

# The SCOTTISH Economy

## SHORT-TERM FORECASTS\*

This section presents short-term forecasts for the quarterly growth rates of Scottish manufacturing (Division D of the 1992 SIC) output and annual growth rates are also included.

The present forecasting period extends to 2002q1. In making the Scottish forecasts, the past performance of the Scottish and UK manufacturing outputs are considered, and the National Institute of Economic and Social Research's quarterly forecasts for UK manufacturing output are used to drive the Scottish forecasts. Figure 1 depicts Scottish and UK manufacturing output from 1986q1 to 2000q1 and the forecasts for 2000q2 to 2002q1. The Scottish Executive Index of Production (1995=100) is used in determining the forecasts of manufacturing output. The results are presented in Table 1 below.

The outturn for Scottish manufacturing growth for 2000q1 was negative (-1.7%) again. The magnitude of the change was unexpected and appears to be due to the effects of the strength of Sterling from the end of last year. UK forecasts of manufacturing output are expected to demonstrate a more optimistic outlook. The forecast for 2000q2 is 0.6%. We do not believe that during the year 2000 Scottish manufacturing will fully recover from its recent problems and the effects of the fuel crisis in 2000q3 are difficult to determine at this stage. We are also still assuming a boost to Scottish manufacturing from inward investment in the year 2001. This contributes to the strong growth rate in the first two quarters of 2001. The National Institute is still forecasting that UK manufacturing will expand particularly in the 2001 and in 2002 but not as fast as other parts of the economy.

\* Development of the short-term model of the economy was made possible by the funding of a three-year research fellowship by TSB Bank Scotland.

**TABLE 1 ANNUAL AND QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)**

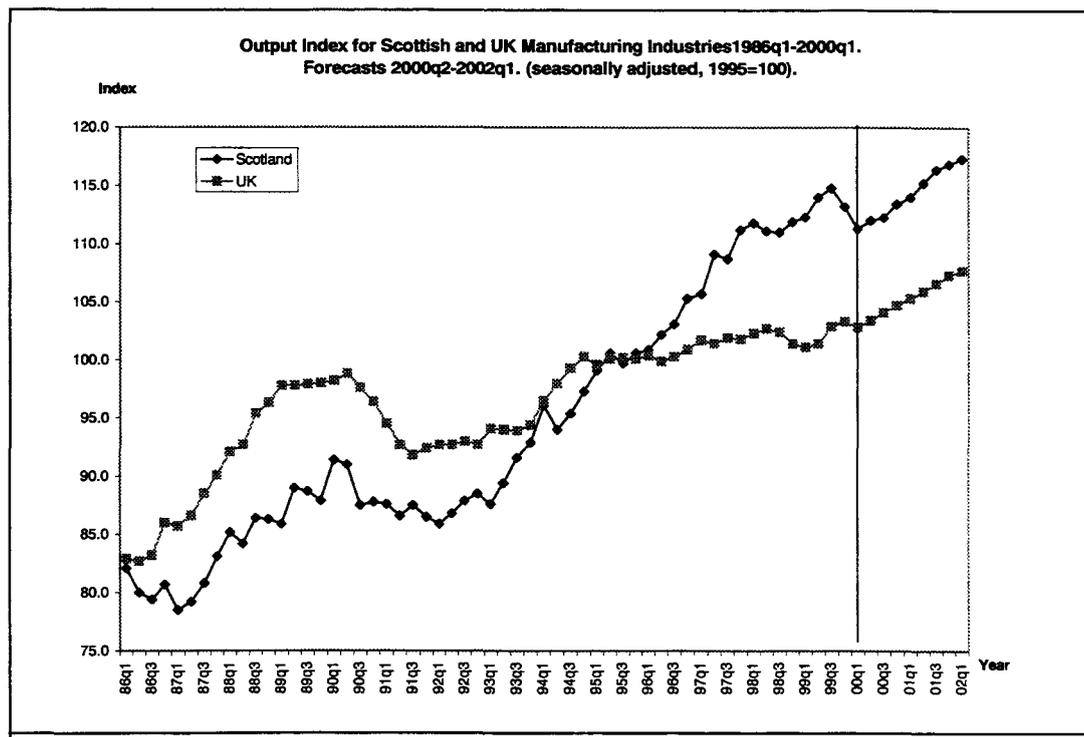
|                  |      |
|------------------|------|
| 95/94            | 4.5  |
| 96/95            | 2.9  |
| 97/96            | 5.6  |
| 98/97            | 2.6  |
| 99/98            | 1.9  |
| 95Q1/94Q4        | 1.8  |
| 95Q2/95Q1        | 1.5  |
| 95Q3/95Q2        | -0.9 |
| 95Q4/95Q3        | 0.9  |
| 96Q1/95Q4        | 0.3  |
| 96Q2/96Q1        | 1.3  |
| 96Q3/96Q2        | 0.9  |
| 96Q4/96Q3        | 2.1  |
| 97Q1/96Q4        | 0.4  |
| 97Q2/97Q1        | 3.2  |
| 97Q3/97Q2        | -0.4 |
| 97Q4/97Q3        | 2.3  |
| 98Q1/97Q4        | 0.5  |
| 98Q2/98Q1        | -0.6 |
| 98Q3/98Q2        | -0.1 |
| 98Q4/98Q3        | 0.8  |
| 99Q1/98Q4        | 0.4  |
| 99Q2/99Q1        | 1.5  |
| 99Q3/99Q2        | 0.7  |
| 99Q4/99Q3        | -1.4 |
| 00Q1/99Q4        | -1.7 |
| <b>FORECASTS</b> |      |
| 00Q2/00Q1        | 0.6  |
| 00Q3/00Q2        | 0.2  |
| 00Q4/00Q3        | 1.0  |
| 01Q1/00Q4        | 0.5  |
| 01Q2/01Q1        | 1.1  |
| 01Q3/01Q2        | 1.0  |
| 01Q4/01Q3        | 0.4  |
| 02Q1/01Q4        | 0.4  |
| 00/99            | -1.1 |
| 01/00            | 3.0  |

## SCOTTISH CHAMBERS' BUSINESS SURVEY

The Chambers' Business Survey is conducted by Strathclyde University's Fraser of Allander Institute together with the Scottish Chambers' of Commerce. In the present survey, which was conducted in June, some 670 firms responded to the questionnaire.

### Summary Points

Changes in business confidence were widely reported in the second quarter. Declining trends in



business optimism was evident in manufacturing, wholesale, retail distribution and tourism. Only construction respondents reported a level trend in business confidence.

Changes in the levels of orders and sales were widespread in all sectors. Declining trends in total orders were reported in manufacturing and declining sales trends were reported in wholesale, retail and tourism. The outturn in demand was worse than anticipated in manufacturing and construction, and weaker than expected in retail distribution and tourism.

Average capacity used rose slightly in manufacturing and construction, but was almost four percentage points lower in tourism (compared to second quarter 1999).

Manufacturing respondents expect a modest rise in orders in the next quarter. In contrast, retail and tourism respondents anticipate continued weak demand in the third quarter of 2000.

Expectations of price increases in the next quarter eased for a further quarter in manufacturing and wholesale, and remained at a low level in retail. The extent of price increases in tourism was less than expected, and some discounting of prices is anticipated in tourism.

There was no evidence of increased pay pressures in the second quarter. Average pay increases in the second quarter ranged from 2.81% in wholesale to 5.7% in construction.

Expectations as to rising turnover over the next year continued amongst manufacturing, wholesale and retail respondents. In manufacturing a rise in profitability over the next year is anticipated, although at reduced levels.

In the service sector the expectations are for rising turnover but declining profitability.

Increasing pressures on margins over the next twelve months were more evident at the end of the second quarter than three months earlier.

**MANUFACTURING**

**Optimism**

The rise in business confidence ended, as the trends in orders and sales weakened.

**Orders and Sales**

For a further quarter the outturn in orders and sales was weaker than anticipated, and respondents have

## Quarterly Economic Commentary

revised downwards their expectations as to trends in orders and sales in the next quarter.

The levels of orders, exchange rates and competition were identified as the factors thought most likely to limit output.

### Finance

Cash flow trends weakened for a further quarter, and whilst expectations as to improvements in turnover over the next twelve months remained unchanged, expectations as to the trends in profitability over the next year eased. Anticipations of price increases eased for a further quarter.

### Investment

Changes to investment plans were reported by 36% of respondents. Investment in the second quarter was authorised for the replacement of equipment [30%] and towards reducing labour [27%].

### Employment

Employment trends continued to fall, a net decline of 7%, but this net rate of decline is expected to reverse over the next quarter. The slight increase in overtime levels reported in the first quarter did not continue through to June.

Recruitment activity rose as 48% sought to recruit staff in the second quarter. 31% reported increasing pay by an average of 3.69%, compared to an average of 3.22% in the previous quarter.

## CONSTRUCTION

### Optimism

A level trend in business was reported, although changes in confidence were reported by less than 40%.

### Orders

The trend in total orders was weaker than anticipated, with a net of 4% of respondents reporting an increase.

The strong upward trend in private sector orders continued, but this strong rise is expected to fade in the third quarter.

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 74% in quarter one to 79% in quarter two.

### Investment

Changes to investment again affected slightly less than 30% of respondents, and the rise in plant/equipment investment ended. Of those investing in the second quarter 52% directed investment towards the replacement of equipment and 21% towards increasing efficiency.

### Employment

The rise in construction employment continued, and this rise is expected to continue, although at reduced rates, through the third quarter. 13% increased pay by an average of 5.7% compared to 4.1% in the previous quarter, and 52% sought to recruit staff in the second quarter, again mainly skilled manual staffs.

## WHOLESALE DISTRIBUTION

### Optimism

The decline in business optimism continued for a further quarter, although almost two thirds reported no change.

### Sales

Respondents had forecast a decline in sales for the second quarter, although the net decline of 7% was less than anticipated. This decline is forecast to continue through the third quarter at a reduced rate. Concerns as to competition were cited by 59%, as the factor thought most likely to limit activity in the third quarter.

Pressures to raise prices were largely unchanged from the previous quarter, and transport costs were the most widely cited factor.

### Investment

Changes in investment plans were reported by 30%, and the upward trend in investment continued.

### Finance

The declining cash flow trend eased significantly to a net decline of 5%. Expectations of turnover and profitability over the next year improved, but the improvement in turnover is expected to be at the expense of profitability.

The net of firms expecting to increase prices over the next quarter eased slightly to 25%.

### Employment

Changes to employment levels again affected less than 32%, and the decline was less than anticipated. Respondents continue to anticipate a decline in employment in the next quarter. 29% reported increasing pay by an average of 2.81% compared to an average increase of 3.12% in the previous quarter.

### RETAIL DISTRIBUTION

#### Optimism

Changes in business confidence were reported by 49%, and the declining trend in business confidence accelerated to a net of 14%.

#### Sales

The decline in sales was worse than had been anticipated, although the decline is forecast to ease through the third quarter.

There was some evidence of increased pressures to raise prices in the second quarter, most notably in terms of pay settlements and transport costs. Concerns as to the level of competition remain the factor thought most likely to restrict sales.

#### Investment

The upward trend in investment plans continued.

#### Finance

Cash flow trends deteriorated in the second quarter, and the trends remained negative. Expectations as to the trend in turnover over the next year were unchanged, however expectations as to profitability eased, suggesting respondents anticipate that turnover growth will impose pressure on profitability levels.

For a further quarter competitive pressures continued to inhibit price increases and the net expectations of price increases remain low.

#### Employment

The outturn in employment was weaker than had been anticipated. The marginal decrease in employment continued (a net decrease of 6%), and is now forecast to continue through the third quarter. Recruitment activity was more widespread in the second quarter, and 32% increased pay by an average of 3.61% compared to an average increase of 4.54% in the previous quarter.

### TOURISM

#### Optimism

Changes in business confidence were again widely reported, and the rise in confidence in the previous quarter proved temporary as a net of 14% reported being less confident than three months earlier.

#### Demand

The outturn in demand was worse than anticipated, with demand from all areas falling. Average capacity used was lower than in the second quarter of 1999 and 1998.

#### Investment

Investment continued to rise, although for more than 83% the main reasons for authorising investment were to replace/renew facilities or to improve facilities.

#### Finance

Increased pressures on margins were again evident. Turnover trends in the second quarter of 2000 were weaker than expected, but again costs rose slightly more than had been anticipated. Discounting of prices was more evident, but less than had been anticipated. The discounting of prices/room rates in the second quarter was more broadly based than had been expected.

#### Employment

57% reported no change to overall employment levels, the anticipated increase did not occur, nevertheless, a marginal increase is forecast for the third quarter.

#### Recruitment

Recruitment activity increased with 87% seeking staff (compared to 84% in the previous quarter). Two thirds of those recruiting staff reported difficulties in attracting suitable staffs, most notably skilled and other manual staffs. 44% reported increasing pay by an average of 4.1%, compared to an average increase of 5.2% in the previous quarter.

### CONSTRUCTION

The latest Halifax House Price Index, covering the second quarter 2000, reveals that in Scotland house prices fell by almost 6%, the largest fall of any area in the UK. For the UK as a whole house prices were unchanged, the first time house prices have not risen since the third quarter of 1995. At a

regional level the average price of a house in Scotland is now £60,689. Annually house prices in Scotland are now 2.3% lower than twelve months ago and Scotland is the only region in the UK that has experienced such a fall in house prices. Annual house inflation slowed to 1.3% in the second quarter from 14.5% in the previous quarter. Despite the overall fall for Scotland there are still pockets of activity throughout the country and demand continues to outstrip supply in areas of Edinburgh, Stirling, Inverness and Ayrshire. The situation is also different in the case of flats where most areas are reporting slow sales for this type of accommodation while new build properties, especially in Fife and Dundee, are selling well.

In contrast the latest Lloyds TSB Scotland House Price Index suggests that Scottish house prices rose sharply in the last three months. The survey, which covers the period April through to July, reported an increase in prices of 11% which follows a static period in the autumn and winter. Prices are still well below the UK price increases of 11.3% to 16% reported in the same quarter. The number of first time buyers fell from 43% during the first quarter to slightly more than a third; this is linked to the increase in house prices and interest rates. The average first time buyers price rose from £42,579 during the first quarter to £44,568, a quarterly change of 4.67% and an increase of 4.18% over the last twelve months. Flats in Glasgow recorded the largest price rises year on year although Edinburgh continues to record the highest overall property price. The second highest overall average prices are to be found in Aberdeen, followed by Glasgow and Dundee.

The latest Scottish Chambers' Business Survey for the second quarter 2000 shows that although the trend in short term optimism was flat respondents continue to report being more optimistic than in the same period one year ago. Total orders continued to improve for a net of firms, fuelled once again by an increase in private sector orders. During the current quarter firms expect the increase in total orders to end and the majority of firms continued to cite lack of demand as the factor most likely to limit output. The trend in total employment remained upward and while this trend is expected to continue it will be at a reduced rate of increase.

The Construction Confederation's latest Trends Survey shows that output increase in the second quarter although the rate of growth slowed, with the balance of firms reporting increased activity down from a net of +18% to a net of +11%. Allowing for seasonal patterns however output was static between the first and second quarters. New enquiries and output are expected to increase

during the third quarter and the industry expects output to rise over the next twelve months.

At a regional level the best results were generally recorded in Eastern, Yorkshire, Scotland and the South West. The Midlands, North West, South and Wales forms a middle group while results were generally quite weak in the Northern region. London regional companies suggest a very mixed picture. At a sectoral level private housing output continues to expand and contractors are optimistic about workload prospects for the third quarter although new enquires growth is slowing. In contrast results for public new housing are very gloomy and little improvement is expected with output and enquires falling. Commercial construction output rose strongly in the second quarter although output is expected to fall over the next two years.

## ENERGY

### OIL AND GAS

The Royal Bank of Scotland Oil & Gas Index demonstrates that for oil production a drop of 9.5% was observed for 2000q2 on 2000q1. On an annual basis the decrease was less pronounced at -6.9%. Gas production for the same periods, is down 24% on a quarterly basis but on an annual basis an increase of 23% is seen. The Combined Index has grown by 3.6% on an annual basis but there was a fall of 16.2% for the second quarter on the first quarter of this year. The oil price has risen by a massive 66% on an annual basis but for 2000q2 on 2000q1 there is a slight fall of -2%. Similar growth figures were recorded respectively for the Provisional Total Daily Oil Value. The Average Daily Oil Value has increased by 59% on an annual basis but over the last quarter there was an 8% drop.

Over the first quarter of 2000 there has been slight growth in oil & gas production but since September 1999 the oil price (for Brent crude) has been above \$20 a barrel and for February and March of this year was above \$25 a barrel. The OPEC decision to increase output may depress the oil price slightly. Oil production from the North Sea has declined recently (see above) and the high oil price is only sustainable if the OPEC production constraints are adhered to. Gas output will start to demonstrate its seasonal decline in the spring. The critical factor in the oil & gas industry will be the actions of OPEC and the effects they have on the oil price. Global economic growth is also important because if the US continues to grow strongly then the demand for oil will remain relatively strong.

The oil price continued to rise in the second quarter of 2000 beyond \$30 per barrel. July did see some slight abatement in price and this has been helped by OPEC's agreement to increase supply slightly. It is expected however that the price will rise further and the slight fuel crisis experienced in Europe may add further to the oil price, particularly in the winter. Even with the advent of a solution to the fuel crisis it will probably take the UK three weeks to restore normal deliveries to forecourts. The main reason for the oil price rise however is the increased economic activity in the world leading to an increased demand for oil. The increase in the oil price has however held several benefits. The Treasury has benefited from extra oil revenues and there is to be an increase in North Sea investment. The latter is a very welcome development as this will secure jobs and prolong activity in the North Sea. Shell Expro, BP and Amerada are all investing more than previously announced.

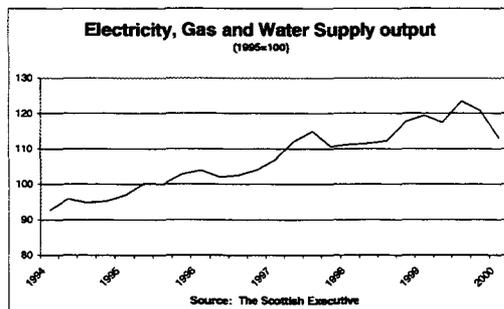
OPEC has agreed to increase oil production by a further 800,000 bpd during September to try to stem the upward rise in the world oil price. They also made it clear however that Western governments should reduce taxation on petroleum products if a real price reduction is to be given to consumers. American oil stocks are at a ten year low and there is a lack of spare refining capacity. This has encouraged the price rise as we move towards winter. If oil prices do remain at this high level then the world economy may face severe problems. In real terms the oil price is still 1/3 below its 1990 price and as we are less oil dependent now this current shock is less likely to hit that hard. It is the response of central banks that differ to the oil price; in Europe the ECB raises interest rates to reduce inflationary pressures whereas in the US they are unlikely to do so because they are less likely to have the oil price feed into wages believing core inflation (excludes energy prices) to be more important.

## UTILITIES

The Index of Production supplied by the Scottish Executive for 2000q1 on 1999q4 shows that for Electricity Gas and Water Supply growth was -6.6% with the index falling to 113. This compares against the UK figure of -2.7%. On an annual basis for the latest four quarters on the preceding four quarters growth is now only 3% in Scotland and only 1.2% in the UK. Growth in this sector has fallen significantly on an annual basis since last quarter.

Scottish Power (SP) has sold its Australian electricity interests for £900 million to a Hong

Kong firm. The assets were part of the Pacificorp deal but it was always clear that they should be sold off. British Energy (BE) has sold Swalec to Scottish and Southern (SSE) for £210 million thus exiting the household energy supply market. This will make SSE the third largest supplier in the UK behind Centrica and TXU but well ahead of SP. SSE now has over 4 million customer accounts as opposed to 3.6 million for SP.



The new energy tax due to come in next April is expected to hit manufacturing and engineering in particular the hardest. Some companies are expected to lose nearly £400,000 a year. OFGEM has announced that proposals to reform the Scottish energy market should mean more competition and result in a cut in prices. The proposal is to have one market for the trading of electricity (BETA) and it is expected to come into force by the year 2002. Prices are expected to fall by between 10% and 15%.

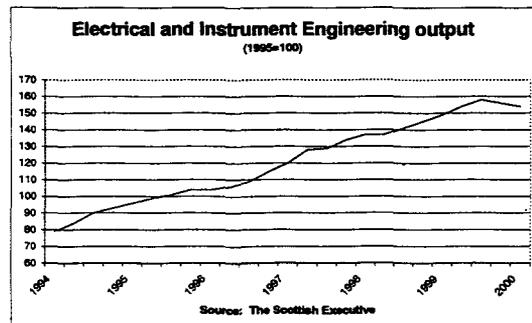
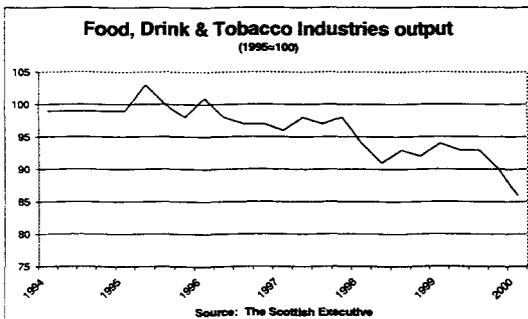
## MANUFACTURING

### FOOD, DRINK AND TOBACCO

The Scottish Executive Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 86 in the 1<sup>st</sup> quarter of 2000 (1995=100), a reduction of 4.5% from its level in the previous quarter. Output levels fell over the year to the 4th quarter by 2%, compared to 0.3% across the industry in the UK. However, the overall reduction masks different short run performances in the two main sectors, Food and Tobacco and Drink. Drink production fell most heavily, from 94 in the fourth quarter of 1999 to 83 in the first quarter of this year, while Food and Tobacco output rose modestly, from 86 to 87. Both sectors of the industry therefore appear to have suffered adverse short-term movements in the final quarter of last year. Both sectors have also performed poorly when measured against the industry across the UK, where drink output fell in the fourth quarter by 3.6%, while food and tobacco output increased by 1%.

The more recent findings of the Scottish Chambers' Business Survey (SCBS) show a slightly reduced level of optimism across the industry in Scotland. 28.6% indicated that they were less optimistic than three months previously compared to 10.7% who felt more optimistic. This result does appear slightly curious given that more companies indicated that new orders had increased, 29.6%, than the 25.9% who indicated a decrease. Similarly, 32% indicated an upward trend in sales compared to only 25% indicating a decrease. Firms are perhaps taking a longer-term perspective, and indeed 31% indicated that the level of capacity utilisation was down from that seen one year previously. There were also few signs of any significant increases in investment, one reason for which appears to be that firms are facing cost pressures, both from higher prices for raw materials - around 43% indicated that they were under pressure to raise prices for this reason - and from higher transport costs, where 68% indicated that this was threatening existing price levels.

The more recent findings of the Scottish Chambers' Business Survey (SCBS), however, appear to indicate that the industry is facing some difficulties. 40.9% of respondents to the most recent survey indicated that the overall trend in sales was downward, similar to the 41% who responded similarly in the previous survey. Against this, however, 33% indicated an upward trend in sales, which does compare a little more favourably with the figure of 29% from the previous survey. The longer-term scenario appears to be little change - 43.9% said that the trend in new orders was downwards (compared to 42.3% in the previous survey). Again, there was a slight increase in the numbers predicting that new orders would increase, which measured 31% in comparison to 26% in the previous survey. Investment intentions were flat and capacity utilisation was unchanged over the year. All things considered, the industry position shows few significant developments over the quarter. More significant developments may be in prospect, however, as a majority does consider that both turnover and profitability are likely to improve in the next twelve months.



**ELECTRICAL AND INSTRUMENT ENGINEERING**

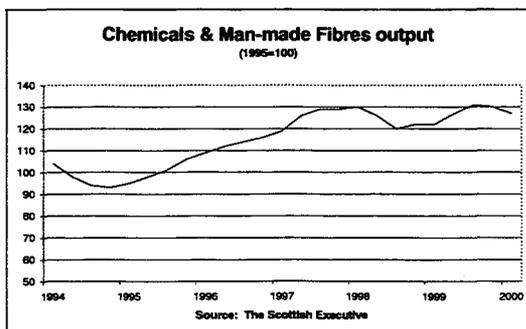
The Scottish Executive Index of Production for the Electrical and Instrument Engineering (EIE) sector in Scotland stood at 154 in the 1<sup>st</sup> quarter of 2000 (1995=100), a decrease of 1.2% from its level in the previous quarter. We are unused to falling levels of production in electronics, and this unusual fall hopefully reflects short-term difficulties, which will quickly be reversed. More encouraging news is that output increased over the year to the 1<sup>st</sup> quarter by 8.7%, compared to a 7.8% increase across the industry in the UK. The industry's annual performance contrasts strongly, yet again, with that seen in other manufacturing sectors in Scotland. For example, EIE's performance over the year was much stronger than that seen in Mechanical Engineering, where output fell by 4.8%. EIE also compares favourably against Paper Printing and Publishing (which recorded a 2.9% fall in output) and Other Manufacturing (where output fell by 2.6%).

Company news includes the announcement by Strategic Software Solutions that it is to create 130 new jobs in Alloa. The company specialises in developing software for the banking industry. The American company ADC, has also announced that it will take on the additional staff over the next two years. The company set up a £27 million European production base in Fife in February, creating more than 1,000 jobs. It employs more than 14,000 people world-wide, manufacturing products for the television market.

**CHEMICALS**

The Scottish Executive Index of Production for the Chemicals and man-made fibres sector stood at 127, a decrease on the fourth quarter 1999 but an increase of 5.4% on the year to the first quarter. Output for the UK as a whole also fell over the fourth quarter (-1.6%) however over the year to the first quarter output rose by 5.6%.

Recent findings from the latest Scottish Chambers' Business Survey showed a marked turnaround in confidence with a net of firms more optimistic about the general business situation compared to both the previous quarter and the same quarter one year ago. The increase in confidence reflects the unexpected increase in demand with firms reporting an increase in orders from the rest of the UK and overseas and an increase in sales to all markets. Firms expect the increase in demand to continue during the current quarter fuelled by an increase in demand from all areas. Exchange rates became the most frequently cited business concern during the second quarter while interest rates and orders and sales were less of a concern.



Cash flow trends improved during the second quarter although more than half (a net of +14%) reported no change and firms expect both turnover and profitability to improve over the next twelve months. More than half expect to leave prices unaltered during the third quarter, however, the balance anticipate prices increases; transport costs was the most obvious price pressure.

In contrast to expectations the downward trend in employment did not occur and a net of firms increased the number they employ and expect to further increase total employment during the current quarter. The increase in employment was however mostly in the form of temporary and sub contracting staff with a net of firms reducing the total number of permanent staff they employ.

In the company sector BP Amoco announced that it has begun the detailed engineering design for construction of a world class plant at its Grangemouth petrochemicals complex. The plant, which will produce bi-modal high density polyethylene used in the production of pressure pipe systems, specialist blow moulding and flexible packaging, will be commissioned in 2003.

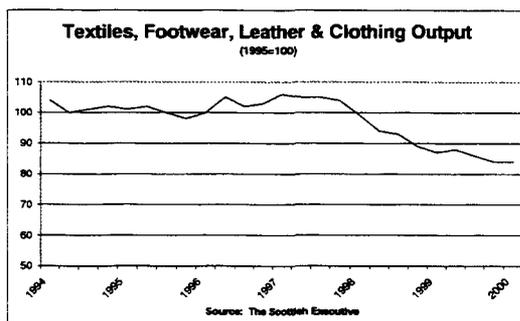
Avecia, formed following the buyout of Zeneca Specialities from AstraZeneca in 1999, is to construct a £4.5 million mutiprodukt pesticide intermediaries plant at its site in Grangemouth. The

move follows the award of a new production contract by one of Europe's leading agrochemical companies to Avecia's LifeScience Molecules business unit. Commercial production for the lead customer is scheduled to start early in 2001.

Scotia Holdings, the Stirling based biotechnology group recently reported a fall in first half losses as it awaits regulatory approval for its flagship drug Foscan. More than a quarter of Scotia's market value was wiped off after a report in May, subsequently shown to be unreliable, that the drug could cause burns. The drug, a palliative for incurable head and neck cancer, has potential sales of up to \$500 million.

### TEXTILES, FOOTWEAR, LEATHER AND CLOTHING

The Scottish Executive Index of Production for the Textiles, Footwear, Leather and Clothing (TFLC) sector in Scotland stood at 84 in the 1<sup>st</sup> quarter of 2000 (1995=100), an increase of 0.6% from its level in the final quarter of 1999. The industry's performance over this most recent quarter compares favourably against that of the UK as a whole, where output fell by almost 4%. The output level in Scotland, however, fell over the year to the 1<sup>st</sup> quarter by just under 6% (comparable to that seen across the UK industry. The annual reduction in the industry in Scotland exceeds that seen across all manufacturing, where output rose by 1.6%, mainly due to strong growth in Chemicals and Electronics.



The more recent findings of the Scottish Chambers' Business Survey (SCBS) show a reduced level of optimism amongst Scottish textile manufacturers. 31% of companies reported a decrease in optimistic compared to three months previously, with only 12% reporting an increase. A net 30% of respondents also reported a downward trend in new sales in the proceeding three months and a net 27% report a downward trend in new orders. Capacity utilisation rose slightly from the level seen in the previous survey, but 38% said that this was down from the same period in 1999, and 36% reported that the utilisation level was unchanged. Investment

intentions were level for most companies, and no change is expected in the immediate future. Finally, while around a quarter of respondents stated that pressure from interest rates had become greater over the three months, over half (54%) stated that the pressure from Sterling had become a more pressing concern over the survey period.

Scottish company news includes the announcement in June by Dawson International that it is to close two woollen mills with the loss of 300 jobs. Dawson's Laidlaw and Fairgreve subsidiary operate the mills, at Dalkeith and Selkirk. Dawson had tried to sell the subsidiary, following its decision to concentrate on cashmere manufacturing, but a lack of interest has forced closure. Dawson has already sold other subsidiaries, notably its well-known Pringle brand. While these developments have cost jobs in the areas concerned - Pringle shed 140 jobs in Hawick following the sale to a Hong-Kong manufacturer - Dawson seems to be profiting from the decision to reposition itself a cashmere specialist. It has seen sales rise by 37% since last year and reduced its losses from £19 million to £9.7 million. There is also speculation that a group of Italian financiers are ready to bid for Dawson, which may benefit the company if it allows access to Italian design expertise.

Elsewhere, Coats Viyella, which includes the remnants of Coats Paton, one of Scotland's most famous textile manufacturers, has announced that it is to drastically cut employment across its UK operations. Coats Viyella's decision to contract its contract clothing division follows the loss of Marks and Spencer's contracts, largely responsible for a 31% drop in company profits. The existing 800 Scottish jobs, at Jaeger and Viyella, are not as yet under threat, but the decision does not bode well for their future.

Finally, there have been two major policy developments in recent months. The first is that the Department of Trade and Industry has, some would say finally, recognised the problems which job-losses in textiles have caused local communities, and has announced a £10 million aid package. The money will be used to increase competitiveness and to retrain former employees who have lost their jobs. In tandem with this, the Scottish Executive also announced its own policy initiative, which includes the establishment of a new textile forum, help for exporters, consultancy advice and around £2 million for retraining.

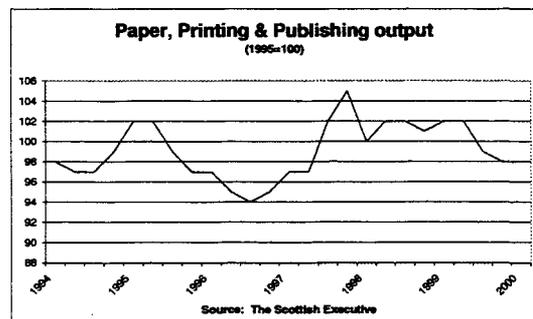
Finally, the United States has announced that cashmere could again be targeted as part of the unresolved dispute over banana imports. The UK has so far successfully managed to keep cashmere

off the US's hit list, but the new threat is that cashmere may be listed as one of the "revolving" products which the US hopes to hit on a rotating basis.

## PAPER, PRINTING AND PUBLISHING

The most recent Index of Production reveals that output growth in the Paper, Printing and Publishing (PPP) sector in Scotland fell by 0.3 per cent in the first quarter of 2000. Over the year to March 2000, output in this sector fell by 2.9 per cent.

The most recent production figures also reveal that the UK PPP sector recorded a slight rise in quarterly output of 0.1 per cent between the final quarter of 1999 and the first quarter of 2000. Annualised output growth for the UK PPP sector stood at 0.3 per cent.



The most recent Scottish Chambers' Business Survey (SCBS) to June 2000 suggests that difficult trading conditions still persist within this sector. Over a third of respondents were less confident about the business climate than three months previously. This has risen since the last survey from just over a quarter.

The general trends in total sales and orders were down for nearly 60 per cent of respondents. Scottish and rest of UK (RUK) sales and orders were down similar margins with around 55 per cent of respondents recording a fall. Exports were not affected as badly with only 40 per cent of respondents reporting a fall. Expectations from respondents suggested that all sales and orders would level off over the next 3 months for Scottish, RUK and export markets.

The average level of capacity utilisation for the Paper, Printing and Publishing sector fell 1.2 per cent to 73.4 in the second quarter of 2000. This followed a fall of 5 per cent in the previous quarter. Investment intentions remained level over the second quarter. The expectations were that it would also remain level over the third quarter of 2000.

The latest SCBS also reveals that 29 per cent of respondents had experienced a decline in the trend of total employment. This had risen from 23 per cent in the previous survey in which the overall respondents had correctly anticipated a decline in overall total employment.

A quarter of respondents had increased wages and salaries by 2.8 per cent. This had sharply risen from just 12 per cent of respondents raising wages and salaries by 2.7 per cent in the previous survey.

In summary trading conditions remain difficult and have appeared to worsen since the previous survey. The number of respondents reporting less confidence in the business climate has risen whilst orders and sales have fallen. However respondents suggest that circumstances will level off over the next quarter.

In the company sector, sales of most Scottish based newspapers have dropped over the last year. Sales of the Daily Record over the last two years have fallen from 685,000 a day to 611,000. Sales for another Glasgow based paper, the Herald, have flattened. A number of UK national newspapers have introduced 'tartanised' Scottish editions that have hit both Scottish based broadsheets and tabloids. However, the Scotsman claims to have increased sales to around 105,000 after revamping and cost cutting.

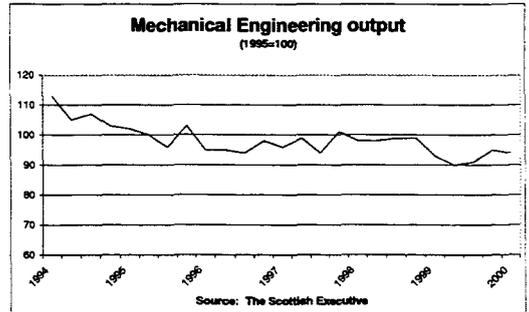
### MECHANICAL ENGINEERING

The most recent Index of Production and Construction for the Mechanical Engineering sector in Scotland reported a 1.5% quarterly drop in output for the first quarter of 2000. This compares with a 0.5% fall across all engineering, and follows the positive signal given by last quarter's first observation of positive growth for the Scottish mechanical engineering sector in the last year. However the Scottish sector's performance remains better than that at the UK level, where a 2.9% decrease in output was recorded for the quarter. In terms of annual growth, however, the Scottish and UK figures are similar, with decreases of 4.8% and 4.9% respectively recorded over the four-quarter period.

The results from the most recent Scottish Chambers' Business Survey (SCBS), for the first quarter of 2000, suggest that trading conditions remain difficult in this sector. Business confidence remains negative for many SCBS respondents, 28.6% of whom report feeling less optimistic about the current business situation than they did three months previous, and 34.1% of respondents said

that they feel less optimistic than they did one year ago.

Underlying continued lack of confidence in much of the sector continues to be the reported trends in total orders and sales over the previous quarter. In fact concern over orders appears to be growing, with 50% of SCBS respondents reporting this to be more of a concern than it was 3 months ago, as the downward trend in the level of orders and sales continues for many respondents.



The average level of capacity utilisation for the Mechanical Engineering sector for the first quarter of 2000 was fell marginally to 73.72%, with the majority of respondents, 41%, reporting that their capacity utilisation was down on the same period last year. Marginally up at 75.38%, but with 48.7% reporting their capacity utilisation to be less than in the same period last year. Investment intentions in this sector, over the past quarter, also remain level for the majority of respondents for both land and buildings and plant and equipment, and are anticipated to do so over the next quarter.

The Scottish Chambers' Business Survey also reveals that employment and wages have, and are expected to, remain level for the majority of respondents. However 28.6% of respondents reported pay settlements as one of the factors causing pressure for them to raise prices (along with other input prices and overhead costs). Of the 23.8% who reported having increased wages over the last quarter, this was by an average of 3.75%, up on the 3.19% of the previous quarter's survey.

In summary trading conditions in the first quarter of 2000 appear to remain fairly gloomy in the mechanical engineering sectors, with orders and sales continuing to be the main cause of concern. The other two main concerns reported are again interest and exchange rates (though the former appears to be easing in light of recent MPC decisions not to change the base rate).

In the company sector, there is continued uncertainty over the long-term future of the Govan

shipyard, as a decision still remains to be made by the MoD over the £300 million order for six roll-on, roll-off ferries. In June the MoD requested revision and confirmation of competing bids, following informal discussions with the four competitors for the order, one of which is the Sealion consortium of which BAe Systems, who own the Govan yard, is part. At this time the MoD stated that they hope to place the contract sometime this year. However while this news was greeted as a positive signal for British yards, the delay seems to have fuelled debate over whether British yards are losing out to European competitors as a result of what are regarded as unfair subsidies received by European yards. Such concerns, particularly for smaller yards, have been accentuated by the closure of the Ailsa-Troon yard only four years after it was rescued from receivership. However other factors, such as the strength of sterling and the state of the fishing industry, upon which the health of many smaller Scottish yards depends, have also given cause for concern in an industry which is already recognised as suffering from over-capacity.

Mixed news also continues to be reported for the Weir Group, Scotland's biggest engineering business, in the wake of reported takeover attempts and profits warnings. However conditions are regarded as improving for the group, with optimism that continuing high oil prices will lead to an increase in demand for Weir products from the oil industry, particularly in the Far East.

The Falkirk-based bus manufacturer, Alexander's, is part of a merger between Mayflower and its rival, Henlys, to form a new company called TransBus International. At the time of the announcement, Mayflower said that it was unable to anticipate whether Scottish staff would be affected by planned job cuts to avoid duplication with Henlys operations, but emphasised that Alexander would continue to be a major production base for the merged company.

## SERVICES

### DISTRIBUTION

The Retail Sales Index for July shows the seasonally adjusted estimate of retail sales volume to be 120.2. This is marginally above the June index of 120.1 and 4.0% higher than the July 1999 level. In May to July the volume of sales was 0.9% higher than in the previous three months and 4.1% higher than in the same period one year ago. Seasonally adjusted volume of sales by predominately food stores rose by 0.2% while sales by predominately non-food stores rose by 1.4%.

Based on non-seasonally adjusted data, the average weekly value of retail sales in July was £3,910 million, 2.7 per cent higher than in July 1999. In May to July the value of sales in current prices was 2.8% higher than in the same period one year earlier. The value of sales by predominantly food stores was 2.7% while sales by non food stores were 3.1% higher.

The all items retail price index (RPI) fell by 0.4 percent over the month to stand at 170.5 for July while in the twelve months to July the all items RPI rose by 3.3%, unchanged from the corresponding figure for June. The main upward effect on the all items twelve month trend came from food and in particular seasonal food.

The latest results from Retail Sales Monitor carried out by the Scottish Retail Consortium/Royal Bank of Scotland suggest that Scotland's retail performance remained steady during August (period covered 30<sup>th</sup> July to 26<sup>th</sup> August). On a like-for-like basis however retail sales fell by 1.8%, with Scotland's figures continuing to under perform compared to those for the UK.

The monitor recorded growth of 5% in total sales, better than growth for the UK as a whole (4.3%). Total sales in the food sector remain better than those in the non food sector with an annual rate of 8.7% for food and only 1.6% for non food. Three factors were thought to have had an effect on the non food sector. The first influence was strong downward pressure on prices prompting consumers to delay spending in the hope that prices would fall again. The second was the introduction of many non-food items to stores that previously had dealt with food items only. The final factor was consumers taking advantage of many new shopping centre openings allowing them to be more selective and benefiting the specialist non-food retailers.

The CBI's latest quarterly distributive trades survey, covering sales from 2 to 22 August 2000, shows the biggest ever fall in prices since the start of the survey in July 1983. Although still positive, growth in sales failed to meet retailer's expectations, 44% of respondents reported an increase in sales while 26% reported falls. This compares with a net of +24% in the July survey. The three months moving average, which smoothes out month to month fluctuations, has also fallen with retailers reporting below average sales for the time of year. Only 13% said that sales were good while 29% reported that they were poor. Retailers remain optimistic about the overall business situation but the level of confidence is the lowest since February 1999. The sectors reporting the largest increase in sales were durable household

goods, grocers and booksellers and stationers. Wholesalers had a better month than expected. Sales rose steadily, a fall had been forecast however respondents still consider business to be well below average for the time of year.

Results from the second quarter Scottish Chambers' Business Survey, which covers the period April to June, suggests that wholesale and retail respondents remain despondent about the general business situation. Wholesalers and retailers had expected the decline in sales to continue however while the decline in wholesale sales was not as bad as had been expected the decline in retail sales was worse than anticipated. These trends are expected to continue though ease during the current quarter.

Concerns as to competition remained the most frequently cited factor by wholesalers and retailers as the factor most likely to limit activity during the current quarter. Wholesalers regarded transport costs as the most obvious price pressure although expectations of price increases eased for a further quarter. There was some evidence of increased pressure to raise retail prices, most notably in terms of pay settlements and transport costs although these remained at a low level.

The declining trend in cash flow among wholesale firms eased significantly to a net of 5%. Expectations of turnover and profitability over the next year improved although the improvement in turnover is expected to be at the expense of profitability. The trend in cash flow for retail respondents continued to deteriorate and while expectations as to the trend in cash flow over the next twelve months were unchanged, expectations as to profitability eased. This is in stark contrast to the previous quarter where expectations as to profitability were the best since the first quarter 1998.

Changes to wholesale employment again affected less than a third and the decline was not as bad as had been forecast. Wholesalers expect the decline in employment to continue through the third quarter. The decline in retail employment continued and this trend is not expected to end during the current quarter. Twenty-nine percent of wholesale firms increased wages during the survey period and the average increase was 2.8%. The corresponding figure for the retail sector was 3.6%.

### TRANSPORT

#### Air

A consortium of Britain's eight largest airlines and BT are to bid for the Air Traffic Control Service.

The Irish Aviation Authority is to provide management advice. The bid values National Air Traffic Control (NATS) at £1 billion and they are not seeking to run the company at a profit. The benefits to the airlines that would accrue would be the improvements in safety and capacity.

#### Rail

Stagecoach has an uncertain future ahead as it is involved in a three way bidding war for South West Trains (SWT). The franchise that is due to be awarded is expected to be between 15-20 years in length and is one of the largest to be awarded. The result will not be known until early next year once the Strategic Railway Authority has completely reviewed each bid. Sea Containers are bidding for SWT and already hold the franchise for the ECML through GNER. It however is to face a rival bid from Virgin for that route in which Stagecoach has a 49% stake.

A new report blames much of Railtrack's poor record on its hasty privatisation. Between 1995-96 and 1998-99 Railtrack received £139 million in bonuses from train operators and is expecting further bonuses for 1999-2000 despite meeting many of its targets. In the same period the number of broken rails has increased. The House of Commons Public Accounts Committee has criticised the Rail Regulator and asked it to tighten up their procedures for monitoring and scrutinising Railtrack. In particular the systems of penalties and incentives has to be improved. At the same time Railtrack warned the Rail Regulator that lower access charges would mean severe implications for future investment in the rail network. To sustain the network in its present condition requires a spend of around £1.3 billion over five years. The investment programme this year is £2.5 billion.

#### Road

Roads in rural areas are coming under increasing pressure particularly in weight restrictions and in downgrading. The Society of Chief Officers of Transportation state that there is an urgent need for £1 billion to be injected into rural roads. The backlog of maintenance is nearly £1.5 billion with a further £23 million needed for lighting and £166 million for bridge strengthening. As a last resort some roads are facing closure because of safety concerns. 95% of roads are under council control and the sharp cut in these budgets is now putting this on the crisis agenda. One way to significantly reduce transport costs in the Highlands and other rural areas is to introduce LPG on a large scale. At 40p per litre this is undoubtedly one of the cheapest fuels available. A 75% grant is available for cars

(under one year old only) to take LPG at a cost of £1,200 per car. A further scheme to alleviate transport costs in rural areas is to have grants for car owners in rural areas and that fuel duties collected in rural areas should be spent in rural areas. The latter proposition is unlikely to gain any headway as taxation in the UK is not collected on this basis.