

*Quarterly*  
**ECONOMIC**  
*Commentary*

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# OUTLOOK *and* APPRAISAL

The latest data on output growth in Scotland's production and construction industries provide a further indication that Scotland's rate of growth is slowing. In the first quarter of this year, output in production and construction (less oil and gas) fell by 1% compared to a 0.9% rise in the fourth quarter of 1997. Output in the same sectors was almost static in the UK, rising by 0.1% in the first quarter after falling by 0.4% in the final quarter of last year. It is clear, however, that Scotland's weaker relative performance reflects the downturn in the construction industry, which contracted by 4.3% in Scotland during the first quarter compared to an increase of 2% in the UK. When construction is removed from the data, the performance of the production industries is seen to be better in Scotland with a first quarter decline of 0.1% compared to a 0.3% fall in the UK.

The production sector is composed of three principal sectors: Electricity, Gas & Water, Mining & Quarrying, and Manufacturing. Of these three, only manufacturing grew in the first quarter in Scotland. Mining contracted by 1.3%, compared to a slight increase of 0.1% in the UK, while Electricity etc. contracted by 2.1%, the same rate of decline as in the UK. The growth of Scottish manufacturing in the first quarter was minimal, only 0.1%. Nevertheless, this compares with a contraction of 0.1% in UK manufacturing.

A comparison of Scottish and UK sectoral growth, year on year to the first quarter, is presented in Table 1. These data reaffirm the generally stronger performance of the Scottish economy over the last year to eighteen months.

	Scotland	UK
	%	%
Production & Construction (less oil & gas)	6	1.5
Production	7.6	1.1
Construction	-0.9	2.8
Manufacturing	7.9	1.1
Mining etc.	2.5	0
Electricity & Gas	7.4	2.2

Only the construction sector displays a weaker performance than its UK counterpart. Within production, both manufacturing and electricity & gas display significantly stronger growth than in the UK. However, because of its relatively small size the Scottish economy is much more volatile than the UK economy. So, a better appreciation of the strengths and weaknesses of Scottish production can be obtained by examining performance during the 1990s.

### Scottish and UK Industrial Performance in the 1990s

Table 2 indicates the cumulative growth during the eight years from 1990Q1 to 1998Q1 by principal sector in Scotland and the UK.

	Scotland	UK
	%	%
Production & Construction (less oil & gas)	21.0	2.5
Production	25.3	9
Construction	3.5	-4.8
Manufacturing	26.0	3.7
Mining etc.	4.2	41.8
Electricity & Gas	34.0	31.0

These data reveal the perhaps-surprising conclusion that while production and construction taken together expanded by a fifth in Scotland, in the UK the expansion at one fortieth was minimal. A closer examination reveals that this was principally due to the growth of manufacturing in Scotland. The construction sector exhibited minimal growth over the period, although this was superior to

the fall of nearly 5% registered in the UK. This superiority was actually present only in the period to the end of 1993. From early in 1994 the performance of construction in Scotland was generally weaker and more volatile than its UK counterpart. In the other two principal sectors, the growth of mining was considerably weaker than in the UK, while the performance of electricity & gas was much the same in the two countries. However, since the weight of the latter two sectors in the economy is small, about 12% of total production and construction, variations in their performance have only minimal impact overall.

So, it is on the performance of manufacturing that Scotland's superior growth in industrial output in the 1990s rests.

Figure 1 compares the smoothed growth performance of Scottish and UK manufacturing during the 1990s. Up to the end of 1994 Scotland's performance was similar to the UK, although turning points appear to have occurred earlier here. From the first quarter of 1995, Scottish manufacturing has consistently outperformed its UK counterpart. For the period 1990Q1 to 1998Q1, the cumulative growth in Scottish manufacturing was 26% compared to just under 4% in the UK. However, regular readers of these pages will not be surprised to hear that this stronger performance is largely due to one sector: electronics.

Table 3 indicates the cumulative growth during the eight years from 1990Q1 to 1998Q1 by principal manufacturing sector in Scotland and the UK.

	Scotland	UK
	%	%
<b>Manufacturing</b>	26.0	3.7
Electronics	199.0	28.7
Refined oil & nuclear	6.9	10.8
Chemicals etc.	0	16.8
Metals etc.	-21.0	-11.9
Mechanical Eng.	-16.2	-13.6
Transport Equipment	-23.0	11.6
Food & Tobacco	-20.2	8.0
Drink	-1.0	12.0
Textiles, Clothing etc.	-15.7	-18.4
Paper, Printing & Pub.	-5.8	0
Other Manufacturing	-15.7	-3.0
<i>Manufacturing (ex Electronics)</i>	-13.4	0.2

Table 3 reveals the importance of electronics to Scottish manufacturing growth. Only one other sector did better than its UK counterpart over the period and this was Textiles, Clothing and Footwear. However, the better performance of textiles was only relative since the sector contracted by nearly 16%, which was only a little less than the 18% contraction in the UK.

An examination of the temporal pattern of growth provides some interesting conclusions. First, overall manufacturing performance (ex. electronics) has clearly been affected by structural change as traditional industries such as metals, transport equipment and food & tobacco contracted. Secondly, the performance of manufacturing (ex. electronics) improved relative to the UK in the latter part of the period. Sectors where this is particularly evident include chemicals, metals, and paper, printing & publishing (see Figures 2, 3 and 4). Figure 5 shows that UK manufacturing (ex. electronics) has generally performed more strongly. However, from 1995Q1 while Scottish performance was still weaker the gap did narrow. Thirdly, Scotland's manufacturing sectors have generally been more volatile than their counterparts in the UK. This is, in part, due to the much smaller scale of the Scottish economy. Finally, the effects of the high pound sterling and the 'Asian crisis' did not occur until mid to late 1997 and appear particularly to affect sectors that compete largely on the basis of price such as textiles, food and to a lesser extent transport equipment. The electronics sector also appears to be affected by these phenomena as the downturn in growth during 1997 indicates (Figure 6).

### Outlook

It is clear that the growth of the Scottish economy is slowing in line with the UK. However, due to the continuing strength of electronics the performance of the manufacturing sector continues to be stronger here than in Britain, despite the general slowdown in the sector for reasons which are now well known. Recent data for service sector performance in Scotland are lacking but there is little to suggest that growth is much different than in the UK. The strength of demand in the economy remains stronger than many people are prepared to admit. In the UK, a falling saving ratio and continuing strong growth in the demand for consumer credit are supporting the growth of consumers' expenditure. But a slowdown in the growth of real personal disposable income and in

earnings pressures should ensure that the growth of consumers' expenditure would continue to slow throughout the year. Similarly, inflationary pressures while still present should be expected to diminish.

Forecasting the Scottish economy is complicated by the recent turbulence on the world's financial markets. Presently, the worst moments of the crisis appear to have passed following the pick-up in stock market prices in the US and Europe. The main threat to the future prospects of the Scottish and UK economies arises from the effect on demand of the significant falls in asset prices and from contractions in the lending activity of the banks whose investments in Russia and elsewhere are now uncertain. The harmful effect on the 'real' economy of this financial turbulence depends in turn on the policy response of the major central banks as the crisis develops.

We assume that financial policy will be accommodating with a loosening of monetary policy to reduce liquidity constraints and improve commercial confidence. Accordingly, we do not anticipate on present information that the Scottish and UK economies will necessarily move into recession, as many commentators are keen to suggest. Nevertheless, there is a small probability of recession, which has increased following the turbulence on the world's financial markets. Moreover, that probability will continue to rise until the Monetary Policy Committee (MPC) of the Bank of England starts to ease UK interest rates downwards.

It is against this background that our forecasts for GDP growth in Scotland from 1997 to 2001 have been constructed. The broad aggregates are presented in Table 4.

	%
1997	3.43
1998	2.13
1999	1.73
2000	2.56
2001	3.04

We forecast that growth last year was appreciably above the trend growth of about 2%. During 1998 growth is predicted to slow considerably to an annual rate just above trend and this is followed in 1999 by below trend growth of about 1.7%. In the subsequent years

growth is expected to strengthen as both world trade and domestic demand picks up.

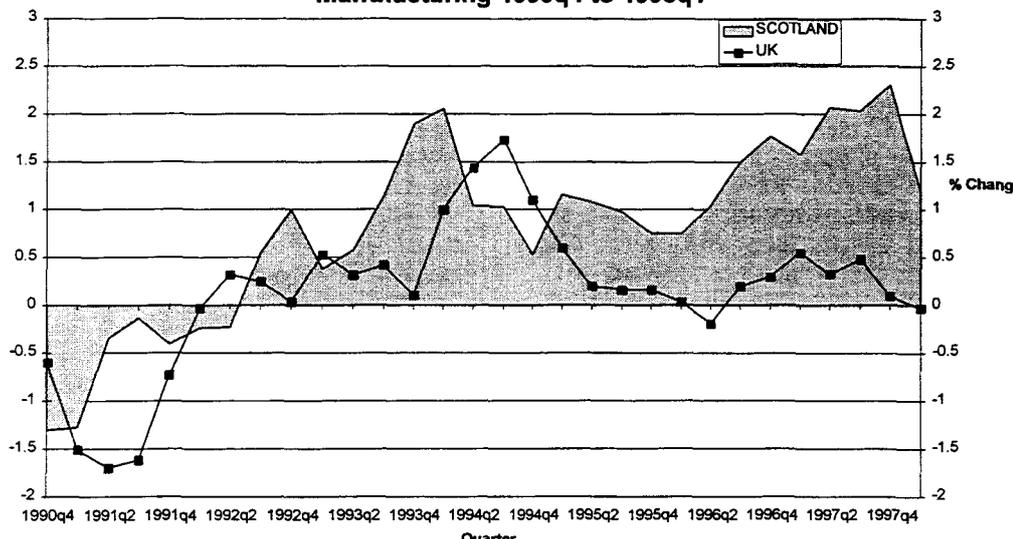
At the sectoral level, electronics is forecast to continue to deliver high rates of growth but these will nevertheless be slower than those witnessed in the early and mid-1990s. Mining & quarrying, oil refining & nuclear fuel and business & financial services are also forecast to grow strongly. At the other extreme, textiles, clothing & footwear and transport equipment are both expected to display negative growth until 2000 picking up only gradually after that.

In the light of the forecasts of GDP growth Table 5 presents our prediction of the growth of employees in employment over the forecast horizon. Strong growth last year increases employment in 1997 by about 14,000 or 0.7%. But the predicted slowdown in growth this year more than halves the job increase in 1998 to just beneath 6,500. In subsequent years employment is predicted to fall as the economy grows below trend in 1999 and as productivity growth accelerates.

	Change	%
1997	13,982	0.70
1998	6,415	0.32
1999	-8,437	-0.42
2000	-9,075	-0.45
2001	-2,962	-0.15

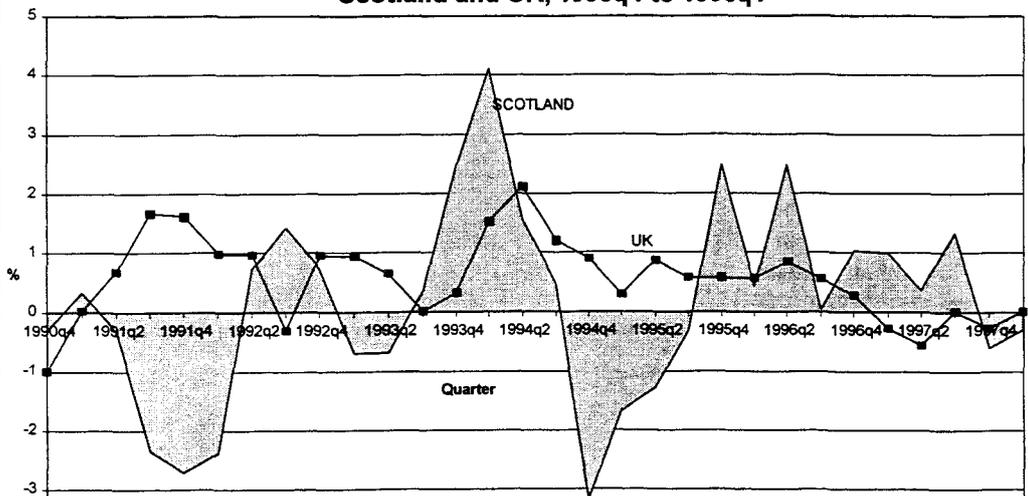
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**Figure1: Quarterly Growth in Scottish and UK Manufacturing 1990q4 to 1998q1**



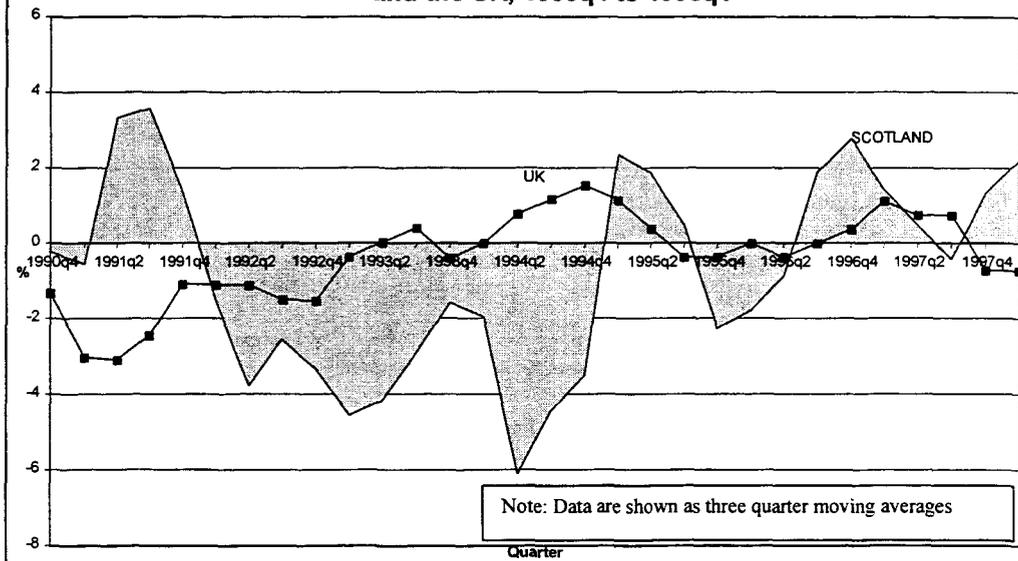
Note: Data are shown as three quarter moving averages

**Figure2: Quarterly Growth in Chemicals & Man-made Fibres, Scotland and UK, 1990q4 to 1998q1**

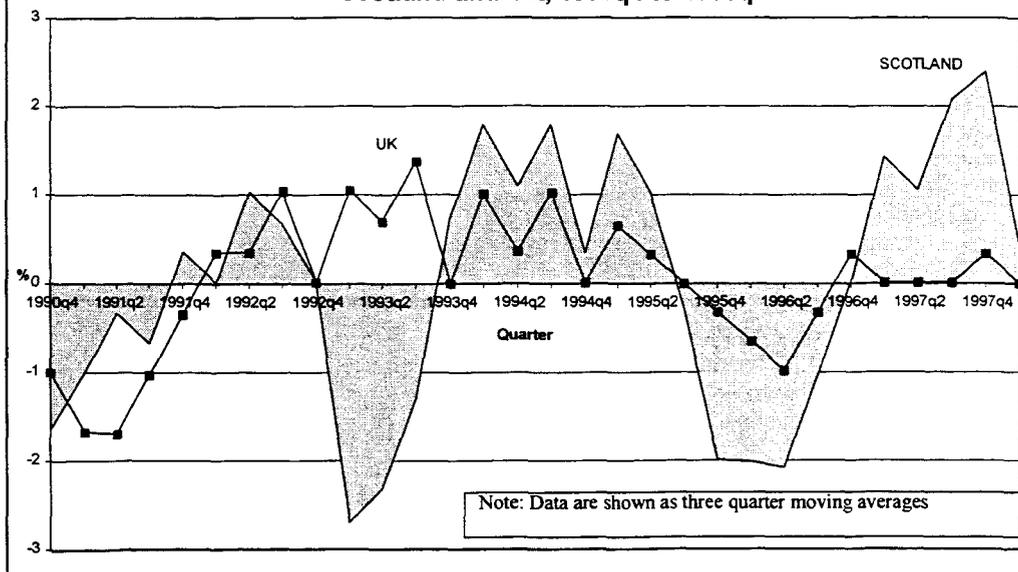


Note: Data are shown as three quarter moving averages

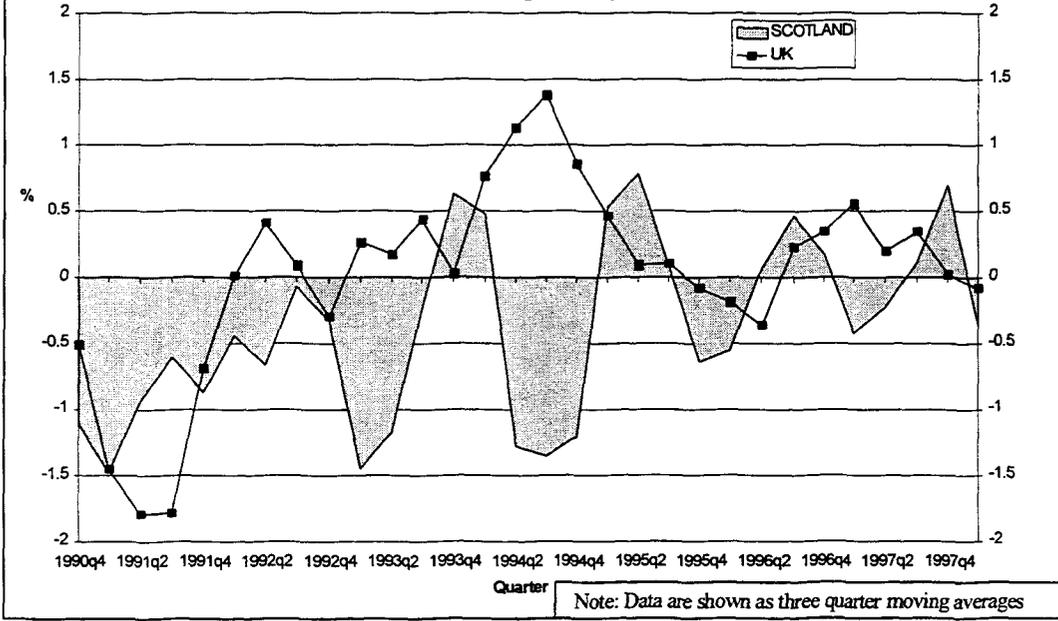
**Figure 3: Quarterly Growth in Metals & Metal Products in Scotland and the UK, 1990q4 to 1998q1**



**Figure 4: Quarterly Growth in Paper, Printing & Publishing in Scotland and UK, 1990q4 to 1998q1**



**Figure 5: Quarterly Growth in Scottish and UK Non-Electronics Manufacturing 1990q4 to 1998q1**



**Figure 6: Quarterly Growth in Electronics in Scotland and UK, 1990q4 to 1998q1**

