Quarterly Economic Commentary

we gratefully acknowledge the contribution of the
Buchanan and Ewing Bequest
toward publication costs

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The Quarterly Economic Commentary is published in March, June, September and December. Annual subscription rates are £40.00, or £10.00 per single issue. Queries should be addressed to the Secretary, the Fraser of Allander Institute.

Notes to contributors

The editors welcome contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Editor.

Articles accepted for publication *must* be supplied on 3.5 inch or 5.25 inch disks in either WordPerfect or ASCII format.

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QUARTERLY ECONOMIC COMMENTARY

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OUTLOOK AND APPRAISAL

Economic prospects over the last quarter have not improved, and have shown signs of worsening in some areas. Recovery from the persistent and lengthy recession is unlikely to become apparent until the second half of this year.

Provisional figures for the fourth quarter of last year indicate that UK gross domestic product fell by 0.3%. Unless subject to an unusually large upward revision, this means that non-oil GDP has fallen for six successive quarters, the longest recession since the Second World War. While still less deep overall than the 1979-81 recession, the extent of the present slump should not be underestimated. For example, in 1991 GDP declined by 2.5%, the largest decline in a single calendar year for sixty years. Investment spending has also been badly hit over the last year; capital expenditure by UK manufacturing industry fell by 15% in 1991, and was still declining in the final quarter of last year. The cumulative amount of outstanding consumer credit (excluding bank loans) has fallen every month from August last year to January, and retail sales are struggling to show any signs of upward movement.

While the picture is far from rosy in Scotland, the Scottish economy still shows clear evidence of escaping the worst aspects of the recession. By January the rate of unemployment in Scotland was indistinguishable from the UK average, an event which has not occurred in more than a generation. Over the period from March 1990 to January this year, the level of Scottish unemployment rose by 13% compared with a rise for the UK of 62% and a 128% increase in the South East. Provisional figures for the index of production and construction suggest that the third quarter of last year saw some evidence of recovery in Scottish industry. Excluding oil and gas, the Scottish index rose by 1.2% during the quarter compared with a decline of 1.0% in the UK index; this results in an annual decline of 4.0% and 4.3% in the Scottish and UK indexes respectively. In manufacturing, the Scottish index rose 1.5% in the third quarter compared with a UK decline of 0.2%. Even so, the Scottish index shows an annual manufacturing decline of 6.6% while its UK counterpart's fall is rather less at 5.1%.

The quarterly rise in the Scottish index comes mainly from two sources. The first is a 2% increase in engineering, the result of sudden 11% increases in both mechanical engineering and transport equipment, two areas which have suffered particularly badly during the recession. Such quarterly fluctuations are possible in sectors whose output tends to be 'lumpy'. However, this is not the case in the other main area of increased output, drink and tobacco, the index for which rose 8% in the third quarter. This increase is somewhat surprising, because production of Scotch whisky is always at its lowest ebb in the third quarter, and was actually 25% **lower** than in the second quarter. For the year to September 1991 the drink and tobacco index shows a rise of 1%, at the same time as a decline in whisky production of 3.6%. Producers of beer, soft drinks and tobacco products must be doing very well.

Outlook

Most British companies have undoubtedly underestimated the length of the recession, which is hardly surprising given the continual claims of government (and, of course, economic commentators) that recovery was 'just around the corner'. One result of this is that the rate of job losses, which slowed in the third quarter of last year, began to accelerate again towards the end of the year. In the three months to January the average monthly rise in UK unemployment was 43,300 compared with 31,300 for the three months to October 1991. The worrying point is that several other economic indicators also weakened towards the end of last year. Provisional data for UK manufacturing output suggests a slump of 1.2% in the quarter to December following a modest 0.2% fall in the previous three months. As indicated earlier, consumers are still repaying credit; indeed, in the three months to January the amount of outstanding credit fell by £293 million, a greater decline than in the previous three months (£212 million). Falling business confidence and new orders late last year also resulted in both the longer and shorter cyclical indicators of the UK economy turning down again in December and January following a steady rise in the former since June 1990 and in the latter since June 1991. These are not the signs of an economy emerging strongly from recession.

The question is whether the continuing weakness of the UK economy will prevent the recovery in Scotland which is hinted at by the index of production figures. Part of the problem arises from the reluctance of consumer confidence to recover as strongly as was hoped, itself partly the result of weak asset prices (especially houses) and consistently high real interest rates. This has resulted in a debt 'overhang' which has been particularly noticeable in the south but much less pronounced in Scotland. For example, between 1980 and 1989 the average ratio of mortgage advances to income in the south of England (South East, South West and East Anglia) rose from 1.7 to 2.4, an increase of 41%. Over the same period, the equivalent Scottish ratio rose more modestly from 1.5 to just under 1.8, a rise of 19%. Interestingly, the Scottish ratio actually declined slightly in 1986-87, just as the size of mortgage advances in most parts of England were starting to rise rapidly. Coupled with a lower level of home ownership, this is one of the main reasons why the policy of high real interest rates affected Scotland less than much of the south of Britain, a favourable effect which will unwind with lower interest rates and eventual emergence from recession.

There is now just a hint that UK high street spending may be beginning to turn up. In the three months to January the volume of retail sales rose by 0.4% following a decline of 0.3% in the previous three months. This increase is welcome, although it should be borne in mind that the January figures are still provisional and may have been distorted by an unusually large monthly increase in sales of food. The latest CBI quarterly distributive trades survey also found some patchy evidence of increased retail spending, although sales of durable household goods remain sluggish. While not the giveaway budget which some had predicted, the measures proposed by the Chancellor are clearly designed to give what boost he could to the economy. Income tax reductions at the lower end of the pay scale will have some favourable effect as will the halving of car tax, although this latter measure is probably more geared towards the fleet than the domestic purchaser (spending on vehicles by UK manufacturing industry fell by almost 40% in 1991). The recent suspension of stamp duty on house purchases is also welcome, although it will take some time for the housing market to revive in the south of Britain.

However, these measures may not be enough to prevent Scotland from suffering some of the adverse consequences of a recession which will not go away easily. The last Scottish Chambers' Business Survey indicated some falling back of business confidence, following two quarters in which confidence had increased. Most sectors anticipated increased orders in the first quarter of this year, but similar expectations failed to be realised in the previous quarter. The latest projections from the Institutes's short-term model of the seasonally-adjusted Scottish output index for production industries reflects the persistence of the recession, and now suggests a very modest rise of 0.2% during this year. This is a downward revision from the last Commentary, and it should be noted that the forecast assumes that the favourable circumstances which have resulted in Scotland outperforming the UK during the course of the recession will gradually unwind as recovery begins. The result is an apparent upturn in the third quarter of last year (consistent with the provisional data discussed above), followed by a period of stagnation, with no real sign of recovery in the first half of this year. However, growth in the production industries is expected to resume in the second half of the year, with the index of production in the final quarter of 1992 forecast to be 1.2% above its position a year earlier.

12 March 1992