

SCOTLAND Q3 2022 SMALL BUSINESS INDEX

The Small Business Index (SBI) fell by 13.9 points in Q3 2022, reaching -45.7, its weakest reading since Q4 2020. Q3's fall was the second in a row, with the Index having fallen by 46.1 points in Q2, reaching -31.8. The negative readings in these quarters mean that the number of Scottish small businesses expecting their performance to improve is outweighed by the number expecting their performance to worsen. This negative sentiment is reflective of an uncertain economic environment at present, with the UK economy set to be in recession in late 2022 and early 2023. Scotland's growth is set to slow markedly, with an annual expansion of just 0.1% currently forecasted for 2023.

For a second consecutive quarter, all UK regions saw a negative reading on the SBI in Q3. This reflects the widespread and indiscriminate nature of the difficulties facing the economy at present, particularly energy price pressures and weaker consumer activity. All but two regions saw a fall in the SBI between Q2 and Q3. Scotland's SBI reading of -45.7 was the second weakest of all nations or regions, with only the South West, at -46.6, being lower.

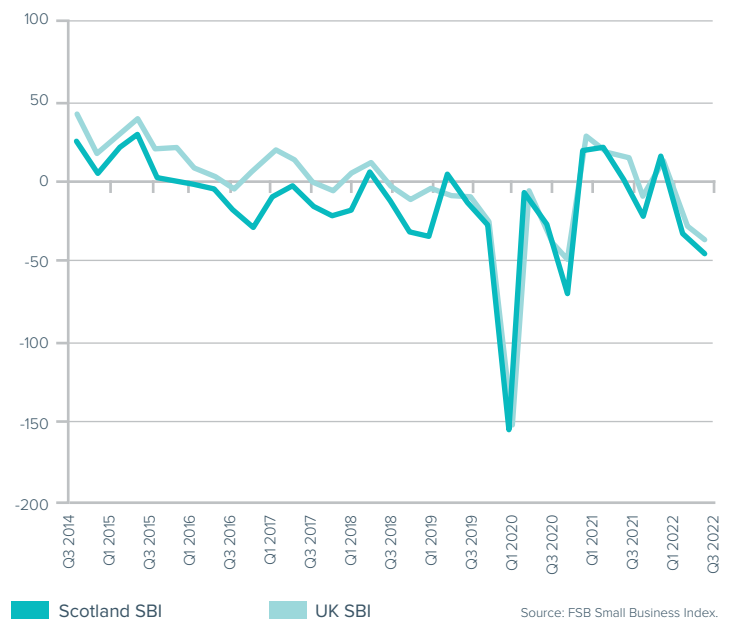
As a result, the UK-wide SBI also fell on a quarterly basis, reaching -35.9, having stood at -24.7 in Q2. As with the Scotland-specific measure, this marked the weakest reading since Q4 2020.

A net balance of -14.2% of Scottish small businesses saw revenue increase in Q3, relative to Q2. The exact same net balance was witnessed in Q2 when respondents were reporting their revenue growth relative to Q1. As such, Scotland has now seen two consecutive negative readings on this measure, meaning that more respondents saw their revenues fall than increase over these periods. This aligns with the general perception of weaker economic conditions reflected in Scotland's headline SBI.

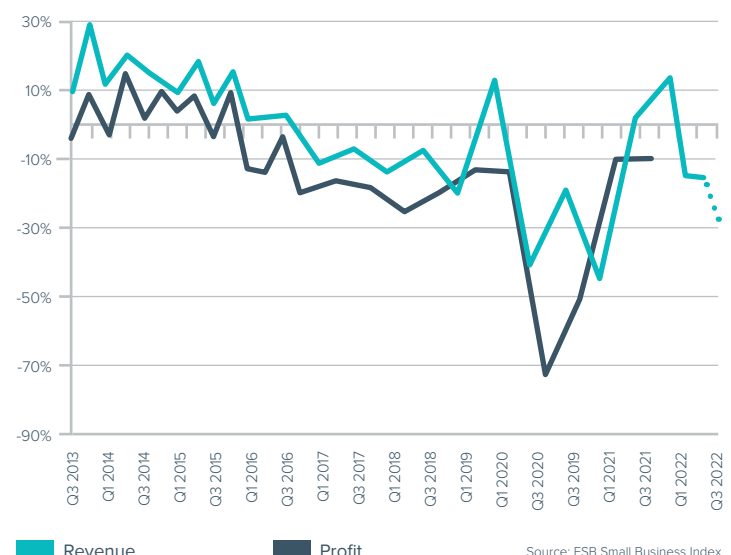
As with the rest of the UK, Scotland is facing considerable inflationary pressures at present. At the consumer level, this is putting downward pressure on living standards and leading to a withdrawal of economic activity. This is obviously also a key factor behind the reports of falling revenue amongst Scottish small businesses in recent quarters.

Looking ahead, a net balance of -28.4% of Scotland's small businesses expect revenue growth over the next three months. Inflation is set to peak over this period, meaning the shortfall between wage growth and price growth will be at its most stark, continuing the trend of weaker consumer activity.

Small Business Confidence



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



A net balance of -4.9% of Scottish small businesses reported increased employee headcount in Q3. The negative net balance means that the number of firms reporting a contraction in their employee numbers outweighed the number of firms reporting an expansion, with this now the case for four consecutive quarters. This picture was mirrored in the headline UK measure, which remained below zero for a second consecutive quarter, at -4.4% in Q3.

As was also the case in Q2, this reported fall in employee numbers showed an opposing trend to aggregate labour market data. The latest ONS figures showed that Scotland's labour market improved in the three months to August, covering most of Q3. The combination of these findings suggests that employment gains were likely to have been concentrated amongst larger businesses.

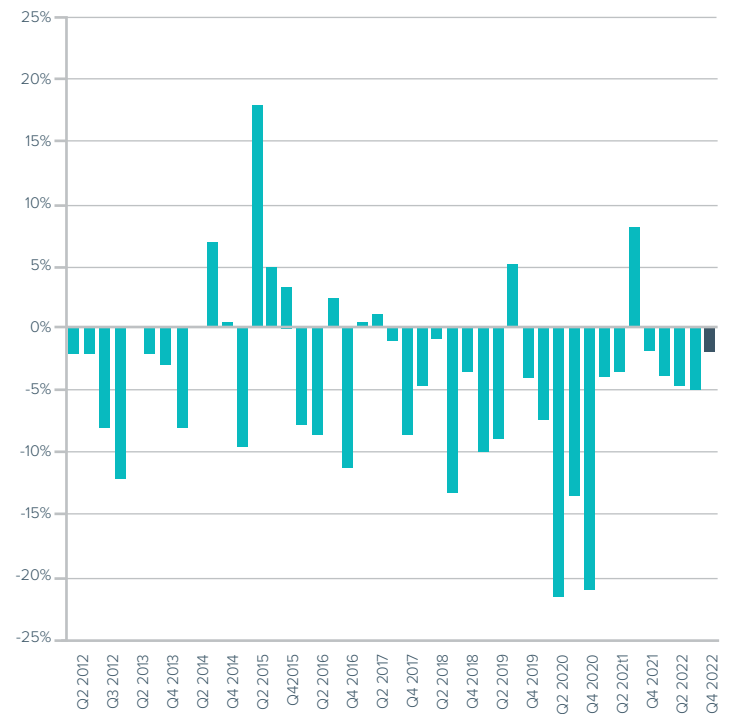
Looking ahead to Q4, Scotland's small businesses expect a further decline in employee numbers, with a net balance figure of 1.8% predicting a fall in headcount. Due to the anticipated recession, businesses' ability to maintain staffing levels is set to be tested. With weaker activity at the aggregate level, redundancies become more likely.

The share of Scottish small businesses reporting increased costs rose in Q3, with 90.7% stating that costs were up relative to the same period last year. This share has increased markedly over the past year. For comparison, the figure at same time last year, Q3 2021, was 77.4%.

This rising share of businesses reporting increased costs reflects several global economic trends. Businesses are facing price pressures from both inputs and supply chain issues. From the former perspective, price pressures have previously been concentrated amongst energy and fuel, but there is evidence that these are becoming increasingly broad-based. For instance, the share of Scottish businesses reporting fuel and utilities as the main causes of cost increases fell between Q2 and Q3. Meanwhile, there was an increase in the share of respondents reporting rises in other categories, including issues caused by currency exchange rates

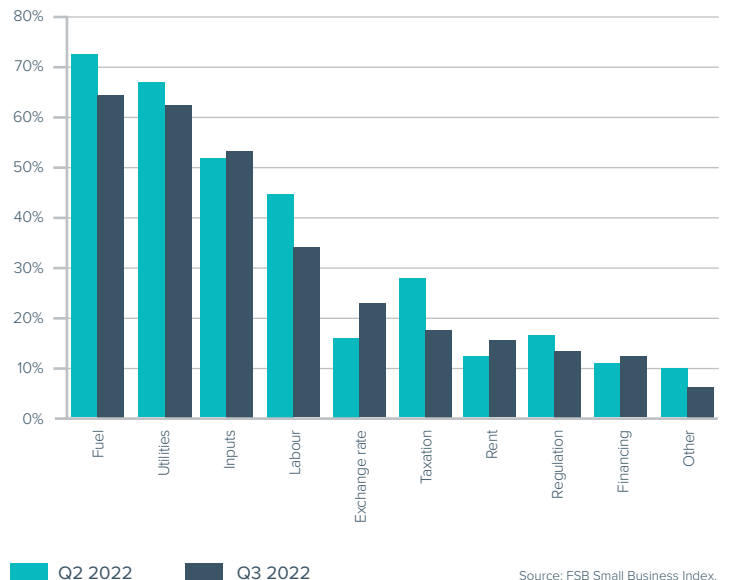
Indeed, 22.7% of Scottish small businesses cited the exchange rate as a main source of cost changes in Q3, up from 15.7% in Q2. This increase was also mirrored at the UK-wide level, with the equivalent share rising from 15.6% in Q2 to 20.1% in Q3. Following September's mini-Budget, sterling depreciated sharply. This has particularly impacted on Scottish businesses reliant on the foreign economy by making imported goods more expensive.

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

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