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 2001q4. 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 Scottish and UK manufacturing output from 1986q1 to 1999q4 and the forecasts for 2000q1 to 2001q4. The Scottish Executive Index of Production (1995=100) is used in determining the forecasts of manufacturing output. The results are presented in Table 1 below.

The outturn for Scottish manufacturing growth for 1999q4 was unexpectedly negative (-0.8%) while we had a slightly more optimistic forecast of 0.5% growth. As most UK forecasts of manufacturing output have been revised down recently we have also been more sanguine about growth prospects for manufacturing. The forecast for 2000q1 is 0.2%. We still believe that during the year 2000 Scottish manufacturing will grow with increasing pace with a slight downturn in the fourth quarter. We are also still assuming a boost to Scottish manufacturing from inward investment in the year 2001. This contributes to the strong growth rate in 2001q2. The National Institute forecast for UK manufacturing still demonstrates slow but steady growth over the forecast horizon. The increase in interest rates, the continued strength of sterling and the slower growth of the UK economy are all factors that contribute to slower growth in Scottish manufacturing.

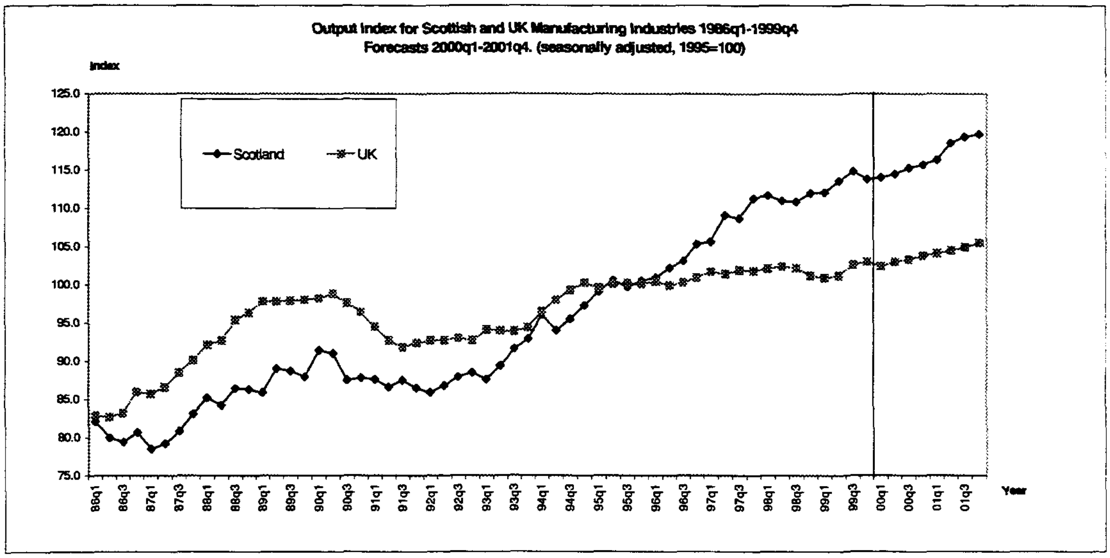
TABLE 1: QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)

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	0.9
96Q4/96Q3	2.1
97Q1/96Q4	0.3
97Q2/97Q1	3.3
97Q3/97Q2	-0.4
97Q4/97Q3	2.4
98Q1/97Q4	0.4
98Q2/98Q1	-0.6
98Q3/98Q2	-0.1
98Q4/98Q3	1.0
99Q1/98Q4	0.1
99Q2/99Q1	1.3
99Q3/99Q2	1.1
99Q4/99Q3	-0.8
FORECASTS	
00Q1/99Q4	0.2
00Q2/00Q1	0.4
00Q3/00Q2	0.7
00Q4/00Q3	0.4
01Q1/00Q4	0.5
01Q2/01Q1	1.9
01Q3/01Q2	0.7
01Q4/01Q3	0.3
99/98	2.0
00/99	1.2
01/00	2.8

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 Chambers of Commerce of Aberdeen, Central, Dundee, Edinburgh, Fife and

* 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.



Glasgow, 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 March, over 700 firms responded to the questionnaire.

Summary Points

Changes in business confidence were less widely reported in the first quarter. Rising trends in business optimism continued in manufacturing (although at reduced levels) and re-emerged in tourism. The declining trends in confidence eased in both wholesale and retail distribution;

Rising trends in total orders were reported in construction. Declining orders and sales were reported in manufacturing and declining sales trends were evident in the service sector. The outturn in demand was better than anticipated in construction, but weaker than expected in manufacturing wholesale and retail distribution and tourism.

In the service sector demand remained weak in retail distribution, although the rate of decline eased further, and the net trends were the best figures since q2 1998.

Manufacturing and construction respondents expect a rise in orders in the second quarter; and service sector respondents anticipate a further easing in the declining trends in sales. Tourist respondents expect the current declining trends to level out in the second quarter.

Expectations as to increases in turnover over the next year continue to improve in manufacturing and retail, although the expectations in manufacturing are weaker than in the previous quarter. In contrast expectations as to the rising trends in profitability over the next year have eased in manufacturing but strengthened in retail distribution.

In tourism the trends in turnover were better than anticipated in the first quarter and the discounting of prices was less widely reported than been predicted.

Employment rose in construction but declined in all other sectors, employment is expected to rise in construction, retail and tourism in the second quarter, but to continue to decline in other sectors.

There was no evidence of increased pay pressures in the first quarter. Average pay increases in the first quarter ranged from 3.12% in wholesale to 3.22% in manufacturing, 4.22% in construction and 5.2% in tourism.

MANUFACTURING

Optimism

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

Orders and Sales

The outturn in orders was weaker than anticipated, but respondents continue to anticipate rising orders and sales in the next quarter.

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

Finance

Cash flow trends weakened further, and firms are not so confident as to improvements in profitability and turnover over the next twelve months than in q4 1999. Anticipations of price increases in quarter two eased again.

Investment

Changes to investment plans were reported by 35% of respondents. Investment in the first quarter was again primarily authorised towards reducing labour [32%] and replacement of equipment [25%].

Employment

Employment trends continued to fall, a net decline of 16%, and this net rate of decline is again expected to continue and at reduced levels. The trends in temporary employment were the strongest employment trends and a slight increase in overtime levels was reported.

Recruitment activity fell further as 42% sought to recruit staff in the first quarter. 34% reported increasing pay by an average of 3.23%, compared to an average of 3.30% in the previous quarter.

CONSTRUCTION

Optimism

The rise in confidence ended, although changes in confidence were reported by less than 35%.

Orders

The trend in total orders was stronger than anticipated, with a net of 14% of respondents reporting an increase.

A strong upward trend in private sector orders emerged, and this strong rise is expected to continue, due largely to rising private sector demand, but also an end to the decline in other public sector orders.

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter rose from 71% in quarter four to 75%.

Investment

Changes to investment again affected slightly less than 30% of respondents, and the rise in plant/equipment investment continued. Of those investing in the first quarter 58% directed investment towards the replacement of equipment and 14% towards increasing efficiency.

Employment

A rise in construction employment was reported and this rise is expected to continue. 31% increased pay by an average of 4.1% compared to 5.6% in the previous quarter, and 62% sought to recruit staff in the first quarter, again mainly skilled manual staffs.

WHOLESALE DISTRIBUTION

Optimism

The decline in business optimism continued, although more than two thirds reported no change.

Sales

Respondents had forecast a decline in sales for the first quarter, and the net decline of 17% was as anticipated. The decline is forecast to continue through the second quarter. Concerns as to competition were cited by 67%, as the factor thought most likely to limit activity in the second quarter, concerns as to interest and business rates increased.

Investment

Changes in investment plans were reported by 29%, and an upward trend in investment was reported.

Finance

Cash flow trends over the three months to the end of 1999 worsened (a net of -24%). Expectations of turnover and profitability over the next year are weaker than in the fourth quarter, and a net of firms now anticipate declining turnover and profitability.

The net of firms expecting to increase prices over the next quarter increased further to 27%. Pressures to raise prices again increased slightly, reflecting increased raw material and transport costs.

Employment

Changes to employment levels again affected a third, and the decline was worse than anticipated. Respondents continue to anticipate a decline in employment in the next quarter. 32% reported increasing pay by an average of 3.12% compared to an average increase of 3.21% in the previous quarter.

RETAIL DISTRIBUTION

Optimism

Changes in business confidence affected 54%, and the declining trend in business confidence eased to a net of -5% (the best trend since q3 1997).

Sales

The decline in sales was again marginally worse than had been anticipated, but the trend is the strongest since q2 1998. A further slight easing in the decline is forecast for the second quarter.

There was no evidence of increased pressures to raise prices in the first quarter. Concerns as to the level of competition remained the factor thought most likely to restrict sales, although concerns as to interest rates again increased.

Investment

The upward trend in investment plans continued.

Finance

Cash flow trends eased in the first quarter, although the trends remained negative. Expectations as to turnover and profitability over the next year are the same as three months ago, however expectations as to profitability over the next year strengthened, to the best figures since q1 1998.

Competitive pressures are continuing to inhibit price increases and expectations of price increases were slightly less than three months ago.

Employment

A marginal decrease in employment was reported (a net decrease of 7%). A marginal rise is forecast for the first quarter, although once again changes in employment were at the margin, affecting only 27% of respondents. 43% sought to recruit staff, and 32% increased pay by an average of 4.54% compared to an average increase of 3.68% in the previous quarter.

TOURISM

Optimism

Changes in business confidence were again widely reported, and a rise in confidence re-emerged as a net of 9% reported being more confident than three months earlier.

Demand

The decline in demand was again slightly worse than anticipated, with demand from all areas falling, although the rate of decline in demand from the rest of the UK eased. Average capacity used was two percentage points lower than in the first quarter of 1999, but one percentage point lower than in the first quarter of 1998.

Investment

Investment continued to rise, although for more than 98% 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 first quarter of 2000 were better than expected, but costs rose by slightly more than had been anticipated. Discounting of prices was more evident, but less than had been anticipated. Discounting of prices is expected to decrease in the second quarter of 2000.

Employment

61% reported no change to overall employment levels and the decline in employment was as had been anticipated.

Recruitment

Recruitment activity remained high with 85% seeking staff. Two thirds of those recruiting staff reported difficulties in attracting suitable staffs, most notably skilled and other manual staffs. 27% reported increasing pay by an average of 5.2%.

CONSTRUCTION

The latest Lloyds TSB House Price Monitor showed Scottish house prices remaining static compared to some spectacular gains in the summer of 1999. According to the Monitor house prices remained unchanged during the three months ending April 2000, leaving them six per cent higher than one year ago. The eight per cent surge recorded in one quarter last summer has been partially reversed.

The first time buyers' market remains buoyant with 43 per cent of all new borrowing coming from this sector. The average first time buyers' price of £42,579 is up 2.2 per cent in the quarter and 3.9 per cent over the year. The average price of a non-first time buyers' property fell 4.6 per cent in the quarter to £70,164 but showed an increase of 3.1 per cent over the last 12 months.

Donald MacRae, chief economist, Lloyds TSB Scotland, said: "The Scottish housing market continues to exhibit a high degree of variation. Aberdeen has recovered from the uncertainty caused by the rise and fall in the price of oil and is now recording an annual price increase of 6.9 per cent."

He continued: "The number of transactions has fallen in Edinburgh, suggesting people are postponing house sales and this is pushing up prices. Areas outside cities generally show less price variation and are all recording annual price increases from 5.2 per cent in the south west outside Glasgow to 11.6 per cent in the south east omitting Edinburgh. The north excluding Aberdeen is displaying an annual price increase of 8.1 per cent. A combination of earnings growth, above trend economic growth, the lowest unemployment for 24 years, the lowest inflation in Europe and a high level of consumer optimism have not lead to any unsustainable housing market boom. Scottish house price growth at six per cent year on year continues to convey the advantages of affordable prices for new entrants and overall growth in value. There should be no inflationary concerns generated by the Scottish housing market."

According to the latest Halifax House Price Index the UK housing market remains buoyant, but the quarterly growth in house prices for the nation as a whole slowed for the second successive quarter during the first three months of 2000. House price growth eased markedly in Greater London and the South East where it appears that the sharp rises in prices over the past year are making it increasingly difficult for potential buyers to enter the market, therefore curbing demand. Despite a rise in prices of more than 5% in the West Midlands, there is little evidence that last year's rapid house price growth in the south of England is more generally spreading out to the rest of the country.

UK house prices rose by 3.2% in the first quarter. This represented a modest slowdown compared with the fourth quarter of 1999 when prices rose by 3.6% and compared with a 4.4% rise in the third quarter of last year when prices were rising particularly rapidly. Despite the slowdown in the quarterly rate of growth, annual house-price inflation accelerated to 14.5% in the first quarter from 11.5% in the previous quarter. This is the highest annual rate since 1989 Q2, but remains well below the 34% peak recorded in the final three months of 1988. Prices increased by at least 1% in all 12 regions during the first three months of this year. The biggest quarterly gains were in the West Midlands (5.1%) and the South West (5.0%). East Anglia (4.4%) and Greater London (4.0%) also reported substantial price rises. Prices in East Anglia and Greater London, however, increased at a slower rate than in the fourth quarter of 1999. House price growth was markedly weaker elsewhere. The smallest rises on a quarterly basis were in the North (1.0%), Wales (1.3%), Scotland (1.3%), the North West (1.7%) and Northern Ireland (1.8%).

At a Scottish level the Halifax noted that house prices continue to rise in Scotland with the Standardised Average Price in Scotland being £64,671. House Prices in Scotland rose by 1.3% during the first three months of 2000. Annually, house prices in Scotland are now almost 8% above twelve months ago, giving further evidence of a slow but steady rise in property prices. The average home buyer in Scotland now spends just under 21% of their gross annual income on mortgage payments compared to a peak of over 28% in 1990.

Commenting upon the housing market in Scotland, Geoff Mackrell, General Manager for the Halifax, said:

"House prices in Scotland continue their steady increase. In Edinburgh and Glasgow demand continues to outstrip supply which as a consequence is pushing up prices. There is a ripple-effect being seen with outlying areas of Edinburgh and Glasgow also witnessing increases in house prices. A consequence of rising prices in these areas is that it is making it difficult for first time buyers to get into the market. Recent changes to Mortgage Interest Tax Relief and mortgage rates may start to impact the housing market during the second quarter."

The Construction Confederation's latest Trends Survey shows a jump in construction output growth during the first quarter of 2000. Sentiment about future workloads is still positive, but has moderated since the last survey.

The Survey found that contractors' tender success and new enquiries also rose during the first quarter, but their growth eased significantly compared to the fourth quarter of 1999. Southern-based contractors recorded the biggest rise in workloads during the first quarter, while those in the Midlands recorded the deepest fall. Looking ahead, Eastern contractors are the most bullish, and the Welsh are the most downbeat. The private housing sector recorded the biggest rise in output, but contractors are most bullish about industrial. Sentiment is also stronger for infrastructure work, which has previously been in the doldrums. Labour market pressure is still high, with a similar proportion of companies experiencing difficulties recruiting the key construction trades. Labour and material cost growth is also edging upwards.

The overall findings of the Survey were as follows.

- The balance of companies' workload growth rose from 18% to 23%, and when adjusted for seasonal factors, the output balance picked up further from 26% to 29%. The balance of new enquiries fell from 19% to 6%. Adjusting for seasonal factors it fell from 9% to 4%.

- Optimism regarding the next quarter's workloads rose from 18% to 40% of companies expecting higher output. Looking twelve months ahead, the balance of companies expecting higher workloads dipped from 54% to 42%.

- The balance of workload growth for Midlands and Welsh contractors fell. Southern contractors' output balance rose the fastest throughout the regions (59%), while national contractors workloads picked up even further (44%).

- Output, again, rose strongly for the private house building sector (balance of 19%), but fell most markedly for new infrastructure and new public housing (balance of –17%). Builders' capacity utilisation rose from 58% to 67% of companies operating at or near full capacity. Civil engineering companies' utilisation fell slightly from 34% to 31%.

- Difficulties securing skilled labour changed little for most of the key construction trades. The proportion of companies reporting recruitment difficulties fell to 73% for bricklayers and 68% for plasterers, but rose to 74% for carpenters and joiners. Unit labour costs rose for a balance of 67% of companies, and a balance of 68% reporting higher materials costs. The balance expecting higher unit costs over the next quarter also rose since the last survey.

ENERGY

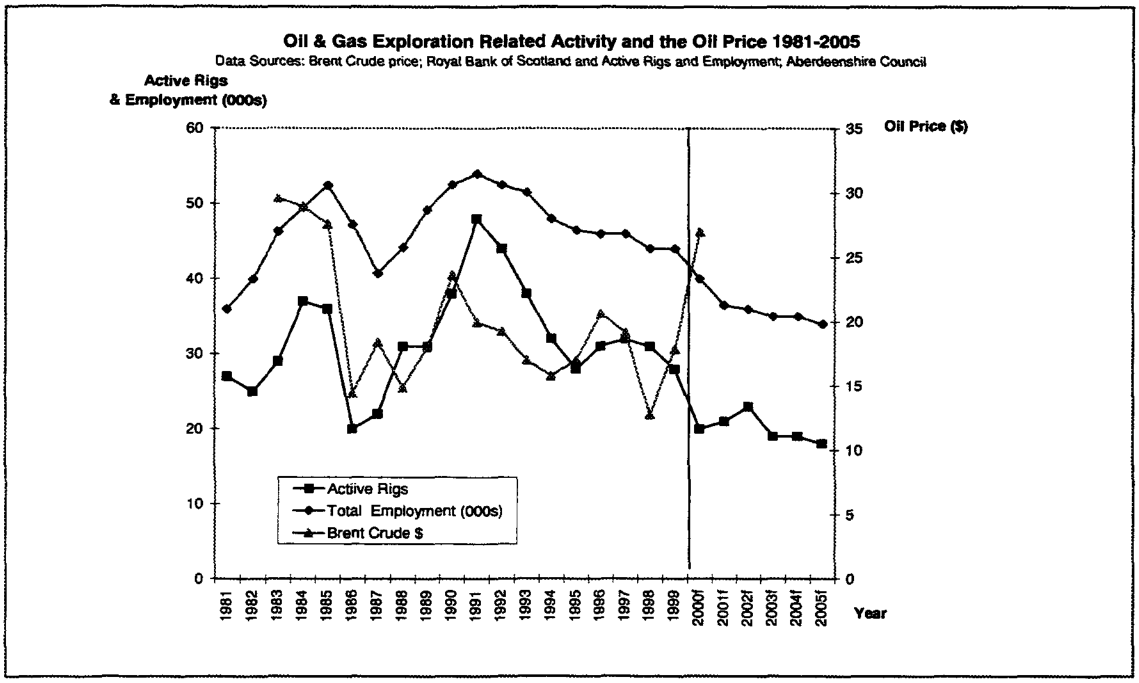
OIL AND GAS

The Royal Bank of Scotland Oil and Gas Index demonstrates that for oil production a drop of 2% was seen on both a quarterly (2000q1 on 1999q4) and an annual basis. Gas production has for the same periods shown similar increases of just over 10%. The Combined Index has grown by just over 3% on a quarterly and an annual basis. The oil price has risen by 11.8% for 2000q1 on 1999q4 but on a year ago the change is nearly 140%. Similar growth figures were recorded respectively for the Average Daily Oil Value. The Provisional Total Daily Oil Value has increased by 10.9% on a quarterly basis but over the year growth was 64.1%.

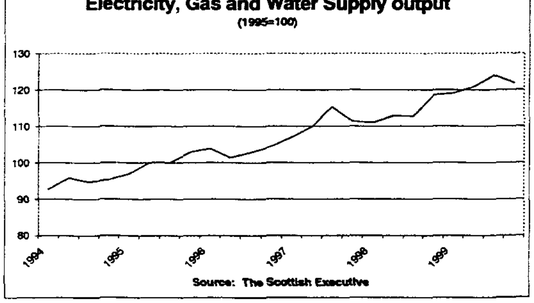
Over the first quarter of 2000 there has been slight growth in oil and gas production but since September 1999 the oil price (for Brent crude) has been above $20 a barrel and for February and March of this year was above $25 a barrel. The OPEC decision to increase output will depress the oil price slightly. Oil production from the North Sea has declined recently (see above) and the high oil price is only sustainable if the OPEC production constraints are adhered to. Gas output will start to demonstrate its seasonal decline in the spring. The critical factor in the oil and gas industry will be the actions of OPEC and the effects they have on the oil price. Global economic growth is also important because if the US continues to grow strongly then the demand for oil will remain relatively strong.

It can be seen quite clearly however from Figure 1 that while the oil price may be rising (and to a certain extent North Sea oil production may follow this) it is clear that exploration and total oil related activity (given by employment) are on a steady downward trend. This has been the trend since 1991. This is because the North Sea is a mature high cost province, despite the CRINE initiatives, and many major fields no longer offer significant development opportunities. This is supported by the fact that many oil majors have sold on some fields to operators who specialise in low cost extraction or marginal field development. This does not mean the end of North Sea oil production, this will continue as many fields still provide excellent revenue streams and only require a care and maintenance programme.

The picture for onshore and offshore contractors however is bleaker. Forecasts of employment by Aberdeenshire Council show a steady decline in oil related employment and the number of rigs involved in exploration is expected to fall below 20 by the year 2005. Many of the yards that service the Northern and Central North Sea have no further significant orders and rationalisation or closure is only a matter of time. The future of the North Sea oil and gas industry is to export its services and technical expertise to other areas of the world. The challenge for those with responsibility for economic development in areas with oil and gas related employment is to either attract new industry to replace jobs that will ultimately be lost or to help companies to develop their potential elsewhere.



OPEC has agreed (excluding Iran) to increase oil production by 1.45mbpd, a 7% increase. The deal cut the price of North Sea Brent by around one dollar and the price of West Texas crude also fell sharply following the announcement. In total the nine members will produce 21.069mbpd. The real winners here are the US (the world's biggest oil consumer) and Asian economies where a small price reduction will alleviate inflationary fears. This movement has kept the oil price in the $22-27 price range that OPEC unofficially targets.



While there is a gradual slowdown in the oil and gas industry three multinationals (Marathon, Enterprise and Agip) are to invest £30 million for three tranches off the Western Isles. This will be particularly important for the Lewis yard in Stornoway, which employed up to 500 people but is now on a care and maintenance basis only. Weatherford are to expand their Aberdeen and Arbroath workforce by 200 over the next four years. The company will invest £5.35 million and the Scottish Executive will provide £2.25 million through Regional Selective Assistance. Aberdeen will become the R&D centre while Arbroath will be the manufacturing site. The firm currently employs 130 in Aberdeen and 40 at Arbroath.

A recent survey carried out by the Royal Bank of Scotland and Scottish Enterprise has shown that 2/3 of oil service and supply firms see the 33% reduction (between 1998 and 2002) in the price of a barrel of oil as unachievable. Many feel that contractors have been squeezed to the limit. 66% of firms reported lower volumes than last year and one in three have suffered a decline of more than 20%. Lower volumes have led to lower prices but the Offshore Contractors Association has warned of a loss of skilled personnel to other sectors of the economy. Two positive findings were; 80% of companies are currently exporting to an average of four countries and secondly firms are also diversifying into other industrial sectors.

UTILITIES

The Index of Production supplied by the Scottish Executive for 1999q4 on 1999q3 shows that for Electricity Gas and Water Supply growth was -1.7% with the index falling to 121.9. This compares against the UK figure of -0.1. On an annual basis for the latest four quarters on the preceding four quarters growth is 6.7% in Scotland but only 2.0% in the UK. The main contribution over the year is electricity exports.

Scottish Power Technology is expected to be bought out by their management with the 440 workers being retained at East Kilbride. The value of the buyout is estimated at £14 million and backers include the 3i group. It is expected to figure strongly in its core business areas of servicing consultancy and power station equipment maintenance. The company had a turnover of £24 million last year. ScottishPower is selling off non-core businesses in order to raise funds for the £3.6 billion take-over of Pacificorp.

British Energy (BE) may have to face a competition inquiry if it does not accept a new licence where the aim is to stop alleged price rigging in the wholesale electricity market. The Office of Gas and Electricity Markets is referring BE and one other generator (AES) to the Competition Commission for not accepting the 'market abuse condition.' Five others - BNFL Magnox, Edison Mission Energy, National Power, PowerGen and TXU Europe have all agreed to the clause. Concerns arose after sharp prices rises were recorded last July (from £30 one week to more than £47 per megawatt hour). In the first week in July average prices were 80% higher than in the same period in 1998.

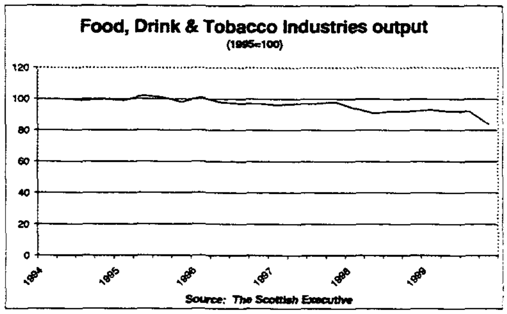
ScottishPower and Manweb are the first company to enter the competitive market for domestic and small business metering. This was previously done by the local electricity supply company giving rise to local monopolies.

MANUFACTURING

FOOD, DRINK AND TOBACCO

The Scottish Executive Index of Production for the Food, Drink and Tobacco sector in Scotland stood at 84 in the 4th quarter of 1999 (1995=100), a reduction of 8.2% from its level in the previous quarter. Output levels fell over the year to the 4th quarter by 2%, compared to 1% across the industry in the UK. The overall reduction is due to reduced output levels in both the drinks and food and tobacco sectors. The Drink index fell from 94 in the third quarter to 86 in the fourth, and food and tobacco fell from 90 to 83. Both sectors of the industry therefore appear to have suffered adverse short-term movements in the final quarter of last year. Both sectors have also performed poorly when measured against the industry across the UK, where drink output fell in the fourth quarter by 3.6%, while food and tobacco output increased by 1%.

The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey show a slightly reduced level of optimism across the industry in Scotland - 20% indicated that they were less optimistic than three months previously compared to 17% who felt more optimistic. This result does appear slightly curious given that a net 20% indicated an upward trend in sales, that a net 14% indicated a trend increase in new orders, and that both trends are expected to continue in the short term. Firms may still be recovering from the 4th quarter experience discussed above, and indeed the survey did indicate that capacity utilisation is still considerably below the level seen one year previously.

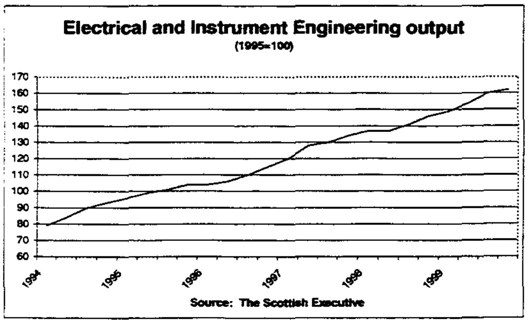


News among Scottish companies includes the Competition Commission's announcement of its finding that the milk company Wiseman has been guilty of operating a monopoly in Scotland. While this is perhaps no great surprise given that it controls around 85% of the Scottish market, what is important is that having determined the existence of a monopoly, the Commission will now investigate whether Wiseman has used its dominant position in Scotland to act in an uncompetitive manner and abused its dominant position to the detriment of Scottish consumers. The news does not, however, appear to have prevented Wiseman from its plans to expand outside Scotland. Despite the failure of its attempts to purchase Unigate's dairy business, which has been bought by Dairy Crest, it has announced that it will continue to seek to increase its share of the UK market by seeking to purchase smaller English-based operators.

In brewing, Whitbread has announced plans to create some 500 new jobs in Scotland through a £20 million investment in hotels and bars. And Scotland's main brewer, Scottish and Newcastle, has become one of Europe's largest drinks companies with the acquisition of the French firm Danone's drink interests. Danone's brands are already well known in the UK, and include names like Kronenburg and Peroni.

ELECTRICAL AND INSTRUMENT ENGINEERING

The Scottish Executive Index of Production for the Electrical and Instrument Engineering (EIE) sector in Scotland stood at 162 in the 4th quarter of 1999 (1995=100), an increase of 1.3% from its level in the previous quarter. Output levels increased over the year to the 4th quarter by 11.5%, compared to a 7.0% increase across the industry in the UK. The industry's annual performance contrasts strongly, yet again, with that seen in other manufacturing sectors in Scotland. For example, EIE's performance over the year was much stronger than that seen in Mechanical Engineering, where output fell by 7.3%. EIE also compares favourably with Transport Equipment (where output increased by only 2.1% over the year to the fourth quarter), Paper Printing and Publishing (which recorded a 0.9% fall in output) and Other Manufacturing (where output fell by 4.1%).



The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey appear to indicate, however, that the growth path may not be as sustainable over the coming period. Forty-one percent of respondents to the most recent survey indicated that the overall trend in sales was downward, compared to 29% who indicated an upward trend. Similarly, 42.3% indicate a downward trend in new orders compared to 26% who indicated that the trend in new orders was rising, and 44% said that they were running below the level of capacity utilisation seen one year previously. Investment intentions were marginally down across the industry.

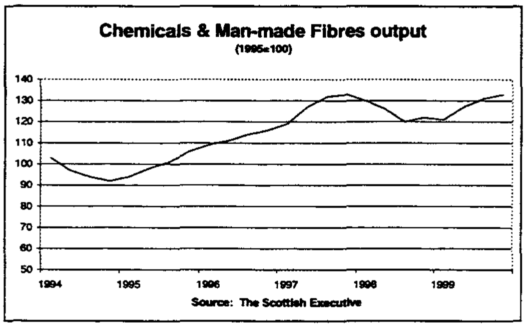
In the company sector, Sun Microsystems is to increase the workforce at its Linlithgow facility by around 200, as part of a new £30 million investment. Sun concentrates on high value, company specific products, and the investment is intended to allow it to develop this aspect of its operations. The company currently employs some 900 people at Linlithgow, one of only three plants operated by Sun.

NEC is to invest a further £60 million at its plant in Livingston. The plant currently produces chips, but NEC is apparently keen to diversify its output towards integrated circuits. While the £60 million is itself a relatively modest sum, what is perhaps more important is NEC's recognition that the plant is able to extend its capabilities away from its initial product, something which represents a vote of confidence for the plant's workforce.

Finally NCR has announced the construction of a new R&D facility in Dundee, which will employ 500 people. While most will be re-deployed from existing sites in the city, some new research on web-enabled automatic telling machines will also be undertaken at the new site.

CHEMICALS

The latest Index of Production for Scotland recorded an increase of 1.0% during the fourth quarter for the Chemical and Man Made fibre sector. In the four quarters to 1999 Q4 output stood at 3.1% compared to the four quarters to 1998 Q4. The corresponding figures for the sector across the UK show increases of 2.9% for the fourth quarter while year on year output rose by 3.1%.



Despite increasing output evidence from the first quarter Deloitte & Touche Scottish Chambers' Business Survey would suggest that respondents within the Chemicals sector remain despondent about the general business situation compared to both the previous quarter and the same quarter one year earlier, nets of -31% and -15% respectively.

The continuing decline in confidence reflected the trends in orders and sales as demand from all areas declined for a net of firms. Little change is forecast for the current quarter as once again a net of firms anticipate demand continuing to decline during the current quarter. Firms appeared to be concerned with a variety of factors although most significantly interest rates, exchange rates and orders/sales.

Cash flow continued to decline over the first quarter with only 15% reporting an increase while almost half noted a declining trend. Over the current year firms expect both profitability and turnover to improve. Price changes over the first quarter were essentially at the margin, as almost 70% reported no change (a net of +15%). The factors most likely to affect prices are transport costs, cited by 38% and raw material prices, cited by 31%.

On balance, firms revised investment intentions in plant/equipment and land/buildings downward and little change is forecast for the current quarter. Investment authorised during the first quarter was generally directed toward replacement and reduction of labour.

Changes in employment were essentially at the margin with 15% of respondents both increasing and decreasing employment however a net of firms do expect to reduce total employment during the current quarter.

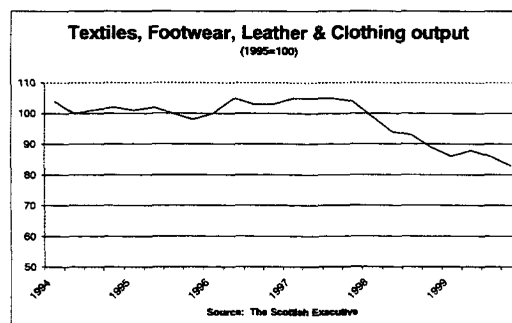
Recent company news includes the announcement that Axis Shield, the Scottish-Norwegian medical diagnostics company, has received regulatory approval from the US Food and Drug Administration to start selling its long-term monitoring test for diabetes. Scotia Holdings announced that it is considering legal action for libel following a report in the British Medical Journal that its drug for head and neck cancer had caused burns to volunteers. The news triggered a sharp fall in Scotia's share price as investors worried this could affect regulatory approval of the drug.

Figures released recently showed the biggest percentage fall since 1994 in Britain's trade surplus in pharmaceuticals. The 1999 surplus in medicines fell 16% to £2.06 billion from £2.46 billion the previous year confirming fears that the UK environment for pharmaceuticals is not as encouraging as it has been in the past due in part to the strong pound.

TEXTILES, FOOTWEAR, LEATHER AND CLOTHING

The Scottish Executive Index of Production for the Textiles, Footwear, Leather and Clothing sector in Scotland stood at 83 in the 4th quarter of 1999 (1995=100), a reduction of 3% from its level in the previous quarter. Output levels fell over the year to the 4th quarter by a staggering 8% (compared to a 6% reduction across the industry in the UK), another reflection of the difficulties seen in the industry Scotland in recent months.

Somewhat surprisingly perhaps, the more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey (SCBS) do not indicate a wholesale panic amongst textile producers. While 26% of companies report feeling less optimistic than three months previously, another 21% report an increase in optimism. Similarly, while 38% report a downward trend in new orders, some 33% report that the orders position improved in the previous three months. The worst may be over, and the fact that the new orders position improved significantly over the sales picture may also be an indication of a turning point. However, capacity utilisation remains low at 71%, and 63% of respondents indicated that they were using less capacity than one year previously.



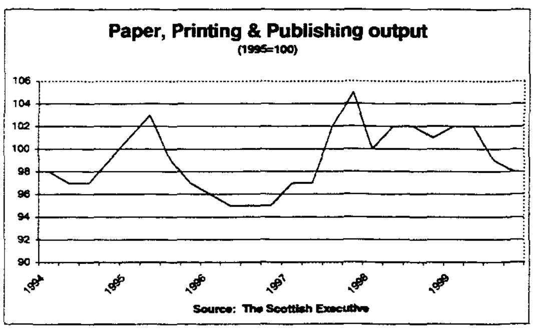
Reflecting the above, the recent news from Scottish companies paints a picture of more gloom. In March, Daks-Simpson announced that it would shed around 600 jobs following the loss of the long-term Marks & Spencer contract. Marks & Spencer's decision arose from its own need to source more from abroad in order to reduce costs. While the current strength of the pound is clearly a problem for the industry, reports (for example, the Financial Times, 18th May 2000, p2) suggest that this is only exacerbating the fact that the UK cannot compete in a relatively low-skilled area such as textiles, and more job losses may follow. The FT report above suggests that up to 30,000 jobs may go in the remainder of this year.

Another company that has suffered in the fallout from Marks & Spencer's restructuring is Courtaulds, which intends to close its lingerie factory in Wishaw, which employs 150. Dawson International intends to close two mills, one in Selkirk and the other in Dalkeith, both operated by its Laidlaw and Fairgreave subsidiary.

However, one recent development is more promising for the industry, the governments' announcement of a new package of measures in response to the recent rash of closures. The package only provides for a relatively small amount of financial aid, around £10 million, although the government has indicated that this is merely the first tranche of assistance. What maybe more important, however, is that the authorities have finally managed to recognise that textiles industry has problems, and is prepared to do something to help.

PAPER, PRINTING AND PUBLISHING

The most recent Index of Production (May 2000) reveals that output growth in the Paper, Printing and Publishing (PPP) sector in Scotland fell by 1.3 per cent in the final quarter of 1999. Over the year to December 1999, growth in this sector fell by 0.9 per cent, despite the increases in output growth in the first two quarters of the year. The most recent production statistics also reveal that the UK PPP sector recorded a slight fall in quarterly output growth of 0.1% between quarters 3 and 4 of 1999. However, annualised output growth, to December 1999, for the UK paper, printing and publishing sector was positive at 0.8 per cent.



The most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggests that the difficult trading conditions noted by respondents in the previous survey continue. The general business outlook by respondents in the first quarter of 2000 indicate that around one quarter of respondent firms are less confident about the general business climate than three month previous. However, as compared with one year previous, there is a positive net balance of respondents (difference between number of respondents that are more confident as compared with number of respondents less confident) more positive about the general business climate.

The anticipated increases in demand for both total orders and sales, noted by respondents in the previous Quarterly Commentary, were not realised in the first quarter of 2000. Both the general trends in total orders and sales were down for a positive net balance of respondent firms. Across Scottish, RUK and export markets, Scottish orders and sales were worst affected, however the trend in both export orders and sales was positive over this period for a positive net balance of respondent firms. DTSCBS respondents anticipate a positive increase in the trend in both orders and sales in the second quarter of 2000, of which, Scottish and RUK orders and sales are expected to bounce back, with export orders and sales remaining positive.

The average level of capacity utilisation for the Paper, Printing and Publishing sector fell by over 5 per cent to 74.6 in the first quarter of 2000. Investment intentions in this sector, over the past quarter, remained unchanged for the majority of PPP respondents. However, of those who revised their intentions, both plant and equipment and land and buildings investment were revised upward.

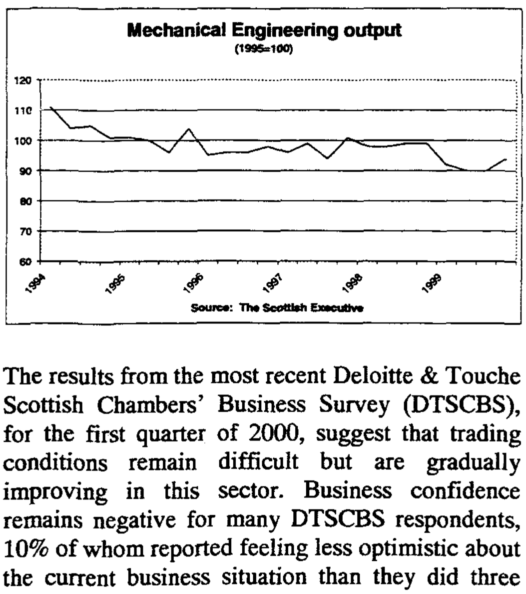
The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that changes in total employment affected around 20 per cent of respondents, with the previous reported declines in employment, which affected a net 23% of respondents in the final quarter of 1999 ended. Thus, of those respondents affected by employment change in the first quarter of 2000, a small positive net balance increased total employment. However, respondents, as anticipated in the previous Quarterly Commentary, expect a fall in total employment in the second quarter of 2000. Finally, over the first quarter of 2000, just over 12 per cent of all respondents increased wages and salaries by an average 2.7 per cent.

In summary trading conditions remain difficult within this sector with both the decrease in business confidence, noted by DTSCBS respondents in first quarter of 2000, and the downward trends in total orders and sales recorded in this period. However, respondents are confident that both turnover and profitability will increase over the forthcoming year. In general, it is difficult to forecast output growth in this sector given the sector's recent performance. Accordingly, sustained output growth will remain difficult for this sector.

In the company sector, Low and Bonar (Dundee-based packaging group), which is set to locate its headquarters in London is keen to dispose of its European packaging interests. The company is restructuring and wishes to focus on speciality materials and plastics. Included in any potential sale is the cartons operation it bought for £67 million from Waddington in 1998, as well as a smaller polymers business. Finally, the Scotsman newspaper hopes to revive flagging circulation and internal disruption with a new £4 million revamp and launch of the paper. The group has more than halved the cover price of the paper in a bid to broaden the geographical and social reach of the paper.

MECHANICAL ENGINEERING

The most recent Index of Production for the Mechanical Engineering sector in Scotland reported a 4.2% quarterly increase in output for the fourth quarter of 1999. This compares with a 2% increase across all engineering, and is the first observation of positive growth for the Scottish mechanical engineering sector for the last four quarters. Moreover it suggests that the Scottish sector is performing well relative to the rest of the UK, with the corresponding figure for mechanical engineering at the UK level showing a 0.4% decrease in output for the fourth quarter of 1999. However year on year growth for the Mechanical Engineering sector in Scotland (in the year from the fourth quarter of 1998) shows output remaining down on the levels recorded at the same time one year ago, with a 7.3% fall in output recorded. This compares with –5.6% figure for annualised growth at the UK level.



The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS), for the first quarter of 2000, suggest that trading conditions remain difficult but are gradually improving in this sector. Business confidence remains negative for many DTSCBS respondents, 10% of whom reported feeling less optimistic about the current business situation than they did three months previous, and 31% of respondents said that they feel less optimistic than they did one year ago. However these figures are notably lower than those reported in the previous quarter's survey.

Underlying continued lack of confidence in much of the sector still appears to be the reported trends in total orders and sales over the previous quarter. DTSCBS respondents continue to report declining orders across all markets, with 27.3% reporting falling Scottish, 25.8% declining rest of UK and 18.2% falling export orders. However, these figures compare with 50%, 48.1% and 22.6% respectively for the previous quarter, suggesting that the decline in orders is slowing. This is reflected by the view of the majority of respondents that orders are expected to remain level over the next three months and the majority of respondents do expect turnover (59%) and profitability (46.2%) to improve over the next twelve months.

The average level of capacity utilisation for the Mechanical Engineering sector for the first quarter of 2000 was marginally up at 75.38%, but with 48.7% reporting their capacity utilisation to be less than in the same period last year. 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 25.6% of respondents reducing employment relative to the previous quarter. Over the last quarter 56.4% of respondents reported no change in wages and salaries, but the 43.6% who did increase wages and salaries did so by an average of 3.19%.

In summary trading conditions in the first quarter of 2000 would appear to be slowly improving within this sector with quarterly output growth becoming positive, though down on the level reported this time last year. However a number of firms still report experiencing falling sales and new orders across all markets, and a third of firms continued to report feeling less confident than they did 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 51.3% of respondents reporting that this is more of a concern to their businesses than three months ago. The other key, and growing, concern reported was again interest rates, with 41% reporting this factor as a greater concern than three months ago. This increased concern over interest rates was notable in the previous quarter's survey, where the number of respondents citing interest rates as a concerning factor had risen from around 9% to 37%. The growing concern over this factor reflects that reported nation-wide over the tightening of monetary policy by the MPC.

In the company sector, there has been renewed uncertainty over the future of the Govan shipyard, sold recently by Kvaerner to BAe systems, as a decision is anticipated by the MoD over the £300 million order for six roll-on, roll-off ferries. There has been varied speculation as to whether Govan will lose out to a more competitive bid from a German shipbuilding consortium, or whether at least part of the contract may be awarded to the Sealion consortium, of which BAe Systems is part. The fear is that BAe's Govan yard will be forced to close if it fails to win at least part of the order. At the time of going to press no final decision from the MoD had been announced.

However there was some positive news for shipbuilding on the Clyde, with the smaller Ferguson Shipbuilders in Port Glasgow reporting a busy order book for smaller commercial orders. Nevertheless, in general the shipbuilding industry world-wide is troubled with a world over-capacity of some 15-25%. There have been positive moves in the industry at the UK level to combat the negative effects of rivalry between UK yards for orders, however. The Shipbuilders & Ship Repairers Association are leading a project for British yards to work together to win new orders following threats of closure at two of the UK's biggest yards, Harland & Wolff in Belfast and the yard at Govan. This has involved applications for government funds to set up a joint marketing scheme. The project has gained particular support from smaller yards, many of which are currently surviving order by order, and would like to see similar results to those realised by a similar and very successful 40-year collaboration by ten yards in the Dutch town of Gronigan.

The Weir Group, Scotland's biggest engineering business, continues to face difficulties. The group has seen increased activity in its operations abroad, and has been reported as planning more expansion via acquisition following last year's £195 million purchase or Warman International. However, it reports that its UK-based companies continue to experience difficulties with meeting budgeted levels of input. A profits warning for the first half of the year announced in May caused the group's share price to slide once again, despite the fact that the announcement was accompanied by predictions of a stronger second half.

SERVICES

WHOLESALE AND RETAIL DISTRIBUTION

After disappointing figures in January, February saw a welcome increase in sales growth in Scotland. The Scottish Retail Consortium/Royal Bank of Scotland Retail Sales Monitor recorded growth in sales of 4.1% in total, more than double January's 2% growth rate. Total sales growth in Scotland was still a little below the growth rate of 5.9% seen in the UK as a whole. However, the margin between Scotland and the UK generally had narrowed since January, when sales growth in Scotland was 4.5% lower than the UK rate. The three-month moving average for growth in retail sales in Scotland improved to 4.2% from 3.5% last month on a total basis.

According to the ONS in March the seasonally adjusted estimate of retail sales volume is 119.2. This is 0.5 per cent above the February figure and 4.6 per cent higher than the March 1999 level. In January to March the volume of sales was 1.5 per cent higher than in the previous three months and 5.1 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 March was £3,690 million, 1.6 per cent higher than in March 1999. In January to March the value of sales in current prices was 3.1 per cent higher than in the same period a year earlier.

The all items retail prices index (RPI) rose by 1.0 per cent over the month to stand at 170.1 for April. In the twelve months to April, the all items RPI rose by 3.0 per cent, up from 2.6 per cent for March. Over the same period, the all items excluding mortgage interest payments index (RPIX) rose by 1.9 per cent, down from 2.0 per cent for the previous month. In the twelve months to April, the UK harmonised index of consumer prices (HICP) rose by 0.6 per cent, down from 0.7 per cent in March.

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) for the first quarter of 2000 showed the decline in wholesale business optimism continued, although more than two thirds reported no change. Changes in retail business confidence affected 54%, and the declining trend in business confidence eased to a net of -5% (the best trend since q3 1997).

Wholesale respondents had forecast a decline in sales for the first quarter, and the net decline of 17% was as anticipated. The decline is forecast to continue through the second quarter. The decline in retail sales was again marginally worse than had been anticipated, but the trend is the strongest since q2 1998. A further slight easing in the decline is forecast for the second quarter.

Concerns as to competition were cited by 67% of DTSCBS wholesalers as the factor thought most likely to limit activity in the second quarter, concerns as to interest and business rates increased. There was no evidence of increased pressures to raise retail prices in the first quarter. Concerns as to the level of competition remained the factor thought most likely to restrict retail sales, although concerns as to interest rates again increased.

Cash flow trends among wholesale firms over the three months to the end of 1999 worsened (a net of -24%). Expectations of turnover and profitability over the next year are weaker than in the fourth quarter, and a net of wholesale firms now anticipate declining turnover and profitability. Among retailers cash flow trends eased in the first quarter, although the trends remained negative. Expectations as to retail turnover and profitability over the next year are the same as three months ago, however expectations as to profitability over the next year strengthened, to the best figures since q1 1998.

The net of wholesale firms expecting to increase prices over the next quarter increased further to 27% and pressures to raise prices again increased slightly, reflecting increased raw material and transport costs. Competitive pressures are continuing to inhibit retail price increases and expectations of price increases were slightly less than three months ago.

Changes to wholesale employment levels again affected a third, and the decline was worse than anticipated. A marginal decrease in retail employment was reported (a net decrease of 7%). 32% of DTSCBS wholesale firms reported increasing pay by an average of 3.12% compared to an average increase of 3.21% in the previous quarter. 32% of retailers increased pay by an average of 4.54% compared to an average increase of 3.68% in the previous quarter.

Retail sales volumes picked up over the year to April but fell short of expectations, according to a survey by the CBI. The latest CBI Monthly Distributive Trades Survey, covering sales from 5 to 25 April, shows 53 per cent of retailers' sales were up while 20 per cent were down, giving a plus 33 per cent balance. However, growth in sales failed to meet retailers' expectations - the balance for sales expected in the previous survey was plus 47 per cent. The three monthly average, which smooths out month to month fluctuations, has remained broadly stable since March, indicating steady growth. Companies expect growth to continue at a faster rate over the coming month (although expectations of accelerated growth in the previous survey were not met). Companies reporting the sharpest increases, when compared with a year ago, were grocers, furniture and carpet retailers, hardware, china and DIY stores, and chemists. Only footwear and leather retailers reported sharp falls.

TRANSPORT

Air

During the month of April more than 1 million passengers used Aberdeen, Edinburgh and Glasgow airports. This is a 4% increase on the same period last year. Growth was greatest at Edinburgh (8.8%) followed by Glasgow on 4.4% but at Aberdeen a contraction of 5.7% was experienced. With more than 14 million passengers for the year up to April using all three airports this represents an increase of 5.5%. The growth of international traffic outpaced that of domestic traffic with increases of 12.6% (up to more than 5 million passengers) and 2% (up to 9 million passengers) respectively. Within the BAA Group Stansted emerged as the fastest growing airport in Europe with growth to the end of March of 34.4%, up to 9.9 million passengers. The airport is to receive a £200 million new terminal increasing capacity to 15 million passengers. Gatwick airport is having a £100 million investment bringing capacity to 100 million passengers although the Heathrow 5th terminal will cost £1.8 billion and raise capacity to 80 million passengers. Heathrow and Gatwick had only modest growth at 2.1% and 2.9% respectively with passenger numbers rising to 62.3 million and 30.4 million. A similar pattern is seen when traffic growth is examined with European growth increasing more than domestic traffic.

Despite previously announcing the cancellation of the air freight service to Prestwick Fed-Ex is now flying a twice daily service to Glasgow Airport. This comes as speculation mounts over a business consortium that wishes to mount a take-over for Prestwick from Stagecoach. BAA is currently building new warehousing facilities for the freight service and hope that the service could expand from the Short 360 jets to an Airbus service.

Rail

The Strategic Rail Authority have issued a forecast that total fare revenue could rise by £2.5 billion over the next ten years with passengers having an increased proportion of investment costs passed onto them. At the same time it is expected that rail subsidies will double to £2 billion. Rail operators estimate that the industry requires £50 billion of investment over the next ten years. The government response has been that any extra funds must be sought through private-public partnerships. £1.6 billion of 'premium payments' made by rail operators to the Treasury will be returned to the industry as investment. The government is due to publish its ten year transport strategy shortly and it is expected to present a coherent integrated transport strategy with a leading role for both road and rail.

Road

Bus delays, congestion, driver shortages, rising fuel costs and increased labour payments are factors that are apparently threatening bus privatisation operations across the whole of the UK. Passenger complaints have increased. Buses still account for more than 2/3 of public transport and 1 in three buses are late. Bus journeys grew by 10% last year but Stagecoach has experienced flat bus volumes and other industry sources are also concerned over growth in traffic.

The government is to cut £93 million from the trunk roads maintenance programme in England leaving spending at just 7.5% of the roads network. The Highways Agency (HA) has an extra £1.45 billion to spend but this is a cut of 2.5% in real terms. In an effort to maintain the level of service however £25 million will be transferred from the HA budget to local authorities. The British Roads Federation hit out at the move citing that spending had now fallen below the levels set out in the Comprehensive Spending Review which had allocated £794 million for next year and £780 million in the following year.

Sea

Forth Ports have reported rising sales and profits despite the collapse of business at Leith. Dundee and Tilbury provided strong performances that offset the loss of the Leith business. They expect business at Rosyth to grow and that would mean an increase in the current 350 strong workforce in the area. North Sea related cargoes were down (particularly pipes) but liquids and compressed gases were up. Tilbury had two new deals that significantly contributed to group performance with Finnish paper and Hyundai cars boosting tonnage by 14%, while at Dundee agricultural exports grew by 31% and dry cargo grew by 22%.