

Quarterly Economic Commentary

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FRASER OF ALLANDER INSTITUTE

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QUARTERLY ECONOMIC COMMENTARY

***** CONTENTS*****

Page		
i	OUTLOOK AND APPRAISAL	Brian Ashcroft
	THE ECONOMIC BACKGROUND	
1	The International Environment	Ole Rummel
3	The UK Economy	Brian Ashcroft
4	UK Labour Market	Kim Swales
	THE SCOTTISH ECONOMY	
7	Short-Term Forecasts	Ya Ping Yin
7	Scottish Chambers' Business Survey	Cliff Lockyer
9	Construction	Eric McRory
10	Oil and Gas	Kenneth Low
11	Coal and Other Energy	Kenneth Low
13	Food, Drink and Tobacco	Stewart Dunlop
13	Electronics	Stewart Dunlop
14	Chemicals	Sarah le Tissier
15	Textiles, Leather, Clothing and Footwear	Stewart Dunlop
16	Paper, Printing and Publishing	Lorraine Armstrong
17	Mechanical Engineering	Ya Ping Yin
18	Distribution	Cliff Lockyer
18	Financial Sector	Paul Draper
20	Transport	Kenneth Low
22	THE LABOUR MARKET	Peter McGregor
23	Business Survey Results	Cliff Lockyer
	ECONOMIC PERSPECTIVE 1	
31	Components of employment change in the Tayside manufacturing sector: a spatial analysis	Keith Glancy
	EDITORS	
		Brian Ashcroft, Stewart Dunlop and Jim Stevens
	GRAPHICS	
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	PRODUCTION	
		Linda Kerr and Isobel Sheppard

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OUTLOOK AND APPRAISAL

The latest Scottish Office output data for the first quarter 1995 indicate that Scotland performed better overall than the UK, due to an upsurge in construction output and stronger manufacturing growth. In the first three months of the year, output of the production and construction industries in Scotland rose by 0.5% compared to a 0.4% rise in the UK as a whole. Removal of oil and gas improves the differential in favour of Scotland resulting in a 0.5% Scottish growth rate compared with zero growth in the UK. Within production and construction, Scotland's performance diverged considerably from the UK. Production output rose by 0.1% compared with a 0.7% increase in the UK; construction output increased by 2% while UK construction contracted by 0.9%. And in manufacturing, Scottish firms raised output by 0.4% while their UK counterparts experienced a small contraction of 0.1%.

In the year to the first quarter, overall production and construction output (less oil and gas) grew by 2.2% in Scotland compared to 3.7% in the UK. Manufacturing grew slightly quicker in Scotland than in the UK, 5.1% compared to 4.5%, while construction experienced a decline in production of 6% in Scotland in contrast to a 3.3% increase in the UK. During the year, electrical and instrument engineering continued to perform strongly in Scotland growing twice as quickly as its UK counterpart (23% compared to 11%). The only other principal manufacturing sectors to exhibit positive growth during the period were chemicals (4%), drink (3%) and paper, printing & publishing (2%). These same sectors all exhibited positive growth in the UK with chemicals growing more quickly (5%), drink growing more slowly (2%) and paper, printing & publishing growing at much the same rate. The other key manufacturing sectors: petroleum products & nuclear fuel, metals and metal products, textiles etc., food & tobacco, mechanical engineering, transport equipment and other manufacturing, all

exhibited positive growth over the year in the UK, while their Scottish counterparts cut back production. These data again serve to remind us that Scotland's recovery continues to be relatively narrowly based.

We have noted in earlier Commentaries that Scottish output tends to be more erratic than its UK counterpart, reflecting in part the sensitivity of a small economy to given shocks. Figure 1 seeks to get round this problem by comparing three quarter moving averages of the quarterly growth rate in Scottish and UK production and construction (less oil and gas) over the period from the fourth quarter 1990 to the first quarter of this year. The figure makes clear that during both the recession and recovery the average Scottish growth rate was appreciably above the average rate for the UK until the middle of last year. From the second quarter 1994 the average Scottish growth rate fell below the UK rate but appears to have moved back above the UK average in the most recent quarter. The figure also suggests that growth rates peaked in Scotland towards the end of 1993, somewhat earlier than the UK growth rate peak which appears to have occurred around about the second to third quarter of last year.

A broadly similar picture emerges when manufacturing alone is considered (Figure 2). Generally, Scotland's manufacturing growth performance was more favourable than the UK until the middle of last year, and the sector in Scotland reached a growth peak about two quarters earlier than the rest of the UK. Three conclusions would appear to emerge from this and the earlier analysis. First, the recovery is continuing in both Scotland and the UK although apparently at a reduced rate of growth. Secondly, the growth differential which has favoured Scotland during both recession and recovery appears to have narrowed in recent quarters, suggesting a convergence in the growth path of the two economies. Finally, the recovery in Scotland has been more narrowly based.

Scottish GDP Data

July saw the publication by the Scottish Office of the output based estimate of Scotland's Gross Domestic Product (GDP) for 1993. The Scottish

data are published on an annual basis after a considerable lag while UK data are available quarterly. Moreover, because net output figures are not always available proxy indicators have to be used and so the data are less reliable than the UK GDP figures and are subject to revision. Nevertheless, the data broadly confirm the story revealed by the Index of Production and Construction, which accounts for about 36% of GDP.

Figure 3 plots the annual GDP growth rates in Scotland and the UK (using output based estimates and including oil and gas) during the period 1979 to 1993. In the early part of the 1980s, the growth of Scottish GDP paralleled the UK growth rate. However, in the mid-1980s the two rates diverged as the effects on the Scottish economy of the sharp fall in the price of oil between 1985 and 1986 helped push the growth rate below the UK rate in four successive years. As the UK economy began to move into recession after the boom of the late 1980s, Scotland began to outperform the UK for reasons which have been documented on many occasions in this **Commentary**. The Scottish growth rate remained positive, implying that technically Scotland did not experience a recession but instead suffered what might be called a "growth pause". However, the new data indicate that by 1993 the UK economy had "bounced back", experiencing a growth outturn just below the 2.2% Scottish rate. And the data on the growth of production and construction presented in Figure 1 would appear to suggest that Scotland's GDP growth rate will, when the data are published, have slipped below the rate of growth of the UK in 1994.

Outlook

The **UK Economy** section indicates that the growth of the British economy slowed in the first half of this year compared to the first three quarters of 1994. Many commentators now believe that the British economy has passed the growth peak of the present recovery and will experience lower growth than the preceding year in both 1995 and 1996. Expectations are for a UK growth rate of 2.8% to 3% this year falling to 2.7% in 1996. A safe prediction would be that Scotland should broadly follow the UK average. However, with consumer spending continuing to be relatively weak throughout 1995 and the balance of growth favouring net exports and investment, this might work to Scotland's relative advantage. It is often repeated that trade is relatively more important to

the Scottish economy. In addition, investment goods production has a greater weight in Scottish output than in the UK. For both these reasons, it would be no surprise if Scotland's GDP performance in 1995 slightly outpaces growth in the UK.

The year started well in production and construction in Scotland and in Scottish manufacturing. Figures 1 and 2 indicate that even when the first quarter data are smoothed into a three quarter moving average, Scotland still displays some relative advantage. Our short-term forecasting model is therefore predicting a year-on-year rate of Scottish manufacturing growth in 1995 of 4.7% which is above the 4.2% manufacturing growth predicted for the UK by the *London Business School*. We expect that manufacturing growth in Scotland will be particularly strong in the final quarter of this year and that this will continue at much the same level into the first quarter of 1996. Growth will then slow considerably in the second quarter of next year.

26 September 1995

Figure 1: Quarterly Growth in Scottish and UK Production & Construction (less oil & gas) 1990q4 to 1995q1

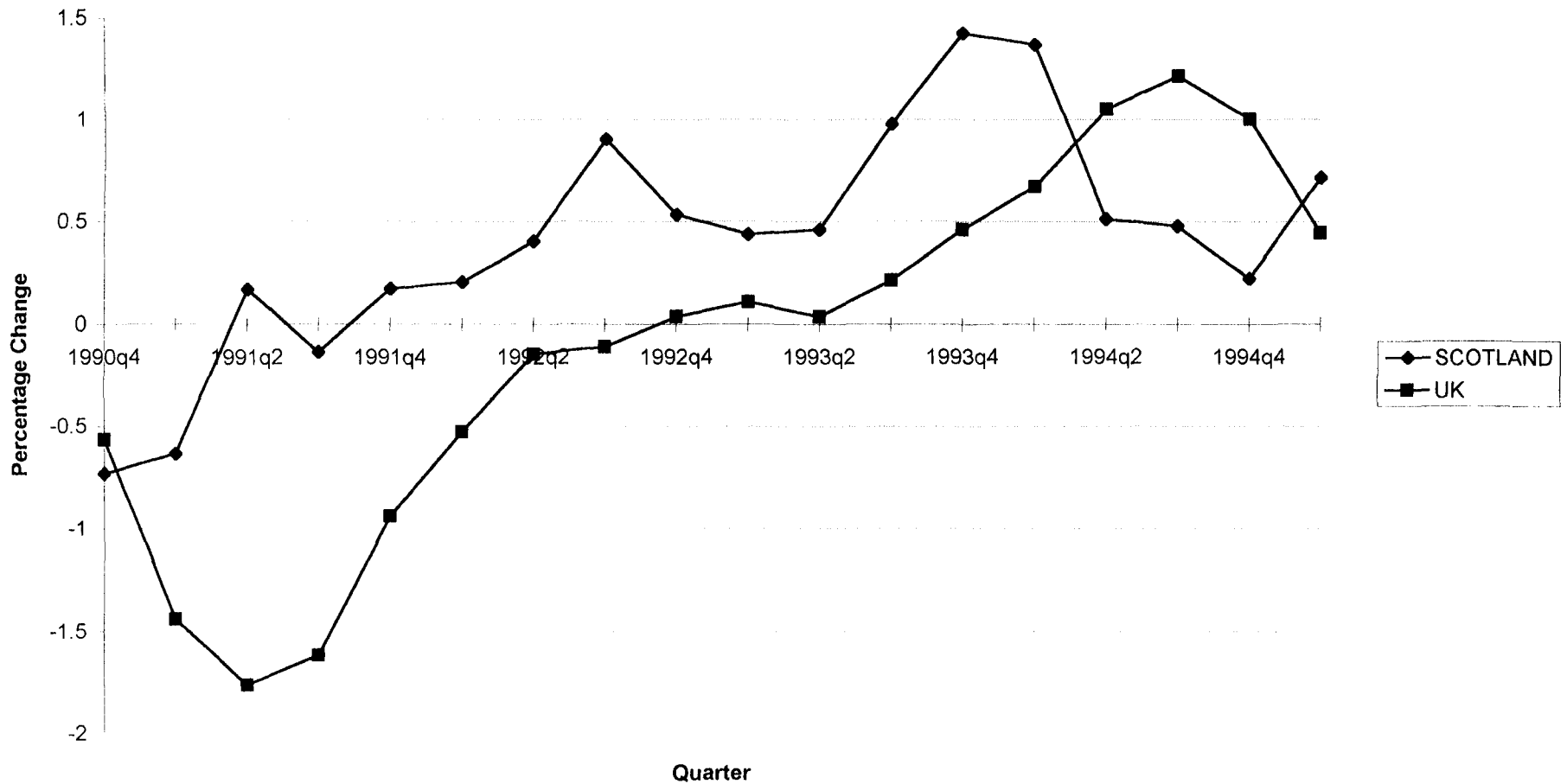


Figure 2: Quarterly Growth in Scottish and UK Manufacturing 1990q4 to 1995q1

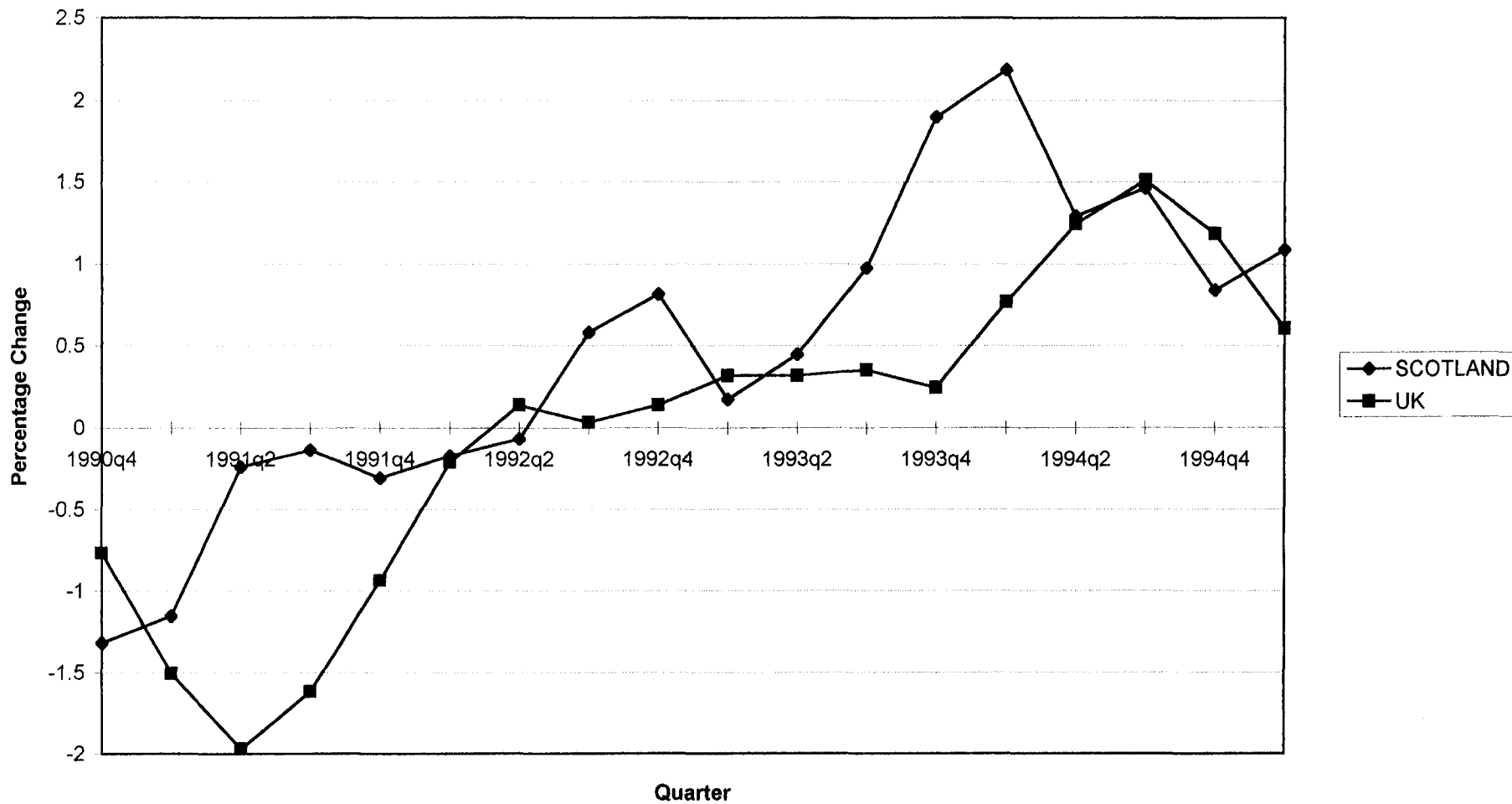


Figure 3: Scottish and UK Annual GDP Growth 1979 to 1993

