THE SCOTTISH ECONOMY

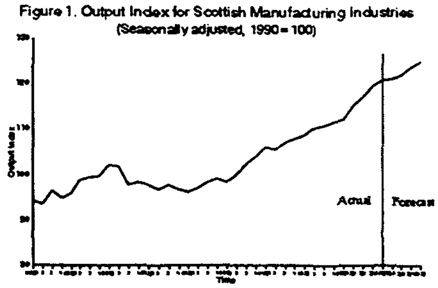
SHORT-TERM FORECASTS*

This section presents short-term forecasts for the quarterly growth rates of Scottish manufacturing (Division D of the 1992 SIC) output.

The present forecasting period extends to 1998Q1. 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 1996Q4 and the forecasts for 1997Q1 to 1998Q1. The latest Scottish Office News Release (7 May 1997) made substantial revisions to the output index for the Scottish manufacturing output in 1996. As a result, the annual growth rate of Scottish manufacturing output in 1996 was reported to be 5.1%.

The present forecasts show that the overall growth trend of Scottish manufacturing output will maintain throughout the forecasting period. However, the same level of growth momentum is unlikely to maintain in 1997. The annual growth rate for Scottish manufacturing output for 1997 is predicted to be around 3.1%. Further details of growth rates 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 (%)	
92/91	0.3
93/92	3.6
94/93	5.6
95/94	3.5
96/95	5.1
95Q1/94Q4	0.7
95Q2/95Q1	1.4
95Q3/95Q2	0.5
95Q4/95Q3	0.7
96Q1/95Q4	0.5
96Q2/96Q1	2.7
96Q3/96Q2	1.7
96Q4/96Q3	2.0
FORECAST	
97Q1/96Q4	1.2
97Q2/97Q1	0.1
97Q3/97Q2	0.7
97Q4/97Q3	1.5
98Q1/97Q4	1.0
97/96	3.1

THE DELOITTE & TOUCHE SCOTTISH CHAMBERS' BUSINESS SURVEY: FIRST QUARTER 1997

The Deloitte & Touche Scottish Chambers' Business Survey, which is conducted by Strathclyde University's Fraser of Allander Institute together with the Chambers of Commerce of Aberdeen, Central, Dundee, Edinburgh, Fife and 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 1997, 779 firms responded to the questionnaire of which 764 were useable.

Business Confidence

In manufacturing, there was a further increase in business confidence. A net balance of 20% of respondents reported that they were more optimistic in the first quarter of this year than three months previously, compared with a balance of 16% who were more optimistic in the fourth quarter of last year. In the first quarter, manufacturing respondents continued to be more optimistic than they were a year ago, with a net balance of 32% of respondents reporting higher optimism.

In construction, optimism has risen for two quarters in succession. A net balance of 14% of respondents reported that they were more optimistic than in the fourth quarter. This compares with a 13% balance of respondents who were more optimistic in the fourth quarter over the third quarter 1996. A net balance of 21% of respondents reported that they were more optimistic than they were a year ago, compared with the situation in the fourth quarter where a net balance of only 1% of respondents were more optimistic than in the same period a year earlier.

In distribution confidence increased both in retailing and in wholesaling, although at a slower rate in both sectors. In retailing, a net balance of 13% of respondents were more optimistic about the general business situation than they were in the fourth quarter, which compares with the 19% balance who were more optimistic in the previous quarter.

In wholesaling, a net balance of 3% were more optimistic compared with a positive balance of 10% in the fourth quarter. In comparison with a year ago, wholesale respondents were more optimistic, registering a positive net balance of 10%, while in retailing, a net balance of 21% were more optimistic.

Respondents in the tourism and leisure sector again reported an increase in confidence. In the first quarter, a net balance of 24% of respondents indicated that they were more optimistic about the general business situation than they were three months earlier, compared with a balance of 16% in the fourth quarter. A net balance of 17% of respondents were more optimistic in the first quarter than in the first three months of 1996.

Orders and Sales

In manufacturing, orders and sales continue to rise and both at a faster rate than in the final quarter of last year. For orders, a net balance of 28% of respondents reported an increase while, for sales, a balance of 28% of firms also experienced a rise. These figures compare with positive balances of 19% for orders and 24% for sales in the fourth quarter. Orders and sales growth continues to be positive from all main markets.

However, the growth of export sales, while still remaining strongly positive (+16%), has slowed down slightly from the fourth quarter (+19%) perhaps reflecting the continued strengthening of sterling which began last year.

In construction, new orders continued on a downward trend but again at a slower rate than in the previous quarter. A net balance of 6% reported a decrease in orders compared with a net balance of 14% reporting a decrease in the fourth quarter. Orders from both Central Government and Other Public Sector remain severely depressed, but orders from the private sector continue to rise; a net balance of 18% of respondents reported an increase in private sector orders, compared with a positive balance of 4% in the fourth quarter.

Sales growth in distribution continues to differ appreciably between the two key sectors. A net balance of 27% of retailers reported that sales had risen, compared with the 35% balance reporting an increase in the fourth quarter. In wholesaling sales fell back again. A net balance of 1% of respondents reported a decrease, compared to the balance of 1% of respondents reporting an *increase* in the fourth quarter.

Tourism demand increased further in the first quarter but at a much slower rate than in the fourth quarter. A net balance of 5% of firms reported an increase compared with a balance of 50% reporting a rise in the three months to December. Demand increased from the Scottish market but remained unchanged from rest of the UK tourists while tourism from abroad actually fell.

Stock Adjustments

In contrast to the fourth quarter, stocks of finished goods and work in progress in manufacturing rose, while stocks of raw materials fell. A net balance of 2% reported a rise in stocks of finished goods, a balance of 6% reported a rise in work in progress, while for stocks of raw materials the negative net balance was 6%.

Finance and Investment

In the financial sector, the demand for personal loans continued to rise at the same rate as in the fourth quarter. A net balance of 61% of respondents reported an increase. The trend in advances to the corporate sector continued to strengthen, while the demand for working capital remained strong. In addition, there was a considerable advance in the demand for finance for investment in buildings and for investment in plant and equipment.

Manufacturing investment intentions in plant and machinery showed a further strong increase in the present quarter, with a net balance of 23% reporting an increase and further upward revisions expected during the second quarter. Investment intentions in land and buildings have now become more positive, with a net balance of 4% of respondents reported an increase, compared with a balance of 1% reporting an increase in the previous survey. Further expansion in land and buildings investment is anticipated during the second quarter. In construction, investment intentions have ceased to decline, although a balance of positive intentions has yet to emerge. In retailing and wholesaling, investment intentions remain significantly positive. Net balances of 26% and 19% of retail and wholesale respondents, respectively, reported an upward revision in investment intentions compared to the same period a year ago.

Expectations

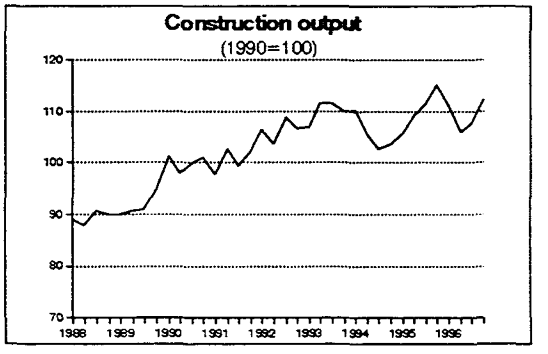
In manufacturing and retailing the outturn in sales and orders in the first quarter was *better* than expected by respondents in the fourth quarter. However, the outturn was worse than expected in wholesaling, tourism and construction. Demand conditions are expected to improve further in the second quarter in all sectors.

CONSTRUCTION

Despite the Index of Production and Construction showing an increase of 4.3% in quarter 4 1996 compared to the third quarter for Construction, annualised growth showed fall of 1%. For the UK the corresponding figure revealed growth of 1.3% for the quarter and annualised growth of 0.9%.

Results from the latest Deloitte & Touche Scottish Chambers' Business Survey show that the trend in total confidence continued to increase during the three months to March, strengthening to a net of 14%, the strongest trend since the end of 1993 reflecting the continued easing of the decline in total orders. Firms also reported being more optimistic than in the same period of the previous year.

The decline in total orders continued but eased to a net of 6% and respondents expect a net increase during the three months to June resulting from increased private sector orders, trends in public sector orders remained and are expected to remain depressed.



Average capacity used rose again to 83% although a marginal net of firms regarded this as lower than in the same quarter one year earlier. The percentage citing the low level of demand as the factor most likely to limit activity in the next quarter eased slightly to 79% with the remaining respondents citing either skilled labour, or to a lesser extent, credit/mortgage finance.

The majority of firms made no changes to investment intentions in either plant/equipment or buildings during the first quarter and little change is forecast for the current quarter. Investment authorised during the first quarter was directed more towards replacement of existing machinery and to a lesser extent capacity expansion, increasing efficiency and the introduction of new technology.

The decline in total employment continued although firms expect the decline to reverse during the next quarter. Almost half attempted to recruit with activity focusing on professional and managerial and skilled staff.

According to the Halifax House Price Index UK house prices rose in April by 0.3% (seasonally adjusted) which follows a rise of 1.0% in March. On an annual basis house price inflation is now 6.6% compared to 7.2% reported last month. NHBC figures show that 39,500 applications were made to start new homes in the UK during the first quarter of 1997 which represents an increase of 3% on the first quarter of 1996. In Scotland, 4,300 applications were made to start new homes in the first quarter.

Morrison Construction is selling four major retail developments including Meadowbank in Edinburgh to Burford, the property investment group. The deal, valued at £65.5 million, is for retail parks at Edinburgh, Stoke, Walsall and Hull and will be paid to Morrison over the next two years as it completes the schemes.

SCB the scaffolding group which is particularly active in the North Sea and one of Europe's largest suppliers and manufacturers of access and support services to the construction industry, is to go public on terms which will value the business at more than £100 million. It will sell up to 49% of its shares in an institutional placing ahead of a full stockmarket listing. The move is thought to enable them to take advantage of identified opportunities and develop further an already strong brand name.

In response to an optimistic statement on prospects, shares in Hewden Stuart, the Glasgow based plant hire and construction equipment firm, jumped 10%. The Chief Executive, Mr Sandy Findlay, said confidence was fuelled partly by construction industry forecasts indicating improved workloads, an improvement in the housing market and the recognition by civil engineering contractors and builders that ownership of mobil plant offers no financial advantage.

The government has announced plans to review the private finance initiative. The review is to be headed by Mr Malcolm Bates, chairman of the Pearl insurance group , and is expected to end the problems which have bedeviled the PFI. It is not expected that the move will hold up any existing projects.

ENERGY

OIL & GAS

During Q1 1997 the oil price has fallen by 20% from $25 in January to just under $20 in March. The decline in oil prices and the decrease in production over the quarter has significantly contributed to a 20% fall in oil revenues from £38.4m to £30.8m. Rising oil production (OPEC and non-OPEC) is leading to higher stock levels and the expectation of the Iraqi 'oil for food' deal in June suggests that the oil price will fall in the short term to around $17-18.

Oil production fell by 1.9% for Q1 1997 on Q4 1996 but is 2.9% higher than a year ago. Gas production increased by 9.8% on a quarterly basis but decreased by 4.4% on an annual basis. The Royal Bank of Scotland Oil and Gas Index shows a fall of 2.1% for Q1 1997 on Q4 1996 but an increase of 2.8% on an annual basis. The seasonal decline in gas production began in February this year, earlier than usual probably due to the mild winter.

The oil price for Brent crude decreased by 10% for Q1 1997 on Q4 1996 but this is still 15.6% higher than a year ago. Similarly the average daily oil revenue rose by 11.1% on a quarterly basis, however this is still 11.7% up on last year. Total average revenue dropped by 3.6% for Q1 1997 on Q4 1996 but has risen by 7.4% on an annual basis.

Oil production over Q1 1997 fell in; BP Harding by 42,130bpd, Enterprise Nelson by 39,287bpd and in Shell Brent by 30,000bpd. Mobil Beryl and BP Magnus both had decreases of over 10,000bpd in the quarter. The largest rise in oil production in the quarter occurred in Amerada Hess's Scott field. Gas production fell by 2633mmcfd over the quarter in the Morecambe field while output dropped by 410mmcfd in Shell Sean. There were no large increases in gas production.

The main drivers of the oil price now are increasing supply, which continues to outstrip demand, rising stock levels and the expectation of the Iraqi oil deal, all of which are depressing the oil price. Only technical trading will keep the oil price higher than fundamentals dictate. As Iraq is allowed a value of oil to be released onto world markets then the only way oil revenues can be maintained is to produce greater volumes of oil. This will probably mean OPEC production will go above quota levels. It is expected that the oil price will fall further, possibly to $16-17.

25 licences were granted to 22 oil companies in the UK's 17th licensing round for exploration mainly north of Shetland and west of the Hebrides. Shell are to spend more than £1bn on the Shearwater gas field 124 miles east of Aberdeen. Although the project will be managed from Aberdeen the gas will be landed via a 290 mile pipeline at Bacton not at St. Fergus. The pipeline cost is £400m and two platforms are to be constructed in the North East of England at a cost of £174m. The main factors in the pipeline decision are avoidance of Transco costs, the close proximity of the UK south east markets and the simplicity of transfer to the

European pipeline at Bacton.

Income from the oil and gas sector in 1996 was £21bn in total and is estimated to contribute 2.5% to UK GDP. Sales of oil and gas generated £12.6bn in 1996. The Exchequer collected £3.6bn in taxes and fees while the balance of payments benefitted by a surplus from oil exports of £5bn. Investment in 1996 was £4.4bn, a 3.5% rise on last year. Contractors, who provide most of Scotland's 100,000 oil-related jobs had revenue of £1.9bn.

Shell reported net profits of £1.55bn for the three months to the 31st March 1997. This is little change on the previous quarter and the forecasts are for the next quarter results to be similar. Earnings from the exploration and production in the North Sea rose by 7% in 1996. The Wood Group reported a 5.2% increase in pre-tax profits to £24.3m. Next year the group forecast that more than 50% of its sales will be outside the UK, a strategy aimed at reducing exposure to the North Sea which is seen as a mature market.

COAL

In April 1997 Monktonhall Colliery went into liquidation after management decided that severe flooding made operations unviable. This is a huge blow to the 300 employees who will lose their jobs. Waverly Mining Finance (WMF), which has £23m in equity and loans in Monktonhall, has withdrawn financial support to the 150 miners who each invested £10,000. Their original stake is now only worth about £3,000. Ownership of the mine will revert to the Coal Authority who will either find a new owner or close it.

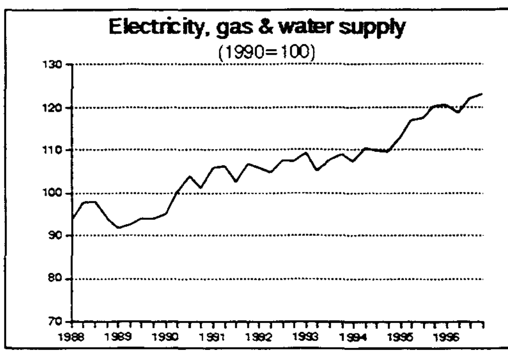
UTILITIES

The Index of Production and Construction for Q4 1996 for electricity, gas and water supply in Scotland rose by 0.7% on the previous quarter and on an annual basis by 3.6%. This compares with UK figures of 1.5% and 5.7%. The UK increase reflects increased economic activity in the UK as a whole as growth returns to trend. Scotland appears to be at trend with little change evident on a quarterly basis. Most of the increases are due to electricity generation.

The Chancellor is set for his budget on 2nd July 1997 and a major source of revenue will be the planned windfall tax on the privatised utilities. It is not the tax which is the issue any more but the criteria adopted as a means of assessing how much companies pay. This is now the battleground for the lobbyists and the privatised utilities. Electricity and water companies want the levy to be based on turnover not reported profits as this would increase the share of the tax borne by BAA and BT. It is attractive to the government as one of the most equitable methods and is less likely to be prone to a legal challenge. It may be that the government will want the tax to reflect the underpricing of the shares at flotation. It is clear however that the more complex the formula used then the greater will be the probability that the government will run into difficulties in the courts.

ELECTRICITY

Competition in the electricity supply market will be available in Scotland between April and July 1998. So far only three Public Electricity Supply (PES) companies will be ready to supply in the competitive market on 1st April 1998. It is expected that competition could bring about benefits of £8bn over 10 years in the UK. However the cost of introducing competition has quadrupled to £1.35bn. The House of Commons Select Committee on Trade and Industry heard that Scotland should not suffer any adverse regional variations in electricity pricing.



Scottish Power (SP) announced pre-tax profits of £558.4m for the year up to 31st March 1997, an increase of 38%. SP continues to shed 4-5% of jobs (750 jobs for the year 1997-98). The SP target for sales in Scotland is 12% (£240m) of the £2bn regional market. SP now serves one in five households in the UK. As 8% of SP's shares are in the hands of US investors the company is to obtain a NYSE listing.

Scottish Hydro Electric (SHE) is to outsource its customer information and IT services to Severn Trent the water company. Due to its geographical distribution and low customer base it has higher operating costs than its competitors. This makes cost cutting a priority in order to remain an independent competitive PES.

GAS

SP has signed up 50,000 customers (6% of the total market) in Kent and Sussex, which contains 900,000 consumers, where 112,000 consumers will switch from Centrica to a competitor. Beacon Gas (a joint venture) has signed up 40,000 households in the same area, therefore the two companies have captured 80% of the switchers. SP offered to cut 25% off the £330 average annual gas bill.

The battle for the Scottish gas market is set to take on a new significance. SP are the favourites to capture most of the market but SHE are keen to gain a considerable share since they failed to secure a deal which would have seen them take over the former British Gas supply business in Scotland and the North of England. The other main competitors are Beacon Gas and CalorTex.

WATER

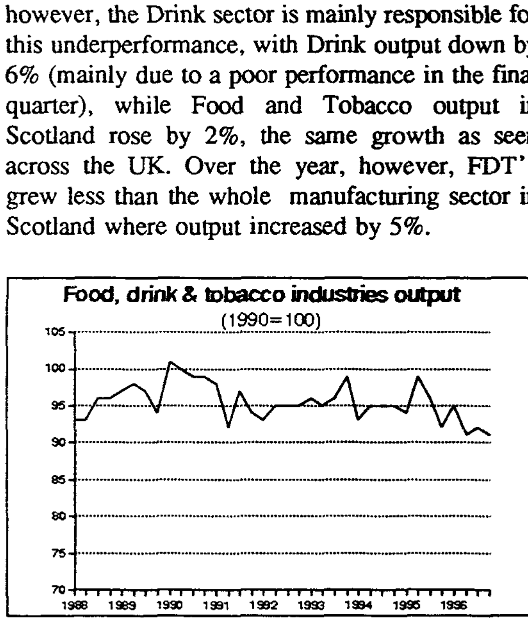
SP has disposed of the computer services business of Southern Water to ICL for £10.8m and intends to dispose of all of Southern's non-core activities by March 1998. It is estimated that the disposals will raise £70m with a further £30m coming from property sales. The aim of the programme is to enhance shareholder value and reduce operating costs by £52m a year when all the disposals are completed.

MANUFACTURING

FOOD, DRINK AND TOBACCO

The Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 91 in the fourth quarter of last year (1990=100), a fall of 2% from the previous quarter. However, the constituent parts of FDT moved in contrary directions in the final quarter, with a 2% rise in output in Food and Tobacco and a 5% fall in the Drink sector, although this latter reduction may be due to seasonal factors. Due to this reduction in drink output, the fall in total FDT output in the final quarter in Scotland is greater than that seen across the UK, where overall FDT output also fell, but by only 1%.

FDT output across the UK was static over the year, compared to a fall of 3% in Scotland. Again, however, the Drink sector is mainly responsible for this underperformance, with Drink output down by 6% (mainly due to a poor performance in the final quarter), while Food and Tobacco output in Scotland rose by 2%, the same growth as seen across the UK. Over the year, however, FDT's grew less than the whole manufacturing sector in Scotland where output increased by 5%.



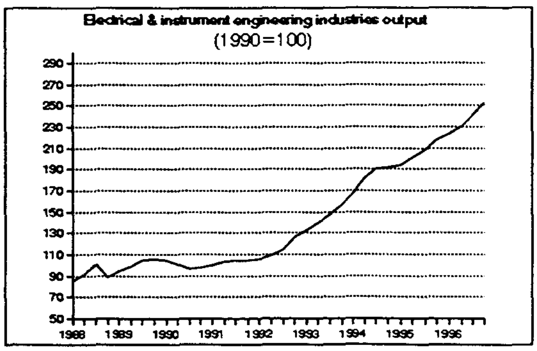
The most recent results from the Deloitte & Touche Scottish Chambers' Business Survey show a rise in optimism for a net 8% of respondents in quarter one. However, the rise in confidence was most evident among large companies (between 200-500 employees), where optimism rose for a net 15% of respondents, compared to a fall in optimism for a net 23% of firms in the 20-99 size-band.

The trend in orders was up in the first quarter for a net 16% of companies, and increased in all size-bands although, not surprisingly given the above, larger companies again saw the largest increases. Both Scottish and export orders had increased during the period, but the strongest growth came from the non-Scottish UK orders, which rose for a net 15% of respondents. Strong sales growth is expected in the coming three months, particularly in exports, which a net 35% expect to see increase.

As a consequence, a net of 35% expect to invest in plant and equipment in the coming three months, and a net 3% expect employment to increase. This is a strong indicator of improved prospects in the industry compared to the previous survey, where a net 7% expected employment to fall.

ELECTRONICS

In the last issue of the Commentary, it was noted that the Index of Production and Construction for the Electrical and Electronic Engineering (EEE) sector in Scotland had risen by a moderate 1% in the third quarter of 1996. However, the increase reported has now been revised to show a 4% increase for this quarter, and a further 5% rise is now reported for the fourth quarter of 1996. The current Index of Production and Construction stands at 253 (1990=100) for the sector, which indicates a rise of 15% in the year until the fourth quarter of 1996. Output growth in Scotland again outstrips the EEE sector across the UK, where output was unchanged between the third and fourth quarter of 1996 and year on year growth was 3%. The previous two quarterly rises in output for the EEE sector in Scotland confirm the importance of this sector in determining the overall growth of all manufacturing output in Scotland.



Following on from the previous quarterly report, the most recent Deloitte & Touche Scottish Chambers' Business Survey reveals continued increased business optimism in this sector. Over one third of respondents (34%) to the first quarter of 1997 reported an increase in business optimism compared to the position three months earlier, with an overall net balance (18%) of respondents reporting increased business confidence. In comparison with the same time one year previously, over half the sample of respondents (55%) felt more optimistic about the current business climate with a positive net balance of optimism recorded across the survey.

The trend in the total volume of new orders, over the last quarter, increased across Scottish, the rest of UK and export markets for a net balance of respondent firms. This trend is forecast to continue over the next three months with the main source of new orders expected to be export orders. Over the previous three months, the actual volume of sales for firms in this sector increased across all markets. This trend is again forecast to continue over the forthcoming quarter with export sales again forecast to rise for over half the sample of respondent firms.

Significantly, the current Deloitte & Touche Scottish Chambers' Business Survey has reported positive growth in orders and sales across all markets, over the previous and forthcoming quarter, for a positive net balance of respondent firms. In particular, the continued increase in export orders and sales is significant given both the volume of output exported by this sector and the relatively high value of Sterling.

The average capacity utilisation for respondents in this sector was reported at 80% which represents an increase of nearly 2% on the previous quarter. Investment intentions for plant and equipment and land and buildings were revised upward for a net 24% and 5% of respondent firms. Of those firms who undertook investment in the previous three months, 32% nominated expanding capacity as the main reason for the investment decision. A further 25 and 17 per cent respectively, cited the introduction of a new project and increased efficiency as the underlying reasons behind the decision.

Total employment over the previous quarter also increased for a positive net balance of respondent firms (14%). The Deloitte & Touche Scottish Chambers' Business Survey also reveals that 32% of respondent firms expect this trend to continue over the next three months. Finally, over the past quarter, 33% of respondent firms increased wages and salaries by an average 3.5% and just over half of all respondents attempted to recruit staff, although 18% of respondent firms reported increased recruitment difficulties. Of those respondents who attempted to recruit staff, 23% encountered difficulty recruiting technical staff, a further 16% noted difficulty recruiting professional and managerial staff and 13% found difficulty recruiting skilled manual workers. In addition, 12% of all respondents cited skilled labour as a potential limiting factor for output growth over the next three months.

In the company sector, the American-owned computer firm, Compaq, has been awarded a one year contract to supply new information technology equipment to Marks and Spencer. The bulk of the work is to be carried out at the company's Erskine plant which recently created a further 200 jobs. Digital Equipment reported higher than expected earnings to the third quarter ending March, 1997. The US computer manufacturer reported net income of £31m, for the third quarter, compared with net income of £75m, for the same period last year.

Pressac the parent company of McGavigan the specialist electronic component maker based in

Kirkintilloch, has acquired the Michigan-based Kaumagraph company for £8.8 million. The acquisition provides the group with a manufacturing base in North America which makes very similar appliances to the Kirkintilloch based plant. This move into the US market is in line with the group's strategic aim of becoming a global supplier to the car industry.

The top 10 computer services companies based in the UK, increased their UK revenues by 29 per cent to £4.06bn last year. Information technology contracts awarded by British industry and the public sector helped this sector expand. The top 10 companies are estimated to control 38 per cent of the UK market, according to industry analyst Mr Richard Holway. US-based computer services group, Electronic Data Systems, increased its revenue by 46 per cent to £765m and is the largest in the sector. Excluding the top 20 companies, revenues in this highly fragmented industry which comprises more than 2,000 companies, grew by a more modest 9 per cent.

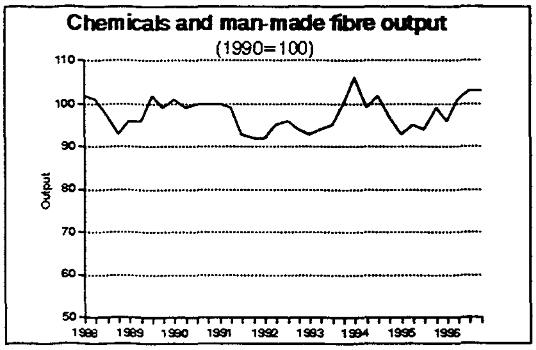
Finally Scottish Telecom, the telecoms subsidiary of Scottish power has launched an advertising campaign aimed at gaining control of 10 per cent of the residential telephone market in its area. The company which was launched in November 1994 has so far targeted only large corporate customers. The increased competition for the residential telephone market which also includes the Cable companies should reduce the overall costs of telecommunications for most Scottish residential households.

CHEMICALS

The latest Index of Production and Construction for the Chemicals sector in Scotland remained unchanged in the fourth quarter of 1996, this was also the case for the UK. Annualised growth however in Scotland shows an increase of 6% while UK growth was a more modest 2%.

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey revealed that for a further quarter the rise in confidence among chemicals respondents continued strengthening marginally to a net of +12%.

Once again respondents tended to overestimate the strength of the increase in demand and while demand strengthened respondents are more cautious as to the rate of increase in total orders and sales than in the previous quarter. The rise in Scottish orders ended and only a marginal increase is forecast for the current quarter. In contrast rest of UK orders rose slightly and a further strengthening is forecast. Export orders strengthened as anticipated but no further improvement is expected. The rise in sales strengthened, as forecast, with some overestimation of rest of UK demand and underestimation of export sales. Respondents expect an improvement in Scottish sales to fuel the increase in total sales during the current quarter.



Less than a third of chemical respondents reported any change to investment decisions however the net trend rose to +28% as none reported reducing investment. Firms authorised investment more in order to replace existent equipment than for expansion or to increase efficiency and introduce new projects.

Firms overestimated the increase in total employment during the previous survey and the actual figure was a more modest +8%. A marginal increase is forecast for the current quarter.

BP recently announced plans to expand their Grangemouth plant creating approximately 150 construction jobs. The investment will add about 50,000 tonnes per year to the output of ethylene and further expansion could in turn lead to the construction of a new polyethylene plant.

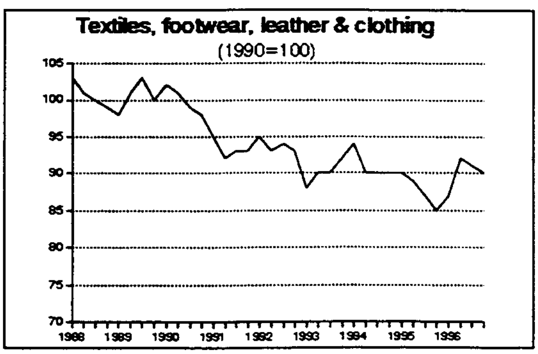
Grampian Holdings is thought to be selling off its pharmaceuticals division as it concentrates on its retailing operations following the takeover of Edinburgh Woollen Mill last year. The move would focus Grampian on its retailing, sports clothing and haulage business.

Following the setback of the new diabetic drug Tarabetic which was refused marketing approval by the Medicine Controls Agency, Scotia Holdings, the Stirlingshire based drug development company, has split into four divisions, some of which may be floated to deter a cash shortage. The most likely candidate for flotation is QuantaNova which focuses on photodynamic treatment of cancer.

Shares in Shield Diagnostics, the Dundee based pharmaceuticals firm known for its work on a new test for heart diseases closed the quarter at 715p an increase of over 400% compared to the start of the year. The stock had dropped after news that one US trial of Activated Factor 12 (AFT) had encountered difficulty but rallied after details of other trials which demonstrated a link between AFT levels and heart disease. The company is now involved in talks with major companies on the best way to commercialise a test based on AFT.

TEXTILES, LEATHER CLOTHING AND FOOTWEAR

The Index of Production for the Textiles, Leather, Clothing and Footwear (TLCF) sector in Scotland stood at 90 in the final quarter of 1996 (1990=100). Output was unchanged from the third quarter, but the output level recorded in the final quarter represents a rise in real output of 3% over the year. This is a better growth performance than that of the TLCF sector across the UK, where output fell by 1% in the final quarter and was unchanged over the year to the end of 1996. However, TLCF grew more slowly than the whole of the manufacturing sector in Scotland, where output increased by 5% over the year, and several sectors outperformed TLCF, most notably Chemicals (where output rose by 6%) and Electronics (15%).



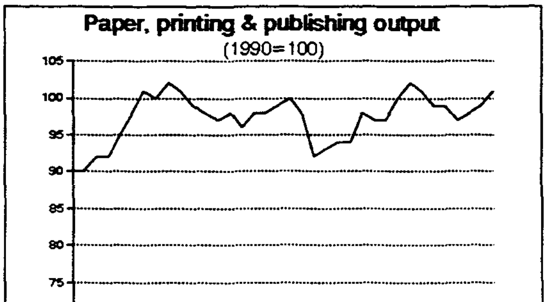
The most recent results from the Deloitte & Touche Scottish Chambers' Business Survey (hereafter referred to as the Survey) also show a rise in business confidence, with a net 12% of respondents feeling more confident than at the time of the previous survey. This is, however, a moderation compared to the previous set of results, where a net 36% felt more optimistic about the general business outlook. There were also notable differences according to size-band, with companies in both the 20-99 employee and 200-499 employee bands reporting net increases of 23% and 15% respectively, while the 100-199 size-band saw a fall in confidence in a net 48% of respondents. Nonetheless, a net 41% reported a rise in orders and a net 21% expect orders to increase in the coming three months. The sales position was also positive, with a net 29% reporting a rise in the preceding three months and a net 31% expecting these to increase in the coming three months, with the strongest sales growth expected in UK and export markets. Nonetheless, a lack of orders or sales is still considered to be the factor most likely to limit output in the near future, and while this was felt across all size-bands, this feeling was strongest in the smallest companies (less than 20 employees) where 81% felt that orders or sales were the most likely constraint compared to 52% in the 100-199 band and 67% in the 200-499 band. Overall, a net 26% of respondents expect employment to increase in the short-term, although this sentiment is most likely to be felt among the larger companies. Indeed, a net 19% of those with less than 19 employees expect to reduce employment in the short-term.

PAPER, PRINTING AND PUBLISHING

The Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland rose by 2% in the fourth quarter of 1996, to stand at 101 (1990=100). The corresponding UK figure reveals output growth of 1% over the same period. However, annualised growth in both Scotland and the UK fell by 1%. Output growth in this sector has not been consistent over previous quarters and the fourth quarter rise, although only 2%, is reasonably significant given the recent performance of this sector. Moreover, in the previous two Quarterly Commentaries, the Deloitte & Touche Scottish Chambers' Business Survey has noted an overall increase in business confidence and conditions for respondent firms within this sector.

The most recent Deloitte & Touche Scottish Chambers' Business Survey reveals that business confidence has continued to improve with a net 39% 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, over half of all respondent firms (51%) reported greater optimism about the present general business conditions, and there was again a positive net balance (39%) of optimism recorded across the survey.

The trend in the total volume of new orders, over the last quarter, increased across Scottish, the rest of UK and exports markets for a positive net balance of respondent firms. This trend is forecast to continue over the next three months with the main source of new orders expected from markets in the rest of the UK. Over the previous three months, the actual volume of sales increased across all markets for a positive net balance of respondents. This trend is again forecast to continue over the forthcoming quarter with sales to the rest of the UK forecast to rise for over half the sample (60%) of respondent firms.



The average level of capacity utilisation for the Paper, Printing and Publishing sector which had increased by over 9% in the previous quarter, has fallen by 4.83% in the current period and now stands at 83.07%. However, a net 44% of the sample of respondent firms note that their current level of capacity utilisation is higher than the same period one year ago. The stocks of finished goods, work in progress and raw materials all declined over the past quarter for a positive net balance of respondent firms.

Investment intentions for both plant and equipment and land and buildings, over the past quarter, had mixed fortunes. The former were revised upward by a net 24% of respondent firms while investment intentions for land and building activities were revised downward, over the same period, by a net 6% of respondents. Over the forthcoming quarter, investment intentions for both activities are forecast to be revised upward again for a positive balance of respondent firms. Of those firms who undertook investment in the previous three months, 35% nominated increased efficiency and a further 27% cited expanding capacity as the main reasons for their investment decision.

The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that total employment increased over the past quarter for 21% of respondent firms. The increased employment occurred across most sectors, apart from the temporary and self-employed categories. This positive trend in employment is forecast to continue over the next 3 months with nearly one quarter (24%) of respondent firms expecting to increase total employment. Finally, over the past quarter, 24% of respondent firms increased wages and salaries by an average 4.04% and exactly half of all respondents attempted to recruit staff, although a small number of respondents noted difficulty in recruiting suitable staff.

In summary, the current level of business optimism as indicated by respondent firms in the current Deloitte & Touche Scottish Chambers' Business Survey, coupled with the 2% rise in the Index of Production and Construction for the final quarter of 1996 suggest that this sector may begin to experience sustained output growth.

In the company sector, Mirror Group which own the Daily Record are hoping to forge closer links with the Herald and Evening Times, with printing one possible area for co-operation. The Mirror Group has a 20 per cent share in Scottish Television which recently acquired Caledonian Publishing, which owns the Herald and Evening Times. The Johnston Press Group, now the fifth largest regional newspaper publisher in the UK saw pre-tax profits rise by 43 per cent to £24.1m for the year ending March 1997. Turnover also increased by 61 per cent to £165m over the same period and was attributed to the acquisitions the company had made over the past year. Analysts suggest more favourable business conditions lie ahead with newsprint prices declining and advertising revenue increasing.

Pearson, the media, information and entertainment group, is to invest £100m in the Financial Times newspaper over the next five years with the aim of increasing international circulation. Within the Pearson Group, the Financial Times showed the greatest year-on-year growth in profit with operating profit up 123% per cent to £16.5m after provisions.

MacFarlane Group, the Glasgow-based packaging group, reported profits down by 3.8 per cent to £20.4 million for the year ending March 1997. The fall in profits resulted directly from whisky companies destocking which reduced orders for the

Group by 20%. The profit warning was widely forecast and noted in the previous Commentary. In addition, Lord MacFarlane of Bearsden has announced his intention to retire as chairman of the Group he founded 48 years ago. He will step down at the annual general meeting next year and be replaced as chairman by John Ward, the former IBM boss in Scotland who has been a non-executive director of MacFarlane for the last two years.

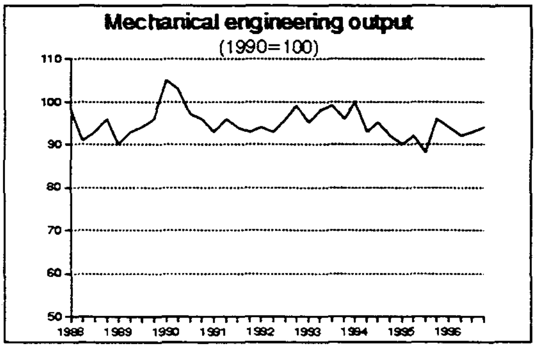
Arjo Wiggins Appleton, the Anglo-French paper group announced pre-tax profits for the last year which were ahead of expectations. The recent recovery in pulp prices left pre-tax profits for the year at £144m, well above the estimates of most city analysts. More favourable trading conditions are anticipated this year with pulp prices stabilising and expected to rise gradually in the second half of the year.

MECHANICAL ENGINEERING

The latest Scottish Office News Release (7 May 1997) reported a slight increase of 1% in the Scottish mechanical engineering output in Q3 96 over Q2, rather than a 1% fall as reported previously. Moreover, the latest figures also showed a 1% increase in output in this industry in Q4 96. These latest output increases are more or less in keeping with the generally improved business confidence as reflected in the recent Deloitte &Touche Scottish Chambers' Business Survey (DTSCBS). However, a note of caution is in place here: despite these latest increases, Scottish mechanical engineering output is still some 16% lower than the historical peak level which occurred 10 years ago. The general state of the Scottish (and UK) mechanical engineering industry is still rather sluggish.

The latest DTSCBS for the first quarter 1997 continued to show improved business confidence in this industry. A net of over 37% of firms were more optimistic in Q1 97 than Q4 96, doubling the number of optimistic firms three months ago. Moreover, compared with the same time a year ago, business confidence also improved. The improvement in business confidence was supported by a balance of firms reporting an across-the-board rise in the volume of new orders from and sales to both domestic and overseas markets in the first quarter this year. Moreover, more firms expected the sanguine new orders and sales performance to last into the second quarter of 1997.

Against the general background of improved business confidence, however, it should also be noted that although on balance the number of optimistic firms exceeded the number of pessimistic firms, the majority of firms did not see any change to their business situation. Therefore, it is still unlikely that there will be any significant increase in the Scottish mechanical engineering output in the near future.



The long-running process of de-stocking of finished goods and raw materials seemed to have come to a halt, with more firms building up stocks. Work in progress continued to increase for more firms, and the rate of capacity utilisation also increased slightly to just over 79%.

The rise in investment plans for plant and equipment maintained in Q1 97 and is expected to last until Q2 97. For those firms which authorised investment in Q1 97, the main reasons were: expanding capacity, increasing efficiency, replacement and introducing new technology.

There seems to be a slight improvement in the overall situation of the job market in this industry. Although the majority of firms reported no change to the level of employment at all, on balance more firms recruited new staff in Q1 97. The situation is expected to be even more encouraging in the next quarter, with very few firms expecting job cuts and many more firms creating new jobs. It is also expected that all forms of employment will benefit.

The generally sluggish state of this industry has helped keep the wage claims modest. Nevertheless, an increasing number of firms have increased their wages and salaries. It is worth noting that the problem of recruiting suitable employees in particular occupations, especially skilled manual workers, has become more acute (over 79% of firms had difficulties in this regard in Q1 97, compared with 59% in Q4 96).

To sum up, the general situation in the Scottish mechanical engineering industry has recovered slightly. However, it is still a long way from any significant improvement.

SERVICES

DISTRIBUTION

Business confidence continued to improve among wholesale firms although the rate of increase was not quite as strong as the previous quarter, a net of 3% reported being more confident than in the fourth quarter whilst a net of 10% were more optimistic than during the same quarter one year ago. Retail respondents continued to indicate higher degrees of confidence compared to both quarter four 1996 [+13%] and the same period one year earlier [+21%]. In both cases less than 20% of respondents reported lower level of business confidence.

The decline in wholesale sales which respondents forecast in the third quarter of 1996 did in actual fact emerge during the first quarter of 1997 despite respondents expecting the upward trend to continue. Respondents do not however expect the decline to continue and a net of +12% is forecast for the current quarter. Almost half of the those responding to the retail survey reported a higher level of sales compared to the same quarter of last year [a net of +27%]. Respondents expect the trend in total sales to strengthen during the current quarter, only 11% expect sales to decline.

Credit facilities became the most frequently cited factor thought responsible for limiting wholesale activity during the current quarter (cited by a third of respondents). The remaining respondents cited stock shortages [28%], insufficient floor space [26%] and shortage of labour [14%]. The factors thought most likely to limit retail activity during the current quarter were insufficient floor space [36%], stock shortages [28%], credit facilities [27%] and shortage of labour [8%].

Compared to the same quarter of 1995 a net of wholesale firms [+19%] revised investment intentions in premises upwards. Compared to the same quarter of 1995 a net of 25% of retailers revised investment intentions in premises upwards which compares to 14% in the previous survey.

The CBI distributive trades survey for April revealed 59% of retailers reported an increase in sales compared to the same period one year ago while only 17% reported that sales had fallen. Clothing, books, furniture and groceries were among the best sellers in April with outlets selling household goods doing less well.

The House of Fraser group plunged £38.4 million into the red for the year to January compared with a £14.3 million profit in the previous year, this was in the main to pay for a £53.2 million shakeup. The group is said to be considering axing many of its suppliers in a drive to increase quality and chairman Brian McGowan confirmed plans to open four new stores by the year 2000.

The Tesco supermarket is to establish links with the Royal Bank of Scotland in order to set up a call centre in Glasgow providing phone support for Tesco Personal Finance. This company will compete with Sainsbury Bank (working closely with the Bank of Scotland) and Safeway. Sainsbury Bank has already announced that it is performing better than expected and plans to introduce loans and mortgages this summer; it attracted 150,000 accounts in the first ten weeks following its launch.

FINANCIAL SECTOR

There can be little doubt that the Scottish Financial Sector has suffered grievous blows in recent months. The takeover of Scottish Amicable despite all the promises to maintain activity in Scotland, the problems at Ivory & Sime and the loss by Edinburgh Fund Managers of the British Investment Trust all signal significant problems in the sector. Scottish Financial Enterprise may argue that restructuring is taking place elsewhere (although just how many Scottish life companies have to disappear before the problem is recognised?) and that ownership is not important but it seems more useful to strip away the self delusion and to examine whether the criticisms of the sector are justified and what can be done about them. To argue as Scottish Financial Enterprise does that we should be concerned with the 'locus of custodianship of the corporate ethos, strategy and the allocation of resources' rather than ownership, is to assume that custodianship can realistically be separated from ownership in the longer term even though ownership gives control over assets, strategy and decision making.

Strident criticism of the Scottish financial sector is not difficult to find. Gill South in the Scotsman provided a representative selection of criticisms including the following: the quality of life in Scotland has kept the workforce happy but the businesses are too complacent and self-indulgent; Scottish financial companies lack critical mass; the Scottish banks although competitive are too small; the fund managers are too small to meet the pricing pressure from competitors; the life companies are too small; the calibre of staff is not good enough; low salaries and a Calvinistic attitude to paying higher salaries.

The list could go on. It is, however if correct, daunting enough as it is, but how justified are these complaints? The lack of scale of Scottish financial companies is an argument that comes through in all sectors of the industry suggesting that the sector's critics believe, implicitly at least, that there are economies of scale in financial services. To some extent this may be true. Retail financial services do appear to benefit from the existence of branch offices but some degree of caution in accepting this view is necessary. All the major players selling retail services through a branch network, primarily banks and building societies, have been and continue to shed branches. Most see the future as requiring a smaller physical retail distribution network than in the past. What appears to be important in retail sales is not the number of branches per se but the complementarity of financial products. The inability to sell life assurance with mortgages has been the major problem for the Scottish life offices, and the major advantage of the building societies. The problem of the Scottish life offices in this area has not been their size but their failure on the distribution side to accept what was happening. Of course, the life companies may and do argue that their resources as mutuals were inadequate to support the growth in sales needed to achieve the appropriate level of sales and distribution network, but there is no evidence of a stampede by joint stock companies to raise capital in the market to support expansion activities. Again, a number of commentators argue that the Scottish life companies are the wrong size. Too large to be specialist boutiques, too small to be general financial product companies but in the absence of convincing evidence of substantial economies of scale in life insurance, the argument is difficult to sustain. It is unlikely that the problems of the life companies stem from their size. Much more likely that they stem from past management decisions and mistakes.

Criticisms of the banks are at present more muted. Both the Royal and the Bank of Scotland have turned in improved results in recent months, and grown significantly for a number of years. Both however, are seen as small banks and for that reason at risk. The argument appears misplaced. They may be at risk from takeover, any company is and presumably the smaller the company the greater the risk, but there is no reason to believe that they encounter higher costs because of their size. Indeed, rather the reverse appears to be true. The Bank of Scotland is renowned for its low cost ratios. Of course, their size precludes them from pursuing certain types of activity perhaps in the volume they might like. They cannot have an extensive overseas branch network and are not large enough to handle certain types of financial transactions, but it is not clear that this impairs their profitability, that their future is any less secure, or that the access of industrial organisations in Scotland to financial services is in any way impaired by the inability of the Scottish banks to service particular types of very large deals. It is difficult to believe that the argument relating to bank size has much substance to it.

The third main arm of the Scottish Financial Sector, investment management and in particular the independent investment managers, are also claimed to be too small. It is certainly true that they face an uncertain future. On the cost side the pressure from index funds is unlikely to abate, whilst competition in the pension fund industry has apparently driven charges down putting severe pressures on the fund managers. On the sales side the small size and independence of most of the managers makes it difficult for them to establish comprehensive distribution networks for retail products such as unit trusts. Despite all this the evidence does not suggest that managing funds is subject to large economies of scale. Bigger managers can have more executives and analysts but there is no evidence to suggest on the whole that this improves their performance and hence sales.

In short, it is difficult to sustain the argument that the companies within the Scottish Financial Sector are too small or that they lack critical mass. They may not make the most of their critical mass, and the retail side of insurance and fund management has been a problem for more than ten years, but these are problems largely separate from their size.

The other main group of arguments advanced by Gill South and others relate to staff. Instinctive reaction in the absence of other obvious causes of institutional problems is to argue that the management are complacent and self-indulgent. It is an argument we have used ourselves when all other explanations fail, but by its nature is difficult to test. Staff calibre and salaries are perhaps easier to deal with. Lucky people are frequently confused with supremely intelligent or capable people. Nowhere is this more common than in the financial service industries. However, much of finance is concerned with marketing and few would argue that marketing, leaving aside the perhaps the more creative aspects of advertising, demands staff of supreme intellect and abilities. Such capabilities are unlikely to be a hindrance but are not necessary. This is not to deny the need for highly gifted and intelligent people in finance, but to identify that their role is predominantly related to technical support for example in arbitrage operations, to providing high level advice, and in the management of organisations. There is no particular reason to believe that there is a shortage of people in Scotland in these areas or a difficulty in obtaining them. Of course, it could be that the best, most talented people go to London where the opportunities are greatest. One can always identify very high calibre graduates who have been snapped up by the London financial institutions, but for every one that goes South there appear to be several who stay in Scotland. It could also be that many of the talented people leave Scotland some years after graduation. However, this appears to be clutching at straws. It is much more likely that the problems occur, if at all, not with the recruitment of talented people, but with the training and responsibility given to these people in subsequent years. Experience outside of Scotland, particularly in London or overseas, may equip people with wider vision and provide them with greater understanding of the opportunities available. This is perhaps one area where larger, bigger organisations might be very useful.

Interestingly, in the critiques of the Scottish Financial sector little of the criticism is ever directed at the majority of the workforce. The bulk of the workforce tends to be ignored despite the employment of 280,000 in Scottish finance and business services. It is tempting to criticise the firms and their managements for the problems of the sector and to ignore the contribution of the employees. On the whole, labour relations are good and the attitudes of employers and unions constructive. A Report of the Scottish Finance Industry Seminar (17/1/97) provides summaries of speeches by a number of people connected with the financial services industry. The speeches, in general, make interesting reading but one speech appears to encapsulate an attitude that has been so destructive in other areas of British industry. "the insatiable need for profit takes precedence over anything else - the job for life and source of employment for school leavers is gone". Supporters of the complacency, self-indulgence and weak management criticisms of the Scottish financial sector believe that the failure of parts of the sector to search for profits is a prime cause of its difficulties now. Long term employment is almost certainly better served by efficiency and the discipline imposed by competition and the need for profitability, than by cosy work practices and inefficiency. The task is not to provide a job for life irrespective of skills or merit but to recognise the rapid pace of change of knowledge and technology and to provide education and training to equip workers to cope with new jobs and tools.

So where does all this take us? As might be expected there appears to be some truth in the criticisms made of the Scottish financial sector. However, criticisms made primarily on the basis of size appear misguided. The problems lie primarily with management. The difficulty is to combine prudence and conservatism in financial decision making with efficiency in operations and aggression in seeking out new activities and business opportunities. The Bank of Scotland appears to have been notably successful with such a strategy. The need is for other Scottish financial service companies to move in the same direction. Takeovers motivated by size considerations do not seem the answer although mergers that remove weak management and clear out layers of bureaucracy might well have some justification if no other method is possible. However, the cuts at Scottish Widows suggests that considerable scope exists for internally generated change.

TRANSPORT

Air

In April of this year, Dublin based Ryanair launched a £19 one way ticket from Glasgow Prestwick to Stanstead and increased the number of flights from four to five per day. The extra early morning service has created 20 cabin crew jobs to be based at Glasgow Prestwick.

British Airways disclosed that the Edinburgh to London route is now the busiest route in the British Airways network with 1.1 million passengers a year, overtaking Paris. To meet the demand BA has developed routes to Gatwick from Edinburgh, Glasgow and Aberdeen in order to supplement flights to Heathrow. Established airlines appear to have continued to gain passengers despite competition from no-frills newcomers with the boom in travel between Scotland and London helping boost the number of passengers using British airports to more than eight million in April. Passengers between Scotland and London using BAA airports (Aberdeen, Edinburgh and Glasgow) reached 458,291 an increase of 10.6% over last April.

Rail

The government announced plans in May to strengthen the regulation of the railway industry following the decision of Mr John O'Brien, the railway regulator, not to levy a further fine on South West Trains following a rash of cancellations in February and March. SWT, a subsidiary of Stagecoach had been forced to cancel up to 39 trains a day during February and March after the redundancy of 71 drivers which left the company with insufficient drivers to operate all its routes. SWT was fined but it escaped another £1 million fine in April by maintaining a 99.6% reliability of train services. The rail regulator said that ministers were concerned that he could take no further action against the company as it had managed a rate of reliability higher than that set by the regulator (98.5%).

Stagecoach have announced a £90 million order for new trains for its SWT subsidiary as part of a package of benefits to be unveiled to passengers over the coming weeks. The director of SWT said the train orders followed commitments to improve train reliability, passenger facilities, stations and installation of security cameras. The company said it would order more trains but only if its franchise was extended. All train operators are pushing the rail regulator, Opraf, and the new Labour government to agree to franchise agreements in return for investment in new rolling stock.

The American backed English Welsh & Scottish Railway (EWS) which bought most of British Rail's freight operations last year plans to boost rail cargo by 300% over the next ten years. Freight has already returned to the Inverness-Wick and Kyle of Lochalsh and Ayr-Stranraer lines and elsewhere rail freight terminals are being reactivated. Plans exist for a line to reopen to Kincardine-on-Forth for coal and there are other plans to restore Ayrshire tracks to carry opencast coal. EWS is investing £250 million in new American diesel locomotives to cope with extra business.

Virgin trains are offering a £25 return ticket between Scotland and London, this ticket undercuts the cheapest return fair between Glasgow and Kings Cross on the Great North Eastern Railway (GNER) by £4.

Road

National Express, which owns the Scotrail franchise and TayBus, is forming a joint venture with a Norwegian bus company, Schoyen. It will look at acquisition possibilities in the German and Scandinavian bus markets, currently being deregulated.

In response to a call for greater competition in the Glasgow bus market Stagecoach is to invest £10 million and buy more than 150 buses in order to open up new routes in a move that could create up to 250 jobs. The initial routes will use new motorways such as the M77 extension and Stepps by-pass.

Sea

Leith based Forth ports reported a 45% increase in annual pre tax profits to £22.2 million, helped by two acquisitions - the ports of Dundee and Tilbury.