

SCOTLAND Q3 2018 SMALL BUSINESS INDEX

After some encouraging signs in the previous two quarters, Scottish small business confidence has collapsed back into negative territory. In the third quarter of 2018, the Scottish small business confidence index fell 18.3 points to -13.2. The index had reached 5.1 in Q2 – its first positive reading in two and a half years. The latest fall leaves the index slightly above the average value over the past two years (-13.8).

Small business confidence also deteriorated across the UK with the index falling by 14.6 points. Alongside the decline in confidence, a greater number of Scottish small businesses saw revenues fall rather than rise in Q3. Although on an upward trend, this measure last showed a positive reading in Q3 2016 when a net balance of 3.4% of businesses recorded higher revenues.

Overheads also rose for the majority of Scottish small businesses in the 12 months to Q3 2018. Higher oil prices and labour were the most significant drivers of cost increases during the quarter.

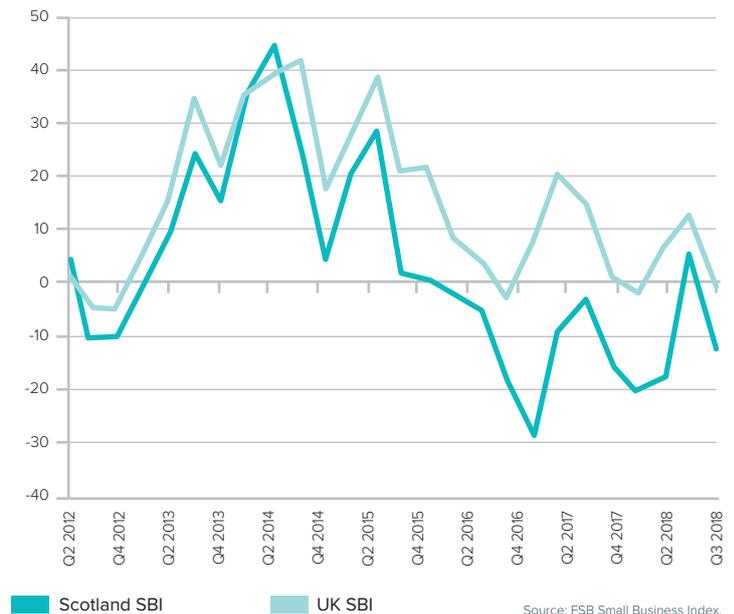
Small business confidence across the UK falls back in Q3. The Small Business Index (SBI) for the UK fell from +12.9 in Q2 2018 to -1.7 in Q3 2018. This is only the third time the index has dropped into negative territory since the start of 2013. By contrast, an uptick in the SBI between Q1 and Q2 coincided with an expansion in the UK economy of 0.4% over the second quarter of 2018. This followed disappointing growth of 0.2% in Q1 as a number of sectors were disrupted by poor weather conditions.

The latest fall in confidence is likely to reflect significant Brexit-related uncertainty following the Cabinet's split over its preferred negotiating stance. While a causal link is hard to prove, it would be surprising if the uncertainty around the Brexit process and the possibility of a "no-deal" exit had no impact on business sentiment. Underlying structural weakness in certain sectors is also becoming apparent as consumer-facing firms deal with the consequences of a long term squeeze on real pay growth.

Small businesses in Scotland report a worsening outlook for revenues over the next three months. In the third quarter of 2018 a net balance of +7.7% of small businesses in Scotland reported that their revenues had declined over the last three months. This was an improvement on the +13.5% who had seen a drop in Q1 2018. Expectations for the coming three months show a continuation of this trend as the net balance moves to -2.2%.

Although the negative balance shows fewer businesses expect their revenues to increase rather than decrease, the movement back towards zero shows that business conditions aren't deteriorating as fast as they were during the first quarter of 2018.

Small Business Confidence



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



Small business employment saw a substantial fall in Q3 2018.

A net balance of +13.2% of businesses reported a decrease in their employment levels. This follows three consecutive quarters of relative improvement (or, rather, things deteriorating at a slower rate), which had culminated in the Q2 reading coming close to being in balance, at -0.8%.

This is broadly in line with the official labour market statistics for Scotland which show that, despite a recent decline, unemployment increased over the year by 7,000. The outlook for employment seems brighter, however, as a net balance of 3.3% of Scottish firms expect employment growth in Q3.

Rising oil prices are pushing up costs for Scottish small businesses.

Overall, the proportion of small businesses that experienced cost increases over the last three months stood at 73.6%, down from 79.8% in Q2. This was above the average for the UK as a whole (71.5%).

A number of causes have become more prominent in increasing costs since Q2. In particular the proportion of businesses citing fuel as a cost driver has increased from 37.4% to 48.6%. Official statistics highlight that petrol and diesel prices increased more in May 2018 than at any point in the last 18 years (6p per litre).

The share of businesses reporting staff cost increases over the last year also rose by two percentage points between Q2 and Q3. The tight labour market, in which unemployment remains low and employment high, is likely to cause wage costs to rise further over time.

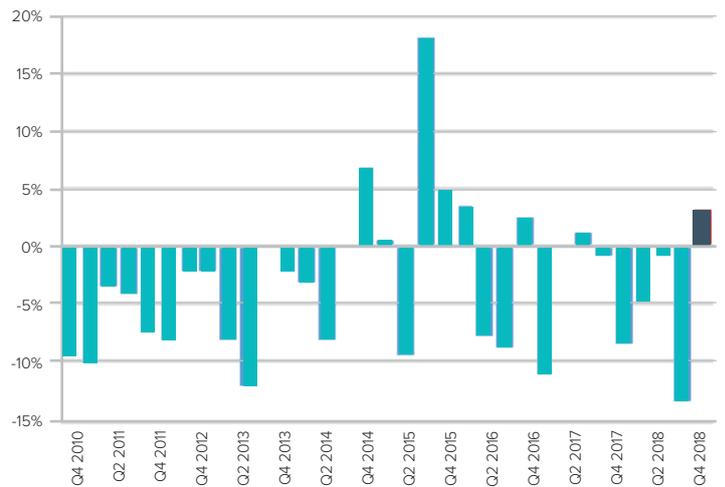
Small businesses in Scotland are operating below capacity. A net balance of 55.0% of small firms reported that they were operating below capacity over the last three months, slightly up on the 54.3% reported in Q2. This was higher than the level recorded in England and Wales, where 50% and 39% of firms respectively were operating below capacity over the last three months.

The outlook for the next three months also shows that Scottish businesses are less optimistic than their counterparts around much of the country. The net balance of Scottish firms that think they will be below capacity stands at 49.4%. This is up by five percentage points from the level that expected to be operating below capacity in Q2 and compares to 40.7% in England and 28.1% in Wales.

Conversely, the net balance of small businesses expecting to increase investment in the coming three months stands at 18.9% - up 5.3 percentage points from Q2. Meanwhile, a net balance of 27.3% of firms aspire to grow, either rapidly or moderately, over the next 12 months, in line with what was reported in Q2.

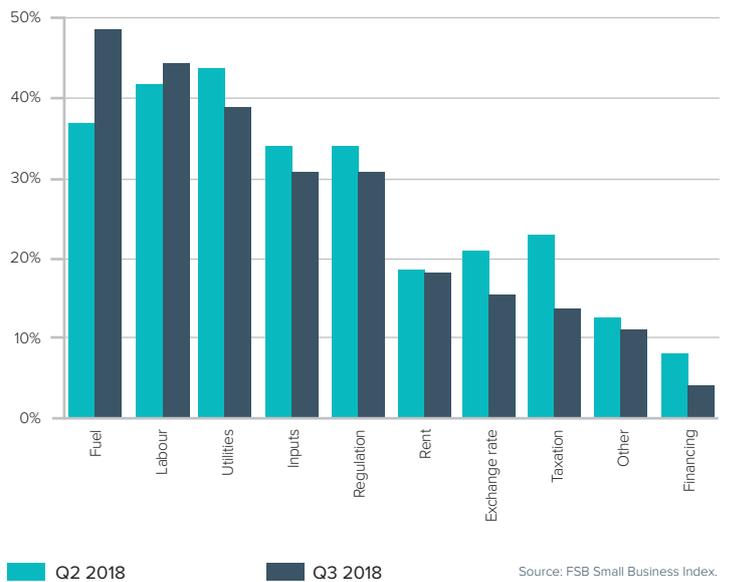
Scottish business confidence returns to negative territory. The dramatic drop in the Scottish Small Business Index comes against a backdrop of squeezed revenues, reduced staff levels and increasing input costs. While it is unclear exactly what role the Brexit negotiations is having on confidence levels, it would be surprising if the uncertainty around markets, supply chains and staffing was not feeding through to consumer and business sentiment.

Net balance of firms reporting employment growth, Scotland



Source: FSB Small Business Index

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



Source: FSB Small Business Index.

FSB Scotland

74 Berkeley St
Glasgow
G3 7DS

Tel: 0141 221 0775
scotland.policy@fsb.org.uk
www.fsb.org.uk/scotland

federationofsmallbusinesses
 @FSB_Scotland