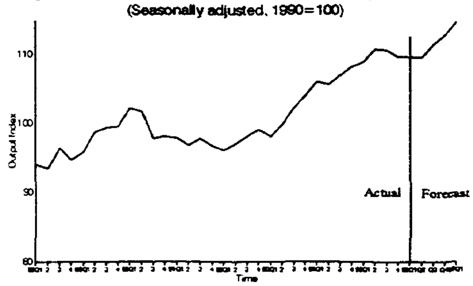
THE SCOTTISH ECONOMY

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 news release confirmed our previous forecasts that the growth momentum of Scottish manufacturing industries would be subdued towards the end of 1995. For 1995, our forecast of an annual growth rate of 3% for Scottish manufacturing output coincides with the unrevised official data.

The present forecasting period extends to 1997Q1, and the LBS quarterly forecasts for UK manufacturing output are used to drive the Scottish forecasts. Figure 1 depicts the actual growth rates for Scottish manufacturing output from 1988Q1 to 1995Q4 and the forecasts for 1996Q1 to 1997Q1. The forecasts show that the performance of Scottish manufacturing industries will remain rather weak in the first half of 96, but will start to revive again in the second quarter of 96 and continue to grow until the first quarter of 97. For 1996 as a whole, the output of Scottish manufacturing industries is predicted to rise by around 1.7% over 1995. 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)



* 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.

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

1992/91	0.3
1993/92	3.5
1994/93	5.6
92Q4/91Q4	2.5
93Q4/92Q4	4.9
94Q4/93Q4	4.0
95Q4/94Q4	1.3
94Q3/94Q2	1.3
94Q4/94Q3	1.1
95Q1/94Q4	0.6
95Q2/94Q1	1.7
95Q3/95Q2	-0.2
95Q4/95Q3	-0.9
Forecast	
96Q1/95Q4	0.2
96Q2/96Q1	0.0
96Q3/96Q2	1.6
96Q4/96Q3	1.2
97Q1/96Q4	1.7
1996/1995	1.7

SCOTTISH CHAMBERS' BUSINESS SURVEY

The principal results of the Scottish Chambers' Business Survey (SCBS) for the first quarter 1996 are detailed below. The SCBS, which is conducted by Strathclyde University's Fraser of Allander Institute together with the Chambers of Commerce of Aberdeen, Central, Dundee, Edinburgh, Fife and 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, 926 firms responded to the questionnaire.

Business Confidence

In Manufacturing, business confidence fell again slightly in the first quarter. A net balance of 1% of respondents reported that they were less optimistic than three months previously, compared with a balance of 2% who were less optimistic in the fourth quarter last year. In the first quarter, Manufacturing respondents continued to be more optimistic than they were a year ago, with a net balance of 5% of respondents reporting higher optimism. This compares with the situation in the fourth quarter where a balance of 7% of respondents were more optimistic than in the same period a year earlier.

In Construction, optimism continues to fall but with the rate of decline continuing to slow down. A net balance of 13% of respondents reported that they were less optimistic than in the fourth quarter. This compares with a 19% balance of respondents who were less optimistic in the fourth quarter over the third quarter. A net balance of 12% of respondents reported that they were less optimistic than they were a year ago, compared with the situation in the fourth quarter where a net balance of 18% of respondents were less optimistic than in the same period a year earlier.

In Distribution, confidence continues to decline in Wholesaling, while a significant turn round in optimism is evident in Retailing. In Retailing, a net balance of 10% of respondents were more optimistic about the general business situation than they were in the fourth quarter, which compares with the 8% balance who were *less* optimistic in the previous quarter. In Wholesaling, a net balance of 5% were less optimistic than in the fourth quarter, compared with the large negative net balance of 24% in that quarter. Compared with a year ago, while Wholesale respondents were again less optimistic, registering a negative net balance of 15%, in Retailing, a net balance of 7% were *more* optimistic.

Respondents in the Tourism and Leisure sector reported a further marked increase in confidence. In the first quarter, a net balance of 26% of respondents indicated that they were more optimistic about the general business situation than they were three months earlier, compared with a balance of 18% in the fourth quarter. A net balance of 38% of respondents were more optimistic in the first quarter than in the first three months of 1995.

Orders and Sales

In Manufacturing, orders and sales continue to rise; at a faster rate for orders and at a slower rate for sales. For both orders and sales, a net balance of 10% of respondents reported an increase. These figures compare with positive balances of 4% and 14%, respectively, in the fourth quarter. Orders from the domestic Scottish market rose slightly while sales fell somewhat. Orders from the rest of the UK continued to fall and sales now also appear to be falling. However, both export orders and sales continued to grow quite strongly.

In Construction, new orders continued on a downward trend and again at a faster rate than in the previous quarter. A net balance of 16% reported a decrease in orders compared with a net balance of 13% reporting a decrease in the fourth quarter and a negative balance of 1% in the third quarter. Orders from both Central Government and Other Public Sector remain severely depressed, while orders from the private sector now appear to be falling again; a net balance of 3% of respondents reported a decrease in private sector orders, compared with a positive balance of 7% in the fourth quarter.

Sales picked up appreciably in the Distribution sector in the first quarter. A net balance of 15% of retailers reported that sales had *risen*, compared with the 5% balance reporting a *decrease* in the fourth quarter. In Wholesaling sales also rose. A net balance of 2% of respondents reported an increase, compared to the balance of 2% of respondents reporting a *decrease* in the fourth quarter.

Tourism demand increased further in the first quarter and at a faster rate than in the fourth quarter. A net balance of 19% of firms reported an increase compared with a balance of 6% reporting a rise in the three months to December. Demand increased strongly in the Scottish and UK markets but rose only marginally from foreign tourists.

Stock Adjustments

Stocks of raw materials in Manufacturing continue to fall, while work in progress rose again and stocks of finished goods fell slightly. A net balance of 8% reported a fall in stocks of raw materials, while for finished goods the negative net balance was 2%. For work in progress, a net balance of 3% reported an increase.

Finance and Investment

In the Financial sector, the demand for personal loans continued to rise, but at a slower rate than in the fourth quarter. A net balance of 29% of respondents reported a rise, compared with the balance of 44% reporting an increase in the third quarter. Advances to the corporate sector are also still rising, while the demand for working capital continues on an strong upward trend. Moreover, the demand for finance for investment in buildings and for investment in plant and equipment has begun to rise again after falling slightly in the fourth quarter.

Manufacturing investment intentions in plant and machinery were again revised upwards in the present quarter, with a net balance of 11% reporting an increase and respondents expect to revise these intentions up further again in the second quarter of 1996. The deterioration in Manufacturers' investment intentions in land and buildings appears to be continuing after halting in the fourth quarter. A net balance of 4% of respondents reported a decrease, compared with a balance of 9% reporting an increase in the previous survey. However, respondents expectations are for a slight increase in buildings investment in the second quarter of 1996. In Retailing and Wholesaling, investment intentions remain significantly positive. Net balances of 15% and 8% of Retail and Wholesale respondents, respectively, reported an upward revision in investment intentions compared to the same period a year ago.

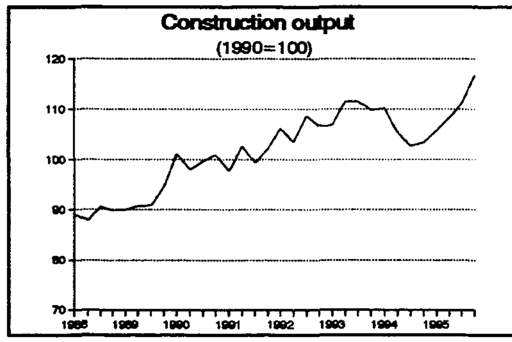
Expectations

With the exception of Construction, the outturn in the first quarter was better than expected by respondents in the fourth quarter. In Retailing and Wholesaling, the outcome was significantly better than expected.

Demand conditions are generally expected to improve in the second quarter. Orders and sales in Manufacturing are expected to grow at a faster rate. In Retailing, the same strong rate of increase as experienced in the first quarter is expected to continue into the second quarter, while Wholesalers expect demand to grow more quickly. Tourism demand is also expected to grow more quickly. On the other hand, the decline in Construction orders is expected to continue but at a slightly slower rate.

CONSTRUCTION

Nineteen ninety-five ended with a 5% quarterly increase in the Scottish index of construction to stand at 116.8. This was the fifth successive quarterly increase and was only slightly higher than the year on year percentage change of 4.9%. The UK on the other hand only managed a 1.4% quarterly increase to reach 89.7, and saw a year on year fall of 1.2%. Over the last eighteen months the pattern emerging in the UK as a whole has been more erratic and reminiscent of that historically portrayed by the Scottish construction industry. The reverse has been true in Scotland, portraying prolonged growth over the same period.



The Scottish Chambers' Business Survey for the first quarter of 1996 shows a continuing fall in confidence in the Scottish construction industry, albeit with the rate of decline continuing to slow down. A net balance of 13% of respondents reporting that they were less optimistic than in the previous quarter. This compares with a 19% balance of respondents who were less optimistic in the fourth quarter over the third quarter. With a net balance of 12% of respondents reporting that they were less optimistic than they were a year ago compared with the situation in the fourth quarter where 18% of respondents were less optimistic than in the corresponding quarter a year ago.

New orders also continued to decline for a net 16% of respondents compared with a balance of 13% reporting a decrease in the fourth quarter. Central Government and Other Public Sector orders remains severely depressed and a net 3% of respondents reported falling private sector orders as well. In the fourth quarter, private sector orders increased by 7%.

The Scottish construction industry exhibited the lowest percentage remuneration of all the sectors covered by the SCBS with increases of 3.4%. Despite this, employment continues to fall for a third of respondents the highest balance for more than two years. In the second quarter a balance of more than 25% expect to reduce employment. Recruitment levels remained the same as in the fourth quarter with the emphasis on higher order skills. Few respondents reported recruitment difficulties and training intentions fell.

The National House Builders' Confederation (NHBC) figures for housing starts in Scotland show that 200 houses were registered in the first quarter of 1996, an increase of 61.5% on the previous quarter. This compares with 36,400 starts in GB as a whole, an increase of 38.4%. Scottish housing completions fell by 2.6% over the same period to stand at 3,700 but GB as a whole saw a fall of only 0.5%. The NHBC first time buyers ability to buy index stood at 125, only one point down from its record high of the previous quarter.

Industry wide restructuring is the order of the day as companies sell or swap large parts of their businesses to concentrate on more profitable specialities. Tarmac swapped its roof tile business for Marley brick interests and two years later sold its brick interests to IB Stock who had purchased Centurian and Scottish Brick. Redlands is reported as planning to sell its UK brick division and restructure its tile operations. They are also forging a joint venture with German tile maker Braas in which they have a 50.76% holding. The newly created Redland Braas Building Group will receive £220 million in cash to reduce debt and expand its aggregate business. This restructuring goes through aggregates, contractors and housebuilding as well and looks set to continue.

The construction and engineering group, AMEC, a major employer in Scotland, has launched a strategic review of its activities but has said that its Fairclough Homes business is not up for sale. The currently employ about 6,000 people in Scotland.

The specialised construction group Amey which is working on the new section of the A1 at Tranent, south of Edinburgh, is seeking a new image in an attempt to get a higher stock market rating. They have asked the stock exchange to switch their share quote from the "construction" to the services sector to recognise the changes made to the group over the past two years.

Hewden Stuart, Glasgow's prominent plant and tool hire company, has been expanding, acquiring the crane hire company Gable and Sadler and the tool hire operation W H Price, which will strengthen their already prominent market projection.

The future of the industry still looks insecure although (as one would expect) the major players are set to survive well albeit with reduced projects initially. It seems that the smart money is once again purchasing land, surely a sign of better prospects to come.

ENERGY

OIL AND GAS

Oil and gas revenues reached their highest levels in the last quarter when Brent crude averaged $19.83 in March. This peaked at $23.86 in April but since then has fallen back below $20. During this period oil and gas production started its seasonal decline and the £ appreciated against the $. The main reason for the higher prices is the low levels of stocks as traders try to anticipate the availability of Iraqi oil which will see the oil price fall significantly.

Over the latest quarter, (Q1), oil output has fallen steadily and the Royal Bank of Scotland oil index fell by 1.5% over the quarter and 4.6% over the year.

In contrast, gas production reached its highest ever level in February at 12164mmcfd. This exceeds last year's high by 15% and is 6.7% higher than the January figure. The relatively cheap gas has caused many industrial consumers to switch to gas. Electricity generation is also a substantial consumer of gas in the cold weather. The Royal Bank of Scotland gas index has fallen 5% over the latest quarter but the increase over last year is 15.6%.

The Royal Bank of Scotland combined oil & gas index fell by 3% over the latest quarter but rose 4.3% on an annual basis. Average sterling values for oil & gas were £53M throughout February and March. Oil revenues were £30 M and £33M in February and March while the respective figures for gas were £23M and £20.5M.

The main falls in oil production were in the Beryl, Scott, Nelson and Magnus fields. Fields which showed increases in production include Brent, Dunbar, Cormorant A and Gannet. The largest fall in gas production was in Conoco's V fields while several other fields had small decreases in production. Morecambe and Alwyn North saw production rise. Throughput at Cruden Bay fell by 48,500bpd but at Sullum Voe it rose by 56,500bpd. Tanker uplift fell by 35,000bpd and rose by 7,000bpd at the respective sites. Over the year, gas exports have increased by 60% and oil & gas exploration expenditure has risen by 42.5%. The number of exploration and development wells has increased by 70.6% over the same period.

Chevron is likely to sell its 23.6% stake in the Ninian field to Oryx who specialise in fields which have passed peak production. BP is to focus on growth to meet improved performance following four years of cost reduction. The refinery at Grangemouth is to receive £54M of investment making it a key performer in the eleven refineries left. Amerada Hess are to develop Durward 90 miles east of Aberdeen. Production is planned to rise to 38,000bpd with a parallel development adding a further 17,000bpd.

Oil prices are becoming more sensitive to the supply/demand balance as 'just-in-time' supply is becoming widespread. Market activity is also 'bullish' at this time with sellers benefitting from higher prices. These factors have all contributed to the recent rise in the oil price. The $20 price is not sustainable and prices are expected to fall to the $16-18.

Coal

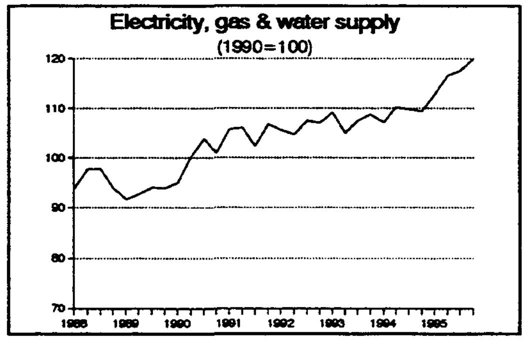
Scottish Coal has signed new contracts with Powergen for coal supplies to Merseyside and Yorkshire. This will double coal exports to England and safeguard jobs at Longannet. The company is also considering plans to invest £15M in Longannet over four years to secure 40M tonnes of reserves. Due to Coal Investments financial difficulties its 32.5% stake in Mining Scotland is up for sale. Waverly Mining, (owner of Monktonhall colliery), could purchase this giving it control of Mining Scotland.

OTHER ENERGY

The index of production and construction for electricity, gas and water supply demonstrates a 4.8% increase for Q2 on Q1 1995 in Scotland. The difference between the Scottish figure and that of the UK is principally because activity in the UK in Q3 1994 was quite high and has fallen slightly whereas activity in Scotland was at a lower level and in Q2 1995 it moved significantly towards the UK level.

Electricity

Industrial sector prices have shown a general downward trend since 1985 and prices were at their lowest ever in 1994 since 1970. electricity prices have fallen 81% in the period 1985-94. Domestic prices have also exhibited a similar downward trend but VAT at 8%, (charged from April 1994), masks this decline. Thus over the last five years annual average electricity prices excluding VAT have fallen by 2.5% but when VAT is included have risen by 3%.



Ian Lang has blocked the bids by National Power and Powergen for Southern Electric and Midlands Electricity. This is contrary to MMC advice but the decision has the support of OFFER, the opposition parties and consumer organisations. It does call into question the role of the competition authorities and has renewed calls for reform. In addition, the decision almost certainly means the Recs are vulnerable to an overseas bid. The message from the DTI seems to be that vertical integration per se is not undesirable but this particular vertical integration is unwanted. Unfortunately for the industry, again, no clear guidance is available on what the criteria for mergers are. Scottish Power and Hanson will both have generating and supply capacity. Southern Company of the US may have been interested in the purchase of National Power but the DTI have issued a statement which effectively blocks hostile takeovers whereby the government will use their 'golden' share to block any investor obtaining more than 15% of the shares. This is the second time in ten days that Ian Lang has surprised both the city and industry analysts.

Hydro Electric is to invest £35M in a Combined Heat and Power (CHP) plant in Kent. The 52MW plant will supply new customers but also provide 30MW to existing customers. Hydro now have six CHP plants in England, an investment of £100M. Last year it sold 25% of its electricity to customers outside Scotland earning £217M. Three other CHP plants are being built and a £315M investment in a gas fired power station is being undertaken with British Gas. When these are completed Hydro will have over 40% of its capacity in England & Wales.

Powergen is planning to build a gas fired power station at Gartcosh at a cost of £210M. The plant will create 30 direct jobs and 35 indirect jobs as well as 900 construction jobs. Full development of the area could mean the creation of up to 3,000 jobs but this is highly unlikely. The STUC have attacked the proposals as a threat to local coal and power jobs at Longannet and Cockenzie.

Gas

British Gas is to demerge into Transco and British Gas Energy, (BGE). Transco will have 90% of all British Gas assets, net assets of £18bn and will own the entire distribution network. It will be responsible for exploration, production, generation and distribution. BGE is a supply related business with net assets of £2.6bn and sales of £8bn to 19M customers. It will also be responsible for the £40bn 'take or pay' contracts. Many analysts blame the government for the present situation as the advice at the time was to privatise it separately but the government chose to privatise British Gas as a vertically integrated national champion.

Transco is to press Ofgas to allow it to charge higher prices. At the moment it is restricted to 5% less than the change in the RPI on an annual basis. Failure to reach agreement will mean Transco seeking an MMC inquiry. The main point of contention is the £300M excess revenues generated annually by Transco who believe that they belong to the shareholder as a reward for previous investment. Ofgas wants a reduction in prices to curb excesses such as these..

Water

South West Water, (SWW), is the target of a takeover bid by Wessex and Severn Trent. If it goes ahead the MMC is expected to call for a 20% reduction in water bills. SWW is valued at £750M. Wessex has an excellent track record and probably has an edge over Severn Trent.

Nuclear

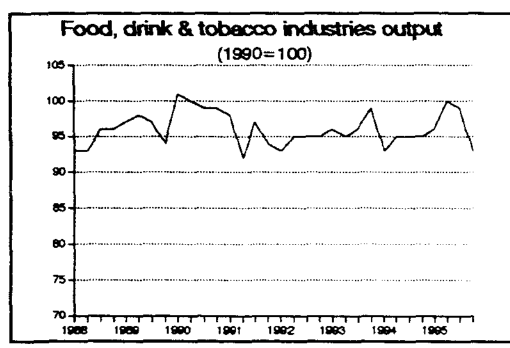
The government is thought to have agreed to British Energy, (BE), taking £600M of debt into the private sector rather than the £1bn originally planned. BE is also to pay £228M into a decommissioning fund and £16M annually thereafter. The offer of BE to the market is expected to raise £2.5bn and will proceed in July. BE, with 25% of the electricity market, is the largest supplier in the country (National Power has a market share of 20%). Only 30% of the shares are to be offered to the public.

Both Torness and Heysham 2 were shut down in January. An incident in on-loading of fuel, i.e. while in operation, caused the alarm. Torness was shut for 18 days and was only allowed to operate with the proviso that refuelling takes place when the plant is shut down. It is unlikely that this will affect the valuation of BE even if there is a design fault at both plants, since the safety procedures which are activated appear to have reassured the market.

MANUFACTURING

FOOD, DRINK AND TOBACCO

Following a small reduction of 1% in the third quarter of 1995, the figures for the index of Food, Drink and Tobacco (FDT) production in Scotland for the fourth quarter show a 6% fall in output. Despite two quarterly reductions, the index shows a 3% increase in the year to the fourth quarter. The fourth quarter figure is certainly a large quarterly fall, although falling output in the final quarter is not unknown (more modest 3% falls also occurred in the fourth quarter in both 1993 and 1991) and one is also well advised to await further confirmation of this, since revised figures may be produced in the future. The UK Index also shows a reduced level of output in the fourth quarter, albeit this is down by only 2%. The UK figures also shows an annual rise in the year to the fourth quarter of 2%.



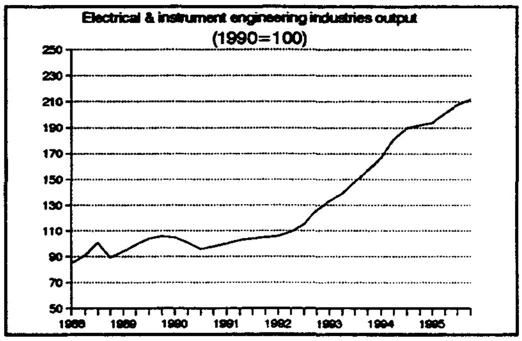
In the food industry, the story of the moment is clearly the BSE scare, and the impact on British and Scottish food sectors of the European Union's decision to ban British meat and meat by-products following findings that the disease may be transmittable to humans. The ban was implemented in March and is still in place at the time of writing, accompanied by a policy of slaughtering up to 4 million older cattle, despite strenuous efforts by the British government to secure at least a partial lifting on by-products such as gelatine. Slaughter seems the only way to ensure that the disease is eradicated from the food chain, although given the blow to confidence in British meat even this may not ensure that markets return to their former level of confidence for some time. The full consequences of the scare are unknown at present, but lay-offs in all sectors of the industry are inevitable until the situation has worked itself through. Job losses have inevitably occurred in Scotland, the largest in March at the Inverurie-based AMN slaughtering and meat processing company, which announced plans to lay-off 400 of its 535-strong workforce. 250 jobs have also been lost at Buchan Meat Producers in Turriff in Banffshire. Concerns over BSE have finally caused the company to go into liquidation, although it had been trading at a loss for several months before March.

The BSE scare appears to have come too early to affect the findings of the Scottish Chambers Business Survey (SCBS) results for April of this year, given that 67% of respondents to the survey reported no change from the January survey in the level of optimism regarding the general business situation (the SCBS's figures are for FDT as a whole, but given the scale of the crisis in the beef industry, one would have expected to see much reduced levels of confidence in the beef industry alone affecting the results for the whole sector). Even despite this, the sector as a whole reported a slight decrease in confidence, down for a net 2% of respondents, and this suggests that the 6% drop in production reported above may reflect temporary or seasonal factors. More worrying, BSE aside, is that a net 12% of respondents to the April survey reported that confidence is down from the position in the year to the April survey.

Elsewhere in the sector, the sausage-casing manufacture Devro which recently completed the acquisition of its American competitor Teepak for £88.4m, faces a one-off loss of around £10m to cover re-organisation costs following the deal. It expects to raise the money from the sale of some of its American operations.

ELECTRONICS

The index of production for the Electrical and Instrument Engineering sector in Scotland increased by a very modest 2% in the fourth quarter of 1995, following a third quarter increase of 9%. For the first time for some while, the fourth quarter increase in this sector is below that for All Engineering in Scotland, which grew by 3% due mainly to a surge in output in Mechanical Engineering. During the same period, the UK industry increased by 2% (fourth quarter) and 1% (third quarter). Over the year to fourth quarter, electronics in Scotland shows a rise in output of 11% compared to 6% across the UK as a whole.



While the most recent figure does represent a very considerable slackening in growth in this sector, it is difficult to reason on the basis of one quarters figures alone that there has been any change in the sector's very considerable growth path (see also below). However, we await the next issue of the index of production with interest, especially in view of the fact that some other indicators are predicting an industry slowdown. In particular, data released in April by the American-based Semiconductor Industry Association report that semiconductor sales in America fell by 3% in March, although this may be due to a temporary overhang of semiconductor sales from the tail end of last year.

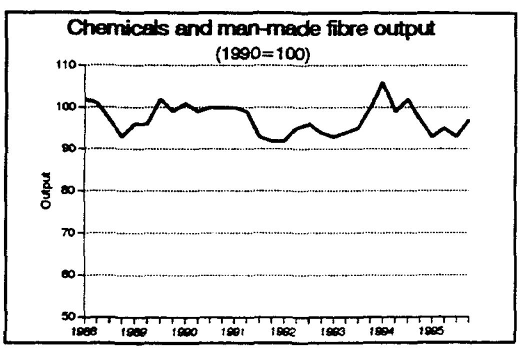
The April results from the Scottish Chambers Business Survey (SCBS) appear to show that this fourth quarter moderation may in fact be something of a temporary blip. This inference is based on the SCBS finding that, while confidence in the industry was down from the January survey for a net 3% of respondents, 12% felt more optimistic concerning the general business situation that in April last year. The trend in orders was also up in the three months prior to April for a net 15% of respondents, while a net 22% expected the trend in orders to continue upwards in the coming three months. The trend in export orders, this sectors major market, was particularly strong and is expected to strengthen further in the coming few months. The recent trend in sales was even stronger than that for new orders although this is expected to moderate slightly.

Following a series of disappointing results, the most recent Scottish Enterprise survey of purchases in the electronics industry in Scotland seems to show that local spending by electronics multinationals is increasing. Although local spending by the big companies still only equals 20.6%, this is an increase on the 18.81% spend in 1993/94. The survey also notes, however, that the local supply picture varies considerably by component, with Scotland doing well in areas such as PCBs, plastics, cable metals and packaging, but pointing to significant gaps in other areas such as keyboards, power supplies and disk drives.

Among companies in Scotland, there has been a major improvement in the fortunes of Prestwick Circuits in the wake of restructuring following as series of ill-judged acquisitions. The company is reported to be able to pay a dividend this year, the first since 1993, having undertaken £5Mn worth of new investment since last summer. One other development is the announcement in April that the American company Simple Technology is to open a Scottish plant in East Kilbride. While only 50 jobs are initially involved, it is hoped to increase this to 350 over the course of the next 3-4 years. The company, which makes memory cards, is believed to be one of the fastest-growing private firms in the US in recent years.

CHEMICALS

The Index of Production and Construction for Chemicals and Man Made Fibres in Scotland showed 5% increase in output in the fourth quarter compared to a 2% decline during the third quarter. However annualised growth continued to decline (-6%). The corresponding UK figures showed no change compared to the third quarter, while annualised growth rose by 4%.



Evidence from the latest Scottish Chambers' Business Survey would suggest the opposite, with respondents indicating that they were more optimistic about the general business situation compared to the previous quarter and the same quarter one year earlier.

The trend in confidence reflects the upward trend in total orders/sales which increased by nets of +40% and +47% of respondents respectively. In both cases demand from all sources rose, although export demand was somewhat stronger than domestic demand. Chemical respondents expect the upward trend to continue, although the rate of increase is forecast to ease slightly.

Orders/sales remained the factor cited by the majority of respondents [71%] as most likely to limit output during the current quarter.

Respondents revised investment intentions in plant/equipment upwards, while the trend with regard to land/buildings was flat. Investment authorised was mainly in orders to replace existing machinery or expand capacity.

The number of staff employed increased for a net of respondents, and a net increase was reported in all categories except female and subcontracting where a flat trend was reported, and self employed staff where a net reduction was reported.

ICI is to invest £60 million in its first Melinex plant, which will result in it becoming the largest polyester film production unit in the world manufacturing polyester film mainly for the packaging industry. The expansion of the Dumfries operation which employs approximately 900 staff, including 550 on the Melinex operation, will create 50 jobs and secure the jobs of hundreds of other workers on the site. It will be the first expansion of the plant since 1985.

Du pont is to build a photomask manufacturing plant at the Hamilton International Technology Park near Glasgow. It will become the companies third photomask plant in Europe and will service existing customers who have set up plants in Europe, including Scotland and Ireland. Du pont hopes to start operations in 1997, creating 25 jobs initially, hopefully increasing to 80.

A Scottish research team is breeding genetically engineered sheep which will produce milk containing a range of human medicines to treat, for example, emphysema, haemophilia, heart attacks, thrombosis and medicine to stop bleeding during surgery. The research team at PPL Therapeutics, Roslin Research Institute, near Edinburgh, hope the research will lead to cheaper, easier to produce milk based medicines and expect clinical trials to start at the end of the year.

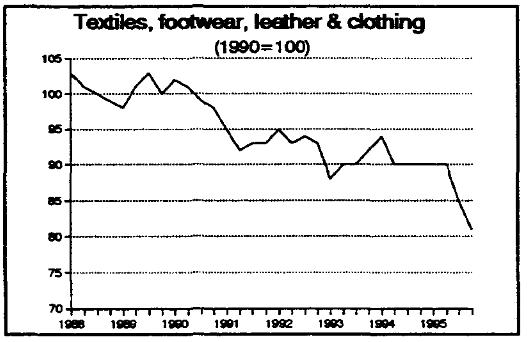
Inverness Medical, which has conducted research into HIV self diagnostic kits, has indicated that its Boston based parent group, Selfcare International, is looking for possible marketing opportunities for the kit which will be produced by the Scottish company. The BMA, however, has expressed concern about patents testing positive without a doctor being present to offer advice if an individual tests positive and also the possibility of patients testing positive when in goods health if the kits were not 100% positive.

Inverness Medical is also currently being sued by a rival, Medisense, alleging that the Inverness factory was built purposefully to produce blood testing strips which infringes its worldwide patent. Inverness Medical is being sued alongside its US-based parent Selfcare which was created by former Medisense employees. Inverness Medical has denied the allegations.

TEXTILES, LEATHER, CLOTHING AND FOOTWEAR

Following a third-quarter increase of 5% in the third quarter of 1995, the Index of Production for the Textiles, Leather, Clothing and Footwear (TLCF) sector in Scotland fell by 5% in the fourth quarter to stand at 81 (1990=100). UK output in the fourth quarter also fell, but by a more modest 1%. Over the year to the fourth quarter, Scottish output is also down by 5% compared to a UK reduction of 1%. Taken together, the Scottish figures are difficult o interpret, but overall indicate little change in the sectors position.

The results of the April Scottish chambers Business Survey (SCBS) are also inconclusive. A net 4% of respondents felt more optimistic concerning business prospects than at the time of the January survey despite the apparent reduction in output in the fourth quarter reported above, but a net 9% felt less optimistic than in April 1995. The trend in new orders in the three months to April was up for a net 11% of survey respondents, and the expected trend is also up for a net 22. The trend in sales was also positive for a net 4% and expected sales in the next three months are also positive for a net 9%., with sales in export markets expected to increase faster than UK sales. In consequence, a net 4% of companies answering the survey also expect to increase employment in the coming three months. Despite this, 79% cite a lack of orders or sales as the factor most likely to limit output in the coming quarter.



Among Scottish companies, the recent news has mainly been bad. The carpet manufacturer Stoddard Sekers is to close its Lyle Carpets factory in Cumbernauld and another at Runcorn in Cheshire in order to concentrate production at its plants at Elderslie and Kilmarnock. The closures are due to falling demand, and Stoddard Sekers hopes to counteract this both by restructuring and by concentrating production at two centres of excellence, weaving in Elderslie and tufting in Kilmarnock. Around 100 jobs will go at Cumbernauld, although some employees will be offered jobs at Kilmarnock.

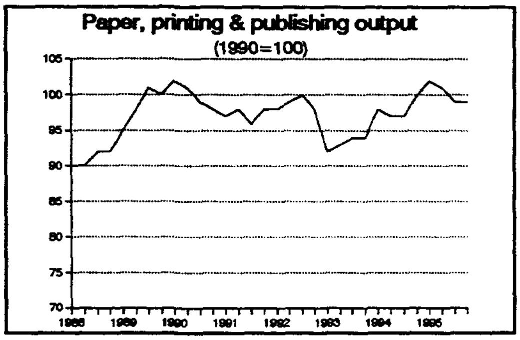
William Baird, a major supplier of clothing to Marks and Spencers, announced a reduction in profits to £10Mn in 1995, down from £25Mn in the previous year. Some £9.8Mn of this is due to restructuring charges following its acquisition of the lingerie and nightwear manufacturer Morris Cohen, but there was also pressure on margins despite rising sales.

PAPER, PRINTING & PUBLISHING

The Index of Production and Construction for the third quarter of 1995 indicates output growth of -3% in Scotland. Annualised growth now stands at 4%. Corresponding figures for the UK indicate growth in the third quarter of 1995 of 0% with annualised growth of 2%.

Output in Scotland showed no change in the fourth quarter of 1995, and annual growth to the fourth quarter in Paper, Printing and Publishing also equalled 2%. Across the UK, the sector recorded growth of 1% in the year to the fourth quarter.

Declining confidence in the paper, printing and publishing sector has continued since the last quarterly report. The latest Scottish Chambers Business Survey reveals that a net -8% of respondent firms are less optimistic about the general business situation compared with 3 months previously.



Paper, printing & publishing output
(1990=100)

Examining the trends in new orders, the volume of new orders have fallen for a net -9% of firms. The volume of new orders have fallen in Scottish, UK and export markets, with, most markedly, a net -30% of firms experiencing a fall in the level of new UK orders. This downward trend is less marked in the Scottish and export markets with level of new orders falling for a net -6% and -14% of firms respectively. An upturn is expected in the next quarter with a net +31% of respondent firms anticipating an increase in new orders.

With respect to the volume of sales, total sales fell for a net -15% and net -28% of firms in the Scottish and export markets respectively. Again however the findings in the UK market are even less encouraging with a net -42% of firms reporting a decrease in UK sales. This trend is expected to be partially redressed in the next quarter with a net +20% expecting an increase in UK sales.

Average capacity utilisation has risen by over 3% since the last quarter and now stands at 76%.

Investment intentions have been revised downwards for both plants & equipment and land & buildings, with net balances of -3% and -7% respectively. However, a net +14% expect investment in plants & machinery to rise in the next quarter.

The expected fall in employment anticipated in the last survey was realised with a net -14% experiencing a decrease in total employment. A net -3% of firms expect further falls in the next 3 months.

Johnston Press, the Edinburgh based local newspaper publisher has achieved record profits of £16.8m in 1995. In spite of increased newsprint costs, Johnston Press achieved overall cost cutting measures which cut consumption by 6.5%. The group is set to acquire 4 new titles in the Doncaster area from Newsquest Media in a deal worth £15m. Johnston Press group's managing director Tim Bowlder believed that the four Doncaster titles will further increase the Johnston Press presence in the Yorkshire area. This move follows the £20m acquisition of East Midland titles form W & J Linney in December 1995.

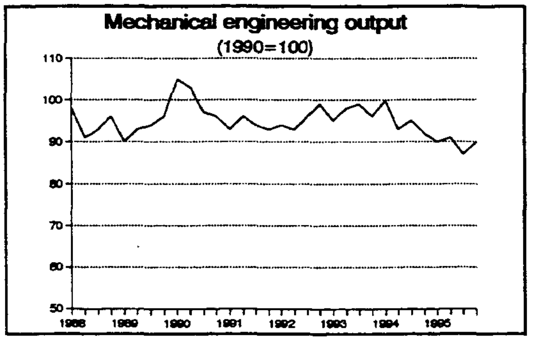
Edinburgh based packaging group Sidlaw is closing its North East England plant in Washington, which produces frozen food and snack packaging. The closure which will mean the loss of 90 jobs is expected to save the group around £2m per annum. This follows the group's 1995 losses of £100,000, the first time that Sidlaw had ever gone into the red. Sidlaw's finance director Ian Bodie has stressed that the Washington plant is the only closure being anticipated at this time.

MacFarlane, the Glasgow based packaging group announced record profits of £21m to the end of December which represents an annual increase of 30%. In the same period group sales rose to £158.6m. Chairman Lord MacFarlane has stated that the group will be on the market for further acquisitions, especially in the packaging sector.

MECHANICAL ENGINEERING

Previous evidence showing that the Scottish mechanical engineering industry is still staggering on the road to recovery is further strengthened by the latest publication of the Index of Production and Construction for Scotland. Although Scottish mechanical engineering output rose by 3.4% in quarter 4 over quarter 3 last year, for 1995 as a whole, it suffered an annual fall of 5.8%. This was the second largest annual fall in output among those Scottish manufacturing industries which recorded declines in 1995, only marginally better than the industry of chemicals and man-made fibres.

In terms of business confidence, the previously-recorded optimism was subdued somewhat as shown in the latest SCBS (April 96), which records a net of 5% of corresponding firms expressing business optimism in Q1 96, down from 12% in Q4 95. Compared with the same time a year ago, however, the marked improvement in business confidence shown in Q4 95 still persisted in Q1 96. The upward trend in total orders in Q1 96 continued with a net 7% of responding firms reporting increases, and the trend is expected to continue in Q2 96. The increases mainly came from export sources. However, the increase in total orders was smaller than in Q4 95, and both the Scottish and UK orders were disappointing. Fortunately, orders from all sources are expected to pick up in Q2 96. Total volume of sales followed a very similar pattern as total orders, with the upward trend continuing until Q2 96, despite a temporary fall in domestic sales in Q1 96. However, a caution should be issued about these increases, because they were usually much smaller than the increases in Q4 95.



In keeping with the subdued orders and sales and expectations, the recovery in work in progress which started in Q4 95 was halted, and there was hardly any change to stocks of goods and raw materials in Q1 96. Moreover, capacity utilization rate stood at 79%, down from 83% in Q4 95.

An encouragement is that the rise in investment plans for plant/equipment strengthened further and is expected to sustain until Q2 96, albeit with eased rates. The main reasons for authorising investment in Q1 96 were: increasing efficiency (38.9%), expanding capacity (27.8%) and replacement (22.2%).

The employment prospects continue to look promising until Q2 96. Most of the increases were accounted for by full-time male employment. Moreover, female employment started to pick up in Q1 96. It is worth noting that the difficulty in recruiting skilled employees persisted, albeit to a lesser degree compared with Q4 last year.

SERVICES

DISTRIBUTION

For Scottish Chamber Business Survey respondents, the decline in Wholesale optimism continued during the first quarter of 1996. There was a turnaround in confidence expressed by Retail respondents both with respect to the fourth quarter and the first quarter of 1995, the first positive net trend since the second quarter of 1994.

Wholesale respondents had forecast that the decline in total sales would accelerate from -2% to -13%; in actual fact a net of +2% reported that, based on the same quarter of 1995, sales had improved and respondents expect this trend to strengthen during the second quarter. The reverse in retail confidence reflects the upward trend in sales exceeding respondents expectations.

Stock shortages remained the factor cited by the majority of wholesale respondents as most likely to limit sales during the second quarter [33%], although 31% of respondents specified credit facilities. Credit facilities remained the factor most frequently cited as most likely to limit retail activity during the current quarter [39%], and 28% cited insufficient floorspace and 27% specified stock shortages.

A net of +7% of wholesalers revised investment intentions upwards based on the same quarter of 1995. Compared to the same quarter of 1995 a net of +15% of retailers revised investment intentions upwards.

The British retail Consortium claimed that the value of retail sales in March was 7% higher than March of 1995, the highest annual rise since it began producing sales data in January 1994.

John Lewis Partnership staff shared in a £57 million profits link bonus following a 28% jump in pre-tax profits to £150 million. Sales rose to £2.8 billion in the year ending 27 January 1996. The bonus represents 15% of annual salaries for the staff who own the firm through the group's partnership structure.

Kwik-Fit Holdings raised annual profits by almost 25% for the year to February 29 from £29.3 million to £36.3 million. The insurance division incurred costs of £1.5 million and is not expected to contribute to profits this year.

House of Fraser profits almost halved to £14.3 million last year. The news was expected as the group had issued several profit warnings. A review of all of aspects of the groups operations is expected by the new chairman, John Coleman.

Tesco's market share roe to 13.6% from 12%, and a 14.5% rise in profit was announced taking full year pre tax profits to £681 million. The group expanded into non food retailing areas i.e. compact discs and videos, pharmacies and clothing. Tesco is planning to invest £700 million a year in the UK and Europe, with 24 new stores are planned in the next year and the group also wants to build on its presence in Europe.

The Glasgow based WEW (What Everyone Wants) group reported a pre tax loss of £3.4 million following compensation of almost £1 million to three former directors. The company also slashed margins to shift old stock and to overhaul its product range. Turnover for the 26 weeks to February 3 was down 7% to £65.5 million.

FINANCIAL SECTOR

Recent banner headlines to the Scottish Financial Enterprise Fact sheet that "banking, insurance and finance in Scotland account for some 20% of Scottish GDP and around one in seven Scottish jobs." indicate the importance and success of the Scottish financial sector to the local economy. Such headlines also invite consideration of the sector's longer term prospects. In recent months the newspapers have been full of stories of job losses in banking, of the threats to the life assurance sector from the conversion or takeover of mutuals, and of reports of dramatic technological change cutting the need for branches and mechanising most routine tasks and transactions in banking. A recent report by the Economist Intelligence Unit, for example, suggested that staff losses in banking by 2005 could be as great as 50%. The causes of this reduction were seen as arising from the limited opportunities that exist for increasing market share and from significant changes in how services are provided. The report emphasised, in particular, a move to screen based provision. If all these stories are to be believed the outlook for the Scottish financial sector could be bleak with dramatic falls in employment likely, but how real are these threats to the sector? Have we reached the peak of employment in the financial sector in Scotland?

The trend towards fewer branches in the banking sector is now well established. At the retail and small business level alternative sources of cash such as ATM's and supermarket checkouts have reduced the need for cashier services. Telephone banking has also increased in popularity and looks set to take over many transactions such as bill paying and money transfers that previously required a branch visit. In the longer term there is bound to be an increase in electronic banking although experience in the past suggests that the practical difficulties associated with introducing new delivery methods slows down or delays their introduction until long after the initial pilot schemes have displayed their feasibility. Ease of use of software tends to come with experience. It is rare for software designers to get it right first time, a reflection of the difficulty of designing new systems, so that workable, reliable software may take many years to appear. New technology will affect how banks operate but it is premature to expect fundamental changes quickly. The process of change is more drawn out than we ever expect. Wholesale changes in bank operations have been a regular prediction for many years, and to some extent they have occurred, but the paperless revolution that has been routinely forecast for banks and elsewhere continues to elude us. A good example of the difficulties is provided by the Bank of Scotland's HOBS service introduced more than 10 years ago. Some analysts predicted that this was the way of the future and that within a few years much of the population would be using home computers to serve their banking needs. These forecasts were far too optimistic. Proper consideration was not given to either the cost of provision, the need to educate customers or the relatively limited services that such terminals can provide conveniently.

With all these forecasts it is important and sometimes very difficult to maintain a sense of proportion. Sceptics may remember that only a few years ago the banks were predicted by the turn of the century to be employing as many as a half of all new school leavers, and bank employment to grow rapidly. There is a tendency to project current trends far into the future with the result that present experiences are greatly magnified. Of course, there are no grounds for complacency. Competition in banking must increase as former building societies fight for the same business as the traditional banking houses. Banks can no longer pass on cost increases to consumers with the same ease as in past times, or delay to the same extent the introduction of new services whilst they observe their competitors. However, it is also important to recognise that reduced costs and greater convenience will generate increased demands for banking services. We may expect a much greater proportion of routine banking to be carried out remotely but that will still leave a need for advice and for the less frequently used services. These services typically have the largest profit margins attached to them. Although there are relatively few new banking products that have emerged in the last

20 years, the liberalisation of the financial system has meant that the use of even the simplest services has expanded greatly. Of course, even if the banks are profitable there may be savage cuts in staff numbers. However, new services particularly those with considerable value added are often expensive in staff time and resources and may greatly change the overall picture. The future for banking is unlikely to be as bleak as many commentators currently suggest. Employment and the number of branches will no doubt continue to fall but reductions in staff to a half of current levels within the next ten years appear exaggerated.

The decline in the building society sector with the rush of many of the larger societies to convert into banks has also been predicted to occur in the life assurance sector with grave consequences for the continued existence of the Scottish mutual life offices. Two distinct argument have been put forward to explain the threat. The first concerns the competitive threat to all life assurance companies. It has been apparent for at least the last 10 years that the societies in Scotland, typically operating through intermediaries, are at a competitive disadvantage in selling their products particularly as many life assurance sales have been tied in the past to sales of mortgages. Building societies and banks are in a much better position to sell their own insurance products to customers. At the same time the rise in telephone selling has suggested that the methods of selling some insurance could be greatly simplified and that financial institutions with well tried systems for such selling could take a substantial part of the life assurance market for their own products. Add to this a tendency for greater transparency in financial transactions, a continuing move to unbundle some products such as life assurance into insurance and savings through unit trusts, and the industry looks set to shrink at least in terms of the number of firms and employment.

The second argument concerns the benefits of mutuality. It is argued that mutuality is no longer appropriate for financial service companies since their managers are too sheltered from the winds of competition. It is difficult to provide definitive evidence for or against such arguments. Certainly, the investment performance of life policies issued by the larger mutuals does not suggest that they are inefficient compared to the proprietary companies. However, recent arguments have not really been about the benefits of mutuality per se but rather about the release of capital that could be achieved by converting a mutual into a joint stock company. As the conversion of the buildings societies has revealed, windfall gains to depositors can be substantial and have encouraged some investors to look at the life companies as ripe targets for demutualisation with the promise of substantial returns to policyholders. Takeovers of life companies to date, however, have not seen the same immediate windfall gains to policyholders as has happened with the building societies. The long term nature of policies means that takeovers that augment the policyholders' life fund do not provide the same quick gains. Policyholders must wait until maturity before they can share in the benefits of demutualisation. There has also been a suspicion that the complexity of life assurance takeovers and the arbitrary valuation methods used by actuaries make it difficult to know the true market value of assets, has meant that, in general, the company taking over the mutual may have benefited rather more than the policyholders. This does not, of course, have to be the case. The conversion of a mutual into a quoted joint stock company with shares in the company being allocated to policyholders would allow the market to value the company and enable policyholders to be certain that they were getting a fair deal in any subsequent takeover. On conversion, policyholders would only be worse of by the costs of conversion since they would effectively remain the owners of the company until they sold their shares in the market. Up to the present the number of demutualisations has been limited and appears to have been driven primarily by worries about costs and access to markets. Managers have looked to takeovers to provide economies of scale and perhaps a more protected and comfortable life than existence as an independent listed company might offer.

Where does all this lead us in evaluating the threat to the Scottish financial sector? It is difficult to be confident about the outcome in the life assurance sector. The distribution problems of the sector remain and there appears no obvious solution for many of the existing life assurance companies. Good investment performance is not enough in a sector driven primarily by marketing. Indeed, some might feel that a move to becoming a quoted company might not only preserve value for existing policyholders but also provide a shake-up to management that appears, in the last 10 years, to have been consistently out manoeuvred by the building society and banking sector. Such a move would have potentially dramatic consequences, at least in the short run, for employment with a likely concentration on cost reduction and increased sales, but in the long term it might provide a better, more broadly based, low cost life assurance sector in Scotland.

TRANSPORT

Air

BAA's pre-tax profits for nine months climbed to £374m, a 14% increase. 6.2m passengers used seven airports in February, a 12% increase over the same period last year. The largest growth is on transatlantic routes, (20%), and the highest level of passenger growth, 20%, occurred in Edinburgh, with Glasgow and Aberdeen experiencing more modest increases.

Three groups are competing for a £200m contract to provide air traffic control at Edinburgh, Glasgow and Prestwick airports. The new air traffic control centre will be based at Prestwick airport. Finally, Crossair is to offer a direct service to Switzerland from Edinburgh. If this is successful then a similar service will also begin from Glasgow.

Road

Single tolls on the Skye Bridge have been increased by 48% and 21% for coaches and cars respectively. Friction over the level of tolls is still evident, with 150 people due in court for non payment and continued disruptive action being taken at the bridge and at sites in Scotland where consortium members are engaged in other work. The £25m bridge built under the Private Finance Initiative, (PFI), is to revert to Scottish Office control after 16-25 years depending on the revenues raised.

Angus Council are the first council to have backed a PFI scheme to reconstruct the A92 coastal road at a cost of £27m. A consortium will design, build and maintain the road. Their return will be in the form of a shadow toll which will depend on traffic levels.

All eight contracts for maintaining the trunk road system in Scotland have been won by local authority bids. This is seen as a major blow to the government's PFI in Scotland where ministers have been encouraging the private sector to bid. Of the 136 proposals for trunk road proposals in Scotland, 92 are alleged to cause serious environmental damage, according to environmental groups. The M80, (Stepps-Haggs), comes in for particular criticism, although the £40m M8 Newbridge extension is seen as having minimal impact, and will reduce congestion on the Newbridge roundabout by 50%.

FirstBus have bought Manchester's GM Buses North for £47m, following Stagecoach's £41m purchase of GM Buses South. This brings the market share of the two Scottish companies to 16% and 17% respectively. Elsewhere, Citylink has introduced a 15 minute service on the Edinburgh-Glasgow route.

Motorway toll testing has been postponed by twelve months, and one supplier has suggested that it may be the year 2004 before viable equipment can be installed. Four of the consortium who had expressed an interest in trials have withdrawn due to uncertainty over the project, lack of finance and the government's unwillingness to bear some of the risk in the project.

Rail

Scotrail is up for franchise again. It is one of seven franchises put on the market by the Office of Passenger Rail Franchising, (OPRAF). The front runners include; Stagecoach, (who are bidding for all 25 franchises), FirstBus, CGEA, (a French group), National Express and a management bid. Invitations to tender will be issued in June. Sources indicate that final bids will be in October and that an agreement will be signed in November. This means that the earliest Scotrail can move into the private sector is January 1997. A major issue still to be decided is the level of service for Strathclyde Passenger Transport Executive who will co-sign the franchise agreement.

The saga of rail privatisation continues; the Great Western franchise has gone to an employee/management team, South West Trains are now run by Stagecoach, all the freight companies are operated by Wisconsin Central Transportation, National express operates Gatwick express and Midland Mainline, Sea Containers run the East Coast Main Line and General des Eaux is to operate Network South Central. The process is still well behind schedule although recently rapid progress has been made. It is not without its problems; the most notable being alleged fraud at LTS, WAGN and Trainload Freight plus the director of OPRAF is to retire two years early. The government have been fiercely criticised with only 17% of rail services in revenue terms in the private sector when the target was 51% by the 31st of March.

First Engineering has acquired the £27.5m track maintenance business in Scotland through a management/employee buyout. The £100m turnover business employs 2,400 people. The Weir Group and 3i each have a 23.5% stake while the management team have the controlling share. Their main contracts are with Railtrack and are worth £65m over 5 years.

The £1.8bn flotation of Railtrack is to go ahead with 1.9m small investors registering an interest. The minimum investment is 200 shares at 380p/share. In the first year the expected return is 25%, due to the £69bn dividend 'sweetner' which will be paid in October. The government now also plan to sell 100% of Railtrack as opposed to the 51% originally planned. In the event of a new Labour government, this would make it harder to reverse or alter the position of Railtrack. The opposition however have signalled that they may divert subsidies from train operating companies to Railtrack giving it a greater say in Railtracks operations and creating uncertainty in the privatised rail industry. Further criticism of Railtrack centres on the claim that £11bn is required to bring the infrastructure up to standard over the next 10 years, a figure that is eight times that published in the prospectus. The HSE have also severely criticised safety standards and are demanding more stringent compliance.

Sea

The Caledonian Canal requires £20bn of repairs at 29 lochs to keep it open to the public in the long term. It supports 470 jobs over 22 miles and generates £14.5m per annum. Both Forth Ports and Clydeport have increased their 1995 profits by 10% and 27% respectively. While Forth Ports needs to consolidate its recent acquisitions at Tilbury, Dundee and Rosyth Clydeport remains eager to purchase an east coast port.