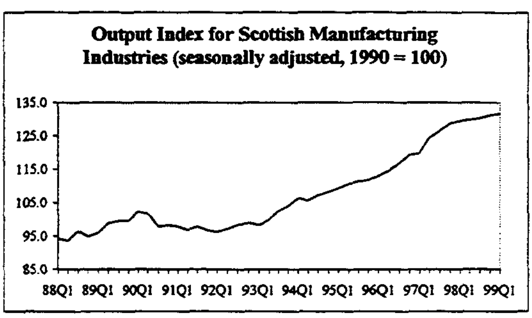
The SCOTTISH *Economy*

SHORT-TERM FORECASTS*

This section presents short-term forecasts for the quarterly growth rates of Scottish manufacturing (Division D of the 1992 SIC) output. Our previous forecast of the annual growth rate for Scottish manufacturing output for 1997 of 6.7% is close to the actual growth rate of 7.7%, as revealed in the latest Scottish Office News Release (6 May 1998).



The present forecasting period extends to 1999Q1. 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 1997Q4 and the forecasts for 1998Q1 to 1999Q1. Despite the downward revisions in the National Institute's forecasts for UK manufacturing output, the latest Scottish Office publication revised the Scottish manufacturing output index for 1997 upward substantially. The latter dominates the forecasts for the Scottish index for 1998. As a result, the present forecasts for Scottish manufacturing output in 1998 have been adjusted upward compared with the previous forecasts. The annual growth rate for Scottish manufacturing output for 1998 is now predicted to be around 4.3%. Further details of the growth rates are presented in the following table.

TABLE 1. QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)	
92/91	0.3
93/92	3.6
94/93	5.6
95/94	3.7
96/95	4.7
97/96	7.7
95Q1/94Q4	1.0
95Q2/95Q1	1.3
95Q3/95Q2	0.5
95Q4/95Q3	0.5
96Q1/95Q4	1.1
96Q2/96Q1	1.5
96Q3/96Q2	2.0
96Q4/96Q3	2.0
97Q1/96Q4	0.5
97Q2/97Q1	3.7
97Q3/97Q2	1.9
97Q4/97Q3	1.7
FORECASTS	
98Q1/97Q4	0.6
98Q2/98Q1	0.2
98Q3/98Q2	0.5
98Q4/98Q3	0.6
99Q1/98Q4	0.5
98/97	4.3

SCOTTISH CHAMBERS' BUSINESS SURVEY

The Deloitte & Touche Scottish Chambers' Business Survey, conducted by Strathclyde University's Fraser of Allander Institute, is the largest and most comprehensive regular survey of the Scottish business community. The latest survey, for the first quarter of 1998, shows weaker than anticipated manufacturing export activity and weaker tourist demand from abroad. Optimism continues to rise modestly in the construction sector. Retail sales continued to strengthen and a further modest

* 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.

improvement is forecast, however, weakening cash flow trends adversely affected business confidence.

MANUFACTURING

Optimism

There was a further decline in business confidence, with a net balance of 9% of respondents reporting that they were less optimistic about the general business situation than they were in the previous quarter. This compares with a balance of 1% who were less optimistic in that quarter.

Orders & Sales

Total orders and sales rose slightly (net balances of 5% and 3%, respectively). But the increase for orders was less than expected in the previous quarter. Orders and sales to the domestic Scottish market rose slightly and were slightly above expectations. Demand from rest of UK markets fell and by a greater amount than anticipated in the previous quarter.

The difficult conditions in export markets continued with demand contracting further as net balances of 15% and 11% of respondents reported a decline, respectively, in orders and sales. The deterioration was worse than expected in the fourth quarter of last year.

Concerns about demand increased, which was the most important factor thought likely to limit output. This is not unconnected to the strength of sterling with concern about exchange rates the second most important constraint on output.

Concerns about the level of interest rates continued alongside worries about the degree of competition. The increased concern as to the level of competition probably reflects a tougher competitive environment as demand weakens.

Finance

The cash flow position of firms deteriorated with a net balance of 1% reporting a decrease compared to a positive balance of 4% in the fourth quarter. This clearly reflects the weakening demand situation and pressures on margins, particularly for exporters.

Both turnover and profitability are expected to rise over the next twelve months, which is broadly the same as the expectation in the fourth quarter.

Pressures to raise prices appear to have slackened slightly in the first quarter particularly from pay settlements and finance costs. As a result a smaller net balance (18%) of respondents than in the fourth quarter (20%) expect output prices to rise over the next three months.

Investment

Investment authorised in the first quarter was again primarily orientated towards reducing labour (35%), with replacement (30%) and efficiency enhancement (21%) the next most important reasons. Only 10% of respondents cited capacity expansion as a reason for investment, underlining the weaker demand situation.

Investment intentions remain positive for plant and equipment and have become positive for land and buildings since the fourth quarter.

Employment

The rise in employment was less than had been anticipated, although changes in employment levels affected less than 50% of respondents. A net of firms anticipate a rise in employment in the second quarter. More than 50% sought to recruit staff in the first quarter. Skilled manual and technical were the most frequently sought occupations. Slightly less than a third increased pay by an average of 4.13%.

CONSTRUCTION

Optimism

There was little change in business confidence with only a net 1% of respondents reporting an increase.

Orders and Sales

Total orders fell with a net balance of 4% of respondents reporting a decline. This was below the expectation in the fourth quarter and so is likely to account for the failure of optimism to rise. There was a further decline in orders from the public sector, particularly from Central Government. The decline in orders from both parts of the public sector was slightly greater than anticipated in the fourth quarter.

Private sector orders continued on an upward trend but the rate of increase slowed and the outturn was below fourth quarter expectations.

Investment

Respondents are now registering positive investment intentions after the deterioration in the fourth quarter. The improvement in investment intentions was greater than anticipated in the previous quarter. Of those investing, 54% of respondents reported that the main reason for investment was to replace existing capacity, and 23% cited increasing efficiency.

There was a sharp deterioration in the percentage reporting that the investment was necessary to expand capacity, from 25% in the fourth quarter to 12% in the present survey. The deterioration is clearly a reflection of the overall downturn in demand.

Employment

Changes to employment levels affected less than 50%, and the trends were slightly weaker than anticipated. Almost a fifth reported increasing pay by an average of 4.4%. Half reported seeking to recruit, problems were again evident in the recruitment of suitable skilled manual staffs.

WHOLESALE DISTRIBUTION

Optimism

Changes in business confidence affected less than 50%, nevertheless, confidence rose from a net of -5% in quarter four to a net of +2% in the first quarter, as sales were better than anticipated.

Sales

Respondents had expected a modest rise in sales in the first quarter, however, the trends were better than anticipated, with 43.3% reporting rising and only 32.2% falling sales (a net rise of +11%). A further improvement in sales is forecast for the second quarter. Two thirds identified competition, 32% interest rates and 29% exchange rates as the factors most likely to restrict activity in the second quarter.

Investment

The rise in investment plans continued.

Finance

Notwithstanding rising sales cash flow trends weakened, with 29.2% reporting lower cash flow and only 13.5% rising cash flow trends. Respondents continue to expect turnover to improve over the next twelve months, although at marginally lower rates than in previous quarters. Expectations of price increases in the second quarter are marginally lower than in the first quarter, nevertheless, 37.5% expect increasing prices in the second quarter. Raw material costs and other overheads remain the main pressures on prices.

Employment

Changes to employment levels were reported by a third of respondents, yet the trends were better than had been anticipated. Slightly more than 50% sought to recruit staff and 37.8% reported increasing pay by an average of 3.96%.

RETAIL

Optimism

Changes in business confidence continued to affect less than 50%, nevertheless, the decline in confidence, a feature of the second half of 1997 continued and steepened as 25.8% reported being less and only 16.3% more confident than at the end of 1997.

Sales

The trends in sales were better than anticipated, and respondents are confident of increasing sales in the second quarter. Changes in the level of sales were widespread, with 40.3% reported rising and 30.1% falling sales. Competition, interest and business rates were identified as the three factors most likely to restrict activity in the second quarter.

Investment

Investment plans continued to affect less than 40%, nevertheless, the rising trends continued and strengthened.

Employment

Employment trends were better than anticipated, although changes affected less than 25%. Most recruitment appeared to be for replacement. Almost 20% increased pay by an average of 4.22%.

FINANCE

Personal advances

Personal advances continued to advance strongly with over 50% reporting an increased trend in the level of advances, yet the trend is not as strong as in the first half of 1997.

Corporate advances

There was a more modest rate of increase than a year ago, however, a strong rise is expected in the second quarter. Corporate demand for credit was most evident for working capital, demand for credit for plant/equipment was more modest and at levels experienced in 1996 rather than in 1997.

Sectoral demand

Demand for credit rose from all sectors, apart from Tourism. Demand is expected to rise from all sectors in the second quarter.

Employment

Changes to employment levels affected less than 25%, declining trends in full time employment were more than offset by the increased employment of part time and temporary staffs. Slightly more than a fifth reported increasing pay by an average of 3.76%.

TOURISM

Optimism

More than half reported no change, and identical percentages reported increased and reduced confidence - a net balance of 0%.

Demand

The rise in total demand was similar to a year ago, 37.7% reporting increased and 30.4% reduced demand. Business demand was the strongest feature with 36% reporting increased business trade. In contrast demand from abroad was weak, with 13.6% reporting increased and 40.9% reduced demand. Capacity used averaged 61.7% in the first quarter.

Finance

The rate of increase in turnover eased in the first quarter, with 51.9% reporting increased and 24.1% reduced turnover. Costs rose more modestly than in the fourth quarter. Over 38% reported increasing their daily room rate in the first quarter and 58% expect to increase rates in the second quarter.

Investment

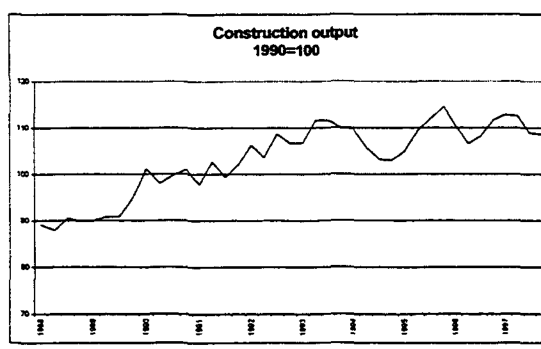
Investment continued to strengthen, although for more than 80% the main reasons for authorising investment were to replace/renew facilities or to improve existing facilities.

Employment

Changes to employment levels were reported by a third of respondents, however, the overall slight decline concealed increased use of part time staffs. Recruitment activity remained high with 77.4% seeking staff, and difficulties in recruiting suitable staff remained widespread.

CONSTRUCTION

The latest Scottish Office Index of Construction shows a fall of -0.3% over Quarter 3 on Quarter 4 of 1997 but a rise of 1.4% over the preceding four quarters to stand at 108.6 (1990=100). In contrast the UK index rose 1.4% to 94.4 over the third quarter (a 2.3% rise on the latest four quarters over the preceding four).



The Halifax House Price Index indicated that house prices in the UK rose by 1% in the first quarter, slightly less than during the fourth quarter of 1997 (1.2%). Over the year to the first quarter, house prices rose by 5.2% compared to 5.4% in the year to the fourth quarter. House prices in Scotland remained fairly depressed, falling marginally by 0.1% in the first quarter. Due to the sharp fall at the beginning of 1997, the annual rate improved but remained negative at -0.8%.

According to the Deloitte & Touche Scottish Chambers' Business Survey for the first quarter of 1998 there was little change in business confidence with only a net 1% of respondents reporting an increase.

Total orders fell with a net balance of 4% of respondents reporting a decline. This was below the expectation in the fourth quarter and so is likely to account for the failure of optimism to rise. There was a further decline in orders from the public sector, particularly from Central Government. The decline in orders from both parts of the public sector was slightly greater than anticipated in the fourth quarter. Private sector orders continued on an upward trend but the rate of increase slowed and the outturn was below fourth quarter expectations.

Respondents are now registering positive investment intentions after the deterioration in the fourth quarter. The improvement in investment intentions was greater than anticipated in the previous quarter. Of those investing, 54% of respondents reported that the main reason for investment was to replace existing capacity, and 23% cited increasing efficiency.

There was a sharp deterioration in the percentage reporting that the investment was necessary to expand capacity, from 25% in the fourth quarter to 12% in the present survey. The deterioration is clearly a reflection of the overall downturn in demand.

The Chartered Institute of Purchasing and Supply Survey saw building activity increasing rapidly despite signs of an economic slowdown. The Survey, for the UK as a whole, found that activity rose for the 13th consecutive month during April with a third of respondents reporting an increase in workload. Commercial activity was rising at a faster rate than house building and civil engineering. Overseas business continued to rise in spite of the high value of sterling. Orders, on balance, rose though the increase in demand put additional pressure on suppliers who lengthened their lead times. Firms also reported shortages of skilled labour.

A number of construction companies have recently reported buoyant results. The Miller Group reported an increase in profits across all its five divisions last year. Profits increased by 18% to £13.4 million on a turnover of £298.6 million. Barratt reported a sharp increase in sales through its Edinburgh and Aberdeen offices and as a result is planning a more rapid expansion. They reported a 27% increase in Scottish sales in the final months of 1997. The stronger housing market also helped AMEC to boost profits in the company's house building subsidiary with operating profits more than doubling to £16.2 million on a turnover of £182 million. Alfred McAlpine, which was originally based in Newarthill, also reported that profits had more than doubled following a takeover of its rival, Raine, helped by rising house prices. Other parts of the group also showed improvements with total group profits rising from £11.3 million to £24.1 million before tax and exceptionals.

Kier Group, in a joint venture with the City institutional fund specialist Innisfree, won the contract to design, build and finance a new £67.5 million hospital for Hairmyres and Stonehouse NHS Trust in East Kilbride. It is the first NHS hospital scheme to be developed through the private finance initiative (PFI) and in total is worth £664 million over the next 30 years.

ENERGY

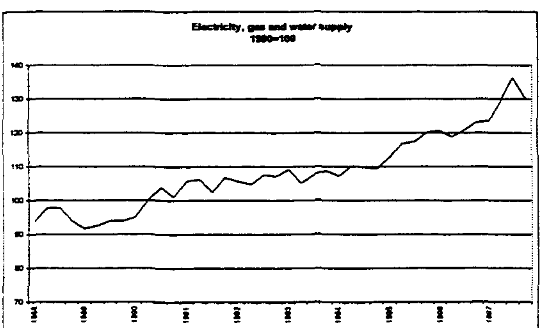
Coal

The Scottish coal industry received another boost as Scottish Power announced new contracts to buy £400 million worth of coal from Scottish Coal. This will allow the £35 million expansion of Longannet colliery to go ahead and keep Longannet power station operating for a further 22 years. Deep mined coal will provide 1.7 million tonnes a year for six years with 750,00 tonnes coming from open cast mines annually over five years. The re-negotiation of contracts is believed to have reduced the price from £36 a tonne to about £28 a tonne. Scottish Power will pay a premium in the first three years but obtain a discount in the next three years in order to help investment at Longannet.

Oil and Gas

Oil and gas production declined by 3.6% for Q1 1998 on Q1 1997 but increased slightly by 1.6% for Q1 1998 on Q4 1997. The quarterly rise was largely due to increases in gas production as a 6.5% increase in production occurred for Q1 1998 on Q4 1997 although on an annual basis it declined by 5.7%. Oil production fell by 1.6% and 2.1% on a quarterly and annual basis respectively. The price of oil ($ per barrel) has fallen by 34% and by 24.7% for Q1 1998 on Q4 1997 and on an annual basis respectively. Total average daily oil value fell from £54.2 million in Q1 1997 and £47.1 million in Q4 1997 to £41.1 million in Q1 1998, respective decreases of 24.2% and 12.7%. In Q1 1997 average daily oil value was £34.4 million but for Q1 1998 is only £22.2 million.

Oil prices are at their lowest in real terms for 25 years. Consequently oil and gas revenues have fallen considerably. Prices are now 82% lower than they were in the peak revenue period i.e. Brent blend per barrel was £25.05 in 1985 which in 1998 prices is £43.11. In 1985 revenues peaked at £118.5 million in February and currently revenues show an 83% decrease in real terms as revenues in March 1998 are only £20.5 million per day. This has been an ongoing trend since the mid eighties. Another important factor is the strength of sterling – it has risen against the dollar by 3.4% over the year since March 1997. When this is taken into account the price of oil in March 1998 stands at £7.92, which is the lowest in cash terms since December 1988. In November 1997 OPEC raised quotas by 10% but in a surprising move in March 1998 10 OPEC and 5 non-OPEC countries agreed to restrict supply by 1.5mbpd. This may result in slight upward pressure on price but given OPEC's poor record on quotas this outcome is not guaranteed.



The implications of these price movements are the need to continue to drive down costs, government revenues will be depressed over the next fiscal year and this will lead to a balance of payments deterioration. It also implies that some marginal projects may not materialise with consequent effects on output and employment. This cannot be generalised because a slight recovery in price has not jeopardised some current marginal developments. The fall in price is principally due to slow demand growth, warmer winter weather, the Asian slowdown, high stocks and the more optimistic view on Iraqi exports. Despite the current situation January 1998 saw a record of 145 fields in production (51 oil only, 51 gas only and 43 oil & gas).

The review of oil & gas taxation, particularly the proposals for supplementary corporation tax and the increased scope for petroleum revenue tax, has caused considerable uncertainty in the industry. The government, while wishing to maximise revenue, need to balance it's commitments to fairness, long-termism and encouraging both investment and employment.

The Deloitte & Touche Oil and Gas Survey for the oil and gas sector conducted in March 1998 reported an end to the rising trend in optimism that has been evident since 1995. 35.4% were less and 12.5% more confident than at the end of December, a net change of –23%. This effect was more prevalent in large companies. Exploration work trends were similar to those in quarter one of 1996 and 1997 but the expectations of future activity fell significantly from that in the previous quarter. The amount of overseas work continued to rise with just over half of respondents reporting an increase. For production and service related work expectations of future activity have dampened and the positive trends are weaker than in the last quarter. A positive trend still exists for investment but is weaker than that of the last quarter. Almost half of respondents reported no change in employment, 47% reported an increase with only 6% having reduced employment. This trend is expected to continue into the next quarter although expectations are weaker than they were at the end of December.

Royal Dutch/Shell reported a 23% fall in profits to £1.2bn for the first quarter of 1998. Shell's return on capital employed was 10.8% some way behind industry leaders with figures of around 14%. Exploration and production profits fell by 45% while downstream earnings remained static. Shell also indicated that it would defer a number of North Sea projects because of the low oil price and uncertainty over taxation. The Wood Group is to provide data on Well performance to Shell on a monthly billing basis for all Shell/Esso joint ventures in the North Sea. Offshore contractors are trying to secure 5% of the offshore technology market by the year 2001 rather than their current 1% share.

UTILITIES

The Index for Production and Construction for electricity, gas and water supply in Scotland for Q4 1997 on Q3 1997 decreased by 4.3% but increased by 7.5% for the latest four quarters on the preceding four quarters. In the UK the respective figures are – 2.8% and 2.5%. Scottish electricity generation outpaced that in the UK during Q3 1997.

Electricity

Scottish Power (SP) and Hydro Electric (HE) have attacked proposals by the electricity regulator

Stephen Littlechild to demerge supply and distribution businesses. Both companies would require separate management, accounting and IT systems thereby increasing costs. SP warned that increased costs would ultimately have to be borne by the consumer.

SP is returning to the US market with £3 billion available for acquisitions if the right investment were to be found. This follows a 14.5% rise in profits for the year to March 1998 mainly due to Southern Water's contribution as electricity profits fell off slightly. SP is aiming to achieve a market share by the year 2000 of 15% in electricity, 12% in gas and 10% in telecommunications compared with 11%, 8% and 4% respectively at the moment.

Electricity suppliers and customers have urged the government to increase competition in the electricity market to deliver lower prices. The three largest generators, National Power, Powergen and the Energy Group were singled out as having undue influence on the electricity pool price. The regulator has backed Powergen in their attempt to have a £120 million gas fired power station built at Gartcosh. Prof. Littlechild has cited the dominant position of SP and HE as constraining new entrants to the Scottish market. A new entrant he believes 'will promote increased competition' and 'maintain pressure to reduce prices to customers.' The moratorium on gas fired power stations has been criticised by the CBI, developers and consumers who cited the cost of lost jobs and inward investment as the price to be paid for these measures designed to protect the coal industry.

A damning report by the National Audit Office (NAO) has revealed that British Energy was sold too cheaply. The NAO report criticised the previous government for not following the Commons public accounts committee recommendations. A key issue was that if the government had kept a stake and the company performed well then it could have been sold at a later date raising considerably more revenue for taxpayers than they have received. A 40% stake sold in March at the current share price would have raised £1 billion more than the fully paid up issue price. The group was valued at £1.4 billion but is now valued at £4 billion. The bad news for Scotland is that British Energy is to merge Scottish Nuclear and Nuclear Electric and brand them under British Energy. The separate administration and headquarter functions will also be merged although the preferred site is not yet known. It is still possible that British Energy will acquire two US nuclear stations including the infamous Three Mile Island.

Gas

As competition in the gas market intensifies the latest figures show that British Gas are losing 20,000 customers a day according to Ofgas. Nearly 19% of the domestic market have switched suppliers totalling 3.5 million homes. A massive regeneration scheme is underway in Edinburgh where the City of Edinburgh Council will buy the 70-acre British Gas site at Granton for £3 million. The £62 million project for the North Edinburgh Waterfront will include an environmental clean up, a £6.2 million re-routing of pipelines and is expected to create 4,000 jobs. British Gas will spend up to £5 million on the environmental side of the project.

Nuclear

Dounreay is set to close after nearly forty years of service. The existing waste material for re-processing will be the last the plant will handle but decommissioning is expected to take at least up to a generation. The contaminated shaft at Dounreay is to be cleaned at a cost of £200 million. The shaft was sealed 20 years ago but still leaks radioactivity. The work is expected to cost between £212 million and £355 million and will be carried out over a twenty five-year period. This announcement comes as the Health and Safety Executive expressed grave fears over safety at Dounreay and stated 'management had lost sight of its duties.'

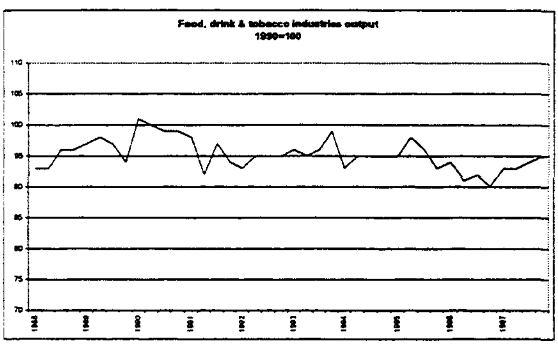
MANUFACTURING

FOOD, DRINK AND TOBACCO

The Scottish Office Index of Production for the whole of the Food, Drink and Tobacco (FDT) sector measured 95 in the fourth quarter of 1997(1990=100), a slight increase of 1% on the third quarter of 1997 but unchanged from the position one year earlier. This compares badly with the performance of the whole manufacturing sector in Scotland where output increased by 1.7% in the fourth quarter and by 7.7% over the year. However, Electrical and Instrument Engineering, which saw output increase 3% in the fourth quarter and 21% over the year, again heavily influence this. The FDT sector across the UK also saw output increase by 1% in the final quarter, although it also registered an increase of 2% for the year to the fourth quarter.

In Scotland, however, the constituent parts of FDT have behaved differently. In Food and Tobacco alone, output also rose by 1% between quarters three and four, but this part of the industry registered a 6%

reduction over the year. In contrast, Drink recorded a 4% increase in production over the year to the last quarter. In comparison with the UK industry over the latest year, Food and Tobacco in Scotland under-performed against the UK - the UK industry saw growth of 1% - while the Drink sector's annual performance in Scotland matches that seen across the UK, where output also increased by 4%.



The more recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) results for the first quarter of 1998 indicate some concerns over the industry's short-term prospects. There was a small net reduction in business confidence in the months prior to the survey, with a net 7% of respondents indicating reduced optimism. This seems to be due at least in part to problems in export markets - some 35% indicated that they had felt a downward change in the trend for export markets (compared, for example, to 21% who said that the trend in UK orders was down) and, of more concern, some 45% said that they expected export orders to fall off in the coming three months. There is little doubt that these findings are due to the recent performance of sterling, and results of this sort are likely to continue to be reported while the pound remains high. Capacity utilisation was down for a net of companies - 29% reported a fall compared to 21% who said it was up - although there were some indications that firms can see beyond present concerns, as a net 10% reported an increase in investment plans.

Employment intentions were flat, however, and look set to fall over the coming period - a net 10% of firms reported that the expected employment to fall in the coming period.

Good news for Scotland's major drink sector is that whisky exports totalled a record £2.4 billion last year, despite the strength of sterling and concerns over events in the Far East. It does seem unlikely that the industry will be able to sustain this level in the coming period due to the above two factors, although it is heartening that the US market grew by 14% and that total sales to Europe were also up. One source of worry, however, is that there is some evidence that the growth rate was partly due to price discounting, as firms try to keep volume up.

Within the whisky sector itself, Highland Distilleries has announced an increase in market share for its main brands, principally Famous Grouse, partly due to an advertising campaign designed to tempt younger people to drink more whisky. Highland's turnover increased by 35 over the year. It has also dismissed rumours that a take-over is in the offing.

Finally, the Dunbar-based brewer Bellhaven is to spend £5 million in the northeast of Scotland over the next five years. The first will be a new distribution centre in Aberdeen, and the company also plans to increase the number of pubs it operates.

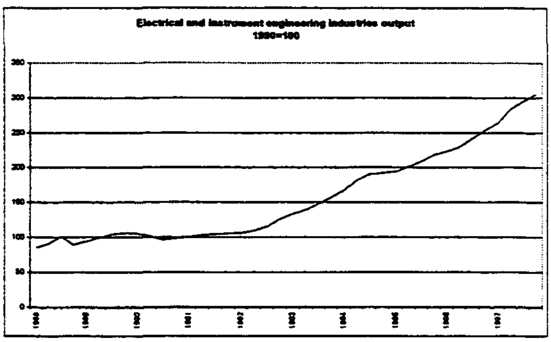
ELECTRONICS

The Index of Production and Construction for the Electrical and Electronic Engineering (EEE) sector in Scotland stood at 305 in the fourth quarter of 1997 (1990=100), indicating a 3% rise from the previous quarter. Year on year growth for this sector to the fourth quarter of 1997 remained high at 21%. Growth by this sector in Scotland again out performed the other Scottish manufacturing sectors. UK output for the sector fell by 1% over the previous quarter, although year on year growth remained positive with a 3% rise.

Business optimism in the EEE sector, as reported in the most recent Deloitte & Touche Scottish Chambers' Business Survey again reveals a slight easing in confidence. However, overall the general level of business confidence in this sector remains positive, with more respondents optimistic about the current business climate than one year previously.

The trend in the total volume of new orders and sales, over the last quarter, reveals an increase for a positive net balance of respondents. However, in both cases, export orders and sales decreased for a small net balance of respondents. The trends in the total volume of both orders and sales, over the forthcoming quarter, are forecast to be positive for a positive net balance of firms across all markets.

The average capacity utilisation for respondents in this sector rose 3 per cent to 82%, which 30% of respondents regarded as being lower than one year previous. Changes to investment intentions for plant and equipment and land and buildings were reported for 23 per cent of respondent firms. The rising trend in investment in plant and equipment continued upward at a net 1% of respondents, while investment in land and buildings was decreased by a small net balance of respondents. Of those firms who undertook investment in the previous three months, the need to reduce labour and increase efficiency were nominated as the most important reasons behind the decision to invest. Investment intentions for both plant and equipment and land and buildings are expected to remain positive over the forthcoming quarter.



Total employment changes affected 54 per cent of respondents over the previous quarter with 35% increasing employment against 19% who reported a fall in employment levels. Once again the net rise in employment in this sector is forecast to continue, and strengthen slightly. Over the past quarter, 26% of respondent firms increased wages and salaries by an average 3.6%.

The general business outlook in this sector remains positive as the deterioration in export demand has eased. Overall respondents expect both turnover and profitability to increase over the next year. However, difficulties still remain for medium sized companies, with continued pressure to control costs and maintain export market shares against the strong value of sterling and the subsequent rise in interest rates.

In the company sector, the turbulent conditions in the east Asian economies and the increasingly competitive nature of the world-wide electronics industry, has led to a strategic review of production activities and costs by multi-national companies throughout the industry. Scotland as both a major recipient of inward investment and an important manufacturing base for the electronics industry has been affected by these recent developments.

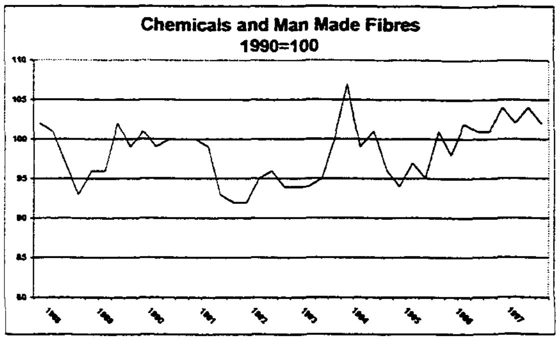
For instance, Mitsubishi Electric (Melco), the Japanese electronics group closed its Scottish television plant at Haddington, East Lothian. The closure of the manufacturing plant with the loss of 500 jobs was due to the continued fall in the price of televisions, which reflected the increasingly competitive and saturated nature of the television market. The company, based in Scotland since 1979, has other production sites at Livingstone, Lothian and Glenrothes that manufacture video recorders, air conditioning and computer equipment. The company employ 970 workers at these three sites and production at these plants is not affected by the closure of the Haddington plant.

Shiva Corporations, the US electronics corporation, closed its Leith site with the loss of 125 jobs. The closure of the Leith site, the corporate research and developmental facility for Shiva, marks the end of the operations in the former Spider Systems corporation. Shiva acquired the Scottish company for £50 million in 1995. The closure is due to internal re-structuring. Lite-On, the Taiwanese electronics giant announced the loss of 230 jobs at its newly opened Mossend plant in Lanarkshire. Two of the three production lines at the plant will be closed. Lite-On blamed intense competition from East Asian producers following the recent devaluations and the strong value of Sterling. The company is focusing its activity on its remaining production line. On a more positive note, Delta Electronics of Taiwan is creating 200 jobs in East Kilbride in a £10.7 million investment in Scotland, with the company set to manufacture a range of electronics products.

These announcements, coupled with the postponed opening of the Hyundia semi-conductor plant in Fife, represent a setback to the electronics industry in Scotland. However, the global nature of the industry means that this type of re-structuring will occur periodically with Scotland benefiting in some occasions and losing out in others. Accordingly, these closures must be considered in light of the continued growth of the electronics industry in Scotland and the continuing flows of investment into this sector.

CHEMICALS

The Index of Production and Construction for Scotland shows that output in the chemicals and man-made fibre sector fell by two percentage points compared to the previous quarter to stand at 102 (1990=100) however growth over the year rose by three percentage points. For the UK as a whole output fell by one percentage point compared to the third quarter and the same quarter one year ago.



Evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey would suggest that respondents continue to feel less optimistic about the general business situation. Only 13% of respondents reported being more confident than in the previous quarter while almost 30% were less confident.

The decline in confidence reflects the continued decline in total orders, a feature since the third quarter of 1997. Changes in the level of Scottish orders affected a third and the decline continued at a net of -17%. In contrast rest of UK orders rose while export orders remained level. Changes in total sales affected more than 70% of respondents with 43% reporting falling and 29% rising sales. Respondents are however optimistic about a strong improvement during the current quarter resulting from increasing sales to domestic markets. Although respondents anticipate a strong rise in demand during the current quarter, they remain concerned about the levels of orders and sales.

Exchange rates remained the factor causing most concern to the majority of respondents while slightly less than half cited orders/sales and interest rates. Average capacity utilisation fell a further percentage point to 72% and this was regarded by a net of firms as lower than in the same quarter one year ago.

Cashflow trends continued to weaken and the net balance declined a further five percentage points. Sixty percent (a net of +40%) expect turnover to rise over the next year and 40% (a net of +27%) expect an increase in profitability. Pressure to raise prices strengthened further and a net of 50% expects to increase prices over the next three months.

Changes to investment plans affected 40%; the declining trend investment ended and a level trend was reported. Investment authorised was directed toward expansion, increasing efficiency and reducing labour.

A modest rise in employment was reported although changes affected only a third of the respondents. This rise however is not expected to continue through the current quarter. Almost half the respondents increased wages and the average wage increase was 4.3%. Forty-six percent of respondents attempted to recruit and activity was widely directed. A third reported an increase in recruitment difficulties but these were confined to those seeking to hire professional/managerial, part time and temporary employees.

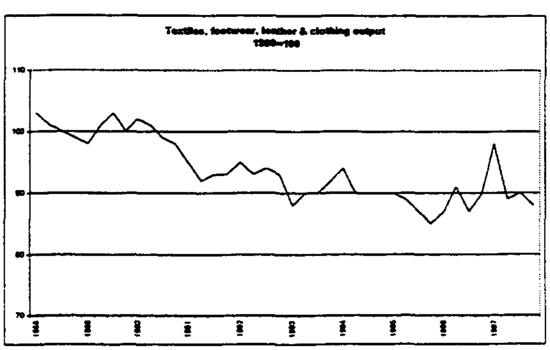
The UK is falling behind its main European competitors in chemicals output according to the UK Chemicals Industry Association (CIA). Output declined by 0.6% in 1997 compared with a rise of 4.2% in Western Europe as a whole. The chairman of the CIA, Mr Chris Andrews, blamed the strength of sterling for undermining UK competitiveness relative to European counterparts and forecasts for 1998 have been scaled down from a 2% rise in UK output to almost zero. Despite this the UK chemical industry maintained its position as number one manufacturing export earner with exports of £22.5 billion in 1997.

Following the appointment of Robert Dow as chief executive of Scotia Pharmaceuticals, the company has decided to suspend work on most of its drugs in development and concentrate on just three businesses. Scotia has signed an agreement with the dairy group Unigate to put its diet additive, Olibra into yoghurts and deserts. Unigate has the right to market the yoghurt and deserts in France, Italy and Ireland but deserts only in the UK. Profits from Olibra and nutritional activities would be ploughed back into its other business i.e. pharmaceuticals.

TEXTILES, FOOTWEAR, LEATHER AND CLOTHING

The Scottish Office Index of Production for the Textiles, Footwear, Leather and Clothing (TFLC) sector stood at 88 in the fourth quarter of 1997(1990=100), unchanged from the position one year earlier, but a drop of 2% on the third quarter. This compares badly with the performance of the whole manufacturing sector in Scotland where output increased by 1.7% in the fourth quarter and by 7.7% over the year. However, Electrical and Instrument Engineering, which saw output increase 3% in the fourth quarter and 21% over the year, again heavily influenced this. In the TFLC sector across the UK, output fell by more in both the fourth quarter and in the year to the fourth quarter, by 3% and 2% respectively.

The more recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) results for the first quarter of 1998, however, show a rather bleaker picture. A total of 35% of respondents in TFLC reported a drop in optimism from the previous quarter with 47% feeling no change. However, of more concern is that 57% of respondents reported feeling less optimistic than in the first quarter of 1997, an indication of more deep-seated difficulties. Most problems seem to stem from a simple lack of orders and sales. For example, 47% report that the trend in the total volume of new orders was down in the three months prior to the survey, and 47% expect them to fall further in the coming three months. UK orders appear to have been badly hit with 43% reporting a downward trend (although the majority of respondents, 62%, expect these to stabilise in the coming quarter) but it is no surprise that the major problems appear to be in export markets - almost half (49%) reported a downward trend in export markets and 45% expect the downward trend in foreign sales to continue in the coming quarter. Export sales had already fallen for 50.5% of respondents (and note that not all companies who respond to the survey will necessarily serve export markets, so the proportion of actual exporters who reported a downward trend in sales is probably much higher), and 43% expect this to continue. The initial ramifications of Scottish firms problems in foreign markets have already hit the industry, and these are discussed further below.



Other DTSCBS results also indicate the current position of the sector. The average capacity utilisation measured 72%, and had fallen from Q4 1997 for 52% of firms, and investment intentions tended, not surprisingly, to have fallen for many firms - while the majority (71%) reported no change, investment plans had been revised downwards for 26% of respondents. The recent trend in total employment was also downward for 42% of respondents.

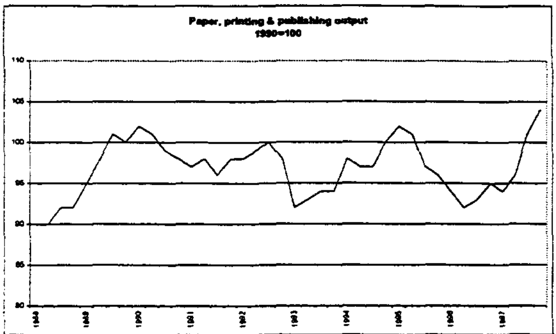
Reflecting the above findings, recent company news in Scotland has also been bleak. Two companies - Edward MacBean and the Sweater Shop - have recently called in the receivers and Scottish jobs are threatened in both cases. Macbean manufactures protective clothing and employs 110 in Cumbernauld. The receiver hopes to sell the company as a going concern, but the Cumbernauld operation's future is currently uncertain. Sweater Shop has 400 employees in Scotland, including 270 in New Cumnock and 100 retail jobs, and all are under threat. Further bad news is the decision of Delta, the sportswear manufacture based to lay off 100 of its 160 employees in East Kilbride.

Delta cite adverse publicity over the price of football strips as one reason for its decision (although one would have thought that there is likely to have been a healthy demand for strips in recent months), but the other two factors they cite - low cost foreign competition and, in particular, the strength of sterling -are more likely to have caused the recent problems in the industry, as the DTSCBS results above confirm. Sterling's strength was certainly advanced as the cause of other job losses made by Dawson International, who recently cut 90 jobs at Laidlaw and Fairgreave in Dalkeith. Dawson employs around 3,000 in Scotland, and any concerns it voices must be listened to with respect. The fact that it predicts more job losses as it struggles to remain competitive - partially because it is considering shifting more of its operations overseas because of the pound - must therefore cause concern in the industry. The only possible prognosis is that it is difficult to see anything other than further reductions in employment in the near future, as long as sterling remains at or around its current level.

PAPER, PRINTING AND PUBLISHING

The Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland increased by 3.0% in the fourth quarter of 1997, to stand at 104 (1990=100). Annualised growth in Scotland increased by 6.0%. The corresponding UK figure reveals output growth fell by 1% to the fourth quarter of 1997 and annualised growth remained unchanged. The Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland has reported output growth for the sector of 7.5% over the third and fourth quarters of

1997. However, the results from the most recent Deloitte & Touche Scottish Chambers' Business Survey suggest that this improved performance will not be sustained by the industry.



The Deloitte & Touche Scottish Chambers' Business Survey reveals a decline in business confidence re-emerged in this sector, as 35% reported being less confident, and no respondents more confident, than three months earlier. Respondents were also less confident about the general business climate than one year previous.

The trends in total orders and sales fell sharply for a positive net balance of respondents, from the increase reported in the previous quarter. Orders and sales fell across all markets, although more respondents noted declines in rest of UK and exports markets. Export activity only rose amongst larger firms in the survey. The trends in orders and sales for the forthcoming quarter are forecast to rise for a small net balance of respondents, although RUK and exports markets are forecast to deteriorate for a net balance of respondents.

The average level of capacity utilisation for the Paper, Printing and Publishing sector fell from 81% in quarter four to 78% by the end of the first quarter of 1998. Investment intentions in this sector, over the past quarter, were revised upward for plant and equipment and downward for land and buildings by a small net balance of respondents. Investment authorised in the first quarter was directed towards reducing labour, the replacement of equipment and introducing new technology.

The latest Deloitte & Touche Scottish Chambers' Business Survey also reveals that changes in total employment affected 44% of respondents, as the decline in employment steepened for a net 8% of respondents, over the past quarter. The decline in total employment is forecast to continue into the next quarter. Over the same period, nearly one quarter of respondents increased wages and salaries by an average 6.4 per cent.

In summary, the reported output growth for the sector in the third and fourth quarter of 1997 are not in keeping with the most recent results from the Deloitte & Touche Scottish Chambers' Business Survey. The survey reveals that expectations as to rising demand in the first quarter of 1998 proved over optimistic as a sharp deterioration in demand was reported. Firms remain confident of a modest increase in demand in the second quarter of 1988, although both cashflow and profitability are weakening for firms in this sector. Sustained growth is unlikely in this sector with increased concerns by respondents about the levels of orders and sales.

In the company sector there were further signs of consolidation within the industry. Jefferson Smurfit, the Irish multinational packaging group, announced plans to merge its US affiliate with a rival, Stone Container, in a deal that will create the world's biggest paper-based packaging company. Sidlaw, the Edinburgh based packaging group is looking towards Europe for acquisitions as it considers forming global alliances. Following the recent merger activity in this industry, Sidlaw are looking to form alliances around the world in order to meet customer needs.

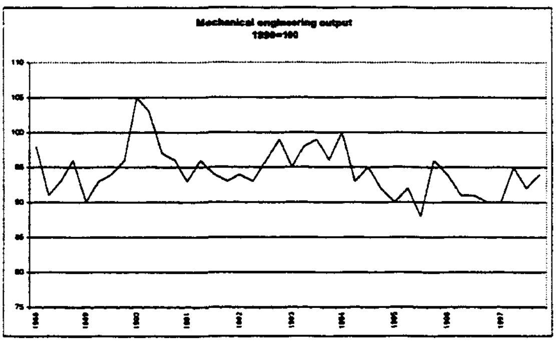
Reed Elsevier, the UK-Dutch publisher and information provider, is set to expand its US legal information publishing business further after its auction success in acquiring the analytical legal publisher Mathew Bender & Co. The government cleared the way for the sale and merger of UK printers Watmoughs (Holdings) and the privately owned British Printing Co (BPC), by the international investment company, Investcorp. The bid by Investcorp's outstripped a previous hostile bid by Canada's Quebecor.

Packaging company Macfarlane Group (Clansman) issued a profit warning following major shortcomings in their planned re-organisation of the plastic moulding division of the company. In the city, estimated profits for the McFarlane group for 1998 were downgraded from £24m to £22.5m. It is anticipated that the company can re-capture its sales by the end of the year. In the regional newspaper sector, the £58.3 million offer by the Eastern Counties group for the Home Counties Newspapers group was accepted. Edinburgh-based Johnston, which was forced to abandon its £52 million bid following a referral to the Monopolies and Mergers Commission are left with a bill for nearly £500,000 following its abortive bid.

Finally Axel Springer, the German publisher is considering a bid for Mirror Group Newspapers which includes the Scottish titles the Daily Record and Sunday Mail. Shares in the Mirror Group rose amidst the speculation of a takeover bid. However, it appears the German publisher is not prepared to rush the offer and is presently holding out.

MECHANICAL ENGINEERING

The latest Scottish Office News Release (6 May 1998) showed a 2.2% increase in Scottish mechanical engineering output in the last quarter of 1997. The main source of this output increase seemed to be sales to the *domestic* rather than the *export* market, as was revealed in the previous Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS). This domestic-demand-led growth represented a departure from the usual growth pattern in this industry, which had been largely export-led over the past few years.



The latest DTSCBS again shows a very uncertain picture of this industry in the first quarter of 98. In terms of business confidence, the majority of the firms (53.3%) saw no change in business optimism in Q1 this year compared with Q4 last year, and the number of optimistic firms was slightly smaller than that of pessimistic firms. Compared with the situation a year ago, there was little change in business confidence.

As was expected by the majority of the firms in the previous survey, export orders and sales remained disappointing in Q1 this year. Export orders were particularly weak in Q1, with a net of 10.7% firms reporting reduced export orders. Despite poor export orders and sales, the total volume of new orders and sales were reported up by more firms on balance, reflecting a strong domestic market. In fact, of the domestic orders and sales, only Scottish ones were encouraging, rest of UK orders and sales remained flat. Over the next quarter, total orders and sales are still expected to be up for more firms on balance. Again, it is the Scottish domestic market that is expected to take the lead. Regarding stock changes, apart from "work in progress" in which more firms built up their stocks, both stocks of finished goods and raw materials were down on balance. Over the next three months, no significant change in stocks of any kind is predicted. Combined with the sales performance, the evidence indicates another probable increase in output in Q1 this year.

Although investment intentions in Q1 remained unchanged from Q4 last year in most of the firms, on balance investment plans for both "plant and equipment" and "land and buildings" rose in most firms and are expected to do so in Q2 98. For those firms that authorised investment in Q1 98, the main reasons were: reducing labour costs (33.3%), increasing efficiency (26.7%), replacement (26.7%), and introducing new technology (17.8%).

Over the next three months, 20% of the firms expect to raise their prices, mainly because of increased prices of raw materials, other overheads and pay settlements. The previous overwhelming concern about the rise in the interest rate eased. Instead, the major concerns now are orders or sales, skilled labour and exchange rates. The ease of the firms' concern about the interest rate might be an underlying factor for the Bank of England's recent interest rate hike. Over a longer-term horizon, firms on balance expect their turnover and profitability to improve in the next 12 months.

On the job front, most of the firms maintained or increased their employment levels in all forms of employment in Q1 98. Male full-time employment benefited most and female employment least. It is noticeable that more firms increased their level of sub-contracting and temporary employment, and permanent employment also increased on balance, albeit to a lesser degree. Over the next three months, apart from permanent employment which is predicted to reduce in a slightly larger number of firms than those firms which will increase permanent employment, all the other forms of employment are expected to increase on balance.

The generally feared excessive wage claims are not obvious in this industry, with 40% of the firms having increased their wages and salaries in Q1 98. The average percentage increase was 3.97%. The difficulty with employing skilled manual and technical workers was still experienced by a large number of firms.

SERVICES

DISTRIBUTION

According to the latest Deloitte & Touche Scottish Chambers' Business Survey (Quarter 1 1998), changes in wholesale business confidence affected less than 50%, nevertheless, confidence rose from a net of -5% in quarter four to a net of +2% in the first quarter, as sales were better than anticipated. Changes in business confidence continued to affect less than 50% of retailers, nevertheless, the decline in confidence, a feature of the second half of 1997 continued and steepened as 25.8% reported being less and only 16.3% more confident than at the end of 1997.

Wholesale respondents had expected a modest rise in sales in the first quarter, however, the trends were better than anticipated, with 43.3% reporting rising and only 32.2% falling sales (a net rise of +11%). A further improvement in wholesale sales is forecast for the second quarter. The trends in retail sales were better than anticipated, and respondents are confident of increasing sales in the second quarter. Changes in the level of sales were widespread, with 40.3% reporting rising and 30.1% falling sales. Two thirds of wholesalers identified competition, 32% interest rates and 29% exchange rates as the factors most likely to restrict activity in the second quarter. Competition, interest and business rates were identified by retailers as the three factors most likely to restrict retail activity in the second quarter.

The rise in investment plans among wholesalers continued. Investment plans continued to be revised by less than 40% of retail respondents, nevertheless, the rising trends continued and strengthened.

Changes to employment levels were reported by a third of wholesale respondents, yet the trends were better than had been anticipated. Slightly more than 50% sought to recruit staff and 37.8% reported increasing pay by an average of 3.96%. Retail employment trends were better than anticipated, although changes affected less than 25%. Most recruitment appeared to be for replacement. Almost 20% increased pay by an average of 4.22%.

Nearly half of respondents to the CBI Survey of retailers reported that the volume of sales in April was higher than a year ago with only 22% reporting a fall, a net balance of +26% compared to +14% in the March survey. The distributive trades panel however fear that the underlying trend in retail sales may be slowing down. Retail sales appear to be slowing down, growing by only 0.1% in April; in the year to April 1998 retail sales rose by 4.2%.

Grampian Holdings, owner of the Edinburgh Woollen Mill, intends to expand its retail division by opening one hundred stores over the next three years.

A £25 million extension to the Marks & Spencer in Argyle Street, Glasgow is expected to create around 250 new jobs and will make it the biggest store in Europe. Under the plan the store would increase from 95,000 square feet to 140,000 square feet encompassing an existing building and a new block in Virginia Street.

Around 400 jobs in Scotland, 100 of which are in nine shops in Scotland, are under threat following news that the retailer Sweater Shop has gone into receivership. The company intends to continue trading through its stores until a buyer is found.

TRANSPORT

Road

Stagecoach have announced a £160.5 million share issue to raise funds for it's continuing expansion. It has plans to acquire Prestwick International (the company that operates Prestwick Airport) for £41 million and to take a 20% stake in a company operating road tolls in China. The appointment of Mike Kiniski as chief executive allows Chairman Brian Souter to concentrate on business development. There are also proposals to acquire Yellow Bus for £40 million. This will intensify the direct rivalry between Stagecoach and FirstBus where both companies are concentrating on expansion in Australasia and China. FirstBus beat off Stagecoach to win the franchise for Hong Kong's buses.

The UK's first road pricing trial took place over eight months in Leicestershire and preliminary results indicate that motorists will be persuaded to use alternatives to a car. 38% of motorist left their car at home when the toll reached £10 in February. Park and Ride, bus lanes and improved public transport networks will need to be in place before road pricing comes into effect but the results show that motorists were in favour of the scheme especially if the revenue was ring-fenced for transport projects. The use of smart cards and construction of the necessary infrastructure would require investment of £250 million and a seven-year time horizon before the planned scheme could be extended to include all motorists.

Rail

A leaked letter from the Health & Safety Executive has warned of "the persistent poor condition of the tracks" across the country. This follows a number of derailments at the beginning of the year. Railtrack has responded by 'prioritising' the £2 billion upgrade of the West Coast Mainline. They have secured a revenue sharing deal with Virgin Rail where Virgin may receive some protection from competition on some routes in return for its investment in upgrading the line. They have also ordered 55 new tilting trains for the line in a £1.8 billion deal. The journey time between Glasgow and London will be reduced by $1^1/_2$ hours to 4hours. The trains will be built at GEC in Birmingham and will secure several hundred jobs.

National Express is to invest £148 million in new trains for Scotrail and Central Trains. It now has outstanding contracts for new trains worth £243 million. Scotrail will receive 40 electric trains and 9 diesels worth £125 million in total. Stagecoach plan to invest £363 million in 441 new trains. Investment in new rolling stock is now a significant part of the transport equipment sector.

Railtrack has announced a further £4 billion investment in the Channel Tunnel rail link. The first phase to North Kent will cost £1.5 billion while £2.5 billion will be spent taking the line to St. Pancras. Railtrack profits rose by 12% in the year to 31st March up to £388 million, which was the upper end of analyst's forecasts. Virgin Rail was to be floated on the stock market in June with a market value of about £250 million. This has been abandoned following Stagecoach buying 49% of Virgin Rail putting a value on the company of £276 million. Essentially Stagecoach are buying out the venture capitalists stake while Richard Branson has increased his stake to 51%.

Air

The Civil Aviation Authority has delayed the introduction of the £53 million new air traffic control centre at Prestwick due to computer problems. The Chancellor has also announced that the government, as part of its public-private partnerships in transport, will sell off 51% of the National Air Traffic Service (Nats). It is thought £250 million could be raised but unions have expressed fears of 'profits before safety.' This will remove Nats debt from the public sector-borrowing requirement and allow the service to borrow capital to finance investment without constraint in the private sector. It is however unclear as yet as how private investors will respond as all three of Nats large capital investment projects are in serious difficulty.

Once again the profits of BAA continue to rise unabated. An 18% rise saw pre-tax profits reach £480 million. 104.5 million passengers used BAA airports last year and traffic growth is forecast at 5-6% this year. New low budget carriers were a major source of growth particularly at Stansted airport. Scotland saw 10% growth in passenger numbers (up to 13 million) last year for Glasgow (6.1 million), Edinburgh (4.2 million) and Aberdeen (2.6 million). Strong growth is expected at Edinburgh airport where passenger numbers could reach 6 million by the year 2002. BAA is expected to have a drop in profits next year due to the abolition of the duty free shops. This may be as much as £40 million in the first year.

Sea

Forth Ports pre-tax profits have increased by 10% in 1997 up to £24.4 million. Last year it had capital expenditure of £22 million but plans to spend £35 million this year. The focus next year will be on internal growth rather than acquisitions.

TOURISM

Nationally, following growth and high occupancy levels in 1997, there are some signs of a period of consolidation in the hotel sector, with a number of firms reshaping and redirecting their hotel and leisure activities. These changes are evident in the Westin Hotels and Resorts purchase of the Turnberry Hotel and golf courses in January and the announcement, in March, by Thistle hotels to sell off 30 provincial (non core) hotels. Elsewhere the emphasis was more on expansion both in Scotland and the rest of the UK; Stakis outlined plans to expand its leisure and health club division, Whitbread plans to expand its Travel Inn, TGI Friday, Costa Coffee and Pizza Hut, and Scottish & Newcastle to refurbish and extend its Rat & Parrot, John Barras & Co pubs and New Orleans restaurants.

Results from the latest survey of Scottish tourism establishments conducted by the Fraser of Allander in co-operation with the Scottish Tourist Board indicates continuing concerns as to the levels of tourist demand, and to the impact of the high exchange rate on overseas demand, the percentage of hotel respondents citing the high exchange rate as the factor most likely to affect activity doubled to 18%

during the first quarter, the highest figure since the beginning of the STB survey. Overall all sectors expect demand to be positive during the current quarter except self catering respondents who expect the decline in demand to continue though at a weaker rate.

Large Hotels

Although almost 60% of respondents reported no change in optimism, the positive trend in confidence ended and a net of -2% was reported. Overall 40% reported rising demand and 30% reduced demand. Demand from abroad remained weak. Respondents expect the trend to remain upward during the second quarter although almost half expect no change to the current level. Once again any increase in total demand is expected to be fuelled by visitors from Scotland and rest of UK while the trend in visitors from abroad is forecast to continue to decline. Average capacity use continued to fall to 55%, but tended to be higher amongst larger hotels.

Costs rose, and at a faster rate than turnover. 41% reported an increase in turnover while 36% noted an increase in costs (nets of +8% and +22% respectively). More than half reported no change to the average daily room charge during the first quarter.

The decline in total employment continued and at much the rate as forecast. Respondents do not however expect the decline to continue with 36% expecting to increase the total number employed and only 8% expecting to reduce total employment in the second quarter.

Recruitment activity increased slightly during the first quarter. Increased recruitment difficulties were noted by 45% of those who sought to recruit while 83% experienced problems recruiting suitable employees for particular occupations.

Family Hotels

The trend in optimism during the first quarter was flat with 26% reporting being more confident and 26% less confident than in the fourth quarter.

Demand from all areas fell with the steepest decline continuing to be from abroad which was as respondents had forecast. Respondents are confident of some improvement during the second quarter, 38% expect demand to increase while only 20% expect demand to fall. Scottish and rest of UK demand are forecast to improve during the second quarter, however the decline in demand from overseas is forecast to continue.

Lack of demand was most frequently cited as the factor most likely to limit activity during the second quarter, higher than the percentage citing it during the first quarter of 1997 but lower than the previous quarter.

Average capacity used in the first quarter fell from a high of 71% in quarter 2 1997 to 52%, slightly lower than the same period one year ago. The rise in costs was slightly lower than anticipated, 49% reported increased costs and 9% falling costs. A net of 57% expects costs to increase during the current quarter.

Bed and Breakfast Establishments

Changes in optimism affected almost half the respondents, 26% reported increased confidence while 21% reported being less optimistic than in the fourth quarter.

The decline in total demand continued although respondents are optimistic that demand will improve during the second quarter. The trend in guests from all areas continued to decline however an increase in the number of guests from overseas is forecast. Once again the majority of respondents indicated that lack of demand was the single factor most likely to hamper activity during the second quarter.

Average capacity used remained at 59%, marginally higher than the figure for quarter one 1997. Costs continued to rise and at a greater rate than respondents had forecast, 50% reported increased and only 6% falling costs. The rate of increase is expected to ease slightly in the second quarter.

Self Catering Establishments

The decline in business confidence continued, although at marginal levels with slightly more than a quarter reporting increased confidence and 28% reporting reduced confidence.

Almost 40% reported falling visitor numbers while only 22% noted an increase in total guests.
Demand from all areas continued to decline although once again the fall in the number of guests from overseas was more pronounced. Respondents expect the decline to continue through the second quarter however the rate of decline is forecast to ease. Lack of demand remained the factor cited most frequently as likely to affect demand although the percentage citing this factor fell 9 percentage points.

Investment intentions continued to rise, with more than 40% revising investment intentions upward and only 10% revised plans downward. Investment continued to be directed more toward replacement/renewal and to a lesser extent improving facilities.

Average capacity used at 53% was lower than the average figure one year ago. Only 2% of respondents indicated a reduction in costs during the first quarter while 56% reported rising costs, a rate slightly lower than expected. Once again respondents expect costs to rise during the current quarter.

Visitor Attractions

Changes in confidence affected less than a third of respondents, nevertheless the decline in confidence ended as 20% reported increased confidence while only 12% noted a decline in confidence compared to the final quarter of 1997.

Almost a third reported increased and only 23% reduced visitor numbers. The decline in visitors from rest of UK and abroad continued although a net of 5% noted an increase in visitors from Scotland. Bad weather continued to be the most frequently cited factor thought likely to limit visitor numbers during the second quarter. Other significant factors included lack of tourist demand and competition.

The decline in the trend in visitor numbers, a feature for most of 1997, continued though at a reduced rate (-6%). Almost two thirds of respondents however, reported no change in numbers compared to the same quarter one year earlier. The trend in income was lower than one year ago however the trend in costs was higher. A net of 14% reported higher income while +16% noted increased costs. Both income and costs are expected to increase over the next three months, only 5% expect costs to fall.

	LARGE HOTELS	FAMILY HOTELS	B&BS	SELF CATERING	VISITOR ATTRACTIONS
Numbers of respondents	133	96	38	94	85
Optimism	-2	0	+5	-1	+8
Demand					
Total guests	+10	-12	-3	-16	+9
Scotland	+7	-18	-24	-13	+5
Rest of UK	+10	-14	-6	-10	-6
Abroad	-18	-34	-6	-28	-34
Business Trade	+9				
Factors likely to restrict sales					
lack of tourist demand	34	55	54	59	14
weather	11	10	6	14	39
price competition	18	12	15	7	13
insufficient space	5	14	18	11	
poor business trade	7				
shortage of labour	2				
high exchange rate	18				
other	1	7	6	7	22
Investment intentions	+31	+24	+25	+31	+14
Reasons for investment					
replacement	47	54	46	59	29
expansion	8	7	8	3	8
improve facilities	37	35	38	29	37
new facilities	9	4	8	9	26
Capacity used	55	52	59	53	
Turnover	+8				
Costs	+22	+40	+44	+53	+16
Total employment	-9	-16	-12	-2	-3