
Quarterly Economic Indicator

RESULTS: Q1 2026

FOREWORD



Professor Mairi Spowage

Director, Fraser of Allander Institute

Economic conditions in Scotland show tentative signs of stabilisation in Q1 2026, albeit amidst wider reasons for caution. While business confidence is still weak overall, the proportion of firms reporting improving sentiment has edged upwards, suggesting a modest shift in outlook despite continued uncertainty. It should also be noted that the escalation of conflict in the Middle East towards the end of the survey period is not yet fully reflected in these findings.

Demand conditions continue to be subdued. Although revenues and orders continue to face pressure, the pace of decline has eased slightly, with more firms reporting increases in activity compared to last quarter. However, a large share of businesses continue to report no change, underlining the modest nature of economic momentum. This caution is also evident in investment behaviour, where firms are largely holding back on new spending, particularly in training, as they navigate ongoing uncertainty.

Cost pressures continue to weigh heavily on businesses, with labour costs remaining the dominant concern. While pressures from utilities have eased, this has been offset by rising costs associated with raw materials and other overheads. These pressures are feeding through into pricing decisions, with a growing majority of firms expecting to raise prices in the coming quarter. At the same time, taxation remains the leading concern for businesses, alongside a notable increase in concern around business rates.

Labour market conditions remain tight, with recruitment difficulties intensifying even as overall staffing levels remain broadly stable. Financial strain also persists, particularly in relation to cash flow, although there are some signs that the rate of profit decline has begun to ease.

Overall, the Q1 2026 results point to an economy that continues to face significant headwinds but may be beginning to find some footing. Whether these modest improvements can be sustained will depend on how both domestic pressures and global uncertainties evolve in the months ahead, not least the extent to which the conflict in the Middle East exerts a sustained upward pressure on energy prices.

Doug Smith

Vice President, Scottish Chambers of Commerce,
& Chair of the SCC Economic Advisory Group



The Q1 data shows a sharp rise in concern around business rates, which should be a clear warning sign ahead of the election.

In just one quarter, we have seen a significant jump in the number of firms telling us that rates are a major pressure. That reflects a deeper, structural issue which is driving up the cost of doing business in Scotland.

Business rates thresholds have barely moved in recent years, while inflation has pushed up costs and rateable values. In reality, that means more firms are being pushed into higher rate bands simply because their rateable value has risen – not because the business is growing.

That leaves firms paying more tax for standing still, and in some cases losing access to reliefs at the same time. Taken together with drastic increases in rateable value, it's little surprise that rates are continuing to cause pain for our members.

These pressures are not happening in isolation. They are feeding directly into business decisions and wider performance. While there are some modest signs of improvement, the fundamentals remain challenging. Investment is flat, recruitment pressures are rising, and momentum is sluggish.

As the election campaign ramps up, reform of business rates must be a top priority for the next Scottish Government. That must include ensuring thresholds keep pace with inflation, providing greater long-term certainty, and ensuring the system supports, rather than penalises, investment and growth.



QEI Q1 2026 - KEY FINDINGS

Q1 2026 shows continued economic strain, but with modest improvements in some key indicators compared with Q4 2025. Confidence, revenues, orders, and profits all showed slight upward movement, yet overall conditions remained challenging. Cost pressures, particularly labour-related, continue to dominate decisions, and businesses increasingly expect to raise prices in the coming quarter.

Business confidence continued to soften in Q1 2026

- 37% of firms reported a fall in confidence compared to last quarter, similar to the 40% in Q4 2025.
- On the other hand, more firms (28%) reported higher confidence, compared to 24% last quarter.
- Confidence is still weak, but Q1 showed a marginal improvement in positive sentiment compared to Q4.

Signs of financial strain continued across the business base

- Levels of cashflow and profits once again showed significant contraction over the quarter.
- Cashflow remained significantly strained, but the rate of profit decline softened in Q1.

Hiring difficulties remained a significant constraint

- 47% had recruitment difficulties in Q1, higher than Q4's 37%.
- For a second successive quarter, the number of firms letting staff go has been higher than the amount being hired, although this rate eased in Q1 2026.

The dominant cost drivers in Q1 were

- Labour costs: 57% (still high, but lower than Q4's 79%).
- Raw materials pressure saw a notable rise: 50% (higher than Q4's 40%).
- Utilities: 44% (down from Q4's 60%).
- Other overheads also saw a notable rise, from 32% in Q4 to 42% for Q1.

Worry about tax remained the leading concern

- 63% in Q1 flagged taxation as a rising concern, which has eased when compared with 73% in 2025 but still remained high.
- Business rates concern rose by 20 percentage points in one quarter, now sitting at 48% and second only to taxation as the leading concern.





CONSTRUCTION

BUSINESS OPTIMISM

For a second successive quarter, confidence saw no change on balance for the quarter as the same number of firms (27%) reported a rise as they did a fall in confidence.

LABOUR MARKET

For a third successive quarter, firms reported a significant contraction on balance in workforce numbers.

The negative net balance of -22% was a sizeable drop-off compared to the previous quarter, and even more so when compared to last year.

CONTRACTS/SALES

2025 was the weakest year on average in terms of contracts and sales for the sector since 2020.

That general trend continued in the first quarter of 2026, with contraction reported across all sales trends.

Regarding contracts, despite relative growth in private commercial contracts, significantly weak housebuilding / residential contracts contributed to an overall slump.

CONCERNS/PRESSURES

The leading cost pressures for construction firms, labour costs and raw material prices, increased over the quarter.

Taxation and inflation remain the top concerns for over six in 10 firms, with business rates seeing the largest increase in any single trend, becoming the third most cited concern overtaking competition.

Business Voice

"Rising operational costs such as national insurance, utilities, fuel, insurance, and haulage, are placing significant pressure on our cash flow. Although demand for work remains strong, skills shortages and cumulative cost increases continue to hinder our business."

A small trades firm in the Highlands



SERVICES

BUSINESS OPTIMISM

Services firms reported general optimism for the start of the year, as confidence returned to a positive net balance after being flat last quarter.

The net balance of +5% aligned closely with the average across 2025 but is well below the +17% Q1 average across the past five years.

CASHFLOW/PROFITS

The end of 2025 saw the weakest performance for cashflow and profits in services for four years.

While profits did return to growth on balance, the contraction rate on cashflow fell further to -10% for the quarter.

This rate of contraction was significantly below the average for the quarter as well as the five-year survey average.

INVESTMENT

Over eight in ten firms (81%) reported either no change or a fall in investment over the quarter. As 19% reported an increase, this resulted in a negative net balance of -6%.

This fall in overall investment was driven by a fall in capital investment, and was the first contraction reported for these trends since Q4 2022.

CONCERNS/PRESSURES

Nearly all cost pressures saw slight easing compared to the previous quarter, aside from raw material prices which saw an increase.

Taxation and inflation remained the top concerns, with business rates concern rising to 42% compared to 24% reported last quarter.

Business Voice

"As a labour-intensive business, increases to the National Minimum Wage, Employer National Insurance, and statutory sick pay present substantial financial challenges and raise concerns about our long-term viability."

A small services firm in Ayrshire



MANUFACTURING

BUSINESS OPTIMISM

The generally negative sentiment carried across 2025 carried over into the start of 2026 across the sector.

The negative net balance of -6% sat 12 percentage points lower than the average for the quarter.

LABOUR MARKET

After two successive quarters of firms reporting declining staff numbers, there was a return to growth on balance for Q1.

Although well below the Q1 average for the sector, it still sat above the +3% average seen across 2025.

SALES REVENUE/ORDERS

Manufacturing firms reported a third successive negative set of sales results for the quarter, with all trends being well below the five-year rolling survey average.

The trend that saw the most significant contraction over the quarter was domestic sales, which fell further to -24%, in comparison to the -6% reported last quarter.

Order trends followed a similar pattern to the previous quarter, with growth in exports being generally outweighed by decline across all other trends.

CONCERNS/PRESSURES

Labour costs saw a slight increase in reported pressure, 81% is the third highest level recorded for this trend in the past five years of the survey.

Pressure from energy bills and raw material prices remained significant for over six in ten firms.

Over half of firms continued to share concern over inflation and taxation albeit eased since the previous quarter.

Concern from business rates was reported by half of firms, a record high for the sector.

Business Voice

"Rising employment costs and taxes are constraining growth and complicating decisions around investment in staff and equipment. Scotland's tax environment is becoming increasingly uncompetitive, contributing to difficulties in recruitment and prompting skilled employees to relocate elsewhere in the UK."

A small manufacturing firm in Dundee & Angus



RETAIL

BUSINESS OPTIMISM

Retail firms have generally reported pessimistically when it comes to confidence since the beginning of 2025, and that continued at the beginning of 2026.

The final negative net balance of -20% was 11 percentage points lower than the average seen across 2025.

INVESTMENT

Half of retailers reported falls in both total and capital investment over the quarter, ultimately leading to negative net balances across both trends of -30%, the largest contraction recorded in a single quarter for the trends since Q2 2020.

Training investment also saw firms report a negative net balance but not to the same extent as the other trends, with half of firms reporting no change over the quarter.

SALES REVENUE

Last quarter's results showed that the festive boom did not materialise for retailers and the downturn in sales which began in 2025 deepened in Q1.

Despite firms reporting significant growth in exports for the first time in over a year, all other sales trends reported contraction on balance.

CONCERNS/PRESSURES

Pressure from labour costs (80%) reached a record high for the sector.

Concern from taxation (70%) increased to the joint second highest recorded in the past five years.

Business rates concern almost doubled to 60%, a joint record high.

Business Voice

"Ongoing increases in fixed operating costs, particularly minimum wage obligations and PAYE, remain a significant concern. A lack of tailored government support, alongside limited banking support for hospitality and retail, also continues to place pressure on the sector."

A small retailer in Moray



TOURISM

BUSINESS OPTIMISM

77% of firms reported either no change or a fall in confidence over the quarter. As 22% reported a rise, this resulted in a contraction on balance of -11%, a rate which was still a significant easing when compared to other recent results.

SALES REVENUE

Tourism firms reported contraction on balance across all sales trends, albeit such results are typically expected in the first quarter of the year due to the seasonal dependency of the sector.

As such, all the negative net balances across the sales trends are still in line with their Q1 average over the past five years of the survey.

CASHFLOW/PROFITS

Cashflow and profits have been a regular difficulty for most tourism firms in recent years, which was reported once again in Q1.

In a similar vein to sales, the level of contraction is still on par with the average for Q1 which is typically the off season for most tourism firms.

CONCERNS/PRESSURES

Labour costs reached a new five-year high at 89%, compared to the previous record of 86% in Q3 2022

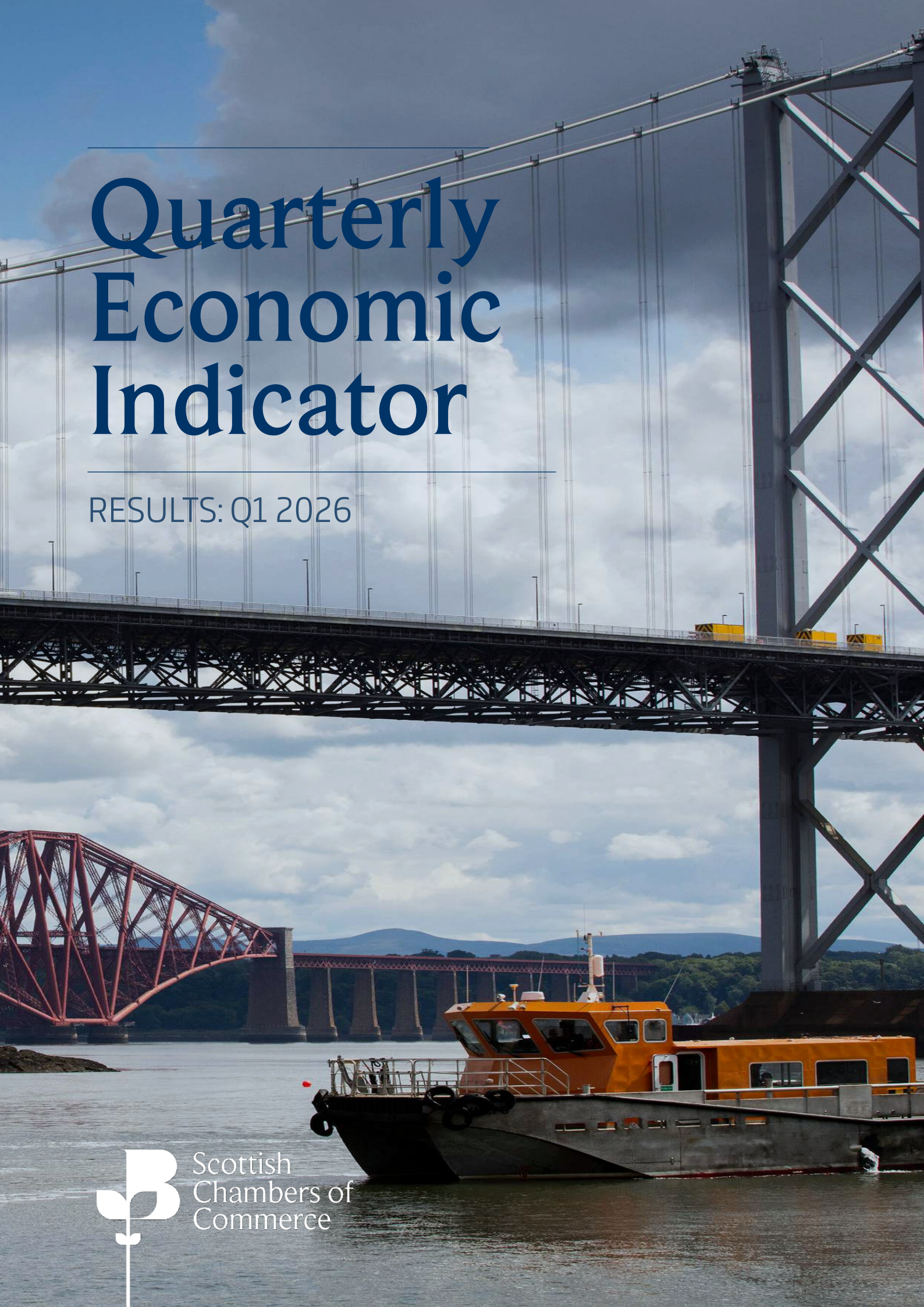
Concern over taxation remained at a near survey high of 75% for the second quarter in a row.

For the first time since Q3 2021, neither inflation nor taxation was reported as the top concern. This instead fell to business rates at 67% which was a joint five-year survey high for the sector.

Business Voice

"Recent rises in business rates appear inconsistent with local property values or comparable premises. Increases of this scale, such as a 170% rise for one location, raise clear concerns about the fairness and sustainability of current rating policies."

A small hospitality firm in Forth Valley



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