Quarterly Economic Commentary

we gratefully acknowledge the contribution of the
Buchanan and Ewing Bequest
toward publication costs

FRASER OF ALLANDER INSTITUTE

The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short term movements in economic activity. Along with the Quarterly Economic Commentary the Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium term and long term aspects of the Scottish economy. The Institute is a research unit in the Strathclyde Business School, a faculty of the University of Strathclyde.

Information for subscribers

The Quarterly Economic Commentary is published in March, June, September and December. Annual subscription rates are £40.00, or £10.00 per single issue. Queries should be addressed to the Secretary, the Fraser of Allander Institute.

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.

Commentary Team

Editor :	Jim Love
Contributors:	Brian Ashcroft, Richard Brooks, Neil Dourmashkin, Paul Draper, Stewart Dunlop, Cliff Lockyer, Eleanor Malloy, Claire Monaghan, Peter McGregor, Iain McNicoll, Eric McRory, Roger Perman and Kim Swales.
Graphics:	Eleanor Malloy
Production:	Linda Kerr and Isobel Sheppard

The Fraser of Allander Institute
Curran Building
100 Cathedral Street
GLASGOW
G4 0LN

041-552 4400 Ext. 3958

QUARTERLY ECONOMIC COMMENTARY

* * * * * * COMMENTARY * * * * * *

* * * * * * VIEWS * * * * * *

OUTLOOK AND APPRAISAL

The economic prospects for both Scotland and the UK have clouded somewhat in the last three months. A deeper (although not necessarily longer) recession is now apparent than previously seemed likely, and the evidence suggests that recovery is likely to be slow.

But before analysing more fully the short-term data, the recent publication of Scottish GDP data for 1989 affords an opportunity to review Scotland's relative economic performance within the context of a longer time period. According to the official statistics, the Scottish economy grew by 3.4% in 1989 compared with 2.0% growth in the UK as a whole, the second successive year in which Scotland's growth rate exceeded that of the UK. Excluding oil and gas narrows the differential in Scotland's favour, but does not remove it (3.4% growth compared with 3.1% for the UK). This outperformance is sure to have continued in 1990, and probably also into 1991. It is unusual and welcome for Scotland to outperform the UK for more than a short period; unfortunately, the situation looks less pleasant when viewed in the proper context, from peak to peak in the economic cycle.

To do so properly requires at least quarterly GDP data, which are unavailable for Scotland. Nevertheless, some conclusions can be drawn on the basis of annual data for the period 1979 to 1989, which is slightly beyond the quarterly peak for the UK and the probable quarterly peak for Scotland. This yields growth per annum of 1.7% for Scotland compared with 2.2% for the UK; thus over the period 1979 to 1989 Scotland's average rate of growth was 0.5 percentage points (or 23%) below that of the UK. This underperformance is largely accounted for not by the depth of the 1980-81 recession, but by Scotland's stuttering recovery thereafter and the growth hiatus in 1986 which was not shared by other parts of the UK. Looked at over the proper time horizon, therefore, even three successive years of relatively fast growth has failed to keep Scotland on course with its southern neighbour.

Recent Economic Performance

Since the middle of last year the UK economy has experienced three successive quarters of falling GDP. Output in the service sector as well as in manufacturing has fallen steadily for the last nine months, raising the possibility of a year-on-year decline in service sector output for the first time in almost twenty years (see British Economy section).

Because of the lack of timely service sector output data the recent movements of the Scottish economy are less clear, but some conclusions can be drawn on the basis of the index of production and construction. During 1990 as a whole the Scottish index rose by 2.3% compared with a fall of 0.4% for the UK. Scottish manufacturing output rose by 1.2% in 1990, and fell in the UK by 0.5%. At first sight this is merely further confirmation of the Scottish outperformance which has been highlighted repeatedly; however, on closer inspection these data reveal some potentially worrying aspects. Between the first and second halves of last year the overall Scottish index of production and construction (excluding oil) fell by 6.6%, more than three times the decline of the UK index. In manufacturing over the same time period the decline in Scotland was 9.8% compared with a fall in UK manufacturing output of just 2.8%., and production of investment goods in Scotland fell by 22%, almost five times the decline experienced in the UK.

This can mean one of only three things. The first is that Scottish output fell off a cliff in the second part of last year, which would raise question marks over the ability of the economy to take advantage of recovery when it eventually does occur. The second is that the massive output jump recorded in the first quarter of last year was overestimated, and so Scotland's relatively good output performance compared with the UK was much less impressive than it first appeared. In the absence of other information, and given the vagaries of quarterly Scottish data, the most likely conclusion seems to be the third possibility - a bit of both, but with the emphasis on first quarter overestimation. Unfortunately, none of these possibilities is very pleasant, making the release in August of output data for the first quarter of this year of even more interest than usual.

Turning to the labour market, Scotland's relatively good performance remains clear - at least on historic data. The rise in the rate of unemployment is now accelerating, but still at a rate considerably below that of southern Britain. Perhaps of more immediate interest, however, is employment data, comparing (as with output) the two halves of 1990. Over this period total employees in employment rose in Scotland by 0.8%, compared with a marginal decline in the UK. Most noticeable here was the static nature of service sector employment in the UK, while Scottish service sector employment grew by 1% in the second half of the year. In manufacturing the disparity was, if anything, even more marked; a fall of 0.3% in UK employment compared with a rise in Scotland of 1.4%.

There are, of course, time lags between output and employment changes in any economy, and it is possible that the size of these lags varies between Scotland and other parts of the UK. However, it seems unlikely that the very different output and employment performance of the two economies in the second half of last year can be explained simply by differences in the UK and Scottish lags, and are more likely to be a further reflection of Scotland's relative economic strength over the last three years. The labour market is, however, clearly becoming much slacker, as indicated by the Scottish Chambers' Business Survey. All business sectors, with the exception of wholesale distribution, indicated employment declines in the first quarter of this year, with manufacturing and financial services particularly pessimistic. The rate of decline is expected to moderate in the second quarter, with modest increases anticipated in the tourism sector and in wholesaling.

Prognosis

As with all recessions, the trick is to spot the likely turning point and assess how robust will be the ensuing recovery. The official line has consistently been that recovery will be led by a revival of consumer expenditure resulting from lower interest rates and encouraged by reduced consumer price inflation. The evidence here remains fairly mixed; retail sales rose by 3.6% in March following the announcement of increases in the rate of VAT, then fell by 3.2% in April. However, there is now some evidence of a recovery in the housing market following a series of mortgage rate cuts, and a modest revival in house prices is a welcome sign - providing that it remains modest and does not herald another price explosion of the type witnessed in 1988-89. Not surprisingly in the midst of a recession, the outlook for investment expenditure is unremittingly bleak. Provisional figures for first quarter manufacturing investment show a fall of 11% over the final quarter of 1990, and a decline of almost 20% from the corresponding period last year. The latest official survey of total manufacturing investment intentions projects a fall of almost 14% during 1991 as a whole, following an earlier fall of 4% during 1990.

The official longer leading cyclical indicator, designed to indicate turning points one year in advance, started rising again last September following several months of stagnation. This suggests a bottoming out of the UK economy in the second or (more probably) third quarter of this year, but does not yet give clear evidence of strong recovery. Clearly the recession still has some way to go.

The Scottish Chambers' Business Survey for the first quarter of this year tells a similar story for Scotland, with business optimism improving slightly but remaining low, and a clearly worsening trend in sales and new orders among manufacturers. Both domestic and overseas markets showed a declining trend in new orders, although the extent of the decline was much less marked for exports of manufactured goods, with the rest of the UK proving to be the most depressed market. Both manufacturing and construction companies indicated a tendency to cut back on planned investment, a trend confirmed by responses from the financial sector which indicated more distress borrowing by Scottish companies and reduced demand for investment funds.

The consistent position of the Commentary has been that economic recovery will be rather later than official forecasts would suggest, and may be rather slow. This view remains unchanged, although the recession is deeper than had been anticipated, and Scotland will suffer accordingly. Nevertheless, it is still likely that the rate of decline in the Scottish economy during the course of the recession will be less than that of the UK.

13 June 1991