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.

Articles accepted for publication *must* be supplied on 3.5 inch or 5.25 inch disks in either WordPerfect or ASCII format.

Commentary Team

Editor :	Jim Love
Contributors:	Brian Ashcroft, Neil Dourmashkin, Richard Brooks, Paul Draper, Stewart Dunlop, Eleanor Malloy, Peter McGregor, Iain McNicoll, Mark McFarland, Eric McRory, Roger Perman, Kim Swales, Jim Stevens and Ya Ping Yin.
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

In common with its UK counterpart, the Scottish economy appears to have reached a turning point during the third quarter of this year. However, the indications are that recovery, particularly in manufacturing, will be very sluggish, with little evidence of a clear recovery until well into 1992.

In the second quarter of 1991 the index of production and construction for Scotland fell by 0.3%, resulting in an annual decline of 4.0% compared with 3.7% for the UK. In manufacturing, the decline in the Scottish index during the quarter was 0.4% compared with 0.7% for the UK, the third successive quarter in which the fall in Scottish manufacturing output has been less than that of the UK. Nevertheless, Scottish manufacturing output fell by 7.5% in the year to June while that of the UK declined by only 3.9%; this is a result of the sharp peak and slump which apparently occurred in Scotland between the first and second halves of 1990.

The construction industry is often cited as a leading indicator of changes in the level of economic activity, which makes its performance of some interest as the economy appears to approach a turning point. For Scotland this is especially true; the construction industry accounts for 20.1% of the Scottish index of production and construction compared with 14.6% of the index for the UK as a whole. Construction in the UK shows the classic signs of deep recession; five successive quarters of falling output, with a fall of 4.3% in output in the year to the second quarter of 1991. Interestingly, this pattern is not shared by the industry in Scotland. Official figures suggest that there has been - literally - no recession in Scottish construction, with output rising by 2% over the four quarters to the middle of this year and never more than a single quarter of decline in any half-year period since 1989.

Of course, the Scottish industry did not experience the boom which was so noticeable in the southern half of Britain, and correspondingly one would not expect recent interest-rate policy to have had such a marked effect here. Nevertheless, the official data do seem to be out of step with both anecdotal and business survey evidence on the construction sector, and are unlikely to be much comfort to Scottish construction companies which were under the impression that times were hard.

The UK Economy

It is impossible to assess the outlook for the Scottish economy without some consideration of the UK economy. Provisional figures for the third quarter indicate a rise in UK GDP of 0.3% following four successive quarters of decline, thus signalling a technical end to the recession. However, this increase was totally due to the energy sector in which output rose by 4% during the quarter; manufacturing and service sector output remained virtually unchanged, and if oil and gas extraction is omitted there was a slight fall of 0.25% in the remaining components of GDP in the three months to September.

Nor do the components of demand indicate that there is likely to be a rapid resumption of economic growth. Provisional seasonally-adjusted retail sales data for October indicate a fall of 0.5% during the month, and a decline of 0.3% in the three months to October. The latest CBI distributive trades survey does suggest some slight upturn in the retail trade, but of a hesitant and patchy nature. Consumer credit figures indicate that the cumulative amount of outstanding credit (excluding bank loans) fell again in August and September after increasing in June and July, perhaps indicating the unwillingness of consumers to take on new credit commitments at a time when house prices remain depressed and unemployment is still rising. Provisional estimates of capital expenditure in UK manufacturing industry do indicate a slight recovery from the very low levels of the second quarter. However, the increase of 2% in the quarter still leaves investment spending 12% lower than in the corresponding period in 1990, and these figures do not suggest that the manufacturing sector is yet ready to gear itself up for a period of rapid growth.

This slothful performance is reflected in the CSO's cyclical indicators. In October the coincident indicator, designed to show current turning points in the economy around its long-term trend, fell for the seventeenth consecutive month. The longer leading index began to show a distinctly upward path only in July, supporting the view that there is unlikely to be a marked recovery before the middle of next year.

With domestic demand still fairly weak it is natural to look for more hopeful signs from external sources. However, the likely performance of UK exports is not helped by the economic condition of some of our major trading partners (see World Economy section). This is especially true of the United States, where sluggish third quarter growth and a recent weakening of domestic demand have prompted real fears of renewed recession unless there is further relaxation of interest rates, perhaps accompanied by fiscal relaxation. If the recovery of the United States economy is significantly delayed this will have correspondingly adverse effects on both the UK and Scotland.

Prognosis

Despite Scotland's close ties with the rest of the Britain, the most intriguing feature of the recession has been the difference between the behaviour of the Scottish and UK economies. Nowhere has this difference been more marked than in unemployment, an issue of some importance as job loss, actual or anticipated, has been suggested as one factor which will prevent the rise in consumer expenditure which is required to bring the recession to a rapid end.

The maximum differential in recent years between Scottish and British unemployment occurred in September 1989 when the Scottish unemployment rate was 1.56 times that of Great Britain; by October 1991 this differential had fallen to 1.06 times. Previous Commentaries have drawn attention to the fact that unemployment in Scotland began to rise six months after the rest of the UK, and that the monthly percentage rises recorded in Scotland over the last year have been consistently lower than those in the rest of the UK. During September and October this differential relationship appeared to enter a new phase when seasonally-adjusted unemployment in Scotland actually fell slightly as the UK total continued to rise.

This fall was as welcome as it was unexpected. To the extent that it is the rate of increase in unemployment rather than its level which affects consumer confidence, then these data suggest that consumer spending in Scotland should continue to be less constrained than that in the south of Britain.

However, unemployment is invariably a lagging indicator of economic performance, and with industrial output only just showing signs of bottoming out the recent falls in Scottish unemployment are likely to be a temporary phenomenon, with unemployment in the middle of next year rather higher than October's seasonally-adjusted figure of 225,400.

Nevertheless, there are signs of improvement from some quarters. The third quarter Scottish Chambers' Business Survey revealed evidence of improved business confidence in all sectors, although there was still little clear sign of an improvement in demand (with the exception of the retailing sector). Investment demand remains weak, but there was some evidence from the survey of a moderation in the demand for working capital, possibly indicating less need for 'distress borrowing' and a slightly easier position for many companies.

This is consistent with the latest results from the Institute's short-term model, which provides forecasts of quarterly movements in the seasonally-adjusted Scottish output index for production industries. The model continues to suggest a turning point in the third quarter of this year. However, the forecast based on revised UK and Scottish data now suggests an even more sluggish recovery in 1992 than had originally been anticipated. The index of industrial production is now forecast to rise by a mere 0.6% during 1992 following an anticipated decline of 5.0% this year. On a quarterly basis, this suggests that by the final quarter of 1992 Scottish industrial production will only have attained its level of two years earlier, indicating a particularly slow recovery from the present recession.

5 December 1991