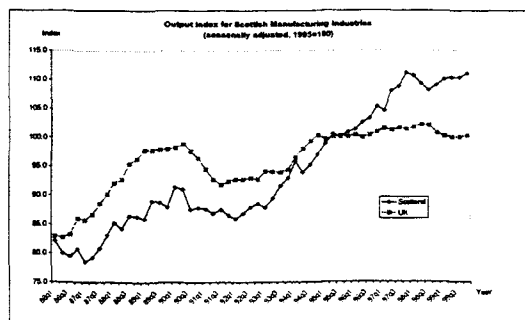


The SCOTTISH Economy

SHORT-TERM FORECASTS*

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

The present forecasting period extends to 1999Q4. In making the Scottish forecasts, the past performance of the Scottish and UK manufacturing outputs are considered, and the National Institute's quarterly forecasts for UK manufacturing output are used for driving the Scottish forecasts. Figure 1 depicts the actual growth rates for Scottish manufacturing output from 1986Q1 to 1998Q3 and the forecasts for 1998Q4 to 1999Q4. The Scottish Office Index of Production has been re-based with 1995=100 and this change has been incorporated into our Short Term Model. The results are presented in Table 1 below.



Source: The Scottish Office
The National Institute

* 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.

The National Institute is forecasting a decline in UK manufacturing from 1998Q3 through to 1999Q2. It is forecast to be static in the next quarter and increase slightly in the last quarter of 1999. Scottish manufacturing output in 1998Q3 fell by 1% compared to a -0.1% decline in the UK. The National Institute is also forecasting steady growth for UK manufacturing during the year 2000. The annual growth rate for Scottish manufacturing output for 1998 and 1999 is now forecast to be 1.1%. On a quarterly basis Scottish manufacturing growth will decline steadily over the first three quarters of 1999 but recovers slightly during the last quarter of 1999.

TABLE 1. QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)

91/90	-2.7
92/91	0.2
93/92	3.6
94/93	5.6
95/94	4.8
96/95	3.0
97/96	4.9
95Q1/94Q4	1.9
95Q2/95Q1	1.7
95Q3/95Q2	-0.5
95Q4/95Q3	0.9
96Q1/95Q4	0.4
96Q2/96Q1	1.2
96Q3/96Q2	0.7
96Q4/96Q3	2.0
97Q1/96Q4	-0.8
97Q2/97Q1	3.3
97Q3/97Q2	0.6
97Q4/97Q3	2.2
98Q1/97Q4	-0.5
98Q2/98Q1	-1.3
98Q3/98Q2	-1.0

FORECASTS

98Q4/98Q3	0.8
99Q1/98Q4	0.9
99Q2/99Q1	0.3
99Q3/99Q2	0.0
99Q4/99Q3	0.6
98/97	1.1
99/98	1.1

**DELOITTE & TOUCHE SCOTTISH
CHAMBERS' BUSINESS SURVEY**

The Deloitte & Touche Scottish Chambers' Business Survey, which is conducted by Strathclyde University's Fraser of Allander Institute together with the Scottish Chambers' of Commerce, is the largest and most comprehensive regular survey of business, employment and other issues affecting the Scottish business community. In the present survey, which was conducted in December, 790 firms responded to the questionnaire.

MANUFACTURING

Optimism

The decline in business confidence continued, although the rate of decline remained unchanged. For a further quarter a net balance of 35% were less confident about the general business situation than they were in the previous quarter.

Orders and Sales

The decline in total orders and sales continued (net balances of -29% and -20% respectively), and for a further quarter the outturn was less than had been expected.

Orders and sales to the domestic Scottish market fell. Demand from rest of UK markets continued to fall, and at a steeper rate than in previous quarters. In contrast the decline in export demand eased slightly, and a further slight easing is anticipated for the first quarter of 1999.

Concerns as to the levels of demand and competition remained high, being reported by 64% and 51% respectively as the two factors thought most likely to limit output.

Finance

The cashflow situation continued to deteriorate, with a net balance of 7% reporting a decrease.

Turnover is expected to rise over the next twelve months, but again the rate of increase remains low, and there is increased pressures on profitability, as the net balance of firms expecting profitability to decline over the next twelve months increased. Pressures to increase prices eased slightly in the fourth quarter and

a net of firms expect to reduce prices in the first quarter.

Investment

Changes to investment plans affected less than 40% of respondents. Investment in the fourth quarter was again primarily directed towards reducing labour [39%] and replacement of equipment [31%].

Employment

In line with forecasts, employment continued to fall, a net decline of 14%, and this net rate of decline is expected to continue. Slightly less than 50% sought to recruit staff in the fourth quarter. 24% reported increasing pay by an average of 3.64%, compared to an average of 4.10% in the previous quarter.

CONSTRUCTION

Optimism

The slight decline in business confidence continued, easing slightly to a net of 8% of respondents reporting a decrease.

Orders

The net decline in total orders was less than anticipated, with a net of 12% of respondents reporting a decrease. The rate of decline in Central Government and other public sector orders was less than expected.

Again, and unexpectedly, the upward trend in private sector orders continued, a net of 1%. However, respondents remain uncertain of any increase in private sector orders in the first quarter.

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 82% in quarter three to 84%.

Investment

Changes to investment affected slightly more than a quarter of respondents and in line with expectations, the decline in plant/equipment investment continued. Of those investing in the fourth quarter two thirds directed investment towards the replacement of equipment.

Employment

The rise in construction employment continued at a net of 10%, once again, most firms expect no change in the next quarter. Some 50% sought to recruit staff in the fourth quarter.

WHOLESALE DISTRIBUTION

Optimism

Changes to business confidence were less broadly based than in the previous quarter, and the rate of decline in business optimism eased to a net decline of 34%.

Sales

Respondents had forecast a further deterioration in sales for the fourth quarter, however, the net decline of 19% was less than had been anticipated. Nevertheless, wholesale respondents continue to expect a further weakening of demand in the first quarter. Concerns as to competition were cited by 68% as the factor thought most likely to limit activity in the first quarter, whilst 26% cited business rates.

Investment

Changes in investment plans were less broadly based, nevertheless the upward trend in investment re emerged.

Finance

Cashflow trends continued to remain weak, with 13% reporting rising cashflow and 29% lower cashflow trends. Only a net of 4% expect turnover to improve over the next year and a net of 33% expect profitability to decline. Respondents continue to expect turnover to decline over the next year (a net of 8%). Expectations of a decline in profitability over the next twelve months were again more widespread, a net decline of 27%. In contrast, expectations of price increases in the first quarter strengthened to a net of 23%.

Employment

Changes to employment levels were less broadly based, affecting less than 25%, however, the trends were better than had been expected, and the anticipated decline did not occur. Respondents continue to anticipate a decline in employment in the

next quarter. 13% reported increasing pay by an average of 4.19%.

RETAIL DISTRIBUTION

Optimism

Changes in business confidence affected 66%, and the decline in business confidence continued, deepening further as a net of 50% reported being less confident than at the end of the third quarter.

Sales

Sales were again markedly worse than had been anticipated, and a further deterioration is forecast for the first quarter. Whilst 20% reported increased sales 57% reported a fall in sales, and 61% anticipate a decline in sales in the first quarter.

Investment

The downward revision in investment plans continued, and was more broadly based at a net decline of 6%.

Finance

The deterioration in cashflow trends was more broadly based with a net balance of 32% reporting a decrease. Both turnover and profitability are expected to decrease over the next twelve months, and the anticipated rate of decrease is sharper than in the previous quarter (net declines of 19% and 31% respectively).

Employment

The decline in employment was largely as anticipated (a net decline of 12%), although for a further quarter changes only affected a third of respondents. 9% increased pay by an average of 4.71%.

FINANCIAL INSTITUTIONS

Personal advances

Personal advances rose strongly during the three months to the end of December for a net balance of respondents and a moderation of the rate of increase is forecast for the first quarter.

Corporate advances

The rate of increase eased further in the fourth quarter, and again corporate demand for credit was most evident for working capital. The demand for credit for plant/equipment and buildings declined for a net of respondents.

Sectoral demand

With the exception of tourism and construction, demand for credit increased from all industrial and service sectors but rising demand is only anticipated from distribution and construction in the first quarter.

Employment

Changes to employment were more broadly based, affecting over 60%. Only 5% reported increasing pay by an average of 2%.

TOURISM & LEISURE

Optimism

Changes in business confidence were again widely reported, and the decline in confidence continued to fall sharply as 59% of respondents reported being less confident than at the end of September.

Demand

The decline in demand was deeper than anticipated, as demand from all areas fell for a net balance of tourism respondents. Average capacity used was six percentage points lower than in the fourth quarter of 1997, but only one percentage point lower than the fourth quarter of 1996.

Investment

Investment continued to rise, although for more than 80% the main reasons for authorising investment were to replace/renew facilities or to improve facilities.

Finance

Increased pressures on margins were evident. Turnover fell sharply, costs rose slightly more strongly than had been anticipated, and the slight decline in prices continued.

Employment

Most firms reported and expect no change to overall employment levels but a small net balance of tourism firms expect employment to decline in the fourth quarter.

Recruitment

Changes to employment levels affected a third of respondents, and the decline in employment was more than anticipated. Recruitment activity remained high with 80% seeking staff. 40% reported increasing pay by an average of 4% (compared to 5.0% in the previous quarter).

CONSTRUCTION

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey showed that the slight decline in business confidence continued, easing slightly to a net of 8% of respondents reporting a decrease.

The net decline in total orders was less than anticipated, with a net of 12% of respondents reporting a decrease. The rate of decline in Central Government and other public sector orders was less than expected.

Again, and unexpectedly, the upward trend in private sector orders continued, a net of 1%. However, respondents remain uncertain of any increase in private sector orders in the first quarter. The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 82% in quarter three to 84%.

The rise in construction employment continued at a net of 10%, once again, most firms expect no change in the next quarter. Some 50% sought to recruit staff in the fourth quarter.

The Halifax House Price Index showed that house prices in Scotland moved up only 0.1% (1.0% in the UK) in the fourth quarter and by 3.9% (5.5% in the UK) over the year. Although house price inflation is up slightly on last quarter's reported figure, it lags behind the UK as a whole.

A report by the TSB Bank showed that average house prices in Scotland fell by 1.4% in the three months to

the end of January compared with the previous quarter. The report found that prices of properties at the upper end of the market continued to rise while those at the lower end declined. The drop in house prices has led to a surge in activity by first-time buyers who account for 48% of the market (although prices of first-time buyer flats have decreased by 3.7% suggesting oversupply in this sector).

Construction summary results

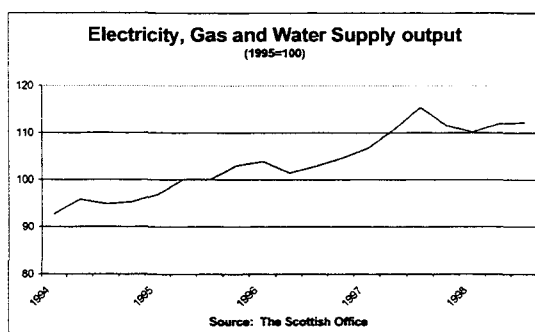
Source: Deloitte & Touche Scottish Chambers' Business Survey

	Percentages		
	Up	Level	Down
Optimism	17.8	56.2	26.0
Trends in actual orders			
Total orders	26.0	35.6	38.4
Central Govt orders	6.7	62.2	31.1
Other Public sector orders	3.7	64.8	31.5
Private sector orders	29.2	43.1	27.8
Capacity used	81.9		
Limits to activity			
Orders/sales	83.8		
Skilled labour	10.3		
Other labour	1.5		
Raw materials	0.0		
Credit etc	0.0		
Supply of land	4.4		
Plant capacity	0.0		
Investment in plant/equip.	10.0	74.3	15.7
Employment trends			
Total actual employment	28.8	52.1	19.2
Total expected next 3 months	9.9	70.4	19.7
Average pay increase	5.8		
Percent recruiting staff	50.7		
Recruitment difficulties	60.5	39.5	

ENERGY

OIL AND GAS

The severe problems facing the oil and gas industry are due to the collapse of the oil price. The average price for 1998 was \$13.14 compared to \$19.13 in 1997 and \$20.82 the previous year. The Asian crisis, the general economic slowdown, continued high OPEC production, high oil stocks and mild weather have all combined to militate against the oil price. It is forecast that the oil price will remain around \$11 in the short term but could rise to nearly \$13 by the beginning of the next century.



Investment in the North Sea in 1998 was only £1.5 billion, less than one third of the £4.2 billion applied for in the previous year. The offshore supply industry employs more than 100,000 and traditionally relies on investment expenditure for about half the annual spending of approximately £12 billion to support this employment. Drilling and exploration fell by 35% in 1998 with some of the largest operators carrying out no exploration activity at all. Cash flow is a considerable problem for many operators and contractors (it has been reduced by one third generally) thus increasing pressure to decrease costs sharply. Many contractors are taking a significant reduction in payments to alleviate some of the pressure. Despite the problems in the industry output has increased and is forecast to rise in 1999 by up to 5%.

The current situation has propelled the industry into a short-term survival scenario, with the general reduction in activity, a severe cost cutting programme and the shedding of jobs. The industry has excess capacity and in the long-run consolidation is probably the best strategy. The recent mergers include Exxon-Mobil, BP-Amoco and Total-Petrofina with

considerable speculation over Shell-Chevron. There has also been a flurry of merger activity in the contracting sector. The effects of these mergers on Scotland and the UK are mixed; firstly there is likely to be a significant relocation of HQ jobs from London to Aberdeen, further strengthening its grip as the 'oil capital of Europe.' Secondly there will be much greater job losses elsewhere (particularly the contracting sector) as investment and exploration activities are cut back. The industry has already lost 10,000 jobs in the UK in 1998 and could lose a further 8,000 as a result to drive down costs.

The fabrication sector only has two major projects (Shearwater and Elgin Franklin) with nothing to fill the books thereafter. The outlook for this sector is very poor. It is likely that few major companies will manage or invest in exploration in the North Sea or in the waters west of Shetland. The BP-Amoco merger will result in the loss of 400 jobs at the Grangemouth refinery with a further 3,000 jobs to go across the UK. Brown & Root AOC, Halliburton and Schlumberger are all expected to have significant job losses this year.

Despite the severe problems in the oil and gas sector, industry sources are confident that with a fiscal restructuring, leaner operations (industry analysts envisage costs being cut to \$6 per barrel with a selling price of \$10 per barrel to keep existing margins) and the use of improved technology so that the North Sea, while a mature province, will continue to support activity for the next 20-30 years.

The latest Aberdeen Chamber of Commerce and Deloitte & Touche Oil and Gas Survey shows 76% of firms in the oil and gas related sector reporting a drop in confidence, 77% reported reduced exploration work and more than 70% expect to reduce exploration over the next six months. 61% of respondents reported reduced volumes of work in the production and service sector with 88% citing demand as a constraint on activity. 42% reported reducing investment plans and 40% of respondents cut employment.

Oil production increased by 7.4% for 1998q4 on 1998q3 compared to only 0.6% for 1998q4 on 1997q4 using data from the Royal Bank of Scotland (RBS) Oil and Gas Index. Gas production increased by 72% on a quarterly basis but only by 4.4% on an annual basis. The RBS Combined Oil and Gas Index increased by 26.6% for 1998q4 on 1998q3 and rose by 2.1% over the year.

The oil price (\$ per barrel) fell by 41.4% over the year and by 11.6% over the quarter. The Average Daily Oil Value decreased by 41.4% for 1998q4 on 1997q4 and by 5.9% on a quarterly basis. The Average Daily Total Value decreased by 26.8% on an annual basis and by 21.6% for 1998q4 on 1998q3.

During 1998 UK oil production rose by 1.1% to 2.54mbpd (the fourth highest level since the 1970s) – the first rise in three years. Revenues however decreased by 33% in cash terms and by 20% in real terms. Daily oil revenues averaged £19.6 million during 1998 while average combined revenues were £33.9 million. Gas output fell slightly while overall combined production remained static whereas combined oil and gas revenues decreased by over 20%. A record number (109) of fields were in production during 1998.

UTILITIES

The Scottish Office's Index of Production for Electricity, Gas and Water Supply increased by 0.3% for Scotland for 1998q2 on 1998q1 and by 1.8% for the last four quarters on the preceding four quarters. The comparable figures for the UK are 1.3% and 1.5%. This reflects the slowdown in economic activity, particularly in the UK, which has curtailed the exports of electricity.

Electricity

Further details of Scottish Power's (SP) bid for PacifiCorp have emerged. The £4.2 billion bid values each PacifiCorp share at \$23.11 (£13.92) based on SP's share price on 5th January 1999 of 600p. The bid was made with a share price of 675p valuing PacifiCorp at £4.7 billion representing a premium of 21%. SP will control 64% of the group and it will be headquartered in Glasgow. The group will be the world's tenth largest multi-utility with a market capitalisation of £13 billion. Cost savings of £120 million will be sought over four years and disposals of £250 million have still to be taken into account. SP will have access to 1.4 million customers in the West of the US and to 550,000 customers in Victoria, Australia. The bid is expected to result in SP returning cash to shareholders by buying back £500 million of its shares. This should leave it with £6 billion of shareholders funds and debt of just under £6 billion.

The government have cleared Scottish Hydro Electric's (SHE) £5 billion merger with Southern Electric after SHE gave an assurance to ring-fence its

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public power supply business. It also guaranteed not to build generating capacity in Southern's area and not to have any new supply contracts between the two companies. The group will have 3.3 million customers and the Southern Group will control 55% of the new company.

Offer has ruled that SP and Scottish & Southern Energy (SSE, formerly Scottish Hydro-Electric) should allow competitors access to the interconnector. This has lifted the threat of closure of the Chaplecross nuclear generating plant, which employs 400 people. This extends the operating licence to 2010. The move is a disappointment for both SP and SSE. There will now be renewed pressure from English power generators to export electricity to Scotland or to build a generating plant in Scotland where generation costs are lower. The regulator has also called upon the government to relax its ban on gas fired power stations in Scotland to increase competition. Companies have submitted plans for distribution, operational costs and capital spending for the five years to 2005 as well as their proposals for the quality of supply. This will be used in the formulation of a new price regime being developed. SP is set to invest 14% more over the next price control period compared to the current £330 million.

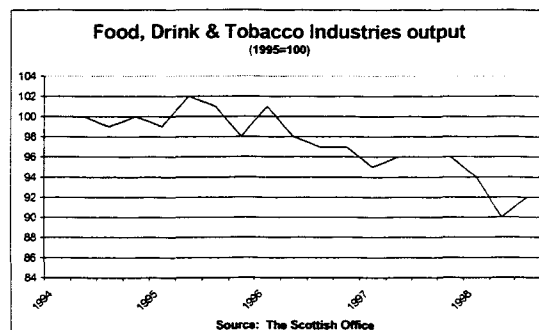
British Energy's (BE) shares closed 3% higher after forecasts of its first full year profits showed that there was a significant increase. Previous expectations were around £210 million-£240 million. The share price closed on the 2nd February at 723.5p, up 27p. The output of the eight nuclear stations rose by 3.9% for a 10-month total of 57.94 tetrawatts. A key improvement here is low inflation which boosts BEs 'revalorisation' charge.

MANUFACTURING

FOOD, DRINK & TOBACCO

The Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 92 in the third quarter of 1998 (1995 = 100), a rise of 1.9% from the previous quarter, although a reduction of 3.3% over the year to the third quarter. The sector's quarterly performance thus compares favourably with the rest of the manufacturing sector in Scotland, where output fell by 1%, (although much of this fall will be due to the performance of the electronics industry) and is a reverse of the recent performance, of output having fallen in the previous three quarters.

The sector's performance is due principally to a 3.9% increase in the Drink sector, although Food and Tobacco output did increase by a more modest 0.3%. Over the year to the third quarter, however, both sectors still show falls in output, of 3.9% for Drink and 4.8% for Food and Tobacco.



The more recent (fourth quarter) results from the Deloitte & Touche Scottish Chambers' Business Survey show, however, that the above quarterly change may be short-lived. The trend in sales was reported as positive (a net 23% reported that they had increased during the survey period) and a net 16% of respondents stated that new orders had increased during the same time. However, a net 13% expected the trend in new orders to turn downwards in the coming three months. New orders were expected to fall in both Scottish and export markets, although stronger demand is expected in the UK (excluding Scottish) market. The majority of firms noted that competition had become more intense during the survey period, and 32% felt that raw materials prices had become more of a concern. Looking over a longer period, however, 61% of companies did expect that turnover would improve over the coming year, although only 37% expect profitability to do so. Capacity utilisation equalled 77%, a slight reduction on the previous period.

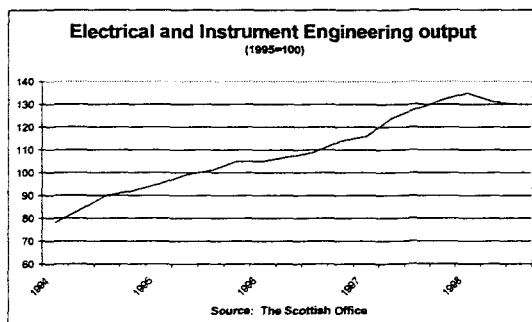
Developments in the sector are dominated by concerns over drinks. Potential problems in Latin America, following the recent problems in Asian markets could rebound on whisky, which accounts for about 13% of all whisky sales, according to the Scotch Whisky Association and the Scottish Council for Development and Industry. Exposure differs by company, however, with some 16% of United Distillers sales going to Latin America compared to only 6% for Allied Domecq. Scotland's other main drinks company, Scottish and Newcastle, has also

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suffered reduced sales recently, although this was mainly due to the depressed state of the beer market last year - the company announced a 4% reduction in pre-tax profits for the last six months of last year.

ELECTRICAL AND INSTRUMENT ENGINEERING

Latest Scottish office figures indicate that the Index of Production for the Electronics sector in Scotland fell by 1.2% during the third quarter of 1998, to stand at 130 (1995=100). This is the second successive quarterly reduction in electronics output, although it is comforting that the pace of the reduction does seem to have eased - the fall in the second quarter equalled 3%. While these figures are not surprising given recent events, two falls in successive quarters will be a source of concern to policy-makers, given the well-known importance of the sector to output growth in Scotland. Year-on-year growth in the sector is still positive - the index rose by 9.5% over the year to the third quarter - although this only indicates that the sector's present difficulties are of fairly recent origin.



More recent results from the Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) do, however, show some tentative signs that the situation may be working through. The short-term balance of optimism (i.e., whether respondents felt more or less optimistic than three months previously) in the sector was negative for a net 38% of respondents. However, it is also interesting to compare this figure with the balance of optimism compared to one year previously. Here, a net 54% of respondents reported feeling less optimistic, so that there has been some change towards greater optimism within the industry. The immediate prospects for orders, however, continue to be flat. The actual trend in orders was reported to be downward for a net 44.7% of respondents to the survey. More importantly, while there is no evidence of any likely rise in orders, the

expected trend in new orders seems to be that they will level off in the short-term, with a net of only 0.8% of companies expecting new orders to fall. Finally, the survey results also show that a net of 11.7% of respondents feel that turnover will improve within the next twelve months. These results, coupled with the increase in optimism noted above, may indicate some degree of stabilisation, albeit at a reduced output level, in the immediate future. We also note, however, that the majority of respondents - 69% - continue to cite a lack of orders or sales as the factor that is presently causing them most concern.

Otherwise, the survey results show little change. Capacity utilisation continues to be around 76%, a slight reduction from the position in the previous quarter. Investment intentions remain flat - although a net 23% reported that they had been revised downwards, 64% of respondents reported that they had not changed in the three months prior to the survey.

Developments in the company sector do also provide some suggestion that the recent period of bad news may be nearing an end. For example, new jobs have been created in the Borders with the announcement by Keltek that it is to create 160 new jobs when it moves to a larger factory in Kelso. Recent research by companies such as Dataquest and the American-based IDC also indicate that optimism has grown throughout the industry in recent months, with some predicting sales growth of up to 10% in 2000.

CHEMICALS

The index of production for Scotland showed a fall in production of 3% for Chemicals and Man-made Fibres for Q3 1998 on Q2 1998 compared to an increase of 0.7% for the UK as a whole. On an annual basis production in Scotland rose by 5.7% while the UK showed a more modest increase of 0.7%.

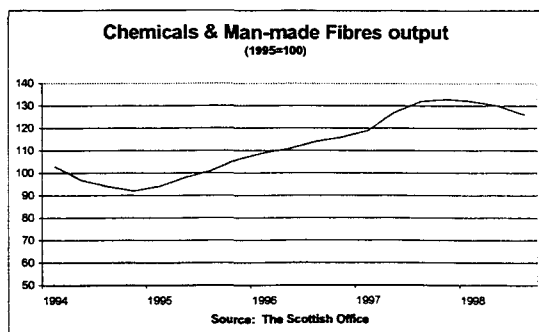
Recent results from the Deloitte & Touche Scottish Chambers' Business Survey suggests that respondents remain despondent about the general business situation. The fall in confidence continued but eased with changes in confidence being reported by 53% of respondents. Only 10% of respondents were more confident about the general business situation, a net decline of 32%.

The decline in total orders, a feature since the third quarter of 1997, continued at a net of -58%. Changes in the level of Scottish orders were less widespread

and the decline eased slightly, a net of 50% reported declining rest of UK orders and the trend in export orders continued to deteriorate. Changes in the level of sales affected 84% and a sharp decline continued with 68% reported falling and only 16% rising sales. Rest of UK and export sales again fell steeply. Overall demand remains weak and the rate of decline is again expected to ease during the current quarter. There were increased concerns as to the levels of orders and sales; insufficient demand continued to be cited by the majority of firms as likely to affect demand during the current quarter. Competition was also a factor causing concern to respondents.

Cashflow trends eased although remained weak with 42% reporting weakening and only 26% improved cashflow trends; 44% now expect turnover to rise over the next year and a net of 17% compared to a level trend during the third quarter, expect profitability to improve over the next year. Once again little change to prices is expected over the current quarter.

Changes to investment plans were at the margin being reported by fewer than 20% and the declining trend in investment in plant/equipment continued. Investment authorised during the fourth quarter was directed toward replacement of equipment and reduction of labour.



Changes to employment were less widespread than in the previous quarter. A net of 22% reduced total employment and while firms expect the trend to continue it should ease.

Scotia Holdings, the Dundee based biotechnology firm, has won a deal with the US foods group General Mills to market Olibra, its appetite suppressant. General Mills has exclusive rights to use Olibra in all food and beverages in the US, Canada and Mexico and will pay Scotia unspecified milestone payments

when set goals are achieved and then royalties on the sale of products. This agreement is the third major deal to market Olibra signed by Scotia, following agreements with a Swedish milk company and the dairy firm St Ivel. Scotia is also in negotiations with between 50 and 60 other companies' worldwide to allow them to use to ingredient.

The European Union recently approved the proposed merger between the British drugs group Zeneca and Astra, its Swedish counterpart. It will lead to the creation of the third largest prescription drugs company in the world and cited advantages such as scope for cost cutting. EU clearance was made possible when AstraZeneca, as the company will be known, agreed to a divestment and other undertakings in response to concerns regarding market share.

Shield Diagnostics Plc and Axis Biochemicals ASA confirmed that discussions regarding the proposed merger are ongoing. Benefits of the merger include a strengthened research and development base, commercialisation expertise, collaboration with industry leaders, complementary technologies and distribution synergies. Initially the deal would have been a straight swap of one new ordinary share in Shield for each Axis share with Shield shareholders controlling 62% of the enlarged group. Amendments mean that the enlarged share capital of Shield will be held approximately 57% by existing Shield shareholders and approximately 43% by existing Axis shareholders. The enlarged firm will have its headquarters in Dundee.

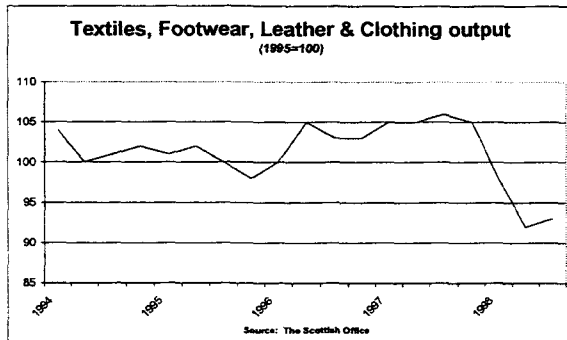
TEXTILES, LEATHER, CLOTHING AND FOOTWEAR

The Index of Production for the Textiles, Leather, Footwear and Clothing (TLFC) sector in Scotland stood at 93 in the third quarter of 1998, a rise of 0.7% from the previous quarter. The rise is in contrast to the position across the textiles industry in the UK, where output fell by 2.9% over the same period. The quarterly increase in output in TLFC in Scotland is also positive when compared to the position across Scottish manufacturing, where output fell by 1% (although much of this fall is due to the situation in electronics). The Index for Scotland does, however, show a fall for the year to the third quarter of 7.2%, slightly less than the UK reduction of 7.3%.

The more recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) provides

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more up to date findings, covering the fourth quarter of 1998. While the yearly output reduction noted above provides the main backdrop, there are one or other signs of optimism. Overall, a substantial 69% of respondents reported a fall in short-term optimism (i.e., compared to the position three months previously), although this does compare with the 80.7% who reported feeling less optimistic than one year before the most recent survey was conducted.



Nonetheless, the position with regard to both sales and new orders remains very weak - sales were down in all three markets (Scottish, other UK and exports). In addition, 68% of respondents reported a downward trend in new orders in the three months preceding the survey, and 60% felt that this was likely to continue in the next three months, with all markets again affected. Capacity utilisation equalled 68%, and while it was unchanged for 70% of firms, some 27% reported that it had fallen over the year. One positive note is that a net number of firms had revised investment intentions upwards, both for plant and equipment and new buildings (by net figures of 11.4% and 21.7% respectively). However, most firms still expect both turnover and profitability to worsen over the next year. Many firms (70%) cite a lack of orders or sales as a factor which had caused them an increasing amount of concern over recent months, with a significant number (46.5%) blaming the level of sterling.

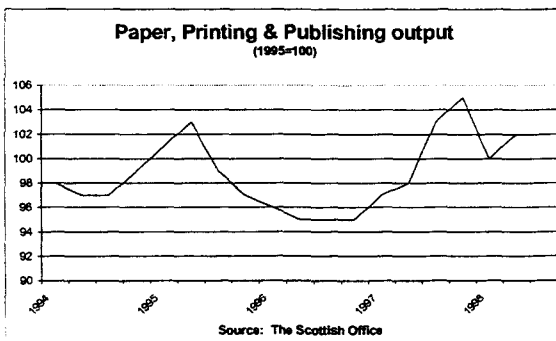
Developments in the company sector are also less than encouraging. William Baird, which owns six factories in Scotland, issued a profits warning in January where it indicated that it would have to lose jobs if retail conditions did not improve. Following this, it announced the closure of its Inchinnan factory, which supplied Marks and Spencers, with the loss of 200 jobs. Baird sells around 40% of its output to Marks and Spencer and has obviously been hit by the

well-known problems affecting that company. Elsewhere, Coats Vyella has shed 200 jobs in Alloa, and jobs have also been lost in the Borders, where Gardiners of Selkirk announced the loss of a further 30 jobs to follow the 40 which it shed last year. Finally, there has been no change at the largest Borders-based company, Dawson International, which continues to perform poorly, with its share price falling further in December following losses at its American operations.

One other source of concern is the "banana" problem, where the American government is threatening to impose punitive (100%) sanctions on a range of luxury items, including Scottish cashmere, in retaliation over the EU's threat to restrict banana imports into Europe. The present state of affairs is uncertain, although it now seems likely that the measures will be enforced, at least temporarily.

PAPER, PRINTING AND PUBLISHING

The most recent Index of Production for the Paper, Printing and Publishing sector in Scotland reveals a small increase (0.3%) in output for the third quarter of 1998. This follows on from the reported 1.5% increase for the second quarter of 1998, noted in the previous QEC. Annualised growth for this sector in Scotland also remained positive with year on growth of 4.3 per cent. The corresponding UK figures reveal that output growth decreased by 2.0% to the third quarter of 1998 and annualised growth increased by 0.5 per cent, respectively.



The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggest that trading conditions remain difficult in this sector. The general business outlook by respondents remains downbeat, with only a small number of

DTSCBS respondents (14%) more positive about the general business outlook than three months previous. Of all respondents in the PPP sector, a net one third are less optimistic about current business conditions than three months previous. Moreover, an increasing number of firms (70%) are less confident about the general business climate than one year previous.

The trends in total orders and sales over the previous quarter confirm this outlook with domestic demand falling for a positive balance of respondents. Thus, declining Scottish and UK orders and sales affected a broad band of respondents over the previous quarter. In contrast, export orders and sales increased, overall, for a relatively substantial balance of respondents, 26 and 35 per cent respectively. Weak domestic demand is forecast to continue, for both orders and sales, for a positive balance of respondents over the forthcoming quarter. However, the upward trend in export orders and sales is forecast to continue into the next quarter, for a positive balance of respondents.

The average level of capacity utilisation for the Paper, Printing and Publishing sector increased by over 2 per cent to 79% for the fourth quarter of 1998. Investment intentions in this sector, over the past quarter, were revised downward again for both land and buildings and plant and equipment, as anticipated by respondents in the previous Commentary. This trend is forecast to continue over the forthcoming quarter.

The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that changes in total employment affected 32% of respondents, as the decline in employment eased (relative to the previous quarter) to a net 18% over the past quarter. This decline in total employment is forecast to increase into the next quarter with a net 29 per cent of respondents anticipating that existing employment levels will fall. Over the same period, around one fifth of all respondents increased wages and salaries by an average 3.28 per cent.

In summary trading conditions remain difficult within this sector with both the Scottish and UK trends in orders and sales within the industry the key concern for respondents. Cashflow and profitability also worsened for a net 10 and 30 per cent of respondents over the past quarter, which continues to underlie the declining trend in business confidence. Accordingly, growth will remain difficult for this sector over the forthcoming quarter unless the expected trends in

export orders and sales are realised, or domestic demand picks up.

In the company sector, Sidlaw (the Scottish based flexible packaging group) that was aiming to grow through acquisition of other packaging companies in Europe, has announced that it is in talks with a potential buyer. Greater consolidation in this sector has followed on from the demands of large consumer groups who wish to deal with one company across all their markets. Witness the recent consolidation within the UK packaging sector with a succession of US firms acquiring UK-based companies. Sidlaw is the most recent UK packaging company to be considered for take-over. Field, the UK packaging group, is currently in take-over talks after approaches from two US-based companies.

Edinburgh-based Johnston Press has been unsuccessful in its bid to acquire further shares in the Portsmouth and Sunderland Newspapers (P&SN) Group. The company, which holds a 15 per cent share in the P&SN Group, failed in a bid to shareholders to acquire a further 10 per cent stake. Since announcing its interest in the P&SN Group, a number of other regional newspaper groups have entered discussions with the P&SN Group.

Mirror Group, which is at the centre of on-going take-over talks with Trinity Newspapers and Regional Independent Media, acquired First Press Publishing, the Glasgow-based publisher of sports magazines and property guides, for nearly £5 million. Finally, the Scottish Media Group (SMG) acquired Primesight, the Poster Company, for £35 million in its first venture into the outdoor advertising market. The deal diversifies the advertising revenue base for SMG, which was predominately derived from TV-based advertising.

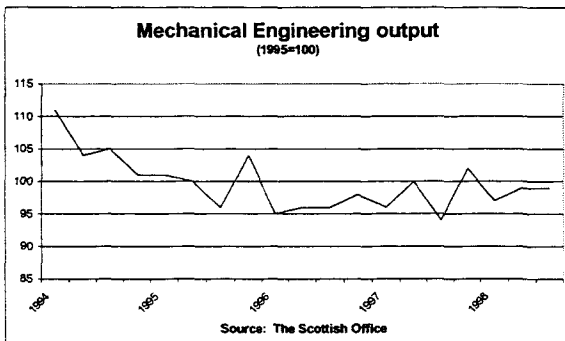
MECHANICAL ENGINEERING

The most recent Index of Production for the Mechanical Engineering sector in Scotland (February 1999) reported a 0.8% increase in output for the third quarter of 1998. However, given the periodic fluctuations in output growth, typically experienced by this sector, this small rise in Mechanical Engineering output marks the second quarterly increase in output growth for this sector (recall that this sector experienced a 3.7% rise in output growth for the second quarter of 1998). Annualised growth for this sector in Scotland also remained positive with an increase of 2.2 per cent over the previous four

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quarters. The corresponding UK figures reveal that output growth fell by both 1.6% to the third quarter of 1998 and annualised growth decreased by nearly 0.5 per cent, over the previous four quarters.

The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggest that trading conditions remain difficult in this sector. Despite the growth in output, reported for the second and third quarter of 1998, business confidence, as reported by the most recent DTSCBS remains shallow, with a net 32 per cent of respondents less confident about the current business conditions than three months previously. Moreover, an increasing number of respondents (58%) are less confident about the general business climate than one year previously.



The trends in total orders and sales over the previous quarter confirm this outlook. Declining orders across all markets were reported by DTSCBS respondents, with 49% reporting falling Scottish, 47% declining rest of UK and 29% falling export orders. The trend in the total volume of sales followed a similar pattern, with both Scottish (38%) and UK sales (38%) most affected. The trends in orders and sales for the forthcoming quarter are forecast to continue with RUK orders and sales anticipated to fall for a wide band (over one third net) of respondents.

The average level of capacity utilisation for the Mechanical Engineering sector increased by nearly 1 per cent to 78% for the third quarter of 1998. Investment intentions in this sector, over the past quarter, were revised downward for both land and buildings and plant and equipment, by a small positive balance of respondents. Investment intentions over the forthcoming quarter are forecast to follow a similar trend.

The latest DTSCBS also reveals that changes in total employment affected 35% of respondents, with a net 10 per cent reducing employment relevant to the previous quarter. Over the next three months, respondents expect the employment situation in this sector to worsen, with a net 14 per cent of respondents reducing total employment. The employment category most affected is part time employees. However, respondents still note difficulties in the general recruitment of staff, with skilled manual workers proving the most difficult. Over the same period, just under one third of all respondents (30%) increased wages and salaries by an average 3.58 per cent, which was less than in the previous period (4.4%).

In summary trading conditions remain difficult within this sector with very few firms expecting either sales or new orders, across all markets, to increase over the forthcoming quarter. The current value of the exchange and interest rates remains the key concern for respondents in the Mechanical Engineering sector. Cashflow concerns remained, on balance, relatively even for respondents over the previous quarter. However, profitability is forecast to fall for a positive net balance of respondents. Accordingly, growth will remain difficult for this sector over the forthcoming quarter unless the expected downward trends in orders and sales are not realised.

In the company sector, Clydebank-based UiE is in line for a jobs boost following discussions with Esso about remedial work for a production vessel. Much of the work could be done in Greenock where the vessel is currently in dry-dock. Weir Group, the Glasgow-based engineering firm, is to consider ventures outwith its core business area following stronger than expected half year profits. It is anticipated that the Group will consider take-overs up to £100 million in engineering related fields. Weir Group was less affected, over the past year, by the high value of Sterling because around two thirds of its business is based overseas.

SERVICES

RETAIL & WHOLESALE DISTRIBUTION

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey for the fourth quarter of 1998 showed that changes in business confidence affected 66%, and the decline in business confidence continued, deepening further as a net of 50% reported

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being less confident than at the end of the third quarter.

Sales were again markedly worse than had been anticipated, and a further deterioration is forecast for the first quarter. Whilst 20% reported increased sales 57% reported a fall in sales, and 61% anticipate a decline in sales in the first quarter.

Retail Summary results

Source: Deloitte & Touche Scottish Chambers' Business Survey

	Percentages		
	Up	Level	Down
Business Optimism	8.1	34.1	57.8
Trends in actual sales	20.1	23.0	56.9
Trends in expected sales	12.9	26.4	60.7
Investment plans	16.9	60.4	22.7
Cashflow past 3 months	12.2	43.4	44.4
Turnover next 12 months	23.9	23.0	43.1
Profitability next 12 months	21.5	26.3	52.2
Price change next 3 months	32.5	55.8	11.7
Employment trends			
Total actual employment	11.1	66.3	22.6
Total expected next 3 months	6.5	69.0	24.5
Average pay increase	4.71		
Percent recruiting staff	46.7		
Recruitment difficulties	54.7	45.3	

The deterioration in cashflow trends was more broadly based with a net balance of 32% reporting a decrease. Both turnover and profitability are expected to decrease over the next twelve months, and the anticipated rate of decrease is sharper than in the previous quarter (net declines of 19% and 31% respectively).

The decline in employment was largely as anticipated (a net decline of 12%), although for a further quarter

changes only affected a third of respondents. 9% increased pay by an average of 4.71%.

Scottish-based non-food retailers have reported further steady growth in non-food sales in the final quarter of 1998, according to the Scottish Retailers Index published by The Royal Bank of Scotland on January 29 1999. The Bank wrote: "Against a background of a rapidly slowing economy and falling sales in Great Britain as a whole, this is good news for Scottish retailers."

The index showed sales volumes (seasonally adjusted) increased by 0.8 per cent over the figure for the quarter to September. Over the year, there has been 4.0 per cent growth in sales volumes. The value of Scottish retail sales has also grown by 0.4 per cent over the quarter, and by 3.5 per cent over the year (seasonally adjusted). Although value growth is weaker than the growth in volume, it still compares favourably with the figures for Britain which show a fall in value of 0.9 per cent over the quarter and a growth of just 0.4 per cent over the year. The differential between volume and value growth in both the Scottish and GB non-food retail figures indicates that unit prices are falling and suggests that price discounting may have been taking place.

The Royal Bank of Scotland report that understanding absolute and relative trends at this time of the year is complicated by a significant variation in seasonal patterns between Scottish-based and GB retailers. For Scottish based retailers, the biggest growth occurs between quarter two and quarter three, whereas for GB as a whole it is during the fourth quarter that the significant increase occurs. The tourism component in Scottish based retailers' non-food sales is probably responsible for much of this difference. In addition, although growth among Scottish-based retailers was strong last year, this was from a very low base, with sales volumes in quarter four of 1997 only slightly above the level for the same period in 1996.

The latest CBI distributive trades survey showed high street shops showing signs of a modest recovery.

The latest available retail price index from the Office for National Statistics (ONS) is for November 1998 and it showed that the all items retail prices index (RPI) fell by 0.1 per cent over the month to stand at 164.4 for November. In the twelve months to November, the all items RPI rose by 3.0 per cent, down from 3.1 per cent for October. The 12-month

rate of change for the all items excluding mortgage interest payments index stood at 2.5 per cent for November, unchanged from October. The main downward effect on the all items 12-month rate came from housing costs, due to a fall in the mortgage interest payments component following recent interest rate reductions. Smaller downward effects also came from motoring costs, largely due to greater falls in petrol prices than last year, and from prices for clothing and footwear which recovered less strongly from mid-season sales than last year. The main offsetting upward effects came from prices for non-seasonal food, which fell by less than last year. A smaller upward effect came from price changes for household goods.

The ONS reported that in January the seasonally adjusted estimate of retail sales volume is 113.3. This is 1.1 per cent above the December figure and 1.2 per cent higher than the January 1998 level. In November to January the volume of sales was 0.4 per cent higher than in the previous three months and 1.5 per cent higher than in the same period a year earlier. Based on non-seasonally adjusted data, the average weekly value of retail sales in January was £3,500 million, 3.3 per cent higher than in January 1998. In November to January the value of sales in current prices was 2.6 per cent higher than in the same period a year earlier.

TRANSPORT

Air

BA announced its first ever loss since 1995, a first quarter loss of £75 million compared to a surplus of £80 million in the same period in the previous year. The figure is better than anticipated because BA avoided £59 million in bonuses. The target for recovery is to lift the number of premium seats on European routes. There would also be a substitution of smaller for larger aircraft and possibly the axing of unprofitable routes. It also has a drive to trim £1 billion off costs by 2001 and at the moment is £100 million ahead of schedule. Shares have risen by 6.5p to 388.75p after the figures were released.

Low cost carriers are proving to be popular with business executives according to a survey by Barclaycard where 86% of executives who had flown with a low cost airline would do so again. The survey of 2000 executives found that more than a quarter had travelled with such an airline and 33% thought they were more reliable. Ryanair announced that third

quarter profits before tax increased by 11.9% (after tax profits increased by 20%) while passenger numbers rose by 20%. EasyJet has annual profits of £2.3 million, its first profit since its launch three years ago. It is expected that the company will be floated on the stock market in the year 2000 but that the present owner will retain control.

Road

The Scottish Association for Public Transport has called on the Government to halt the £170 million extension of the M74 into Glasgow. The group has an alternative scheme that costs £20 million less. They would build a non-motorway link between the M74 and the M8 but also add a rail link to Glasgow Airport, extending the number of bus lanes and adding to the number of electrified rail lines. The group is confident that its proposals are more in keeping with the government's integrated transport policy.

The £50 million project to build Edinburgh's rapid transport scheme has been narrowed down to two bidders; the first consortium includes FirstGroup, Balfour Beatty and Central Parking System while the second includes Go-Ahead, VIA GTI, John Mowlem and Volvo Bus. Construction is to begin later this year and it is expected to be fully operational in 2001. The winner will get to operate the expressway for 25 years. The project should provide a 9km-guided busway with a 15-minute journey time from the city centre to the airport. The Edinburgh Business Park, the Gyle Centre, the Scottish Parliament and several city centre sites have all to be serviced by the link.

Stagecoach is to seek a new headquarters in Perth while at the same time streamlining its bus management team. The number of regional chairmen has been cut from five to three and the Scottish companies will now report to the Newcastle office and not Perth. The corporate team will be expanded but no other effects are expected. Profits increased by 36% from £70.5 million to £96.1 million although turnover only increased by 6%. Profits of the core bus operations rose to £37.4 million from £33.6 million as passenger volumes increased by 1.5%. Prestwick Airport made a profit of £1.8 million (profit margin of 14.2%) and overseas buses contributed £10.5 million, up from £9.7 million previously. South West Trains had profits of £17.3 million (from £7.8 million last time) and Porterbrook (a rolling stock leasing company) made £64.8 million, slightly up on previous performance. Stagecoach have made a £276.5 million

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bid for Hong Kong listed Citybus valuing Citybus equity at £181 million. Stagecoach announced a share placing to raise £140 million with the balance coming from the Hong Kong debt market.

Sea

It is likely that the new generation of ferries will be bad news for Galloway as there may well be a move from Cairnryan to Port Glasgow. It is likely that the new fast ferries will transport freight more quickly than conventional ferries and, more importantly, from more convenient locations. The days of long road journeys (because road transport was quicker than sea) are over. Not only will freight benefit but there is scope for a considerable rise in trade, tourism, the island economies and possibly ship repairing.