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 and annual growth rates are also included.

The present forecasting period extends to 2001q2. 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 1999q2 and the forecasts for 1999q3 to 2001q2. The Scottish Executive 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.

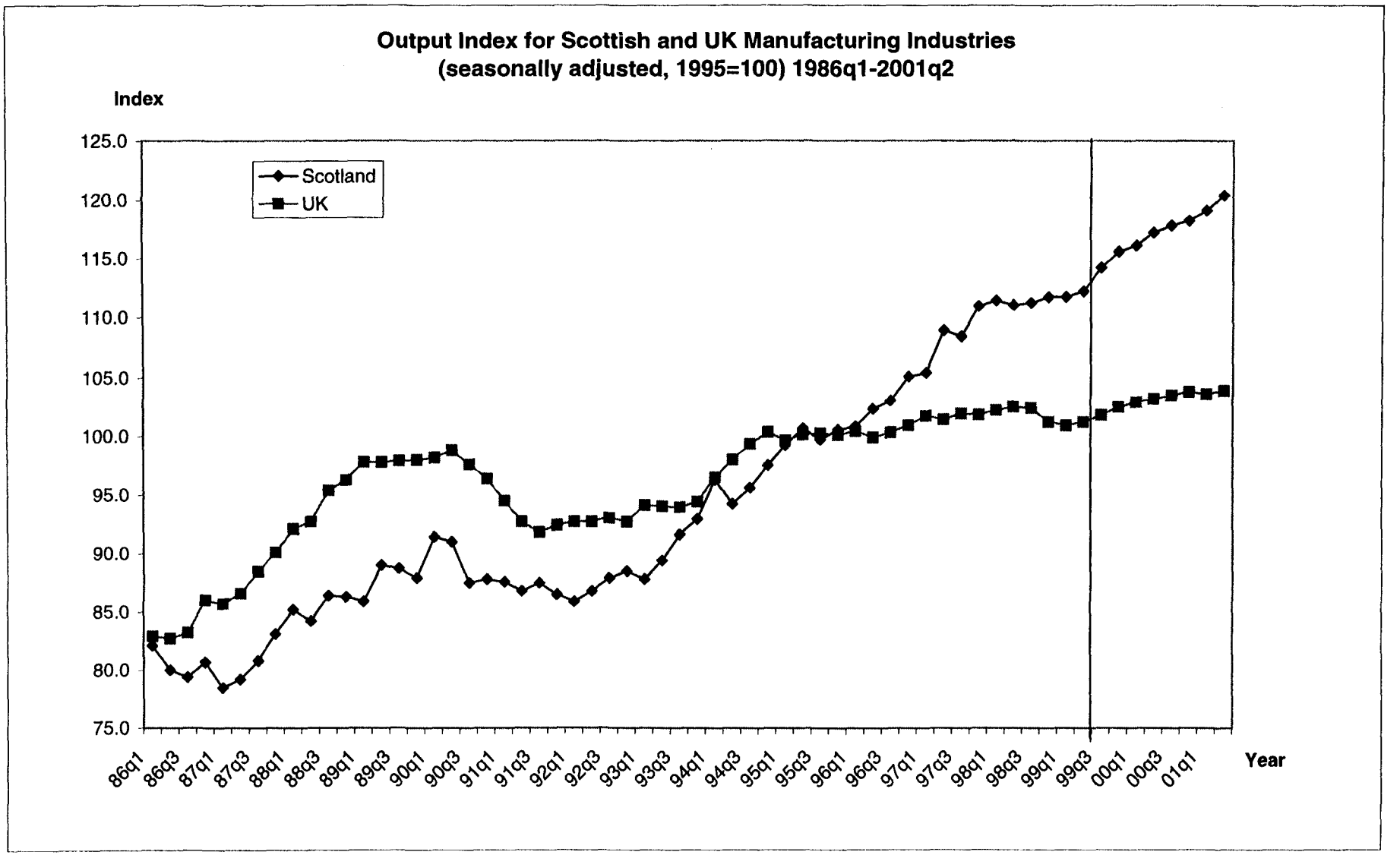
UK manufacturing performance is relatively poor compared to Scotland's. In particular during 2000 UK manufacturing is forecast to grow by only 1.2%. Again in the Short Term Forecast of the *QEC*, 24, (4) we forecast manufacturing growth of 0.6% for 1999q2 and the Scottish Executive Index of Production figure to the second quarter was 0.5%. There has been a considerable change to the forecast but not to the pattern of growth given the new information about the economy. We forecast manufacturing growth to be 1.8% and 1.2% in quarters three and four of 1999 respectively. We also forecast growth of only 0.5% in the first quarter of the year 2000. The annual growth rate for Scottish manufacturing output for 1999 and the year 2000 is now forecast to be 1.9% and 3.5% respectively. The former figure may be underestimating growth while the latter may be slightly over-estimating growth as the Medium Term Model forecast for manufacturing growth is 2.36% and 3.03% for 1999 and 2000 respectively. Scottish manufacturing has performed relatively well compared to the UK and electronics, chemicals, oil refining, paper, metals and even textiles have done relatively better than their UK counterpart.

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	4.7
96/95	3.1
97/96	4.8
98/97	2.1
95Q1/94Q4	1.7
95Q2/95Q1	2.0
95Q3/95Q2	-0.6
95Q4/95Q3	0.9
96Q1/95Q4	0.4
96Q2/96Q1	1.2
96Q3/96Q2	0.6
96Q4/96Q3	2.0
97Q1/96Q4	-0.8
97Q2/97Q1	3.5
97Q3/97Q2	0.5
97Q4/97Q3	2.4
98Q1/97Q4	-0.3
98Q2/98Q1	-0.4
98Q3/98Q2	-0.2
98Q4/98Q3	-0.4
99Q1/98Q4	0.0
99Q2/99Q1	0.5
FORECASTS	
99Q3/99Q2	1.8
99Q4/99Q3	1.2
00Q1/99Q4	0.5
00Q2/00Q1	0.9
00Q3/00Q2	0.5
00Q4/00Q3	0.4
01Q1/00Q4	0.7
01q2/01q1	1.1
99/98	1.9
00/99	3.5

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

* Development of the short-term model of the econmy was made possible by the funding of a three-year research followship by TSB Bank Scotland.


Output Index for Scottish and UK Manufacturing Industries
(seasonally adjusted, 1995=100) 1986q1-2001q2
Index
125.0
120.0
115.0
110.0
105.0
100.0
95.0
90.0
85.0
80.0
75.0
Scotland
UK
86q1
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Year

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 September, 720 firms responded to the questionnaire.

Summary Points

Business confidence rose in manufacturing, construction and tourism, however the decline in wholesale and retail distribution continued;

The outturn in demand was better than anticipated in manufacturing, construction and tourism, but weaker than expected in wholesale and retail distribution;

Manufacturing orders continued to ease but were better than anticipated. In construction the decline in orders ended and a rise in private sector orders was reported;

In the service sector demand continued to weaken in wholesale and retail distribution. The slight decline in demand in tourism was better than had been anticipated, and concealed rising trends in business demand and demand from abroad;

Construction respondents expect a further rise in private sector orders in the fourth quarter, and manufacturing and wholesale respondents anticipate a modest growth in orders and sales in the final quarter of 1999. In contrast retail and tourism respondents anticipate continued weak demand;

Expectations of price increases over the next quarter continue to increase in manufacturing, wholesale and retail distribution. However, pressures on margins in wholesale and retail remain evident;

Expectations as to increases in turnover over the next year continue to strengthen. Similarly expectations as to the trends in profitability over the next year have improved in manufacturing but remain weak in wholesale and retail distribution;

Employment rose in construction and wholesale, but continued to decline in all other sectors, employment is expected to rise in construction and retail in the fourth quarter, but to continue to decline in other sectors;

Pay increases in the third quarter ranged from 3.32% in wholesale to 6.01% in retail. A small number of respondents in the service sector continue to report large increases, reflecting the introduction of the minimum wage provisions.

MANUFACTURING

Optimism

The decline in business confidence ended and a rise (a net of +10%) was reported for the first time since quarter 2 1997.

Orders and Sales

The outturn in orders and sales, whilst weak, was better than anticipated and respondents anticipate rising orders and sales in the fourth quarter.

Concerns as to the levels of orders/sales and the level of competition eased, being reported by 50% and 40% respectively as the two factors thought most likely to limit output. The importance attached to interest rates increased slightly.

Finance

The cash flow trend improved, and a net of firms now expect profitability and turnover to increase over the next twelve months. Anticipations of price increases have now emerged.

Investment

Changes to investment plans again affected less than 40% of respondents. Investment in the third quarter was again primarily directed towards reducing labour [29%] and replacement of equipment [31%].

Employment

Employment continued to fall, a net decline of -7%, and this net rate of decline is again expected to continue. Recruitment activity increased slightly as 51% sought to recruit staff in the third quarter. 29% reported increasing pay by an average of 3.44%, compared to an average of 3.75% in the previous quarter.

CONSTRUCTION

Optimism

The slight decline in business confidence ended.

Orders

The trend in total orders was better than anticipated, with a net of +3% of respondents reporting an increase.

Unexpectedly, the upward trend in private sector orders re-emerged at a net of +15%. Respondents expect a further increase in private sector orders in the fourth quarter.

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter fell from 77% in quarter two to 70%.

Investment

Changes to investment affected slightly less than 25% of respondents, nevertheless, the decline in plant/equipment investment ended. Of those investing in the third quarter 56% directed investment towards the replacement of equipment and 22% to increasing efficiency.

Employment

The rise in construction employment continued at a net of +10%, and this increase is expected to continue through the fourth quarter.

A quarter increased pay by an average of 5.8%, and 61% sought to recruit staff in the third quarter, again mainly skilled manual staffs.

WHOLESALE DISTRIBUTION

Optimism

The decline in business optimism eased to a net of -10%.

Sales

Respondents had forecast a further deterioration in sales for the third quarter; however, the net decline of -22% was more than had been anticipated. Nevertheless, wholesale respondents continue to expect a significant improvement in demand in the next quarter. Concerns as to competition were cited by 68% as the factor thought most likely to limit activity in the fourth quarter, whilst 24% cited business rates.

Investment

Changes in investment plans were reported by less than 25%, nevertheless an upward trend in investment re-emerged.

Finance

Cash flow trends remained weak but positive (a net of +3%). A net of 12% expect turnover to rise over the next year, compared to the net of –2% expecting profitability to fall. The net of firms expecting to increase prices over the next quarter increased to +18%. Pressures to raise prices increased slightly, reflecting increased finance and transport costs.

Employment

Changes to employment levels affected less than 35%, and the anticipated fall did not occur as a net of 1% reported increasing employment. Respondents continue to anticipate a decline in employment in the next quarter. 16% reported increasing pay by an average of 3.32% compared to an average increase of 3.19% in the previous quarter.

RETAIL DISTRIBUTION

Optimism

Changes in business confidence were broadly based, being reported by 48%, and the decline in business confidence continued, deepening slightly to a net of -11% reporting being less confident than at the end of the second quarter.

Sales

The decline in sales was less than had been anticipated, and less than had been reported throughout 1999, but only a slight easing in the decline is forecast for the fourth quarter. Whilst 33% reported increased sales, 44% reported a fall in sales, and 35% anticipate a decline in sales in the fourth quarter (compared to 33% who anticipated a fall in sales in the third quarter).

Investment

The downward revision in investment plans ended and a net of 6% reported revising upward investment plans.

Finance

The deterioration in cash flow trends continued to ease to a net balance of -6% reporting a decrease. Both turnover and profitability are expected to increase over the next twelve months, and the anticipated rate of increase is greater than that anticipated in the previous quarter.

Employment

A marginal decline in employment was reported (a net decline of -1%), and a slight improvement is forecast, although once again changes only affected a third of respondents. 22% increased pay by an average of 6.01%, compared to an average increase of 3.71% in the previous quarter.

FINANCIAL INSTITUTIONS

Personal advances

Personal advances continued to rise during the three months to the end of September for a net balance of respondents and little change in the rate of increase is forecast for the third quarter.

Corporate advances

The increase continued through the third quarter, and again corporate demand for credit was most evident for working capital though it did increase for longer-term investment.

Sectoral demand

Demand for credit increased from all sectors with the exception of construction (a net balance of 0%) manufacturing and during quarter four demand is only expected to decline from tourism firms.

Employment

Changes to employment were limited, affecting around a tenth of respondents. 15% reported increasing pay by an average of 2.5%.

TOURISM

Optimism

Changes in business confidence were widely reported, and the decline in confidence ended as a net of +3% reported being more confident than three months earlier.

Demand

The decline in demand was weaker than anticipated. Demand from Scotland and the rest of the UK fell whilst demand from abroad and business demand increased. Average capacity used was three percentage points lower than in the third quarters of 1997 and 1998, but four percentage points higher than the second quarter of 1999.

Investment

Investment continued to rise, although for more than 85% of firms the main reasons for authorising investment were to replace/renew facilities or to improve facilities.
Finance

Increased pressures on margins were again evident. Turnover rose less than expected, costs rose slightly less than had been anticipated, and the increase in prices continued, but at lower levels than had been anticipated.

Employment

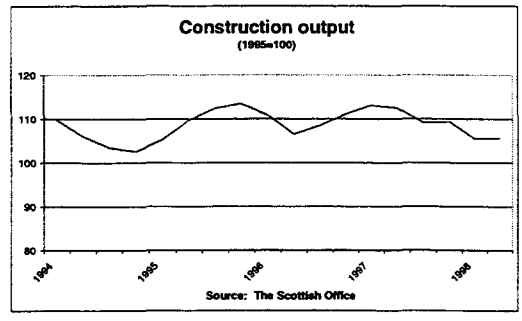
Less than 40% reported no change to overall employment levels and the decline in employment was greater than had been anticipated.

Recruitment

Recruitment activity remained high with 85% seeking staff. 19% reported increasing pay by an average of 9.6% (as a small number of hotels increased rates to meet minimum wage requirements).

CONSTRUCTION

According to firms from the latest Deloitte & Touche Scottish Chambers' Business Survey for the third quarter of 1999 there was an increase in confidence expressed by construction respondents with approximately a quarter more optimistic, although 17% were less confident. Respondents were also more confident than compared to the same quarter of the previous quarter. Increased optimism was a factor evident in firms employing between 20 –199.



The outturn for orders was better than respondents had expected and a net of 3% reported an increase in total orders. Central government and public sector orders continued to decline however a net of firms reported an increase in private sector orders. Rising total orders were reported by firms employing fewer than 19 and between 100-199 with firms employing between 1-199 reporting increasing private sector orders. A net of firms employing between 100-199 also reported an increase in other public sector orders. During the current quarter respondents expect orders, on balance, to continue rising.

The percentage of firms citing orders/sales as the most constraining factor continued to ease (70%) while almost a quarter cited skilled labour (14% during the second quarter).

The trend in investment in plant/equipment was flat while a net of 3% revised investment plans in land/buildings downwards. Respondents expect to revise investment plans downward during the current quarter.

In general investment was authorised in order to replace existing equipment however the majority of firms employing between 200-499 authorised investment in order to increase efficiency.

The upward trend in total employment continued (+10%) and respondents expect to continue increasing total employment during the current quarter. There was an increase in recruitment activity with many reporting recruitment difficulties. The average wage increase rose marginally.

According the Halifax House Price Index house prices in Scotland fell by 2.2% during the third quarter compared to a rise of 3.1% during the second quarter with Scotland the only part of the UK to suffer such a reverse. Annually, house prices in Scotland fell by -1.3%.

The Halifax noted some localised 'hot-spots' particularly around Glasgow, Edinburgh, Aberdeen and Dundee and commented that the birth of the Scottish Parliament has coincided with a big demand for status properties in the Capital

Commenting on the housing market, Geoff Mackrell, General Manager for Halifax, said: "Although house prices fell by 2.2% during the third quarter, the housing environment in Scotland reflects what is happening in the rest of the UK; buoyant in parts with other areas experiencing a fairly difficult economic situation and with house prices in those areas remaining flat.

Local variations are prevalent in the cities with property 'hot-spots' in Glasgow, Edinburgh, Aberdeen and, to a lesser extent, in Dundee. The major towns, Perth, Inverness, Stirling and Falkirk are similarly affected. In each of these areas premium prices are being obtained for popular house types in sought-after locations. There has been a ripple effect out from these locations to secondary areas and commuter towns. This activity has not, however, led to significant rises in property values across the board.

City centre flats in Edinburgh are in particularly strong demand with increases of almost 20% in prices achieved over the past year. The birth of the Scottish Parliament has coincided with a big demand for status properties in the city centre. Housing affordability in Scotland remains very good as the average homebuyer now spends just under 20% of their gross annual income on mortgage payments compared to a peak of over 28% in 1990."

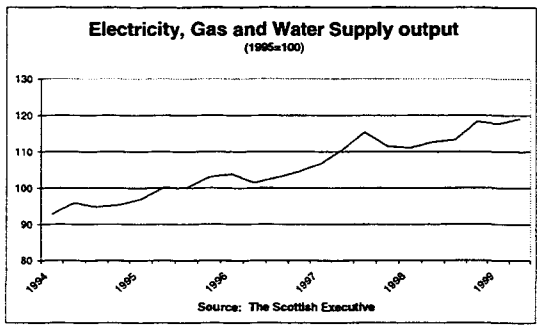
Commenting on prospects for the housing market in 2000 the Halifax report that house price growth this year has been stronger than expected. House prices have risen by 11% in the nine months since February. The annual rate of house price inflation has accelerated from under 4% to around 11% currently, the highest level for a decade. Higher interest rates and the phasing out of mortgage interest tax relief are expected to cause annual house price growth to slow to 8% by the final quarter of 2000 from 11% in the last three months of this year. A factor expected to dampen the market will be the withdrawal of mortgage interest tax relief in April 2000. The gradual reduction of this relief over recent years, combined with the current low level of mortgage rates, means that the impact will be relatively modest. Nevertheless, abolition will add around £200 a year to mortgage payments for homeowners with a mortgage of £30,000 or above and will be equivalent to a further 0.35 percentage points rise in mortgage rates. Regions where house prices are lowest and where tax relief therefore makes up a larger proportion of the mortgage will bear the brunt of the change. The housing markets in Scotland, Wales, Northern Ireland and most northerly English regions will be most affected, with the greatest impact on first-time buyers.

ENERGY

OIL AND GAS

Using data from The Royal Bank of Scotland Oil & Gas Index the oil index for 1999q3 on 1999q2 increased by 2.8% but rose by 6.1% on the same period last year. The gas index fell by 13.2% over the quarter but increased by 17.3% on an annual basis. The combined oil & gas index declined over the last quarter by 3% but again over the year grew by 9.3%. When we examine what has happened to the oil price over the same period we see that the price has increased from an average of $15.58 in 1999q2 to $20.55 in 1999q3. In 1998q3 the average oil price was only $12.46. Thus over the quarter and over the year the oil price has increased by 32% and 65% respectively. This has been the main stimulus to increased production of oil & gas. The economic slowdown has of course dampened down demand for energy and thus has had a downward effect on production particularly in 1999q2 although seasonal factor also need to be taken into account. The average daily oil value increased by 36% over the quarterly period to stand at £33.5 million, up from £24.7 million. Over the year an 80% rise was observed from the £18.6 million

figure in 1998q3. The provisional total average daily value also increased by 18% and 54% over the quarter and the year respectively. The figure now stands at £42.6 million compared to £36.1 million in the previous quarter and £27.7 million in 1998q3.



Undoubtedly the compliance by OPEC members and the increased demand in Asia as the Asian economies recover have been significant factors in the oil price rise. The oil revenue rise was mainly due to the increase in price, in the period July 1998 to July 1999 this was 56.7% in US dollar terms and 63.7% in sterling terms. Past investment in new technology, new pipelines and smaller fields have also contributed to profitability. There is no doubt however that cost reduction in the North Sea remains a major challenge to UK operators. The outlook for price is uncertain as it is unknown what OPEC will decide in March. OPEC members are already set to make an extra £15.4bn ($25bn) from export revenues. This is up 26.6% from the 1998 revenue of $95.7bn. Given their recent success they could be tempted to continue with their current strategy but the higher the price rises then it is more likely that compliance with quotas will weaken. It is a widely held belief that an oil price of more than $20 is unsustainable.

Aberdeen and Aberdeenshire Councils have forecast that the oil industry will lose 10,000 jobs by the year 2011. The losses will be split evenly between onshore and offshore work. Oil & gas employment peaked at 54,000 in 1991 but has fallen to 46,000 in 1996. The forecast now is for that trend to continue but at a steeper rate than previously seen. Kvaerner is to shed 3,00 jobs most of them based in the North Sea. McKay Consultants have forecast that total offshore expenditure is forecast to fall by 19% next year. The decline in expenditure is likely to carry on for the next twenty years. They also forecast oil production to peak around 2000 to 2001 with the peak of gas production following two years later. Thereafter larger fields like; Brent, Forties, Ninian etc. will decline. Shell Expro is to invest £50 million in three North Sea projects for next year. The developments are for the Curlew, Gannet and Kingfisher fields.

The Aberdeen Chamber of Commerce and Deloitte & Touche Oil & Gas Survey for 1999q3 revealed that optimism, investment and activity are all expected to increase over the next six months. This news was tempered however by the fact that 45% of respondents expected to decrease their employment levels. It was demonstrated that a rise in exploration activity in 2000q1 might be realised.

UTILITIES

The Index of Production produced by the Scottish Executive showed that Electricity, Gas & Water output increased by 1.2% for 1999q32 on 1999q1 and by 4.0% for the latest four quarters on the preceding four quarters. In the UK the respective figures were 1.5% and 2.2%.

Electricity bills for 24 million households should on average fall by 10% from next April according to plans by the regulator for price reductions leading to a £25 cut in the average bill of £252. Utility companies are unimpressed by the regulator's arguments and many are suggesting that further price controls will lead to considerable job losses. Scottish Power is worried about returns to shareholders dropping after profits fell by £7.5 million to £239 million in the six months to September 1999. The company share price was unaffected however as the Pacificorp deal and expected future earnings make Scottish Power an attractive investment. Scottish Power now has 12% of the UK electricity market and 5% of the gas market. In a move designed to focus on core businesses Scottish Power is set to sell off SP Technology and SP Contracting. The firms employ 1,300 people and are worth about £2 million each. This is small beer compared to the planned £2.6 billion floatation of Scottish Telecomm.

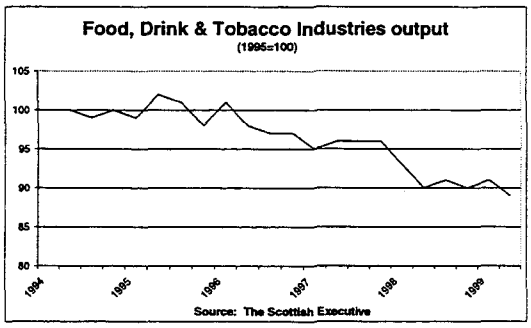
MANUFACTURING

FOOD, DRINK AND TOBACCO

The Scottish Executive Index of Production for the Food, Drink And Tobacco sector measured 89 in the second quarter of 1999 (1995=100). This represents a 1.4% fall from the previous quarter and a reduction of 3.7% over the year to the second quarter. The Scottish sector also performed poorly compared to the industry in the UK, where output fell by only 2.1%.

The more recent results from the Deloitte & Touche Scottish Chambers' Business Survey, however, indicate that the sector's prospects may be about to improve. The net balance of optimism

was strongly positive at 44.8%, and only 7% of respondents felt less optimistic than in the previous quarter. The main reasons appear to be strong growth in new orders, which showed a net balance of 17.2% reporting an increase. More importantly, an even larger net balance of respondents, 38%, expect the flow of new orders to increase, and sales show a similar picture, particularly because of improved prospects in the home market. A small net balance of respondents actually report an increase in capacity utilisation, and around a third of companies reported that they had revised their investment intentions for plant and equipment upwards. Over a quarter also reported a positive trend in employment, and 23% expected to increase employment in the coming period.

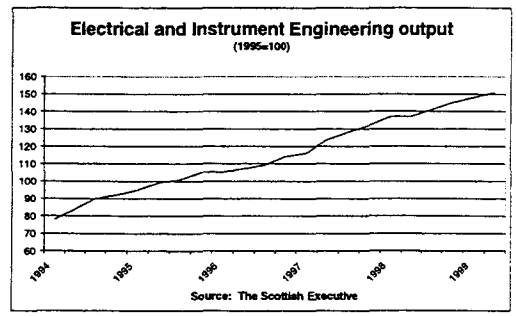


In the company sector, the whisky company John Dewars is to invest £4 million in new bottling facilities in Glasgow following strong sales growth. The company was recently bought by Bacardi, and Dewars access to its distribution networks and marketing strengths are believed to be the main factors behind its increased sales and a 45% jump in profits. The rise in profits is in sharp contrast to other spirits producers with, for example, shares in Diageo falling amid concerns over falling volumes.

Wiseman Dairies has finally received planning permission for its new English dairy, which should allow it to increase its share of the UK milk market. Wiseman recently announced a 12% increase in profits, and currently accounts for about 13% of all UK milk sales.

ELECTRICAL & INSTRUMENT ENGINEERING

The Scottish Executive Index of Production for the Electrical & Instrument Engineering (EIE) sector measured 151 in the second quarter of 1999 (1995=100). This represents a rise of 2.2% from the first quarter and a rise of 8.7% over the year from the second quarter of 1998, far in excess of the 1.2% increase seen across the whole of the manufacturing sector in Scotland. Indeed, a substantial part of this 2.1% increase in manufacturing will be the result of growth in EIE, given that it was one of few manufacturing sectors in Scotland that showed positive growth over the year. The 8.7% rise in Scottish output compares with a UK increase of 6.7%, and so the sector in Scotland also outperformed its UK counterpart. The occasional predictions one sees about the imminent demise of the Scottish electronics sector still show no sign of coming true.



The more recent results from the Deloitte & Touche Scottish Chambers' Business Survey show that the industry's current state of health is likely to continue over the short-term. The balance of optimism is positive at 17.3%, and a positive balance of firms also reported an increase in orders in the three months prior to the survey period, while the expected trend in both sales and orders were also positive. A majority of companies, 56%, also felt that turnover was likely to improve over the coming twelve months.

In the company sector, Pressac has announced that it is to build a new factory at Kirkintilloch, which would employ 200 people making components for mobile phones. Pressac is the owner of one of Scotland's most innovative companies, McGavigans, and has benefited from the recent explosive growth in the mobile phone market, which has also fuelled substantial growth in other Scottish companies.

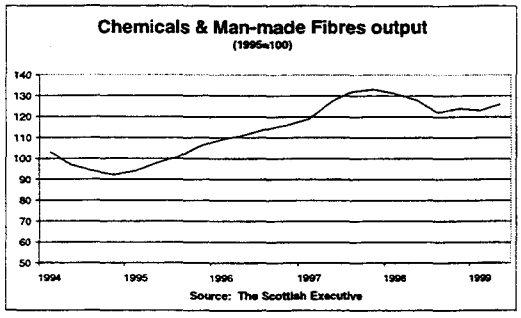
One less welcome piece of news is that Cadence Designs, which promised to employ around 2000 people in high-quality research work, has scaled down its expansion plans due to a world-wide shortage of senior managers in electronics. The company insists, however, that the setback is temporary and that its long-term commitment to R&D at its Scottish operation remains.

CHEMICALS

The latest Scottish Executive Index of Production for Scotland shows a 2.9% increase in output for the second quarter on the first quarter. Annualised growth however shows a fall in output of 4.3%. Figures for the UK show a smaller increase in

output for the third quarter (1.8%) although growth for the year was positive (0.7%).

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey suggests that respondents remain confident about the general business situation with a net of firms continuing to report a positive trend in optimism.



The upward trend in optimism was despite the decline in total orders. A net of 29% reported a decrease during the three months to September as orders from all areas declined however a net of 29% expects an increase in orders during the current quarter although only export orders are set to rise. Sales to all areas declined though firms expect all trends to improve during the final quarter.

Average capacity used fell fourteen percentage points to 69%. Orders/sales and competition were equally cited by 57% as factors of concern.

Cash flow trends eased with 29% reporting improving and 29% worsening cash flow trends. A net of 21% expects turnover to rise over the current year although the trend in profitability is no longer expected to improve (0%). Although half of those responding to the survey do not expect to alter prices, on balance, firms expect to increase prices citing transport costs (57%) and raw material prices as the biggest pressures on prices.

Changes to investment trends were less widespread being reported by less than a third and both trends declined. Investment authorised during the third quarter was generally directed towards the replacement of equipment (36%).

Overall, although business confidence continued to improve the rate of increase slowed. Demand deteriorated with concerns over lack of demand intensifying. Firms still expect a rise in turnover though no longer expect a rise in profitability and there are signs of increase pressure to raise prices.

In the company sector Meconic, the Edinburgh based opiates manufacturer recently reported a 135% surge in pre-tax profits. This follows the refocusing of the business, which sold its loss-making Phoenix Chemicals in 1998 and proposed an £800,000 restructuring designed to save £1 million a year. Recent growth was attributed to expanding sales of its high-margin specialist opiates.

Following the granting of orphan drug designation to the drug Foscan by the United Sates during November, shares in Scotia Pharmaceuticals rose by almost 10%. Granting of such status from the US Food and Drug Administration means that, once approved, the drug will enjoy seven years of exclusive rights in the US market. It will also be given various forms of support, these include access to certain grants and up to 50% tax credit on the costs of clinical trials in the US.

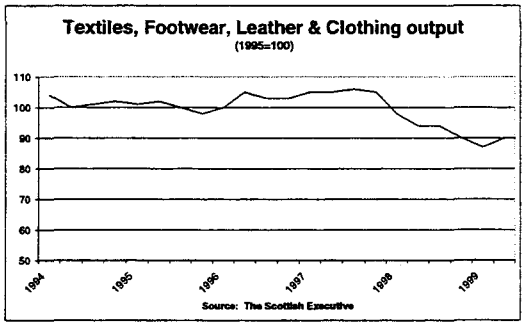
BP recently announced plans to create 1,600 construction jobs and 50 permanent jobs through a £300 million expansion at its Grangemouth petrochemical complex. This is the second phase of a £500 million investment for the site and BP hopes the project will elevate Grangemouth to the top of the world market in the field. The development will involve a significant expansion of the company's KG ethylene plant, used as a building block for plastics, and construction of a new ethanol plant, an environmentally clean substitute for petrol and diesel.

TEXTILES, FOOTWEAR, LEATHER AND CLOTHING

The Scottish Executive Index of Production for the Textiles, Footwear, Leather and Clothing (TFLC) sector measured 90 in the second quarter of 1999 (1995=100). This represents a rise of 3% on the first quarter figure, and is a welcome change in the industry's recent performance. Prior to this, real output had fallen continuously since the start of 1997. Overall, however, TFLC shows a reduction of 10% over the year to the second quarter, probably a more realistic indication of its current state. This 10% reduction is almost exactly mirrored in the UK industry, where output is recorded as having fallen by 9.9% over the year. However, it is notable that the Scottish sector's performance in the second quarter is better than that seen in the industry across the UK, where output fell by 0.1%. This may be an indicator that companies in Scotland are coping with the factors adversely affecting the industry better than their UK counterparts.

The more recent results from the Deloitte & Touche Scottish Chambers' Business Survey also provide a modicum of positive news. The overall balance of optimism does remain negative, with

26% of firms feeling less optimistic than three months previously compared with only 18% who felt more optimistic. However, 56% of firms report no change, and this figure should be seen in a positive light given the scale of the problems that have beset the sector over the last year. Nonetheless, while the situation may be stabilising at a lower level, the fact remains that few firms see much prospect of imminent change. Indeed, a net balance of firms report a falling trend in recent sales and in the expected trend in forthcoming sales. Similarly, a net 21% of companies report that they are likely to shed labour over the coming few months.



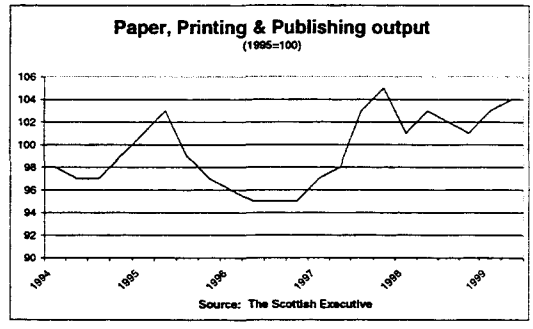
In the company sector, retraction continues at Dawson International, which has now put one of its leading brands, Pringle, up for sale. Dawson's decision to concentrate on luxury cashmere means that it is seeking the disposal of all other operations. The Pringle name undoubtedly carries some weight, and there appears little doubt that a buyer will be found. However, there are concerns in the Borders that a buyer may acquire the name and move production out of Scotland. One good result of Dawson's retrenchment is that another of its subsidiaries, Laidlaw and Fairgreave, looks likely to be sold to its existing management, although no final decision has yet been taken on this.

Further bad news is that the American sportswear company Russell Europe is to close two factories, at Boness and Livingston, with the loss of 300 jobs. The company blames competitive pressure in Europe. Levi Straus announced that it expects to halve its Scottish workforce, due to a fall in demand for jeans in Europe. The company's Whitburn plant is expected to close and there will be heavy cuts at its factory at Bellshill.

Finally, Marks and Spencer has announced that it will not renew contracts at several Scottish suppliers, including Daks-Simpson. Around 800 of Daks employees work on Marks and Spencer's contracts, which will end this spring.

PAPER, PRINTING AND PUBLISHING

The most recent Index of Production for the Paper, Printing and Publishing sector reveals an increase in output growth of around 1.0% in both Scotland and the UK to the second quarter of 1999. Annualised growth for the sector, however, decreased in Scotland and the UK by –0.4 and –1.5 per cent, respectively.



The most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggests that the difficult trading conditions noted by respondents in the previous DTSCBS may now be easing. The general business outlook by respondents for the third quarter of 1999 improved relative to previous periods and the downward trend in business confidence ended. Moreover, in comparison with one year previous, a positive net balance of respondents are more confident about the general business outlook.

The trends in total orders for the third quarter of 1999 improved in this sector with an unanticipated rise in rest of UK and export orders. This upward trend is forecast to continue across all markets for a positive net balance of respondents in the final quarter of 1999. The trends in the total volume of sales over the third quarter of 1999, however, remained sluggish with only export orders showing a small net increase for DTSCBS respondents. The anticipated trend in sales is forecast to be positive in Scotland, but stable in both rest of UK and export markets.

The average level of capacity utilisation for the Paper, Printing and Publishing sector increased to 80% in the third quarter of 1999, which represents a 4 per cent rise over the previous two quarterly periods. Investment intentions in this sector, over the past quarter, remained unchanged for the majority of respondents in this sector. However, of those who revised their intentions, plant and equipment investment was revised upward with land and buildings investment revised downward. This trend is forecast to continue over the forthcoming quarter.

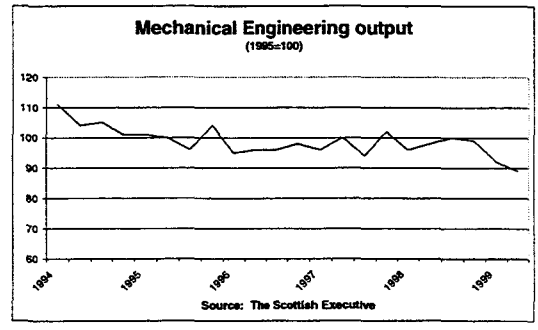
The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that changes in total employment affected more than one third of respondents, with the decline in employment easing (relative to the previous quarter) to affect a net 22% of respondents, over the past quarter. Respondents in the previous Commentary anticipated this decline in total employment and this trend is again forecast to continue over the final quarter of 1999. Over the same period, around 40 per cent of all respondents increased wages and salaries by an average 3.16 per cent.

In summary trading conditions seem more favourable within this sector with both an end to the previous reported quarterly falls in business confidence within the sector, and the upturn in the trends in total orders recorded over the third quarter of 1999. Moreover, cashflow and profitability concerns continue to ease for respondents within the sector, with turnover and profitability expected to rise in the final quarter of the year. However, in general, growth will remain difficult for this sector over the forthcoming quarter unless demand across all markets increases.

In the company sector, Johnson Press (Edinburgh-based Regional Newspaper Group), which recently acquired Portsmouth and Sunderland Newspapers and has over 180 local newspaper titles, is looking to move into other areas of publishing in order to maintain the momentum of past growth, which the company has enjoyed since it was floated in 1988. The company has confirmed its intention to table a rival offer for publisher Newscom, following a bid by Gannett, the owner of the regional newspaper group Newsquest. Macfarlane Group, the Glasgow-based plastics to packaging business is to axe 150 jobs and close three operations in its packaging division as part of its restructuring. The on-going restructuring saw the sale, at a £6.5 million loss, of the Montgomery bottling business to Italian company Alucapvit. Finally, Inveresk, the Dunfermline-based paper manufacturer reported profit warnings which were substantially below expectations due to 'unusual trading conditions'. The company blamed the effects of the strong pound and cheap imports which were making it difficult to push through higher paper prices on the back of increased pulp costs.

MECHANICAL ENGINEERING

The most recent Scottish Executive Index of Production for the Mechanical Engineering sector in Scotland reported a 3.4% decrease in output for the second quarter of 1999. This compares with a 0.9% increase across all engineering (although this positive figure is solely a result of performance in the Electrical and Instrument Engineering sector), but is a smaller decrease than that of the first quarter of 1999 (7.3%). Year on year growth for the Mechanical Engineering sector in Scotland (in the year from the second quarter of 1998) was also negative with a 1.4% fall in output recorded. The corresponding UK figures reveal that output in the sector at the UK level rose by 0.9% in the second quarter of 1999, but that annualised growth, over the previous four quarters, was negative at -4.2%, a larger fall than at the Scottish level.



The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggest that trading conditions in the third quarter of 1999 remain difficult in this sector. Business confidence remains negative for a significant proportion (33.3%) of DTSCBS respondents, who report feeling less confident about the current business conditions than they did three months previous. There does appear to be some improvement in business confidence, in as much as 31% of respondent firms report feeling more optimistic about the current business climate than they did three months previously, an improvement on the 16.3% who reported an increase in confidence in the previous quarter's survey. However this represents at best a gradual improvement in confidence however, with only 21.4% stating that they feel more optimistic than in the same period one year ago, and 52.4% reporting that they feel less optimistic than they did this time last year.

Reported trends in total orders and sales over the previous quarter confirm the continued lack of confidence in much of the sector. Declining orders across all markets were reported by DTSCBS respondents, with 44.7% reporting falling Scottish, 42.9% declining rest of UK and 36.6% falling export orders. Only marginal improvements are anticipated over the next three months. The trend in the total volume of sales followed a similar pattern. However, as with reported levels of confidence, the picture is not quite as gloomy as reported in the previous quarter with a lower proportion of respondents reporting falling orders and sales in the third quarter than in the second quarter.

The average level of capacity utilisation for the Mechanical Engineering sector for the third quarter of 1999 was 72.84%, with 52.3% reporting their capacity utilisation to be less than in the same period last year. Investment intentions in this sector, over the past quarter, do however remain level for the majority of respondents for both land and buildings and plant and equipment, and are anticipated to do so over the next quarter.

The Deloitte & Touche Scottish Chambers' Business Survey also reveals that total employment remained level and is expected to remain so for the majority of respondents, but with 28.6% of respondents reducing employment relative to the previous quarter. However over the next three months respondents expect the employment situation in this sector to ease, with a fall in the net number of respondents (to 23.8%) expecting to reduce total employment. Over the last quarter 80% of respondents reported no change in wages and salaries, with the 20% who did increase wages and salaries doing so by an average of 3.56%.

In summary trading conditions in the first quarter of 1999 remain gloomy within this sector with output growth still remaining negative, many firms experiencing falling sales and new orders across all markets, and confidence generally lower than this time last year. The key concern for respondents in the Mechanical Engineering sector is still the current level of new orders and sales. However there does seem to be some levelling off in investment, employment and cash flow, reflecting signs of improving confidence, at least in part of the sector.

In the company sector, the future of Kvaerner, the troubled Anglo-Norwegian Conglomerate, remains uncertain. While the company has reported a return to profits in the third quarter, it has warned that there may be further job cuts as the company continues its programme of restructuring.

Order book concerns in the sector were reflected in the Glasgow-based Weir Group's warning over a fall in profits for 1999, for which weaker than expected orders were said to be partly responsible, along with sluggish conditions in the North Sea market leading to customer requests for delivery delays on contracts. However the company reports improved order prospects for 2000, which, along with the first full year's contribution from the recently acquired Australian industrial machine manufacturer Warman, should boost earnings again.

Positive news in the sector comes from Mayflower, the car components manufacturer, which is expecting continued growth, largely as a result of strong demand for buses internationally and in the UK market, which is expected to be driven in part by government attempts to boost public transport. Mayflower has expanded its Alexander operation in Falkirk with a new 90,000 square foot facility at Larbert. However the company reports that the number of new jobs arising from this expansion will be limited because existing Falkirk staff will be moved to run the new facility.

SERVICES

RETAIL AND WHOLESALE DISTRIBUTION

In November the seasonally adjusted estimate of retail sales volume is 117.3. This is 0.2 per cent above the October figure and 4.1 per cent higher than the November 1998 level. In September to November the volume of sales was 1.1 per cent higher than in the previous three months and 4.1 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 November was £4,240 million, 3.3 per cent higher than in November 1998. In September to November the value of sales in current prices was 3.2 per cent higher than in the same period a year earlier.

In September to November the seasonally adjusted volume of sales by predominantly food stores increased by 1.1 per cent compared with the previous three months; sales by predominantly non-food stores also increased by 1.1 per cent. In September to November the value of sales (not seasonally adjusted) by predominantly food stores was 2.9 per cent higher than a year earlier; sales by predominantly non-food stores were 3.8 per cent higher.

According to the Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) for the third quarter of 1999 wholesalers overall continued to report declining confidence (reported by firms employing less than 19); those employing between 20-199 reported a flat trend in confidence. Changes in retail confidence affected less than half of firms nevertheless the decline in confidence continued and was a feature in firms employing less than 200 employees. Firms employing more than 200 appeared to be more sanguine about the general business situation.

Changes in the sales trend affected almost 70% of wholesale respondents with sales, compared to the same quarter of 1998, continuing to fall (-22%). Wholesale respondents expect the decline to end during the current quarter. Competition remained the principle factor thought most likely to limit wholesalers' sales during the current quarter, a feature regardless of firm size. According to retail

respondents the decline in sales, compared to the previous quarter, continued although the rate of decline eased once again. Once again competition and business rates were the factors thought most likely to affect retail sales during the current quarter.

Compared to the same quarter one year earlier a net of 6% of DTSCBS wholesalers reported revising investment plans upward. Among retail respondents investment plans were revised upward by a net of 6% compared to a net of +2% during the second quarter.

Over the current year wholesale firms expect turnover to improve but profitability to decline suggesting increased pressures on margins. Retail respondents expect turnover and profitability to improve over the next twelve months.

Expectations of price increases continued for wholesale firms (a net of +18% compared to +13% during the second quarter). Once again a net of retailers expect to increase prices over the fourth quarter. Transport costs and other overheads were the most obvious cost pressures.

Only a third of DTSCBS wholesale respondents reported changes to employment (+1%), almost three-quarters of retailers made no change to total employment nevertheless a net of firms reduced the total number they employ.

In the UK as a whole retailers reported higher than expected sales volumes for December but expectations for January are more moderate, according to a Confederation of British Industry Survey (Thursday 6 January). This survey, together with last September's results, shows the strongest growth in annual sales volumes since April 1997.

The latest CBI Distributive Trades Survey, covering sales from 1 to 28 December, shows 60 per cent of retailers reporting increased sales and 19 per cent reporting a fall in sales compared with a year earlier. This gives a positive balance of 41 per cent and compares with 23 per cent in November and 16 per cent in October. Sales are expected to moderate in the year to January. The three monthly moving average of sales volumes is unchanged from November suggesting that the underlying trend in sales growth remains steady.

Sales in December were reported to be significantly above average for the time of year, and to the greatest extent since January 1998. Sales in January are expected to be only slightly above average.

For the first time since January 1998 the CBI Survey showed that all sectors within retailing reported a rise in sales volumes compared with a year earlier. Furniture and carpets stores, grocers, confectioners and footwear and leather retailers reported the sharpest increases in sales, while clothing stores and off-licences reported modest growth.

The volume of orders placed on suppliers rose significantly in December, and at a faster rate than had previously been expected. However the rate of growth is expected to slow in the year to January. Stocks were run down over the past month, despite expectations that levels would remain unchanged. Stocks are expected to be run down slightly in January although remaining more than adequate to meet demand.

Wholesalers' annual sales volumes fell slightly in December, despite expectations of a sharp rise. This is the first survey since November 1998 when sales increases have not been reported. A more significant decline in sales volumes is now expected in the year to January. Business was considered to be below average for the time of year. January's sales volumes are expected to be well below average for the time of year, and by a greater extent than in December.

TRANSPORT

Air

BAA has suffered from the removal of duty free shopping at airports and £66 million has been suggested as the level of lost profits. The US arm of BAA is expected to miss profits of £147 million. This write-off will see profits for the six months to September fall to £306 million. Operating profits from UK airports fell by 2.5% to £316 million. Profits held up because of the group's investments from property interests. Despite facing a 20% drop in income BAA have seen this slow to 13% in September and believe this trend will continue. The markets shared the group's expectations of future performance and shares rose slightly after a 26% fall immediately after the profits warning.

BA warned that conditions in the air traffic market were to become tighter following their fall in passenger traffic and load factor. BA's first half profits fell by 38% to £240 million. A drop in transatlantic traffic has hit BA hard through a deal with Boeing it is to dispose of 34 Boeing 757-200s that have been contracted to DHL. They are the older versions of the aircraft and are hard on fuel. The deal will see BA and Boeing share in a $400 million (£250 million) profit. This is line with BA's strategy to cut capacity and focus on premium markets. Capacity is to be cut by 12% over the next three years.

Rail

The Strategic Railway Authority, the new transport watchdog will have increased powers over Scottish railways. Full powers will not be available until next year. This would reduce the role of the Scottish Parliament considerably over the railway network in Scotland. Railtrack admitted that investment in the railways had been inadequate because rail traffic would grow by more than its forecast of 30%. It was also forced to admit that it would take until 2001 to upgrade the track to a level that existed in 1994, prior to privatisation! In a bizarre move Tom Windsor offered Railtrack a 'reward' scheme for improvements that were actually carried out to the rail network. While this is still in the consultation process Railtrack's shares moved up 3% at the prospect of more public money coming its way for a performance so far that has been abysmally poor.

Road/Rail Groups

FirstGroup has seen profits increase by 21% for the first six months of 1999 to £55 million. Their three rail franchises contributed £2.5 million to the £350.6 million group turnover despite the loss of £11.7 million in government payments. First Great Western saw passenger traffic up by 11.9%, First Great Eastern rose by 7.5% and First North Western was up by 5.5%. Their 'Overground' strategy in Glasgow has seen passenger volumes rise by 4% in the last three months, the first time Glasgow has seen an increase in 20 years. FirstGroup will also be introducing yellow US style school buses into rural and remote routes for Scottish Schools on a trial basis.

Stagecoach continues its multi-transport policy with various ups and downs in its fortunes. It is to sell off Swebus at a £12 million loss for £100 million. This move comes as Arriva announced it was to increase its presence in the Norwegian market. Stagecoach wants to concentrate on the US market. Stagecoach has raised £400 million to help fund its £1.1bn acquisition of Coach USA, America's second biggest bus firm. Lately however the news for Stagecoach has been better with the share price being driven up, the possibility of an extension to their rail franchise at South West Trains in exchange for part funding the refurbishment of Waterloo Station. The Hong Kong bus group has seen profits rise by 33% to £9.7 million. The subsidiary has trimmed £3m from its cost base and shed 400 jobs. Stagecoach has also been tipped as the preferred bidder for MTL the troubled Merseyside transport group. They have also taken a minority interest in Suckling Airways for £5 million and renamed it ScotAirways. Last year they carried 11,000 passengers and the target this year is 20,000.

Sea

The property division of Forth Ports has doubled its turnover and increased its contribution to profits in the first half of this year. There are important developments at Ocean Terminal, Leith and City Quay, Dundee. During the six months to the end of June turnover was £51.9 million (up 3.1%). Dry cargo tonnage at Leith dropped from 1.4M tonnes to 500,000 tonnes but largely because of the reduction in demand in pipes for the North Sea. Grain, coal and aggregates volumes were up on the previous period and pulp and paper made a strong contribution at Dundee and Tilbury. Tilbury has seen an investment of £20 million for a paper terminal and now also has an agreement to house 8,000 Hyundai cars.