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.

The latest official data release showed a 0.2% increase in Scottish manufacturing output over the period 1992/1991, instead of a 0.8% fall as recorded previously. It also showed a slight fall (0.5%) in Scottish manufacturing output in the second quarter this year, in contrast to our prediction of a slight increase in Scottish manufacturing output in the same quarter as we reported in the previous issue of the Commentary. Despite the sign difference, the prediction of a weak performance of output growth by Scottish manufacturing industries in the second quarter is in keeping with the latest official data.

The present forecasting period extends to 1995Q3. Figure 1 depicts the actual growth rates for Scottish manufacturing output from 1988Q1 to 1994Q2 and the forecasts for 1994Q3 to 1995Q3. As is clear from the figure, the performance of output growth by Scottish manufacturing industries is predicted to remain weak until the final quarter this year. For 1994 as a whole, the output of Scottish manufacturing industries is predicted to rise by around 3.9% over 1993, partly driven by the strong growth in the UK manufacturing industries as a whole. The momentum of output growth picked up in the final quarter this is predicted to maintain well into the third quarter of 1995, indicating even faster growth rates in 1995 than in 1994. Further details of growth rates for Scottish manufacturing outputs are presented in the following table.

Figure 1. Output Index for Scottish Manufacturing Industries (Seasonally adjusted. 1990=100)

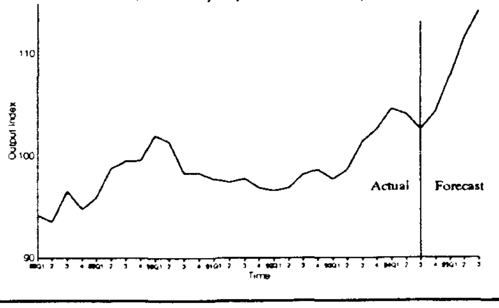


TABLE 1. QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)	
1992/91	0.2
1993/92	2.6
91Q4/90Q4	-1.4
92Q4/91Q4	1.9
93Q4/92Q4	4.1
94Q1/93Q4	1.8
94Q2/94Q1	-0.5
Forecast	
94Q3/94Q2	-1.4
94Q4/94Q3	1.6
95Q1/94Q4	3.5
95Q2/95Q1	3.3
95Q3/95Q2	2.4
1994/93	3.9

* 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.

SCOTTISH CHAMBERS' BUSINESS SURVEY - QUARTER 3 1994

The Scottish Chambers' Business Survey is conducted by Strathclyde University's Fraser of Allander Institute together with the Chambers of Commerce of Aberdeen, Central, Dundee, Edinburgh, Fife and Glasgow. It 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 during September, 1013 firms responded to the questionnaire. The main conclusions from the latest SCBS are discussed below.

Business Confidence

In Manufacturing, there was a further increase in business confidence, although the rise was at a slightly slower rate than in the previous quarter. A net balance of 18% of respondents reported that they were more optimistic than three months previously, compared with a net balance of 23% who were more optimistic in the second quarter. In the third quarter, Manufacturing respondents were more optimistic than they were in the same period a year ago, with a net balance of 32% of respondents reporting higher optimism. This compares with the situation in the second quarter where a balance of 38% of respondents were more optimistic than in the same period a year earlier.

In Construction, optimism continued to rise at much the same rate as in the second quarter. A net balance of 8% of respondents reported that they were more optimistic than in the previous quarter. This compares with a 9% balance of respondents who were more optimistic in the second quarter over the first quarter. A net balance of 20% of respondents reported that they were more optimistic than they were a year ago, a deterioration of 15 percentage points on the response in the second quarter.

In Distribution, confidence continued to fall in Retailing although at a slower rate, while in Wholesaling optimism remained positive, but with an increase somewhat less than in the second quarter. In Retailing, a net balance of 8% of respondents were *less* optimistic about the general business situation than they were in the second quarter, which compares with a negative balance of 15% in the second quarter. In Wholesaling, a net balance of 8% reported that they were more optimistic. This can be compared with a positive net balance of 11% in the previous quarter. A net balance of 15% of wholesalers reported that they were more confident than they were a year ago, while a net balance of 9% of retailers were *less* confident, a fall of three percentage points on the previous quarter.

Optimism among respondents from the Tourism and Leisure sector continued to rise but at a slower rate than in the second quarter. A net balance of 19% of respondents reported that they were more optimistic about the general business situation than they were three months earlier, compared with a balance of 36% in the second quarter. A net balance of 11% of respondents were more optimistic in the third quarter than in the same period of 1993.

Orders and Sales

In Manufacturing, orders and sales continued to increase strongly. For orders, a net balance of 23% of respondents reported an increase while, for sales, a balance of 23% of firms also experienced a rise. These figures compare with positive balances of 29% and 28%, respectively, in the second quarter. Orders and sales from all principal markets maintained growth. Export and rest of UK orders appeared to be stronger than those from the domestic Scottish market while for sales, the Scottish market appeared to be the more buoyant.

In Construction, there was a fall in new orders in the third quarter which, given the rise in optimism, may have been due to seasonal factors. A net balance of 4% reported a *decrease* in orders compared with the 11% positive balance in the second quarter. Orders from the private sector continued to be a source of growth in demand, while orders from Central Government were severely depressed after a marked deterioration over the second quarter.

Retail sales fell again in the third quarter. A net balance of 6% of retailers reported that sales had fallen, compared with the same balance of 6% reporting a decrease in the second quarter. In Wholesaling, sales rose at much the same rate as in the second quarter. A net balance of 21% of respondents reported a rise in sales, compared with a balance of 24% reporting an increase in the last survey.

Contrary to expectations, Tourism demand appeared to have barely increased in the third quarter, after rising markedly in the second quarter and falling in the first quarter. A net balance of 1% of companies reported an increase compared with the balance of 18% in the three months to June. Demand from rest of UK and abroad rose in the current quarter while the demand from domestic Scottish tourists fell.

Stock Adjustments

Stocks of finished goods in Manufacturing fell again in the third quarter, but with a smaller net balance of 6%, compared with 15% in the second quarter, reporting a decrease. Stocks of raw materials also continue to be run down, while work in progress continued to rise.

Finance and Investment

In the Financial sector, the demand for personal loans continued to rise. A net balance of 40% of respondents reported a rise, compared with the balance of 49% reporting an increase in the second quarter. Advances to the corporate sector were also still rising at broadly the same rate as in the previous quarter. The demand for working capital remained on an upward trend, with a further slight reduction in the rate of increase compared with the second quarter. The demand for finance for investment in buildings rose again in the third quarter following the reversal of the downward trend in the second quarter. In addition, the demand for finance for investment in plant and equipment appeared also to be rising again.

Manufacturing investment intentions in plant and machinery were revised upwards again in the third quarter and respondents expect to revise them upwards further in the fourth quarter. There was a further deterioration in manufacturers' investment intentions in land and buildings, with a net balance of 7% of respondents reporting a decline. In Retailing and Wholesaling, investment intentions continued to be positive. Net balances of 9% and 13% of retail and wholesale respondents, respectively, reported an upward revision in investment intentions compared to the same period a year ago. The investment intentions of Construction respondents became unfavourable again for plant and equipment, and continued further to decline for investment in buildings.

Expectations

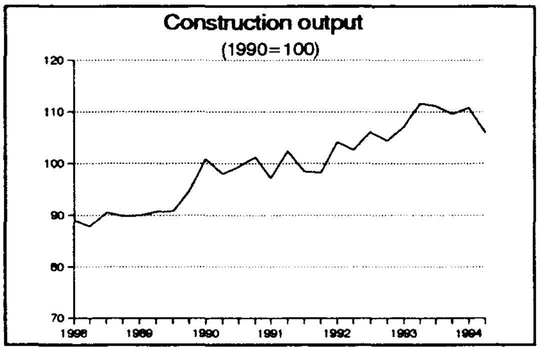
The outturn in the third quarter generally did not accord with the expectations of respondents in the second quarter, with the exception of manufacturing. In Construction and Retailing, second-quarter expectations were confounded by the decrease in orders and sales, while in Tourism the outturn for demand was significantly less strong than expected in the second quarter. Only in Wholesaling did the actual performance of demand outstrip expectations in the second quarter.

Demand conditions are generally expected to improve further in the final quarter of 1994. Construction respondents expect positive growth to resume, while In Manufacturing, the growth of demand is expected to be slightly faster. In Wholesaling the rate of growth is expected to slow down slightly, while in Retailing, there is the expectation that demand will return to an upward trend.

PRIMARY

CONSTRUCTION

The latest index of construction for the second quarter of 1994 shows that, in Scotland, after revisions to the previous quarter's figure, there was a fall of 4.5% to stand at 106.0, with a reported 0.9% increase in the year on year figure. The UK figure is 90.2, a quarterly increase of 0.9% and a year on year increase of 1.5%. This is the third consecutive quarterly increase in the UK, a sign of a strengthening recovery in the South. The Scottish picture is however less clear, the quarterly fall in the index is contrary to survey evidence and it may be that the current Scottish figure will be revised in the future.



The latest SCBS for the third quarter 1994, shows that construction optimism has improved for a net 8% of respondents and 20% saw an improvement over the same period in 1993. The expected upturn in new orders proved to be transitory, with a net 4% experiencing a fall. This could, however be a result of seasonality. The upward trend in private orders was weaker, falling from a balance of 15% to 5% in the quarter and the decline in central government and other public sector orders strengthened with 43% and 15%, respectively facing falling orders. This general decline in orders is not forecast to continue as an improvement in private sector orders is expected in the fourth quarter. The major limiting factor to output was cited as a lack of new orders/sales for 86% of respondents, a slight increase on the previous quarter and 11% cited a lack of skilled labour.

There was a slight drop in capacity utilisation to 79%, down 1% on the same quarter a year ago. Investment for replacement was the main reason cited by 51% of respondents; expansion and increasing efficiency were the main reasons for 19% and 12% respectively. Investment intentions in plant & equipment and land & existing buildings, were revised downwards by a net 2% and 12% of respondents respectively..

The optimistic employment forecast in the previous quarter did not materialise in the third quarter and a net 5% of respondents reduced overall employment. Once again there could be a seasonal explanation for this decline. Male and temporary employment were the main recipients of this reduction. Respondents forecast a slight improvement in the fourth quarter. Around half of all respondents reported reaching a wage settlement during the third quarter and the average increase was 2.7%, which was slightly up on the previous quarter. Recruitment difficulties increased for 22% of respondents, a considerable increase on the previous quarter, with the greatest difficulties in finding suitable skilled manual and technical staff. Edinburgh was the most buoyant of the chambers areas and expects to hold this position in the fourth quarter.

The latest NHBC figures for the third quarter 1994 show a 2.7% increase in housing starts in Scotland to 3,800. This compares with an 8.4% increase in GB as a whole. Applications for housing starts in the third quarter in Scotland fell by 16%, a part of which must be attributable to seasonal variations. This is most likely to be the reason behind the 7.7% fall in the UK. The underlying trend in Scotland is however downward. Scotland has 10% of the houses started in GB as a whole in the third quarter 1994, down 1% from the previous quarter. The NHBC first time buyers ability to buy index has been falling since its all time high in the first quarter 1994 of 117 to stand at 113. As a lead indicator of housing starts, with a time lag of two quarters this index has been very accurate since the early 1970s and is telling us that the number of housing starts is likely to fall in GB as a whole.

The Construction Industry Training Board (CITB) has recently launched recruitment targets for its new skills training strategy in a move to standardise requirements across the industry. The CITB plans to recruit 10,200 trainees in 1994-95, rising to 17,000 by 1996-97 in anticipation of a 1% annual growth in construction output. It is felt, however that this will only go halfway towards recouping the losses through natural wastage. This is a scheme that will operate throughout Great Britain and will train skilled craftsmen as well as manual labourers. The emphasis is on flexibility with six alternative "flexible routes" to training which accommodate changes in education and the industry itself. Recognising the increasing use of self-employed and labour only sub-contractors rather than employee craftsmen, the board has introduced grants for contractors to provide work experience or apprenticeships.

Glasgow based Hewden Stuart, Britain's biggest independent plant-hire group reported a 77% jump in profits in the six months to July to £16.2 million, on sales ahead by 39% to £128 million. This excellent performance is put down to Hewden Stuart's decision to invest throughout the recession, with an 18 month £100 million capital expenditure programme.

The major building societies show little or no change in house prices in the third quarter 1994, with prices around four percent up on the figures a year ago.

The development hotspot of North Lanarkshire continues to forge new property schemes. The latest is in Hamilton where a 70,000sq ft new office development costing nearly £12.3m, is planned for the town centre. It is the latest scheme to be undertaken by Akeler (Scotland) Ltd. The company was set up earlier this year by Akeler Developments plc with Scottish Enterprise and Lanarkshire Development Agency to bring forward projects in the enterprise zone. The company is already involved in developing the first phase of Hamilton International Technology Park, which is nearing completion on an EZ site.

Lothian Region Development Authority has recently completed the first phase of a new industrial estate on what was until recently a green field site at Newhailes, Musselborough. It is expected that the first building (which will be of 9,000 sq ft) will be completed by June of next year and the contract for this work has been given to Maxi Construction of Livingston. At present, LRDA has asked for design work to be carried out on a further 14,000sq ft of premises and it is hoped that the private sector will be encouraged to co-operate in the investment required for the development of these phases. The first phase of the development will comprise units of 2,000, 3,000 and 4,000sq ft of work spaces, with associated office accommodation of high quality specification. The cost to Lothian Region will be some £350,000. In addition, the work on site access roads, on utility servicing, and on landscaping will cost an additional £100,000. In total, this development will complement the British Coal Enterprise/East Lothian District Council development at Fisherrow nearby. The total area of the site is 10 acres and, assuming that the maximum potential of its development will be realised, there could be an area of industrial development of some 150,000 sq ft

The Institution of Civil Engineers, in their Scottish External Affairs Newsletter state that whilst the statistics show a slow but steady increase in overall workload in Scotland, other factors are now affecting the confidence of the construction industry. The effects of Local Government Reorganisation, which it seems will be carried out by some bodies reluctantly and in a spirit of non co-operation, can only mean a slowing down in the issue of contracts by Local Authorities during the transitional period. Also, whilst the resolution of future price increases for the Southern Water Companies has meant a release of work for companies in England and Wales, the opposite is true in Scotland where the impending transfer of water and drainage to three new boards yet to be established is likely to slow down the issue of contracts.

A further problem affecting confidence is that the increases in costs of materials, and in the going rates for skilled craftsmen which are sustained in areas of the country where the recovery from recession is stronger than in Scotland, are affecting both contractors locked into current fixed price contracts and contractors who are currently tendering on a fixed price basis. Unfortunately construction tender prices and rates have a lot of catching up to do before increases will follow the overall inflation figures.

FISHING

In the first nine months of 1994, the total value of landings of fish by British and foreign vessels in Scotland was £222,194,000, 3.7% higher than the figure for the corresponding period of 1993. At the level of the three major classifications of fish, there were falls in the volume of fish landed in each. However, the value of landings only fell for pelagic fish (by 0.4%). For demersals and shellfish there were increases in the value of landings by 1.9% and 10.7% respectively. The absolute size of the increased value of shellfish landings is almost twice that for demersals.

Among the individual species of demersals, haddock, cod, monkfish and whiting are the most important by value. Cod and whiting both showed large falls in the value of landings: 9.9% for cod and 11% for whiting. In both of these species, the decline in volume was greater than the fall in value, so that there was some increase in price. Haddock and monkfish had an increase in the value of landings, of 8.5% and 11.8% respectively. For haddock, the increase was almost totally the result of price increases. For monkfish the increase in the volume is greater than the increase in value, implying a fall in the price for this species.

For the pelagics, there has been a big increase, in terms of both volume and value of landings of the major species, mackerel. The value of landings increased by £929,000, a proportionate increase of 8.8% and the increase in the volume of landings was even greater at 10.1%. However, there were significant falls in the volume and value of landings in the other two economically important species in this group, herring and blue whiting.

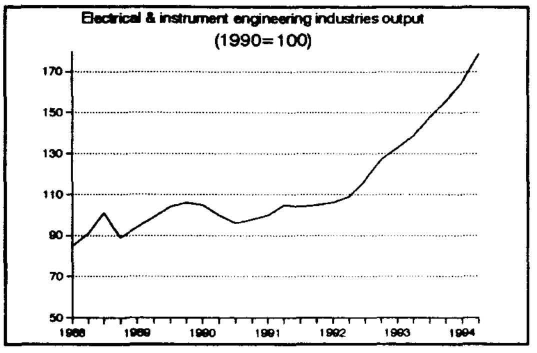
In the case of shellfish, Norway lobsters make up over a half the total value of landings in this category. There has been a 6.5% increase in the value of landings for this species, wholly the result of increased prices as the volume of landings has remained constant. The second most economically important species of shellfish is scallops where there has been a 74.6% increase in the value of scallops landed, almost wholly due to the increased volume.

Whilst the value of total landings rose by 3.7% as compared with the same period in 1993, the value of landings from British boats increased by 5.1% and the share of the value of landings going to British boats increased from 92.5% to 93.8%.

MANUFACTURING

ELECTRONICS

The latest figures from the Index of Production for Scotland further confirm the continuation of the seemingly inexorable rise in output in the electronics sector. During the second quarter of 1994, electronics increased output by 9% and the increase over the year to the second quarter totalled a massive 26%, figures which far outstrips the increase observed in the industry across the UK (where the increases amounted to 1% and 4% respectively) and also leave the performance of other sectors in Scotland far in its wake. Output in the Production industries in Scotland showed no change in the second quarter, while the increase of 4% in the year to the second quarter, given that this includes electronics output, merely indicates the importance of growth in electronics to the overall performance of Scottish industry.



A spate of announcements in recent months also appear to confirm that this importance will continue, and probably grow, in the future. Beginning in September with the announcement by Digital that it is to take over the former Ankor Anam factory in Irvine to produce PC's because its Ayr factory is working to capacity, the last few months have also seen expansions by OKI at Cumbernauld which will create 60 new jobs by expanding its product range into page printers (an investment won in competition against its plant in Thailand) and by JVC at East Kilbride which is to extend its range to produce CDs, creating 100 jobs. Most substantially, however, is the decision by NEC to invest £650M to create a new semiconductor facility at Livingston. 400 new jobs are expected when the new factory opens. The plant, which is the second largest inward investment project ever seen in the UK , was won against competition from California largely due to the excellent productivity record of the workforce who, immediately prior to the announcement, received a productivity award from the Japanese Institute of Plant Management, only the second time the award had gone outside Japan. Scotland's performance in productivity terms is also confirmed by a survey recently carried out on behalf of Locate in Scotland, which showed that over three quarters of electronics plants in Scotland had increased productivity by over 5% in the last year.

Other, more modest new investments, have also occurred. The US-owned company Madison Cable Corporation is to create 200 new jobs in Dundee with a £12M investment to design and manufacture cables for the electronics sector, while, again in East Kilbride, Test Solutions is to open a new factory to build test equipment. This will create 65 new jobs, many of which will be for design engineers.

While developments in the externally-owned sector are clearly continuing apace, two developments among Scottish-owned companies signal less welcome news. Mcgavigans, the Kirkintilloch company which makes a range of electronic control devices which it sells to some of the world's major companies in a wide range of sectors has been sold to the Nottingham-based company Pressac for £10M. While the move is necessary to fund growth opportunities - the Managing Director of Mcgavigans has said that the companies growth opportunities are unlimited while their resources are not - what is one of the most innovative and successful companies in Scotland has quietly slipped out of local ownership. And Exacta Circuits, the Borders company which is Europe's largest PC manufacturer, is to offer itself for sale to at some point in the future, partly to relieve its proportion of high fixed debt. The move is again due to successful growth but, given this and its need for finance for expansion, it seems at least probable that we will again see the removal of local ownership from a highly successful Scottish-owned company.

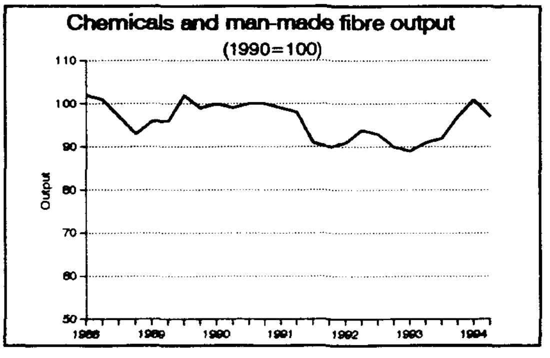
CHEMICALS

The latest index of production shows a decline in Scotland of 4% in the second quarter 1994 which compares with growth of 2% in the UK as a whole. Annualised growth for the latest four quarters on the preceding four shows growth of 6% for Scotland and 4% for the UK.

Business confidence among Chemical respondents continued to rise with a net of +41% were more optimistic than in the first quarter whilst a net of +46% were more confident than in the same quarter one year ago.

The upward trend in business confidence reflects the continued increase in total new orders, which showed a balance of +45%. As expected, the trend in export orders continued to strengthen, with 59% of respondents reporting increases in orders from overseas and none noted a decline. The upward trend is forecast to continue but ease marginally and orders from all areas should improve. The trend in sales mirrored that of orders with sales to foreign markets stronger than domestic sales and again respondents expect this upward trend to continue.

Average capacity utilisation remained at 72%. However, for a net of +15% of respondents this was higher than the same period of 1993. There was a slight increase in the amount of work in progress [+5%], though respondents do not expect this to continue. The factor cited by 91% of respondents as most likely to limit output during the third quarter was orders/sales.



A net of +14% continued to revise investment intentions with regard to plant and equipment upwards, although there was no change to investment intentions with regard to land and buildings. Authorised investment occurred for the following purposes: expand capacity [33%], replacement [22%], increase efficiency [17%], introduce new project [17%] and introduce new technology [11%].

Contrary to expectations employment was increased by a net of +14%, this trend is forecast to continue, a net of +19% expect to increase employment further during the current quarter.

One of the largest British bio technology companies, LEXIPAFANT, claims to have made a breakthrough in the treatment of acute pancreatitis. The company plans to embark on phase three of the project and seeks regulatory control before the end of 1995, planning to exploit a market with an estimated worth of £300 million a year. The company is also presently working on the worlds first oral treatment for cancer sufferers, BANTIMASTAT.

BASF announced plans to pay £850 million for the pharmaceutical division of Boots in a deal which will offer laboratory and sales expertise in the UK and a marketing and distribution network in the US, the worlds largest drugs network. The merger will be a major step in BASF Pharma's strategy to expand its ethical business. Other offers had included one from Zeneca who were prepared to pay up to £900 million for the pharmaceutical division of Boots. The offer from Zeneca would have ensured no factory closures and further investment in the division, factors which Boots promised to take account of.

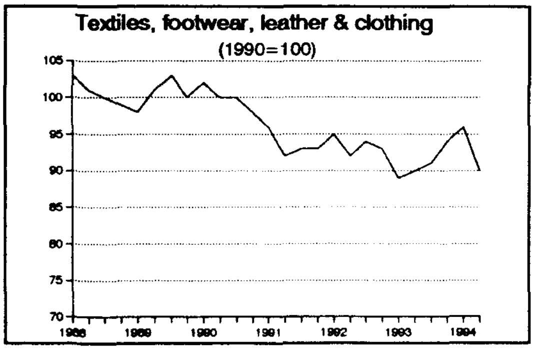
A number of companies have announced plans to restructure, Zeneca intends to shed 500 jobs, 35 of which are to go at the companies Grangemouth site. The German chemicals group Hoechst revealed plans to reorganise its centralised management and operational structure. The changes, effective from January 1 will reduce the number of operating divisions from 15-7 and employment by 800 and is estimated to save the group DM200 million ($129m) a year.

Grampian Holdings, the Scottish mini conglomerate announced disappointing pre tax profits of only £3.59 million for the half year to July 1. Although pre tax profits were up by 75%, however the 1993 figures were depressed by the cost of intensive restructuring the expected benefits of which have yet to be recouped.

TEXTILES, FOOTWEAR, LEATHER AND CLOTHING

The last issue of the QEC commented on the steady growth shown by the Textiles, Leather, Clothing and Footwear (TFLC) sector in Scotland, where output had increased in every quarter of 1993, and the year-on year increase until the first quarter of 1994 equalled 3%. Unfortunately, the Index of production for the second quarter of 1994 shows a substantial reversal of this trend with a reduction in output of 6% over the quarter. However , this may reflect either seasonal factors - the index has dropped in the second quarter in every year since 1990, albeit usually by a smaller percentage level - or one-off factors. If so, these factors had a lesser effect across the UK, where output was unchanged across the second quarter.

Reasons for supposing that the large second quarter reduction is more of a temporary deviation are contained in the findings of the most recent Scottish Chambers Business Survey (SCBS). Respondents to the October survey showed a positive balance of optimism regarding the general business situation, compared to three months previously i.e., around the end of the second quarter when the drop in output occurred. A net balance of 17% of respondents also reported an increase in the trend in sales, particularly to U K (excluding Scotland) and foreign markets. Capacity utilisation continues to be relatively high at 81%,and while this is a reduction on the figure of 83% recorded in the previous survey, the difference is small. In addition, 39% reported having revised upwards their investment intentions for plant and equipment compared to 31% in the previous survey, further suggesting that the sharp reduction recorded by the index of production is more likely to be in the nature of a short-term blip. Overall, therefore , while the size of the second quarter reduction, coming as it does following a period of steady but modest growth, is unwelcome, the SCBS results appear to show that it does not indicate a sharp reversal of short term prospects in the industry.

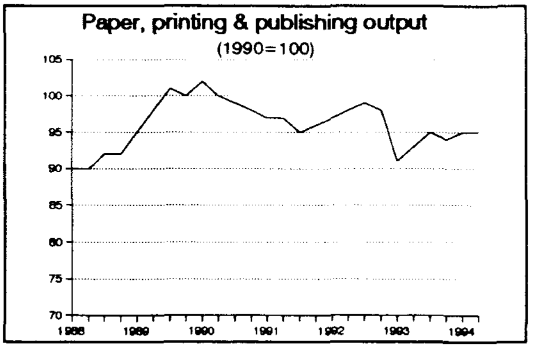


At the beginning of the December, Dawson International reported a doubling of interim profits to £15.8Mn. Much of the increase is , however, due to the fact that it has discontinued operations of its loss-making fleece and jersey business in the US and profits from its continuing operations actually fell. This was despite a 6% increase in turnover, and Dawson blame the loss in its continuing operations on its inability to pass on increased raw material prices in the face of very competitive markets.

Elsewhere, Coats Vyella is to sell both its yarn and carpets divisions as part of its strategy of moving into core business's which are closer to consumer markets. The divisions employ around 5,000 in total and while the majority of employees are based in England, the sale will include a factory in Alloa. Business's will be sold as going concerns which should reduce any prospect of job losses. The sales are expected to go through sometime in 1995.

PAPER, PRINTING AND PUBLISHING

The Index of Production for the Paper, Printing and Publishing (PPP) sector in Scotland indicates levels of output growth of -1% in the second quarter of 1994, with UK growth in this period also standing at -1%. These figures take annualized growth, the comparison of output growth in the last four quarters compared with the previous four to 0% and 3% respectively.



The Scottish Chambers Business Survey for PPP indicates that a net 32% of firms feel more confident about their general business situation than in the previous 3 months. Specifically, the total volume of new orders has risen for a net 34% of firms with a similar increase expected in the next quarter. Order levels in the Scottish, UK and export markets appear strong, with net increases in new orders reported in each market. General sales figures show the same upward trend with a net 40% of firms indicating that their total volume of sales has increased in the last 3 months. Further increases in the volume of sales are also expected in the next quarter, particularly in the domestic market with a net 29% of respondents expecting sales in the Scottish market to improve.

Average capacity utilisation was 81% for the industry which for a net 12% of respondents was higher than at the same period last year. Investment in plant and equipment has been revised upward for a net 17% of firms while land and buildings investment has been revised downward for a net 5%. These investment trends are expected to continue into the next quarter.

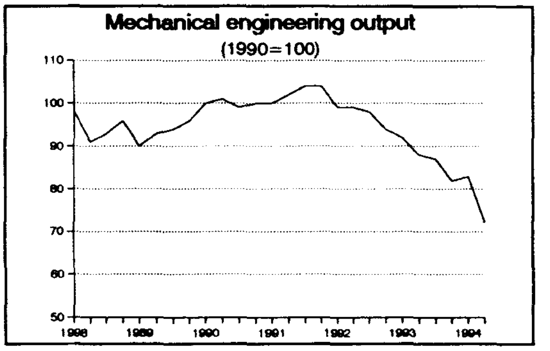
Employment figures appear more promising than in previous quarters. A net 15% of firms have increased their total levels of employment and a net 5% expect further employment expansion in the next quarter.

Plans were revealed by publishers Harpers-Collins of a proposed sell-off of its book printing operations at Bishopbriggs, Glasgow. The plans appear to follow a decrease in the world demand for books. The plant currently employs over 400 staff and although management would hope any takeover would not involve the shedding of jobs, executive chairman Eddie Bell stated that unless a buyer was found by March the plant would face closure. Workers fear that any move would also pose a threat to the distribution, finance and administration sections of the company, which Harper-Collins will continue to control. The plant has suffered losses of £3 million in the last year, but Scottish Secretary of the Graphical, Print and Media Union, David Munro suggested that a lack of investment capital in the plant has contributed to the company's current position.

Price increases in the paper and printing industries continue to be reported in recent weeks. Generally prices have risen by at least 30% in the last year, with price rises of as much as 300% in the waste paper industry. Increased raw material costs continue to be cited as a main reason for this current trend. David Lyons, chief executive of Bowater packaging and printing group, claims that raw material costs are so high that failure by firms to pass on these costs to customers would result in the closure of many paper firms. Prices have also been pushed up due to an upsurge in the demand for paper products. The Bowater chief executive says that general economic recovery has increased the demand for packaging material and estimates that every 1% increase in GDP increases the demand for paper and packaging by between 1-2%. In addition, the market supply for pulp has been restricted by increasing environmental concerns which reduce the volume of forest produced products. These factors seem set to keep paper prices higher for the foreseeable future. The paper and packaging section of the FT All Share Index has risen by over 14% in the last year and City analysts expect further increases to follow.

MECHANICAL ENGINEERING

Just when we thought an upward-turning point had arrived in Scottish mechanical engineering industry in the first quarter this year, the 13.3% dip in output in the second quarter as recorded in the latest official data release came as a shock. Moreover, the growth in the first quarter this year was also revised down to just over 1%. The poor performance of output growth in Scottish mechanical engineering industry is in sharp contrast with the UK mechanical engineering industry as a whole, which has been undergoing steady growth in the first half of this year, reflecting the extreme volatility of recovery in the Scottish industry.



It is difficult to square the huge dip in Scottish mechanical engineering output with the results of the Scottish Business Survey (SBS) for the second quarter (which indicated a noticeable improvement in business confidence in that quarter). However, it is worth noting that the SBS results for the first quarter showed a deterioration in business confidence, thus reflecting possible lagging effects of the SBS evidence. Even so the magnitude of the fall still comes as a shock, and the reason for the dip, to our knowledge, is due to capacity closure in some big companies. It should be pointed out that in such cases (where some dominant companies undergo rapid expansion or capacity closure), the SBS results might well be biased as it only counts the number of firms reporting business optimism or pessimism.

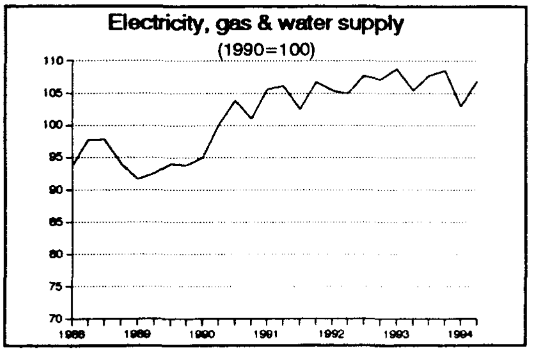
Notwithstanding the poor performance in the second quarter, the latest SBS still showed a strong persistence in business optimism in Scottish mechanical engineering industry in the third quarter. Among the corresponding firms, a net 18% were more optimistic about the general business situation in the third quarter, following a net of 23% firms being more optimistic in the second quarter. Compared with the same period a year ago, a net 29% of corresponding firms expressed business optimism. Export orders and sales remain buoyant and are expected to be so in the final quarter, although the domestic markets are still sluggish.

The trend of running down on stock of finished goods and raw materials continued in the third quarter, and such a trend is expected to persist over the final quarter. However, the volume of work in progress was still increasing and the firms' capacity utilisation rate (at 77%) was higher than that in the second quarter. Investment intensions in plant and equipment remained and are expected to be sanguine. There was hardly any change to employment prospects in general, with new jobs mainly arising for part-time and temporary workers. There was still restraint on increases in wages and salaries in this industry. All the evidence indicates that the recovery in Scottish mechanical engineering industry is painfully slow and volatile.

ENERGY

COAL, ELECTRICITY AND WATER

Coal privatisation may be complete by the end of December with Mining (Scotland) the preferred bidder for Longannet and nine opencast mines. The consortium has the support of the trade unions, public companies and financial institutions. Investment plans hope to secure the future for Longannet beyond 2020 and to reopen Frances colliery in Fife which costs £2M to maintain having ceased production ten years ago. Monktonhall colliery is to triple production in the next year from 120,000 tonnes per annum to 400,000 tonnes. Waverly Finance, a main shareholder, has seen several investments rise sharply and has an option for 30% of Mining (Scotland) which puts the company in a strong position. A merger between the two companies has not been ruled out.



RJB is the preferred bidder for the English coalfields with a £914M bid which is to be reduced by £35M due to a shortfall in coal stockpiles. Pretax profits of £220M have been predicted by the turn of the century with a selling price of £1.32 per gigajoule. Industry analysts have criticised this as demand may have been overestimated by 20%, there is little account of electricity imports, heavy fuel oil burn and supplies from competitors. Experts believe prices will be close to £1.10 per gigajoule and that RJB need to go for high prices or high volumes with low prices. It will be a costly error to have to close pits to cut volume so RJB must get it right from the outset.

The Mining and Quarrying production figures for 1994 Q2 on the preceding quarter show a 4% rise for Scotland and a 4.5% rise in the UK. The year-on-year figures on the preceding four quarters was a slight decrease of 0.7% for Scotland but a 17.9% increase for the UK. This substantial rise may be due to the reclassification of the index.

Electricity companies have delivered substantial dividend increases to shareholders following the regulatory review which has allowed a rate of return of 6.5-7% for English RECs, 6% for Scottish Power and 2% for Hydro Electric. Hydro Electric have rejected Prof Littlechild's proposals and are seeking an MMC referral. Their case for a rise in real prices will be that they cover 25% of the UK land mass incurring high maintenance costs and generation prices have been cut to match those in England. Both Scottish Power and Hydro Electric are to invest £39M and £12M respectively to upgrade the interconnecter by 600MW as sales of electricity south of the border are extremely important.

The campaign to privatise the nuclear industry is ongoing. Increased efficiency, substantial funds for decommissioning and prudent waste management have strengthened their position so much so that Stephen Littlechild has endorsed privatisation but recommends Nuclear Electric surrender some power stations to Scottish Nuclear.

The production index for electricity, gas and water supply for 1994 Q2 on the preceding quarter shows a rise of 3.7% and 4.7% for Scotland and the UK respectively. Comparing the last four quarters with the preceding four quarters Scotland has a fall of 0.7% whereas the UK demonstrates a rise of 4.9%.

Government sources confirmed that Scottish water charges will rise substantially because £15bn is needed to improve water and sewage to European standards. The Government have also identified 15 local authority capital plans which could be financed under BOO, (build, own and operate), in the next few years. This would allow private sector practice to play a leading role in the three new water authorities. The Government acknowledge the extra cost but it is necessary to avoid raising the PSBR.

SERVICES

DISTRIBUTION

Evidence from the latest Scottish Chambers' Business Survey shows the results for the third quarter of 1994 and indicated that the rise in business confidence among wholesalers weakened marginally and confidence levels among Retail respondents remained depressed.

The trend in total sales among wholesale firms (+21%) exceeded expectations of the previous quarter, although respondents do expect the upward trend to weaken during the current quarter. During the second quarter, retail respondents forecasted an end to the decline in total sales. However the trend has not reversed and a net of -6% reported a decrease in sales during the third quarter, equalling the rate of decline of the second quarter. Retail respondents do not expect the decline to continue, with a net of +10% forecasting an increase in sales.

The upward trend in investment plans for wholesale distributors eased slightly, a net of +13% revised investment plans upwards compared with the same quarter of 1993. Compared to the same period one year ago, a balance of +9% of retail respondents revised their investment intentions in premises upwards.

Marks and Spencer reported a 15 per cent rise in profits with a 7 per cent increase in sales. Pre tax profits for the 26 weeks to October 1 grew from £308 million to £354 million and sales increased from £2.87 billion to £3.07 billion. Sales in Europe rose from £134.5 million to £152.3 million in the six months to October 1, although operating profits fell from £9.3 million to £5 million after charging £3.8 million for the opening of new stores. Marks and Spencer expect to continue to expand in Europe and have identified 45 to 50 sites across France, Spain and the Netherlands; they are also looking at Japan and China following the success of the Hong Kong shop.

FINANCIAL SECTOR

There can be little doubt that the proposed merger of the Halifax and the Leeds Building Societies and the conversion of the merged entity into a bank represents the most important event of the past year for UK financial institutions. The possible merger is significant on a number of accounts not least the consequences for the UK's existing banks and building societies in terms of its likely impact on competition in the banking market; the scope it suggests for further mergers and conversions of building societies; and the implications of the conversion from mutual structure to a joint stock basis both for the building society and life assurance, particularly the Scottish sectors.

The move by the government in the 1980's from a system of structural regulation in which institutions were regulated according to their perceived financial purpose to a less rigid system of prudential regulation in which institutions are regulated according to the risk of their activities and in which the rigid demarcation between institutions is greatly reduced, inevitably meant that institutions that continued to be regulated according to their structure were at a competitive disadvantage since such institutions were more constrained and regulated than some of their competitors. The Building Societies Act gave societies more freedom than previously but still restricted them with regard to their sources of borrowing and types of lending, restrictions that are considerably more onerous than those faced by the banks. It was therefore inevitable that they should face competition in their traditional markets from banks and moreover that the banks, with a wide range of lending opportunities could enter and withdraw temporarily from the housing market as conditions and profitability dictated. The recently announced increase by the Royal Bank in mortgage lending of 24% in its financial year illustrates clearly the competition that the building societies face. In short, banks are able to do everything building societies can do and more besides. In the circumstances it is hardly surprising that the societies have found surviving and thriving in the mortgage market much more difficult than previously. When the market is booming they face intense competition from banks with consequent effects on margins and security. When business is weak, the societies face difficulties in acquiring new business, particularly with the margins they would like. It is unavoidable given these circumstances that many building societies should view the opportunities afforded by banking status as more desirable than the prospect of remaining as building societies since becoming a bank offers them wider access to funds and markets. As a bank, institutions have the option of raising finance in a less constrained fashion, and of lending to a wider circle of borrowers. For building societies with aspirations to grow rapidly and profitably it may be difficult to see why they should want to remain as a building society.

counterparts. Indeed, preliminary evidence suggests that the very large mutuals have for some periods of time in the 1980's performed significantly better then their other competitors. Generalisation on the basis of limited data is dangerous but given significant performance advantages it would be dangerous to write off the mutual structure as unattractive. What is apparent, and particularly relevant in recent cases, is the accumulation of capital that mutuals represent and that can be distributed on their break up, takeover or under some other similar arrangement. The potential gains from unlocking such capital make them a tempting target.

Mutuals need capital like any other business in order to pursue their particular line of activity. Accumulations from the past provide the risk capital of the business. This risk capital is the result of the efforts of past members of the societies. Such members did not receive the highest rate of interest on deposits or the lowest cost of borrowing that was possible for the society to pay with the result that surpluses built up providing capital for the **current** activities of the societies. Past members, however, have no claims against the assets of the society that their receipt of less generous terms created. Indeed, the assets are considered to 'belong' to current members. These assets may represent substantial capital sums which, however, can only become available for distribution if risk capital is acquired from elsewhere. The result is a strong incentive to sell or dispose of the Society to a third party, or to find some way of making the risk capital tradeable such as by an issue of tradeable shares. The process is in some senses inevitable and perhaps even desirable. The scenario in which a mutual society has risk capital available but few opportunities to use it profitably is not an attractive one although it may well reflect the situation that some societies have or do currently face. From a societal perspective there is no advantage in the accumulation of wealth which is then used on poor investment. The problem is that the current means employed to distribute risk capital to members appears arbitrary, haphazard and sometimes unfair and does not necessarily reflect the significance and importance of different types of members in having helped the society to acquire and accumulate that capital. There appears little merit in recent members acquiring large windfall gains simply because they have deposited (or borrowed) large sums with (from) the society in recent years. What is required are schemes for distributing capital that recognise more accurately the contribution of different classes and groups of members. Most societies already operate such schemes. Whether they are adequate is a subject for debate. There remains too the important contribution of past members to the societies well being. Is it possible (or desirable) to compensate them for their efforts? One rough and almost certainly unpopular method, might be to tax the distribution of cash or other marketable assets by mutual societies. Some of the benefits at least would then accrue to society as a whole (as representatives of past members) to reflect the large and important contributions of past members. Taxing the benefits would also make the break up of societies less profitable. Until we know rather more, preferably in the form of quantitative evidence, about the relative costs and benefits of the mutual structure over other forms of organisation this might be no bad thing. The fear must be that the desire to access easy profits leads to a dismantling of a form of organisation that may offer significant advantages to consumers. A particular problem for Scotland is the possibility of a significant reduction in its indigenous financial industry. Conversion of mutuals to joint stock companies, or other forms of capital reconstruction such as takeovers could lead to a loss of control and ultimately possibly a significant loss of jobs. In the current discussion of the Halifax little has been said about the long term prospects of the North retaining the headquarters of a major bank. However, history, admittedly an unreliable guide at the present time of change, does not suggest that the major English banks can ignore the centralising pull from London. The fear must be that the Scottish mutuals, once converted, might go the same way.

TOURISM

Evidence of the decline of Scotland as a destination for British visitors continues to accumulate. The main vehicle for monitoring domestic demand, the UK Tourism Survey, has extended its definitions of "short" and "long" holidays. It now records trips of medium length (4 to 7 nights) and longer trips (8 or more nights). As a result, the growing preference of UK residents to take main holidays abroad while taking only short leisure breaks in the UK is becoming ever more apparent.

The broad trends have been bearing heavily on UK tourism for some time. An analysis of market share of UK tourism in the period 1984 to 1992, published in the June issue of the STB's Research Newsletter, shows no statistically significant differences between the UK and Scotland as far as domestic holiday trips and bednights are concerned. Where Scotland is shown to have performed significantly worse than the UK as a whole over the seven year period is in terms of visits to friends and relatives and in business/ conference tourism. But Scotland's loss of share in these markets is minor in comparison to what the analysis shows to have been a truly startling decline across the board in domestic UK tourism. Thus although Scotland has not performed much worse than the UK as a whole, the overall performance has been disastrous.

The STB analysis shows the loss of UK tourism to Scotland in the period 1984 to 1992 to have been:

*	all trips	-32%
*	all bednights	-32%
*	holiday trips	-23%
*	holiday nights	-22%
*	VFR trips	-45%
*	VFR nights	-50%
*	bus/conf. trips	-71%
*	bus/conf. nights	-76%

Against this, there is evidence from the UKTS that during 1993 tourist trips by UK residents to Scotland increased very slightly compared with 1992, while bednights decreased slightly. Expenditure by all UK visitors in Scotland (which is not analysed in the STB Newsletter report for the 1984/92 period and may not be as seriously down) increased markedly in 1993 - by 16.4%, thereby surpassing the 1989 total.

However, this is an insecure basis for believing that Scotland's precipitous decline is over. The current year is widely held to have been a poor one for UK tourism in Scotland. The UKTS trend data for the first half year again show lower volumes and values for Scotland in 1994 than in 1993. As economic recovery holds and UK demand for tourism rises, VFR trips show the biggest increase, followed by business/work related trips. But the principal beneficiaries of the increased volume and value of *holiday trips are destinations abroad.* The revised presentation of UKTS findings will make it clear that the loss for Scotland is greatest in the area of holidays of 8 or more nights. This underlines the need to persist with the new strategy of promoting Scotland in the UK marketplace as a second holiday destination.

Overseas visitors to Scotland have grown fairly satisfactorily in recent years. But here again the most recent available figures (in this case the first three quarters of 1993) reveal a sharp decline in trip numbers, with perhaps the most alarming feature the fact that losses are registered across all geographic divisions and not just in the volatile American market.

The new Scottish Tourism Index, compiled by the Royal Bank of Scotland and the Scottish Tourist Board, is based essentially upon seasonally adjusted hotel occupancy statistics. The November issue seeks to present a broadly optimistic view. Occupancy in the second quarter of this year was up on last year, although only by 2%. However, the general economic background for the sector is deemed positive. Higher earnings, rising employment levels and lower savings may, it is suggested, counteract any negative impact from the increase in VAT on fuel.

The Index also points out that the longer term trend towards shorter leisure breaks will be likely to have an adverse effect on smaller rather than larger operators. Smaller operators are more dependent on domestic leisure tourists. whereas larger operators are better placed to attract domestic business and conference demand as well as overseas visitors. Both the STB's How's Business survey and the Tourism Index indicate that large hotel operators have performed better than small operators over the past few quarters.

In the context of a rapidly changing domestic tourism market and some apprehension about continued growth in overseas visitors, it is perhaps less remarkable than it might otherwise have been that the now finalised Scottish Tourism Strategic Plan has been substantially modified in the targets it sets for the year 2000.

Comparing the consultative version with the final plan, it emerges that the increased visitor expenditure to be achieved (in 1993 prices) has been brought down from 2,500 million to 2,300 million; the number of bednights to be aided for is reduced from 72.5 million to 65 million; and the targeted number of jobs is lowered from 210,00 to 195,000. Given the tender condition of the Scottish tourism industry, these are sensible revisions.

TRANSPORT

Air

A lack of demand from business travellers is blamed for the cessation of transatlantic flights by US carriers from Glasgow Airport. United has followed Northwest and American Airlines have suspended winter flights. The problem for Glasgow is the lack of choice of destinations, infrequency of flights and superior customer care facilities offered at London or Manchester. Prestwick Airport on the other hand has been completely rejuvenated since its takeover by PIK in 1992. Employment has grown from 50 to 250, passenger numbers have increased from 145,000 this year to an estimated 345,000 next year, freight traffic continues to grow and a fixed rail link has been built, with Charter holiday traffic the main growth area.

Scottish airports continue to be the star performers for BAA, with only Stanstead outstripping their growth. Glasgow and Edinburgh both show strong increases in passenger traffic although Aberdeen has a slight drop this year, largely due to new working practices in the offshore oil industry. The London-Edinburgh route is a particularly good barometer of the economy and passenger numbers here remain high.

Rail

The rail strike has been settled with annual efficiency savings of £7.6M while signal workers earnings will increase on average by 8% this year and basic rates will rise by 20% on average. The working week has been reduced from 39 to 37 hours and new working practices have been adopted. However the cost of the strike has been high; Railtrack has lost £100M, the train operating companies have lost over £200M and business sources estimate losses at £180M. This raises serious questions about the long term future of the network, especially with cuts in services being an attractive method of recouping losses. Franchisees have already agreed to share the cost of disruptions should a similar event occur again.

The rail strike has also increased uncertainty for investors with Railtrack's floatation which has not been finalised. With 10,000 miles of track, 2,500 stations and 12,000 employees the Treasury have valued it at £6.5bn using the 'modem equivalent asset value' but city analysts give a more realistic value as £3.3-£4.3bn. While earning a rate of return of 5.1% rising to 8%, if it is sold off after 1996 then the city expects returns from its £2bn property portfolio to rise dramatically while access revenue should also increase.

Most of Scotland's rolling stock is owned by three rolling stock companies and the Government hopes to sell them for £3-£4bn next year, probably for tax cuts prior to the election but certainly not for investment in new rolling stock. There are no plans to scrap or replace Scottish rolling stock and train building , employing 12,000 directly and 25,000 indirectly, is seriously threatened. If closures result when rolling stock is eventually replaced it will have to be imported.

Road

Stagecoach have established themselves in the London market with a £38M acquisition giving them a balanced UK network. As the market is not yet deregulated there will be strong cash flow benefits, especially as East London made £2.2M pre tax profits. Stagecoach has also acquired a 20% stake in Strathclyde Buses, (who recently bought Kelvin Central), giving the group a combined turnover of £86M with 1300 vehicles and 3700 employees. GRT have also expanded adding SMT and Lowland to their group. Both companies are continuously modernising their fleets which is ideal for Scottish bus builders.

In the first review of the Scottish trunk road system since 1946 the Scottish Office plans to add 100 miles onto the trunk road system. They would then be centrally managed rather than unitary authorities having responsibility for them. The controversial M77 project will go ahead where 71% of Glasgow's south side roads will see a decrease in traffic and 18% will have more traffic. Shadow tolling is being considered to complete the A74 upgrading to M74 between Gretna and the M6, with payment dependent on road usage. More than 70 companies have submitted proposals for electronic toll systems.

A second Forth road bridge is recommended as part of a £280M package for West Edinburgh and Fife. The new bridge would be a trunk route and the old will be for local traffic. Environmentalists claim the scheme will result in greater congestion in Edinburgh, while the bridge would not be completed until next century and almost certainly built with private finance.

Sea

The Government is believed to have accepted a report recommending rejection of privatisation of Cal Mac, however, P&O Ferries require to replace their four vessels serving the northern isles at a cost of 100M and are seeking government aid. It is unlikely to be forthcoming and with a subsidy of less than £7M an investment of this magnitude will not take place. Clydeport holdings is to be floated on the stock market at £50-60m. It is hoped to raise £4.1M from a rights issue to strengthen the company's financial position and to pursue growth plans.

Employment Changes in the Transport Sector

	Q2 on Q1 1994	Year-on-Year
Road	+1.3	-1.6
Rail	-	-4.6
Sea	-1.8	+1.0
Air	+0.9	+1.0
Misc. Transport & Storage	-0.5	-3.4
Transport	+0.3	-2.3