SCOTTISH BUSINESS MONITOR

Q1 2023

ADDLESHAW GODDARD

MORE IMAGINATION MORE IMPACT

INTRODUCTION

THIS REPORT SUMMARISES THE KEY RESULTS FROM OUR LATEST FRASER OF ALLANDER (FAI) SCOTTISH BUSINESS MONITOR, PUBLISHED IN PARTNERSHIP WITH ADDLESHAW GODDARD.

The survey sampled 400 firms in April from across the Scottish economy, examining business sentiment in Q1 2023 and the outlook and expectations for the year ahead.

The majority of sectors reported an improvement in their volume of business this quarter compared to Q4 2022, with the exception of transport and storage firms. Business sentiment has also improved significantly since last quarter and is now at its highest level since the end of 2021.

Overall, the outlook of firms has improved since the beginning of 2023. Last quarter, more than 75% of firms expected growth in the Scottish economy over the year to be weak or very weak. This quarter, **62%** are expecting weak/very weak growth.

OUR SURVEY RESULTS ALSO SHOW THAT:

- The proportion of Scottish firms anticipating reduced operations this year due to higher energy bills decreased to **39%** this quarter from almost **50%** last quarter. However, despite improvements, **50%** of hospitality firms still expect to reduce their operations this year due to their energy costs.
- When asked whether or not the UK Government's Energy Bills Discount Scheme, which replaced the Energy Bills Relief Scheme on 1st April, will adequately support their business in the next year. Only **8%** of responding businesses felt it would, while **37%** felt that it would not. **60%** of hospitality firms reported that the discount scheme would not adequately support them over the next year.
- Inflationary pressures continue to show signs of easing, despite headline inflation estimates across the economy remaining stubborn. However, the majority of firms (**69%**) still expect their prices to increase by more than normal over the next year.
- Supply chain issues seem to also be easing for Scottish businesses. Just **30%** of businesses reported that they were finding it difficult to purchase goods and services – down from **41%** of businesses last quarter. However, firms citing prices as a driver of their supply chain issues has increased to **64%**. So, whilst inflationary pressures are easing slightly, prices are still high, making it difficult for firms to afford the inputs that they need.
- Firms continue to struggle with labour supply in filling vacancies however, firms are finding it less difficult to retain their staff. In Q4 2022, just over **25%** of firms reported difficulties retaining existing staff. This number has since decreased to **22%**.
- Employee costs and wages surpassed energy costs as the main cost drivers for businesses in the past three months. Scottish firms expect labour costs to be their main cost driver in the next six months, outweighing inflation, credit costs, and energy bills.

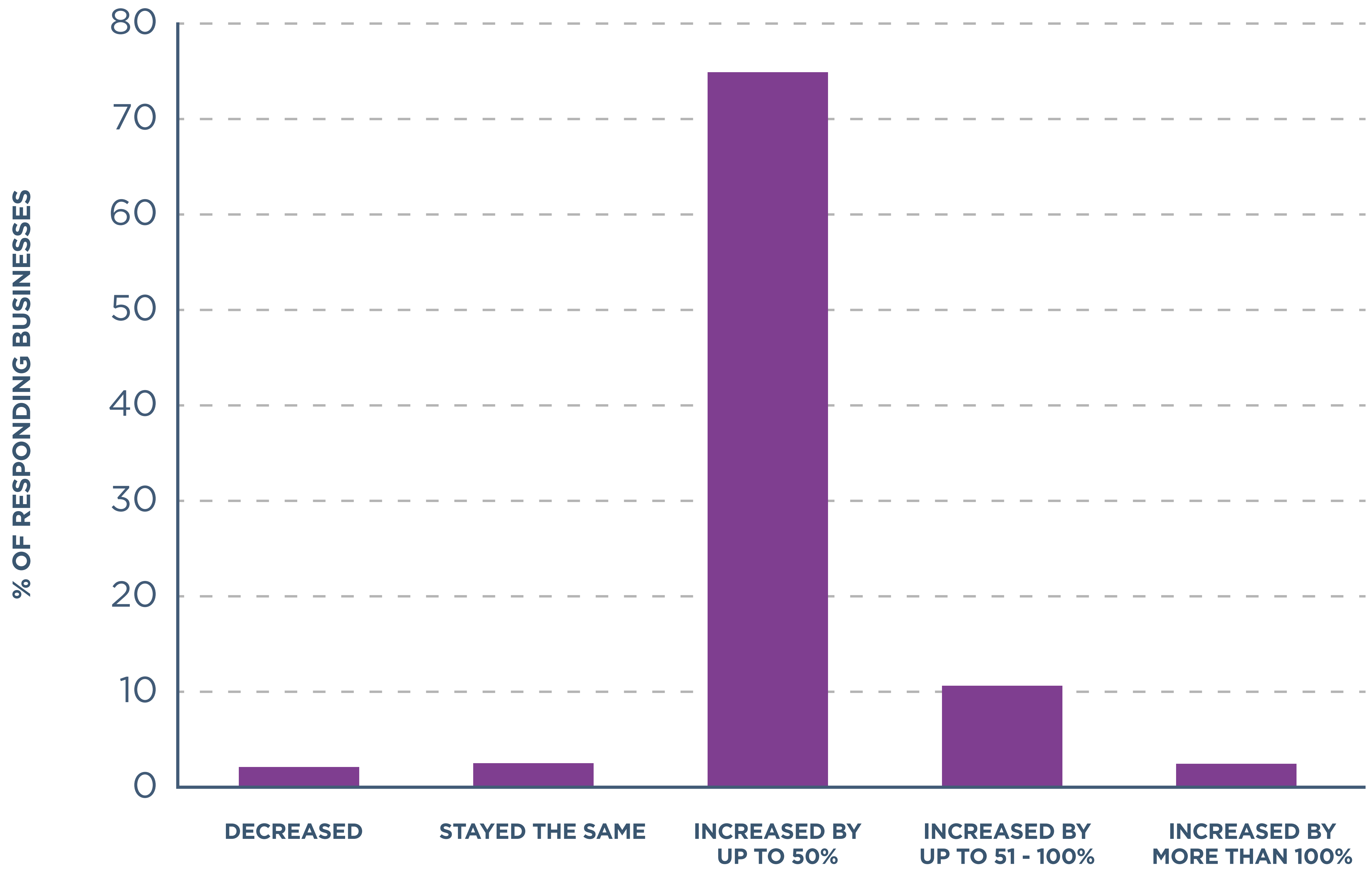
KEY RESULTS

BUSINESS COSTS

- This quarter we asked businesses across Scotland how their costs have changed over the past year.
- **85%** of firms in Scotland surveyed had experienced increased business costs, with the majority (**75%**) experiencing increased costs of up to **50%**.
- Accommodation & food service and the manufacturing sector have been significantly affected by rising business costs. More than a quarter of both industries have seen costs rise by more than **50%** in the past year.

Chart 1

Over the past year, roughly how have your business costs changed?



*11% of businesses responded N/A; therefore, percentages will not sum to 100%

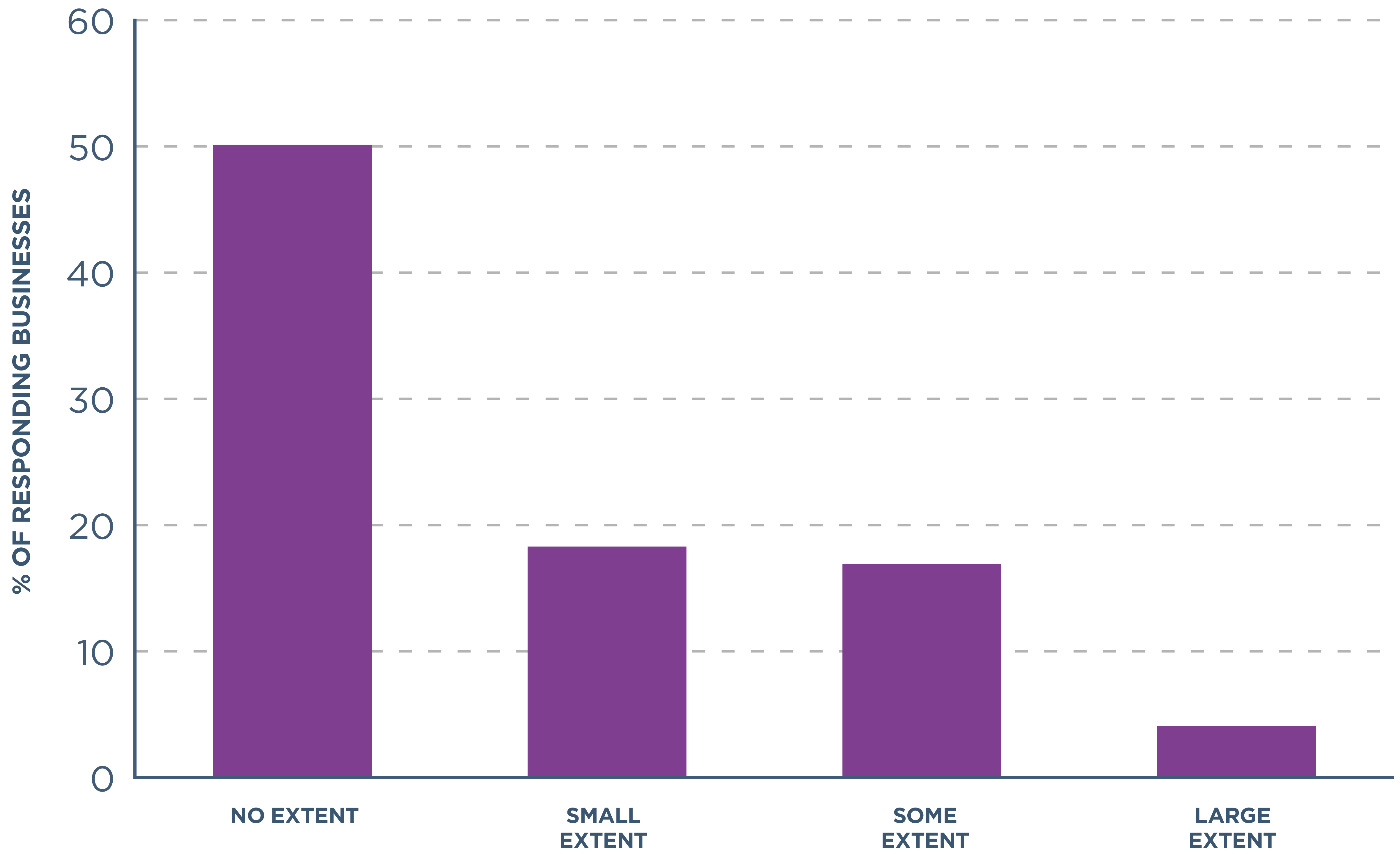
KEY RESULTS

ENERGY COSTS

- We continued to ask firms about energy costs and how this is expected to impact their operations.
- **39%** of businesses expected to reduce operations due to increases in energy prices. This is slightly more optimistic than last quarter when nearly half of all businesses expected a reduction in operations.
- Just over half of businesses in the hospitality sector expect to reduce operations due to high energy costs, bringing it in line with the Transport & Storage and Manufacturing sectors. This is an improvement compared to last quarter, when around **60%** of hospitality firms expected to reduce operations due to hikes in their energy bills.
- We also asked firms about whether or not the UK Government's Energy Bills Discount Scheme, which replaced the Energy Bills Relief Scheme on 1st April, will adequately support their business in the next year. Only **8%** of responding businesses felt it would, while **37%** felt that it would not.
- The Accommodation & Food Service sector was particularly pessimistic about the Energy Bills Discount Scheme, with around **60%** reporting that it would not adequately support them in the next year.
- The Professional Services and Construction sectors also felt more negatively than the rest of the economy about the discount scheme, with over **40%** of each sector responding that it was not sufficient.

Chart 2

To what extent do you expect to reduce operations this year due to increases in energy (electricity, gas, or fuel) prices?



*11% of businesses responded N/A; therefore, percentages will not sum to 100%

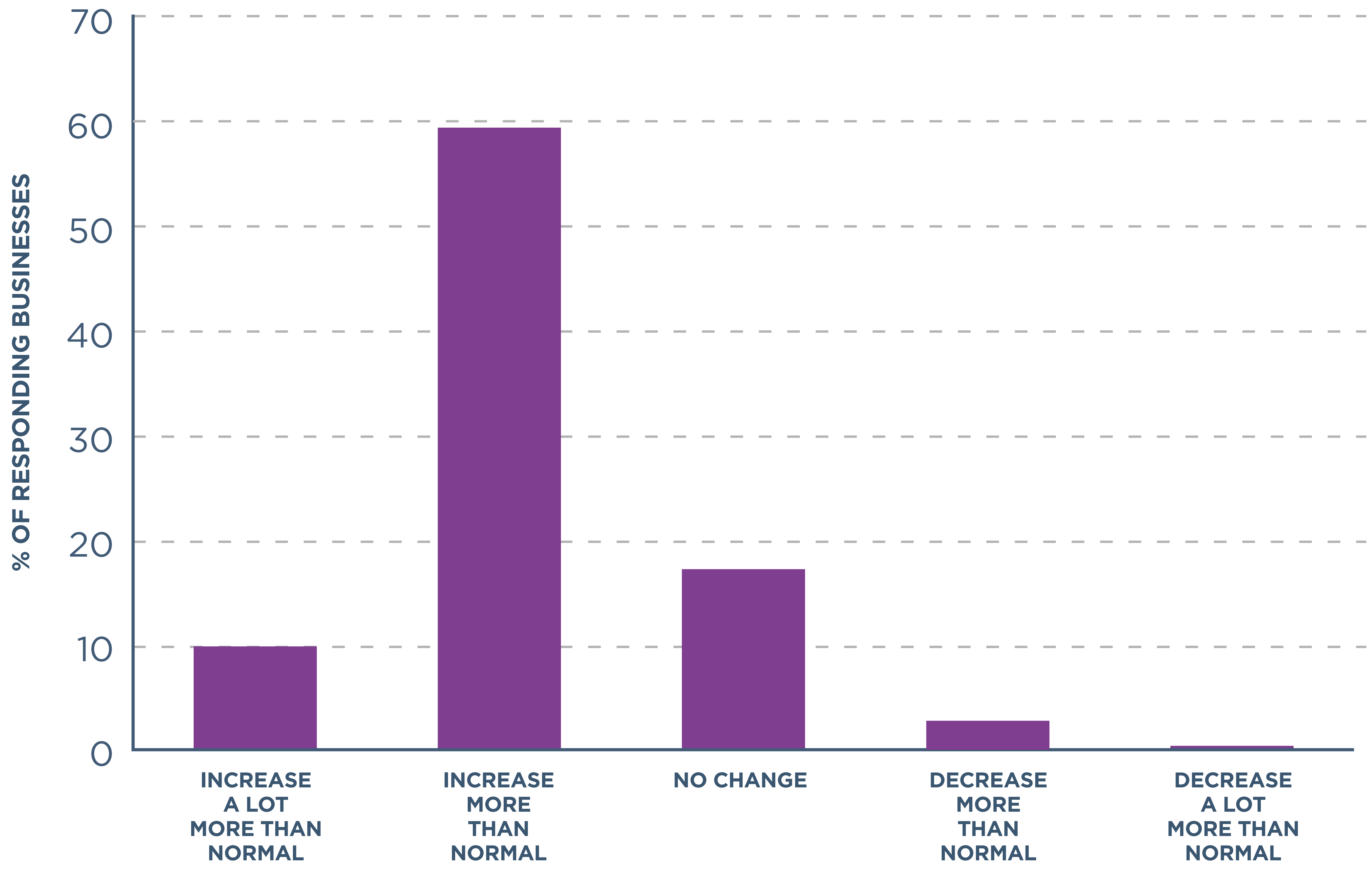
KEY RESULTS

INFLATIONARY PRESSURES

- Inflationary pressures continue to show signs of easing, despite headline inflation estimates across the economy remaining stubborn.
- Last survey, **81%** of firms said that they expect to increase their prices by more than, or a lot more than normal, over the next 12 months. This quarter, the share of firms reporting this fell to **69%**.
- **88%** of accommodation and food services firms expect their prices to increase, followed by **75%** of firms in the wholesale and retail sector. Although still high, this is a decrease from last quarter, when over **90%** of both industries expected price increases in the coming year.

Chart 3

Over the next 12 months, how do you expect the prices of your goods and services to change compared to normal?



*7% of businesses responded N/A; therefore, percentages will not sum to 100%

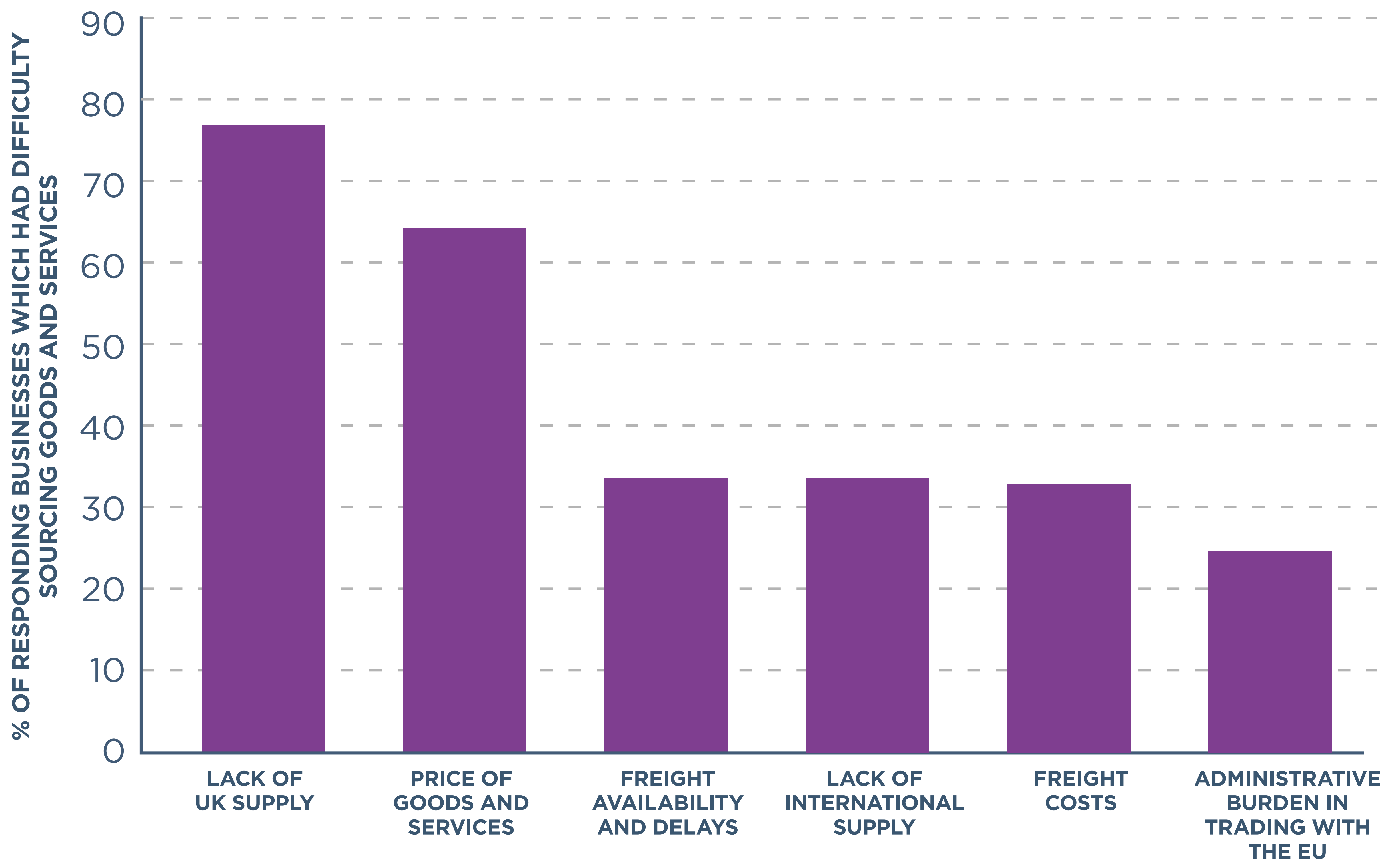
KEY RESULTS

SUPPLY CHAIN ISSUES

- Given ongoing supply chain challenges, we continued to ask firms about their experience sourcing goods and services.
- Supply chain issues seem to be easing for Scottish businesses. Only **30%** of businesses reported that they were finding it difficult, or very difficult, to purchase goods and services – down from **41%** of businesses last quarter.
- A lack of UK supply continued to be the most common factor affecting firms' ability to source goods and services, with **77%** of firms reporting this in the latest survey. This is consistent with last quarter.
- The price of goods and services is also severely affecting businesses, and has worsened since last quarter. **64%** of firms stated that price was a factor in sourcing goods and services, compared to **41%** last quarter.
- On the other hand, difficulties with freight costs, delays, and administrative burdens in trading with the EU have eased since last quarter.

Chart 4

What factors, excluding seasonality, are affecting your ability to source available goods and services?



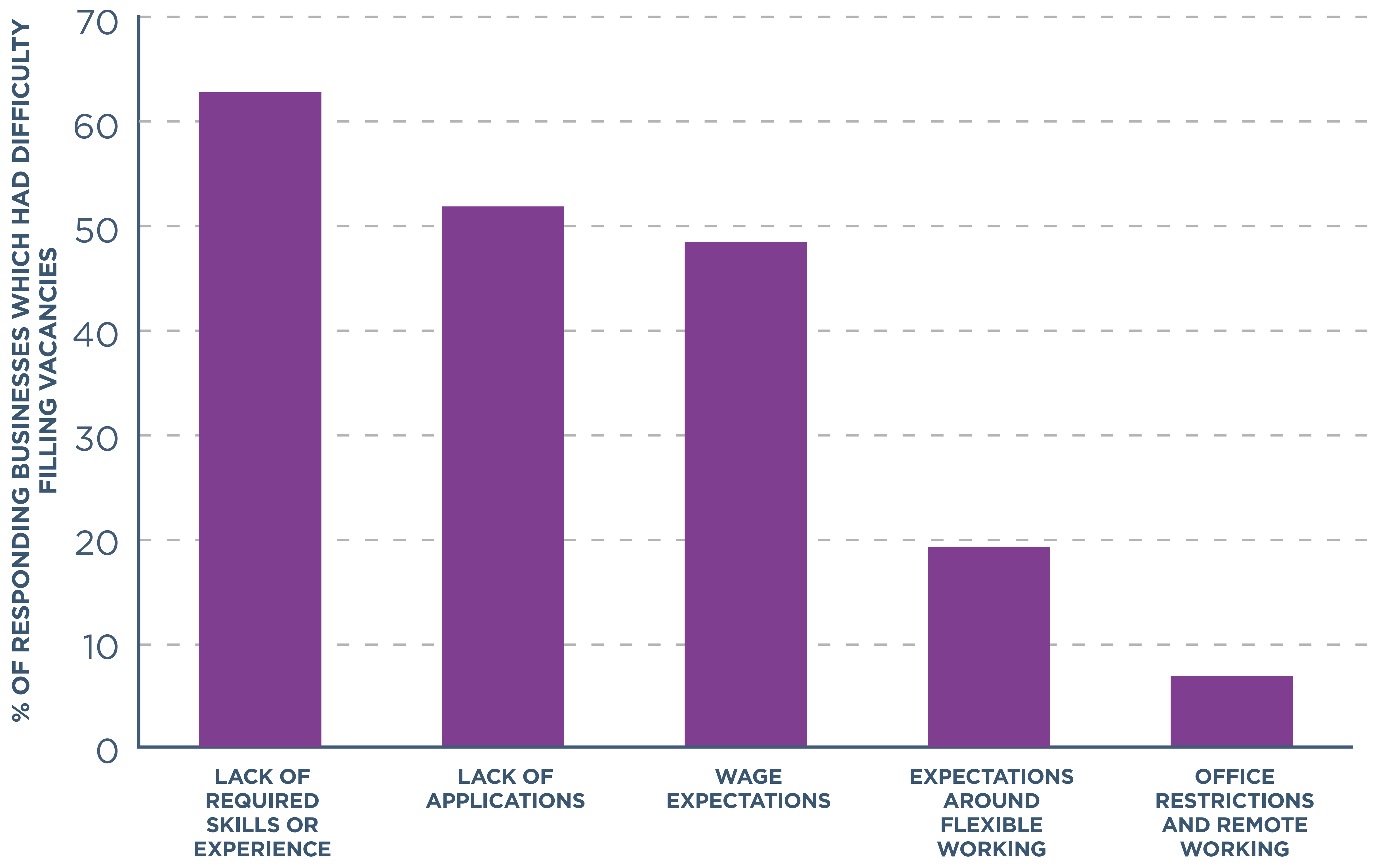
KEY RESULTS

VACANCIES

- Just over **50%** of businesses had current vacancies, a slight increase from Q4 2022 (**49%**).
- **83%** of these businesses found it difficult or very difficult to fill these vacancies, which has not changed since last quarter.
- Most of these businesses cited a lack of skills (**63%**) and a lack of applications (**52%**) as contributors to this difficulty.
- Interestingly, firms are finding it increasingly less challenging to retain their current workforce. In Q4 2022, just over **25%** of firms reported difficulties retaining existing staff. This number has since decreased to **22%**.
- Furthermore, a quarter of businesses surveyed found that it was easier than normal to retain workers in the current climate, up 10-percentage points from last quarter.

Chart 5

What factors have made filling vacancies difficult?



CURRENT AND EXPECTED BUSINESS ACTIVITY

CURRENT BUSINESS ACTIVITY

- The net balance of firms reporting an increase in their volume[1] of business over the first quarter[2] of 2023 rebounded after a difficult Q4 2022.
- In spite of business volume and activity increasing, capital investment and export activity remain in the red. In March of this year, we published a report which analysed 25 years of Scottish Business Monitor data, outlining key concerns around the impact poor investment and export activity could have on the longer-term growth of the Scottish economy.

Table 1

Net balance (%) of firms experiencing an increase in activities over the past three months, Q1 2021 – Q1 2023

	2021				2022				2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
VOLUME OF BUSINESS ACTIVITY (I.E., SALES)	-7.1	30	26	27.1	30.1	15.3	4	-2.2	9.1
VOLUME OF NEW BUSINESS ACTIVITY	-1.9	20.8	21.9	10.4	24.9	8.8	0	-4.9	5.7
VALUE OF BUSINESS ACTIVITY (I.E., TURNOVER)	-8.8	23.7	18.7	12.8	32.3	15	6.4	-0.7	8.1
LEVEL OF EMPLOYMENT IN YOUR BUSINESS	-13	6.4	5.7	10.8	15.5	10.2	8.5	-5.4	-0.5
LEVEL OF NEW CAPITAL INVESTMENT	-9.9	4.2	3	7.6	6.3	1.2	-5.9	-14.7	-4.4
EXPORT ACTIVITY	-21.6	-19.5	-18.1	-11.8	-8	-9	-9.2	-11.5	-8.4

*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

[1]i.e., business sales.

[2]Q1 2023 compared to Q4 2022

CURRENT AND EXPECTED BUSINESS ACTIVITY

CURRENT BUSINESS ACTIVITY - SECTORAL ANALYSIS

- The majority of sectors reported a substantial improvement in net balance for the volume of business compared to the fourth quarter of 2022, with construction being the only sector remaining negative.
- Transport and Storage is the only sector which saw their business volume contract over the quarter.
- More firms in Construction also reported a decrease in employment compared to the previous three months, as did the Accommodation and Food Services sector.

Table 2

Net balance (%) of firms experiencing an increase in their volume of business over the past three months, Q1 2021 – Q1 2023

	2021				2022				2023
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
MANUFACTURING	5	45	36	-6	22	2	24	-21	2
ACCOMMODATION & FOOD SERVICES	-77	46	31	0	14	17	17	-11	33
CONSTRUCTION	14	55	40	5	29	26	16	-25	-7
TRANSPORT & STORAGE	-36	32	15	9	41	21	9	25	0
INFORMATION & COMMS	3	44	29	7	27	14	7	7	29
RETAIL & WHOLESALE	-11	18	17	4	30	17	-1	-4	18
PROFESSIONAL, SCIENTIFIC, AND TECHNICAL	15	24	32	14	31	14	-5	9	17
ADMIN & SUPPORT SERVICES	-13	26	7	0	31	3	-14	-6	22

*Net balance of firms is defined as the share of firms reporting higher minus the share of firms reporting lower

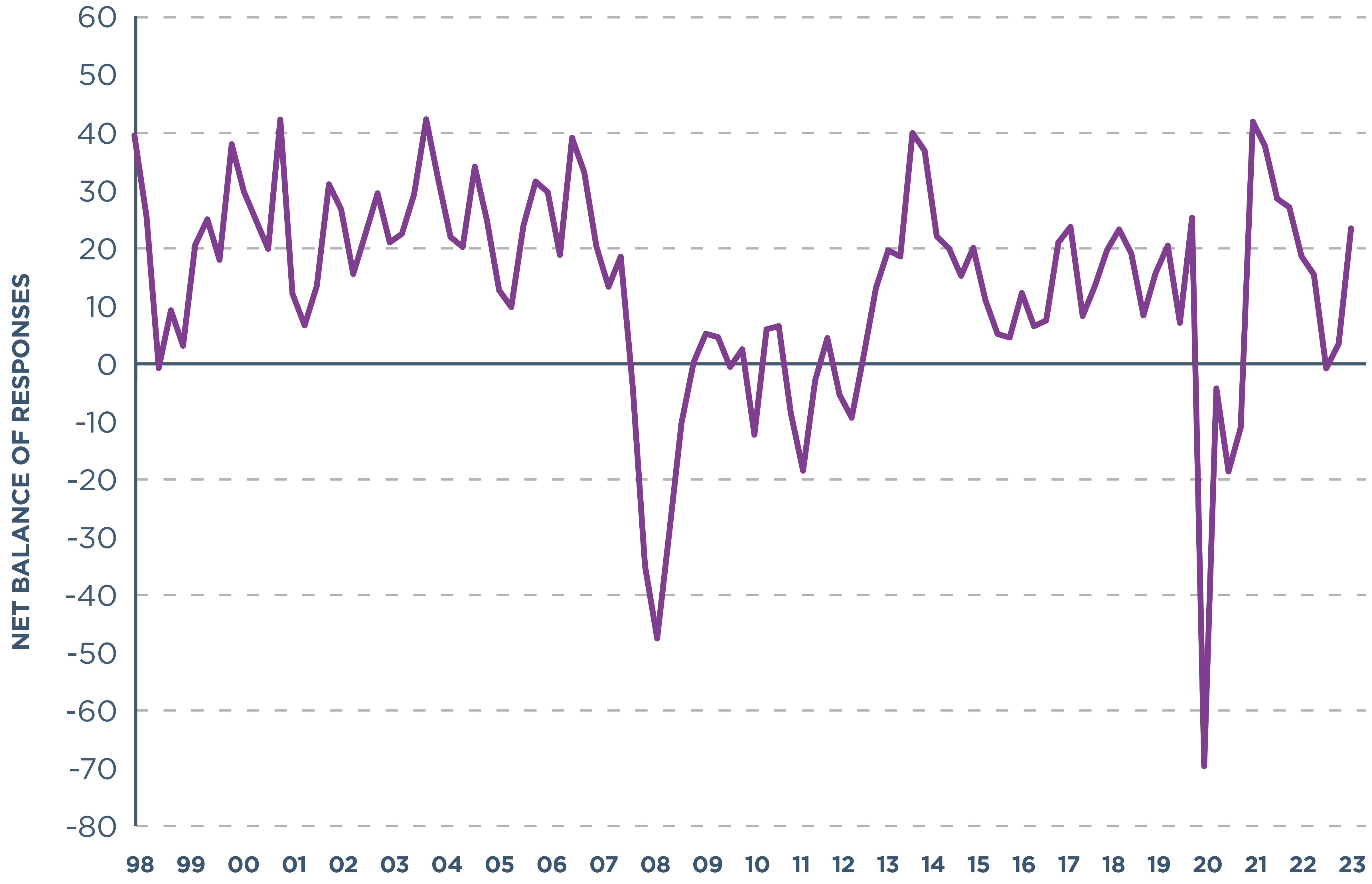
CURRENT AND EXPECTED BUSINESS ACTIVITY

EXPECTED BUSINESS ACTIVITY

- On average, firms were much more optimistic about their expected volume of business over the next six months compared to the last survey. This is the highest level business sentiment has been since the end of 2021.
- While there were also positive net balances in expectations for the level of employment and turnover in the coming six months, there continued to be small negative net balances for expected capital investment (-1 percentage point) and export activity (-3 percentage points).

Chart 6

Net balance (%) of firms expecting an increase in their volume of business over the next six months, Q1 1998 – Q1 2023



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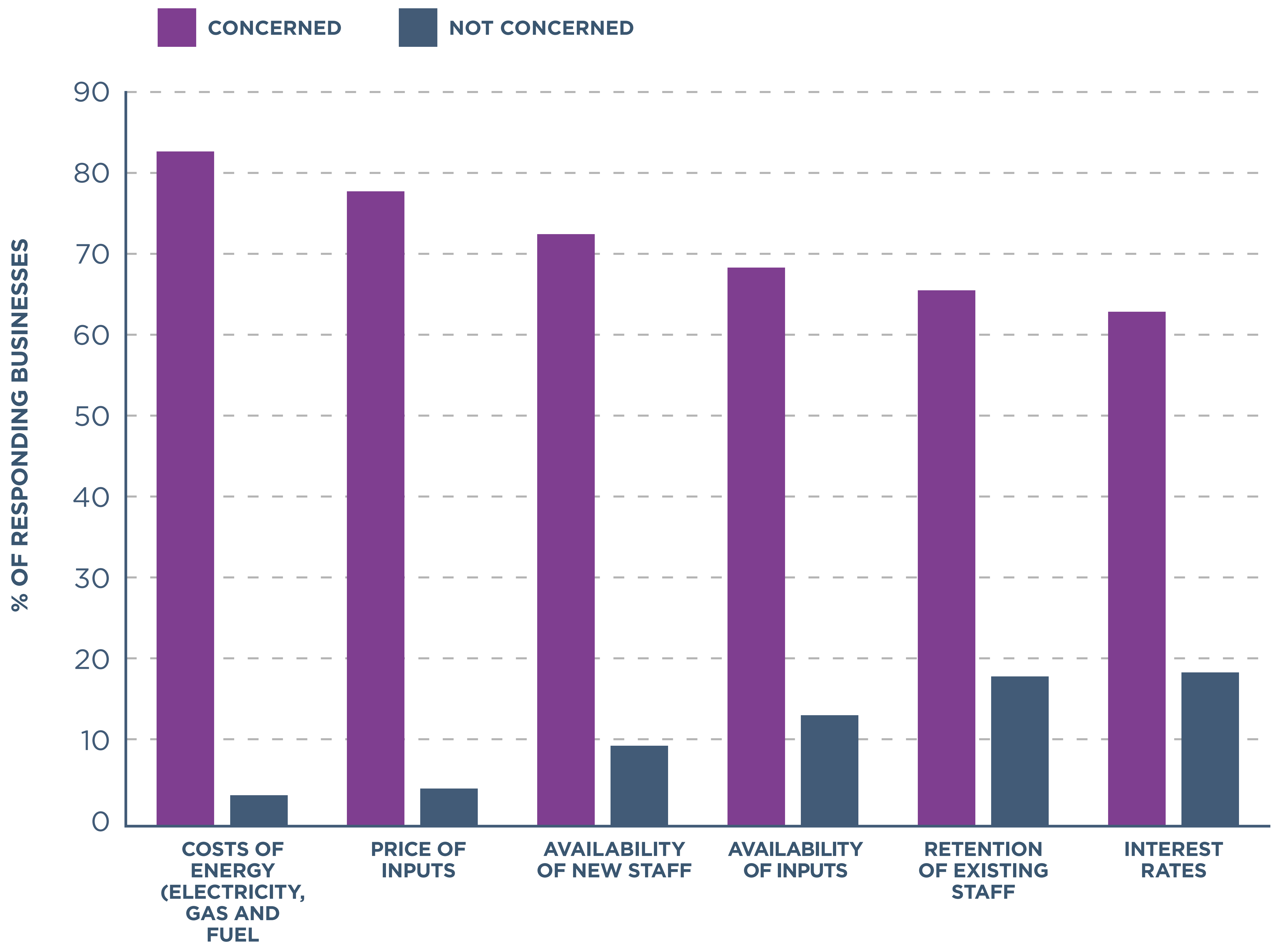
BUSINESS CONCERNS

- In the latest quarter, we asked Scottish firms what they expect to be important to their business over the coming quarter.
- The majority of firms expect economic and business uncertainty (**80%**), staff availability (**79%**), and policy uncertainty (**71%**) to be important, or very important, to their business over the next 3 months.
- Additionally, firms were asked what the biggest concerns for their business were likely to be over the next quarter.
- Very similar to previous quarters, the most common concerns among responding businesses were the costs of energy (**83%**) and the price of inputs (**78%**). However, both of these have decreased relative to last quarter.
- The number of firms reporting concerns over interest rates (**64%**) has also fallen by 8-percentage points since last quarter.
- All indicators have seen a reduction in businesses reporting them as a concern in this latest survey.

Chart 7

Compared to normal, how concerned is your business about the following factors?



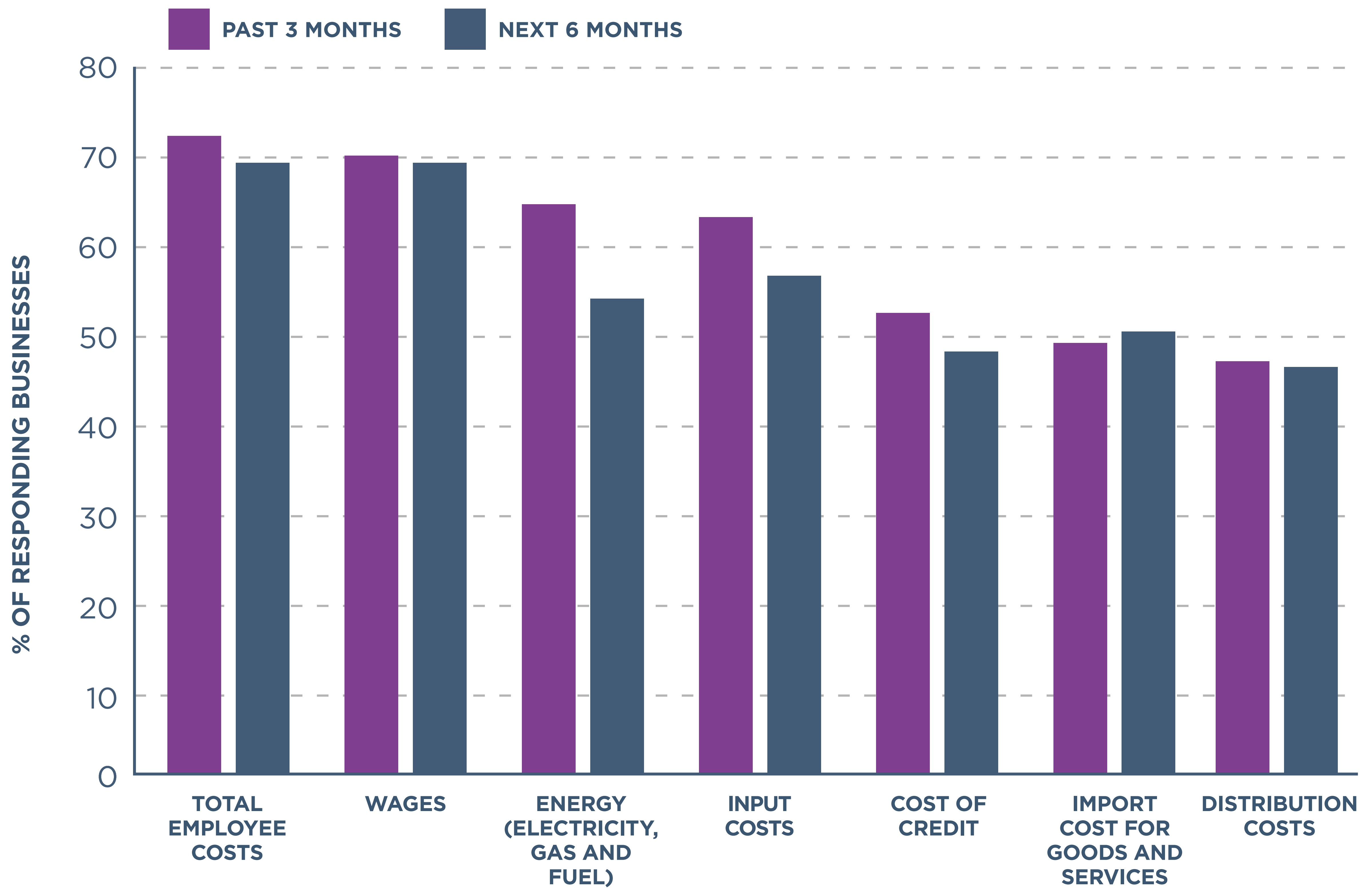
*Some businesses responded N/A; therefore, percentages may not sum to 100%

THE OUTLOOK FOR THE NEXT YEAR…

- We also asked businesses what the main cost drivers have been over the last quarter and what effect they might have over the next 6 months.
- Interestingly, fewer businesses are expecting energy costs to be their key cost driver over the next two quarters. **65%** of firms reported energy bills as their key cost driver over the past 3 months, while **54%** expect them to continue to be a key cost pressure in the coming six months. This is a significant decline from last quarter when over **70%** of firms expected energy costs to be one of their main cost drivers.
- Total employee costs and wages were the most common cost pressure for businesses in the previous 3 months, overtaking energy costs, and are expected to remain that way in the future.

Chart 8

Thinking about the key cost drivers for businesses, what is your business' assessment of the following cost pressures over the past 3 months and the next 6 months?



THE OUTLOOK FOR THE NEXT YEAR...

- We then asked businesses about their outlook for growth in the Scottish economy over the next 12 months.
- Overall, the outlook of firms has improved since last quarter, although it remains pessimistic. **62%** of responding businesses expect economic growth to be weak or very weak in the next year compared to the previous year. This is down from more than 3 in 4 firms last quarter.
- Businesses felt slightly more confident in the outlook for their business following the UK Government's Spring Budget Announcement than they did following the Autumn Statement. **12%** of businesses felt more confident following the Autumn Statement compared to **14%** following the Spring Budget.

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