Quarterly Economic Commentary

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

FRASER of ALLANDER INSTITUTE

The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short term movements in economic activity. Along with the Quarterly Economic Commentary the Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium term and long term aspects of the Scottish economy. The Institute is a research unit in the Strathclyde Business School, a faculty of the University of Strathclyde.

Information for subscribers

The Quarterly Economic Commentary is published in March, June, September and December. Annual subscription rates are £30.00, or £8.00 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.

Commentary Team

Editor : Jim Love

Contributors: Brian Ashcroft, Neil Dourmashkin, Paul Draper, Stewart Dunlop, Cliff Lockyer, Lesley Magee, Eleanor Malloy, Claire Monaghan, Peter McGregor, Iain McNicoll, Eric McRory, Roger Perman, Jim Stevens and Kim Swales.

Graphics: Eleanor Malloy

Production: Linda Kerr and Isobel Sheppard

The Fraser of Allander Institute
Curran Building
100 Cathedral Street
GLASGOW
G4 0LN

041-552 4400 Ext. 3958

QUARTERLY ECONOMIC COMMENTARY

* * * * * * COMMENTARY * * * * * *

* * * * * * VIEWS * * * * * *

Opinions expressed in signed contributions are those
of the authors and not necessarily those of the Fraser Institute

© Fraser of Allander Institute 1990

Outlook and Appraisal

Previous Commentaries have stated that Scottish industrial output has probably been outperforming that of the UK throughout 1990. The index of production and construction for the first three months of the year underlines this to a remarkable degree, recording a rise of 4.6% in a single quarter and overtaking the UK index for the first time for many years. This single quarter's performance is even more marked within the manufacturing sub-section of the index, which recorded a 5.6% rise in the three months to March. This now ascribes to Scottish manufacturing an annual rise of 6.6%, more than double that of the UK as a whole (3.0%).

The usual caveats about not reading too much into one quarter's figures certainly apply here, but some attempt has to be made to analyse the sectors responsible for this unusual performance. Almost two thirds of the rise in the overall index is accounted for by the engineering and drink and tobacco sectors, with electrical and instrument engineering showing especially strong growth. The engineering sector production index is notoriously prone to subsequent revisions, and output in this sector does tend to be 'lumpy', with the completion of individual large orders having a significant effect on the index for a single three month period. However, both of these explanations generally apply with more force to mechanical engineering rather than electrical engineering and electronics, which leaves the issue of a 14% rise in this sector in a single quarter unresolved. In some ways the 11% rise in the drink and tobacco manufacturing index is more surprising, coming at a time when Scotch whisky output actually fell slightly. By taking a slightly longer term view it becomes apparent that the jump in production in this sector is more illusory than real; what the official figures actually show is a slump in the final quarter of last year followed by an immediate recovery early in 1990, although the causes of the apparent slump last year remain unclear.

Much more recent information on the Scottish economy is available from the latest Scottish Chambers' Business Survey, the last of the present series before the SCBS becomes much enlarged with a survey base of 4000 companies. Perhaps most interesting here is the continued buoyancy of the retail sector, with a net 16% of respondents still feeling more optimistic about the general business outlook for the three months to July than they did at the time of the last survey. This optimism is borne out by results, with a net 38% reporting increased sales over the last three months and a balance of 21% expecting further increases to come. The contrast between these results and the problems being encountered by high street retailers in the south of Britain could hardly be more marked. Despite this, there is some evidence of labour shedding, both actual and anticipated, in this sector. Manufacturers have also experienced reasonable fortunes over the last three months; a balance of 12% of respondents to the SCBS had increased new orders in the last quarter, with a balance of 7% anticipating further increases. However, despite also exhibiting some evidence of enhanced employment opportunities, manufacturers are relatively pessimistic about the business situation, with a balance of -18% on the issue of whether they felt more or less optimistic about the general situation.

In construction, however, the picture is very far from buoyant. A balance of 27% of respondents reported a feeling of decreased optimism about the general business situation, a sharp contrast to the situation three months ago and the most pessimistic returns ever for construction in the SCBS. The reason for this seems to hinge on a sharp downturn in private sector orders, with a net 33% of respondents reporting a fall. Aberdeen construction firms clearly buck the trend, however, with both orders and employment booming and expected to continue to do so (see Construction section).

Scottish Labour Market

Scotland's outperformance of the UK tends to disappear as we move from the market for goods and services to the labour market. For example, in the year to March Scottish employment rose by 2.0% (39,000) compared with 2.2% for the UK. There are some interesting differences in relative performance, however. The UK rise was the lowest annual increase since June 1987, and revealed the first actual decline in male employment since late 1986. This is a clear indication of the slowdown in the UK economy as a whole. By contrast, male employment in Scotland continued to grow in the year to March, albeit by only 8,000; full-time female employment grew by 24,000. There are also some differences in the sectoral composition of employment changes between Scotland and the UK. In the year to March UK manufacturing employment fell by 49,000 (1%), with 20,000 of this occurring in the final quarter. In Scotland, by contrast, manufacturing employment continued to grow slightly - by 2,000 - with the vast majority of new employment continuing to arise in the service sector.

Continuing increases in Scottish manufacturing employment may simply be a reflection of the time lag between a slowdown occurring in the southern part of Britain and the same thing happening in Scotland. It may, however, also have something to do with the structure of Scottish manufacturing and particularly its export orientation and ability to switch to export markets when domestic demand falters. The time-lag element does seem fairly clear when we turn from employment to unemployment. Four years of continuous decline in UK unemployment stopped in April, and unemployment is now showing clear signs of accelerating again. In Scotland unemployment did not bottom out until July, fully three months after the UK, and unemployment rises have so far been modest. Like the UK as a whole, however, unemployment increases are likely to gather pace as the slowdown continues, and it should be remembered that the Scottish rate of unemployment remains stubbornly high; in July Scottish unemployment stood at 8.0% compared with 5.7% for the UK.

The Gulf

It is impossible to assess Scotland's economic prospects without making some reference to the situation in the Gulf. From a Scottish perspective there are two fairly obvious themes which can be explored. The first is the effect on exporters of the loss of Iraq and Kuwait as export markets for the time being; the second, and probably more important theme is the impact of higher oil prices in the short and long term.

According to the latest available Scottish Council data, in 1988 Scotland exported just £16 million of manufactured goods to Iraq (of which nearly one quarter was, interestingly, whisky) and less than £10 million to Kuwait. These figures take no account of service exports to these countries, but it is clear that neither can be regarded as a crucial export market. Sanctions imposed on Iraq seem likely to have a smaller impact on Scottish exporters than those in other parts of the UK. Iraq accounted for just 0.22% of total Scottish manufactured exports for 1988 compared with 0.6% of UK manufactured exports. Indeed, Scotland seems less exposed to the Gulf as a whole than does the UK, with just over 1% of Scottish manufactured exports going to this region compared with over 4% of UK manufactured exports ('The Gulf' is here defined to include Iran and Iraq as well as Saudi Arabia, UAE, Bahrain, Kuwait, Oman and Qatar). This is not to deny the region's importance to individual Scottish companies, especially those in power engineering which have been making inroads into the Iraqi market; but, in general, sanctions against Iraq are unlikely to prove of major direct consequence for the Scottish economy.

The rising price of oil could have more important consequences, however. In the short run Scotland suffers from the effects of higher oil prices because petrol becomes dearer and transport costs become higher. In the longer run, however, Scotland stands to benefit from an oil price which sticks around $25 per barrel because of the boost which it can give to both oil production and exploration. Several marginal oil fields are expected to become commercially viable at an oil price somewhere in the range of $25 per barrel upwards, giving a further boost to an industry which has already entered a clear period of expansion. The importance of this to Scotland should not be underestimated; the collapse in the price of oil in 1985-86 precipitated a recession in Scotland which was not shared by the rest of the UK and from which it took the Scottish economy almost three years to recover. A corresponding boom from firmer oil prices cannot be guaranteed, but some net benefit to Scotland is almost certain.

From the Government's point of view higher oil prices are much more of a mixed bag. Since the UK is a net oil exporter the current account of the balance of payments will improve, and the Exchequer gains from increased tax revenues. To the extent that sterling is stronger than would otherwise be the case as a result of events in the Gulf, this also gives some assistance to the

Government's anti-inflation strategy by making imports cheaper than they would otherwise be. But since every silver lining has a cloud in economics, there are offsetting drawbacks. Higher oil prices will rapidly feed into an inflation rate already destined for double figures, and the corporate sector will be given another turn of the screw when major companies are already clearly feeling the effects of the slowdown in economic activity.

None of this is likely to persuade the Chancellor to relax his high interest rate policy in the near future, Mr Major preferring on balance to flirt with recession rather than trifle with inflation. The drop of 1.6% in August's provisional retail sales figures will be welcome news, suggesting that high street spending has been flat over the last three months, but will not yet convince Mr Major that the time is right to reduce interest rates. For the time being there is unlikely to be any shift in Government economic policy, and the signs are that Scotland's economy will continue to slow down rather more slowly than that of the UK.

12 September 1990