

# SCOTLAND Q4 2017 SMALL BUSINESS INDEX

**Small business confidence fell further in the last quarter, ending 2017 at its lowest level of the year.** In Q4 2017, the Small Business Index fell to -21.4 points, down from -15.3 in the previous quarter. This is the lowest level since Q4 2016. Similarly, UK-wide business confidence has fallen into negative territory for the first time since Q3 2016.

After outperforming UK GDP growth in the first quarter, the Scottish economic growth slowed over the three months from April to June. Growth slowed from 0.6% in Q1 to just 0.1% in Q2 2017, weighed down by declines in the production and construction sectors. This compares to GDP growth of 0.3% in Q2 for the UK.

In annual terms, Scottish GDP growth is falling behind UK levels, with Q2 year-on-year growth at 0.5% compared to 1.5% for the UK. The persistent confidence gap between UK and Scottish small businesses suggests that the disparity in economic performance will continue. Certainly, the Scottish Fiscal Commission expects subdued growth rates over the next five years. According to its latest forecast, the average rate of growth in Scotland will be 0.8% which is substantially lower than the 2% pre-recession growth rates and 0.6% lower than equivalent UK growth rates.

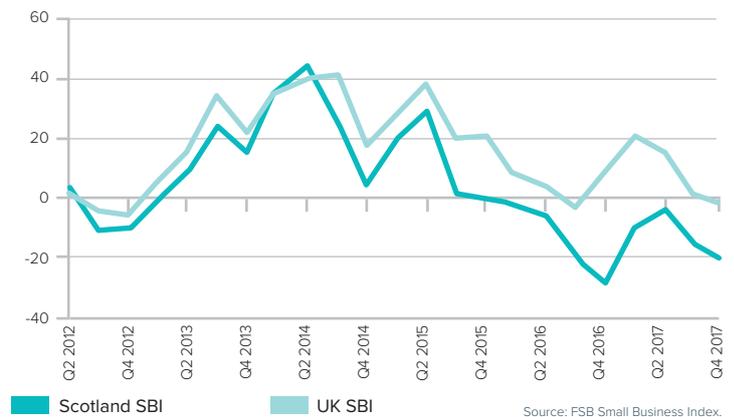
**UK small business confidence fell into negative territory in Q4 2017.** The UK-wide Small Business Index now stands at -2.5 in Q4 2017, 3.6 points below the Q3 level. Having rebounded quite strongly after the EU referendum, small business confidence has fallen during the past three quarters. This is only the second time since 2013 that UK-wide small business confidence has been on the negative side of the line. The latest data on GDP growth show that the economy expanded by 0.4% over the third quarter, reaching annual growth of 1.5%.

**More Scottish small businesses reported a fall in profits over past three months.** A net balance of 17.5% of Scottish small businesses reported a fall in gross profits over the past three months. This is slightly higher than the 16.0% recorded in the second quarter and only just lower than the 18.9% recorded in Q4 2016. The squeeze on Scottish profit margins has been constant for 18 months now. Several factors are at play, ranging from fluctuations in oil prices, the depreciation in the pound raising input prices and a decline in real incomes for consumers depressing spending.

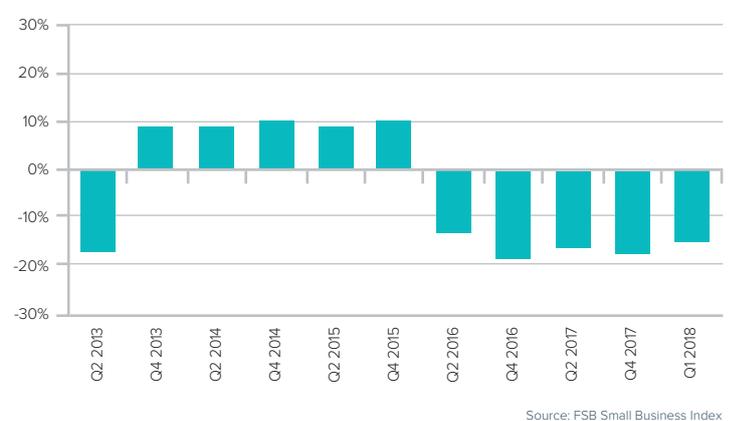
With inflation expected to ease somewhat in the coming months, Scottish small businesses are slightly more optimistic about Q1 2018, though it looks likely that the squeeze on profits will continue.

**Lower profitability has had a knock-on effect on small business employment.** In the last quarter of the year, a net balance of 8% of small businesses in Scotland reported reduced employment levels. This is significantly down from the -1% seen in the third quarter and has potentially consequences for overall employment levels in Scotland. With business confidence subdued and profit margins under pressure, some small businesses may be forced to reduce staff numbers to cut costs.

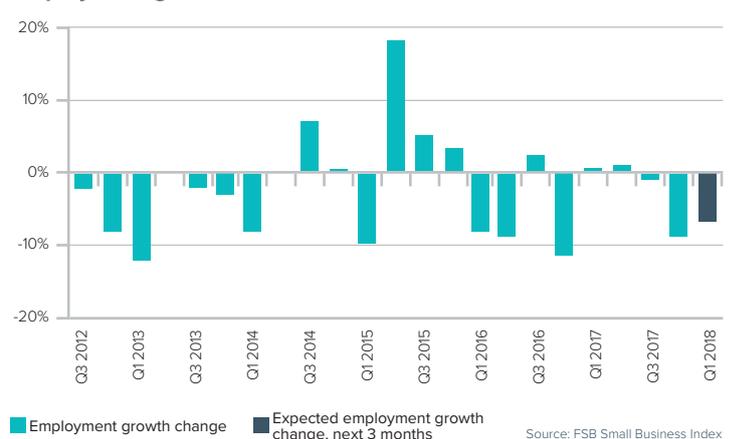
**Small Business Confidence**



**Net balance of small firms in Scotland reporting profit growth**



**Net balance of small firms in Scotland reporting employment growth**



The outlook remains gloomy, with a net balance of 7% projecting that they will reduce employment over the next three months. This should come as no surprise given that Scotland's jobless rate increased by 0.3% in Q3 to 4.1%, according to new ONS figures. However, it should be noted that Scotland's labour market is performing well and overall unemployment rates remain lower than the UK's rate of 4.3%.

**The state of the domestic economy continues to be the most commonly cited barrier to growth.** Similar to Q4 last year, more than half of respondents highlighted the condition of the domestic economy as a perceived barrier to growth. In line with the fall in real incomes, worries about consumer demand rose sharply in the last year. There was also a significant increase in those who identified their tax burden as a barrier.

In addition, we saw a sharp increase in the number of firms worrying about fuel costs, as prices for diesel and petrol rose over the past 12 months. Labour costs are the second most cited barrier to growth for Scottish small businesses, though the net balance fell from 37.7% in Q4 2016 to 32.5% in the same quarter of this year.

**Investment intentions continued to strengthen in Q4.** The net balance of firms with intentions to increase investment rose for the second consecutive quarter in Q4 2017 to 15.2%. This is good news for the Scottish economy and contrasts with reports elsewhere that Brexit negotiations have led businesses to delay investments.

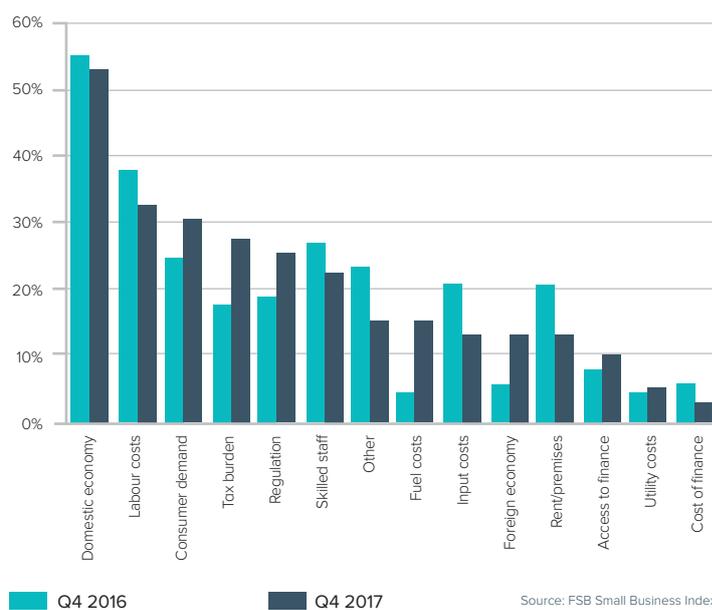
**The Small Business Index highlights a continued gap between the Scottish and broader UK performance.** Although both the UK-wide index and the Scottish small business confidence index have declined in the last quarter of the year, the Scottish index remains at a lower level.

After a growth spurt in Q1 2017, the Scottish economy has fallen behind the national average. Dealing with the broader economic impact of the low oil price, high inflation and weak domestic demand, growth could be expected to remain below the UK average for some time.

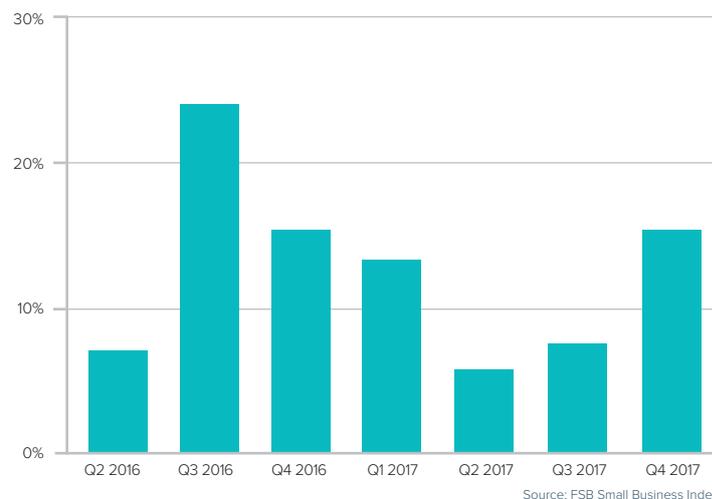
Mounting cost pressures mean that more Scottish employers have been forced to reduce headcounts – for Q1 2018, more businesses expect to reduce staff numbers than not. Further, it is unknown what impact the planned income tax increases will have on recruitment and investment intentions as detailed in the Scottish Government's 2018-19 Draft Budget.

Nonetheless, there is some good news. Easing inflation in 2018 will help consumers' budgets and strengthen domestic demand, while the low pound is expected to benefit exporters.

### Share of firms reporting factor as perceived barrier to growth, Scotland



### Net balance of firms with intentions to increase investment spending over next quarter



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