

SCOTTISH BUSINESS MONITOR

September 2019

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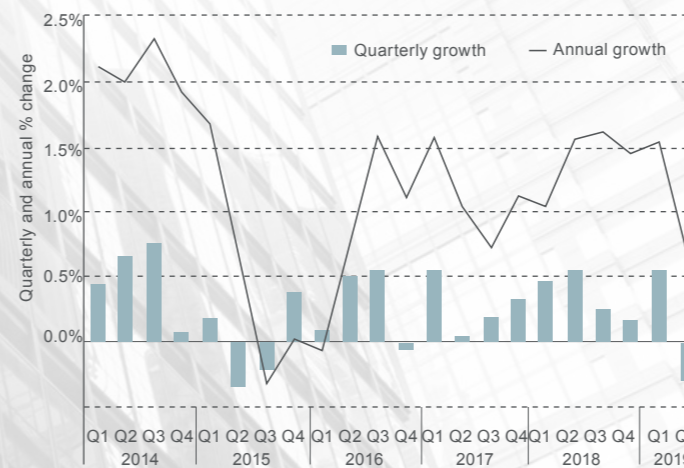
ECONOMIC CONTEXT

Businesses continue to operate in a time of significant uncertainty. The looming Brexit deadline casts a shadow over the outlook for the Scottish economy. At the same time, the global economy is slowing, not helped by heightened tensions between the US and China. Despite all this, activity in the UK economy remains positive with near record levels of employment.

The latest economic data

Last week's official growth figures for the 3-month period to June, showed that the Scottish economy contracted, much in the same way that the UK economy did over the same period.

CHART 1: ECONOMIC GROWTH IN SCOTLAND



Source: Scottish Government Q2 GDP

Growth over Q2 2019 was -0.3%. Annual growth – at just +0.7% – remains well below trend and lags the UK as a whole.

These movements can largely be explained by a number of businesses stock-piling in the run up to Brexit.

This latest Business Monitor covers the following three month period – that is, Q3 2019 – providing a more up-to-date picture of activity in the Scottish economy.

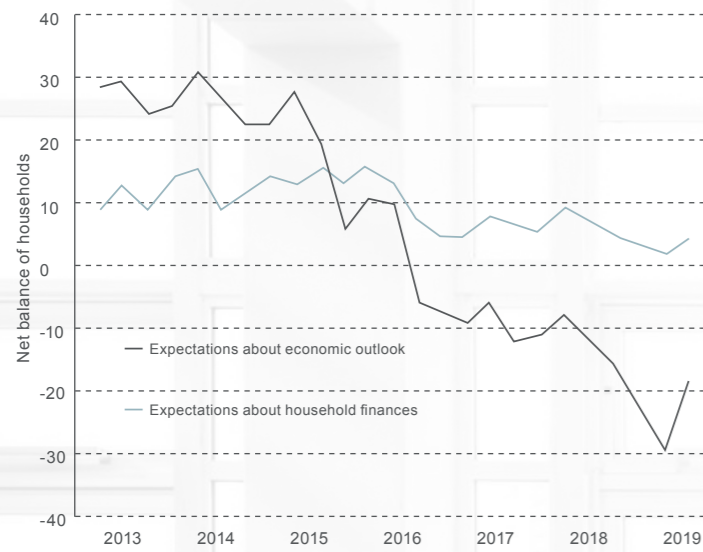
It shows that Scottish businesses have remained relatively resilient, with growth continuing through the summer.

But longer-term prospects continue to be hampered by uncertainty. Business investment in Scotland has fallen by over 4% over the last year and has now declined for three consecutive quarters. This survey suggests little improvement.

At the same time, rising costs – in part driven by the continued weak value of Sterling – are putting pressure on cash-flow and future planning.

Recent Scottish Government survey work suggests that such trends are feeding through to the wider economy, with consumers less confident about the outlook than in the past.

CHART 2: CONSUMER CONFIDENCE IN SCOTLAND



In such times, it is vital that businesses develop contingency plans for different eventualities.

The results of today's survey suggests that some businesses have still yet to fully prepare. This is a concern.

At the same time, it is important that businesses do not lose sight of the long-term drivers of success they can control.

Seeking out opportunities to grow new markets, innovate, and to invest in the future of their businesses and their people, is now more important than ever.

Our principal measure of activity – the FAI Business Activity Index – has fallen over the quarter, but remains positive.

Source: Scottish Government Consumer barometer

The Scottish Business Monitor

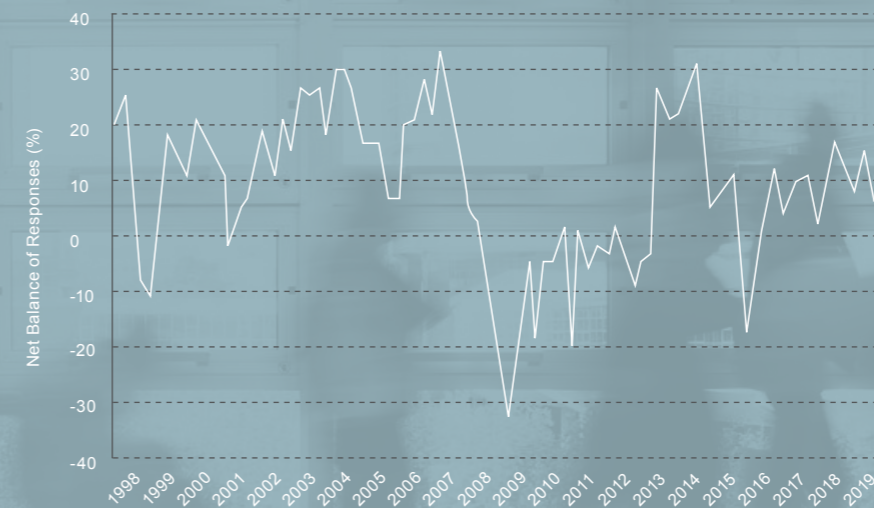
Launched in 1998 – and now in its 21st year – the Scottish Business Monitor is one of Scotland's preeminent trackers of business sentiment and activity.

Compiled by the Fraser of Allander Institute – an independent economics research institute at the University of Strathclyde – the Business Monitor compiles responses from around 500 businesses across Scotland – and from a range of sectors – on issues such as business activity, investment, employment prospects and turnover/costs.

The Scottish Business Monitor is published weeks in advance of official growth data on the Scottish economy. It also provides a detailed assessment of sentiment in the business community, including investment and recruitment intentions.

	Q3 2019	3-year average	Change over quarter	Change over year
FAI Business Activity Index (net % balance*)	5	8	-9↓	-11↓
New Business	3	9	-8↓	-12↓
Turnover	8	10	-5↓	-12↓
Costs	56	50	5↑	2↑
New Capital Investment	-3	-3	4↑	8↑
Export Activity	-8	-1	3↑	-8↓

CHART 3: FAI BUSINESS ACTIVITY INDEX



The net balance of +5 suggests that – on average – businesses in Scotland continue to grow with a majority reporting an improved order book.

Performance does vary by size of business, however.

We find that activity remains particularly weak amongst smaller firms, but more positive in larger firms.

Expectations for the next 6 months remain – on the whole – fragile. Exporting and capital investment activities remain weak.

Source: Scottish Business Monitor

DETAILED RESULTS

Finance and services report the strongest performance

The latest results show that four out of the five sectors have reported a contraction in activity and the extent of the growth performance varies quite significantly.

Financial services firms have reported the strongest growth over Q2 and Q3.

Several sectors are showing clear impacts of stockpiling at certain points over the past year. Firms have then effectively curtailed operations in the immediate aftermath as they run down inventories.

In the latest quarter, activity in the retail & wholesale and the accommodation & food services sector is particularly negative.

TABLE 1: TREND IN VOLUME OF BUSINESS ACTIVITY, NET RESPONSE OF FIRMS

	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019
Construction	25%	22%	21%	0%	-6%
Retail & wholesale	-9%	0%	0%	8%	-14%
Manufacturing	17%	7%	-2%	12%	-2%
Accommodation & food	14%	0%	24%	17%	-32%
Finance	42%	35%	0%	32%	25%

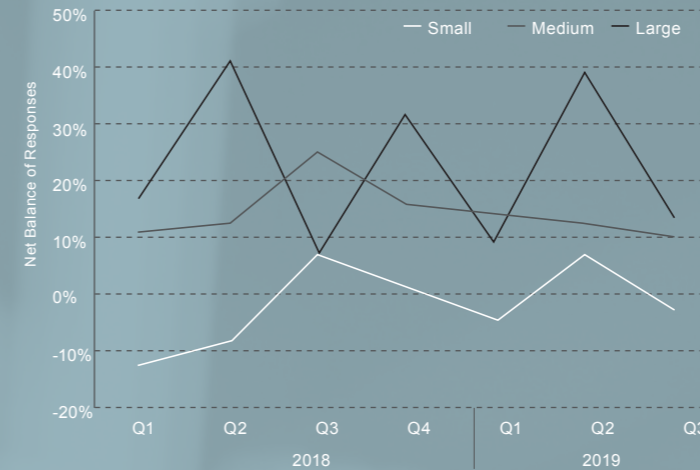
Source: Scottish Business Monitor

Large and medium sized firms report the strongest growth

Chart 4 shows the results of our activity index broken down by size of firm.

On the whole, we find that firms with more than 10 employees report positive growth over the summer.

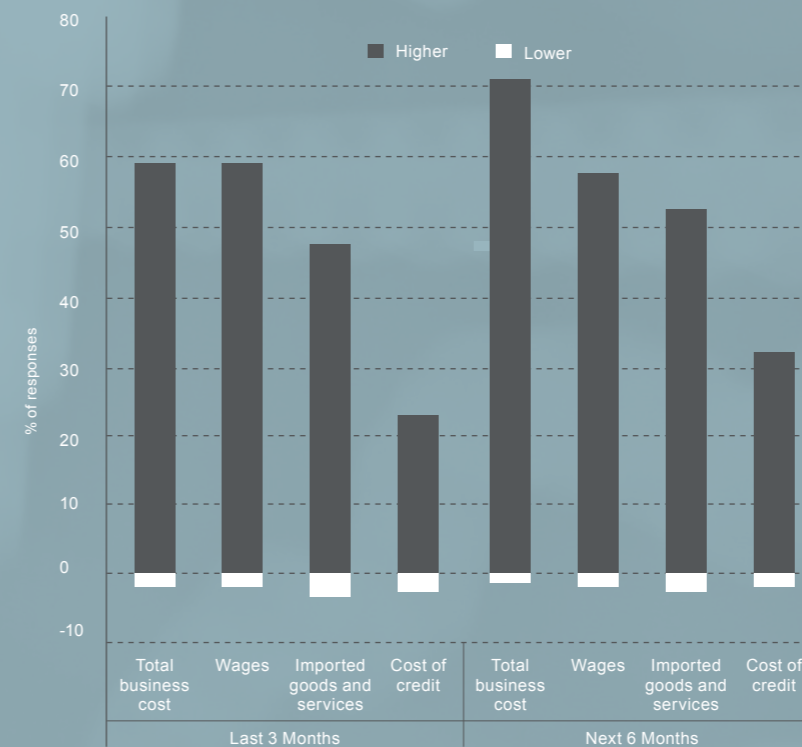
In contrast, smaller firms – on average – report conditions to be tougher, with activity negative over the period.



Source: Scottish Business Monitor

Costs have been increasing and are expected to increase further

Businesses have faced increasing costs over the last 3 months, driven by wage pressures and rising import prices.

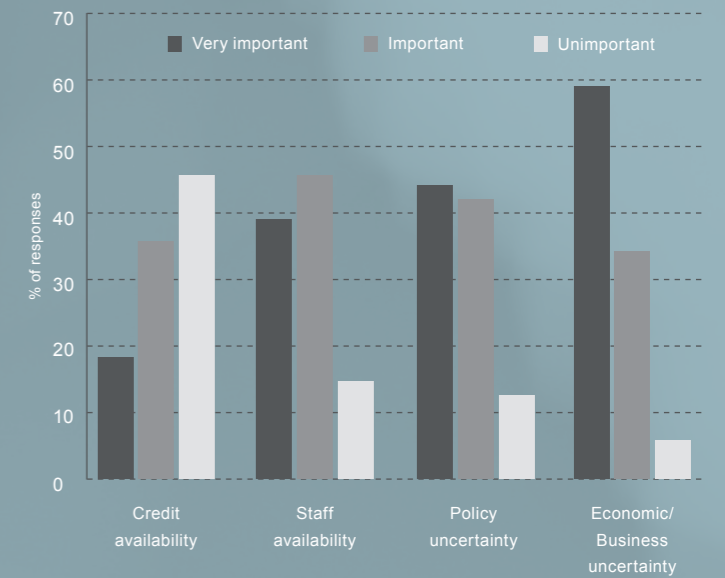


Source: Scottish Business Monitor

The majority of businesses (71%) expect costs to increase further over the next 6 months, with under 2% of businesses expecting total costs to fall and around 27% no change.

Uncertainty key concern facing Scottish businesses in near future

Unsurprisingly – but still a concern – we find that uncertainty is the key worry for businesses in the near future.



Source: Scottish Business Monitor

Businesses have been reporting changes in capital investment

Low growth in capital investment by businesses is one of the chief impacts of this uncertainty.

Since 2017, the net number of firms reporting increases in capital investment has stayed negative and below the 2014 – 2019 average. Data on expectations for the next 6 months suggests that capital investment growth will remain slow over the period.

CHART 7: BUSINESS CAPITAL INVESTMENT, 4Q MOVING AVERAGE



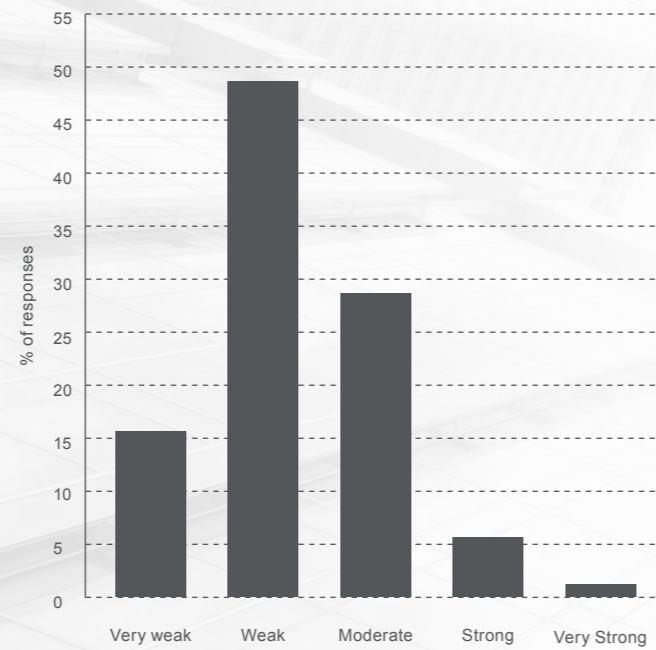
Source: Scottish Business Monitor

Of course, there is a large degree of variation in capital investment. For instance, signs have been pointing to investment picking up in the oil and gas sector.

Business expect that Scotland's economic growth will slow over the next 12 months

With such uncertainty, growth expectations amongst Scottish businesses remain fragile.

CHART 8: GROWTH EXPECTATIONS (NEXT 12 MONTHS VS. PREVIOUS 12 MONTHS)



Source: Scottish Business Monitor

BREXIT

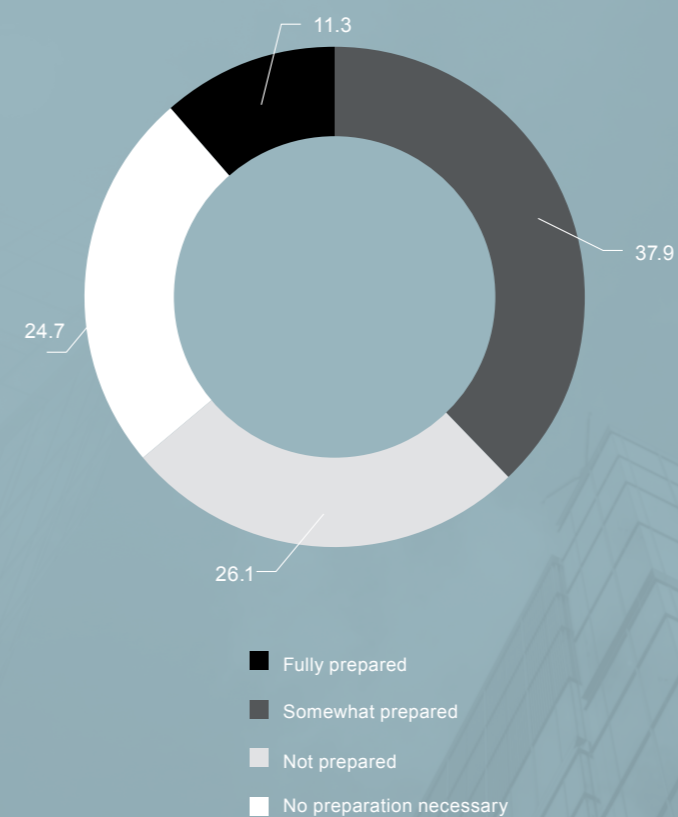
Brexit clearly remains the dominant factor influencing business decisions at the current time.

Brexit 'no deal' preparations on the rise

In previous Business Monitors, we have highlighted concerns around the lack of preparation for Brexit – and particularly a 'no deal' Brexit – amongst Scotland's business community.

As the chart below highlights, the Q3 2019 Business Monitor highlights the pick-up in preparatory work for a 'no-deal' Brexit.

CHART 9: PREPARATION FOR A 'NO-DEAL' BREXIT



Source: Scottish Business Monitor

Whilst just over 10% of Scottish businesses are fully prepared for 'no deal', a further 38% are somewhat prepared.

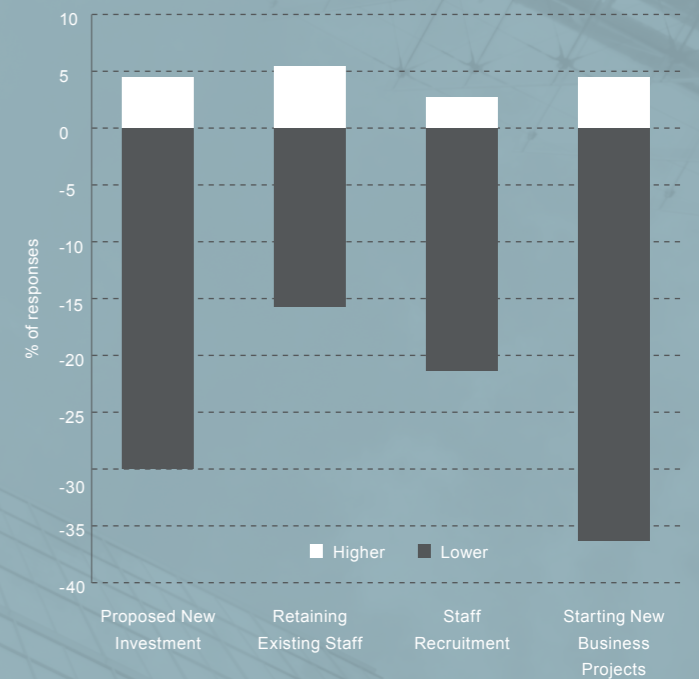
Only around one quarter of businesses are 'not prepared'.

A significant number of firms have been impacted by the ongoing uncertainty

To better understand what activities may be being impacted by Brexit preparations, we asked businesses what action that they had taken to get ready.

Of those that responded, we found that – in the main – the biggest reactions had been in the form of long-term planning and investment.

Around 30% of respondents indicated that they have scaled back new investment.



Source: Scottish Business Monitor

Of all respondents, over 35% of businesses have indicated that they have taken action to scale back new business projects.

Whilst a smaller number have scaled back staffing levels, the impacts are less severe than for investment.

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