



Quarterly Economic Indicator Q1 2018

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Methodology

The Quarterly Economic Indicator is owned and produced by the Scottish Chambers of Commerce Network, in collaboration with the Fraser of Allander Institute of the University of Strathclyde.

This survey was conducted between March and April of 2018. 385 firms responded to the Q1 2018 edition of the Indicator.

Results are reported as the “net % balance”, calculated by deducting the % of firms reporting a decrease from the % of firms reporting an increase.

E.g. If 50% of firms report an increase in profits over the quarter (compared with the previous quarter) and 49% report a decrease, the net % balance of firms reporting an increase in profits is (50-49 = +1).

A negative net % balance generally indicates contraction and a positive net % balance expansion.

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Foreword

This first Scottish Chambers of Commerce Quarterly Economic Indicator for 2018 offers some useful insights into the current state of the Scottish economy.

Some of the trends which were highlighted toward the tail of end 2017, appear to have continued into 2018. In particular, the results for retail continue to be much improved. In contrast, optimism amongst Scotland's tourism firms continues to decline.

Overall, there are notable reasons to be positive.

For example, whilst weak business investment has been a feature of Scotland's economy in recent times, the survey suggests that levels of investment have increased significantly over the last year.

As we have previously highlighted, in times of uncertainty, it is important that businesses focus on the drivers of growth that they can control such as investing in their own productivity and efficiency, and in developing the skills of their workforce.

But the survey also highlights some reasons to be cautious. In recent times, the weakness of the construction sector has been a major drag on growth. The survey suggests that construction activity continues to remain fragile, with public sector orders slipping back. In addition, and across all sectors, recruitment difficulties remain a concern.

Overall, the survey finds that Scottish businesses are remaining resilient to uncertain trading conditions.

Professor Graeme Roy

*Director
Fraser of Allander Institute*



Introduction

The results of SCC's first quarterly economic indicator of 2018 show that while the economy has not been without challenges, most sectors are reporting increasing levels of investment across capital and training.

A number of factors will underlie this. Legislative change, whether through industry wide regulations such as the GDPR, or through reforms to the Business Rates system via initiatives such as the Business Growth Accelerator, is encouraging firms to upskill their staff and push forward on capital investments.

This upswing in investment trends does not come without expectation however. Every sector in our report, from Construction to Tourism, expect to see sales revenues increase in the second quarter, with firms anticipating that this investment will gain rapid returns.

Although some sectors are reporting lessened levels of recruitment difficulties in comparison to previous quarters, such as financial services firms recording a drop of ten percentage points, these still remain relatively high in areas like construction.

In terms of wider business concerns and cost pressures, certain areas remain stubbornly challenging particularly in manufacturing as the cost of raw materials reflects rising global competition. Given the limited ability of firms to pass on these costs to customers, this may also be a further reason for rising investment, as businesses look to compete on customer experience and efficiency."

It is clear that businesses are adapting to the changing economic environment and have positive expectations for the quarter ahead. To achieve the gains that companies are anticipating, we look to policymakers to mirror the agility and adaptability shown by the private sector, particularly on areas such as increasing Scotland's exporting performance, creating a favourable tax environment and an attractive migration policy, which meets the needs of Scotland's economy."

Neil Amner

*Chair of SCC Network's Economic Advisory Group
Director at Anderson Strathern*



Key Findings

CONSTRUCTION

Sales

Construction experienced a substantial decline in net % balances reported sales in most areas. Total sales declined significantly to -7 from +17 in the fourth quarter, and domestic sales also returned to negative territory at -5.

Rest of UK sales was the only area to experience an upswing, up three percentage points to a net % balance of +5.

These figures remain below averages for Q1 across the dataset, and continue to suggest some concern for the industry.

Investment

Construction is the only sector not to have experienced significant upturns in investment into capital, training and other areas this quarter. However, investment in construction in the fourth quarter of 2017 was above the overall average across our trend data – particularly in capital improvements. Investment intentions for Q2 are also higher than the same period last year.

FINANCIAL & BUSINESS SERVICES

Business Optimism

The Financial and Business Services sector continues to show positive net % balance figures for optimism, with Q1 2018 sitting at +9 on the quarter. Although optimism remains positive, there is sign of a slowing trend with current optimism reporting at half the Q4 2017 figure of +18. At the same time last year, optimism was reported at +16.

The current figure is below the overall 2017 average, suggesting that the industry may be becoming more cautious around the business environment.

Recruitment Difficulties

Data from this quarter's QEI suggests that some of the unprecedented challenges in recruitment experienced across 2017 may be beginning to soften.

The number of firms recruiting within the sector has continued to fall – dropping to 43% from approximately 50% in the fourth quarter. Similarly, firms are also reporting a significant drop in recruitment difficulties, down from 47% of firms in Q4 2017, one of the highest figures on record, to a more moderate 37%.

Although this suggests a more forgiving environment for businesses looking to recruit this quarter, at 37%, the level of recruitment difficulties is still somewhat beyond the Q1 average for FBS firms of 29%.

MANUFACTURING

Key Financial Indicators

Although Sales metrics in some areas remain relatively positive, especially Exports (+17), this quarter's set of results is somewhat more muted for manufacturers than the strong final quarter of 2017.

Order levels suggest that exports may weaken slightly in the future, with exports at a negative net % balance of -5. However, Q1 is traditionally a weak quarter for exports in the manufacturing dataset, and the annual average has trended significantly higher over the past few years.

Price Changes

Price changes for manufacturers have returned to levels closer to the overall average, but at +41, a significant portion of manufacturers are still looking to increase prices this year (43% of the group).

Raw material costs continue to drive this process, with 86% of firms citing this as a cost pressure – down one percentage point from Q4 2017. Firms also remain concerned with exchange rates, with over 50% of businesses focused on this issue.

Key Findings

RETAIL & WHOLESALE

Key Financial Indicators

Despite the challenging conditions for retail and wholesale firms, optimism has continued to increase (+14), and sales figures remain in positive net % balance territory (+9 overall). However, with the exception of a slight rise in sales outside of the UK, the majority of key financial indicators have seen a decline against their fourth quarter figures.

Although this is to be expected for retail given that the fourth quarter is traditionally a stronger time of year for the sector, domestic sales, down to -15 from +20 in the fourth quarter, represents a specific area of concern. This is substantially below average levels for Q1 across the dataset, and reflects some of the additional research on the challenging conditions in the Scottish High Street

Concerns

Concerns shifted significantly for retailers in this quarter, with pay settlements and other overheads now acting as more substantial cost pressures.

With this in mind, higher levels of concern have been apportioned towards business rates, and competition. Furthermore, despite an improving trend profile, inflation continues to be the dominant concern at 50%, unsurprising given its effect on consumer spending power.

TOURISM

Key Financial Indicators

Tourism is the only sector to report a negative net % balance for optimism, and this is reflected in sales revenue figures.

Although not quite as negative as the fourth quarter, revenue remains at -15 total, in comparison to -20 in Q4. This is also down on last year by two percentage points.

Guest numbers are similarly concerning, with only guests from Outside the EU increasing in this quarter. Guests from the rest of the UK was a particular area of difficulty, at a net % balance of -13. This is down further on the negative figure reported in Q4, and substantially below the overall average for this metric of +8.

Employment and Training

Recruitment has remained fairly steady for the industry despite some of the challenging conditions, with a slight increase to 68% of firms.

Recruitment difficulties have decreased and are now trending closer to levels seen across late 2016 / early 2017 at 53% of firms, a significant decrease on the 67% figure reported in the fourth quarter.

Investment

Perhaps driven by some of the changes in Business Rates legislation, firms are now looking to seriously invest in capital, with the +32 balance far removed from normal levels of traditionally muted investment levels in the industry across Q1.

This also comes with significant expectations however, with expectations for sales also far outstripping the previous quarter, and expectations at this time last year, at a net % balance of +49 – compared to +32 for Q1 2017.

Construction

Construction

BUSINESS OPTIMISM

Construction firms have observed a substantial rise in optimism across the quarter, with 30% of firms expecting business conditions to improve across the year. Although this is a substantial increase from the previous quarter and previous year, it remains in line with optimism figures observed in the remainder of 2017.

CONTRACTS

A net % balance of **+10** was reported for total contracts. Public sector orders have returned to negative territory at **-11**, perhaps reflecting some of the disruption in the area. However, the net % balance for public sector orders has remained consistently low, with +6 the highest figure observed since Q1 2016.

SALES

Reflecting the contraction in construction displayed through official figures and emphasised in the recent GDP statistics, sales have slipped into negative territory, at **-7** for overall sales and **-5** domestically.

Although domestic sales have been at a negative % balance as early as Q1 2017, total sales have not been as low since Q1 2015, suggesting broader concerns in the industry.

CONCERNS + PRESSURES

Construction firms have reported the lessening of certain pressures, with raw material prices seeing some reduction (while remaining a concern for over two thirds of firms).

There has however, been a substantial jump in pay settlements, with 29% of firms indicating this as a cost pressure, in line with the increase in % balance terms of firms offering pay increases to **+27**.

Concerns around monetary policy, such as interest rates and inflation, will see many construction firms eagerly anticipating the next MPC meeting on 10th May.

(blank space indicates data not available)				(rounded up to nearest %)		
(balances may not add up to 100% due to N/A responses)				Q1/18	Q4/17	Q1/17
(figures given as % of respondents)	Up	Level	Down	Net % Balance	Last Quarter	Last Year
Business Optimism	29.5	56.8	13.6	16	4	2
Sales Revenue						
Total	25.6	37.2	32.6	-7	17	0
Domestic (Scotland)	23.8	45.2	28.6	-5	9	-5
Rest of UK	4.9	14.6	0.0	5	2	3
Contracts						
Total new contracts	38.5	28.2	28.2	10	14	8
Public sector orders	23.7	18.4	34.2	-11	5	0
Private commercial	34.2	31.6	15.8	18	9	-3
Domestic/house build	25.0	27.5	12.5	13	17	-8
Investment						
Total	30.2	32.6	23.3	7	15	7
Capital	21.4	42.9	21.4	0	17	5
Training	16.7	52.4	14.3	2	21	29
Work in Progress	45.0	27.5	27.5	18	18	11
Cashflow	29.5	40.9	27.3	2	-17	-24
Applied for Credit?	20.5			20	19	27
Profits	27.9	51.2	18.6	9	-4	-24
Capacity used (ave. %)				81	80	79
Employment						
Total	20.5	52.3	25.0	-5	9	0
Recruiting Staff			(yes)	52	53	63
Recruitment Difficulties			(yes)	52	50	62
Increased Wages?			(yes)	27	21	39
Average pay increase (%)				3.5	7.3	4.2
Expectations Next Quarter						
Price Change	38.1	57.1	4.8	33	46	43
Sales Revenue	45.5	31.8	20.5	25	19	22
Investment	31.8	45.5	18.2	14	11	0
Employees	25.0	61.4	13.6	11	2	22
Cost Pressures (%)						
Pay Settlements			(yes)	29	18	-
Finance Costs			(yes)	7	5	-
Raw Material Prices			(yes)	61	74	-
Other Overheads			(yes)	49	41	-
Concerns (%)						
Interest Rates			(yes)	32	31	-
Business Rates			(yes)	22	26	-
Competition			(yes)	46	45	-
Exchange Rates			(yes)	2	26	-
Inflation			(yes)	32	48	-
Taxation			(yes)	29	40	-

Financial & Business Services

Financial & Business Services

SALES REVENUE

Generally, the Financial and Business Services sector remains buoyant in terms of overall revenue, but the industry has displayed more muted growth when compared to Q4.

However, a Net % Balance of +25 for total revenue remains substantially ahead of average Q1 figures, suggesting that the industry is still in broadly positive health.

EMPLOYMENT

Further evidence of a recruitment slowdown in the sector is provided, with the number of firms recruiting dropping to 43% from 50% in Q4 2017.

This drop in recruitment has also seen a decline in the level of recruitment difficulties, dropping to 37% - a full ten percentage points.

INVESTMENT

Perhaps linked to a sectoral push away from recruitment and additional staff, investment has increased across the board this quarter.

Net % Balances for Capital (+8) and Training (+16) investment, at some of the highest levels observed across the past few years.

CONCERNS

Increasing investment rates suggest a desire to make organisations more lean and efficient, which may be reflected in growing concerns around competition, which has replaced taxation as the largest area of concern for Financial and Business Services firms.

42% of firms are now expressing competition as one of their leading areas of concern.

As with construction businesses, FBS firms have also seen levels of concern around monetary policy increase, as others have lessened

(blank space indicates data not available)				(rounded up to nearest %)		
(balances may not add up to 100% due to N/A responses)				Q1/18	Q4/17	Q1/17
(figures given as % of respondents)	Up	Level	Down	Net % Balance	Last Quarter	Last Year
Business Optimism	29.3	50.7	20.0	9	18	16
Sales Revenue						
Total	44.9	34.8	19.6	25	42	9
Domestic (Scotland)	35.8	41.6	19.0	17	34	-1
Rest of UK	16.4	32.8	9.7	7	11	0
Exports	11.3	16.5	4.5	7	10	10
Online	11.5	25.2	8.6	3	4	2
Investment						
Total	25.4	47.8	10.9	14	13	6
Capital	20.3	44.2	12.3	8	2	-1
Training	24.5	53.2	8.6	16	14	14
Cashflow	30.2	43.9	23.7	6	16	-15
Applied for credit?	8.7			9	11	7
Profits	30.2	42.4	24.5	5.8	22.7	-6.0
Capacity Used (Ave. %)				72	73	70
Employment						
Total	26.5	58.8	11.0	15.4	16.0	-7.7
Recruiting Staff	42.8			43	50	34
Recruitment Difficulties	37.3			37	47	29
Increasing Wages	24.3			24	20	20
Average pay increase (%)				4	6	6
Expectations Next Quarter						
Price Change	26.5	69.9	3.7	22.8	36.1	29.6
Sales Revenue	55.7	29.3	15.0	40.7	31.1	32.0
Investment	29.0	55.1	7.2	21.7	21.3	10.1
Employees	33.1	63.3	3.6	29.5	21.5	18.1
Cost Pressures (%)						
Pay Settlements			(yes)	27	29	-
Finance Costs			(yes)	9	13	-
Raw Material Prices			(yes)	11	25	-
Other Overheads			(yes)	46	77	-
Concerns (%)						
Interest Rates			(yes)	19	17	-
Business Rates			(yes)	20	32	-
Competition			(yes)	42	34	-
Exchange Rates			(yes)	27	23	-
Inflation			(yes)	28	35	-
Taxation			(yes)	38	41	-

Manufacturing

Manufacturing

ORDERS

The first quarter of 2018 has been somewhat disappointing for Scottish manufacturers focused on exports, with future order levels to the wider UK (-7) and further afield (-4) sitting below long-term averages.

This suggests that the broadly positive sales export figures, which have already slowed relative to Q4 2017, may experience further pressure.

CASHFLOW + PROFITS

In contrast to last quarter, both cashflow (-7) and profitability (-4) seem to have come under renewed pressure in 2018.

Although profitability has been at similar levels across 2017, this is the lowest figure observed for cashflow since Q4 2016.

CONCERNS + COST PRESSURES

Raw Material Prices, at 86% of firms, continue to be the overriding cost pressure to manufacturing businesses – only changing by one percentage point relative to Q4 2017.

It is possible that the significant pressure put on firms by these rising costs is contributing to their cash flow difficulties.

Furthermore, these concerns can be seen in the focus on manufacturing firms towards exchange rates – which at 51% of firms, continues to highlight the reliance on international supply chains across the sector.

INVESTMENT

Linked to expectations observed in Q4 2017, Manufacturing businesses are observing sharp rises in investment, with total (+16) and capital (+16) investment both at their highest levels since Q4 2016.

As with some of our other observed sectors, this perhaps speaks to a broader desire to extract greater efficiency in an environment of broader external pressure

(blank space indicates data not available)				(rounded up to nearest %)		
(balances may not add up to 100% due to N/A responses)				Q1/18	Q4/17	Q1/17
(figures given as % of respondents)	Up	Level	Down	Net % Balance	Last Quarter	Last Year
Business Optimism	25.9	51.7	22.4	3	8	11
Sales Revenue						
Total	36.8	40.4	22.8	14	36	13
Domestic (Scotland)	23.2	46.4	21.4	2	12	-2
Rest of UK	20.0	32.7	27.3	-7	27	7
Exports	33.3	27.8	16.7	17	34	24
Orders						
Total	40.4	31.6	26.3	14	19	11
Domestic (Scotland)	19.0	50.0	19.0	0	3	0
Rest of UK	17.2	32.8	24.1	-7	9	2
Exports	17.5	28.1	21.1	-4	9	13
Work in Progress	36.8	49.1	14.0	23	20	18
Investment						
Total	28.1	56.1	12.3	16	2	0
Capital	29.8	52.6	14.0	16	-2	6
Training	19.3	64.9	8.8	11	12	4
Cashflow	22.4	48.3	29.3	-7	7	6
Applied for Credit?	10.3			10	16	17
Profits	24.6	45.6	28.1	-4	10	-4
Capacity Used (Ave. %)				76	77	76
Employment						
Total	25.4	57.6	16.9	8	17	15
Recruiting Staff			(yes)	64	67	70
Recruitment Difficulties			(yes)	39	58	45
Increased Wages			(yes)	24	20	14
Average pay increase				3	5	5
Expectations (next quarter)						
Price Change	43.1	55.2	1.7	41	66	49
Sales	55.2	25.9	19.0	36	19	23
Investment	22.4	58.6	10.3	12	14	2
Employees	33.9	61.0	5.1	29	25	21
Cost Pressures (%)						
Pay Settlements			(yes)	28	28	-
Finance Costs			(yes)	9	6	-
Raw Material Prices			(yes)	86	87	-
Other Overheads			(yes)	35	54	-
Concerns (%)						
Interest Rates			(yes)	14	17	-
Business Rates			(yes)	18	20	-
Competition			(yes)	26	50	-
Exchange Rates			(yes)	51	52	-
Inflation			(yes)	37	43	-
Taxation			(yes)	16	33	-



Retail & Wholesale

Retail & Wholesale

OPTIMISM

Somewhat surprisingly, retail firms have expressed growing optimism figures for the first quarter of 2018 at **(+14)** – perhaps reflecting continued confidence from a relatively positive Q4 in 2017.

SALES REVENUE

Generally, this positivity does not appear to have carried over into revenue figures, with domestic revenue in particular experiencing a sharp drop into negative territory **(-15)**.

These domestic figures are more reflective of the current narrative in retail, with an April report from PwC highlighting increasing rates of store closures in Scotland.

The picture is certainly not universally negative however, with exports **(+13)** increasing slightly relative to last quarter.

PROFIT & CASHFLOW

Weakening revenue figures have brought cashflow **(-11)** and profitability **(-8)** figures back into negative % balance territory, with both figures in line with previous Q1 averages.

CONCERNS + COST PRESSURES

As with the broad overall theme expressed throughout industries for this report – retail also paints the picture of an industry investing to tackle significant external challenges.

External competition, business rates and consumer pressure through inflation are all acting as concerns which are forcing the sector at large to invest in training and business transformation.

(blank space indicates data not available)				(rounded up to nearest %)		
(balances may not add up to 100% due to N/A responses)				Q1/18	Q4/17	Q1/17
(figures given as % of respondents)	Up	Level	Down	Net % Bal- ance	Last Quar- ter	Last Year
Business Optimism	38.9	36.1	25.0	14	2	-8
Sales Revenue						
Total	45.7	17.1	37.1	9	29	-20
Domestic (Scotland)	32.4	17.6	47.1	-15	20	-3
Rest of UK	20.0	20.0	10.0	10	21	-11
Exports	13.3	0.0	0.0	13	8	5
Online	20.6	20.6	14.7	6	26	-3
Investment						
Total	42.9	37.1	20.0	23	-5	0
Capital	41.2	35.3	20.6	21	2	0
Training	26.5	47.1	14.7	12	5	15
Cashflow	25.0	38.9	36.1	-11	14	-27
Applied for Credit?			(yes)	7%	8%	4%
Profits	33.3	25.0	41.7	-8	12	-16
Capacity Used (Ave %)				70%	76%	72%
Employment						
Total	27.8	61.1	11.1	17	13	-8
Recruiting Staff			(yes)	64	56	41
Recruitment Difficulties			(yes)	26	39	44
Increased Wages?			(yes)	31	33	36
Average Pay Increase				7.1%	7.6%	4.2%
Expectations Next Quarter						
Price Change	60.0	37.1	2.9	57	53	68
Sales Revenue	58.3	19.4	22.2	36	8	20
Investment	41.7	41.7	16.7	25	-5	13
Employees	28.6	57.1	14.3	14	-5	5
Cost Pressures (%)						
Pay Settlements			(yes)	41	21	-
Finance Costs			(yes)	9	21	-
Raw Material Prices			(yes)	47	70	-
Other Overheads			(yes)	68	64	-
Concerns (%)						
Interest Rates			(yes)	9	24	-
Business Rates			(yes)	44	32	-
Competition			(yes)	47	38	-
Exchange Rates			(yes)	29	38	-
Inflation			(yes)	50	47	-
Taxation			(yes)	38	41	-

Tourism

Tourism

GUESTS/CUSTOMERS

Tourism firms have experienced a challenging first quarter in terms of overall guest figures, with only guests from outside the EU area increasing **(+4)**.

Rest of the UK figures are of particular concern, having declined significantly over several quarters. This has had a corresponding effect on revenue, with figures remaining in negative territory for the majority of key metrics. However, the trend does show improvement in this area, and strong expectations for Q2 suggest that firms are hopeful of growth in the second quarter.

INVESTMENT & EMPLOYMENT

As experienced throughout the vast majority of sectors, businesses are embarking on a renewed period of investment.

The figure for capital investment in particular is one of the highest on record for tourism at **+32**, and training investment **(+27)** sits just below the highest figure, observed in Q2 2015, of **+29**.

Tourism firms have been investing heavily in training for a number of quarters, perhaps linked to the high levels of recruitment difficulties experienced across 2017 in the sector.

EXPECTATIONS AND CONCERNS

These renewed plans for investment come with renewed expectations – tourism firms expect future sales to increase, with the % balance figure of **+49** significantly above the Q1 Average of .

Recruitment is also surprisingly strong for the sector, with 68% of firms seeking to bring on additional staff, and at **+22**, strong employment expectations for the following quarter.

Given the focus of tourism firms on property, Business Rates and Taxation continue to be some of the primary concerns. Continued reform of the Business Rates system will hopefully act to soften this concern for tourism firms going forward.

(blank space indicates data not available)				(rounded up to nearest %)		
(balances may not add up to 100% due to N/A responses)				Q1/18	Q4/17	Q1/17
(figures given as % of respondents)	Up	Level	Down	Net % Balance	Last Quarter	Last Year
Business Optimism	23.9	47.8	28.3	-4	-16	-6
Sales Revenue						
Total	26.1	32.6	41.3	-15	-20	-13
Domestic (Scotland)	28.9	28.9	33.3	-4	-15	-13
Rest of UK	17.8	26.7	28.9	-11	-21	-10
Online	30.4	32.6	17.4	13	-13	-4
Investment						
Total	30.4	47.8	8.7	22	20	-2
Capital	38.6	40.9	6.8	32	6	6
Training	33.3	51.1	6.7	27	27	10
Cashflow	23.9	37.0	34.8	-11	-21	-21
Applied for credit			(yes)	16	13	19
Profits	19.6	45.7	32.6	-13	-29	-26
Employment						
Total	29.5	52.3	13.6	16	-19	-14
Recruiting Staff			(yes)	68	67	61
Recruitment difficulties			(yes)	53	67	41
Increased wages?			(yes)	49	37	28
Average pay increase (%)				5	5	4
Guests/Customers vs last year						
Total	41.3	17.4	41.3	0	4	13
From Scotland	33.3	28.9	33.3	0	2	2
From Rest of UK	22.2	33.3	35.6	-13	-8	6
From Rest of EU	24.4	24.4	26.7	-2	-2	-10
From Outside the EU	26.7	26.7	22.2	4	4	-5
Expectations Next Quarter						
Price Change	44.2	51.2	4.7	40	44	51
Sales	62.2	24.4	13.3	49	-2	32
Investment	20.0	60.0	8.9	11	4	-7
Employees	28.9	64.4	6.7	22	4	18
Cost Pressures (%)						
Pay Settlements			(yes)	26	39	-
Finance Costs			(yes)	14	15	-
Raw Material Prices			(yes)	51	73	-
Other Overheads			(yes)	65	73	-
Concerns (%)						
Interest Rates			(yes)	14	18	-
Business Rates			(yes)	56	57	-
Competition			(yes)	26	50	-
Exchange Rates			(yes)	30	25	-
Inflation			(yes)	44	50	-
Taxation			(yes)	53	45	-



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