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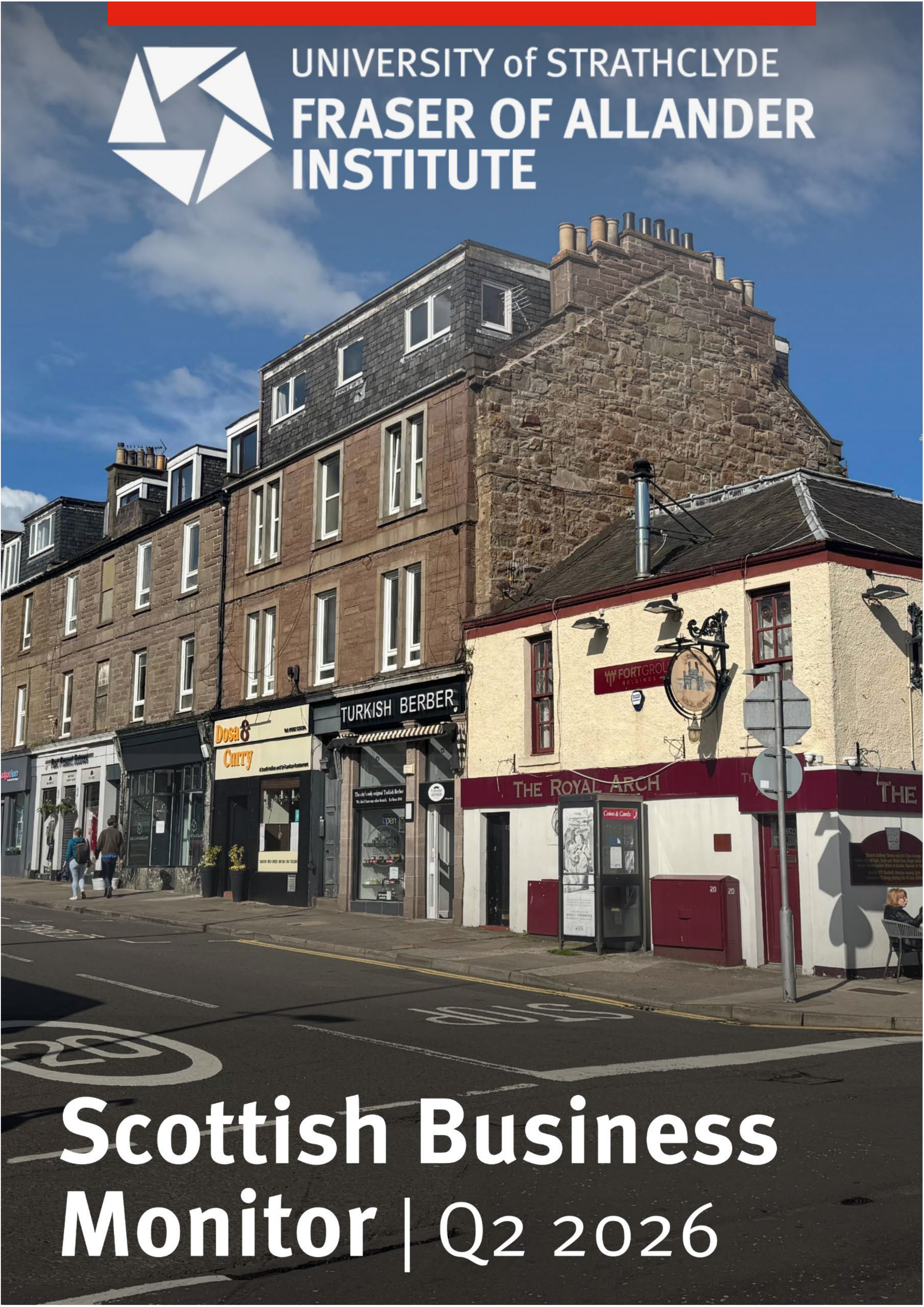

Scottish Business Monitor | Q2 2026

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The analysis in this report has been conducted by the Fraser of Allander Institute (FAI) at the University of Strathclyde. The FAI is a leading academic research centre focused on Scotland's economy.

The analysis and writing-up of the results was undertaken independently by the FAI. The FAI is committed to providing the highest quality analytical advice and analysis. We are therefore happy to respond to requests for technical advice and analysis. Any technical errors or omissions are those of the FAI.

Summary

Scottish businesses show signs of improved sentiment as AI use spreads across the economy.

This wave of the Scottish Business Monitor (SBM) sampled over 300 firms in June from all 32 local authorities across Scotland's economy.

Almost two-thirds of Scottish businesses are now using artificial intelligence, with a majority of firms in every major sector reporting use of the technology for the first time, according to the latest Scottish Business Monitor produced by the Fraser of Allander Institute, at the University of Strathclyde.

AI use remains highest among Service-sector firms, at 72%, but has now also passed the halfway mark in Construction, at 55%, and Manufacturing and Production, at 54%. This is the first time a majority of firms across all broad sectors have reported using AI, suggesting that the technology is becoming increasingly widespread across the Scottish economy.

Among businesses already using AI, 94% reported using it for day-to-day tasks. Around three-quarters also said they used AI for role-specific tasks, graphic design and branding, specialist advice and business planning, while around seven in ten used it to support decision-making and future planning.

However, while AI adoption is widespread, most firms are not yet using the technology intensively. Across all business activities, firms were more likely to report low or moderate use of AI than significant use, indicating that for many businesses the technology remains a supporting tool rather than something deeply embedded across their operations. Many firms now use AI, but most are still doing so in a relatively light-touch way.

The quarterly survey also examined business sentiment in Q2 2026 and the outlook for the year ahead. It found:

- Businesses have become somewhat less pessimistic about the economic outlook. The share expecting very weak growth over the next 12 months fell to 27%, from 34% in the previous quarter. However, only 2% expect growth to be strong or very strong.
- Overall business sentiment rose to a net balance of 10%, above the post-pandemic average, while sales, new business activity, turnover, and employment all improved compared with the previous quarter.
- Firms continue to report exceptionally high levels of concern about economic and political uncertainty, with 98% identifying economic and business uncertainty as a significant concern and 94% citing political uncertainty. These concerns now rank above more traditional business constraints such as staffing availability and access to credit.
- Cost pressures remain widespread, although there are some signs of moderation. 86% of firms reported higher overall business costs during the quarter, while 88% expect costs to rise over the next six months. Both figures were lower than in the previous quarter.

Adoption & Usage of Artificial Intelligence (AI)

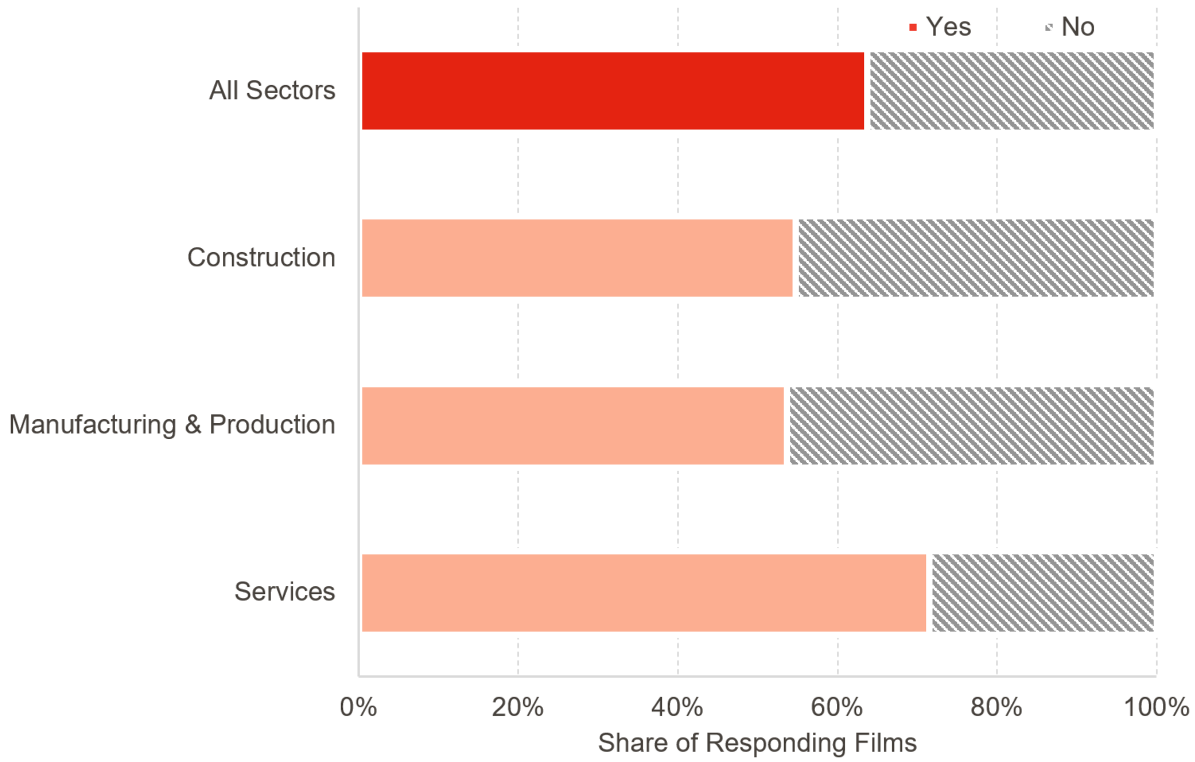
AI use becomes widespread across Scottish businesses.

AI adoption increased substantially this quarter, with 64% of firms reporting use of the technology, up from around half in the previous quarter.

Adoption remains highest among Services firms (72%), and now exceeds 50% in every sector, including Construction (55%) and Manufacturing & Production (54%). This marks the first time a majority of firms across all sectors have reported using AI and suggests that adoption is becoming increasingly widespread across the Scottish economy, and is no longer concentrated in service-based or digitally focused businesses.

However, as the Scottish Business Monitor is conducted electronically, results may be skewed towards more digitally engaged firms.

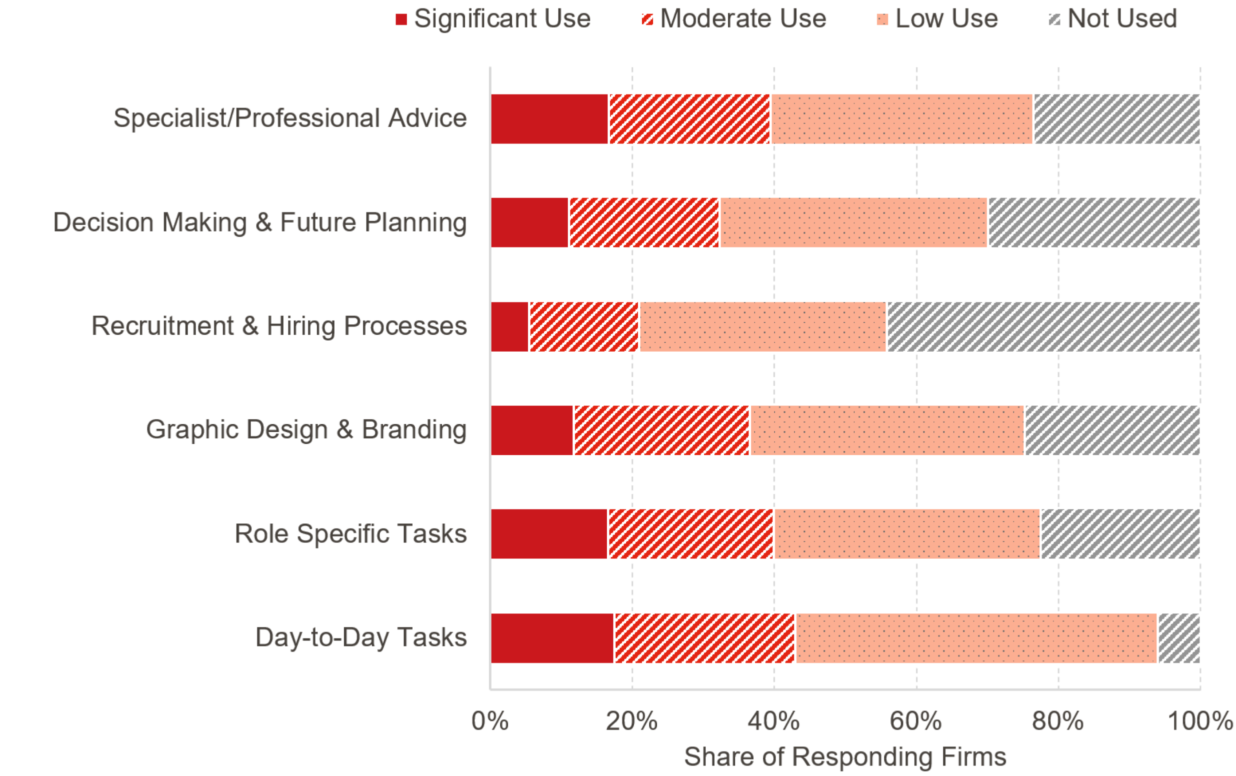
Chart 1: Use of AI, by Sector, in the Previous 3 Months, 2026Q2*



**Sectors aggregated to Construction, Manufacturing and Services*

Source: Scottish Business Monitor

Chart 2: Use of AI by Workplace Activity in AI-using firms*, 2026Q2



**Firms who answered 'Yes' in Chart 2*

Source: Scottish Business Monitor

Unsurprisingly, our results show that among firms already using AI, day-to-day tasks remain by far the most common use, with 94% reporting at least some use in this area. This represents the clearest route through which AI can improve productivity by reducing time spent on routine administrative activities.

AI has also become widespread across a range of other business functions. Around 3 in 4 firms report using AI for role-specific tasks, graphic design & branding, specialist advice, and business planning. Around seven in ten also use it to support decision-making and future planning.

Across every activity, low use is the most common response. Significant use remains limited, with fewer than one in five firms reporting heavy use even for day-to-day tasks, specialist advice and role-specific work. This suggests AI is mainly being used as a supporting tool rather than being deeply embedded in business operations.

Recruitment and hiring stands out as the least developed area, with 44% of AI-using firms not using it at all and only 5% reporting significant use. This suggests businesses remain selective about where AI can be trusted to support decision-making in areas involving sensitive information or decisions that directly affect people.

Overall, the findings show a clear difference between AI adoption and AI intensity: many firms now use AI, but most are still doing so in a relatively light-touch way.

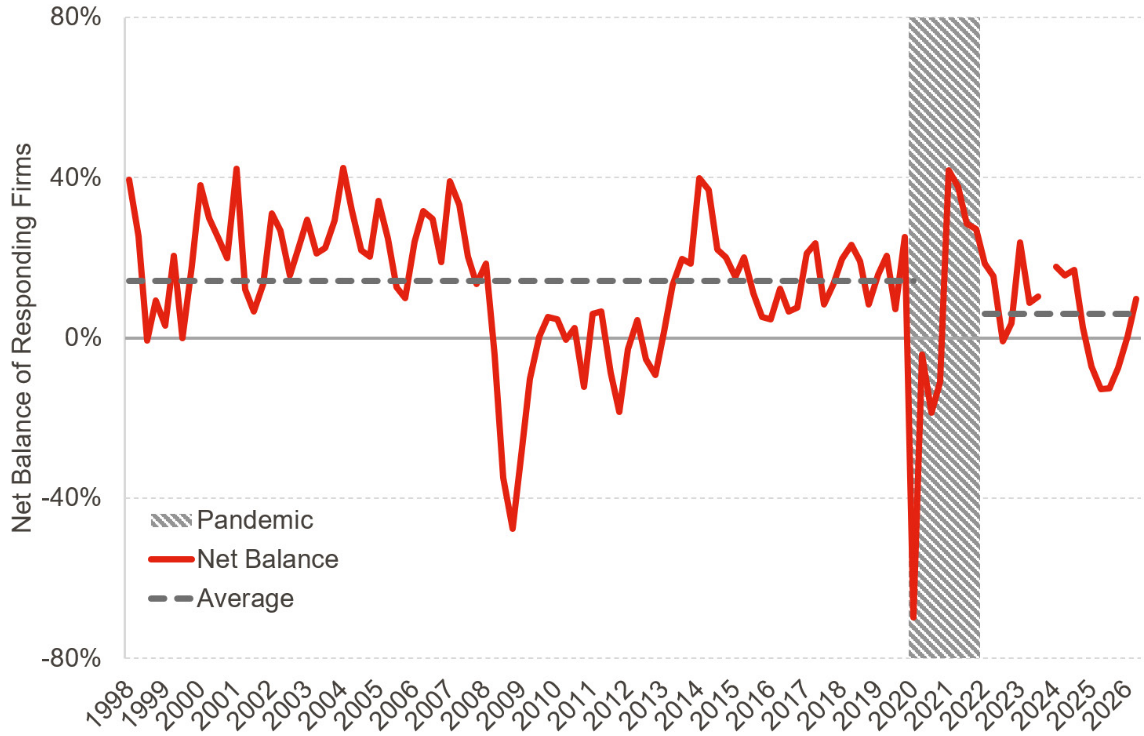
Headline Indicators

Scottish business conditions show signs of stabilising, but weak investment and exports continue to hold back growth.

Overall, business activity improved across four of the six headline indicators this quarter. Business confidence also increased to 9.7%, above the average recorded since the pandemic.

Although all six indicators remain in negative territory for the 7th quarter in a row, the overall picture is showing some positive signs. Improvements in sales, new business, turnover, and employment suggest Scotland's business environment is beginning to stabilise after the significant challenges experienced throughout much of 2025.

Chart 3: Net balance of firms expecting increased sales in the next 6 months, 1998Q1 – 2026Q2



Source: Scottish Business Monitor

The volume of business activity (sales) increased by 4.2 points to a net balance of -7.4%, while the volume of new business activity improved by 4.1 points to -9.6%. Improvement in both indicators suggests demand conditions have strengthened over this quarter, providing tentative evidence that underlying business activity is recovering.

Similarly, the value of business activity (turnover) rose by 6.3 points to a net balance of -7.8%. The improvement in both sales volumes and turnover is encouraging and suggests that the increase in business activity is not solely the result of inflation and higher prices. However, rising costs remain a significant challenge for Scottish businesses and are explored later in this report.

The net balance of employment levels has risen from -12.4% to -8.1%. Although still negative, this continues the gradual improvement seen since the start of the year and suggests firms are becoming less cautious about staffing levels.

However, not all indicators improved. New capital investment declined slightly, falling 0.8 points to a net balance of -19.9%. Continued investment weakness, despite broader improvements in business conditions, suggests firms remain reluctant to make longer-term commitments. This is important because business investment helps firms expand and become more productive and is therefore a key mechanism for economic growth.

This wave of the SBM was conducted during a period of heightened political uncertainty, following the Prime Minister’s announcement that he would be stepping down. As discussed later in this report, political and economic uncertainty continues to play an important role in shaping business decisions.

Exports also weakened further this quarter, falling to a recent low of -26.6%. This suggests international pressures and challenging trading conditions continue to create difficulties for Scottish businesses.

Despite the overall improvement across the indicators, most businesses reported no change in activity. The rise in net balances therefore reflects fewer firms reporting declines, rather than widespread growth. This is indicative of the Scottish business environment becoming more stable, but still far from showing signs of sustained economic growth.

Table 1: Net balance of firms experiencing increased activities over the past 3 months

	2024		2025				2026	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Volume of Business Activity (i.e., Sales)	-0.8	-8.8	-20.7	-12.8	-12.3	-8.6	-11.6	-7.4
Volume of new business activity	-1.4	-18.0	-27.4	-13.4	-16.0	-14.0	-13.7	-9.6
Value of business activity (i.e. turnover)	3.4	-7.9	-16.2	-10.3	-11.4	-14.6	-14.1	-7.8
Level of employment in your business	3.9	-8.3	-18.3	-9.9	-8.5	-13.9	-12.4	-8.1
Level of new capital investment	-5.4	-21.6	-26.6	-18.6	-20.4	-25.0	-19.1	-19.9
Export activity	-11.3	-17.2	-16.6	-25.3	-16.6	-20.7	-22.4	-26.6

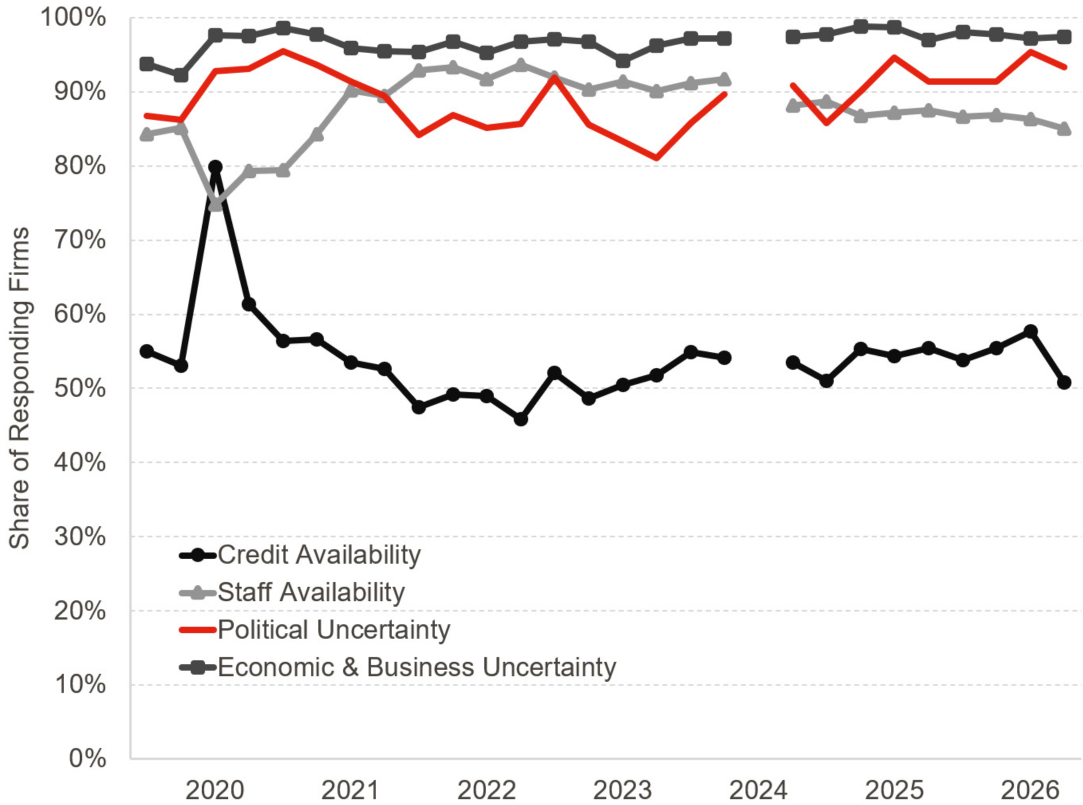
** Net Balance is defined as the share of firms reporting ‘higher’ minus the share reporting ‘lower’*

Source: Scottish Business Monitor

Business Concerns & Uncertainty

A decade of economic and political uncertainty weighs on the willingness of Scottish businesses to commit to investment decisions.

Chart 4: Businesses Concerns, by Factor, for the next 3 months, 2019Q3 – 2026Q2



Source: Scottish Business Monitor

Economic uncertainty remains the most significant concern for Scottish businesses, with 97.7% of firms identifying it as important or very important for the next 3 months. Political uncertainty is similarly prominent, cited by 93.3% of firms. Both continue to rank above constraints such as staff and credit availability. Neither has fallen below 80% since the question was introduced in 2019.

This is economically relevant because persistent uncertainty can weigh on investment decisions, with firms being more likely to delay or scale back investment when the economic outlook is unclear, even where financing conditions remain supportive. This is consistent with evidence from the Bank of England showing that investment can be particularly sensitive to uncertainty[1] .

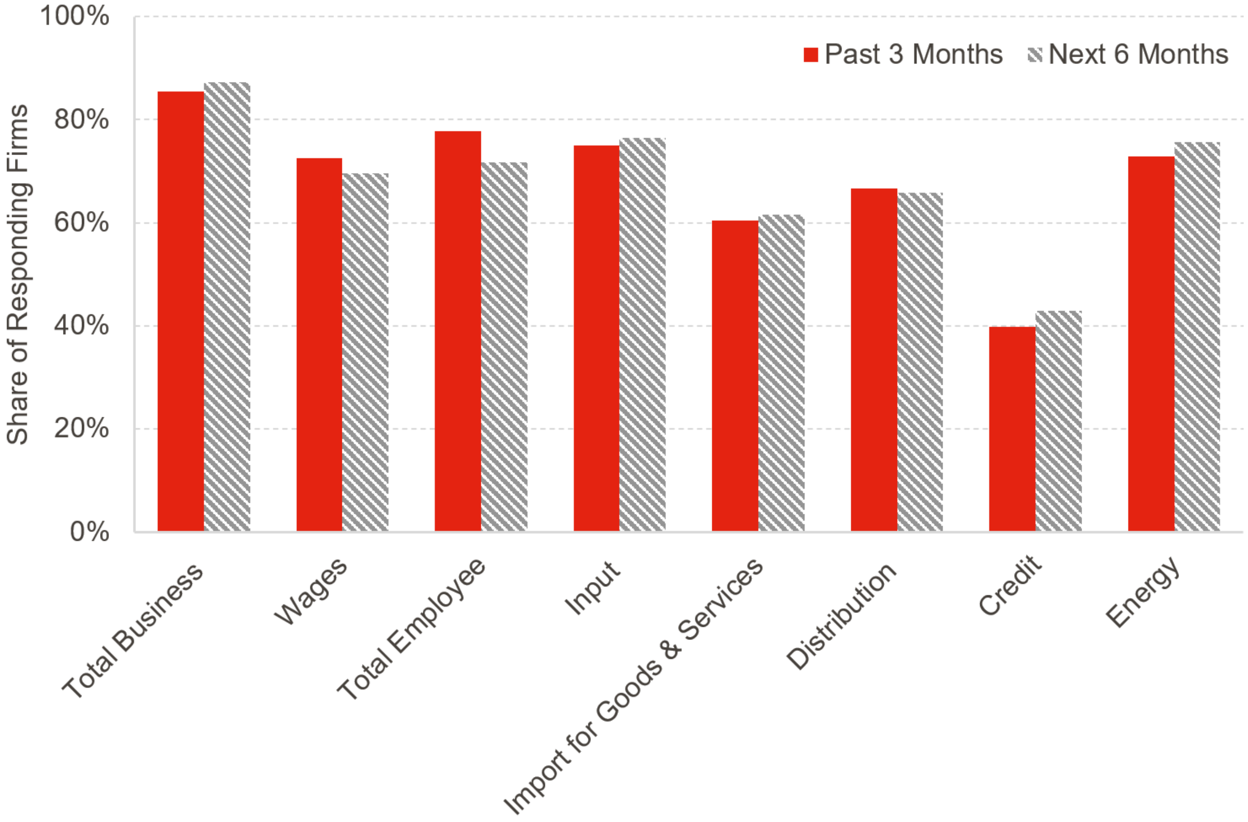
Taken together with few businesses identifying the cost of credit as a major constraint, these results suggest that uncertainty about future demand, policy and economic conditions is having a greater influence on investment decisions than more conventional constraints. While business activity, employment, and sentiment improved this quarter, elevated uncertainty may continue to restrain investment and limit the pace of Scotland's longer-term economic growth.

[1] Bank of England, 2018, BoE | Cost of Capital and Uncertainty

Cost Pressures

Cost pressures are expected to persist through the remainder of the year, despite some signs of moderation.

Chart 5: Current and Anticipated Cost Pressures, 2026Q2



Source: Scottish Business Monitor

Cost pressures remain intense across Scottish businesses, with 85.5% of firms reporting increased overall business costs this quarter and 87.3% expecting costs to rise over the next six months. However, both measures have eased from the previous quarter, when 89.0% of firms reported rising costs and 95.1% anticipated further increases. This decline may point toward a welcome but gradual moderation in cost pressures.

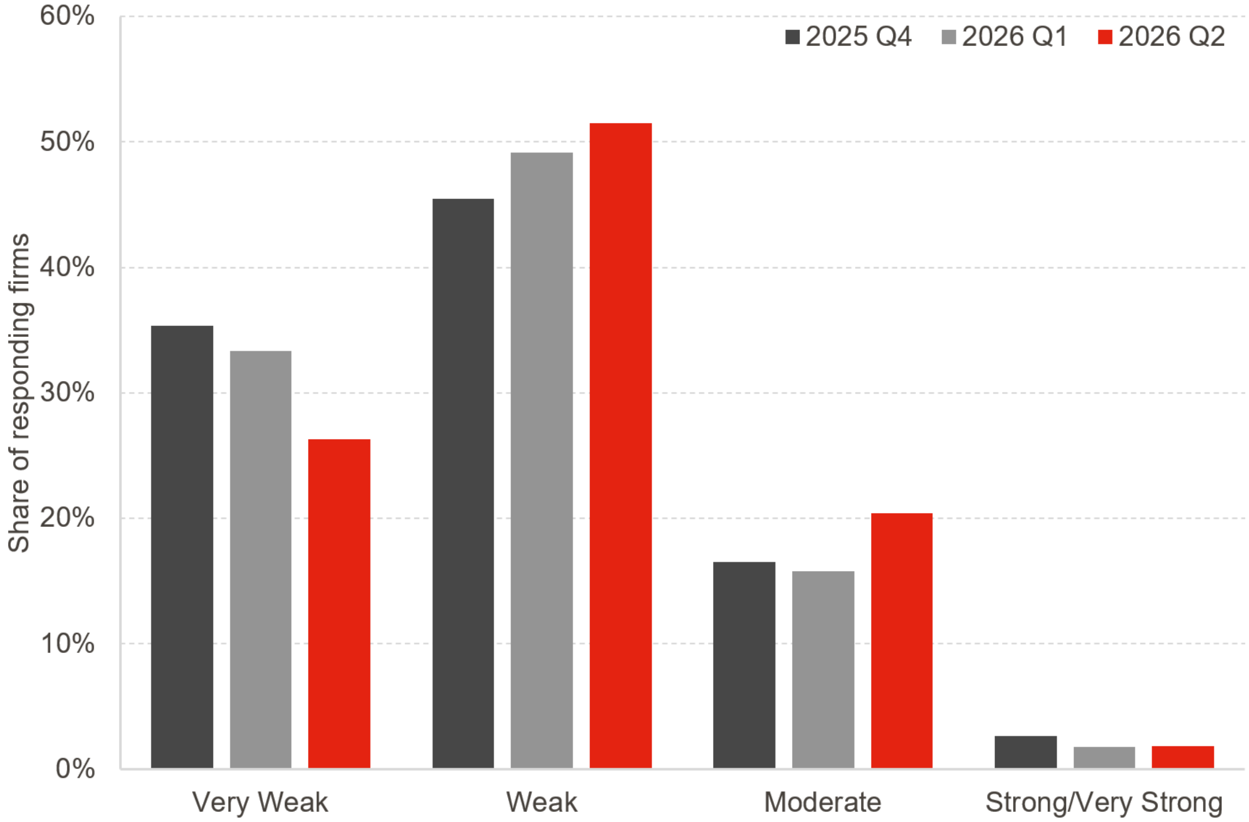
Energy costs remained the most cited component of cost pressure, despite falling by 6.3 points from last quarter. Total employee costs and input costs also continued to be significant sources of pressure, although both eased compared with Q1, further pointing toward a moderation of cost pressures. Looking ahead, businesses expect these components to remain the main drivers of cost increases, with anticipated pressures generally exceeding firms' experience in this quarter.

Credit costs were cited as a pressure by fewer than two in five firms, making them the least significant cost component. This aligns with evidence elsewhere in this report, suggesting high borrowing costs do not explain current weakness in new capital investment.

Economic Outlook

Businesses have become less pessimistic about prospects for growth in Scotland's economy.

Chart 6: Economic Growth Expectations for the next 12 months, 2025Q4 – 2026Q2



Source: Scottish Business Monitor

Expectations for business growth over the next 12 months improved this quarter, continuing the gradual strengthening seen since 2025 Q3. The share of firms expecting *very weak* growth fell to 26.3%, down from 33.3% in the previous quarter and 35.2% in 2025 Q3.

This improvement reflects a gradual movement in expectations from *very weak* to *weak* growth, and from *weak* to *moderate* growth with the proportion of firms anticipating *moderate* growth increasing to 20.4%. Meanwhile the share expecting *weak* growth rose to 51.5% as fewer firms reported the most pessimistic outlook.

However, there has been little movement into the most positive category, with only 1.9% of businesses expecting growth to be *strong* or *very strong* over the coming year.

While expectations remain subdued, the shift away from *very weak* growth expectations is consistent with the recent improvement in business activity, employment and confidence indicators reported elsewhere in this survey. Nevertheless, elevated economic and political uncertainty combined with persistent cost pressures may continue to constrain firms' expectations for stronger growth.