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 present forecasting period extends to 1997Q4. In making the Scottish forecasts, the past performance of the Scottish and UK manufacturing outputs are considered, and the National Institute's quarterly forecasts for UK manufacturing output are used as the driving force. Figure 1 depicts the actual growth rates for Scottish manufacturing output from 1988Q1 to 1996Q3 and the forecasts for 1996Q4 to 1997Q4. The forecasts show that the overall growth trend of Scottish manufacturing output will maintain throughout the forecasting period. However, the growth momentum will subdue towards the end of 1996 and into 1997. The annual growth rates for the output of Scottish manufacturing industries are predicted to be around 2.8% over 1996/1995 and 1.8% over 1997/1996 respectively. 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)

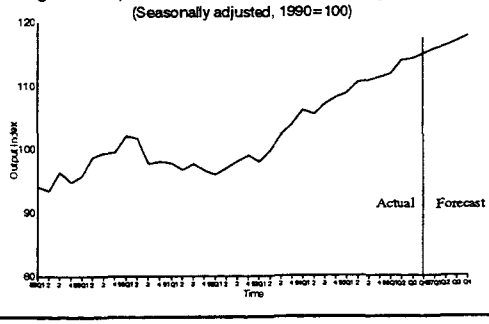


TABLE 1 QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)	
92/91	0.3
93/92	3.5
94/93	5.6
95/94	3.4
93Q4/92Q4	4.8
94Q4/93Q4	4.1
95Q4/95Q4	2.9
95Q1/94Q4	0.6
95Q2/95Q1	1.6
95Q3/95Q2	0.3
95Q4/95Q3	0.4
96Q1/95Q4	0.5
96Q2/96Q1	1.9
96Q3/96Q2	0.3
FORECAST	
96Q4/96Q3	0.7
97Q1/96Q4	0.6
97Q2/97Q1	0.4
97Q3/97Q2	0.7
97Q4/97Q3	0.6
96/95	2.8
97/96	1.8

* 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.

THE DELOITTE & TOUCHE SCOTTISH CHAMBERS' BUSINESS SURVEY: FOURTH QUARTER 1996

The Deloitte & Touche Scottish Chambers' Business Survey for the fourth quarter of 1996 are detailed below. The Deloitte and Touche 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 in December, 808 firms responded to the questionnaire of which 797 were useable.

Business Confidence

In manufacturing, business confidence has risen again. A net balance of 16% of respondents reported that they were more optimistic than three months previously, compared with a balance of 10% who were more optimistic in the third quarter. In the fourth quarter, manufacturing respondents continued to be more optimistic than they were a year ago, with a net balance of 20% of respondents reporting higher optimism, compared to 9% in the third quarter.

In construction, optimism has at last risen, for the first time since the first quarter of 1995. A net balance of 13% of respondents reported that they were *more* optimistic than in the third quarter. This compares with a 6% balance of respondents who were less optimistic in the third quarter over the second quarter 1996. A net balance of 1% of respondents reported that they were *more* optimistic than they were a year ago, compared with the situation in the third quarter where a net balance of 1% of respondents were *less* optimistic than in the same period a year earlier.

In distribution confidence rose further in retailing, while in wholesaling there was also a net increase in optimism after the declines of the previous seven quarters. In the fourth quarter in retailing, a net balance of 19% of respondents were more optimistic about the general business situation than they were in the third quarter, which compares with the 20% balance who were more optimistic in the third quarter. In wholesaling, a net balance of 10% were *more* optimistic than in the third quarter, an increase on the negative net balance of 1% in that quarter. Compared with a year ago, wholesale respondents were *more* optimistic, registering a positive net balance of 5%, while in retailing, a net balance of 30% were more optimistic.

Respondents in the tourism and leisure sector reported another increase in confidence, although at a slower rate than recent quarters. In the fourth quarter, a net balance of 16% of respondents indicated that they were more optimistic about the general business situation than they were three months earlier, compared with a positive net balance of 43% in the third quarter. A net balance of 44% of respondents were more optimistic in the fourth quarter than in the final quarter of 1995.

Orders and Sales

In manufacturing, orders and sales exhibited strong growth in the fourth quarter. For orders, a net balance of 19% of respondents reported an increase while, for sales, a balance of 24% of firms experienced a rise. These figures compare with positive balances of 7% for orders and 8% for sales in the third quarter. Orders and sales growth is now positive from all main markets. Exports continue to be the strongest market followed by the rest of the UK and the domestic Scottish market. However, the gap in growth between exports and rest of the UK sales appears to have narrowed in the most recent quarter following a strong pick up in demand from the rest of the UK.

In construction, new orders continued on a downward trend but at a slower rate than in the third quarter. A net balance of 14% reported a decrease in orders compared with a net balance of 29% reporting a decrease in the third quarter. Orders from both Central Government and Other Public Sector continue to be severely depressed, but perhaps slightly less so than in the previous quarter, while orders from the private sector continued to rise slowly: a net positive balance of 4% compared with a 1% positive balance in the third quarter.

Sales growth in distribution continues to differ markedly between the two key sectors, although the contraction in wholesaling turnover appears to have ceased. A net balance of 35% of retailers reported that sales had risen, compared with the 36% balance reporting an increase in the third quarter. In wholesaling sales appear to have risen slightly. A net balance of 1% of respondents reported an *increase*, compared to the balance of 14% of respondents reporting a fall in the third quarter.

The growth of tourism demand moderated

somewhat after the dramatic increases in the previous two quarters. A net balance of 50% of firms reported an increase compared with a balance of 67% reporting a rise in the three months to December. Demand increased strongly in all major markets.

Stock Adjustments

Stocks of raw materials, finished goods and work in progress in manufacturing all fell. A net balance of 13% reported a fall in stocks of raw materials, while for finished goods the negative net balance was 9%. A negative net balance of 1% suggests a small fall in work in progress.

Finance and Investment

In the financial sector, the demand for personal loans continued to rise and at a faster rate than in the third quarter. A net balance of 61% of respondents reported a rise, compared with the balance of 46% reporting an increase in the third quarter. Advances to the corporate sector also continued to rise strongly, while the demand for working capital continued on a strong upward trend. In addition, the demand for finance for investment in buildings continued to rise although at a slower rate than in the third quarter, while the demand for finance for investment in plant and equipment appears neither to have risen nor fallen over the previous quarter.

Manufacturing investment intentions in plant and machinery were again revised upwards in the fourth quarter, with a net balance of 13% reporting an increase and respondents expect to revise these intentions up further again in the first quarter of 1997. The deterioration in manufacturers' investment intentions in land and buildings has ceased. A net balance of 1% of respondents reported an *increase*, compared with a balance of 2% reporting a decrease in the previous survey. Respondents also expect a slight further increase in buildings investment in the first quarter of this year. In retailing and wholesaling, investment intentions continue to be significantly positive. Net balances of 21% and 15% of retail and wholesale respondents, respectively, reported an upward revision in investment intentions compared to the same period a year ago.

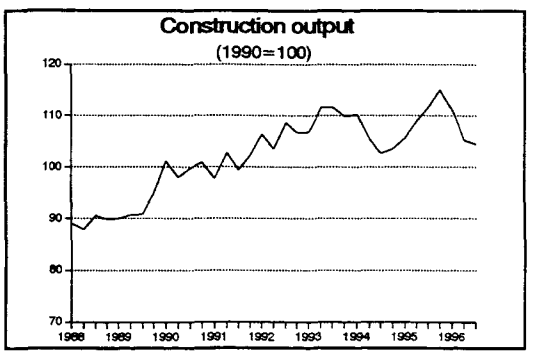
Expectations

In distribution and tourism the outturn for demand in the fourth quarter was better than anticipated in the third quarter. In manufacturing, the outturn was broadly as anticipated while in construction the outturn was worse than expected.

Demand conditions are expected to improve in the first quarter in all sectors except construction. Manufacturing is expecting a further strong increase in orders and sales at much the same rate of increase as in the fourth quarter. In retailing, strong growth is expected but at a somewhat lower rate than the outturn in the current quarter, while in wholesaling there is expected to be some improvement in the now positive growth trend.

CONSTRUCTION

The latest Index of Construction showed that once again output in the Scottish construction industry fell (by 0.8%) to stand at 104.5. The year on year figure however recorded an increase of 1.6%. Nationally output increased by 0.5% over the quarter however the year on year figure continued to decline, a fall of 0.4%.



Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey suggests that in spite of the continued decline in total orders, a net of respondents are more optimistic about the general business situation than in the previous quarter (+12%) and the same quarter of 1995 (+1%).

The continued decline in the total volume of new orders was steeper than respondents had anticipated, only 26% reported increased orders while 41% noted a fall. Respondents do however expect the decline to ease considerably during the current quarter, largely as a result of increased private sector orders. In contrast firms expect public sector orders to remain depressed.

Firms were utilising, on average, 82% of available capacity, an increase compared to the previous

quarter and the percentage of respondents citing the low level of demand as the factor most likely to limit activity in the next quarter eased slightly to 81%.

Respondents continued to reduce the total number employed and the decline continued at a net of -18% however once again firms expect this trend to end during the current quarter. The average wage increase was 3.5%.

NHBC figures for the fourth quarter of 1996 show that the level of house building activity increased throughout the UK. Some totals of almost 37,000 applications were made to start new homes which represents an increase of 30% on the same quarter of 1995. Growth in Wales remained static, however, growth was particularly strong in Scotland, North East England, the East Midlands and East Anglia. Housing starts in the fourth quarter 1996 show Scotland with 3840. New home completions reached the highest levels since the 1970's in Scotland.

Scottish house prices rose by 3.8% over 1996 as a whole according to the latest Royal Bank of Scotland Housing Index. Glasgow showed the strongest performance at 6%, in Dundee average prices actually fell by 2%. Mr Andrew McLaughlin, the Royal Bank of Scotland's housing economist, is forecasting a further 4% to 5% rise in Scottish house prices despite anticipated interest rate rises, although further increases would be moderated by the impact of more property coming onto the market.

The number of home starts for last August was the highest since 1989. Mr James Clappison, environment minister, said that builders had started work on 42,000 homes in the three months to the end of November, 39% higher than in the same quarter one year earlier. This news was welcomed by retailers as rising property sales and prices were beginning to boost demand for household goods. This was mirrored by the following results, the house builder Crest Nicholson sold a record number of homes in its latest financial year, lifting profits to 61%, from £6.2 million to £10 million.

The government recently published new guidance, developed with the Confederation of British Industry, aimed at cutting red tape and reducing delays which have affected those negotiating private finance initiative projects. Companies had complained that they were forced to negotiate basic contract terms for every new deal. Mr Michael Jack, financial secretary to the Treasury, was confident that guidance would allow the government to meet its projection of £14 billion in signed deals by 1999, last year the government fell short of its projected total of £2 billion in signed PFI deals.

The Inland Revenue in Scotland is to use the private finance initiative for the first time to build a new £14 million headquarters in Edinburgh. The deal involves a fifteen-year contract and will provide 55,000 sq. ft of serviced office space as the Revenue merges its assessment and collection offices involving 320 staff.

The government was criticised by The National Council of Building Materials Producers who claimed that failure to invest sufficiently in infrastructures was seriously affecting competitiveness. They forecast that output would rise by 2.5% over the next two years following an increase of 0.5% this year. The increase, led by a recovery in private sector investment, would be less than the general rate of growth in the economy.

ENERGY

Oil & Gas

In Q4 UK oil revenues were at their highest levels for 11 years during October while in November oil and gas production increased to a 13 month high. Oil production increased by 9.4% for Q4 1996 on Q3 1996 with no significant annual change. Gas production had a sharp quarterly rise due to seasonal demand but over the year production rose by 15.4%. The oil price peaked at $24.13 in October with average daily oil revenues of £40.2 million. Combined total average revenues peaked at 59.4 million in December.

The Royal Bank of Scotland Oil and Gas Index rose by 33.1% for Q4 on Q3 1996 and by 6.3% over the year. The annual change is driven mainly by an increase in gas production. Both oil and gas contributed significantly to the quarterly change.

Oil and gas revenues rose by 24.2% over the year and by 33.7% for Q4 on Q3 1996. While oil and gas production increases were significant factors here the high oil price continues to strengthen revenues. Towards the end of Q4 the oil price dropped slightly perhaps reflecting that these prices are not sustainable in the longer term.

The largest increases in oil production were in

Enterprise Nelson, BP Andrew, Chevron Alba and Amerada Hess Fife. The largest increases in gas production occurred at BG Morecambe, Philips Hewitt, BP Bruce and Conoco's V fields.

The Aberdeen Chamber of Commerce Oil and Gas Survey for Q4 1996 shows that in the oil and gas related sector 35% of respondents reported a decrease in exploration activity. Scottish based exploration work is expected to decline in the first six months of 1997 as is the rest of the UK. Overseas work however is predicted to have a positive trend although respondents remain cautious. Investment in Q4 was principally concerned with expansion rather than replacement.

Oil prices have fallen to $19.50 following the temporary lifting of the UN embargo on Iraqi oil exports. Currently 600,000bpd will be added to the market. Despite this general downward trend, low stocks in the US and political developments in Russia and Iraq have temporarily driven the price up.

BP increased net profits to £2.6billion, a rise of 30%, in 1996 with exploration and production profits rising by 35% but the company warned that this growth was not sustainable. BP remained the largest holder of UK North Sea oil and gas assets valued at £7.5billion followed by Shell at £5.5billion. Shell's profits rose to £5billion in 1996. BP and Shell have discovered a new potentially commercial field, Suilven, west of Shetland. It is thought that the west of Shetland area contains mostly gas and that companies are generally disappointed with exploration results. BP is to expand its Bruce field creating 350 offshore jobs. BP will spend £360million and while the platform will be built in Holland the UK is expected to win 80% of the contracts creating a further 500 jobs.

Gulf have taken over Clyde Petroleum for £495million while Halliburton have paid £72.6million for OGC International the Aberdeen based group.

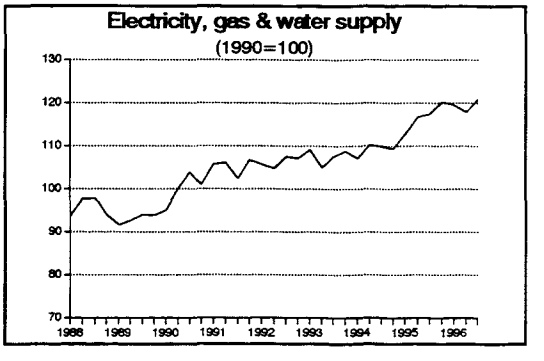
UTILITIES

The Index of Production and Construction for Q3 1996 for electricity, gas and water supply shows little difference for the latest four quarters; the figures for Scotland and the UK being 4.8% and 5.4%. The change for Q3 on Q2 1996 however is 2.6% for Scotland and -1.4% for the UK. While these figures have opposite signs both the indices in Scotland and the UK are returning to trend. It was in Q2 1996 that electricity demand was below trend in Scotland but above trend in the UK.

The Commission on the Regulation of the Privatised Utilities has recommended tough measures on anti-competitive behaviour by the utilities. It also proposes legislative changes, regulators publishing reasons for their decisions, advisory boards to regulators and the merger of Offer and Ofgas after 1998.

Electricity

Electricity prices fell last year with gas having the largest increase as a generation fuel. The share of coal in generation fell below 50% in 1995 for the first time. For 1996 the figure for coal is estimated to be closer to 40%. For the UK average domestic energy prices fell by 2.5% in real terms while industry saw electricity prices fall by 3.2% and gas prices decrease by 14.8%. In England and Wales a reform of the pool price system could see electricity prices fall by up to 20%. There is no comparable Scottish data.



Scottish Hydro Electric (SHE) saw pre-tax profits fall by £400,000 to £61.3 million for the first half of 1996. Low rainfall was the main reason for the drop in output from Hydro generating stations. Trading in England and Wales increased by 17.5% to reach 39% of SHE's total. Scottish Power (SP) has secured the right to increase power bills following a legal victory over Offer, this allows SP to operate under the same terms as SHE.

Gas

British Gas has been demerged into BGplc and Centrica. Centrica will sell fuel to households and businesses and will have assets of £2 billion on a historic cost basis. BGplc will own the pipeline network and overseas interests with assets valued at £5.5 billion on the same basis.

Ofgas is to launch an inquiry into SP's gas division after allegations that it does not take on low profit margin customers with pre-payment meters. Concentrating on high margin customers would be against the terms of the public supply licence.

British Gas has paid BP £250 million to free itself from obligations to buy North Sea Gas. The company is also set to put aside it's Morecambe gas fields as part of a global settlement for its 'take or pay' contracts. Centrica is committed to buying 137 billion therms of gas worth £2.6 billion over ten years. Earlier estimates of its liabilities were £1.37 billion compared to the value assigned to the Morecambe field of £1.45 billion. British Gas has resolved one fifth of its problems with the BP and Mobil deals . It still has to reach an agreement with Shell and Esso which are the company's two biggest gas suppliers.

Water

The North of Scotland Water Authority has awarded a £45 million contract for sewage plants at Inverness and Fort William. The deal is a Public Finance Initiative (PFI) scheme and could lead to £500 million worth of contracts for Scotland's water industry. There are currently 22 projects awaiting approval but they all require PFI involvement.

SP is to cut £52 million in costs from Southern Water, 710 jobs are to be axed leaving SP with a one off charge of £21 million. A further 1,340 staff are earmarked to leave the payroll due to contracting out and it is expected this move will raise £100 million.

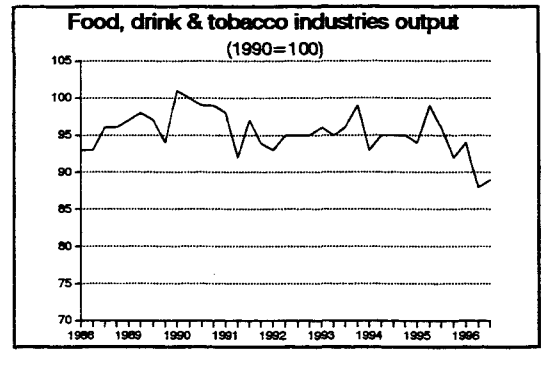
MANUFACTURING

FOOD, DRINK AND TOBACCO

The Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 89 in the third quarter of 1996 (1990=100). This represents a 1% increase on the previous quarter, but a fall of 5% compared to the position one year previously. Output in the third quarter was unchanged in Food and Tobacco, although total Food and Tobacco output fell by 2% in the year to the third quarter. In the Drink sector, output rose by 3% over the third quarter, but fell by 8% over the year, clearly the main reason for the overall fall in Scottish output.

The UK FDT index fell by 1% in the third quarter and remained unchanged for the year, a better performance than the overall Scottish sector. In Food and Tobacco, the annual performance across the UK shows a 1% fall in output, below the Scottish level, while the UK Drink sector saw output increase by 5%, so a relatively poor Scottish performance in Drink appears to be the mean reason for the poor relative performance across FDT as a whole. Both industry sectors, however, compare poorly on an annual basis against the whole manufacturing sector in Scotland, where output increased by 3% in the year to the third quarter.

The December results from the Deloitte & Touche Scottish Chambers' Business Survey (which gives coverage only for FDT as a whole) show little change in optimism across the industry compared with the position three months earlier. A total of 60% reported little change in optimism over the period, although there was a small positive balance (the percentage of those reporting greater optimism compared to the percentage reporting less) of 5%. Confidence does appear to be higher when compared to the situation one year previously, however. Here, 36.8% reported increased optimism, compared to only 22.5% who were more optimistic than three months previously, although the net balance of optimism is again low at 5.2%.



The trend in new orders was reported as flat across the sample of responding firms, with around a third of all companies seeing increases, decreases and no change, although the overall net balance was positive at 5%. The expected trend over the three months from December does appear healthier, however, due mainly to fewer companies expecting the trend in orders to fall, leading to a positive balance of those expecting new orders to increase of 12.8%. While the expected trend was positive in all three main markets (Scotland, other UK and export markets), export markets, where the positive net balance is 15.4%, were expected to grow fastest in the three months from December.

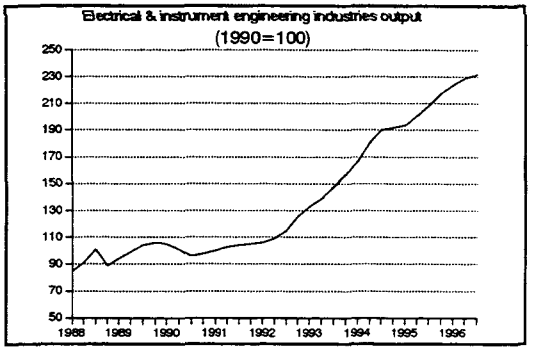
Average capacity utilisation stood at 73.4% in the period until December, and while this had increased for 32.5% of firms, the net balance was negative at 5%. Despite this, 22% of companies made plans to increase investment in plant and equipment during the period, and the net balance figure was positive at 7.4%. Investment intentions for land and buildings was however, flat. The trend in employment in the three months to December showed a negative net balance of -7.3%, and the expected employment trend is forecast to deteriorate in the next period, with a negative net balance (-10.3%) of companies expecting to reduce labour.

In the company sector, the soft-drink manufacture AG Barr expects further increases in profits this year following a move to a new factory in Cumbernauld. Barr had previously to produce across four sites, and the efficiency increase following the move to Cumbernauld occurred with a rise in total sales from £101 million to £103 million. Total profits rose over the year from £4.5 million to £5 million.

The milk company Scottish Pride, the former manufacturing arm of the Scottish Milk Marketing Board, has gone into receivership, threatening over 700 jobs. However, it now seems likely that the company will be sold to Wiseman, who were already negotiating a takeover, as the Office of Fair Trading (OFT) seem to accept that this is the best way to guarantee continued employment at Scottish Pride. Wiseman, who would control about 80% of the milk market in Scotland in the event of a takeover, have offered certain concessions to the OFT, mainly that they will make public the prices at which it sells milk to different customers.

ELECTRONICS

The Index of Production for the Electrical and Electronic Engineering (EEE) sector in Scotland rose by a moderate 1% in the third quarter of last year, to stand at 232 (1990=100). However, while this small increase is modest by the industry's past standards, it does outstrip the change seen across the engineering sector in Scotland as a whole, where output fell by 1%, and is also a better performance than that of EEE across the UK, where output was unchanged between the second and third quarters. The 13% increase recorded in the year until the third quarter also far outpaces the performance of all engineering in Scotland, where output increased by 4%, and that of EEE across the UK, which saw a rise in output of 2%. EEE's performance in the third quarter is also significantly better than the annual performance of the whole manufacturing sector in Scotland, where output increased by 3% in the year to the third quarter.



Some indication of more recent performance can be gauged from the results of the 1996 fourth quarter results of the Deloitte & Touche Scottish Chambers' Business Survey. Over one quarter (27.3%) of respondents to the fourth-quarter survey reported an increase in business optimism compared to the position three months earlier, and the net balance of optimism (the percentage of those reporting greater optimism compared to the percentage reporting less) equalled +13.6%. In addition, 38.7% of survey respondents said that they felt more optimistic than at the same time one year previously, and there was again a net balance of optimism across the survey, equal to 13.9%. The position with regard to new orders also appears to be fairly healthy. Although the sample was split fairly evenly between those reporting increased, decreased and no change in new orders in the last three months, a small net balance of 4.8% of respondents reported an increase in orders. However, the expected trend over the coming three months is expected to be a good deal stronger with a balance of 18% of firms in the sector expecting this to increase.

The main source of new orders is expected to be export sales. These had increased in the three months to December for 37.7% of respondents, which means that a net balance of 7.9% saw some increase in export orders. Perhaps more significant is that 43% of firms expect export orders to increase in the coming three months, and the net balance of those expecting an increase over those expecting export orders to decrease widened to 25.6%.

Average capacity utilisation was reported as 78.1%, and 30% of firms in the survey reported that utilisation had increased from the same time last year. Investment intentions had also increased, with

24.4% reporting that they intended to increase investment in plant & equipment compared to three months earlier, which means that a net balance of 11.4% of respondents reporting an increased intention to invest. Similarly, investment intentions for land and buildings was also positive at 9%. The trend in total employment was also upward. A total of 26.2% of respondents said that the trend, excluding seasonal factors, was upward, a net balance of 10.9%.

In the company sector, Motorola at East Kilbride has won a contract to supply chips for credit cards which will use its new crypto chip. The card can be used for credit and debit functions, and can also be used as an alternative to cash for value transactions. The company has also announced that it would like, over the next three years, to double its recruitment of skilled engineers in Scotland, owing to difficulties in recruiting sufficient numbers in America.

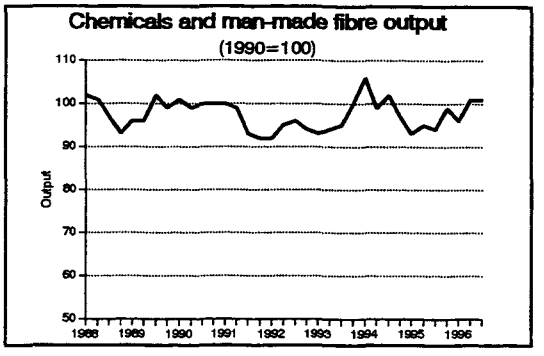
The Scottish computer company Rodime has announced its first set of profits since 1992. The company, which in the 1980's made the significant technological advance of inventing the first 3.5 inch disk-drive, now operates only as a financial shell and makes money from the patents still outstanding on these.

CHEMICALS

The Index of Production and Construction for Chemicals shows that for Scotland and the UK as a whole there was no change in output in the 3rd quarter compared to the second quarter. However, year on year output rose by 5% in Scotland whilst for the UK the corresponding figure was a more modest 2%.

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey indicates that notwithstanding weaker than anticipated trends in demand business confidence among chemical respondents continued to rise at a net of +11%. Chemical respondents also reported being more confident than in the same quarter of the previous year.

The increase in both orders and sales was less than anticipated. In the case of total orders the increase resulted from increased orders from Scotland and overseas, a flat trend in rest of UK exports was reported whereas in total sales the increase was solely as a result of increases sales to Scotland, sales to both the rest of the UK and abroad were flat. Respondents expect both trends to improve during the current quarter as a result of increased demand from all markets.



Respondents reported utilising, on average, only 75% of available capacity, a decrease of 7% compared to the third quarter.

For a further quarter respondents overestimated the trends in employment. The level trend reported during the previous quarter was not sustained and a net of -18% resulted. Once again respondents expect an increase in total employment during the current quarter.

Only 6% of responding chemical firms increased wages during the fourth quarter and the average wage increase was 3%.

Core Technologies, the drug delivery company based in Ayrshire, aims to raise £20 million through its flotation which will finance new products and a state of the art manufacturing unit in Irvine. The company plans to more than double its workforce of 50 and most of the jobs would be recruited locally. Drugs which are ready for production include a suppository to provide pain relief for cancer sufferers and a pessary for the treatment of thrush. Both of these drugs rely on Hydrogel, licensed from Strathclyde University, which releases a controlled amount of the drug over an extended period. The company has also licensed a technology that releases a controlled oral dose of a drug and it is developing its own proprietary system.

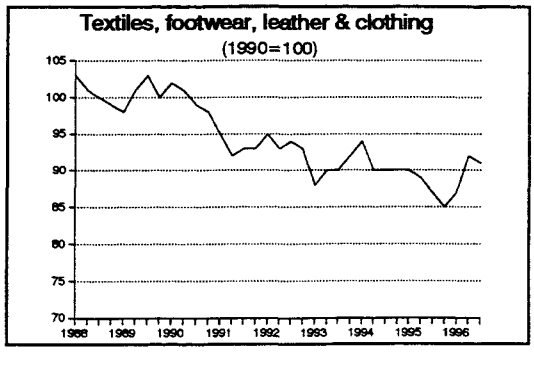
Shares in the Dundee based company, Shield Diagnostics, jumped by 22% following news of an exploratory link with the US health care giant Abbot Laboratories which could develop into a long term financial association between the firms. The move involves a project to assess whether Shields' medical testing technology can be developed to run

on Abbotts equipment which is supplied around the world. The trial, if successful, could result in a more formal agreement. The announcement followed warnings, at the end of January, by Shields of worse than expected losses which analysts said could hit £1 million. The losses were higher than anticipated due to exceptional charges such as a one off payment of £70,000 for 12 redundancies announced before Christmas and £378,000 for the value of intellectual property. Shield blamed falling sales of its syphilis and chlamydia test kits for the first half losses.

An alliance between the drug discovery company group Peptide Therapeutics and fellow bio tech company Medeva is hoped to produce a vaccine against the E-Coli bacterium. The deal will combine Medevas' expertise in creating oral and nasal vaccines and Peptides vaccine discovery skills. The initial agreement is to cover flu, typhoid and E-Coli vaccines.

TEXTILES, LEATHER, CLOTHING AND FOOTWEAR

The Index of Production for Textiles, Leather, Footwear and Clothing (TLFC) in Scotland stood at 91 in the third quarter of last year (1990=100), a fall of 2% on the previous quarter, with no change in output from the third quarter, of 1995. The third quarter result compares with a 2% rise in output in the sector across the UK, although the UK industry recorded a fall of 2% in the year to the third quarter. TLFC's performance is poorer than both the third quarter performance of all manufacturing in Scotland, where output rose by 0.3, and for the year to the third quarter, during which period all manufacturing in Scotland saw an increase in output equal to 3%.



The results of the Deloitte & Touche Scottish Chambers' Business survey for the three months to December of last year, however appear to show some signs of optimism regarding the sector's short-term performance. The figures to December show that there was a positive balance of optimism among respondents, with 42.6% reporting an increase in confidence compared to three months previously, and a net balance of optimism (the percentage of those reporting increased optimism compared to the percentage reporting a decrease) of 35.6%. The position looks even better when compared to that one year previously, where 52.9% of respondents reported an increase in confidence.

The position regarding new orders also seems fairly sanguine. Some 54.7% of respondents reported that new orders had increased in the three months to December, and there was a positive net balance of 40.4% across the sample. The expected trend over the coming three months was also expected to remain positive, if falling slightly. Here, 50.3% of companies expected the trend in new orders to rise, a net balance of 33.7%.

The source of new orders is fairly similar across the three categories of Scottish, other UK and export orders. Firms reported a positive balance in the trend in new orders across all three areas in the period until December, and this is expected to improve further in all three in the current quarter, with the largest trend increase expected to arise in export markets, where the positive net balance is forecast to be 32.5%. Capacity utilisation recorded an average across the sample of 78%, an increase for a net 27.3% of firms questioned compared to Q4, 1995. Investment intentions for plant & equipment had also increased in 29% of cases, a positive net balance of 17.6%. The survey also noted that, while the trend in employment was upward for 21.6% of companies, there was a net balance of -2.3% who had seen the trend in employment fall in the three months to December. However, this trend was expected to reverse in the coming three months with a net 12.1% of firms expecting the trend in employment to rise.

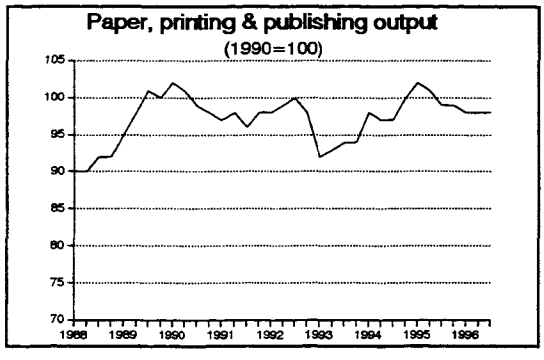
Richards, the Aberdeen-based carpet manufacturer, announced a £2.3million loss last year, due to poor sales and a loss on the sale of its shirts business. Total employment at Richards has more than halved since 1990.

Elsewhere, Coats Vyella announced a set of poor results across its main engineering, home furnishing, textile and thread markets, caused by low demand across a range of international markets and adverse currency movements. Although restructuring, including some plant closures are

expected to improve the company's performance, the group predicted that overall trading conditions are unlikely to abate significantly during this year.

PAPER, PRINTING AND PUBLISHING

The Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland remained unchanged in the third quarter of 1996 although the actual percentage change in output, from the second quarter of 1996, shows a 1% fall. The corresponding UK figure reveals output growth of 1% over the same period. Annualised growth in both Scotland and the UK fell by 2% and 1%, respectively. The output growth in this sector (as in most other manufacturing sectors apart from Electronics) has not enjoyed the steady growth path experienced by the Scottish manufacturing sector as whole.



Following on from the previous quarterly report, the most recent Deloitte & Touche Scottish Chambers' Business Survey reveals that business confidence has continued to improve within this sector. In the previous quarterly report, a net 23% of respondent firms reported more favourable business conditions, as opposed to the previous quarter. This trend has continued in the current quarter with a net 28% of respondent firms, within this sector, more optimistic about the general business situation than in the previous quarter. In comparison with the same period one year ago, a net 41% of respondent firms reported greater optimism about the present general business conditions.

The increase in the volume of new orders as indicated by a net 47% of respondent firms, over the previous quarter, would seem to support the continued business confidence recorded in this sector. Furthermore, the increase in the volume of new orders, for a net balance of respondent firms, was evident across Scottish, Rest of UK and export markets. The previous Deloitte & Touche Scottish Chambers' Business Survey predicted this upward trend in the volume of new orders and the current survey reveals that a net 24% of respondent firms predict the volume of new orders to increase over the next quarter. These increased orders are again anticipated, by respondent firms, across Scottish, UK and export markets.

The trends in the volume of sales over the past three months further supports the continued business confidence in this sector. The volume of sales, as forecast in the previous report, increased across all markets, with the largest net balance of respondents (45%) noting that export sales had risen. This trend in sales is forecast to continue into the next quarter as a net 30% of respondent firms forecast an increase in the volume of sales across all markets.

The average capacity utilisation for the paper, printing and publishing sector increased by over 9 percentage points, from the previous quarter, and now stands at 87.9%. Stocks of finished goods and work in progress also increased, over the period, although a net balance of respondents noted a fall in the stocks of raw materials over the same period.

Investment intentions for both plant and equipment and land and buildings, over the past quarter, have been revised upwards by a net 18% and 12% of respondent firms. Over the forthcoming quarter, investment intentions for both activities are forecast to be revised upward again by a positive net balance of respondent firms. Of those firms who undertook investment in the previous three months, 28% nominated increased efficiency and expanding capacity as the main reason for the investment decision. A further 25 and 10 percent respectively, cited replacement and the introduction of new technology as the underlying reasons behind their investment.

The latest Deloitte & Touche Scottish Chambers' Business Survey reveals that total employment in this sector increased for a net 14% of respondent firms. The increased employment occurred across all sectors, apart from part-time employment, with the largest net balance of firms (26.3%) noting sub-contracting as the main source of employment expansion. A positive balance of respondents (16%) also increased overtime working over the last quarter. The employment trend, over the next three months, is forecast to rise for a positive net balance of respondent firms (13%). Finally, over the past quarter, 7.9% of respondent firms increased wages and salaries by an average 4.67% and nearly half of

all respondents (47.4%) attempted to recruit staff, although 8% of these firms reported difficulty in recruiting skilled manual workers.

In summary, the most recent Deloitte & Touche Scottish Chambers' Business Survey confirms the upbeat business confidence recorded in this sector in the previous two quarterly reports. Rising volumes in new orders and sales across all markets, increased employment and investment by firms, coupled with the substantial quarterly rise in the average capacity utilisation suggest positive signs for future growth in this sector.

Shares in the Glasgow-based packaging group, MacFarlane, dropped 28p to 168p following a profit warning by the group (December 1996), owing to problems in its plastics moulding division which supplies the whisky industry. Orders from the whisky industry were 20 percent down due to destocking by the industry and profits were revised downward by 5%. However, the City did not interpret this news as a major setback and the recent share price (195p) would seem to vindicate this view.

David S Smith, paper and packaging group, reported a 2 per cent fall in interim pre-tax profits (December 1996) and warned that earnings would be lower in the second half of the year, reflecting difficulties in continental European markets. However, the company remains upbeat about its future performance, although the share price fell by 18p to 288.5p on news of the profit reduction. Subsequent declines in the share price leave the group currently trading at 245.5p per share. Field Group, Britain's biggest maker of cartons, has enjoyed a 16 per cent rise in half yearly pre-tax profits, rising from £9.1 million to £10.5 million. The group which supplies labels and cartons to whisky and cigarette producers has an exclusive contract to supply United Distillers as well as number of other whisky distillers.

Sidlaw, the Edinburgh-based packaging group, which has been troubled with poor performance over past years is more upbeat about the future after an extensive period of restructuring. The group disposed of its oil services division (ASCo) in September for £56 million as part of a restructuring package aimed at reducing current debts. The restructuring of activities kept the group in the red last year with a £7.3 million loss recorded to September 1996, compared with a £112,000 loss, the previous year. The sale of its oil services division (ASCo) wiped the group's half year borrowing (£45.2 million), although planned capital investment of £12 million this year will return the group to a borrowing position. Finally, the new chief executive (John Durston) is confident the group can increase margins.

Rupert Murdoch's global media group, News Corp, reported an 8.1 percent fall in net profits, for the first quarter of 1996/97, in stark contrast to market expectations of a healthy rise. The weaker profits were attributed to poorer returns in US television, Australian newspapers and book publishing. However, the UK newspaper and book publishing sector recorded increased operating profits. Media giant Pearson shocked the City with news that 1996 profits will be hit by up to £100 million following the discovery of accounting irregularities in its Penguin USA division (February 1997). Speculation surrounding the Pearson group as a possible takeover target has offset any potential adverse share price reaction. The group which owns the Financial Times also acquired two South African business publications, Business Daily and Financial Mail, in a deal worth £11.5 million (December, 1996).

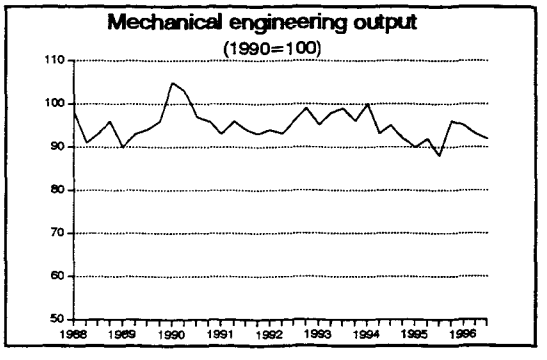
Express newspapers has confounded those who forecast that it was set to pull out of Scotland by committing the company to a new investment programme. The drive to maintain Scottish sales in their Daily and Sunday titles will involve more spending on promotions and investments. Finally, the environment minister John Gummer has called for newspapers to publish, on their titles, figures showing how much recycled newsprint they use. The government believes publishing such information would promote competition between newspapers to use more recycled newsprint and encourage readers to recycle more paper.

MECHANICAL ENGINEERING

Notwithstanding the improvement in the overall business confidence as shown in the previous Deloitte & Touche Scottish Chambers' Business Survey, the latest Scottish Office News Release (12 February 1997) reported another slight fall of 1% in the Scottish mechanical engineering output in the third quarter of 1996. This latest fall was the third consecutive fall since quarter 4 of 1995, reflecting the generally depressing state of the Scottish (and UK) mechanical engineering industry.

However, business confidence in the Scottish mechanical engineering industry is rather resilient at the moment. The latest Deloitte & Touche Scottish

Chambers' Business Survey shows that more firms were optimistic about the general business situation in quarter 4 than in quarter 3 of 1996. In quarter 4 of 1996, a net of 18.2% of firms expressed increased business optimism. Moreover, compared with the same time a year ago, business confidence also improved. The improvement in business confidence was backed up by a net balance of firms reporting an across-the-board rise in the volume of sales to both domestic and overseas markets in the final quarter of 1996. Moreover, more firms expected the sanguine sales performance to last into the first quarter of 1997. The situation with new orders shows a similar picture apart from export orders which were rather weak in quarter 4 of 1996, although this is expected to improve in the first quarter this year.



One caution about the improvement in business confidence is in place here. Although on balance more firms are optimistic, the majority of firms have expressed no change to their business confidence or performances in terms of new orders and sales. Since the volume of sales and new orders is the single most important factor in limiting the firms' output, the implication of the improved business confidence for output and employment growth is rather difficult to predict.

The process of de-stocking of finished goods and raw materials is still on-going and is expected to last into the first quarter of 1997. Work in progress continued to increase for more firms, and the rate of capacity utilisation stood virtually unchanged at 78%.

The rise in investment plans for plant and equipment maintained in quarter 4 of 1996 and is expected to do so in quarter 1 of 1997. However, investment in land and buildings suffered a setback in Q4 96, with no firm reporting an increase at all. For those firms which have authorised investment in Q4 96, the main reasons were: expanding capacity, increasing efficiency and replacement.

The overall situation of the job market in this industry is still stagnant, with the majority (up to 90%) of firms reporting no change to the level of employment at all. It is also expected that all forms of employment will remain stable for the near future. The generally depressing state of this industry has helped keep the wage claims modest. Against this general stagnant background of the job market, it should be noted, however, that 54.5% of the corresponding firms experienced problems in recruiting suitable employees in particular occupations, especially skilled manual and technical workers.

To sum up, the Scottish mechanical engineering industry remains depressed at the moment. However, there are signs of a recovery in terms of improved business confidence, rising trends in the volume of new orders and sales, and firms' intention to invest for the future. Although it is difficult to predict the timing and the scale of the recovery, the Scottish mechanical engineering output in 1996 is likely to be higher than that in 1995.

SERVICES

DISTRIBUTION

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey shows that business confidence among wholesale firms improved during the fourth quarter and a net of 10% reported being more confident than in the third quarter whilst a net of 5% indicated that they were more optimistic than in the same period one year ago. Once again retail respondents continued to report high levels of confidence with respect to the general business situation. Compared to the third quarter 33% reported increased optimism whilst only 14% indicated that they were less optimistic. Year on year confidence also remained buoyant with 48% more confident and only 18% less confident than in the same period one year ago.

Wholesale respondents had forecast a continued decline in total sales compared to the same period of 1995 however, in actual fact total sales improved for a net of respondents [+1%] and respondents expect sales to improve further during the current quarter. Actual retail sales exceeded expectations during the fourth quarter and a net of +35% was

recorded, only 19% of retailers reported a decrease in total sales. Respondents expect the trend to continue and remain upwards during the current quarter although a greater proportion of firms expect the trend to remain level.

Stock shortages remained the most frequently cited factor thought most likely to limit wholesale activity during the current quarter [42%] followed by credit facilities [23%]. Credit facilities became the most frequently mentioned factor thought likely to limit retailers' activity [37%], 31% cited insufficient floor space and 23% cited stock shortages. Compared to the same quarter of 1995 a net of wholesale[+15%] and retail firms [+21%] revised investment intentions in premises upwards.

Retail sales rose more strongly than expected in January with the highest year on year growth for eight years. Retail sales were up 0.6% in the months following a surprise fall of 0.8% in December. However in spite of this January increase, the British Retail Consortium (BRC) reported that high street sales slowed to levels not seen since last spring. According to the BRC, sales in January were 4.9% higher than in the same month of last year, slightly above the 4.3% annual growth in December, but below the increases recorded in the summer.

House of Fraser announced a £49 million restructuring programme involving shop closures and job losses (including 100 in Scotland). The company will shed administrative jobs at its seven Scottish stores although there are plans to relocate its London-based accounting operation to Glasgow creating around 60 jobs. The Glasgow store will account for a quarter of the job losses with the remaining being spread among Frasers shops in Aberdeen, Edinburgh and Perth and Arnotts shops in Dundee, Inverness and Paisley. There are plans to sell three English shops employing more than 200 people and to build four new stores in the next two years creating 1,000 jobs.

Marks & Spencer bought the Gyle Shopping Centre from Edinburgh City Council for more than £122 million. The Council claim that they were forced to sell the shopping centre because of the Government's squeeze on expenditure.

Watson & Phillips announced plans to double in size by the year 2000 by opening 500 more branches of Alldays shops, the expansion will be through a franchise scheme. Pre tax profits rose 11% to £20 million on turnover, up 16% at £576.6 million.

FINANCIAL SECTOR

The future looks gloomy for the continued health and vibrancy of the Scottish Financial Sector. Mutuality, supermarkets, Dublin and building societies are just some of the factors that threaten the sectors prospects and growth. The impending demutualisation and auction of Scottish Amicable must top the list of factors although at this stage knowledge of the winner of the auction for Scottish Amicable, the event that many commentators have been primarily interested in, is to some extent irrelevant. The real problem is that the auction took place at all. The loss of control of some of the smaller mutuals to institutions controlled from outside Scotland could in large part be ignored but the loss of the Amicable, a large well established player in the life market, cannot. Its loss reveals that any of the remaining players are vulnerable although the size and financial stability of Standard Life and Scottish Widows suggests that for the time being they are free to ignore threats to their viability. For how long this will continue to remain true has yet to be seen. Who after all, ten years ago would have foreseen the sorry plight the Amicable has been reduced to?

The causes of the auction for Scottish Amicable and whether it could have been avoided, will no doubt be argued over for some time. The greed of the senior managers with their share option scheme has been suggested by many as an important factor that seriously undermined outside support for the existing management's efforts. The structure of the original share offer to policyholders has also been attacked; in this case a failure to appeal to the greed of shareholders through the swift issue of shares associated with a capital restructuring. Whatever the cause the prospects for the financial sector are not good. All of the potential purchasers have existing life businesses and it will make sense to integrate, downsize and reduce costs. The move of Scottish Amicable's smaller companies team to Ivory & Sime, itself troubled by the defection of a number of senior managers to form their own boutique, clearly shows how the Amicable's own personnel view their prospects. Given the nature of the Amicable's business significant economies of scale must exist which will allow the new owner to lay off considerable numbers of senior and middle level staff. It will be no surprise if clerical processing activity grows given the siting of Amicable's clerical operations in a low cost area, but it is doubtful if the growth in that area will outweigh the

losses elsewhere. Even in the processing area the gains are far from assured. The continued fall in the cost of computing power and the increasing sophistication of voice recognition and optical character reading software suggests that more and more tasks can be mechanised. It is entirely reasonable to envisage that within the next ten years policies will be issued at point of sale with remote programs via the network handling all the mundane tasks associated with record keeping and the clerical aspects of the sale involving little or no human intervention. Similarly, payouts may be handled at any location convenient to customers, including in their own homes with the input of documents via scanners etc. Even if this vision of the future takes a longer time to come about, slowed perhaps by the requirements for verification, a more immediate threat to the expansion of processing activities comes from the continued expansion of Dublin as a financial centre and the accessibility Dublin offers to an English speaking labour force which, whilst no longer necessarily cheaper than the UK, is situated in a country that appears more main stream European in its orientation. The flow of investment operations to locations such as Dublin and, more particularly, any flow out of Scotland is a real concern not just because of the direct impact on employment but also because of the effect on the viability of the centre as a whole. Attempts to explain precisely how and why financial centres have come about in particular locations are generally example specific and difficult to generalise from. Agreement exists, however, that an important factor arises in the development of a financial centre, from the agglomeration of financial activities in one location since it means that it is possible for specialist services to develop. The existence of these services, in turn, means that other players are attracted and the sector grows and develops rapidly. The inverse of this virtuous circle threatens those centres which fail to grow or lose services and personnel. There is a real fear that this could and will happen in Scotland as the sector loses control of its major institutions and decision making migrates to other regions, since it is within the decision making function that the requirements for specialist services are typically identified. Prompt, on demand help is demanded and if not forthcoming will lessen the attractiveness of an area as a financial centre. In short, the loss of control of Scottish Amicable and the probable dispersal of functions could have an impact on the viability of the entire financial sector.

Change in the insurance industry is not the only area of concern. The announcement of the setting up of banks within supermarkets has also featured prominently recently and brings home the dramatic changes that are taking place in the banking sector with changes both in the point of delivery of banking, and the vast increase in the number of providers of banking services with the conversion of building societies. The stock market view appears to be that the banking sector is fit and healthy. Banking shares have risen significantly relative to the rest of the market in recent months but it is difficult to fully understand the cause of this optimism. Technical factors may play some part, in particular the need for index funds to acquire bank shares for their portfolios as the building societies convert into large banks, but technical share trading explanations cannot adequately explain the rise. The recovery of bank profits and the repeated claim by the banks that they have learned from past mistakes and will not go on a lending spree which combines high risks with low yields may also be a factor, but such promises have been heard before. Natural forces in the industry arising from increased competition and the associated decline in profitability, lead to more speculative lending and then, in turn, to a subsequent cycle of bad debts. This suggests that any claims of learning from past errors should be treated with a healthy degree of scepticism.

The rise of the supermarket bank has been gathering momentum for a number of years. The concept is not new; a few stores have had bank branches for many years. More recently, Marks & Spencer took the plunge into financial services some years ago but it is really only with the rise of debit cards and the availability of cash at the tills that we have really started to see significant movement by the major retailers into important elements of consumer banking. The supermarket chains offer out of town locations and shopping centres from which the traditional banks are often conspicuous by their absence; a range of goods for which credit may be desired by their customers; long shopping hours and convenience. Add to this the rash of store cards and the accumulation of points - basically a form of saving, and the supermarkets have all that is needed to make a major assault on the consumer banking sector. Of course, the shift of customers to supermarket banks is unlikely to happen overnight. It will also take time for the retailers to develop comprehensive consumer services such as foreign currency and travellers cheques for holidays, but the move to supermarket banking appears an almost irreversible and unstoppable process that will deprive the traditional banks, in the not too distant future, of a

considerable customer base and reduce their access to consumers for the sale of financial services. The development of telephone banking and computer based banking will, no doubt, slow the switch to supermarket banking, but there can be little doubt that the banks are about to lose market share, customers and, more importantly, profitability from this source. The changes in the branch network that we have seen so far almost certainly have a long way to go yet.

Banks, of course, are aware of the new sources of competition. One strategy may be to become a wholesaler providing the services that supermarkets need. Bank of Scotland appears to be pursuing this strategy with Sainburys. However, the dithering over the last ten years of some of the big life assurance companies and the failure of a number of them to get to grips with the distribution problems they faced with the advent of the Financial Services Act given one no confidence that the banks will all pursue rational survival strategies. It appears likely that the banking sector, particularly with regard to consumer finance, in ten years time will look very different from the present with a significant number of mergers and amalgamations and consequent branch and organisational changes.

This review started on a gloomy note. The prospects for the Scottish Financial Sector do not look encouraging. The sector will not disappear but it could well lose more of its important players as well as see a relative shrinkage of others. Any such loss will have an important impact on the provision of more specialised financial services and the viability of the sector as a whole.

TRANSPORT

Air

The 'open skies' campaign for freight transport in Scotland has gained momentum over the last few months. The aim of the campaign is to establish a cargo link between Scotland and the Far East by changing the current arrangement in which non-European carriers can bring in freight but cannot collect from Scotland. The reversal of this policy would require the consent of the government and there are indications that the campaign already has support from the Scottish Office.

If the government is willing to change the present policy, then the American Freight carrier, Federal Express, would start cargo services by unloading at Prestwick and reloading Scottish goods. It is believed that this would result in boosting Scottish exports by more than half a million and result in cost savings for manufacturers.

Road

In a £12.5m takeover bid for the employee-owned Taybus, National Express was named as a preferred bidder after beating its rivals, the Scottish bus giants FirstBus and Stagecoach, and Yorkshire Traction, which operates Scottish Strathtay buses. Taybus was owned by Tayside Regional Council until 1991 when it was sold to workers at £500 share per employee. At the moment it runs a fleet of 165 buses and employs 500 people. The bid resulted in a windfall lump sum payment of £25,000 to each employee for the single share they own in the company. Prior to this successful bid, the operation of National Express in Scotland was limited to the coach firms Scottish Citylink and Highland and Country coaches.

Meanwhile, based on the recommendation from the Monopolies and Mergers Commission, the Department of Trade and Industry has ordered FirstBus to sell some of its activities in Scottish buses on the grounds it could act against public interest. The most likely operations to be affected are parts of its subsidiaries Midland Bluebird and Strathclyde Bus Holdings in Glasgow. If FirstBus cannot find a buyer for parts of these activities within nine months then it will be forced to sell Strathclyde Bus Holdings in its entirety.

Despite this setback in Scotland, FirstBus has made its first acquisition in London by taking over CentreWest in a £54m bid. CentreWest was privatised by London Transport in 1994 and is currently the UK's seventh largest bus company with a 10 per cent share of the London market.

Rail

In the race for the franchise of ScotRail, National Express has become the preferred bidder with Stagecoach as runner-up. If the Strathclyde Passenger Transport Authority approves the privatisation of ScotRail, it is expected that council tax payers will save £250 million over the next seven years. On the grounds that National Express already owns Scottish Citylink which competes with ScotRail, Stagecoach has called for an investigation into the case by the Monopolies and Mergers Commission. However, it will be the case that even if the Monopolies and Mergers Commission rules that there will be a conflict of interest, National Express will take the franchise over since

franchising contracts are drawn in such a way that franchisees retain their rail operations and change aspects of bus or coach business.

National Express is said to have ambitious plans for its newly acquired company. This includes new rolling stocks, a refurbishment programme, building of a new station at South Dalgetty in Fife, and an airport link from Glasgow airport to the city centre. However, it is expected that ScotRail is not likely to be run without difficulty. At the moment, the company generates around £110m mostly from ticket sales in passenger transport. Moreover, the largest proportion of this amount is generated from services in the Strathclyde area. Since the rest of the lines were not profitable, ScotRail has been run with a level of subsidy which amounted to more than double that of the total revenue it generated.