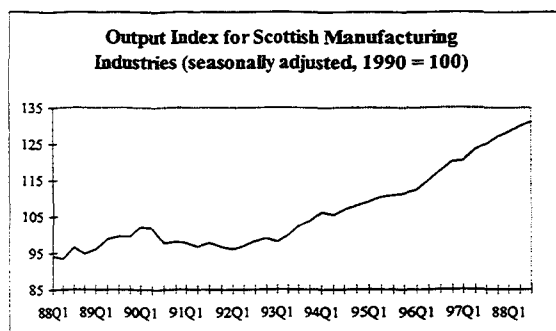


# The SCOTTISH Economy

## 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 1998Q3. 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 for driving the Scottish forecasts. Figure 1 depicts the actual growth rates for Scottish manufacturing output from 1988Q1 to 1997Q2 and the forecasts for 1997Q3 to 1998Q3. With the better-than-predicted performance of Scottish manufacturing industries in the second quarter of 1997, the present forecast for 98/97 has been adjusted upward slightly compared with the previous forecast. However, we still maintain that the strong growth in Scottish manufacturing industries in 1996 is unlikely to sustain in 1997 and the annual growth rate for Scottish manufacturing output for 1997 is predicted to be around 4%. Further details of growth rates are presented in the following table.

\* 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	5.3
95Q1/94Q4	1.1
95Q2/95Q1	1.1
95Q3/95Q2	0.6
95Q4/95Q3	0.5
96Q1/95Q4	0.9
96Q2/96Q1	2.2
96Q3/96Q2	2.3
96Q4/96Q3	2.3
97Q1/96Q4	0.1
97Q2/97Q1	2.6
FORECAST	
97Q3/97Q2	1.3
97Q4/97Q3	1.7
98Q1/97Q4	0.9
98Q2/98Q1	1.0
98Q3/98Q2	1.1
97/96	4.0

## DELOITTE & TOUCHE SCOTTISH CHAMBERS' BUSINESS SURVEY: THIRD QUARTER OF 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 September, 735 firms responded to the questionnaire.

### Business Confidence

In manufacturing, business confidence fell for the first time since the fourth quarter last year. A net balance of 11% of respondents reported that they were *less* optimistic in the third quarter of this year than three months previously compared with a balance of 7% who were more optimistic in the second quarter of this year. In the third quarter, manufacturing respondents continued to be more optimistic than they were a year ago, with a net balance of 5% of respondents reporting higher optimism.

In construction, optimism has risen again for the fourth quarter in succession. A net balance of 13% of respondents reported that they were more optimistic than in the second quarter. This compares with an 11% balance of respondents who were more optimistic in the second quarter over the first quarter. A net balance of 18% of respondents reported that they were more optimistic than they were a year ago, an identical balance to the one reported in the second quarter.

In distribution confidence fell in retailing and remained unchanged in wholesaling. In retailing, a net balance of 4% of respondents were *less* optimistic about the general business situation than they were in the second quarter, which compares with the 6% balance who were more optimistic in the previous quarter. In wholesaling, respondents were neither more nor less optimistic than they were in the second quarter. In comparison with a year ago, wholesale respondents were more optimistic, registering a positive net balance of 16%, while in retailing, a net balance of 6% were more optimistic.

Respondents in the tourism and leisure sector again reported an increase in confidence. In the third 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 balance of 28% in the second quarter. A net balance of 16% of respondents were also more optimistic in the third quarter than in the same quarter a year ago.

### Orders and Sales

In manufacturing, orders and sales rose but at much slower rates than in the second quarter. For orders, there was almost no change with a net balance of well under 1% of respondents reporting an increase while, for sales, a balance of 5% of firms also experienced a rise. These figures compare with positive balances of 12% for orders and 18% for sales in the second quarter. Major differences are now present in the performance of orders and sales in key markets. The Scottish market has held up relatively better with a small net balance (3%) of respondents reporting an increase in sales, while a small balance of 3% reported a *decrease* in orders. Orders and sales have contracted in both the rest of UK and export markets. By far the biggest contraction is exhibited in export markets, with a net balance of 20% reporting a *decrease* in orders and a balance of 16% reporting a *decrease* in sales.

In construction, new orders showed a small increase for the first time since the first quarter of 1995. A net balance of 3% reported an *increase* in orders compared with a net balance of 15%

reporting a decrease in the second quarter. Orders from both Central Government and Other Public Sector remain severely depressed, while orders from the private sector now exhibit strong growth; a net balance of 22% of respondents reported an increase in private sector orders, compared with a negative balance of 4% in the second quarter.

Sales growth in distribution is now positive in both key sectors. A net balance of 19% of retailers reported that sales had risen, compared with the 12% balance reporting an increase in the second quarter. In wholesaling sales rose. A net balance of 5% of respondents reported an *increase*, compared to the balance of 9% of respondents reporting a decrease in the second quarter.

Tourism demand continues to rise at much the same rate as in the second quarter. A net balance of 28% of firms reported an increase compared with a balance of 27% reporting a rise in the three months to June. Demand increased in all markets with a particularly strong rise in tourism from abroad.

### Stock Adjustments

Stocks of finished goods and work in progress in manufacturing rose, while stocks of raw materials fell. A net balance of 4% reported a rise in stocks of finished goods; a balance of 9% reported a rise in work in progress, while for stocks of raw materials the negative net balance was 3%.

### Finance and Investment

In the financial sector, the demand for personal loans continued to rise but at a slower rate than in the second quarter. A net balance of 25% of respondents reported an increase, compared with a balance of 62% in the second quarter. The trend in advances to the corporate sector continued to strengthen, while the demand for working capital remained strong. In addition, there was strong 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, although at a slower rate than in the previous three months. A net balance of 10% reported an increase compared to a balance of 16% in the second quarter. Further upward revisions are expected during the final quarter of this year. Investment intentions in land and buildings continue to be positive, with a net balance of 2% of respondents reported an increase, compared to a balance of 7% reporting an increase in the previous survey. Further expansion in land and buildings investment is anticipated during the fourth quarter. In construction, investment intentions are now

positive both for plant and equipment, and for buildings. In retailing and wholesaling, investment intentions continue to be positive. Net balances of 10% and 13% of retail and wholesale respondents, respectively, reported an upward revision in investment intentions compared to the same period a year ago.

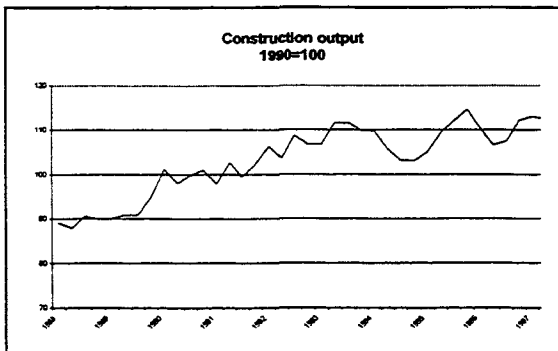
### Expectations

The outturn for demand, or sales and orders in the third quarter was *worse* than expected by respondents in the second quarter in all principal sectors, with the shortfall between expectation and outturn being the most extreme in manufacturing.

Demand conditions are generally expected to improve in the final quarter of the year, the only exceptions being the demand for manufacturing exports, which is predicted to contract further, and tourism from abroad, which is also expected to decline.

## CONSTRUCTION

The latest Scottish Office Index of Production and Construction (quarter 2 1997) showed a 0.6% fall in activity from the first quarter to the second of 1997 although during the year to the second quarter there was a 0.4% increase in activity. In the UK construction activity rose by 0.6% in the second quarter over the first and by 3.4% over the year to the end of the second quarter.



Evidence from the Deloitte & Touche Scottish Chambers' Business Survey showed business confidence among construction respondents continued to improve during the third quarter. A net of 12% reported being more optimistic than in the second quarter while compared with the same quarter of 1996 a net of 18% were more confident.

In line with expectations the forecast increase in total orders did materialise although not to the extent respondents had forecast, a net of +3% as opposed to the forecast net of +8%. Central

Government and other public sector orders continued to decline with the net increase in private sector orders [+22%] responsible for the increase in total orders. Respondents expect the trend to remain upwards during the current quarter again purely because of a net increase in private sector orders. Again most respondents cited lack of demand as the factor most likely to limit activity during the current quarter. Twenty three percent of firms cited skilled labour while the remaining respondents cited credit/mortgage finance and supply of land.

Average capacity utilisation rose marginally in the third quarter to 85% and a balance of firms reported using more capacity than in the same quarter of 1996. In contrast to expectations but in line with the increase in confidence the trend in work in progress reversed and a balance of firms reported an increase, a trend that is forecast to continue.

Firms revised investment intentions in both plant/equipment and land/buildings upwards during the third quarter. During the fourth quarter firms expect to continue revising investment intentions in plant/equipment upwards while the trend in land/buildings investment is forecast to ease to a net of 0%. Investment during the third quarter continued to be authorised more to replace existing machinery [47%] and to a lesser extent introduce new technology [18%], capacity expansion [13%] and increase efficiency [10%].

The forecast increase in total employment did occur during the third quarter [+11%] and respondents expect the trend to remain upwards during the current quarter. Increases were in male and female employment in full time and part time positions while net reductions were recorded for temporary, sub contracting and self-employed staff. Of the 58% of firms that attempted to recruit almost 40% experienced increased recruitment difficulties compared with the previous quarter. Recruitment difficulties were widely reported although more prevalent among the professional/managerial and skilled manual categories.

The latest Halifax House Price Index for the third quarter of 1997 shows that in the UK house prices rose by 0.2% in September, and on an annual basis by 6.9%. Following falls in house prices in the first two quarters of this year, house prices in Scotland recovered slightly in the third quarter rising by 0.9%, taking the annual rate to 0.8% (the lowest rate within the UK). The most recent figures from the National House-Building Council (NHBC) on housing starts in the third quarter

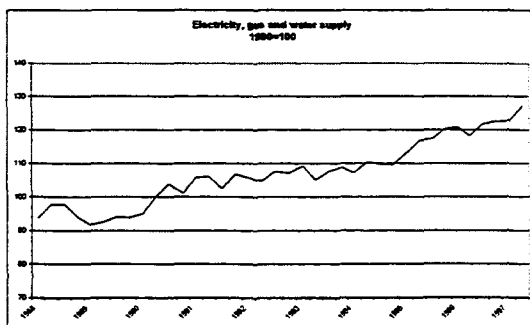
shows Scotland with 3,810 - a decrease of 559 over the previous quarter.

Beazer, Scotland's second largest house builder, reported a record number of completed house sales with Scotland accounting for 22% of their 7,177 total. Annual pre-tax profits rose from £46.5 million to £62.2 million. Bett Brothers, the Dundee based builders reported a 23% increase in turnover to £47 million and a 38% increase in pre-tax profits to £6.9 million for the year to the end of August. Much of the profits came from their 311 new house sales in Scotland, up from 275 last year.

## ENERGY

### OIL AND GAS

The number of oil and gas fields in the UK has reached record levels with more marginal fields being developed due to new technology and the ability to reduce production costs dramatically. In the early days of oil production the Northern North Sea accounted for most of the UK's oil output and the Central North Sea was the next most productive region. Since 1994 the Central North Sea has become more important in terms of output (it always had more fields in production than the Northern North Sea) and in 1996-97 contributed 55% of UK oil production from 50 fields with the Northern North Sea accounting for just under 40% of oil production. In the future the West of Shetland area will become increasingly important.



Average daily oil production for Q3 1997 on Q2 1997 increased by 5.9%, the Royal Bank of Scotland Oil Index showing a similar rise but there is little annual change. Gas production continues its seasonal decline with a 22% fall for Q3 on Q2 1997 but this level of production is 19.5% higher than a year ago. Overall the Royal Bank of Scotland Combined Index fell by 4.5% for Q3 on Q2 1997 but increased by 5.3% on an annual basis. Total Daily Average Output (boe) fell by 3.7% from 3,696,557 to 3,558,566 for Q3 on Q2 1997 but increased by 6.2% over the year. The oil price remains slightly above \$18 with little change over the quarter but has fallen by 11.6% since last year

when prices were close to \$21. The recent strength of the pound and the relative weakness of the dollar has not helped oil revenues. Since Q3 1996 average daily oil revenues have declined by 15.7% but there has been an 8.1% increase for Q3 on Q2 1997. When gas is included then the annual change is -9.6% and the quarterly change is -2.3%.

Over the quarter the main net increases in oil output came from Amerada Hess Scott (38,000bpd), BP Miller (27,000bpd) and BP Magnus (23,000bpd) while Chevron Alba and Statoil Statfjord recorded a net loss of 22,000 and 26,000 barrels per day respectively. In gas production the major net increases were in Shell Galleon (200mmcf), Conoco V Fields (160mmcf), and BP Miller (120mmcf). The main net losses in gas production occurred in BG Morecambe (250mmcf), Conoco Victor (120mmcf), and Mobil Beryl (100mmcf).

Shell is to axe 3,000 jobs in Europe, mainly in refining and marketing. This will be felt worst in the UK by Merseyside and the Shellhaven plant on the Thames but Scotland will escape fairly lightly as most jobs are exploration and production based. Shell plans to increase UK oil output by 25% after the Curlew field, 140 mile east of Aberdeen, went on stream just after 18 months of development. Output should peak at 45,000bpd with 100mmcf of gas per day. Extra output is also expected from Gannet E, Mallard, Osprey and Cormorant giving the company at least another 30 years in the North Sea. BP face an extra £120 million on their Foinaven development on top of its £550 million budget. The project with now two years behind schedule. BP still reported a profit of £691 million for the three months to 30th September up from the £650 million seen for the same period last year. AMOCO has made a new discovery 160 miles east of the Tay which could become the new hub for exploration and development. Amerada Hess are partners in the venture and it is expected that others will carry out exploration in the area where considerable reserves could be located. Conoco is set to sell some of its North Sea interests which will no longer be developed further. Enterprise Oil are reported to have paid £58 million for a number of interests next to the Beryl field. Other companies which are likely purchasers include Mobil, Amerada Hess and OMV.

### Coal

Scottish Coal received a boost as Longannet returned a £7.8 million first half profit. This comes after Scottish Coal suffered losses of £10 million and lost a coal face due to geological problems. Further good news was that Scottish Power are close to agreeing a 5 year supply contract which

would secure the future for Longannet. The deal is for 2.5 million tonnes of coal with Scottish Power reported as paying below £30 a tonne reflecting the drop in the world price of coal. The mine has reserves which could last until 2020 and the new development plans will result in some job losses.

### UTILITIES

The Index of Production and Construction for Q2 1997 for electricity, gas and water supply in Scotland increased by 3.6% on an annual basis with a 3.7% change on a quarterly basis. In the UK the annual change was 5.2% and for Q2 1997 on Q1 1997 an increase of 2.7% was seen. The annual growth is higher in the UK than in Scotland reflecting increased industrial demand for electricity.

#### Electricity

The Scotland-Northern Ireland interconnector took a step closer to completion as Donald Dewar lifted constraints, which would have involved burying one quarter of the 60km powerline. Scottish Power (SP) estimates this will save them £34 million. The project is designed to supply Northern Ireland with 2500MW of electricity just as two of its own power stations are being run down. The electricity is likely to be generated on the Firth of Forth increasing demand for coal by 600,000 tonnes a year, which mainly comes from Scottish Coal.

SP is to build a £200 million CHP station with Seaboard in Sussex as a 50:50 joint venture. SP has only one small 50MW station in England but has also applied for a station with a capacity of 1,125MW in Enderby, Leicestershire. The company has completed the sale of Topmark, Greenhill Enterprises and ERG in its reform of the Southern Water group, and expects to raise over £90 million in disposals from the group, £20 million above the target set by SP. The company has now sold 13 subsidiaries in 15 transactions. Interim profits of £240 million were announced earlier which was an increase of 44% in six months, although this does not include the £317 million windfall tax. SP has denied that in order to raise more cash Scottish Telecom will be sold.

#### Gas

Scottish Gas (SG) was at the centre of a major disagreement with Ofgas last month as both sides issued conflicting figures over how many consumers had switched from Scottish Gas to new suppliers. Ofgas report 400,000 customers in Scotland and the North East have switched supplier, that is 16% of the total market. SG however repudiates this as only 150,000 or 6% of

customers were preparing to leave. Further they claimed that 1,000 customers per week were returning to British Gas in the South West and South East of England. Ofgas also dispute these figures and report only 16,000 had rejoined British Gas, claiming that 524,000 or 26% of customers have left British Gas.

SG is to cut domestic bills by 9% after Ofgas ordered household bills to be reduced. This move will particularly apply to customers who use direct debit and users who only consume small amounts of gas. It is thought that 1.5 million customers will be affected. SG claimed its prices had fallen by 26% since privatisation, other cost cutting measures include the loss of 2,500 jobs across the UK.

SP has claimed that it has won over 55,000 customers in Scotland and was adding 1,000 a week in November this year. SP remains confident that they will be the second biggest players after Centrica. SP's rivals claim to have a considerable number of customers; Northern Electric have 100,000, CalorTex the same amount and Eastern have 200,000 split equally between Scotland and the North East. SP has another 80,000 customers in England. It also hopes to add another 6 million new customers through a major gas and electricity alliance similar to the one which exists with the AA.

#### Water

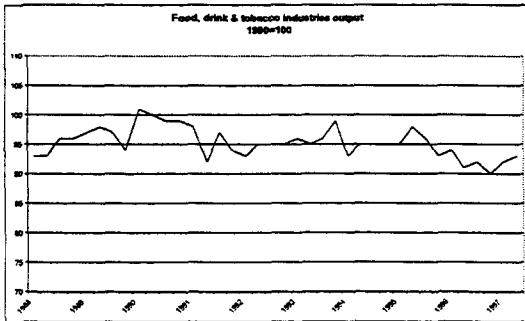
Household water bills are set to increase by around 30% due to a 10-15% planned price increase and the removal of a large subsidy provided by Central Government. The transitional relief for sewage will continue in 1998-99 but at a lower rate, around half of the existing subsidy. The total subsidy is set to decrease from £59.7 million this year to £29.7 million next year. The government is also considering a semi-privatisation scheme which would allow water companies greater borrowing powers. This is thought to be the preferred option as the status quo would see considerable increases in water charges on a year on year basis. The scheme is designed to alleviate the necessity to increase charges, to maintain some degree of local authority control and to maximise the benefits of the private sector.

## MANUFACTURING

### FOOD, DRINK AND TOBACCO

The Index of Production for the Food, Drink and Tobacco (FDT) sector in Scotland stood at 93 (1990=100) in the second quarter of this year, a 2%

increase on its first quarter position. However, the increase is wholly due to a 5% rise in drink production, with output in the food and tobacco sector falling by 2%. UK output in FDT was unchanged in the second quarter. Over the year to the second quarter, total FDT output in Scotland fell by 3%, while the FDT sector in the UK saw output increase by 1%. These figures compare to a 7% increase in manufacturing output in Scotland over the year and a 1.2% increase in manufacturing in the UK as a whole.



September's Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) provides figures for the third quarter of this year. Overall, 22.9% of respondents reported a fall in confidence (with regard to the general business situation) compared to three months previously, while only 6% reported a rise. There was no change for most respondents, however, with 71.4% indicating no change in the level of confidence. There was a more positive finding, however, if we compare the September figures with those for the same time in 1996, with 38.2% of respondents feeling more confident compared to 26.5% who reported a drop in confidence.

Survey respondents were also more likely to report an increase than a decrease in the trend for new orders - 35.3% compared to 26.5% - and most companies expected the current trend to either remain stable or to increase in the short-term. Just over one third reported a drop in export orders (compared to just over a fifth for both the Scottish and other UK markets) although 82.3% expect export orders to either increase or remain stable in the coming few months. Prospects also appear brighter over the medium-term, however, given that a net 42.4% expect turnover to improve in the coming year, and a net 16.1% expect profits to improve. The average capacity utilisation in the sample totalled 75.2%, an increase for a net 9.4% of survey respondents.

The whisky industry will have been cheered by a recent change in the tax regime in Japan. Following complaints from the European Union, a World

Trade organisation ruling that excessive duties on imported spirits were contrary to free trade rules has meant that the duty on whisky imports into Japan have been reduced by 44% at the same time as the duty on local spirits have been increased, and more beneficial (to Scotland) changes are planned in the future.

The above news will provide a further fillip to Glasgow-based Highland Distilleries, who last month reported a 7% rise in profits. The increase is due largely to a spirited attempt to increase its foreign sales, where it reported an overall 5% increase in sales in the year to August compared to a rise of 1% in the UK. The only black spot in the picture, according to the company, is the effect of the strength of sterling on profits.

The dairy company Wiseman's has recorded a 40% hike in profits over the year, a result which does not include the effects of its recent purchase of Scottish Pride in March. The company is also reported to have around £100 million to spend on either acquisition or increasing capacity should restructuring in the UK industry be necessary.

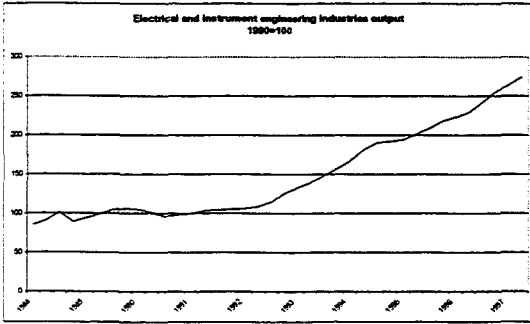
## ELECTRONICS

The latest Index of Production and Construction for the Electrical and Electronic Engineering (EEE) sector in Scotland reported a 4% increase to the second quarter of 1997. Year on year growth to the second quarter of 1997 indicates a substantial rise of 18%. Output growth in Scotland again outstrips the EEE sector across the UK, where output increased by a modest 1% from the previous quarter and 2% over the year. The EEE sector still remains a strong growth sector in Scotland.

The Deloitte & Touche Scottish Chambers' Business Survey provides an indication of the factors that are affecting the performance of firms in this sector. The most recent survey (third quarter 1997) reveals a slight increase in the level of business optimism for the sector as compared with the previous Quarterly Commentary. Overall the general level of business confidence remains positive, however, respondents are not as optimistic about the current business climate as the same time one year previously.

The trend in the total volume of new orders, over the last quarter, reveals a slight fall in net orders for a small positive net balance of respondents, that stems primarily from a reduction in Scottish orders. The overall trend in the total volume of new orders, over the forthcoming quarter, is forecast to be positive with Scottish and UK orders expected to rise, although export orders are forecast to fall for a small positive balance of respondents.

The actual trend in the total volume of sales over the last quarter increased for a positive net balance of respondents across Scottish and export markets, although rest of UK sales fell for a positive balance of respondents. The overall trend in the total volume of sales, over the forthcoming quarter, is forecast to be positive with Scottish and UK sales expected to rise, although export sales are again forecast to fall for a small positive balance of respondents.



The average capacity utilisation for respondents in this sector remained at 81%, which a net 17% of respondents regarded as being lower than a year ago. Investment intentions for plant and equipment and land and buildings were revised by 41 per cent of respondent firms. Investment in plant and equipment was revised downward for a net 7% of respondents, while investment in land and buildings was increased by a small net balance of respondents. Of those firms who undertook investment in the previous three months, 31% nominated new technology as an important reason for the investment decision. Investment intentions for both plant and equipment and land and buildings are expected to remain positive over the forthcoming quarter.

Total employment over the previous quarter increased for a positive net balance of respondent firms (25%). The Deloitte & Touche Scottish Chambers' Business Survey also reveals that around half of all respondent firms attempted to recruit staff over the same period. Of those respondent firms who attempted to recruit staff, 47% experienced increased difficulties recruiting technical and skilled labour. The trend in total employment is forecast to remain positive over the next three months with a net balance of respondents (20%) expected to increase total employment. Over the past quarter, 23% of respondent firms increased wages and salaries by an average 3.5%.

The general business outlook in this sector remains positive with over half of all respondents expecting both turnover and profitability to increase over the

next year. However, there are some strong concerns by respondents that the current value of Sterling and interest rates may affect demand over the forthcoming quarter. Moreover, firms are also noting greater pressure to raise prices through pay settlements and raw material costs.

If we consider the factors affecting continued growth in this sector, i.e. the strong pound, interest rates and increased pressure on prices, then the greater pressure on prices may actually be more significant. Recall that the concentration of this sector is predominately made up of overseas-owned manufacturing companies that typically export the bulk of their output. Production in Scotland for this sector is typically low value added (assembly type) with the more substantial value added content of gross output imported into the region. Therefore, as imports form such a large component of the total output of this sector, then the effects of the strong pound are offset to some degree by the relative fall in import prices. However, increased wage and raw material prices will effect the competitiveness of this sector particularly for exporting into European markets. Therefore, continued growth in this sector could be influenced by changes in factor conditions in both the Scottish and UK economy.

In the company sector, there was speculation that the currency crisis in Asia would effect the rate at which overseas-owned companies, from this region, continued to invest in Scotland. For instance, there was conjecture that the Hyundai group would delay its £3 billion investment in two semiconductor plants in Fife. The project is expected to eventually generate around 2,000 jobs. However, recent reports suggest that the planned investment will stick to the existing schedule, despite pressure by the South Korean government for the company to reduce its external debt. External market conditions and shocks will have impacts in this sector and the Scottish economy because of the concentration of overseas-owned plants. However, overall these impacts should be transitory with no long-term effect.

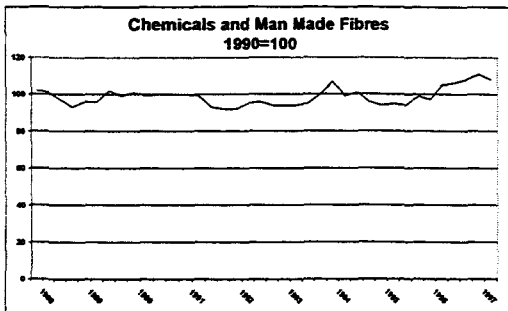
Calluna, the Glenrothes-based computer disk drive specialist saw sales increase substantially to just over £1 million in August. The trend is forecast to continue with the company entering into a joint manufacturing venture with the Innotech Corporation from Japan to adapt their product for handheld computers. Hewlett-Packard (HP) increased its workforce at its South Queensferry plant by over 200 over the past year, and the recent profit announcements suggest that this trend could continue. HP announced a 21 per cent increase in worldwide profits to \$3.1 billion (£1.84 billion). Last year the Scottish plant provided around a fifth

of HP's UK turnover. Pressac, the electronics components group has reported increased profits in the year to the end of July. The group, owner of the John McGavigan plant in Kirkintilloch, has benefited from its acquisitions into overseas markets last year. Pre-tax profits jumped 57 per cent to £10.1 million.

Finally, the first European facility for training electronics industry staff has been built in Livingstone's Kirkton Campus and will be run by West Lothian College and Napier University. The £13 million Scottish Advanced Manufacturing Centre is expected to train around 5,000 people per year. It is hoped that the centre will alleviate the potential skills gap that exists within the electronics industry in Scotland.

### CHEMICALS

The latest Index of Construction and Production for Scotland shows a 3% fall compared to the previous quarter however in comparison to the same period one year ago output in the chemical and man made fibre industry rose by 10%. For the UK as a whole output also fell by 1% over the second quarter and though an increase as recorded for year on year growth, it was not as great as for Scotland at 1%.



Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey showed that the decline in confidence continued as demand proved weaker than anticipated. A net of 5% reported being less confident than three months earlier however a net of 5% reported being more confident than in the same quarter one year ago.

Once again respondents tended to overestimate the strength of demand, only 20% of firms reported increased total new orders while 45% reported reduced orders as orders from all sources declined. Though firms anticipate an improvement in rest of UK orders, they remain cautious as to the rate of increase in total, Scottish and export orders.

Total sales declined as 50% of firms reported declining sales to abroad while approximately 40% noted a fall in sales to domestic markets. Little change is forecast for the current quarter with firms

expecting sales to the Scotland and abroad to continue to fall while the trend in rest of UK sales is forecast to be flat.

The majority (63%) of firms surveyed indicated that exchange rates were more of a concern to their business than three months previously. Other factors of concern included orders/sales (42%) and interest rates (32%).

Over the past quarter cashflow improved for a net of firms, only 10% of firms reported a decline. Firms expect both turnover and profitability to improve over the next twelve months. Pressure to raise prices is expected in the form of pay settlements (16%) an raw material prices (16%) while 10% expect finance costs to influence price increases.

Few firms made or expect to make changes to investment plans and investment authorised during the third quarter was predominately in order to replace existing machinery, increase efficiency and reduce labour.

The trend in total employment was flat with 21% both increasing and decreasing employment and firms expect the trend to remain flat during the current quarter. A quarter of firms increased wages during the average wage increase was 3.2%. Slightly less than half sought to recruit and activity was widespread. Although a quarter reported increased recruitment difficulties and two thirds experienced problems recruiting suitable employees for particular occupations, these were confined to those seeking professional/managerial, technical, manual, temporary and young staff.

Scotia Pharmaceuticals, the Stirling based drugs group, recently sold the marketing rights for Foscan for £33 million. Foscan is a light sensitive drug, which when used in conjunction with laser therapy, can treat cancerous cells in the lung, stomach and gullet. Boehringer Ingelheim of Germany plans to market the drug in Europe and America while Kyowa Hakko will do so in Japan. Scotia will capture a significant share of Foscan sales revenue through a combination of product supply and royalties.

Scotia also revealed plans to launch next year yoghurt that can help people avoid gaining weight. LipidTeknik, Scotia's Swedish subsidiary, has developed Ileal Brake, which can be added to many foods without regulatory approval if sold as a weight control as opposed to a weight loss drug. Scotia has also signed a two-year deal with one of the big three US pharmaceutical firms to develop and evaluate Ileal Brake and its potential for over the counter sales. This will replace two slimming

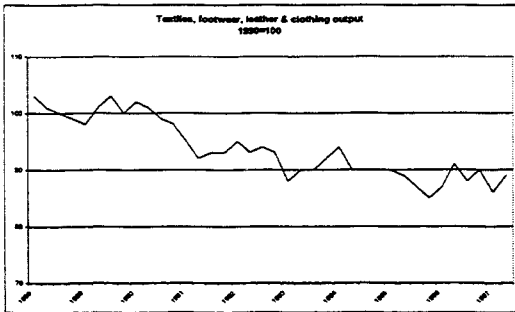


drugs, which were withdrawn from the UK market after fears they might cause heart defects.

Following ICI's £5 million purchase of Unilever the group plans a significant disposal from its chemicals side which includes the explosives plant at Ardeer in Ayrshire. At its peak the explosives plant employed more than 10,000 although the current workforce is now approximately 400. The plant is a major supplier to the British coal mining industry and has suffered from pit closures and the decline of the industry. ICI also announced plans to sell its last large interest in fertilisers in a move towards speciality chemicals that command higher profit margins than the bulk chemicals used in fertilisers. Terra Industries of Sioux City, Iowa, is paying £200 million plus a deferred payment of up to £50 million for the business.

**TEXTILES, LEATHER, CLOTHING AND FOOTWEAR**

The Index of Production for the Textiles, Leather, Footwear and Clothing (TLFC) sector in Scotland stood at 89 in the second quarter of 1997, a rise of 3% from the previous quarter. The rise is in contrast to the position across the UK, where output fell by 2% over the same period. The Index for Scotland shows a yearly increase of 1% compared to the preceding four quarters, the same change as seen across the UK. While the increase in output in TLFC in Scotland is positive, it compares to an increase of 7% for the whole of the Manufacturing sector in Scotland.



The September Deloitte Touche Scottish Chambers' Business Survey (DTSCBS) provides figures for the third quarter of this year. Overall, 36.5% of respondents reported a fall in confidence (with regard to the general business situation) compared to three months previously, with only 16.6% reporting a rise and 46.9% indicating no change. This is little changed compared to the same point in 1996, with 20.0% reporting an increased level of confidence compared to 40.1% who reported a decrease and 36.9% who felt no change.

The position with regard to new orders is somewhat weaker - 53.2% report no change in the trend in the total volume of new orders in the three months preceding the survey, but 30% felt a decrease in trend compared to only 16.8% reporting an increase. Export orders appear to have fallen off most heavily, with 50.1% seeing a falling trend in export markets in the three months to September, in comparison to 32.5% for Scottish orders and 26.1% for the rest of the UK. Also worrying is the fact that 37.4% of respondents see export orders falling in the coming three months. Although a net balance of respondents do expect both Scottish and other UK orders to increase, the overall position with regard to new orders is negative. The survey also reports that the orders position began to cause an increased degree of concern in the previous three months, with 62% reporting this. 58% also specifically cited that the level of sterling had become more worrying in the three months to September. Reflecting this outlook, there is little expectation that profitability will improve across the sector.

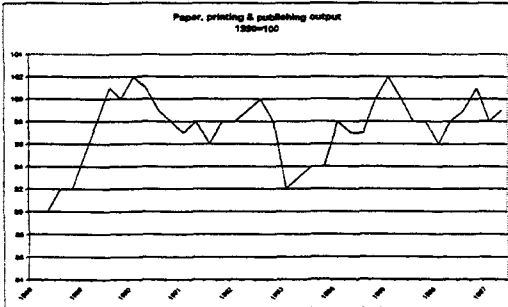
The strength of sterling has indeed been blamed by Pringle for its decision to shed three hundred jobs in the Borders. The company sells around 60% of its output abroad and has been particularly hard-hit in the Far-East, where the recent turmoil may presage further bad news, and in Germany. Pringle's most recent figures in fact show that the company has returned to profitability but has been hit by an estimated £2-3m loss due to the strength of the pound. The company is to consult with unions before deciding where the redundancies are to fall.

**PAPER, PRINTING AND PUBLISHING**

The Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland increased by 1% in the second quarter of 1997, to stand at 99 (1990=100). Annualised growth in Scotland increased by 2%. The corresponding UK figure reveals output growth increased by 1% to the second quarter of 1997 and annualised growth remained unchanged. The most recent Deloitte & Touche Scottish Chambers' Business Survey (3<sup>rd</sup> quarter 1997) reveal that the fall in business confidence, reported in the previous Quarterly Commentary, has steepened to a net 24 per cent of respondents. In comparison with the same period one year ago, a net 16 per cent of respondents are less confident about general business conditions.

The anticipated rise in the trends in total orders, noted by respondents in the previous Quarterly Commentary, proved to be over optimistic as a net 16 per cent of respondents reported falling orders over the last quarter. The downturn in the trend in

the total volume of new orders was reported across all markets with export orders recording the most significant fall. However, respondents remain confident that orders will improve across Scottish and UK markets, but not export markets. Over the previous three months, the actual volume of sales decreased sharply across all markets for a positive net balance of respondents. Again export sales deteriorated sharply with a net balance of 50 per cent of respondents reporting that export sales had declined. This trend is forecast to continue over the forthcoming quarter.



The average level of capacity utilisation for the Paper, Printing and Publishing sector has eased down substantially over the last quarter, and now stands at 76%. There was also substantial changes in investment intentions, over the past quarter, for some 50 per cent of respondent firms. However, overall the net balance of respondents show no change in investment intentions. Of those respondents who undertook investment, 40 and 36 per cent, respectively, nominated increased efficiency and reducing labour as the main reasons for the investment. In the forthcoming quarter, investment intentions for both plant and equipment and land and buildings are forecast to be revised upward for a positive balance of respondent firms.

The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that total employment increased over the past quarter for a net balance (8%) of respondent firms. This trend is again forecast to continue over the forthcoming quarter. Over half of all respondents attempted to recruit staff over the past quarter although a net 12% of respondents noted difficulty in recruiting skilled manual workers. Over the past quarter, 40% of respondent firms increased wages and salaries by an average 3.4%.

In summary, the current small increase in output growth, over the past quarter, coupled with the weaker trends in orders and sales suggest an uncertain outlook for future growth in this sector. Respondents remain upbeat although their main concerns for activity in the forthcoming quarter

stem from the low levels of demand and the current value of Sterling.

In the company sector, the Scottish Media Group (SMG), owners of Scottish & Grampian Television and the Herald newspaper, posted record half year profits. SMG's profits for the six month of the year were higher than its own interim forecast at £18.5 million. The Group's newspaper activities contributed nearly £7 million to the half yearly profits.

Newsquest, the regional newspaper group, has completed a successful flotation on the stock market. Although its shares were offered at the bottom end of its price range (250p), the flotation was oversubscribed with more than 8,400 members of the public applying for shares. Some 1.7 per cent has been allocated to employees and the 70.6 million shares left are being placed with institutions. The Newsquest group now plans to grow through acquisition and by developing its existing businesses and it is believed to be considering acquisitions in Scotland where it currently has no papers.

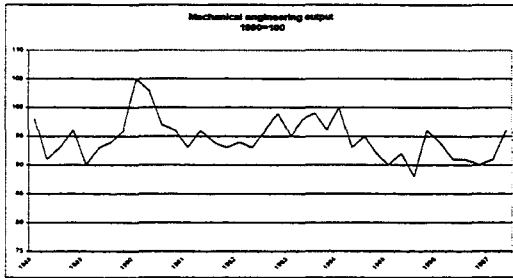
Donside paper mill in Aberdeen has been sold to a management but-in team in a £33 million deal. However, the new company, Donside Paper Company, still had to go ahead with anticipated job cuts affecting 128 employees, that were blamed on falling export orders and over capacity in the market. Finally, Edinburgh Financial Publishing (EFP), the specialist financial information supplier, is being sold to Barra, the California-based financial and money management software company for £7.25 million.

### MECHANICAL ENGINEERING

The latest Scottish Office News Release (5 November 1997) showed a much-improved performance of the Scottish mechanical engineering industry in the second quarter of this year, with output rising by 6% from the first quarter. This improved output performance is likely to last until the end of this year, as the latest Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) revealed. In the survey, the largest proportion of the responding firms reported increases in their total volume of new orders and sales (with net balance of 11.6% and 12.5% of firms reporting increases respectively).

Notwithstanding these recent improvements, business confidence deteriorated further in this sector in quarter 3, with a net of 7.7% of firms being less optimistic than the previous quarter. This deterioration in business confidence seems to be mainly due to sluggish export orders and sales,

despite a modest improvement in the domestic markets. The anticipated rise in export orders and sales failed to materialise in quarter 3. Moreover, export orders and sales are expected to remain flat until quarter 4, as are domestic orders and sales.



Work in progress continued to increase in more firms, and the rate of capacity utilisation was higher than quarter 2 at 82%. There was a strong indication that investment plans for plant and equipment rose in quarter 3 and are expected to do so in quarter 4. More firms were also investing in land and buildings. For those firms that authorised investment in quarter 3, the main reasons were: reducing labour costs, increasing efficiency, replacement and introducing new technology.

In quarter 3, less than a quarter of the firms were under pressure to raise their prices because of increased prices of raw materials and other overheads, and even less firms expected to actually raise their prices. On a longer-term basis, firms, on balance, expect their turnover and profitability to improve over the next twelve months.

On the job front, the overall situation of the job market in this industry seemed encouraging. Although the majority of firms reported no change to the level of employment at all, on balance more firms recruited new staff in quarter 3. The generally sluggish state of this industry has helped keep the wage claims modest. Although the problem of recruiting suitable employees in particular occupations, especially skilled manual workers, eased further in quarter 3, the majority of the firms (57%) still experienced difficulty in this regard.

## SERVICES

### DISTRIBUTION

Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey shows that business confidence among wholesalers eased from a net of +13% during the second quarter to a net of 0% but compared with the same quarter one year earlier a net of 6% reported being more confident. Despite the continued upward trend in retail orders, a net of firms reported being less confident about

the general business situation than in the previous quarter although more than 50% of firms reported no change. Compared to the same period one year earlier, however a net of 6% of retailers reported being more confident.

In line with expectations the trend in wholesale sales, based on the same quarter one year earlier, increased [+5%] although not to the extent forecast by firms during the previous survey. Wholesalers expect the trend to continue although the rate of increase is expected to ease slightly during the current quarter. Compared to the same quarter of 1996 a net of 18% of retailers reported an increase in sales and firms, on balance, expect the trend to remain upwards during the current quarter and at much the same rate of increase.

Turnover and profitability are expected to improve over the next twelve months for nets of 28% and 8% of wholesale firms respectively. Cashflow improved during the third quarter for a net of 4% although more than 60% reported that there had been no change. Nets of 28% and 23% of retailers expect that over the next year both turnover and profitability will increase. Only a net of 3% reported an increase in cashflow over the third quarter however almost 50% reported no change.

Over the next three months a third of wholesale respondents expect the prices of goods and services to rise while only 9% expect them to fall. The factors thought most likely to affect prices were raw material prices [29%], pay settlements [16%] and finance costs [14%]. Over the next three months 40% of retailers expect the price of their goods and services to increase while only 3% anticipate reducing prices. Respondents felt that they were under pressure to raise prices from the following factors: finance costs [24%], pay settlements [12%] and raw material prices [12%]. Other overheads were cited by 37% of firms.

A net of 10% of wholesalers increased total employment during the third quarter, slightly higher than forecast. Net increases were recorded in all categories of employment. Firms expect the upward trend to ease to a net of +4% during the current quarter with the only net reduction expected to be for overtime working. The upward trend in retail employment continued with net increases in all forms of employment. Again the majority of respondents made, and expect to make, no changes to total employment with the only net reduction expected to be in overtime working.

Approximately half of the responding wholesalers attempted to recruit in the three months to September and slightly more than a fifth reporting increased recruitment difficulties. Recruitment

activity continued to be fairly widespread among retailers, as were recruitment problems. 26% of firms felt that recruitment problems had intensified since the second quarter while 40% indicated that they had encountered problems recruiting suitable employees in particular occupations.

September saw the largest monthly fall in retail sales for six and a half years, falling by 1.9%. Analysts put the fall down to effects from the death of Diana, Princes of Wales, the unseasonably warm weather and the end to building society demutualisation windfall payments. Sales improved by more than expected in October, up 2.8% from September and 6.4% higher than a year earlier.

Company news includes, the department store group House of Fraser announced a cut in their losses in the six months to July 26, falling from £13.6 million in the same period last year to £1.8 million. Waston & Philip, the Dundee based wholesaler, retailer and distributor, is also benefiting from its recent investment program signing a £45 million three-year deal with Queens Moat Hotels. This is the first deal of its kind since the company invested in 200 multi compartment lorries capable of delivering frozen and chilled products at the same time as non refrigerated foods.

### TRANSPORT

#### Air

British Airports Authorities (BAA) announced an increase in passenger numbers at all its airports with its busiest September to date. The seven airports saw an increase in traffic of 7.4% compared to the same period last year and handled more than 10 million passengers. Passenger numbers across the Atlantic rose by 10.1% with European charters advancing by 8.2%. Traffic to Ireland increased by 10.6% with domestic passengers rising by 7.6%. Glasgow airport led the way with an 11.3% rise to 618,900 passengers, compared to Gatwick and Heathrow where passenger numbers increased by 10.8% to 2.9 million and 4.8% to 5.4 million respectively. BAA also announced half year pre-tax profits of £310 million, an increase of 2%, because of accounting changes profits would have been £326 million, growth of 10%. The high value of sterling did not help profits. BAA has acquired Duty Free International for £423 million.

#### Rail

Virgin are backing a £600 million project which will add to the upgrading of the West Coast Mainline (WCML) taking the total project spend from £1.5 billion to £2.1 billion. Virgin will spend

an additional £750 million on new trains using tilting technology reducing the journey time from 5hrs to 4hrs 20 min initially in 2002 then to 3hr 50min in 2005 as speeds of 140mph will be attainable. WCML has not seen an improvement in journey time between London and Glasgow for 23 years. There will be increased services between London and Glasgow, Manchester, Birmingham and Liverpool.

The Scottish Eurostar service is to be axed to improve services from Manchester. Virgin is considering a bid for leasing the seven trains built by the taxpayer at a cost of £24 million but no final decision has been made. A spokesman for Eurostar, while acknowledging the delays, stated that it still hoped to provide a Scottish service but could not give a date for this and dismissed the Virgin bid as 'pure speculation'.

Passenger rail services are allegedly squeezing freight off the rails particularly at busy bottlenecks where passenger trains which may have relatively few passengers can hold up trainload freight like steel, coal and aggregates. The lack of capacity in urban areas and in busy junctions are causing significant delays to time sensitive freight deliveries. It has been estimated that up to 1 billion tonnes of freight (or 20% of growth up to 2005) will be prevented by travelling by rail due to the existing policy.

#### Road

The government is considering calls to radically alter the burden of transport taxation from public to private and towards usage where the private user must pay. The proposals include tax breaks for electric vehicles, road tolling, congestion and pollution taxes, increased fuel duty and non-residential car parking charges. It may be that Edinburgh drivers will be the first to experience a toll ring where they would have to pay to cross when entering the city. By the year 2005 legislation could be in place for Edinburgh to proceed with road tolling.

FirstBus raised their dividend to 22% last month and turnover rose by 47% to £363 million, pre-tax profits increased by 35% to £32.5 million. Due to diversification into rail and airports (Bristol and Luton) the company is proposing to change its name to FirstGroup. The contribution to profits from bus operations rose to £42.2 million with a 14% profit margin. Great Eastern Railway made an operating profit of £900,000 while Great Western Holdings added £2.1 million to pre-tax profits. The success of the group has seen the placing of an order for 810 buses worth £84 million distributed

between Plaxton, Scania, Volvo, Alexander, Wright, Dennis and Mercedes.

**Sea**

Calmac are to increase commercial fares on the Ullapool/Stornoway route by 9%, which is three times higher than expected. Passengers and non-commercial traffic fares will rise by 6.6%. The fares increase is to cover the rise in berthing costs, in Stornoway harbour after the Scottish Office refused any further assistance.