.0	-26.7	-50.0	-66.7
Private commercial	17.6	64.7	17.6	0.0	-6.3	-54.5
Domestic/house build	5.6	72.2	22.2	-16.6	-15.4	-65.0
Trends in work in progress						
Actual	28.0	60.0	12.0	16.0	-17.6	-44.0
Expected	16.0	72.0	12.0	4.0	-29.4	-56.0
Capacity used	78.8			78.8	77.7	71.8
Invest in plant/equip.					-52.9	
Leasing in plant/equipment.					-43.8	
Employment trends						
Total actual employment	24.0	64.0	12.0	12.0	-23.5	-24.0
Total expected next 3 months	4.3	91.3	4.3	0.0	-17.6	-66.7
Average pay increase	3.9			3.9	n/a	2.8
Percent recruiting staff	40.0			40.0	29.4	8.0
Recruitment difficulties increasing	0.0			0.0	0	0.0

WHOLESALE DISTRIBUTION

Optimism

Business confidence amongst Scottish wholesale respondents deteriorated sharply in Q2, reflecting the general weakness in consumer demand.

Sales

Sales trends remained weak during the three months to June, and once again the outturn was weaker than anticipated. 50% of firms reported declining sales and now only a modest easing in the decline is anticipated in Q3.

Cost pressures remained intense with over 90% of respondents citing increased transport costs, over 80% citing increased suppliers costs and 50% increases in other overheads. Over 70% expect to increase prices over the next three months, but cash flow trends remain weak and over 40% expect turnover and profitability to weaken over the next year.

Finance

Once again most firms reported no change to investment plans; nevertheless the net decline continued.

Employment

For the past year firms have shed staff, and this pattern continued and accelerated for a further quarter. Slightly more than a third sought to recruit staff; largely for replacement as once again no firms reported that actual total employment levels had increased. The average pay increase in Q2 was 3.3% compared to an average of 2.4% for the past year.

	Q2 2011			Net Balances		
	Up	Level	Down	Q2/11	Q1/11	Q4/10
Business Optimism	0.0	55.6	44.4	-44.4	0.0	-33.3
Trend in actual sales	11.1	38.9	50.0	-38.9	-21.4	-33.3
Trend in expected sales	6.3	56.3	37.5	-31.3	0.0	-18.2
Investment plans	0.0	82.4	17.6	-17.6	-7.2	-25.0
Cash flow past 3 months	16.7	50.0	33.3	-16.6	-28.6	-8.3
Turnover next 12 months	5.6	50.0	44.4	-38.8	21.4	0.0
Profitability next 12 months	16.7	38.9	44.4	-27.7	0.0	0.0
Price change next 3 months	72.2	27.8	0.0	72.2	85.7	83.3
Pressures to raise prices from						
Pay settlements	11.1			11.1	21.4	16.7
Raw material costs	83.3			83.3	92.9	91.7
Finance costs	27.8			27.8	21.4	16.7
Other overheads	50.0			50.0	21.4	50.0
Transport costs	94.4			94.4	85.7	91.7
Employment trends						
Total actual employment	0.0	58.8	41.2	-41.2	-28.6	-25.0
Expected next 3 months	0.0	68.8	31.3	-31.3	-14.3	-27.3
Average pay increase	3.3			3.3	2.13	4.1
Percent recruiting staff	35.3			35.3	50	25.0
Recruitment difficulties inc	7.7			7.7	10	30.0

RETAIL DISTRIBUTION

Optimism

Weak and declining consumer confidence, flat sales trends, increasing competition, rising costs and declining margins explain the continuing low levels of business confidence which have been a feature for more than the past year.

Sales

The trend in sales remained weak with 64% reporting and 61% expecting a decline in the total value of sales. Only 9% reported increased sales during the second quarter of 2011, and once again continuing widespread concerns over consumer confidence are moderating sales expectations for the coming quarter with only 7% of firms expecting an overall increase in total sales.

Finance

Cost pressures remain intense with over 70% reporting increased suppliers costs, 56% reporting increased transport costs and 50% increased utility costs (and this before the recently announced price increases take effect), Inflationary pressures were more widely cited than in previous surveys. Pressures on margins, turnover and profitability remain widespread with two thirds expecting declining profitability over the next year.

Employment

Labour market activity continues to remain at low levels with more than 70% of retailers again reporting no change to overall employment levels. Recruitment activity eased for the eighth consecutive quarter.

Almost a quarter reported increasing pay, and the average increase in for quarter 2 2011 was 3.08% - little changed from the previous two quarters.

	Q2 2011			Net Balances		
	Up	Level	Down	Q2/11	Q1/11	Q4/10
Business Optimism	8.9	26.7	64.4	-55.6	-52.3	-51.4
Trend in actual sales	17.4	21.7	60.9	-43.5	-69.1	-45.9
Trend in expected sales	7.1	35.7	57.1	-50.0	-60	-62.9
Cash flow past 3 months	8.9	48.9	42.2	-33.3	-31.7	-21.6
Turnover next 12 months	8.9	33.3	57.8	-48.9	-47.6	-51.4
Profitability next 12 months	8.9	24.4	66.7	-57.8	-68.3	-45.7
Price change next 3 months	65.5	28.3	6.5	58.7	71.5	70.3
Pressures to raise prices from						
Pay settlements	19.6			19.6	23.8	27.0
Raw material costs	73.3			73.3	76.2	67.6
Finance costs	30.4			30.4	23.8	21.6
Other overheads	21.7			21.7	16.7	35.1
Transport costs	56.5			56.5	66.7	37.8
Utility costs	50.0			50.0	52.4	51.4
Regulation costs	23.9			23.9	42.9	27.0
Employment trends						
Total actual employment	2.2	71.7	26.1	-23.9	-21.4	-13.9
Expected next 3 months	2.4	69.0	28.6	-26.2	-20.5	-31.3
Average pay increase	3.08			3.08	3.05	2.3
Percent recruiting staff	15.6			15.6	19.0	22.2
Recruitment difficulties inc	20.0			20.0	25.0	25.0

TOURISM

Optimism

Business confidence rose significantly in Q2 with the net trend stronger than in the same quarter in 2011, as the trends in demand improved.

Demand

The rising trends in demand were stronger than anticipated, as the rising trend in the numbers of guest reflected rising trends in Scottish, rest of UK (staycations) and overseas demand, but in contrast business demand remained weak.

On the one hand the trends in demand were the strongest for four years, but average occupancy remained lower than the average for Q2 for the past four years and the trends in margins remained weak. Average occupancy rose to 68%, some three percentage points weaker than a year ago. Trends in bar/restaurant trade improved but those for conference/function facilities remained weak. Overall local and tourist demand accounted for 68% of total demand.

A third reported reducing average room rates and the widespread pattern of 'special offers' seems set to continue.

Business constraints

68% reported that the lack of tourist demand remained the primary business constraint and almost 30% noted competition and poor transport infrastructure.

Employment

71% sought to recruit staff, but employment trends remained weak with net declining trends in employment continuing.

	Q2 2011			Net Balances		
	Up	Level	Down	Q2/11	Q1/11	Q4/10
Business Optimism	38.2	41.2	20.6	17.6	-17.3	-20.9
Trends in demand/visitors						
Total demand/visitors	52.0	20.6	26.5	26.5	-46.2	0.0
Demand from Scotland	38.2	35.3	26.5	11.8	-30.8	2.3
Demand from Rest of UK	45.5	30.3	24.2	21.2	-36.5	-11.6
Demand from abroad	42.4	27.3	30.3	12.1	-50.0	-39.5
Business Trade	26.5	51.7	31.0	-4.5	-35.3	-21.4
Trends in expected demand						
Total demand/visitors	48.3	31.0	20.7	27.6	-6.5	-22.0
Demand from Scotland	37.9	37.9	24.1	13.8	-4.3	-17.5
Demand from Rest of UK	46.4	32.1	21.4	25.0	-2.0	-29.3
Demand from abroad	39.3	32.1	28.6	10.7	-13.0	-51.2
Business Trade	17.2	51.7	31.0	-13.8	-13.3	-33.3
Occupancy	68.0			68.0	49.8	56.4
Average daily rate	37.5	28.1	34.4	3.1	-38.0	-21.1
Expected average daily rate	33.3	40.0	26.7	6.7	-12.8	-24.3
Employment trends						
Total actual employment	12.1	66.7	21.2	-9.1	-32.0	-21.1
Expected next 3 months	15.6	68.8	15.6	0.0	2.0	-32.4
Average pay increase	2.9			2.9	5.4	2.7
Percent recruiting staff	70.6			70.6	53.8	53.7
Recruitment difficulties	20.0			20.0	11.4	11.4

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.

Please contact

Cliff Lockyer 0141 548 3198 or c.j.lockyer@strath.ac.uk
Eleanor Malloy 0141 548 3967 or e.malloy@strath.ac.uk

The Fraser of Allander Institute,
Sir William Duncan Building,
130 Rottenrow
Glasgow,
G4 0GE