

SCOTLAND Q2 2018 SMALL BUSINESS INDEX

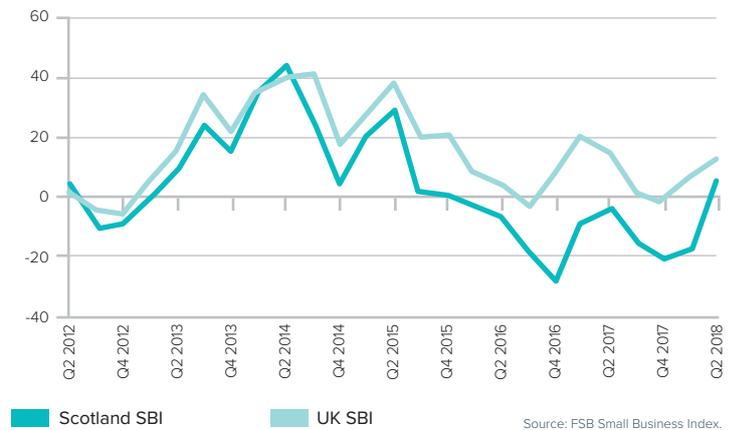
Scottish small business confidence turns positive. In the second quarter of 2018, the Scottish Small Business Index climbed from -17.8 points to +5.1 – marking its first positive reading in two and a half years. As a result, the gap between the Scottish and the UK SBI narrowed to 7.8 points, the closest it has been since the second quarter of 2014. The narrowing of the gap in confidence this quarter is a welcome sign on the back of recent weak growth projections published by the Scottish Fiscal Commission. Despite the improvement in confidence, the profitability of Scottish small businesses declined in Q2, due in part to higher oil prices and the increasing costs of regulatory compliance.

Small business confidence across the UK continues to improve in Q2. The UK-wide Small Business Index climbed from +6 in Q1 2018 to +12.9 in Q2 2018. This is welcome news given disappointing recent official growth figures. The UK economy expanded by 0.1% in real terms over the first three months of 2018. As a result, annual growth registered its lowest value since Q2 2012, at just 1.2%. The strong improvement in the measure is in line with other recent survey data, such as the UK Purchasing Managers' Index, and suggests that, although growth remains modest, it is set to improve.

More Scottish small businesses report a decrease in profits over the past three months. In the second quarter of 2018, a net balance of -23.9% of small Scottish firms reported improving profits over the past three months. This is down on -17.5% recorded in the previous quarter. 42.7% of small firms reported that profits declined over the past three months in Q2. Nonetheless, there is reason to believe that Scottish businesses may have turned the corner as the expected net profit balance in the coming three months rose to -7.7%. Although, of course, still negative, it is an improvement on profit expectations in Q4 of last year, which stood -14.9%. Moreover, these findings are supported by the Purchasing Managers' Index data, noted above, which reported that the Scottish economy expanded at its fastest rate in six months in April.

Small business employment declines marginally in Q2. Small business employment growth continued to move in the right direction. Although a net balance of 0.8% of small firms reported that the size of their workforce declined in Q2 2018, the measure is 3.8 percentage points better than the 4.6% who lost jobs in Q1. These figures appear to be reflected in recent labour market statistics for Scotland, which show that the employment rate increasing by 0.3 percentage points in the first quarter of 2018 and Scotland's unemployment rate holding at 4.3% over the last two quarters. The improvement in small business employment growth and the positive employment expectations – a net balance of 5.8% of firms expect employment growth in Q3 – is good news for the labour market.

Small Business Confidence



Net balance of small firms in Scotland reporting revenue/profit growth



Net balance of firms reporting employment growth, Scotland



Utilities, fuel and regulatory compliance are the key drivers of changing costs for Scottish small businesses.

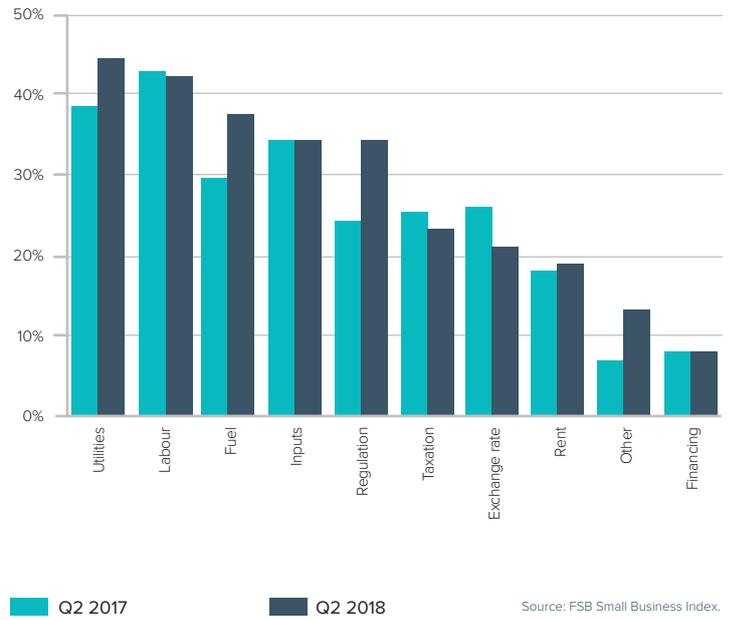
Nearly four out of five small businesses in Scotland (79.8%) experienced cost increases over Q2. While labour costs are an important factor, 44% cited utilities as the main cause and 37% cited fuel – both of which have seen noticeable year-on-year increases of over five percentage points. This will, in part, be attributable to the fact that Brent crude oil was priced at around \$50 a barrel in May 2017, but now stands at more than \$75 a barrel. Another significant year-on-year increase is around the cost of regulatory compliance. This was cited by 34% of small firms, meaning it was 9.6 percentage points more likely to be cited as a cost driver than a year ago. Though the precise cause of this increase is unknown, the introduction of the General Data Protection Regulation (GDPR) law has certainly played a part.

Credit applications decline in Scotland. 12.2% of Scottish small businesses applied for credit in Q2 2018, down 5.8 percentage points on Q1 and 1.8 points on the same period last year. However, of those that applied for credit, 71.4% were accepted – a much higher rate than the 60.4% seen across the UK. Credit affordability declined slightly in Q2, with 34.5% of Scottish small businesses deeming it unaffordable, up on 33.3% in Q1. Investment intentions remain largely unchanged compared to Q1, with a net balance of 13.6% of small businesses expecting to increase investment in the coming three months.. With little sign of resolution and interest rates expected to rise later in the year, credit conditions are primed to deteriorate.

Small business confidence returns to positive territory for the first time since Q4 2015.

In the second quarter of 2018, the Small Business Index climbed over twenty percentage points. This increase is among the largest seen in all the UK's nations and regions. The confidence gap between small businesses in Scotland and the rest of the UK has also closed substantially. The gap now sits at 7.8 points, compared to 23.8 points in Q1. The gap is now the narrowest since the second quarter of 2014. This pickup in confidence suggests that the gap in growth between the Scotland and the UK could also narrow over the course of 2018.

Share of firms reporting factor as main cause of change in business cost, Scotland



Share of firms applying for credit in the past three months, Scotland

