Performance of the Scottish Economy - Written Evidence
About the Scottish Chambers of Commerce Network

Scottish Chambers of Commerce (SCC) is Scotland’s largest business network. SCC brings the views of the business community together, forming a clear and powerful expression of Scottish business opinion through its network of 26 accredited Chambers of Commerce, representing 11,000 members.

Introduction + Broader Economic Context

This briefing document is intended to provide some context on the general performance of the Scottish economy, as illustrated by the network level data we hold, collected via the Quarterly Economic Indicator survey.

For some general background in Scottish economic performance vs UK performance:

With the exception of a spike in Q1, Quarterly GDP has tended to lag behind the UK.
This sluggish quarterly growth has also impacted in slower overall GDP increases than the UK as a whole, compared to the same time last year.

As illustrated by Fraser of Allander / ONS - GDP growth in the UK as a whole has also slowed across 2017.
In terms of industries, Services (+0.7%) and Agriculture, Forestry + Fishing (+0.6%) displayed growth. Meanwhile, Construction suffered a significant contraction (-3.5%), with Production also displaying negative growth (-0.7%).

This is illustrated above in the industries contributing to growth, with production + construction contractions offsetting growth in the services sector.
Employment for both the UK + Scotland has maintained at record high levels, which translates into rising reports of recruitment difficulties in our QEI data.

New employment figures have been provided since this analysis above, in the latest results, Scotland has demonstrated a deviation from this national trend, with a slight increase in the unemployment rate of 0.1%, and a fall in the number of economically inactive individuals. However, generally the market is in good health in terms of pure numbers.
In terms of business focused policy, it’s worth noting that there has been a sharp rise in self employment in Scotland over the past year, which ties in to a broader trend of increasing self-employment across the decade.

Finally, in a consumer driven economy like the UK, it is important that wages grow + consumers continue to have disposable income to drive the economy:

Recent wage data has pointed to continued wage decline in real terms - with inflation outpacing wage growth. In Scotland, this has been expressed as a real terms decline in wages by 0.2%.
Quarterly Economic Indicator Data

The Scottish Chambers of Commerce Quarterly Economic Indicator, conducted in conjunction with Strathclyde University's Fraser of Allander Institute, is Scotland's longest running business survey of its kind and regularly provides an accurate and authoritative picture of the health of the Scottish economy and the issues facing businesses across various sectors.

The QEI reports trend data for five key sectors:

- Financial & Business Services (includes Oil & Gas)
- Manufacturing
- Retail & Wholesale
- Construction
- Tourism

Our most recent QEI asked businesses around their perceptions of economic conditions in the third quarter of 2017. Fourth quarter research fieldwork has just completed, and provisional data on these results can be provided to the committee in January 2018.

The QEI uses a net % balance methodology to display trend data, outlined below:

- 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.

The main themes from this report is very much in line with the broader economic narrative, that while the current situation is fragile, growth and positivity is still present in most of our analysed sectors.

The majority of sectors are comparatively positive overall this quarter in terms of key economic indicators and sentiment for this specific quarter.

However, across the sectors, there are some developing concerns in areas such as recruitment. Furthermore, specific sectors such as retail & wholesale are encountering profoundly changing operating environments - for example, increasing competition from e-commerce vendors, which is impacting on their financial performance.

In terms of individual sectoral performance:
Retail & Wholesale:

Retail & Wholesale is experiencing some significant difficulties this quarter, following a significant period of change and challenging conditions.

Some of the key concerns in this sector include:

- Domestic revenue in retail has remained at a continuous negative net % balance since Q1 2017.
- Cashflow has been at a negative net % balance since Q3 2015
- Profitability has remained at a negative net % balance since Q4 2015.

There is positivity in some of the findings, with rUK and export sales at positive % balances.

The outcome of this is a higher % balance of businesses seeking to raise their prices than we have observed in the same quarters in both 2015 and 2016, though this remains slightly less than observed in Q2 2017.

Business Sentiment in Retail:

When compared to the group average, respondents from our retail sector have broadly been less optimistic in comparison to the long-term average for Scottish businesses generally.

Despite a rise over the third quarter of 2017, optimism for retailers remains in negative territory. The results in Q4 will be crucial to understand the long-term trend here, as generally retailer optimism tends to improve in this period as it encompasses the prime retail season.
Profitability in Retail:

As with sentiment, profitability in retail is also cyclical - with several rises towards positive territory in the Q4 period. In contrast to the other analysed sectors, retail did not see an improvement in profitability across Q2, and this has remained in negative territory in Q3.

One of the main positives is in relation to online sales, which are at the highest level observed since Q3 2015. This may indicate the start of a more pronounced shift towards ecommerce and online sales as a revenue stream.

Generally, alongside declining domestic revenue, this trend emphasises the need for Scottish retailers to upskill themselves (supported by government) when it comes to ecommerce capability.

Financial and Business Services:

Financial and Business Services organisations are optimistic, with the % balance fig of 13.9 significantly above that observed in the same periods in 2015 + 2016.
Long term sales trends are positive, with the results showing a steadily improving trend, pushing away from the last negative trend balance figures observed in Q2 2016. Total sales are now at the strongest level since Q4 2014. Linked to overall revenue, most of the businesses in this sector will be maintaining their prices at current levels, with only 8% seeking to lower prices based on this data.

Further to this strong revenue, profitability in FBS is in positive % balance territory for the first time since Q1 2015, in addition to cashflow figures maintaining at a positive % balance.

Following on from these positive financial performance indicators, businesses in the sector are looking to significantly increase investment, both in capital and in training. In this context, credit applications across the sector have almost doubled, from 7% in Q2 to 13% in Q3.

Concerns:

The main concern in the FBS sector centred around recruitment difficulties, with 32% of businesses experiencing recruitment difficulties. Although this is lower than Q2, it is in line with higher reported recruitment difficulties for a number of years across this sector.
To provide some context, in Q3 2015, only 18% of businesses reported difficulties in recruiting.

**Construction:**

The Construction Industry has displayed a more mixed / subdued picture, but still positive in a number of areas:

- Optimism is steadily rising, although has yet to return to the peak observed in Q2 2016.

![Business Optimism in Construction](image1)

- Private commercial orders up significantly from both the previous quarter and the previous period

![Private Commercial Orders - Construction](image2)

- Work in progress slightly lower than same period last year, but Q3 2017 is the highest figure by far since Q3 2016.

- Training investment figures were outlined as a concern in subsequent analysis by the Fraser of Allander Institute. The figures recorded for training investment in
both Q2 (6.1) + Q3 (8.3) 2017 were in single digit % balance figures. Levels this low have not been observed since at least Q4 2014, with the average net % balance figure usually recorded at approximately 25.

QEI Q3 construction results are somewhat of an anomaly in relation to comparable datasets which broadly point to more negative business conditions in construction. Recent PMI data found that at a UK level, construction had contracted - with the first drop in overall business activity since 2016, and the sharpest drop in civil engineering work since April 2013.

Our results did display a significant drop in public sector orders (which have been at a negative or neutral balance since Q3 2016). Furthermore - although Scotland sales observed an increase, Rest of UK sales are at their lowest level since Q1 2015 - dropping to a negative net % balance for the first time in 2017.

Manufacturing:

The manufacturing industry was broadly positive, though with some caveats, especially in terms of key financial indicators.

- Optimism holding steady at positive % balance, in comparison to falling into negative territory in same period last year.
• With the exception of export orders, all order metrics improved in comparison to Q3 2016.

The majority of financial metrics remained positive in Q3 2017, however cashflow has dropped to negative territory for the first time this year. Profitability has also observed a significant decrease from Q2.
Unlike the majority of sectors, Manufacturing observed a decline in recruitment difficulties, which are now sitting slightly below trend, although it is worth highlighting that this followed several quarters of record high recruitment difficulties for the sector.

**Tourism:**

Within our Q3 results, Tourism stands out as one of the more positive sectors, with improved financial performance, driven by rising guest numbers.

- Growth in number of guests both domestically, from rUK and from outside the EU.
As can be observed, the percentage balance increase in guests from outside the UK is rising significantly faster than the domestic market, suggesting that currency effects may be making the UK comparatively more attractive as a destination for these groups.

- Significant increase vs previous quarter in number of businesses applying for credit, perhaps linked to increased investment expenditure. Credit applications are up from 11% of the sample in Q2 to 23% in Q3 2017.

- Cashflow has improved against both the previous period + previous quarter.

- Recruitment difficulties are rising, although they have not returned to the prior peak observed in Q2 2016.

Generally, recruitment difficulties in the tourism sector maintain at higher levels than those found in other sectors, such as financial and business services. The current net % balance figure of 65 is significantly above trend, and Q4 data will be critical to determine if this trend will continue (allowing for seasonal variation).

Qualitative evidence collected from members, as part of the SCC response to the Migration Advisory Committee, suggested that members in tourism were beginning to encounter increased difficulties recruiting EEA workers to fulfil seasonal demand, even amongst members with well-established recruiting networks in EEA countries.

Given the slowing (but still net positive) migration observed in the most recent migration figures, there remains concern as to how this will impact already high levels of recruitment issues throughout our membership.
Summary

Our third quarter Quarterly Economic Indicator results point to a fragile, but growing Scottish Economy. The retail & wholesale sector stands out as a sector which is in the midst of adapting to a rapidly changing environment, as consumer preferences shift towards e-commerce and high streets shift from primarily retail to an emphasis on experiences.

The continuing concern, especially with the current debate around migration & skills, is the persistence of above trend recruitment difficulties in many of our analysed sectors.

With migration slowing, in addition to the currently predicted fall in the working age population across Scotland, businesses continue to experience difficulties in finding the right staff across the breadth of the economy. This is also highlighted by the record high vacancies displayed in the latest labour market figures.

With this in mind, it is critical that the Scottish and UK Governments continue to emphasise Scotland as attractive place to work, and that a future system of migration recognises the current challenges in the labour market.

Furthermore, the challenge in recruiting specific occupations (engineers were routinely mentioned in qualitative feedback) - suggests clear directions for future skills investment.

An ambitious approach in the upcoming Enterprise & Skills review can provide a foundation for this, with a focus on technical skills, and areas such as e-commerce, to provide Scottish businesses with the right talent to meet the challenges of the future.

SCC is happy to provide further data to the committee. Results from our Q4 research will be available in early January and we will circulate a copy of our Q4 Quarterly Economic Indicator report to the group upon release.

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