Quarterly Economic Commentary

we gratefully acknowledge the contribution of the
Buchanan and Ewing Bequest
toward publication costs

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The Quarterly Economic Commentary is published in March, June, September and December. Annual subscription rates are £50.00, or £15.00 per single issue. Queries should be addressed to the Secretary, Fraser of Allander Institute.

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QUARTERLY ECONOMIC COMMENTARY

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OUTLOOK AND APPRAISAL

The provisional estimates of output in the production and construction industries in Scotland for the fourth quarter 1994, suggest that performance weakened compared with the rest of the UK. In the fourth quarter, output of the production and construction industries in Scotland *fell* by 0.3%, production output fell by 0.3%, manufacturing output fell by 0.5%, and construction output also fell, by 0.2%. In the UK, in contrast, output *rose* in all principal sectors. Production and construction output rose by 0.5%, with activity in the production, manufacturing and construction industries rising by 0.6%, 0.7%, and 0.4%, respectively. Mining and quarrying output grew by 1.2% in both Scotland and the UK during the quarter, while electricity, gas and water generally *fell* but at the faster rate of 1.4% in the UK compared with 0.3% in Scotland.

The data for production in the fourth quarter 1994 can be contrasted with the data for the third quarter, reported in the March **Commentary**. In that quarter, Scottish industry, with the exception of construction, generally performed better than its UK counterpart. Such contrasts indicate that it is dangerous to deduce trends from one quarter's figures alone.

Manufacturing output in 1994 rose by 5.6% in Scotland compared with a 4.1% increase in UK manufacturing as a whole. However, when the poorer Scottish performance of mining and quarrying, and electricity and water is introduced, the output of the production industries during the year rose more slowly in Scotland, by 4.3%, compared with the UK outturn of 5.3%. Finally, the construction industry in Scotland registered no progress in 1994, while its UK counterpart enjoyed growth of 5%.

Overall, the latest data are not sufficient to contradict the view that the Scottish recovery remains on an upward trend. Recent performance remains fairly narrowly based, however, with manufacturing providing the main impetus. And within manufacturing, electrical and instrument engineering (EIE) remains by far the leading sector, with output rising by 24% in 1994. Strong export growth is clearly fuelling growth in the EIE sector, and to a lesser extent in some other key sectors such as chemicals. However, as the Scottish Chambers' Business Survey shows, sales to domestic Scottish and rest of the UK markets are much less strong. Moreover, the first quarter results from the SCBS indicated a tendency for the growth of manufacturing export sales to slacken in sectors other than EIE and chemicals, particularly in food, drink and tobacco, and to a lesser extent in textiles, clothing & footwear, paper, printing and publishing, and metal goods.

The Labour Market

In May, seasonally adjusted unemployment in Scotland stood at 200,500, a fall of 2,000 on the previous month, and a reduction of 32,100 over the year. The May total represented 8% of the Scottish workforce compared with a GB rate of 8.2%. Unemployment in Scotland and GB has been falling since the beginning of 1993. In the first half of 1995, the rate of decline has been somewhat less than in the second half of 1994 in both countries. As the **Regional Review** shows, in the four months to May the Scottish unemployment rate again fell below the GB rate. In July of last year, the Scottish rate moved back up to the GB rate and the two series remained at much the same rate until January of this year.

However, differences between Scotland and GB exist in the unemployment performance of males and females. The male unemployment rate in Scotland continues to be above the GB rate, while the female rate is lower. Indeed, Scotland's improved unemployment relative is largely due to the stronger fall of female unemployment here. The Scottish female unemployment rate moved below the GB rate in 1992 and has remained there since.

The buoyancy of both the Scottish and GB labour markets is not unambiguously due to job creation. Previous **Commentaries** have noted that the Labour

Force Survey (LFS) - a survey of households - has generally tended to show faster employment growth than the Department of Employment (DOE) series - based on an employer count. The LFS series therefore attributes a greater role to job creation in determining unemployment change than the DOE series. In the year to March 1995, the DOE data indicate that the Scottish civilian workforce in employment *fell* by 28,500, while the LFS series - to February 1995 - shows an *increase* of 20,000. However, both series suggest that male employment fell over the period - by 11,000 and 13,000, respectively. So, for males at least, the fall in unemployment over this period cannot be attributed to job creation, nor to a fall in the population of working age. While for females, the picture is complicated by the different estimates of jobs change provided by the LFS and the DOE series. In the former, new jobs have been absorbed largely by a *rise* in participation and a small relative fall in unemployment, whilst the latter series suggests that, as with males, unemployment is falling due to a decline in participation.

When labour market accounts are constructed for 1994 - using the LFS employment and DOE unemployment data - the participation of males is generally seen to fall. In fact, the fall in male participation was slightly less in Scotland than in GB (0.3% compared with 0.5%). Only in Wales, East Anglia, West Midlands and the South West was the fall in male unemployment less than or equal to the rise in employment. In all other regions, net employment change provides a less than complete explanation of the male jobless fall, with regions such as the North West, Yorkshire & Humberside, London and the South East, exhibiting marked reductions in male participation. For females, the decline in unemployment in the British regions was more likely to be accounted for by net job change. In 6 out of 11 regions, the fall in female unemployment was less than or equal to the rise in employment. Only, in London, the North West, Yorkshire & Humberside, East Midlands, and the North did the female participation rate fall. While in regions such as Scotland, the West Midlands and Wales, a rising participation rate appreciably dampened the effect of positive employment growth on the fall in unemployment.

Outlook

The UK economy is continuing to grow above trend, although less rapidly than in the first half of 1994 (see **UK Economy** section). The continuation of the recovery in both Scotland and the UK depends crucially on the prospects for investment, continued net export growth and the extent of the threat of accelerating inflation.

Domestic demand remains relatively subdued. It seems likely that the growth of consumer demand will continue to be subdued throughout 1995, due to the debt overhang, the effects of earlier tax and interest rate rises, and weak nature of the housing market. Consumption growth is unlikely to be much more than 2% this year. However, private sector investment is expected to expand strongly in the remainder of this year and into 1996, exhibiting an annual growth rate of around 5% to 6%. The SCBS indicates that investment intentions in manufacturing and construction have improved fairly slowly during the recovery, particularly for land and buildings. Construction displays the most persistent upward trend but from a strong negative position. It is very probable that declared investment intentions will become appreciably stronger in both sectors as the year proceeds and 1996 comes into view, providing a significant contribution to growth.

Net exports have contributed strongly to recent growth, boosted by a large increase in oil production, and should contribute positively for the remainder of the year. However, export growth seems likely to slow down in 1996 with the likelihood of some appreciation of sterling and the emergence of capacity constraints. On the import side, while the subdued nature of consumer demand should preclude a rapid increase, the prospect of a surge in plant and machinery investment is likely to fuel the growth of imports. So, against this background it is probable that net exports will contribute less to growth in 1996 than in 1995.

With domestic demand relatively subdued, there would appear to be no prospect of inflation accelerating from the demand side. However, there are some worrying signs of cost pressures on the input side, even though the labour market is relatively subdued (see **UK Economy** section). Moreover, the effects of weakness in sterling have not fully fed through into the inflation figures. Nevertheless, on a broad assessment of all economic data there is no clear indication that inflation is about to accelerate appreciably, and we expect the Chancellor to remain cautious over raising interest rates.

Against this background it is to be expected that there will be some slackening of GDP growth next year in both the Scottish and UK economies. However, in the short term we expect that manufacturing output in Scotland will exhibit positive growth to the third quarter of this year, turning negative for a period in the final quarter of 1995 and the first quarter of 1996. For 1995 as a whole, the Institute's Short-Term Model predicts that manufacturing output will grow by 3.7% over 1995, compared with our forecast of 3.1% for 1994.

27 June 1995.