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'EXPORT EFFECT' DRIVES BUSINESS CONFIDENCE IN SCOTLAND, BUT FEARS REMAIN OVER DOMESTIC DEMAND

- **Business confidence climbs to highest level since 2007**
- **Renewed optimism is fuelled by hopes for growing exports**
- **Firms are hopeful of better profits in the second half of 2010**

Scottish SMEs are drawing strength from overseas markets, predicting rising sales and anticipating improved profitability, despite continued weak domestic demand, according to Bank of Scotland.

The **Bank of Scotland Business Confidence Report** - which measures firms' outlook for sales, order book and profitability - shows that business confidence in Scotland is continuing the climb back from the historic lows of 2008.

Scotland recorded a balance of 14 per cent in June – rising from 3.3 per cent in the first quarter of 2010. The 14 per cent figure is the average of business confidence on future sales (23%), orders (21%) and profits (1%) based on how they think they will perform over the next six months. These individual balances show the net percentage of businesses with a positive outlook – the number of companies expecting a rise minus those expecting a fall.

Renewed momentum in business confidence is being driven in large part by the promise of growing exports. A balance of 21 per cent of businesses expects order book levels to rise in the second half of this year, with over half (57 per cent) expecting a rise in foreign sales, as a result of the rebound in world demand and a sustained fall in the pound.

Uncertainty about falling domestic demand is the biggest worry amongst businesses with 62 per cent of businesses in Scotland say that fragile domestic markets are their greatest concern.

UK national trends

Confidence levels across the sectors reflect this concern over domestic demand – with those sectors that are most reliant on domestic markets proving to be the least optimistic. Confidence levels in firms in the whole of the UK serving the public sector hit -1 per cent, while the hospitality and leisure sectors were similarly pessimistic (a balance of two per cent).

The fact that confidence levels across businesses serving the public sector are significantly lower than the average of all businesses is likely to be a reflection of worries about the potential impact of government spending cuts on business opportunities across the UK.

The UK's smallest businesses (with a turnover of under £1 million) saw confidence slip, albeit by just one percentage point, to ten per cent, though that level is significantly above lows plumbed in 2008.

A new North-South divide

Despite the apparent strengthening of confidence amongst manufacturers, overall fears of a slowdown in domestic demand are hitting the UK's manufacturing heartlands, perhaps a reflection of the importance of the public sector to the economy of these parts of the UK. Confidence levels are weakest in the West Midlands (a ten per cent balance), with Wales, Scotland and Northern England all registering similarly low levels, compared to relatively strong confidence levels in London and the South East (balances of 25 per cent).

However, expectations for export sales are strongest in those areas struggling with domestic demand – a further indication that firms are resting hopes on overseas markets where demand at home is seen to be weak. The balance of firms expecting to grow exports over the coming six months is 57 per cent in Scotland, 48 per cent in Yorkshire and 46 per cent in Wales.

Impact on investment

Lack of confidence in prospects for domestic demand is having a knock on effect on business plans for the coming year. The balance of Scottish firms expecting to be able to boost investment is at -4 per cent. Other factors that have caused firms to keep the brakes on investments spending include weak profits and excess capacity – both reflections that demand remains an issue for many firms.

Donald Kerr, Head of Bank of Scotland, Commercial, said: “Business confidence in Scotland is on the turn and we are beginning to see signs that firms in Scotland are hopeful for the future, with many seeing better sales and profitability on the horizon. Concerns about home-grown demand unsurprisingly weigh on the minds of business owners whose success depends on domestic markets.”

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EDITORS' NOTES:

Regional confidence levels

Region	Confidence Index
West Midlands	10
South Midlands	19
East Mids/East Anglia	12
London	25
South West	20
South East	25
Wales	11
North West	13
North East	14
Yorkshire	15
Scotland	14
AVERAGE	18

Responses from 2,300 firms across the UK were collated in July 2010.

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