

SCOTLAND Q4 2016 SMALL BUSINESS INDEX

Scottish business confidence has fallen substantially. The Small Business Index stands at -28.9 in Scotland at the end of 2016, falling further from -18.8 in Q3. This likely reflects the fact that economic growth in Scotland in 2016 has been significantly weaker than the UK-average. The significant decline in Scottish small business confidence level highlights this pessimism. Persistent low oil prices are having a negative impact on many parts of the country. Small businesses also point to low consumer demand holding back growth, something which could be exacerbated by likely rising inflation. Concerns about labour are also impacting Scottish business confidence, with specific worries about finding appropriately skilled workers. Confidence readings on the Scottish Small Business Index have now fallen for a sixth consecutive quarter.

In contrast to Scotland, the UK Small Business Index rebounded in the last quarter of 2016. After a disappointing reading in Q3 at -2.9, the Small Business Index bounced back to +8.5 in Q4. This follows the publication of a series of strong UK economic indicators. These include low UK unemployment rates and the release of stronger-than expected Q3 GDP growth in the UK, 0.5% quarter-on-quarter. However, whilst confidence has improved for now across the UK, 2017 still looks set to be a challenging year, especially for consumers who will feel the squeeze of rising inflation.

Figures show slow economic growth in Scotland, despite good job figures. After a disappointing start to 2016, in which the Scottish economy saw zero growth in Q1, the latest GDP data showed a 0.4% quarterly expansion in Q2, compared with 0.7% growth for the UK as a whole. On an annual basis, Q2 GDP in Scotland grew by just 0.7% - the UK-wide figure was three times as high at 2.1%. Despite this, unemployment is relatively low. The latest labour market figures show that the rate of unemployment in Scotland stood at 4.6% in the three months to August 2016, lower than the 4.9% seen for the UK as a whole and 0.8 percentage points lower than the previous quarter.

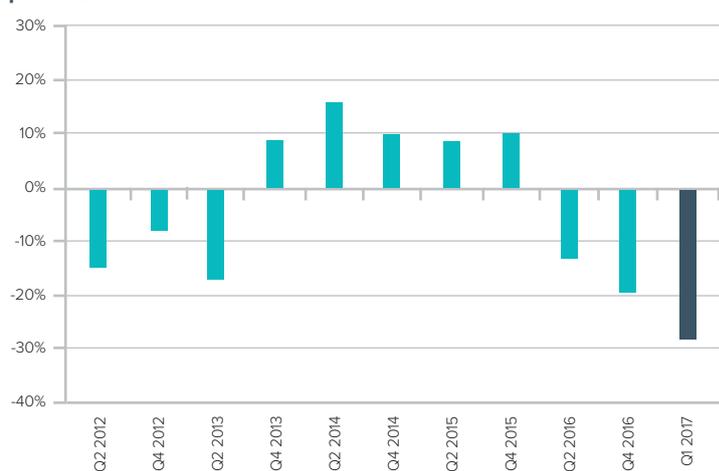
A large proportion of firms report falling profits this quarter. This quarter 46% of small firms in Scotland say profits decreased, with 27% reporting they are approximately the same. Overall, in Q4 a net balance of 19% of Scottish small businesses report profits declining over the past three months, worse than the 3% seen for the UK as a whole. This is also the most negative net response for profit performance since Q1 2013 in Scotland. Alongside profits falling off in recent months, firms are pessimistic about future income. With weak economic performance and low investment in the Scottish economy, profit expectations for next quarter are negative.

Small Business Confidence



Source: FSB Small Business Index.

Net balance of small firms in Scotland reporting profit growth - past three months



Source: FSB Small Business Index.

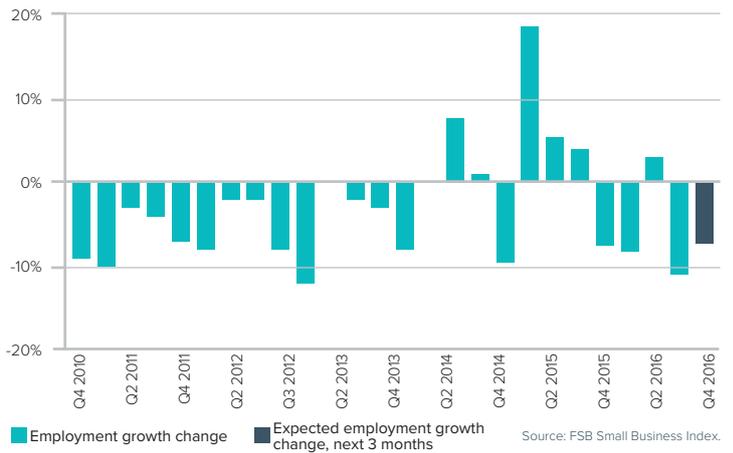
Small businesses report falling headcounts in the last three months. Smaller businesses across Scotland reduced their employment over the last three months, with a net balance of 11.1% of small businesses reporting lower headcount. This suggests that unemployment in Scotland may start to rise again over 2017. Small businesses have now reported cutting the number of people employed in three of four quarters in 2016 (the only exception being Q3). With confidence falling across the quarter, a net balance of 7.6% of businesses expect to cut back staff over the next quarter. High levels of economic uncertainty mean firms may be cautious and less willing to commit to hiring.

The domestic economy remains a primary concern. 55% of firms cited the domestic economy as the main perceived barrier to growth this quarter, only slightly lower than 63% high reported earlier in the year. Firms are also concerned about consumer demand, which is likely to take a hit as a weaker sterling translates into higher consumer prices over the coming months. Elsewhere, and especially in much of England, fears of a post-Brexit downturn have been assuaged by a range of positive economic indicators which suggest immediate concerns were overblown. But, with Scotland posting significantly lower GDP growth than the UK as a whole, small businesses have not necessarily felt this reassurance.

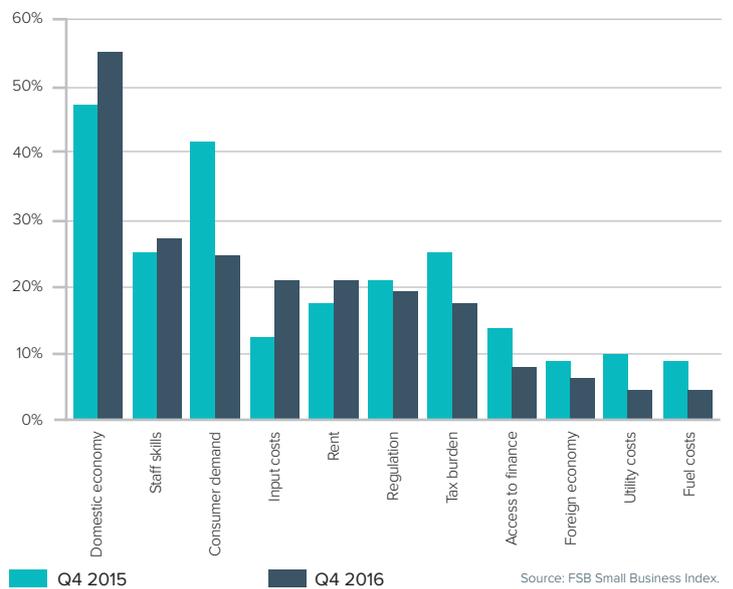
A majority of firms still plan to invest despite overall declines in confidence. A net balance of +15% of Scottish firms expect their capital investment to rise over this quarter. Whilst a lower reading than in Q3, investment intentions are more positive than they were in Q2 2016. This comes despite the fact that fewer Scottish firms report good availability of credit, at only 20%, down from 31% last quarter. Despite the Bank of England slashing interest rates to 0.25%, credit affordability has not improved across the UK.

Overall, the Small Business Index suggests that firms across Scotland could be in for a challenging 2017. While other parts of the UK experienced a resurgence in small business confidence in the last quarter of 2016, Scotland's firms present a far more pessimistic outlook. The Scottish economy may be in for a challenging 2017. A general lack of certainty, both politically and with regards to the future economic environment, is also hampering firms. This, combined with on-the-ground conditions and weak indicators, means it may take time for small businesses in Scotland to recover their confidence. The weak pound is likely to soften consumer demand as prices for imports rise, but it may also boost exports and encourage tourism to Scotland from overseas.

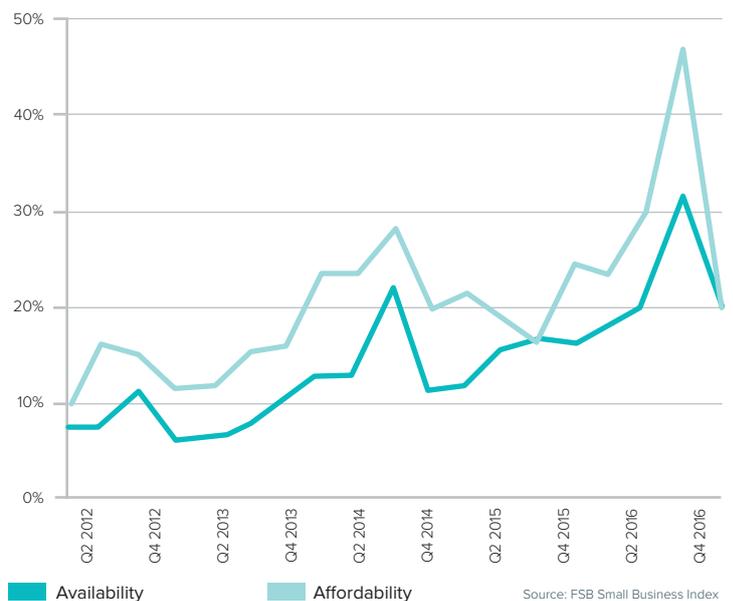
Net balance of firms reporting employment growth, Scotland



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



Share of firms reporting good availability/affordability of credit



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