Dundee & Angus CHAMBER OF COMMERCE

Quarterly Economic Indicator

April 2022

In Partnership with

CONDIES ACCOUNTANTS & ADVISORS

Executive statement

As we see the shoots of recovery 'Springing' forth in the responses to our first survey of 2022, we are also hearing of the pain points that are causing local businesses significant concerns.

Huge rises in business costs, with the inability of some key sectors to negotiate fixed contracts for supply of energy, along with short term changes to the pricing of raw materials makes it all very difficult for businesses to operate within the ranges of certainty that help us all take those calculated business decisions that we are all used to.

Covid has brought significant innovation, combined with a level of workforce movement that is currently seeing some sectors struggle to fill vacancies, or facing increased costs to attract the right talent.

In recent weeks, levels of absence are impacting productivity, while we hope that we are all finally learning to live with and operate under a level of the pandemic which will cause less and less disruption.

This quarter we are pleased to have hosted Josh Hampson on an internship from the University of Dundee. Josh was able work with Dr Shona Dobbie to add some topical questions, learn more about the interpretation of data and see how his work has influenced our survey going forward.

A huge thanks from us to Condies for coming on board as our Enterprise Partner for the Economy, to Shona for all of her expertise (and support for Josh) and to all the businesses who took the time to respond.

"Absorbing price increases.
Extended materials lead in periods."

"Increased activity and pent up demand"

"Order intake is up by 218%"

"Skills & staff shortages"

Alison Henderson
Chief Executive DACC

Dr Shona Dobbie
Angus Economics

Josh Hampson
University of Dundee Intern

Dundee & Angus Chamber of Commerce, proud to recognise its Partners

Partner

This is our first foreword for the Dundee & Angus Quarterly Economic Indicator for 2022 after becoming Enterprise Partner for the Economy with the Chamber. We are proud to be part of the business community and support small and medium local businesses to reach their potential.

The two year anniversary of the first lockdown has come and gone and as with all anniversaries it's a time to reflect on the past year and look forward to the future. If 2020 was the year to take stock and review your business then 2021 was the year of being adaptable and "pivoting". The year started with restrictions but by halfway through, business confidence was high again with most businesses feeling the consumer confidence returning and orders expected. Unfortunately, this was short-lived with restrictions returning in late 2021. The ebb and flow of restrictions, compounded by staff shortages and surging prices, meant 2021 was a bit of a rollercoaster for many businesses.

2022 has already seen a fair amount of challenges with the war in Ukraine having an effect on global energy prices and fuel. Let's not forget Covid hasn't gone away and although customer confidence is slowly returning, some businesses are still impacted by staff shortages due to illness and isolating. Finally, elevated inflation has been driven by supply chain issues and demand for goods after the economy effectively reopened in 2021.

The Chancellor's Spring Statement was just that, a statement and not the mini-Budget that was perhaps expected. Ignoring Rishi's big reveal at the end of a 1% income tax cut from April 2024 as this doesn't affect Scotland, there were some, if very little, key points for Scottish businesses. Namely:

- the 5p fuel duty cut;
- Employers NIC allowance increasing from £4,000 to £5,000;
- R & D relief reforms;
- consideration of options after the enhanced (130%) allowances cease in April 2023; and
- VAT on energy saving materials cut to 0%.

What positives can we take forward into 2022? The resilience of businesses and the expectations for 2022 are fantastic after the pull back in confidence from last quarter. Businesses must be able to plan for the future and prioritise workforce development to ensure they retain their top talent to push on in 2022 and into 2023.

Graham Parker
Condies Accountants & Advisors

Key results

This chart shows the 'net balance' measure of confidence for the key variables in our local economic survey. This is calculated by subtracting the percentage of firms reporting a decrease in activity from the percentage reporting an increase and, in general, a positive net balance indicates growth and a negative net balance indicates deterioration. This methodology is consistent with that used by the Scottish Chambers of Commerce QES.

Our Q1 survey was undertaken against a background of further loosening of Covid related restrictions, sharply rising costs and the initial stages of Russia's invasion of Ukraine. It is, therefore, extremely encouraging to see the majority of key results have improved from Q4, reflecting a strengthening in optimism across the Dundee & Angus region. Not only is every key variable now in positive territory, but the readings for both orders and investment have reached record highs. The strongest result confirms that the majority of local businesses intend to increase prices, largely in response to higher costs rather than strong levels of demand. And, whilst it is encouraging to see that local business profitability has improved slightly over the last 3 months, assessments of cash flow have worsened once more, highlighting the adverse consequences of sharply rising costs.

Our key variables indicate that business conditions have largely improved during the last 3 months. Every variable is now in positive territory and both orders and investment have reached record highs. As before, there is a strong intention to increase prices in response to rising costs.

Change in business optimism

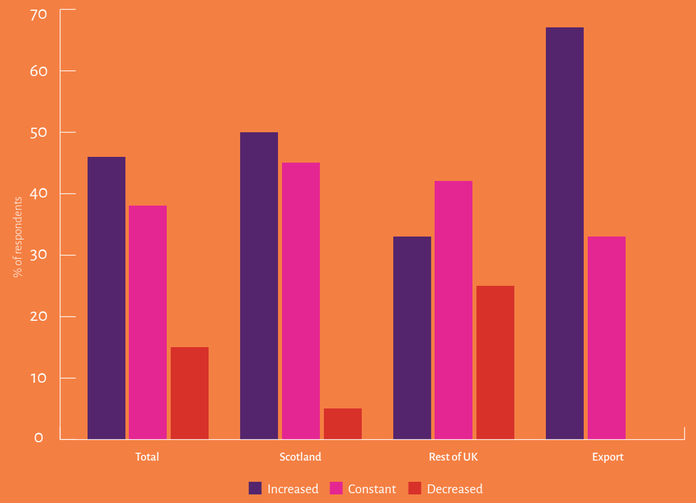
Our survey asks respondents to assess their current level of business optimism against both 3 and 12 months ago and the net balances are displayed for each sector. These results confirm that business optimism is considerably higher than it was both 3 months and 12 months ago, helped by the fact that revenue, orders and investment have all been relatively strong. Respondents from the arts sector, education, hospitality and manufacturing are significantly more optimistic than they were 12 months ago, but it is disappointing to see that sector wide optimism has lessened over that time in both construction and healthcare. Over the last 3 months, optimism has improved widely across most sectors, particularly arts and education, and has deteriorated in only 2 sectors, namely construction and healthcare. These results are stronger than we saw in Q4, undoubtedly helped by the fact that a net balance of +8% of businesses are now operating above 'normal' levels of capacity.

Local business optimism has improved significantly across the Dundee & Angus Region. The arts sector and education are leading the way whilst construction and healthcare appear to be facing more challenges.

Change in business revenue since last quarter

Our survey indicates that businesses' assessment of revenue raised over the last 3 months remains robust. The net balances for total revenue, revenue achieved in Scotland, that earned in the rest of the UK and export sales all remain positive, with sales within Scotland and export sales being particularly robust. Both the finance & insurance sector and hospitality have a very positive assessment of revenue raised over the last 3 months and it is really encouraging to see that no sectors have recorded a negative net balance. Our survey also covers future revenue expected over the next 3 months and in this case the arts, finance & insurance, hospitality and trades sectors are the most confident overall whilst the healthcare sector sees more challenges ahead.

	net balance (%)
Total	+31
Scotland	+45
Rest of UK	+8
Export	+67

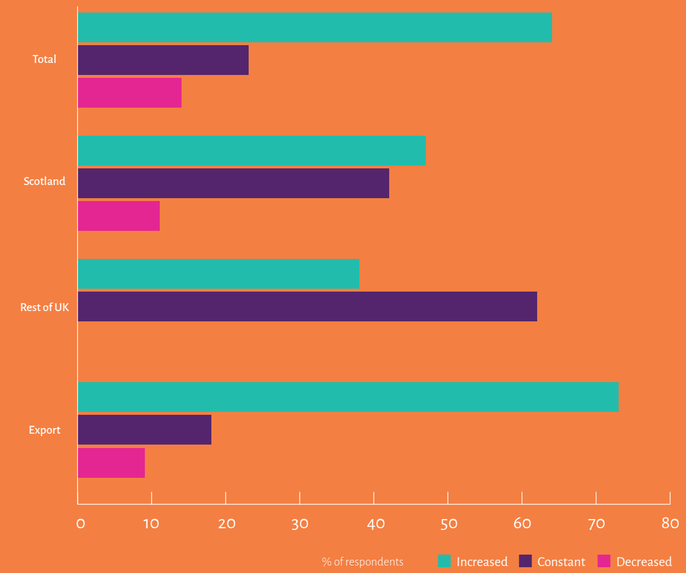


100% of survey participants who export report that these sales have either increased or remained unchanged over the last 3 months.

Change in orders since last quarter

The net balance figure for total orders has increased sharply, from +26% to a joint record high of +50%, reflecting a considerable boost to confidence amongst businesses in the Dundee & Angus area. Around 64% of participants have reported that total orders have increased, boosted by the export market where 73% of respondents have recorded an improvement. The arts sector and finance & insurance are performing particularly well whilst the healthcare sector appears to be facing the biggest challenges, with both total orders, and orders from Scotland, deteriorating over the last 3 months. Our survey also covers orders expected over the next 3 months and it is encouraging to report that the net balances for total expected orders, and orders expected from within Scotland, have both reached record highs. The construction sector, finance & insurance, healthcare and hospitality are the most optimistic about future orders.

	net balance (%)
Total	+50
Scotland	+37
Rest of UK	+38
Export	+64



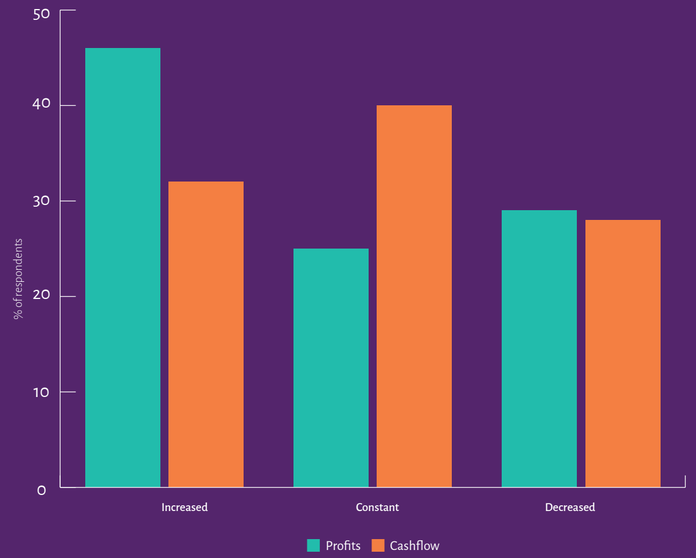
Local businesses have enjoyed a strong 3 months with regard to orders, and expect these positive conditions to continue over the next 3 months too.

Profits and cash flow

Profitability and cash flow are significant factors in the ability of businesses to thrive and expand, but the results of our survey indicate that, while profitability has improved slightly, cash flow has deteriorated further. Both variables are still recording positive net balances, but rising cost pressures are clearly having an impact. The most positive trends in profits were reported by the finance & insurance and manufacturing sectors, whilst the arts, healthcare and trades sectors all reported a decline in profitability. The finance & insurance sector was also the most positive about cash flow, whilst the arts and healthcare sectors provided the weakest assessments.

Net balance (%)	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022
Profits	-45	+4	+36	+10	+17
Cash flow	-39	+4	+23	+6	+4

Local businesses continue to give a positive assessment of both profits and cash flow, but the challenge of sharply rising input costs is having a negative impact on cash flow, particularly in the arts and healthcare sectors.



Investment

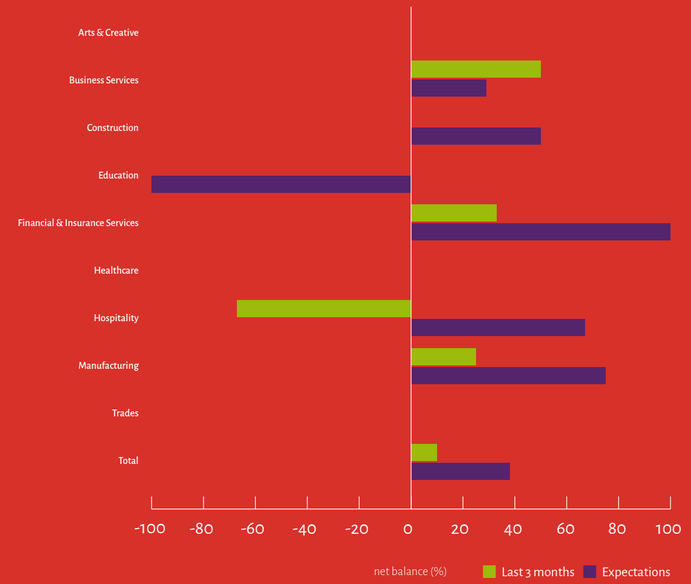
The net balance for total investment has increased sharply from its previous reading of +22% to reach a new record high of +48%, reflecting the fact that 90% of respondents say investment has either increased or remained unchanged over the last 3 months. And, during this time, capital investment has become more popular than training, recording a net balance of +44% compared with +33% for training investment. The education, healthcare and manufacturing sectors are leading the way in terms of capital investment, whilst only the construction sector is reporting a decrease. Training investment is most popular in the healthcare and hospitality sectors, and we are pleased to report that no sector has been forced to decrease spending in this area. Looking forward over the next 3 months, total investment spending is expected to increase once more, led by the hospitality sector, and training investment is expected to be more popular than capital spending.

Our survey's assessment of investment spending over the last 3 months has reached a new record high, led by capital spending in the education, healthcare and manufacturing sectors.

Employment situation

Having cut employee numbers during Q4, it is encouraging to see that this trend has been reversed during the first 3 months of 2022. The net balance measure of total employment has improved from -3 to +10 and the outlook for the next 3 months is even more encouraging, with an increase in the net balance from +30 to +38. During the last 3 months the hospitality sector was the only one to reduce its total level of employment, whilst business services, finance & insurance and manufacturing all increased employment levels and all other sectors left employee numbers unchanged. Looking forward, it is encouraging to see that the hospitality sector intends to recruit once more, along with finance & insurance, manufacturing, construction and business services. The education sector is the only one expecting to reduce employee numbers over the next 3 months.

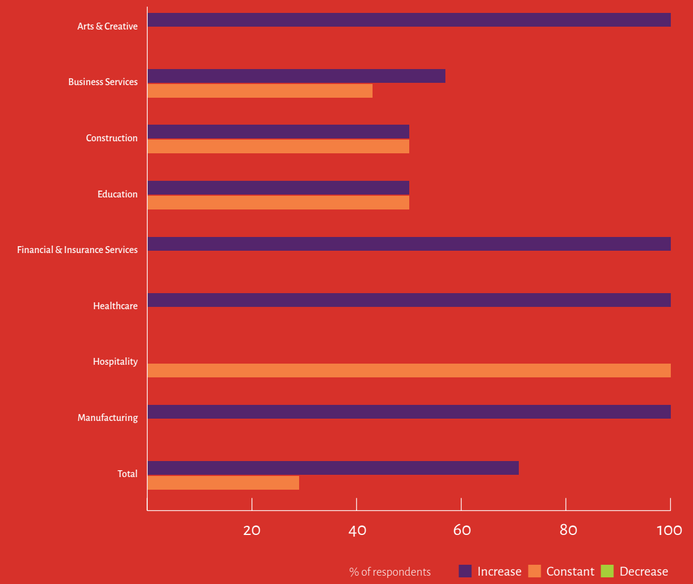
Although employment levels dipped during Q4, it is reassuring to see that this trend has not only fully reversed but that the outlook for employment is now even more encouraging.



Expected prices

Rapid and sharp cost increases are currently threatening economic activity and many businesses are exploring whether they can pass on at least some of these cost increases via higher prices. In our latest survey the net balance of businesses expecting to increase prices has increased from +53% to a new record high of +71%. And, for the third successive time, not a single business expects to cut prices in the coming 3 months. The pressure to raise prices is currently highest in the arts sector, along with finance & insurance, healthcare and manufacturing, whilst the hospitality sector largely expects to leave prices unchanged. Respondents also told us that the pressure to increase prices comes mostly from the increased costs of overheads and raw materials, accompanied by some wage pressure too.

The net balance for potential price increases has reached a new record high reflecting significant cost pressures arising from overheads, raw materials and wages.



Contributions to inflation

Concerns over energy costs are likely a continuation of the increase in wholesale natural gas prices from 2021, which saw a 33% increase in UK non-domestic gas prices[1]. Further to this, recent sanctions against Russia in response to the war in Ukraine are likely to exacerbate the cost increase of natural gas, meaning energy costs will continue to be a cause of inflationary pressure for DACC members.

UK average regular earnings have increased by 4.1% to the year ending January 2022[2], which reflects a rise in labour costs. Although these earnings increases are below CPI inflation (5.5%)[3] and both PPI inflation rates[4], this will still contribute to inflationary pressures on DACC members. Further, labour costs may increase more in the coming months due to the cost-of-living crisis.

Material shortages are also a significant contributor. ONS data shows that in the year to January 2022 producer input costs increased by 13.6% compared to a 9.9% increase in output prices[5]. This reflects global supply issues causing cost-push inflation. Given 47% of respondents are producer-facing firms, DACC members are vulnerable to material shortages. However, this also appears to be impacting consumer-facing members too, as 52% of total respondents have experienced supply chain disruptions.

Energy costs, labour costs, and material shortages were the three factors identified as the most significant contributors to inflationary pressures this quarter. 52% of respondents have experienced supply chain-based issues in the previous quarter.

Category	Response %
Shipping/Transport Costs	25%
Material Shortages/Supply Chain Disruptions	60%
Energy Costs	70%
Labour Costs	65%
Other	25%

[1] Department for Business, Energy, and Industrial Strategy (2021) Quarterly Energy Prices: July to September 2021, Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1043434/Quarterly_Energy_Prices_December_2021.pdf (Accessed: 22 March 2022).

[2] Office for National Statistics (2022) A01: Summary of labour market statistics, Available at: https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/summaryoflabourmarketstatistics (Accessed: 22 March 2022).

[3] Office for National Statistics (2022) Consumer Price Inflation tables, Available at: https://www.ons.gov.uk/economy/inflationandpriceindices/datasets/consumerpriceinflation (Accessed: 22 March 2022).

[4] Office for National Statistics (2022) Growth rate of output and input producer price inflation, Available at: https://www.ons.gov.uk/economy/inflationandpriceindices/datasets/growthratesofoutputandinputproducerpriceinflation (Accessed: 22 March 2022).

[5] ONS (2022) Growth rate of output and input producer price inflation

Expected inflation

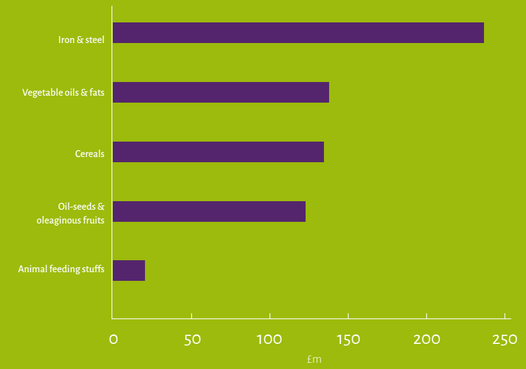
Expected inflation is a concern in the DACC region as most respondents are expecting significant price increases next quarter. The war in Ukraine is likely to have a noticeable impact on DACC members as it will reduce imports from Ukraine contributing to more material shortages. As the table shows, this will impact businesses who rely on imports such as crops, metals and organic oils and fats, i.e. those in the hospitality, construction, and manufacturing sectors.

	Response %
<1%	0.00
1-5%	36.84
5-10%	47.37
10-20%	10.53
20-50%	5.26
50-100%	0.00
>100%	0.00

An alarming 81% of respondents have increased concerns over inflation compared to the previous quarter, with 71% expecting inflation to cause price increases in the next quarter.

UK trade with Ukraine 2021

Top 5 import goods

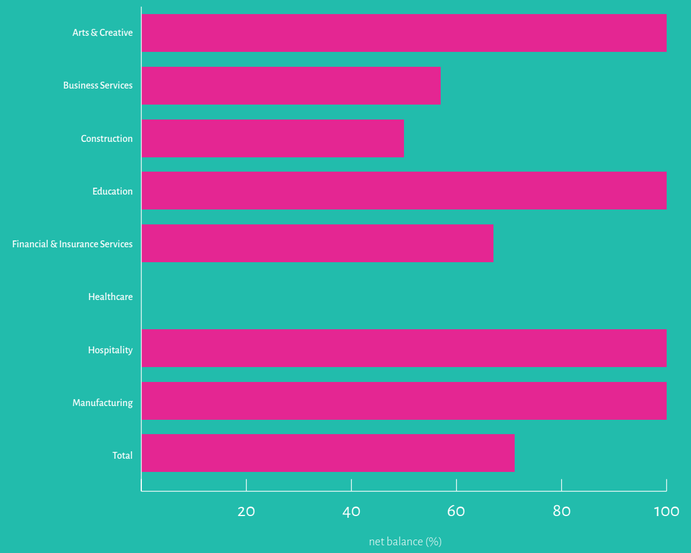


Source: Office for National Statistics - UK trade statistics

Expectations of future business prospects

We ask local businesses to assess their business prospects over the next 12 months and this chart illustrates the results. In line with the more optimistic trends apparent in the assessment of several key variables, the headline net balance has improved sharply, from +40% to a new record high reading of +71%. The arts sector, education, hospitality and manufacturing are the most optimistic this time and, given that there are no negative net balances, the healthcare sector is the weakest with an expectation of 'no change'. Although businesses have expressed considerable concerns about inflation, taxation, interest rates and exchange rates, it is really encouraging to see that no respondent in our survey expressed any concern about their ability to survive the next 12 months.

Given the challenging conditions we currently face, it is a testament to the strength and flexibility of local business that 71% of respondents expect business prospects to improve over the next 12 months.



DACC business sentiment indicator

Using all the data collected in our Quarterly Economic Survey, we have created a set of confidence indicators for businesses located in the Dundee & Angus area. The 'current conditions' indicator, assesses trading conditions over the last 3 months, and it is great to see that this has reversed the previous quarter's decline, rising from +11% in Q4 to a level of +26% today. And our 'expectations' index, which assesses future trading and activity, has also improved significantly this time, rising from a level of +30% in Q4 to a new record high of +55% today. This clear expression of confidence amongst local businesses is particularly encouraging as it comes at a time when the corporate sector must deal with the ongoing presence of Covid 19, supply chain issues and rising costs and, most recently, the political and economic fallout from war in Ukraine.

Our DACC Business Sentiment Index has recovered sharply over the last 3 months, led by expectations which have risen to a record high.

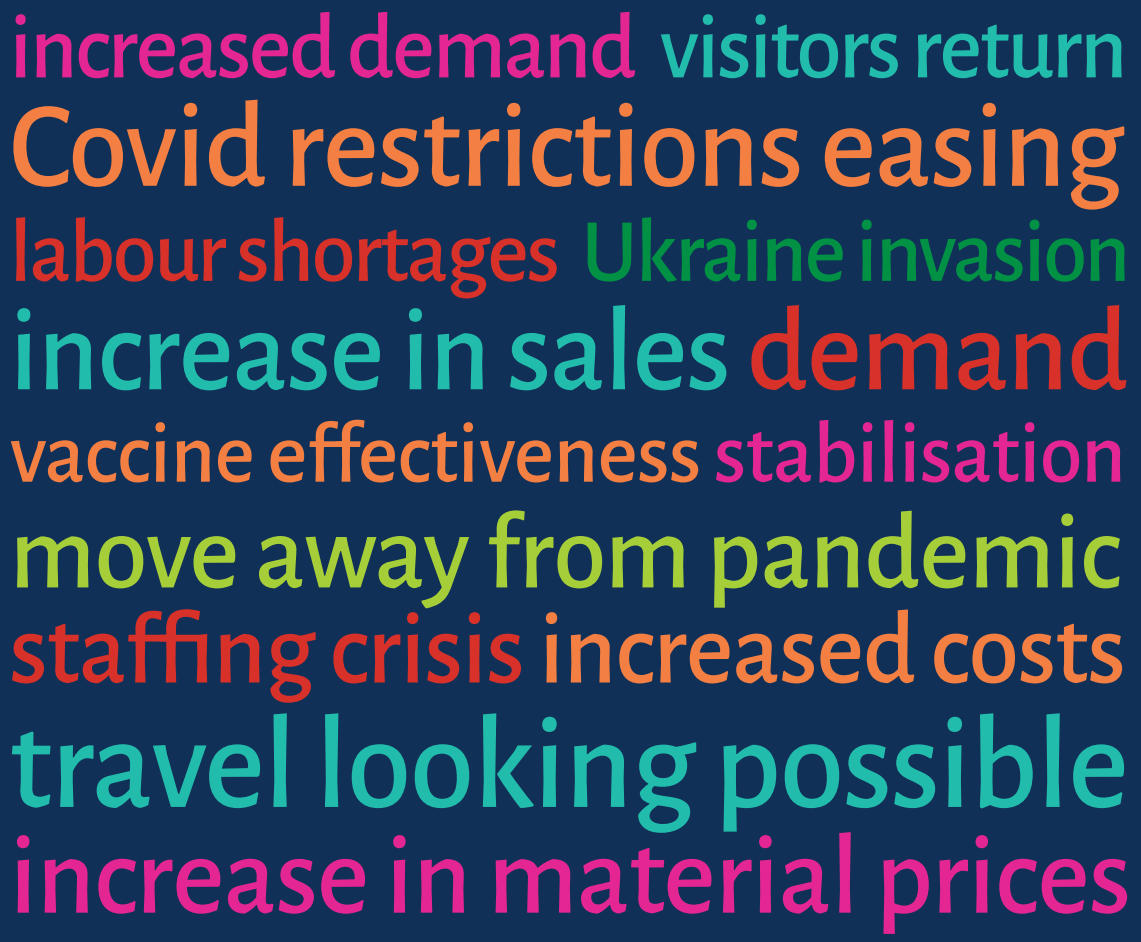
Conclusions and outlook

This is the eighth presentation of our quarterly business and economic survey which focuses on activity across the Dundee & Angus region and it has been undertaken during a period of considerable challenge. After 2 years of global pandemic, businesses must now learn to live with the ongoing threat of Covid, whilst supply chain issues and sharply rising costs have threatened profitability and cash flow. In addition, Russia's actions in Ukraine have produced some significant political and economic reactions already, and there may be more to come.

Given this adverse background, we are encouraged by the robust results of our survey. Assessments of our key variables have largely improved, with both orders and investment reaching record highs, and the local employment situation appears to have turned positive once more. And, looking ahead over the next 3 months, the assessments of future revenue and orders have also attained record highs. As a result, our indicator of current conditions has now reversed its fall in Q4, and our indicator of local business expectations has recorded a new record high.

Despite this very positive outlook, local businesses are clearly aware of the many challenges being faced. Although the majority of respondents express concerns about inflationary pressures; taxation, interest rates and exchange rates are also cited as significant risks. But local businesses have proved in recent years to be both resilient and flexible, and it is encouraging to see that they are entering this next challenging period with a relatively high degree of confidence.

Dr Shona Dobbie, Angus Economics
April 2022



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