

Quarterly Economic Commentary

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FRASER OF ALLANDER INSTITUTE

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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.

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OUTLOOK AND APPRAISAL

In the fourth quarter 1995, Scotland's production sector performed less well than its UK counterpart while the construction sector performed better. Overall, the output of the production and construction industries in Scotland, excluding oil and gas, rose by 0.6% in the fourth quarter compared with a 0.1% increase in the UK. However, production output actually fell, (-0.7%) and at a faster rate than in the UK (-0.2%). The construction industry, on the other hand, grew by a sizeable 5% in Scotland during the quarter, while the sector in the UK grew at the lower rate of 1.4%. Within production, the manufacturing sector in Scotland (accounting for 85% of production) contracted by 0.9%, a much bigger slow down than the 0.2% fall registered in the UK.

The Scottish construction sector is therefore seen to be continuing the superior performance which, from the evidence of the Scottish Office data, has resulted in the sector expanding by 12.7% since the recovery began (in the second quarter 1992). This can be compared with the 2% increase in UK construction output over the same 14 quarters. The production sector in Scotland is more volatile. As we noted in the previous *Commentary* both production and the manufacturing sector within it, grew more quickly in Scotland in the third quarter and this has reversed in the most recent quarter. For the whole of the recovery phase, the growth of production in Scotland has advanced marginally faster in Scotland (11.7%) than in the UK (10.9%). However, the relative position of the two economies has changed during this period.

Figures 1 and 2 follow the practice of earlier *Commentaries* and present the time series of quarterly growth data for the UK and Scotland in terms of three quarter moving averages for production and construction combined (Figure 1) and for manufacturing (Figure 2). Smoothing helps to remove some of the volatility present in data for

a small, open economy. The data presented in these figures incorporate the latest revisions which principally affect the Scottish data. From figure 1, it is evident that the growth of Scottish production and construction has been stronger than in the UK since the first quarter of last year, although there was some narrowing of the growth differential in the last two quarters. Furthermore, figure 2 makes clear that the favourable contribution from Scottish manufacturing to this superior performance had disappeared by the fourth quarter of last year, underlining the current importance of construction to the favourable differential.¹ Weakness in key export markets from the middle of 1995 may in part account for the greater impact on Scottish manufacturing output performance (see *International* section). Figure 3 indicates that Scottish manufacturing export growth as measured by the SCDI quarterly index² slowed in the middle of 1995 compared with the strong performance of 1994, while the Scottish Chambers' Business Survey's (SCBS) net balances of manufacturing export sales suggest that the deceleration of export growth was present for much of 1995. Both data series indicate that the slow down was continuing into 1996.

One factor in the narrowing of the gap between Scottish and UK manufacturing growth is the return of the Scottish electronics industry to the UK average for the industry: in the fourth quarter, the electrical and instrument engineering sector grew by 2% in both Scotland and the UK. It is now well known that electronics has been the main motor of growth for Scottish manufacturing industry in the recovery. Figure 4 indicates the stronger growth of Scottish manufacturing (12.9%) compared with UK manufacturing (7.8%) during the recovery. However, with every manufacturing sub-sector, except electronics, performing less well than their UK counterpart during this recovery phase, the removal of electronics results in an overall manufacturing outturn in Scotland which is significantly worse (-7.4%) than for manufacturing, excluding electronics, in the UK as a whole (4.6%). In the most recent (fourth) quarter, the broad pattern of under performing Scottish manufacturing sub-sectors appeared to be continuing, with only mechanical engineering, transport equipment, and chemicals (from 11 sub-sectors) performing better

than their UK counterparts. Clearly, if the electronics industry continues to grow at the UK average for the industry then Scottish manufacturing growth would be expected to continue to fall below that in the UK. However, our judgement is that, for the foreseeable future, such an outturn is unlikely in view of the recent successes in attracting further foreign investment in the sector.

Scottish Unemployment

In April, Scottish unemployment rose by 2,400, or 1.25%, on a seasonally adjusted basis, to 197,400, or 8.1% of the Scottish workforce. In Britain, the count decreased by 3,900, or 0.2%, to stand at 2,097,500, or 7.75% of the GB workforce. Unemployment also rose in Wales, Yorkshire & Humberside, and the Northern region whilst falling in all other regions, particularly in London and the rest of the South East (ROSE) (see **Regional Review** section). One suggestion put forward for the rise in Scottish unemployment in April is that it is a consequence of the BSE 'crisis' and particularly the EU ban on UK beef exports. A close inspection of the data does not support this explanation. The numbers moving on to the register in April (30,165 or 15.1% of the opening stock) were not abnormally high but the flow off the register (27,893 or 14% of the opening stock) was fairly weak. We therefore conclude that unemployment rose in April because of a weak trend in the movement into work. Moreover, in April there was no surge in the temporary jobless, which is where the beef 'crisis' might have been expected to have had an impact.

Figure 5 charts the annual percentage change in unemployment in both Scotland and Britain. It is clear from this chart that the decline in unemployment has been moderating for some time: in Scotland since June 1993 and in Britain since February 1995. At present, unemployment is currently falling by 6.5% per annum in Britain and by 2.6% per annum in Scotland. Across the British regions, the sharpest annual decreases are evident in ROSE (-9.6%), the South West (-8%) and the West Midlands (-7%). Put simply, the jobless count is falling more quickly in Britain the further south one looks.

The trend in the Scottish unemployment relative is charted in Figure 6. The chart indicates that Scotland's position relative to GB has been deteriorating since the fourth quarter of 1993. Moreover, the rate of relative decline has stepped up sharply since the final quarter of last year.

Figure 7 compares the unemployment relatives for Scotland, the south of England, the Midlands & Wales, and the north of England. In the early 1990s, the onset of the recession led to a convergence of the unemployment relatives as the jobless count rose more sharply in the south. However, while unemployment has been generally falling since January 1993, the degree of imbalance in British regional unemployment rates began to worsen from the second half of 1994. As the figure indicates, the divergence of relative rates has been gathering pace in recent months and this appears likely to continue. Nevertheless, the current unemployment relative in Scotland and the north of England is more favourable than at any time since the mid-1970s.

Outlook

In the absence of production data for the first quarter 1996, we must rely on business survey evidence to gauge the current performance of the Scottish economy. Both the SCBS and the CBI survey reported a fall in optimism in manufacturing while output and sales continued to rise, at a slower rate in the SCBS. The SCBS covers other sectors of the economy and the most significant development here was the marked turn round in both optimism and sales growth in the retailing sector. This was coupled with the continuing strong performance of tourism particularly from Scottish and UK residents. These data are consistent with the expectation of a rebalancing of growth away from exports (largely manufacturing) in favour of consumption and domestic demand (initially affecting the high street). Nevertheless, Scottish manufacturers responding to the SCBS expected orders and sales to grow at faster rate in the three months to June, suggesting that the sluggish manufacturing growth forecast for the UK in the first half of 1996 (see **UK Outlook** section) may be less evident in Scotland. We noted in the previous **Commentary** that Scottish manufacturers did not appear to have built up stocks of finished goods to the same extent as firms elsewhere in the UK. Accordingly, the stock-adjustment expected for the UK as a whole in the first half of 1996 might not have such a depressing effect on Scottish output growth.

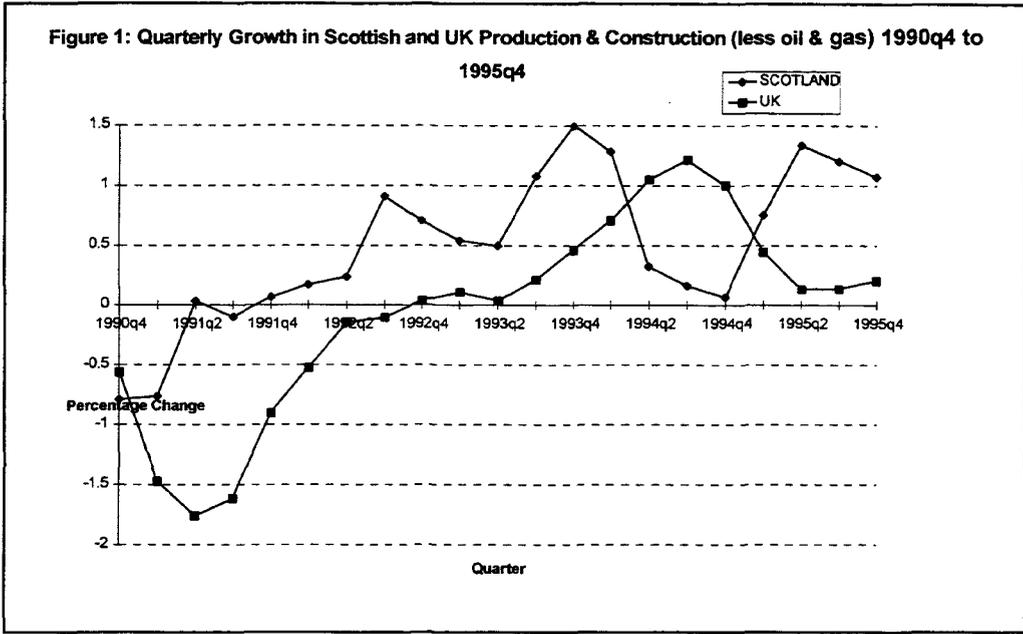
We still hold to the view, however, that the growth of Scottish manufacturing output will be weak in the first two quarters of 1996, reflecting continuing weakness in our principal export markets. However, we predict that growth will be stronger than in the final two quarters of 1995. The Institute's short-term forecasting model is predicting 0.2%

manufacturing growth in the first quarter, no growth in the second quarter, and then much stronger growth in the following three quarters of 1.6%, 1.2% and 1.7% respectively (see **Scottish Economy** section). We expect that the already buoyant growth of consumer demand and retail sales will increase and be sustained during the remainder of 1996 and into early 1997. In addition, Scottish manufacturing growth will be buttressed by the expected pick up in activity in France and Germany during the second half of the year as monetary policy is eased further. This should provide a boost to Scottish exports, although the BSE 'crisis' could still push growth slightly below earlier expectations.

ENDNOTES

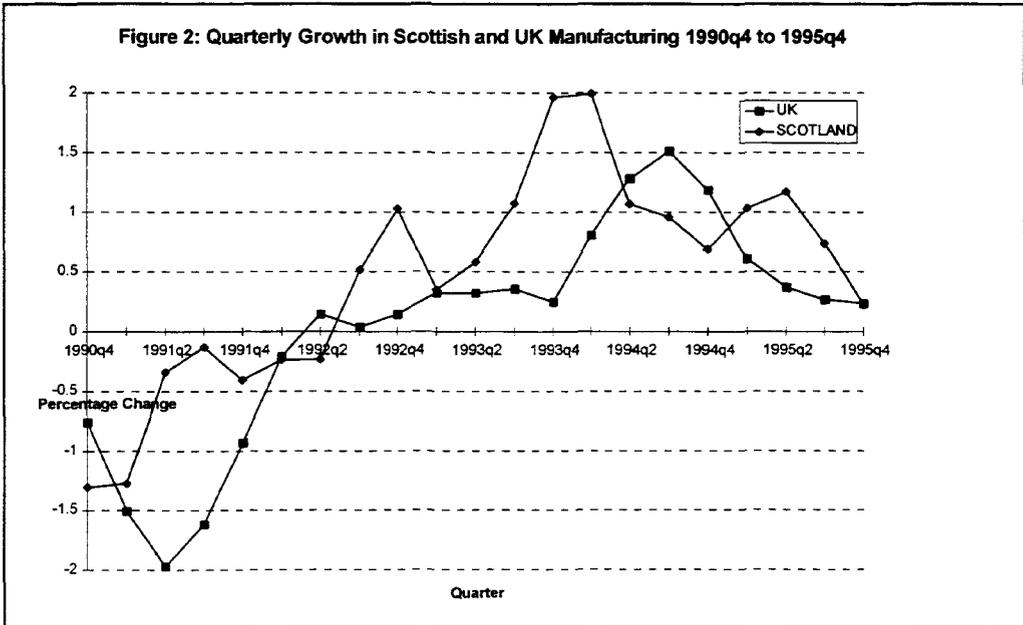
1. It is worth noting that the recent buoyant performance of construction industry output in Scotland is not confirmed by the survey evidence provided by the Scottish Chambers' Business Survey.
2. The index is constructed in nominal terms so the growth of export volumes will be slightly inflated, although this would not appear to be sufficient to account for the upturn in the fourth quarter of 1995.

30 May 1996



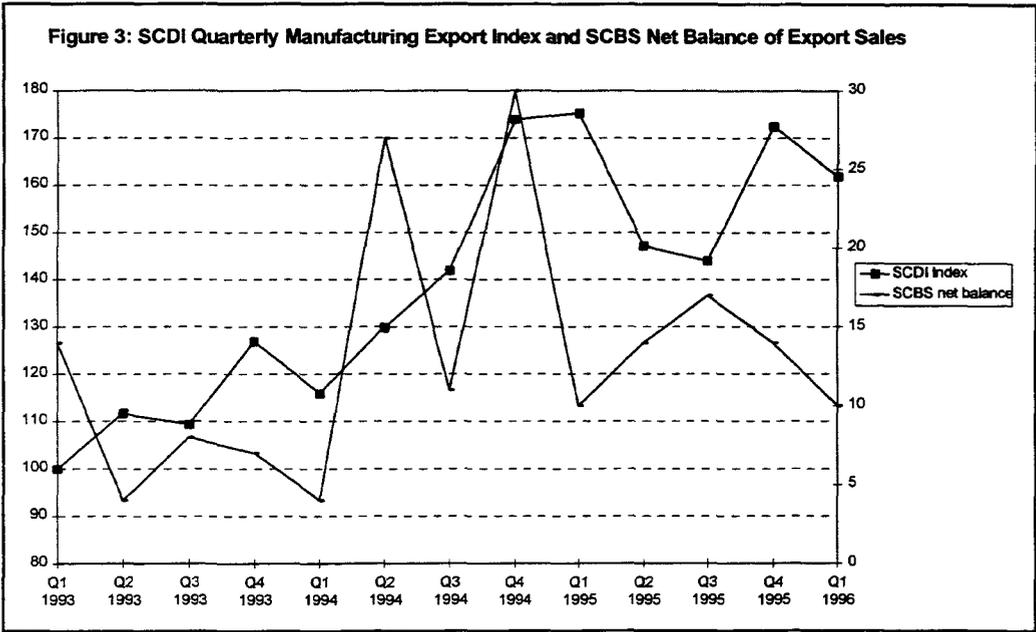
Source: Scottish Office

Note: Data are presented as three quarter moving averages.

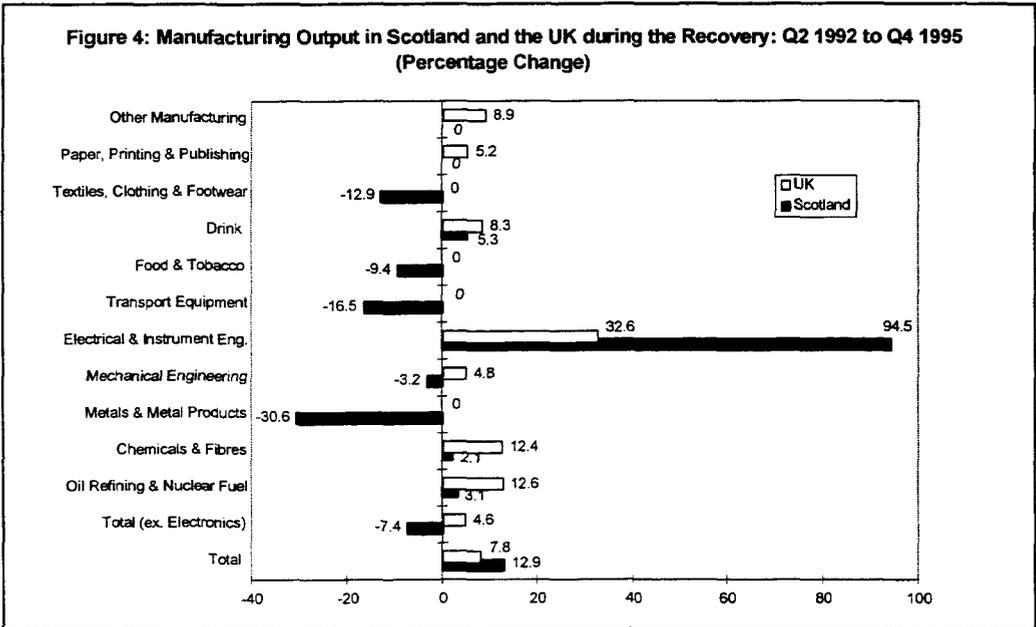


Source: Scottish Office

Note: Data are presented as three quarter moving averages.

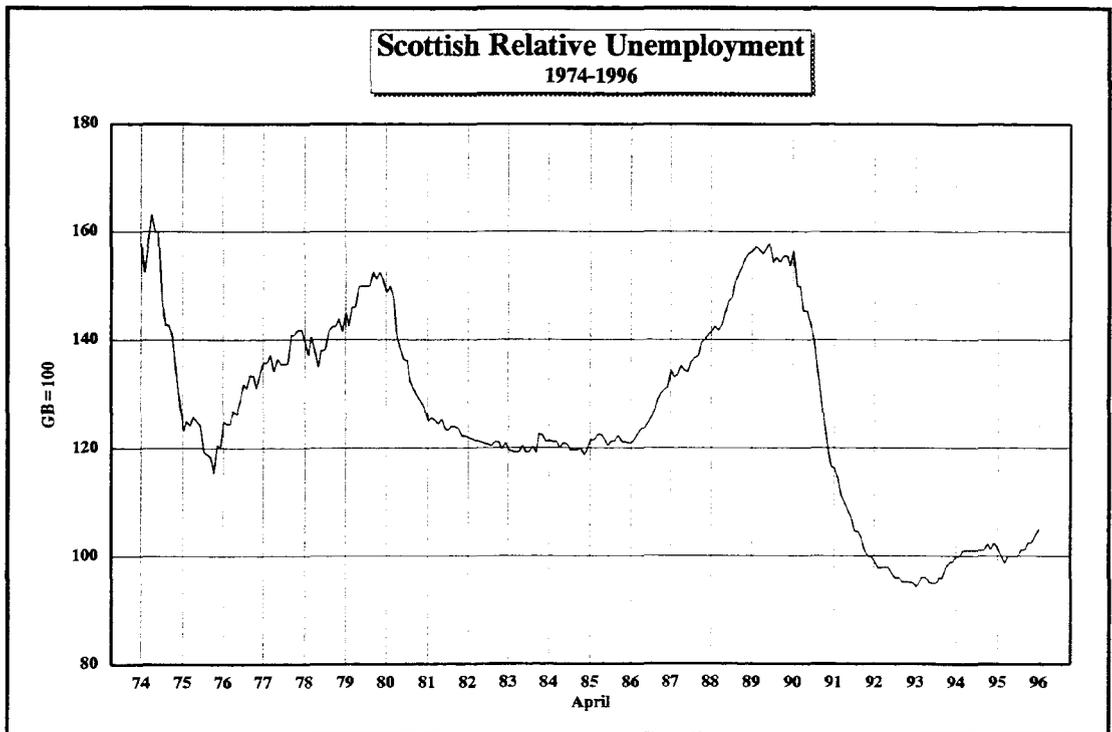
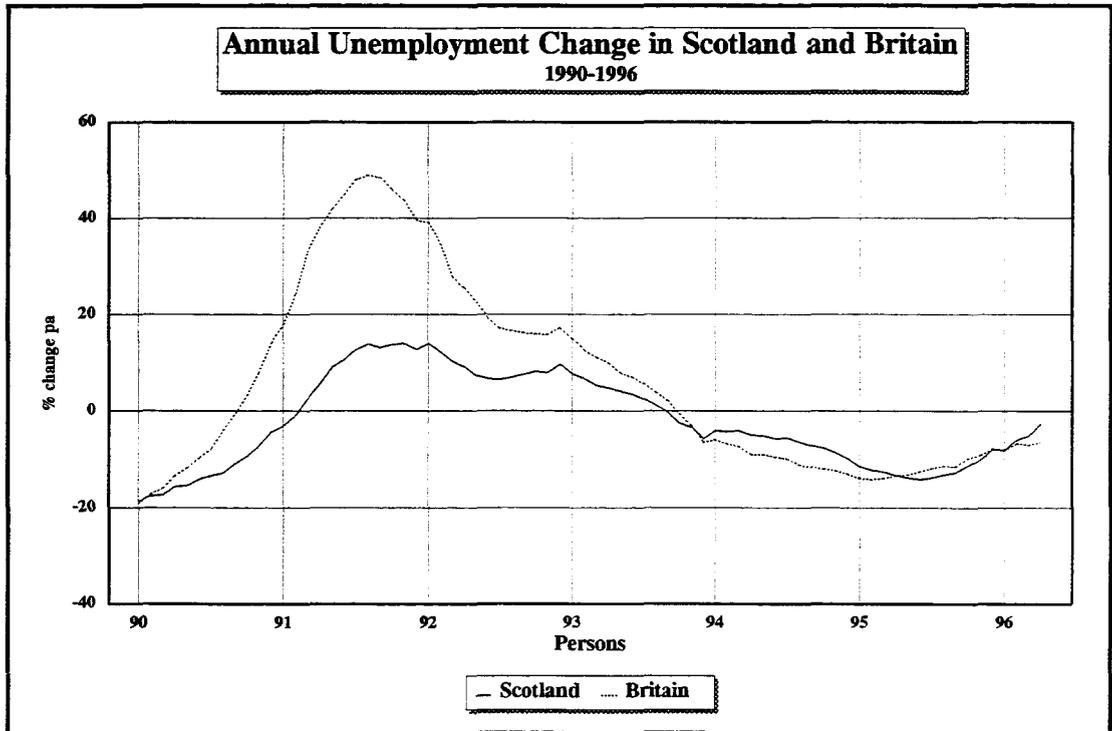


Source: SCDI and SCBS.



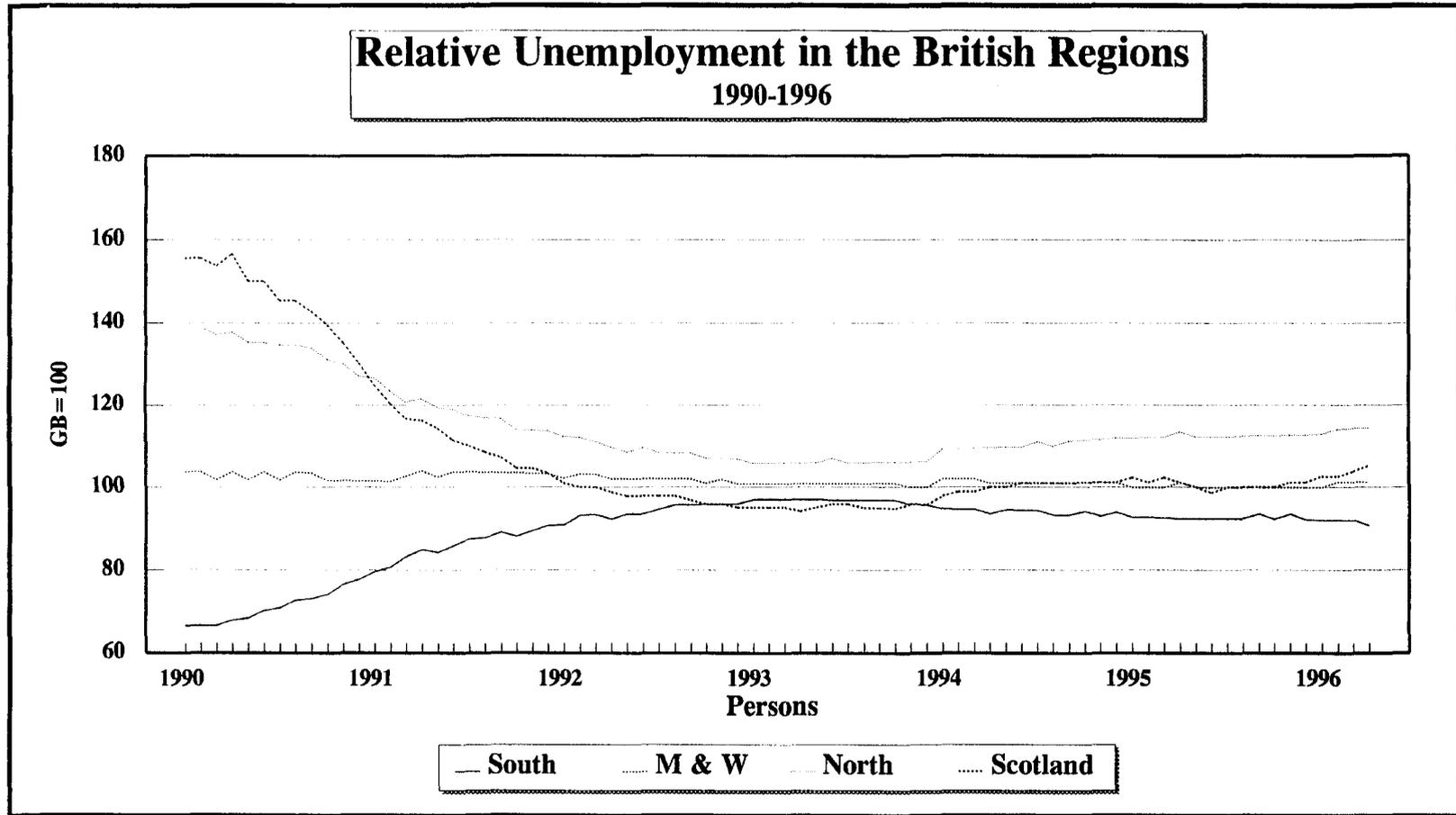
Source: Scottish Office.

Figure 5-6



Source: Department of Employment, Fraser of Allander Institute

Figure 7



Source: Department of Employment, Fraser of Allander Institute