

# 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 2001q3. 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 2001q3. 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.

Our forecast of Scottish manufacturing growth for 1999q3 was slightly high with an outturn of 0.4%. The forecast for 1999q4 is more prudent at 0.5%. During the year 2000 Scottish manufacturing is forecast to grow steadily gathering pace as the year progresses. There is a slight drop in the rate of growth for 2000q4 and 2001q1 but we are assuming a boost to Scottish manufacturing from inward investment in the year 2001. This contributes to the strong growth rate which accelerates sharply for 2001q2 before dropping back slightly. The National Institute forecast for UK manufacturing demonstrates slow but steady growth over the forecast horizon. The anticipated continued strength of sterling in 2000 and the

slower growth of the UK economy might constrain growth in the Scottish economy.

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

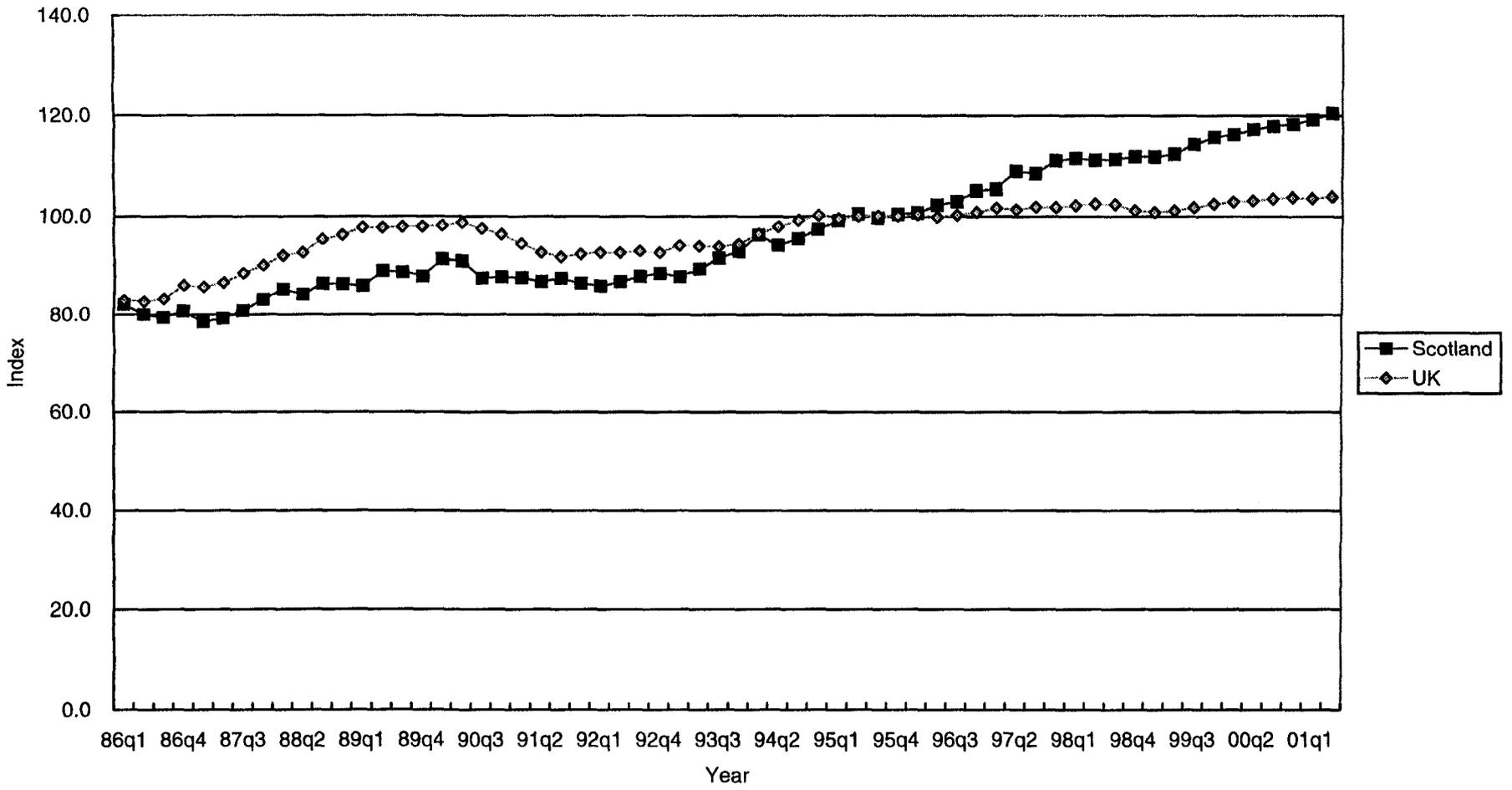
91/90	-2.7
92/91	0.2
93/92	3.6
94/93	5.6
95/94	4.7
96/95	3.1
97/96	4.8
98/97	2.1
95Q1/94Q4	1.8
95Q2/95Q1	1.5
95Q3/95Q2	-0.9
95Q4/95Q3	0.8
96Q1/95Q4	0.4
96Q2/96Q1	1.3
96Q3/96Q2	1.0
96Q4/96Q3	1.9
97Q1/96Q4	0.5
97Q2/97Q1	3.1
97Q3/97Q2	-0.2
97Q4/97Q3	2.1
98Q1/97Q4	0.5
98Q2/98Q1	-0.7
98Q3/98Q2	0.2
98Q4/98Q3	0.6
99Q1/98Q4	0.1
99Q2/99Q1	1.4
99Q3/99Q2	0.4
<b>FORECASTS</b>	
99Q4/99Q3	0.5
00Q1/99Q4	0.7
00Q2/00Q1	0.8
00Q3/00Q2	1.0
00Q4/00Q3	0.4
01Q1/00Q4	0.6
01Q2/01Q1	2.4
01Q3/01Q2	1.5
99/98	1.9
00/99	2.8
01/00	3.7

## THE DELOITTE & TOUCHE SCOTTISH CHAMBERS' BUSINESS SURVEY

The Deloitte & Touche Scottish Chambers' Business Survey, which is conducted by Strathclyde University's Fraser of Allander 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.

Output Index for Scottish and UK Manufacturing Industries''''  
(seasonally adjusted, 1995=100) 1986q1-2001q2



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 1999, 670 firms responded to the questionnaire.

### **Summary Points**

Changes in business confidence were widely reported in the fourth quarter. Rising and strengthening trends in business optimism continued in manufacturing and construction but declining trends were reported in wholesale, retail distribution and tourism;

Changes in the levels of orders and sales were widespread in all sectors. Rising trends in total orders were reported in manufacturing and construction. Declining sales trends were reported in wholesale, retail and tourism. The outturn in demand was better than anticipated in manufacturing and construction, but weaker than expected in wholesale and retail distribution and tourism;

In the service sector demand continued to weaken in wholesale and retail distribution and tourism. The retail trends, whilst weak, were the best figures for 1999;

Manufacturing and construction respondents expect a further rise in orders in the first quarter. In contrast retail and tourism respondents anticipate continued weak demand in the first three months of 2000;

Expectations as to increases in turnover over the next year continue to improve in manufacturing, wholesale and retail, although expectations in the service sector are weaker than in the third quarter. Similarly expectations as to the trends in profitability over the next year have improved in manufacturing but weakened in wholesale and retail distribution;

Pressures on margins were more evident in the service sector. In retail there are expectations that profitability trends will deteriorate over the next year whilst turnover trends will improve. In tourism turnover was down in the fourth quarter whilst costs rose and the discounting of prices was more widely reported than had been predicted; Employment rose in construction, retail and finance (due to the employment of part time, temporary and agency staffs), but declined in all other sectors, employment is expected to rise in construction in the first quarter, but to continue to decline in other sectors;

There was no evidence of increased pay pressures in the fourth quarter. Average pay increases in the fourth quarter were lower than in the three months to September, and ranged from 3.2% in wholesale to 5.6% in construction.

## **MANUFACTURING**

### **Optimism**

The rise in business confidence continued, although at weak levels.

### **Orders and Sales**

The outturn in orders was again better than anticipated, and respondents anticipate rising orders and sales in the first quarter.

Concerns as to the levels of orders, exchange rates and competition remained the factors thought most likely to limit output. The importance attached to interest rates continued to increase, as did concerns as to exchange rates.

### **Finance**

The cash flow trends weakened, although firms are more confident as to improvements in profitability and turnover over the next twelve months than for the past two years. Anticipations of price increases eased slightly.

### **Investment**

Changes to investment plans again affected less than 35% of respondents. Investment in the fourth quarter was again primarily authorised towards reducing labour [38%] and replacement of equipment [27%].

### **Employment**

Employment trends continued to fall, again a net decline of 9%, and this net rate of decline is again expected to continue. The trends in temporary employment were the strongest and a slight increase in overtime levels was reported.

Recruitment activity fell slightly as 47% sought to recruit staff in the fourth quarter. 24% reported increasing pay by an average of 3.30%, compared to an average of 3.44% in the previous quarter.

## **CONSTRUCTION**

### **Optimism**

The rise in confidence continued and strengthened slightly.

**Orders**

The trend in total orders was as anticipated, with a net of 13% of respondents reporting an increase. The upward trend in private sector orders ended, however, almost a third of respondents expect a further increase in private sector orders in the first quarter (a net increase of 12%).

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 69% in quarter three to 71%.

**Investment**

Changes to investment again affected slightly less than 24% of respondents, and the rise in plant/equipment investment continued. Of those investing in the fourth quarter 60% directed investment towards the replacement of equipment and 16% towards expansion.

**Employment**

The rise in construction employment continued at a lower rate, although this dip is seen as temporary and an increase is expected in the first quarter. 30% increased pay by an average of 5.6% compared to 5.8% in the previous quarter, and 48% sought to recruit staff in the fourth quarter, again mainly skilled manual staffs.

**WHOLESALE DISTRIBUTION**

**Optimism**

The decline in business optimism deepened, although the average rate of decline remained less than that reported in 1998.

**Sales**

Respondents had forecast a marginal increase in sales for the fourth quarter, however, once again this was an over estimation, and the net decline of 12% was more than had been anticipated. Nevertheless, wholesale respondents expect no improvement in demand in the first quarter. Concerns as to competition were cited by 67%, as the factor thought most likely to limit activity in the first quarter, and concerns as to interest rates increased.

**Investment**

Changes in investment plans were reported by 31%, nevertheless the upward trend in investment ended.

**Finance**

Cash flow trends over the three months to the end of 1999 remained weak and negative (a net of -14%). Expectations of turnover and profitability over the next year are weaker than in the third quarter. The net of firms expecting to increase prices over the next quarter increased further to 26%. Pressures to raise prices increased slightly, reflecting increased finance and raw material costs.

**Employment**

Changes to employment levels again affected less than 33%, and the decline was as anticipated. Respondents continue to anticipate a decline in employment in the next quarter. 16% reported increasing pay by an average of 3.21% compared to an average increase of 3.32% in the previous quarter.

**RETAIL DISTRIBUTION**

**Optimism**

Changes in business confidence affected 52%, and the declining trend in business confidence deepened marginally to a net of 10%.

**Sales**

The decline in sales was again slightly worse than had been anticipated, but the trend is the strongest for 1999. A further slight easing in the decline is forecast for the first quarter. Competition and costs are increasingly the major concerns reported by retail respondents. Concerns as to the level of competition remain the factor thought most likely to restrict sales, concerns as to interest and business rates also increased.

**Investment**

The upward trend in investment plans continued.

**Finance**

Cash flow trends worsened in the fourth quarter. Expectations as to turnover and profitability over the next year are now weaker than three months ago, with a net of firms anticipating a fall in profitability over the next year. Pressures to increase prices were more evident, but expectations of price increases were less than three months ago, suggesting competitive pressures are inhibiting price increases.

### Employment

A marginal increase in employment was reported (a net increase of 3%), due mainly to the increased employment of temporary staffs. A decline is forecast for the first quarter, although once again changes in employment were at the margin, affecting only a quarter of respondents. 42% sought to recruit staff, and 9.3% increased pay by an average of 3.68%, compared to an average increase of 6.01% in the previous quarter.

## FINANCIAL INSTITUTIONS

### Personal advances

Personal advances rose during the three months to the end of December for a net balance of respondents but an easing in the rate of increase is forecast for the first quarter.

### Corporate advances

The increase continued through the fourth quarter, and again corporate demand for credit was most evident for investment in buildings. The demand for credit for plant/equipment and for working capital increased at more modest rates.

### Sectoral demand

Demand for credit increased modestly from all sectors except distribution. Demand for credit in the first quarter is expected to be strongest from construction, tourism and other services.

### Employment

Changes to employment were reported by 42%, although the increase in employment was due to increased use of part time, temporary and agency staffs. 46% reported increasing pay by an average of 3.40%.

## TOURISM

### Optimism

Changes in business confidence were again widely reported, and the decline in confidence re-emerged as a net of 20% reported being less confident than three months earlier.

### Demand

The decline in demand was worse than anticipated, with demand from Scotland, the rest of the UK and from abroad falling, whilst business demand remained flat. Average capacity used was four percentage points higher than in the fourth quarter

of 1998, but one percentage point lower than in the fourth quarter of 1997.

### Investment

Investment continued to rise, although for more than 81% the main reasons for authorising investment were to replace/renew facilities or to improve facilities.

### Finance

Increased pressures on margins were again evident. Turnover trends in the three months to the end of 1999 were worse than expected, whilst costs rose slightly more than had been anticipated. Discounting of prices was more evident, and more than had been anticipated. Discounting of prices is expected to increase in the first quarter of 2000.

### Employment

61% reported no change to overall employment levels but the decline in employment was less than had been anticipated.

### Recruitment

Recruitment activity remained high with 88% seeking staff. Three quarters of those recruiting staff reported difficulties in attracting suitable staffs, most notably skilled and other manual staffs. 43% reported increasing pay by an average of 4.6%.

## CONSTRUCTION

According to the Scottish Executive GDP figures for Scotland in the four quarters to 1999 Q3, output in the Scottish construction sector grew by 1.1per cent and the equivalent figure for the UK was -0.6 per cent.

The Deloitte & Touche Scottish Chambers' Business survey for the fourth quarter of 1999 reported that the rise in confidence continued and strengthened slightly. The trend in total orders was as anticipated, with a net of 13% of respondents reporting an increase. The upward trend in private sector orders ended, however, almost a third of respondents expect a further increase in private sector orders in the first quarter (a net increase of 12%). The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 69% in quarter three to 71%.

Changes to investment again affected slightly less than 24% of respondents, and the rise in plant/equipment investment continued. Of those

investing in the fourth quarter 60% directed investment towards the replacement of equipment and 16% towards expansion.

The rise in construction employment continued at a lower rate, although this dip is seen as temporary and an increase is expected in the first quarter. 30% increased pay by an average of 5.6% compared to 5.8% in the previous quarter, and 48% sought to recruit staff in the fourth quarter, again mainly skilled manual staffs.

According to the Halifax House Price Index for the fourth quarter of 1999 UK house prices rose by 3.4% in the fourth quarter. This was smaller than the 4.4% increase in the previous quarter - the largest quarterly rise since the height of the late 1980s booming. The significant pick-up in house prices during 1999 was driven to a considerable extent by the south of England and, in particular, Greater London. The market has been notably less buoyant elsewhere. Nevertheless, prices increased more in 1999 than in 1998 in all parts of the country except the West Midlands and Northern Ireland. Despite the slowdown in the quarterly rate of growth, annual house price inflation accelerated to 11.5% in the fourth quarter from 8.8% in the previous quarter. This is the highest annual rate since 1989 Q3, but remains well below the 34% peak recorded in the final three months of 1988.

The biggest quarterly gain in house prices in the fourth quarter was in Greater London (8.4%). The South East (7.4%), Scotland (5.8%), the South West (4.2%) and East Anglia (3.9%) also reported substantial price rises. Prices in Greater London, the South West and East Anglia, however, increased by less than in the third quarter. Yorkshire and Humberside (4.0%), Northern Ireland (4.0%), West Midlands (4.4%), the North (4.7%) and Scotland (4.8%) had the lowest rates of annual house price inflation in the fourth quarter of 1999.

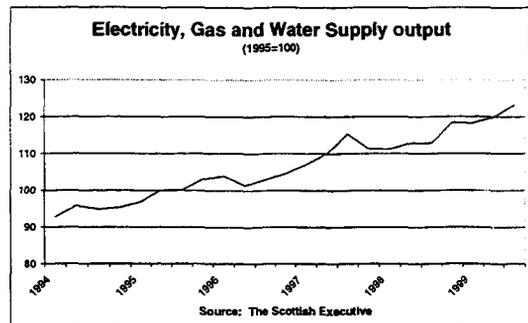
**ENERGY**

**Oil and Gas**

The Royal Bank of Scotland Oil & Gas Index data demonstrates that oil production over 1999q4 on 1999q3 rose by 2.1% compared to a 63.6% rise in gas production over the same period. The rise in the Combined Index over the quarter was 21.8% whereas over the year the increase was 4.9%. The increase over the year for 1999q4 on 1998q4 for oil production was 0.9% and gas production rose by 11% on an annual basis. The average oil price in 1999q4 was \$24.10 compared to \$20.55 in 1999q3, an increase of 17.3%. For 1999q4 on 1998q4 the oil price increased by 116% up from \$11.16. The Average Daily Oil Value rose from £33.5 million

in 1999q3 to £39.4 million in 1999q4, up 17.6% whereas the rise is 125% on an annual basis. The Provisional Total Average Daily Value rose from £42.6 million in 1999q3 to £54.1 million in 1999q4, an increase of 27%. On an annual basis the increase is 55%.

The large increase in the oil price is driven by OPEC's cuts in production while the very low stocks in the USA have reinforced the move. A further underlying factor is the economic recovery in Asia. When the oil price was below \$10 this was widely accepted as unsustainable and now prices above \$25 are also unsustainable. It is difficult to see where prices will settle but even in the medium term it may be that \$14-18 is a more sustainable price. The high price level has led to increased revenue but the global rise in oil prices is beginning to feed through into inflation whereas the non-oil commodity price index has remained relatively static over the past year. A weakening of oil prices will undoubtedly make the macroeconomic situation somewhat easier. The continuing strength of sterling however does little to help oil revenues. It is likely that OPEC will reduce production quotas slightly in March for two reasons; to reward countries that have complied so far and to avoid the situation of 'cheating' which would weaken the cartel's position.



If this is the outcome then this is good news for the UK. A slight fall in the oil price (to below \$20) would still allow a slight increase in investment in the North Sea over the next year.

The DTI has approved the development of the Keith field, which is 200 miles north-east of Aberdeen. BHP is expected to bring the field onstream by the end of 2000 with an initial production of 15,000bpd. The announcement has guaranteed the 200 Halliburton jobs at the Rockwater fabrication yard in Wick.

British Borneo, the UK Independent exploration business, recently announced a cut in forecast output down to 45,000-50,000bpd, which resulted in its share price halving. The company now

require a partner for their Gulf of Mexico operations and will sell their 8% stake in the Elgin/Shearwater development. Enterprise are back in the black after pre-tax losses of £29.6 million. The full year results show a £289 million profit and dividend has been increased by 5.8% to 7.3p. The company has seven new fields and oil production has risen to 210,000bpd. This is in contrast to Premier who reported a £27.7 million loss for 1999 but is still expected to be a leading player in the Asian gas market.

BP Amoco is to take over Burmah Castrol for £3 billion. Cost savings are estimated to be £162 million by the year 2003. 1,7000 job losses are forecast and blending facilities will be reduced from 60 to 45 across the world. The company has stressed however there are no plans to close Grangemouth. The acquisition of the Castrol brand name is a major coup for BP Amoco although market share may be a competition issue in some countries. BP Amoco will become the second largest lubricants group in Europe with a 13% market share. BP Amoco also plans to sell its Alaskan assets of its Atlantic Richfield £17 billion target.

The February 2000 Aberdeen Chamber of Commerce and Deloitte & Touche Oil and Gas Survey had 27.5% of respondents reporting being more confident than three months earlier, a net balance of only 5% being more sanguine. This is more likely to reflect expected future prospects rather than current trading conditions. The rate of decline in exploration and in Scottish based activity has slowed, again an indicator of expected future improvements. Concerns were expressed over the future level of demand by 84% of respondents (the fourth highest since the survey started) while the shortage of skilled labour continued to decline in significance. 50% of respondents reported no employment change while 37.5% reported falling employment.

## UTILITIES

The Index of Production supplied by the Scottish Executive for 1999q3 on 1999q2 shows that for Electricity Gas and Water Supply growth was 2.7% up to 123.2, a relatively better performance than the UK with 1.6%. On an annual basis for 1999q3 on 1998q3 the change is 7% in Scotland compared 2.3% in the UK. The main reason for this continues to be electricity exports particularly during the winter of 1998.

Scottish water charges are to rise by at least 12% - 15% according to the Scottish Executive minister Sarah Boyack. The average annual water charge will rise to £214 in 2001-02 a figure just £2 below

that of English and Welsh water charges. In the North of Scotland water charges will rise by 35% next year then by a further 12%, that is from the current average of £175 to £264 in 2001-02 or £48 above the average English charge. In the West of Scotland the current average charge is £135 but will rise to £197 in 2001-02 and in the east the charge will be £202 in 2001-02 up from £157 at the moment (a rise of 28.6% compared to a 45.9% rise in the west). The reason for the charges is the upgrading of water supply and sewerage treatment facilities to meet EU standards giving a cumulative spend of 2.5 billion. It is likely that for the consumer the average charge will only be an extra 60p per week but the rise in the north will mean this will be higher. There have been calls to stagger the 35% increase in the north and for the Scottish Executive to commit themselves to improving rural supplies.

Scottish & Southern Utilities have backed off from the proposed merger with United Utilities but still retains £1.5 billion for acquisitions. SSE have had a falling share price for some time, under-performing the FTSE index by some 30% since the beginning of 1999. The group believes that hostile bids destroys value and would like to replicate the merger that took Scottish Hydro-Electric and Southern Energy together.

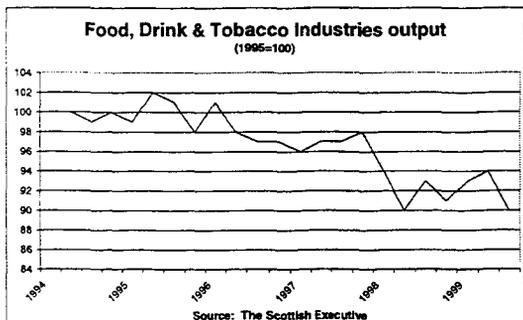
## MANUFACTURING

### FOOD, DRINK AND TOBACCO

The Scottish Executive Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 90 in the third quarter of 1999 (1995=100), a reduction of 4% from its level in the previous quarter. Output levels fell over the year to the third quarter by 1.8%, compared to a 2.1% reduction across the industry in the UK. However, this most recent quarterly decrease appears to be due largely to reduced output levels in the drinks sector, with the Drink index falling from 99 in the second quarter to 90 in the third. Food and Tobacco output actually grew by 1.1%. It is therefore likely that this recent adverse movement in the sector as a whole is due to short term problems in the Drinks sector.

The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey appears to paint a slightly more encouraging picture. The sector's balance of optimism - those reporting feeling more optimistic about the industry's prospects than three months previously, minus those feeling less optimistic - was positive at 11% (although two-thirds of respondents reported no change in optimism). Similarly, both the actual and expected trends in new orders also showed positive

balances, of +29.6% and +16% respectively, and a similar picture pertained with respect to both current and expected sales. Capacity utilisation measured 75.2%, and almost half (46.2%) of respondents reported that capacity utilisation had increased compared with the position one year previously. Additionally, a net balance of firms had increased their investment intentions, both for plant & equipment (14.8%) and land & buildings (12.5%). Finally, a substantial proportion of respondents felt that both turnover (64.3%) and profitability (57.1%) were likely to improve over the coming twelve months. One negative note, however, is that firms continue to argue that foreign sales are adversely affected by the strength of sterling. 50% of respondents cite that this has become a greater source of concern in the last three months, and it is notable that the expected growth in new orders mentioned earlier is seen as less likely to emerge from export markets.



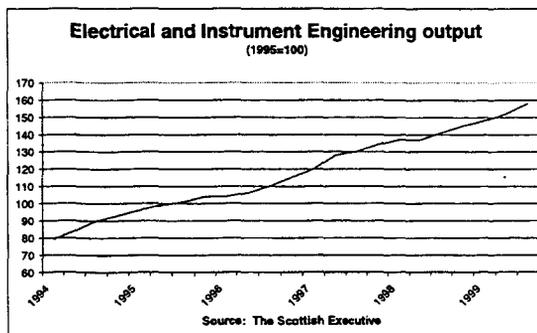
News amongst Scottish companies includes a report that Wiseman Dairies is to be investigated by the Competition Commission, following allegations that it has been using its dominant position in Scotland to indulge in anti-competitive practices. Wiseman currently controls around 75% of the milk market in Scotland. Wiseman is also pressing ahead with plans to extend its share of the UK market by investing £30million in a new dairy in Birmingham.

## ELECTRICAL AND INSTRUMENT ENGINEERING

The Scottish Executive Index of Production for the Electrical and Instrument Engineering (EIE) sector in Scotland stood at 158 in the third quarter of 1999 (1995=100), an increase of 3.4% from its level in the previous quarter. Output levels increased over the year to the third quarter by 9.9%, compared to a 7.7% increase across the industry in the UK. The industry's short term performance contrasts, yet again, with that seen in other manufacturing sectors in Scotland, with, for example, quarterly reductions in Mechanical Engineering (-0.8%), Transport

Equipment (-4.1%), Paper Printing and Publishing (-2.6%) and Other Manufacturing (-1.3%). EIE growth in Scotland was, for once, outstripped by that seen across the UK, where output increased by 4.4% over the third quarter.

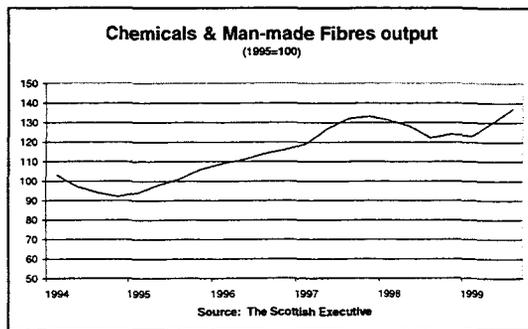
The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey also paint a fairly encouraging picture. The sector's balance of optimism - those reporting feeling more optimistic about the industry's prospects than three months previously, minus those feeling less optimistic - was positive at +23% (although half of those responding reported no change in optimism). Similarly, both the actual and expected trends in new orders also showed positive balances, of +21.7% and +32.9% respectively. A similar position also held with respect to both current and expected sales, with the expected trend in sales expected to be particularly strong. Capacity utilisation measured 82.5%, and just over two-fifths (42.8%) of respondents reported that capacity utilisation had increased compared with the position one year previously. Despite this, however, few firms report an increase in investment intentions, either for plant & equipment or for land & buildings. Finally, a substantial proportion of respondents felt that both turnover (66.3%) and profitability (60.5%) were likely to improve over the coming twelve months. One negative note, however, is that around a third of firms (32.7%) continue to argue that foreign sales are adversely affected by the strength of sterling, arguing that this has become a greater source of concern in the last three months.



News amongst Scottish companies includes the decision by Pressac to build a new factory in Bishopbriggs that will produce mobile phones. Pressac is the former McGavin Company, recognised as one of Scotland's most successful innovators. It aims to capitalise on the substantial recent growth in mobile phones, an area where Scotland has seen other successes, notably Motorola. The new facility is expected to employ about 200 people once completed.

**CHEMICALS**

The Index of Production for Scotland showed an increase in output of 5.0% for the chemical and man-made fibre sector for the third quarter of 1999. In the year to 1999 Q3 the increase in output was more modest at 1.6%. Output in the sector across the UK as a whole showed an increase of 3.8% over the third quarter and 1.3% for the year to Q3 1999.



Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey (Quarter 4 1999) showed that once again respondents appeared fairly sanguine about the general business situation compared to both the previous quarter and the same quarter one year ago.

The declining trends in both orders and sales ended as demand from rest of UK and overseas markets improved for a net of firms while the trend in Scottish demand was flat. Despite the increase in confidence firms are not confident that the upward trend in demand will continue through the current quarter as demand from all markets (except rest of UK orders) declines for a net of firms.

Cash flow trends improved with 40% reporting improving and 20% worsening cash flow trends. Over the current year firms expect, on balance, profitability and turnover to improve (nets of +60% and +30% respectively). Once again most firms do not expect to alter prices during the first quarter despite increased pressure from transport costs and raw material costs.

Changes to investment plans were once again essentially at the margin with 80% making no change to investment in plant equipment and all reporting a level trend in investment in land/buildings. Investment authorised during the fourth quarter was generally directed toward increasing efficiency, replacement, and reduction of labour and capacity expansion.

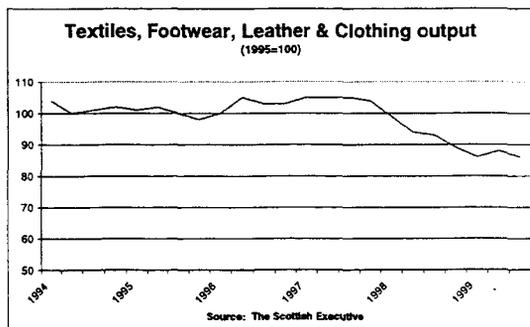
Overall, business confidence continued to improve reflecting an increase in orders and sales for a net

of firms. Firms are not confident that the increase in demand will continue and remained concerned about levels of demand; 60% reported being concerned with exchange rates. Both profitability and turnover are forecast to improve over the current year.

In the company sector PPL recently announced plans to build a £42 million plant, expected to be in the Lothians. The company secured a funding package backed by Scottish Enterprise, which will underwrite £13.8 million of the debt that PPL will have to repay. The plant will manufacture the drug AAT which is used for treating cystic fibrosis and emphysema and was recently awarded orphan drug status in the United States which will give it, when approved, seven years of exclusive right in the US market.

**TEXTILES, FOOTWEAR, LEATHER AND CLOTHING**

The Scottish Executive Index of Production for the Textiles, Footwear, Leather and Clothing (TFLC) sector in Scotland stood at 86 in the third quarter of 1999 (1995=100), a reduction of 2% from its level in the previous quarter. Output levels fell over the year to the third quarter by a staggering 10% (compared to an 8% reduction across the industry in the UK), a simple reflection of the difficulties, resulting in the plant closures seen in Scotland in recent months.



The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey however, appear to paint a slightly more upbeat picture. The sector's balance of optimism - those reporting feeling more optimistic about the industry's prospects than three months previously, minus those feeling less optimistic - was actually positive at 8.3%. However, this result refers to the companies which have survived the recent difficulties, and it is notable that almost half (45.3%) of respondents report no change in optimism. Similarly, both the actual and expected trends in new orders also showed positive balances, of +11.1% and +16.7% respectively. A similar picture pertained with respect to expected sales.

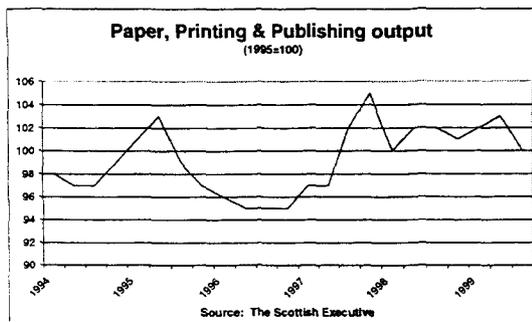
where 43.5 % of firms expect an increase in the coming quarter.

Capacity utilisation measured 73.8%, although 31% of firms report that capacity utilisation was down compared with one year previously, compared to only 23% reporting an increase. Not surprisingly, few firms in the sector seem to wish to invest, and 73% report no change in investment intentions for plant & equipment. However, a substantial proportion of respondents felt that both turnover (54%) and profitability (52.8%) were likely to improve over the coming twelve months (although these figures are notably below those reported in some other sectors). One final note is that firms continue to argue that foreign sales will continue to be adversely affected by the strength of sterling. 66.7% of respondents cite that this has become a greater source of concern in the last three months.

News amongst Scottish companies includes the sale of Pringle to the Shanghai-based entrepreneur Kenneth Fang, for £10 million. Mr Fang has given assurances that production will remain in Scotland, and that the company will also continue to be managed from its current base in Hawick. However, he has stated that Pringle requires to move away from its current outdated manufacturing techniques, and has promised the investment necessary to do this. More job losses seem possible, although at the expense of a more secure future for those employees who remain.

### PAPER, PRINTING AND PUBLISHING

The most recent Index of Production reveals that output growth in the Paper, Printing and Publishing (PPP) sector in Scotland fell by 2.6 per cent in the third quarter of 1999. Over the year to September 1999, growth in this sector fell by 0.8 per cent. The most recent production statistics also reveal that the UK PPP sector also recorded falls in quarterly and annualised output growth, to September 1999, of 0.2 and 0.1 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 continue to ease. The general business outlook by respondents for the final quarter of 1999 improved relative to previous periods with a positive trend in business confidence noted. Business confidence in the sector had increased or remained as before for four fifths of the responding firms. In comparison with one year previous, around three-quarters of the sample were more, or at least as confident, about the general business outlook than one year previous.

The upward trends in total orders and sales, anticipated in the previous Quarterly Commentary, were realised for a positive net balance of respondent firms. The trend in orders, for the final quarter of 1999, increased across all markets, with export orders increasing for the largest (net) band of respondents. This upward trend in orders is forecast to continue for RUK and export markets, though Scottish orders are expected to fall. The trends in the total volume of sales over the final quarter of 1999 increased relative to the previous quarter, though Scottish sales remained sluggish. However, the trend in sales to RUK and export markets increased for a positive net balance of respondents. Finally, DTSCBS respondents anticipate a positive trend in the volume of sales, across all markets, in the first quarter of 2000.

The average level of capacity utilisation for the Paper, Printing and Publishing sector remained unchanged at 80% in the final quarter of 1999. 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 around 43 per cent of respondents, with the decline in employment (relative to the previous quarter) increasing slightly to affect a net 23% of respondents, over the final quarter of 1999. Respondents in the previous Commentary anticipated a fall in total employment and this trend is again forecast to continue into the first quarter of 2000. Over the same period, around 23 per cent of all respondents increased wages and salaries by an average 2.7 per cent.

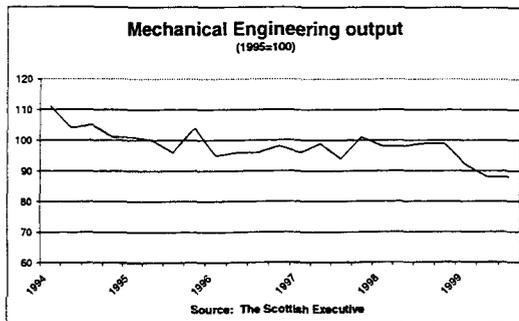
In summary trading conditions are more favourable within this sector with both the continued increases in business confidence and the rising trends in total orders and sales. Moreover, cashflow and profitability concerns continue to ease for respondents within the sector, with turnover and

profitability expected to rise in the first quarter of the year. However, in general, continued growth has been difficult for this sector, though the most recent DTSCBS suggests that output growth in the sector should bounce back in the final quarter of the year.

In the company sector, Inveresk, the Dunfermline-based paper manufacturer that previously issued profit warnings for trading this year, reported pre-tax profits of £1.3 million to the year end November 1999. The company moved into the black despite what it called '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 Index of Production for the Mechanical Engineering sector in Scotland reported a 0.8% decrease in output for the third quarter of 1999. This compares with a 2.2% 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 those observed in the previous two quarters (7.3% in Q1, and 3.4% in Q2). However year on year growth for the Mechanical Engineering sector in Scotland (in the year from the third quarter of 1998) is a less positive indicator, with a 7.4% fall in output recorded. The corresponding UK figures reveal that output in the sector at the UK level rose by 0.3% in the third quarter of 1999, but that annualised growth, over the previous four quarters, was negative at -4.9%.



The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) for the fourth quarter of 1999 suggest that trading conditions in the fourth quarter of 1999 remain difficult in this sector. Business confidence remains negative for a quarter of DTSCBS respondents, who report feeling less optimistic about the current business situation than they did three months

previous, and almost half the respondents said that they feel less optimistic than they did one year ago.

Underlying continued lack of confidence in much of the sector appears to be the reported trends in total orders and sales over the previous quarter. Declining orders across all markets were reported by DTSCBS respondents, with 50% reporting falling Scottish, 48.1% declining rest of UK and 22.6% falling export orders. However improvements are anticipated by the majority of respondents over the next three months. The trend in the total volume of sales followed a similar pattern.

The average level of capacity utilisation for the Mechanical Engineering sector for the fourth quarter of 1999 was 71.37%, with 54.5% reporting their capacity utilisation to be less than in the same period last year, figures that are roughly unchanged from the previous quarter's survey. Investment intentions in this sector, over the past quarter, also remain level for the majority of respondents for both land and buildings and plant and equipment, and are anticipated to remain so over the next quarter.

The Deloitte & Touche Scottish Chambers' Business Survey also reveals that total employment has, and is expected to, remain level for the majority of respondents, but with 29.4% 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 significant fall in the net number of respondents (from 23.8% in last quarter's survey, to 9.4%) expecting to reduce total employment. Over the last quarter 88.6% of respondents reported no change in wages and salaries, but with the 11.4% who did increase wages and salaries doing so by an average of 4.75%.

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. A key concern for respondents in the Mechanical Engineering sector is still the current level of new orders and sales, with 60% of respondents reporting that this is more of a concern to their businesses than three months ago. The other key concern reported was interest rates, with 37.1% reporting this factor as a greater concern than three months ago. This compares to the much smaller proportion of respondents, 8.9%, who cited interest rates as a concerning factor in the previous DTSCBS survey, reflecting the concern of businesses around the country in response to the

recent series of increases in the base rate by the MPC.

In the company sector, positive news came with the final closure of the sale of Kvaerner's Govan shipyard to BAe systems, which is now part of the Sealion consortium. Sealion is one of the bidders for a £250million MoD contract for six roll-on, roll-off equipment transport vessels, with a decision by the MoD expected by March 2000. Sealion has been named as the preferred supplier, but it has not yet been decided how the order would be split between BAe's three shipyards (at Govan and Scotstoun in Glasgow, and Barrow-in-Furness in Cumbria) if the consortium's preferred supplier status is confirmed.

More positive news came from First Engineering, the Glasgow-based rail infrastructure maintenance group as a £100million contract from Railtrack was confirmed. The group has been up for sale since 1998, and it is thought that the new Railtrack contract will boost its sale prospects.

Motherwell Bridge, the Scottish Engineering group reported more positive news, with the sale of its information systems division to institutional investors, led by the venture capital company 3I, for £75million.

Less positive news has come from the Weir Group in the first two months of 2000. After finishing 1999 on a low note, with the group's share prices falling in response to a profit warning, the new year began with the announcement that the Weir Pumps foundry at Alloa, Clackmananshire, would close, with the loss of 49 jobs. The group's share price, under pressure since the December profits warning, fell to a 15-month low at the end of January. Part of the pressure on the group results from the recent rises in interest rates, and the strength of sterling was cited as the causal factor behind Weir's decision in February to axe many of its UK components suppliers in favour of overseas rivals. February also brought another announcement of job losses in Weir Pumps Ltd, with 93 white collar redundancies at the company's main plant in Cathcart, where 1200 employees are based.

## SERVICES

### RETAIL AND WHOLESALE DISTRIBUTION

In marked contrast to the UK as a whole, it appeared that there was no improvement in sales growth as a result of the January sales in Scotland. The Scottish Retail Consortium /Royal Bank of Scotland Monitor recorded growth in sales of 2.0% in total, and -3.9% on a like-for-like basis.

Total sales growth in Scotland was subdued compared with the 6.5% growth rate seen in the UK as a whole. However, Scotland had seen stronger growth than the UK generally in December. The three-month moving average for growth in retail sales in Scotland was 3.5%, down from 4.0% last month on a total basis. The January Monitor covers four weeks from 2 January to 29 January and is the only quantitative monthly measure of retail performance in Scotland.

Whilst it is true that the Scottish economy as a whole has been showing signs of recovery since last summer, the pick up is more patchy north of the border than for the UK as a whole, and the retail sector has been one of the weakest performers. The January increase in total sales of 2.0% is well below the rise for December, and the BRC UK figure of 6.5%. Like for like sales in Scotland are down this month, compared with an increase at UK level. Were it not for some uplift in the non-food sector, reflecting post Christmas sales promotions, the Scottish January figures would be weaker still.

The Monitor noted a number of short term factors as having influenced the January figures. The longer New Year holiday removed at least one, and in some cases two trading days. The timing of Christmas also meant many monthly paid consumers had, by the end of January, not received any pay for six weeks. Retailers reported significant moves into credit at the end of the month. Plus, the 'flu epidemic peaked during the post-Christmas sales period, reducing shopper volumes, and in non-food, notably clothing, overstocking before Christmas meant extended January sales periods.

According to the ONS in January the seasonally adjusted estimate of retail sales volume is 119.9. This is 1.5 per cent above the December figure and 6.1 per cent higher than the January 1999 level. In November to January the volume of sales was 1.8 per cent higher than in the previous three months and 5.3 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 £3,670 million, 4.8 per cent higher than in January 1999. In November to January the value of sales in current prices was 4.1 per cent higher than in the same period a year earlier.

In November to January the seasonally adjusted volume of sales by predominantly food stores increased by 2.1 per cent compared with the previous three months; sales by predominantly non-food stores increased by 1.8 per cent. In November to January the value of sales (not seasonally adjusted) by predominantly food stores

was 4.3 per cent higher than a year earlier; sales by predominantly non-food stores were 4.5 per cent higher. In November to January the estimated value of sales (not seasonally adjusted) of food, drink and tobacco was 4 per cent higher than a year earlier; sales of clothing and footwear were 4 per cent higher; sales of household goods were 7 per cent higher and sales of other non-food products were 3 per cent higher.

According to the latest Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) the decline in business optimism among wholesalers deepened, although the average rate of decline remained less than that reported in 1998. Changes in business confidence affected 52% of retailers, and the declining trend in business confidence deepened marginally to a net of 10%.

DTSCBS wholesale respondents had forecast a marginal increase in sales for the fourth quarter, however, once again this was an over estimation, and the net decline of 12% was more than had been anticipated. Nevertheless, wholesale respondents expect no improvement in demand in the first quarter. Concerns as to competition were cited by 67% of wholesale firms, as the factor thought most likely to limit activity in the first quarter, and concerns as to interest rates increased.

The decline in retail sales was again slightly worse than had been anticipated, but the trend is the strongest for 1999. A further slight easing in the decline is forecast for the first quarter. Competition and costs are increasingly the major concerns reported by retail respondents. Concerns as to the level of competition remain the factor thought most likely to restrict sales, concerns as to interest and business rates also increased.

Cash flow trends over the three months to the end of 1999 remained weak and negative (a net of -14%) among wholesale respondents. Expectations of turnover and profitability over the next year are weaker than in the third quarter. The net of wholesale firms expecting to increase prices over the next quarter increased further to 26%. Pressures to raise prices increased slightly, reflecting increased finance and raw material costs.

Cash flow trends for retail firms worsened in the fourth quarter. Expectations as to turnover and profitability over the next year are now weaker than three months ago, with a net of firms anticipating a fall in profitability over the next year. Pressures to increase prices were more evident, but expectations of price increases were less than three months ago, suggesting competitive pressures are inhibiting price increases.

Changes to employment levels again affected less than 33% of DTSCBS wholesalers, and the decline was as anticipated. Respondents continue to anticipate a decline in employment in the next quarter. A marginal increase in employment was reported by retailers (a net increase of 3%), due mainly to the increased employment of temporary staffs. A decline is forecast for the first quarter, although once again changes in employment were at the margin, affecting only a quarter of respondents.

The latest Confederation of British Industry's quarterly Distributive Trades Survey, covering sales from 2 to 22 February, shows that, when compared to a year ago, 61 per cent of retailers reported increased sales, while 14 per cent reported falls. This gives a positive balance of 47 per cent, the highest seen since November 1996. This compares with plus 29 per cent in January and plus 41 per cent in December.

The three month moving average of sales volumes moved up to plus 39 per cent from plus 31 per cent in January and plus 27 per cent in November. Sales were considered to be above average for the time of year and were higher than retailers had previously expected. This has boosted retailers' confidence to a three-year-high. Thirty-one per cent expect the business situation to improve in the next six months, while only three per cent expect the situation to worsen. This gives a positive balance of plus 28 per cent, which compares to plus 19 per cent in November and plus 6 per cent a year ago.

Prices dipped for the first time in the survey's 16-year history. Thirty per cent of retailers said they had cut prices, while 26 per cent put prices up, leaving a negative balance of 4 per cent. This decline is expected to speed up in the coming months. Import penetration has increased at the fastest rate for almost ten years, with a greater share of retailers' deliveries from suppliers coming from imports.

## TRANSPORT

The Scottish Transport Bill presents some concerns as there is no statutory requirement for local authorities to produce a local transport strategy (LTS). This would be essential to support any bid for bids to the Public Transport Fund. The probable net effect will be that only authorities that wish to promote public transport will produce an LTS. The second issue is that the Scottish Executive does not make any specific provision for funds to support local authorities to introduce charging schemes that recently was a central plank in the National

Transport Policy. Given that there are some current misgivings about charging for road use, it may be that this will not come to fruition. It is expected that this bill will go through Parliament in Autumn of this year.

### Air

BAA saw a record number of passengers, 116.9 million (an increase of 5.7%) use their seven UK airports last year. Most of the rise was driven by low price seats offered by budget airlines. The Christmas period was quieter than usual with a drop of 0.4% in passenger numbers in December. Edinburgh traffic rose by 12%, Glasgow airport traffic increased by 4.3% but Aberdeen contracted by 7.2%. The Scottish airports as a whole grew by 4.6% in 1999. 14 million passengers used Scottish airports last year, that is 600,000 more than in 1998. The main drivers behind the increased traffic are the Scottish Parliament and flights to Brussels from Edinburgh and the increased number of Easyjet flights to Luton at Glasgow. The decline of 180,000 passengers at Aberdeen is attributed to the reduced oil activity particularly helicopter flights. Of all BAA's airports, Stansted was once again the best performer with a 38% rise in traffic. Concerns still remain over the loss of revenue from the duty free shops at airports and despite the increase in passenger numbers the share price has declined on the announcement of these results and over the year they have lost half of their value.

Federal Express (Fedex) are to stop their freight services to Prestwick following the failure of the US and UK governments to reach an agreement that would have given Fedex fifth freedom rights at Stansted airport. Stagecoach (Prestwick's owners) appear unconcerned as a new freight service from AirFreight Express (AFX) is to be launched sooner than expected. The seventeen job losses announced along with the Fedex decision means that some of these employees will be offered jobs with AFX. Prestwick is the only airport north of Manchester able to take wide-bodied freighters 24 hours a day and already has five other carriers operating from the airport. These include Lufthansa, Singapore Airlines, Air France, Cargolux and Polar Air. Stagecoach has spent £10 million refurbishing Prestwick and recent research shows that the boost to the UK economy of flying freight from Prestwick is £126.7 million a year with a total of 7,400 jobs by 2005.

ScotAirways (owned by Roy Suckling and Stagecoach) have ordered new aircraft at a cost of £67 million in order to increase the fleet size over the next three years. The expansion will allow the company to fly to European destinations. BA has bought a 18.3% stake in Comair, which is its

franchise partner in South Africa, for £17 million. The strategy is aimed to increase its market share of South African regional passengers. Comair increased its profit by 33% to £6 million.

### Rail

The demand for rail travel in the UK is growing with passenger journeys growing at 6% for the last twelve weeks to October 1999. Railtrack expects passenger growth of about 5%p.a. and it plans to increase investment from £15 billion to £35 billion over the next ten years. The taxpayer was set to fund £1 billion of this with the projection that this would fall to £700 million over the next five years. A recent announcement by Railtrack forecasts a shortfall of £1 billion at least, due to extra demand and this might mean that the taxpayer's contribution would have to rise to around £2.3 billion.

### Road

Coach USA is set for a shake up following a high level Stagecoach visit. It may be that non-core assets will be sold or the possibility of a joint venture partner may be a possibility. The two-day visit by Brian Souter, Mike Kiniski and Keith Cochrane had just passed when the group announced that with immediate effect Mike Kiniski would be leaving the group and Keith Cochrane would move from Finance Director to Chief Executive. Shares in Stagecoach have fallen slightly. Larry King executive chairman of Coach USA is also leaving with immediate effect. Stagecoach have announced that this *'was an appropriate juncture as the transition plan for Coach USA.'*

National Express has paid £106.5 million for the Chicago based ATC, which is the biggest privately owned public transport provider in the US. In the US school bus sector Stagecoach is the largest, owning Coach USA (in a deal worth £1.1 billion), First-Group are number two (a deal worth £660 million) and this will place National Express at number three. The National Express deal is likely to be worth only £200 million overall. Together the three groups own over 30,000 vehicles in the US. ATC have retained 95% of their contracts over the past five years and revenue has grown by 25% since 1994. The school market is worth about £5.5 billion a year with only 16% of scheduled services currently contracted out to the private sector.