Quarterly Economic Indicator

Scottish Chambers of Commerce Network

in partnership with Fraser of Allander Institute

RESULTS: Q2 2023

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Foreword

In the last three months the news about the economy has been quite mixed. Three months ago, most forecasters thought it was likely that the UK and Scottish economies would be in a shallow recession as the impact of high inflation hit consumers and businesses.

However, the data in early 2023 has (mostly) confounded these expectations, with growth in the Scottish economy being recorded at 0.4% in Q1 of 2023. Surprisingly, there is also healthy growth in consumer-facing services in Scotland, which, in this early data, is showing some divergence in the experience in the UK as a whole.

This short-term optimism is countered somewhat by the stubbornly high inflation we are seeing in the UK economy. Inflation stood at 8.7% in May, unchanged from the April figure. Worryingly, core inflation (so inflation excluding food, energy, alcohol and tobacco) rose in May, to 7.1%.

These recent pieces of news last week undoubtedly contributed to the Bank of England's decision recently to raise rates for the 13th time in a row, taking the base rate up to 5%.

Food price inflation does seem to be easing, now at 18.4% for the year, down from the highs of 19.1% in March. While this is good news, it is still significantly above the average rate of inflation and is a source of inflation that is impacting those on the lowest incomes.

Despite the latest data showing little movement, we still expect that inflation will come down as we move through 2023 as we compare to the higher price levels in 2022. This chimes with the expectations in the survey, albeit there are significant sectoral variations.

The expectations are that inflation will get down to around 5% by the end of 2023 – meaning that while the Prime Minister may meet his commitment to halve inflation it is looking much closer than it did before. It is now not likely to be until 2025 when inflation gets back to the Bank of England's target level of 2%.

So despite the fact we are not in technical recession, it is still going to feel like a period of pain for many businesses.

Professor Mairi Spowage
Director
Fraser of Allander Institute

Introduction

Stephen Leckie
President
Scottish Chambers of Commerce

The survey results highlight that persistent economic uncertainty is forcing firms to put investment decisions on hold, which makes prospects for medium and long-term growth far more challenging. The flatlining performance across the business community must act as a wake-up call to Governments north and south of the border. Governments must work with us if we are to revive investment decisions and maintain our competitiveness as a business destination.

The eyes of the business community are firmly on how the First Minister will respond to the New Deal for Business Recommendations. Specifically, how he will reform non-domestic rates to incentivise businesses to grow as well as find the right balance between taxation and spend.

Pressures from a tight labour market are making it difficult for firms to fulfil orders and inflation is placing great pressure on businesses to meet growing demands for higher wages.

Strong competition for labour and skills are also leaving many firms with job vacancies that they simply can't fill. We are rightly focused on ensuring our domestic skills and labour are supported into the jobs market, with many initiatives and reforms underway. However, businesses cannot wait for these schemes to pay dividends which could take years.

That's why we need to simultaneously accelerate plans for improved access to the international labour market so that we can address worker shortages. This action alone would lift some of the pressure facing businesses and demonstrate that we have a UK Government which listens to business.

Inflationary pressures are easing for firms, but it is still too high with most businesses still expecting to increase their prices next quarter.

Firms are now increasingly feeling the impact of consistent interest rate rises by the Bank of England attempting to cool inflation. Up to this point, businesses have had to adjust to seeing interest rates mainly squeeze their borrowing and input costs but now they are increasingly feeling the pinch in other ways, with consumer spending stifled and now the housing market coming under pressure.

It is critical that the right balancing act is struck from the Bank of England on interest rates or there is a threat that spiralling interest rates will make repayments simply unsustainable in the medium and long-term. Governments must also consider what regulations and upfront costs can be reduced or paused to reduce the costs burden on business such as a temporary reduction in VAT.

QUARTERLY ECONOMIC INDICATOR

Key Findings

Q2 2023

The Q2 2023 survey was conducted between May & June 2023. 300 firms responded to the survey.

Inflation Concern Easing:

- Concern over inflation remains high among all firms but has eased generally over the quarter. Last quarter, it was at 80% but has eased slightly to 75%. On a sectoral level, at least seven in 10 firms in each reported increased concern from inflation with the construction, retail, and tourism sectors reporting the highest level of concern.

Labour Costs now the leading cost pressure:

- 75% reported increased cost pressures from labour costs, including salaries
- 74% reported increased cost pressures from energy costs
- 48% reported increased cost pressures from raw material prices
- 43% reported increased cost pressures from fuels such as diesel and petrol

Investment Largely Frozen:

- ·29% of all firms reported increased total investment over the quarter, with 20% reporting a decrease. While on balance, this is an overall positive, 43% reported no change over the quarter.
- This freezing of investment is most apparent significant when it comes to training investment, with over half reporting no changes to funding for training staff (52%).

Tight Labour Market:

- Recruitment difficulties continue to be a significant challenge and have risen over the quarter, from 47% last quarter back to over half of firms (55%).
- Nearly 7 in 10 (69%) report that they don’t expect staff numbers to change in the next quarter, compared to only 24% that expect it to increase and 8% a decrease.

Less firms planning to raise prices:

- Significantly less firms are indicating that they will raise prices this quarter compared to last. Just over half (55%) say they will raise prices next quarter compared to 73% in the last quarter.

CONSTRUCTION

Business Concerns:
Inflation remained the largest concern with interest rates seeing the largest increase (12%) since the previous quarter, to being reported by a five-year survey high of 73% of firms.

Cost Pressures:
Labour costs were firmly the leading cost pressure, with eight in 10 firms reporting it, compared to other trends. Energy costs and raw materials prices remained significant for over six in 10 but both have generally eased.

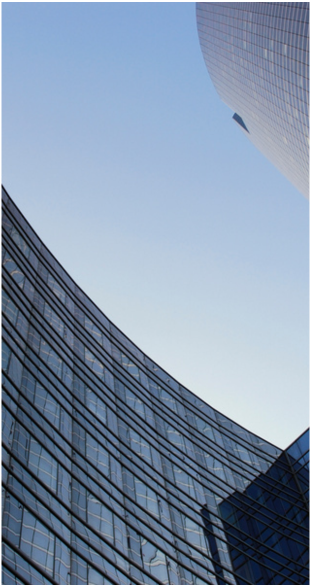
Labour Market:
Construction firms continued to report consistent increases in staff levels, with this quarter seeing an 8% increase in the number of firms hiring. However, recruitment difficulties also rose to a five-year survey high.

Housebuilding Contracts:
Housebuilding saw a sizeable fall on balance with over half of firms (53%) reporting a decrease. The net balance of -40% was the single largest fall in a quarter since Q2 2020.

BUSINESS VOICE:

“Massive shortage of skilled labour in the construction industry and no incentives to take on apprentices. Despite this we currently employ three and are about to employ another two. This will make our apprentices equivalent to 25% of our total staff." - Construction firm in Aberdeen

FINANCIAL & BUSINESS SERVICES



Business Concerns:
Which inflation remained the largest concern, interest rates, business rates, and taxation all saw sizeable increases over the quarter.

Confidence:
Confidence among services firms remained strong, with nearly eight in 10 (78%) reporting increased or no changes in levels of confidence. The net balance of +17% was in line with the five-year average.

Sales Revenue:
Sales trends remained largely positive despite seeing some easing in growth, when compared to the previous quarter. The most significant growth was reported in domestic sales.

Investment:
All investment trends remained at positive net balances, seeing growth despite at least half of firms reporting no changes over the quarter in each of these trends.

Expectations:
Firms in the sector are generally positive for the next quarter when it comes to sales and staff levels increasing, but they are cautious on investment with six in 10 saying they anticipate no change in this area.

BUSINESS VOICE:

"General level of demand for business services in the B2B sector - (understandable) caution in committing to discretionary spend. Uncertainty affecting business appetite for innovation and transformation which is a concern for long-term growth." - Services firm in Inverness

MANUFACTURING

Inflation:
Inflation remained the largest concern for firms, but saw some easing (at 78%) compared to the previous quarter (87%).

Cost Pressures:
Most cost pressures saw some easing when compared to the previous quarter. Energy costs, raw material prices, and labour costs remain the leading cost pressures.

Labour Market:
Firms reported a 5% increase in recruitment difficulties to 65% of firms, compared to the previous quarter. This was the second highest amount recorded for this trend in the past five years of the survey.

Cashflow & Profits:
Cashflow remained at a positive net balance (+6%) and was significantly higher than the Q2 average. Profit levels returned to growth after contraction in Q1.

Confidence:
Manufacturing firms continued to report strong levels of confidence. The net balance of +25% is a 13% increase from the previous quarter and is 20% higher than the five-year average.

BUSINESS VOICE:

"Improved world trade, easing supply chain issues, more stable UK political situation, more stable currency situation, all contributing to improved performance." - Manufacturing firm in Dundee & Angus

RETAIL & WHOLESALE

Inflation:
Sustained high inflation impacts consumer spending power, so it is no surprise that nine in 10 retail firms have reported increased concern, close to record highs.

Cost Pressures:
All cost pressures have increased over the quarter, except for energy costs which saw a small decrease.

Sales Revenue:
Firms have seen some boost from summer sales, particularly domestic sales which has been the main driver of growth in sales.

Labour Market:
Recruitment difficulties increased by 10 percentage points to being cited by 60% of retail firms. This is a five-year survey high.

Investment:
While training investment has seen no movement over the quarter, capital investment has seen a considerable fall (-17%) when compared to Q1. Investment is predicted to fall further in the next quarter on balance.

BUSINESS VOICE:

"Cost of living really impacting non-discretionary spend in the economy, consumers feeling the pinch is harming the high street firms like us." - Retail firm in Fife

TOURISM

Business Concerns:
Concern from inflation remained the most significant, being reported again by close to a near record high at 90% of firms.

Cost Pressures:
Most trends were reported as increased cost pressures by over half of firms, with energy and costs remaining the leading challenges.

Investment & Sales:
Firms reported mostly positive sales trends, with domestic sales seeing the largest growth on balance. However, all investment trends saw a significant fall on balance, with over half of firms (55%) reporting they had pulled investment altogether.

Cashflow & Profits:
Significant challenges around cashflow and profits continued from Q1 for tourism firms, with successive negative net balances for both trends being reported.

Expectations:
Firms are forecasting sales and staff levels to increase in Q3 but investment is projected to fall on balance.

BUSINESS VOICE:

"All costs are spiralling higher constantly! Our fixed costs are 300% higher than last year!" - Tourism firm in Ayrshire

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