

Quarterly
ECONOMIC
Commentary

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Fraser of **ALLANDER** *Institute*

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OUTLOOK *and* APPRAISAL

Scottish office data on production and construction are now available for the second quarter of this year and suggest a further slowing down of the Scottish economy. The data show that the output of the production industries fell by 1% compared to an increase of 1.2% in the UK. Within production, manufacturing output fell by 1% in Scotland but rose by 0.3% in the UK. However, the poorer performance of Scottish manufacturing in the second quarter is almost wholly due to the outturn in the Scottish electronics industry. Electrical and instrument engineering contracted by 3% in Scotland compared to an increase of 0.7% in the UK. When the performance of manufacturing (ex.electronics) is compared, the sector is found to have grown by 0.3% in Scotland compared to growth of 0.2% in the UK. From separate data provided by the Scottish Office on the construction sector, output in the industry can be seen to have risen by 0.2% in Scotland compared to a significant contraction of 2.9% in the UK.

A comparison of UK and Scottish growth, year on year to the second quarter reveals that the overall stronger performance of Scotland's production industries has been sustained. Over the year, the production industries expanded by 4.3% compared to growth of 0.6% in the UK. This largely reflects the strong performance of the manufacturing sector, which registered a 4.6% increase in Scotland

compared to an increase of 0.7% in the UK. Similarly, electricity, gas and water grew by 5.2% in Scotland over the year, while in the UK the sector grew by only 1.3%. However, the performance of mining and quarrying was broadly comparable, with the industry contracting by 1% in Scotland and by 0.9% in the UK. For construction, however, the sector contracted by 3.5% in Scotland over the year but grew by 2.2% in the UK.

A New Index of Production and Construction

The latest Scottish Office data are the product of new indices of production and construction which have been re-based to 1995 and which incorporate revisions due to later and revised data and the updating of seasonal adjustment factors. The new data allow comparisons of sectoral performance quarterly back to the first quarter of 1994. Figure 1 highlights the cumulative growth by broad sector for Scotland and the UK between the first quarter 1994 and the second quarter 1998. The production industries as a whole are seen to considerably out perform their UK counterpart. However, as we have noted in previous **Commentaries** this has been principally due to the stronger performance of manufacturing here, reflecting particularly the strong growth of electronics. The removal of electronics results in manufacturing (ex. electronics) considerably under performing its UK counterpart, with output falling by 6.2% compared to a 3.1% increase in the UK. In addition, both construction and mining & quarrying have been much weaker in Scotland during the period. Figure 2 decomposes manufacturing growth by sub-sector over the eighteen-quarter period. Apart from electronics, only chemicals exhibited stronger growth in Scotland. And, only two other sectors, metals & metal products and transport equipment, displayed growth, while all the remaining sectors contracted. Indeed, five of these sectors, oil refining, food & tobacco, drink, paper, printing & publishing, and other manufacturing, contracted while their UK counterparts either expanded or exhibited zero growth.

The computation by the Scottish Office of the new indices considerably changes the picture of Scotland's industrial performance over the last four years. Tables 1 and 2 compare the cumulative sectoral performance of Scottish and UK industry on the old and new index

over the four years from the first quarters 1994 to 1998. In Table 1, the performance by broad sector is compared. Several conclusions emerge. First, the absolute and relative performance of the construction sector remains broadly unchanged between the old and new indices. Secondly, the absolute performance in Scotland of electricity, gas and water, and mining and quarrying is broadly similar, while their relative performance has improved. This is due to downward revisions in the estimates of UK growth in these sectors. Thirdly, the performance of the production industries in Scotland was overestimated on the old index and this appears to have been due principally to an overestimate of manufacturing industry performance. On the new index, the cumulated growth of manufacturing during the period is 15.6% compared to 21.2% on the old index. The estimate for UK manufacturing growth remains much the same at 5.2% to 5.3% for the period.

In Table 2, the comparison is extended to the sub-sectors within manufacturing. Five sectors show some improvement in their estimated performance over the period: textiles, mechanical engineering, metals, chemicals and oil refining. But of these, the improvement in textiles, mechanical engineering, and oil refining is only marginal. In contrast, the performance of metals goes from negative growth of 2.5% to growth of 2.8%, while in the chemicals industry the estimated turnaround in performance is staggering. The estimate changes from a contraction of 4.7% on the old index to significant growth of 29.1% on the new. The remaining six sectors are all subject to an estimated deterioration in performance. For other manufacturing, paper, printing and publishing, drink, and food & tobacco, the changes are marginal. However, for transport equipment the new index suggests a contraction of 3.1% over the period compared to growth of 4.1% on the old index. Finally, the performance of the electronics industry is reduced by nearly 14 percentage points on the new index, with cumulated growth now estimated to be 73% compared to 87% on the old index. The downgrading of the performance of the electronics industry appears to be the principal reason why the overall growth of manufacturing industry is reported to be weaker in the new index and this again highlights the importance of the electronics industry to the overall performance of industry in Scotland.

Outlook

Growth in both the UK and Scottish economies is clearly slowing. The annual percentage change of UK GDP at constant market prices peaked at 4% in the fourth quarter of last year. The annual percentage change then fell gradually to 3.7% in the first quarter of 1998, 3% in the second quarter and 2.5% in the third quarter. In Scotland, while recent GDP data are not available, the annual percentage change in the production industries fell from 5.4% in the fourth quarter 1997 to 5.2% in the first quarter 1998 and 1% in the second quarter. In manufacturing, UK growth has been almost stagnant on an annual basis, with the recorded annual percentage change standing at 0.5% in the fourth quarter 1997, then falling further to 0.2% in the first quarter 1998 and rising slightly to 0.7% in the second quarter. Scottish manufacturing growth has been more robust, with annual percentage changes of 5.5% and 6% in the fourth and first quarters falling to 1.5% in the second quarter.

In view of the revision downward in forecasts for UK manufacturing next year and the recent marked deterioration in orders and sales in Scottish business surveys including the third quarter Deloitte & Touche Scottish Chambers' Business Survey, we have revised downward our forecast for Scottish manufacturing in 1998 and 1999. We now predict that Scottish manufacturing will grow by 2.5% in 1998 compared with our forecast in the September **Commentary** of 3.3%. In the first two quarters of 1999 we are forecasting quarterly growth of 0.4% and 0.3% respectively. On the basis of these forecasts, Scottish manufacturing is expected to stagnate during the first half of 1999 and be close to recession.

Table 3 provides labour market accounts embodying forecasts of the Scottish workforce up to 2004. We are currently expecting employment to fall this year by 7,400 and by 11,800 in 1999. Thereafter employment is expected to pick up again, so that over the period 1998 to 2001 net jobs growth of 15,700 is predicted, of which nearly 6,000 come from the self-employed. Over this period jobs in manufacturing are expected to contract by about 11,500, while service sector employment is predicted to rise by just over 20,000. ILO unemployment is forecast to fall by 12,100 this year to an average rate of 7.9%, but rise by

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over 36,000 next year to 9.3%. However, over the period 1998 to 2001 ILO unemployment is expected to fall by fewer than 10,000. The claimant count of the unemployed is forecast to fall by 16,700 this year to an average rate of 5.8%, but rise by over 15,000 next year to 6.4%. However, over the period 1998 to 2001 claimant unemployment is expected to fall by just fewer than 22,000.

9 December 1998

Figure 1: Cumulative Output Growth by Broad Sector in Scotland and the UK 1994q1 to 1998q2

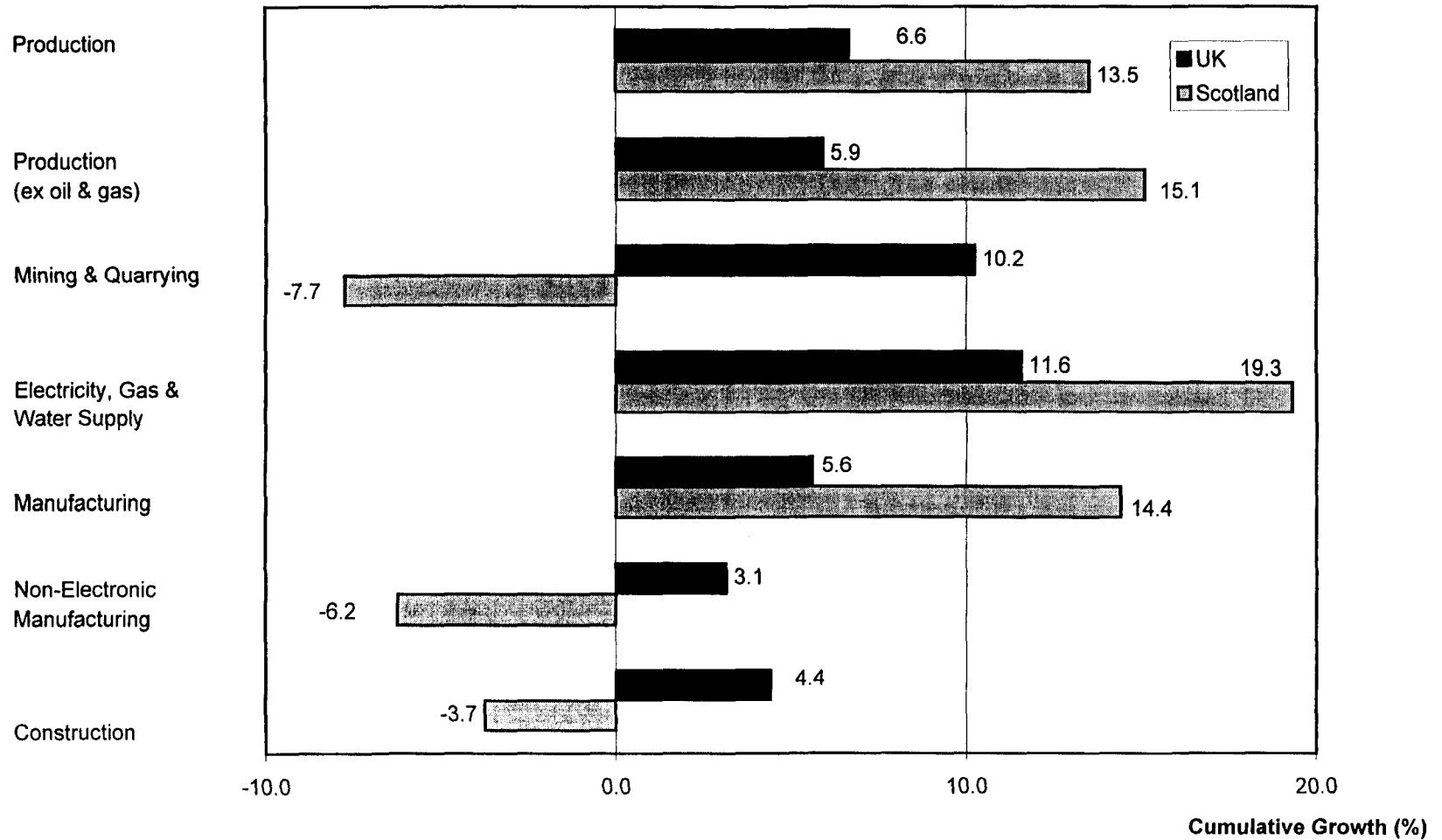


Figure 2: Sectoral Cumulative Output Growth in Manufacturing in Scotland and the UK 1994q1 to 1998q2

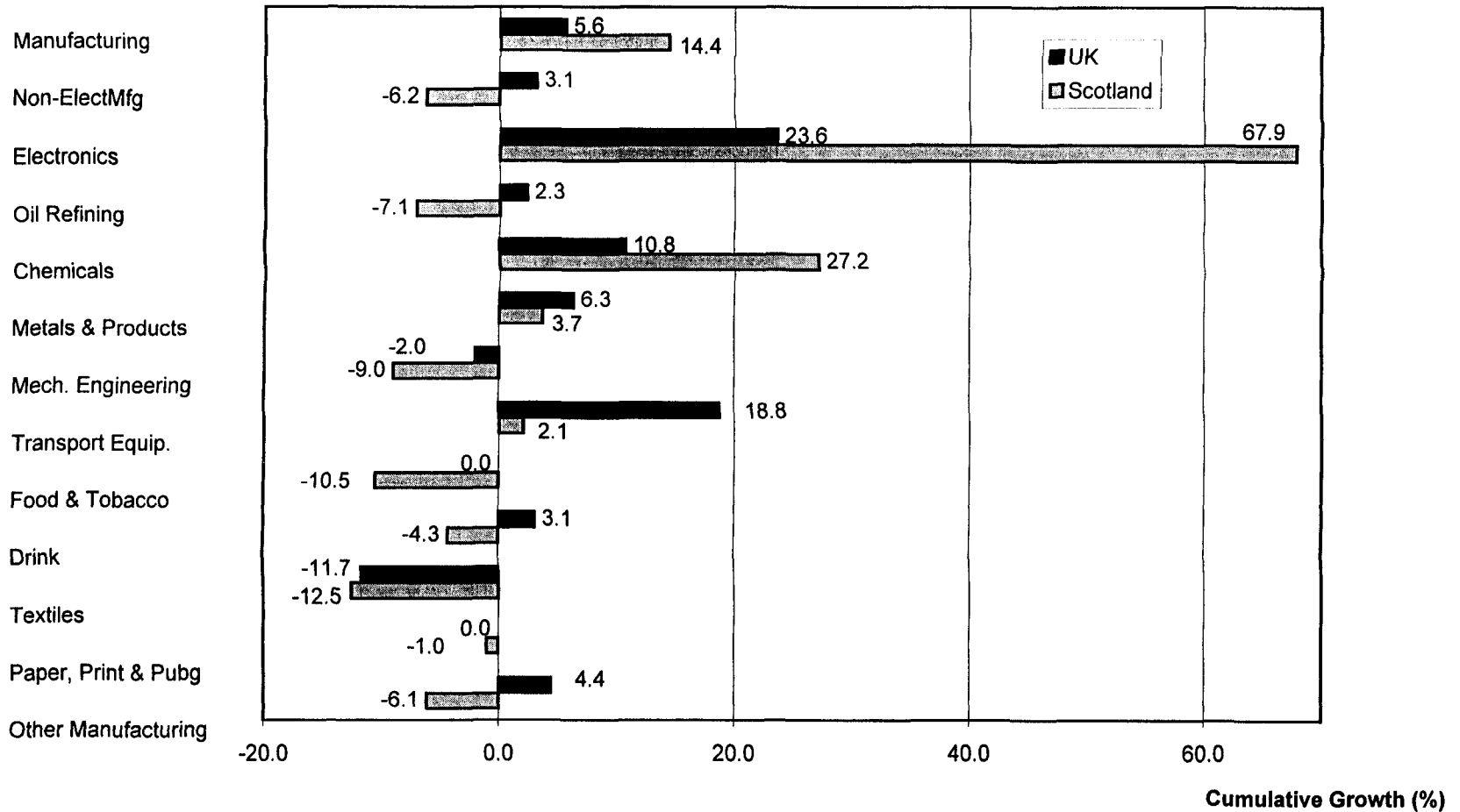


Table 1: Cumulated Percentage Output Growth 1994Q1 to 1998Q1 by broad sector

	Old Index		New Index	
	Scotland	UK	Scotland	UK
Construction	-4.6	7.6	-3.9	7.5
Manufacturing	21.2	5.2	15.6	5.3
Electricity, Gas & Water Supply	18.6	12.4	17.7	6.6
Mining & Quarrying	-3.3	12.5	-3.0	5.1
Prod. ex oil & gas	15.0	5.9	15.9	5.2
Production	19.4	6.5	14.6	5.4

Data source: Scottish Office Index of Production and Construction

Table 2: Cumulated Percentage Output Growth 1994Q1 to 1998Q1 in Manufacturing

	Old Index		New Index	
	Scotland	UK	Scotland	UK
Other Manufacturing	-5.5	0.0	-6.1	0.0
Paper, Print, Pub.	-1.0	-1.9	-2.0	0.0
Textiles	-8.5	-7.7	-5.8	-9.7
Drink	4.3	13.1	2.2	4.1
Food & Tobacco	-9.8	2.9	-13.3	0.0
Trans. Equipment	4.1	17.8	-3.1	16.7
Mech. Engineering	-12.0	0.0	-11.7	0.0
Metals & Products	-2.5	3.5	2.8	4.2
Chemicals	-4.7	5.4	29.1	9.7
Oil Refining	-9.2	1.8	-8.9	1.2
Electronics	86.9	17.1	73.1	22.5

Data source: Scottish Office Index of Production.

Table 3 The Scottish Workforce; 1990-2004, (000s) and (%)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Population	5,102.0	5,107.0	5,111.0	5,120.0	5,132.0	5,137.0	5,128.0	5,123.3	5,117.9	5,114.0	5,110.1	5,106.1	5,101.8	5,097.3	5,092.8
Working Population	3,177.8	3,181.3	3,225.0	3,235.7	3,240.6	3,243.4	3,252.1	3,252.1	3,252.5	3,252.4	3,254.3	3,258.6	3,261.2	3,262.9	3,262.3
of which															
Male	1,648.4	1,649.8	1,672.6	1,678.4	1,680.4	1,681.7	1,685.3	1,685.7	1,686.9	1,687.9	1,689.3	1,691.6	1,693.5	1,695.9	1,697.0
Female	1,529.3	1,531.5	1,551.6	1,556.2	1,559.2	1,560.7	1,566.8	1,566.3	1,565.6	1,564.5	1,565.0	1,567.1	1,567.8	1,567.0	1,565.3
CWE	2,256.1	2,265.6	2,254.6	2,219.2	2,275.1	2,270.3	2,250.3	2,272.8	2,267.7	2,250.1	2,266.7	2,291.1	2,316.4	2,327.6	2,335.4
of which															
Male	1,236.7	1,233.0	1,219.3	1,180.8	1,203.4	1,190.2	1,163.1	1,179.8	1,171.3	1,160.1	1,166.0	1,175.0	1,180.6	1,180.3	1,179.8
Female	1,019.3	1,032.6	1,035.3	1,038.6	1,071.7	1,080.4	1,087.3	1,092.9	1,096.4	1,090.0	1,100.7	1,116.1	1,135.8	1,147.3	1,155.6
Full-time	1,737.2	1,755.8	1,758.5	1,717.9	1,746.0	1,725.1	1,716.6	1,727.2	1,717.3	1,698.2	1,707.0	1,719.1	1,725.7	1,725.0	1,724.6
Part-time	518.9	509.8	496.0	501.5	529.1	545.5	533.8	545.4	550.4	551.9	559.7	572.0	590.8	602.6	610.8
Employees	1,990.0	2,001.3	1,996.5	1,962.7	1,997.3	1,986.6	1,981.8	1,998.5	1,991.1	1,979.3	1,992.6	2,014.2	2,033.4	2,040.6	2,046.4
of which															
Manufacturing	372.4	354.9	335.3	318.0	312.4	316.5	314.4	310.7	304.8	297.9	298.0	299.2	299.3	297.4	294.8
Services	1,401.4	1,438.7	1,449.7	1,444.2	1,459.8	1,476.4	1,484.2	1,503.7	1,497.0	1,493.8	1,506.7	1,523.7	1,541.9	1,551.7	1,560.9
Other Employees	216.2	207.8	211.4	200.6	204.8	194.0	183.4	184.0	189.3	187.6	187.9	191.2	192.2	191.5	190.7
Self Employed	210.1	216.2	216.4	222.7	246.0	254.4	243.9	251.3	254.2	250.1	253.6	257.3	263.7	268.2	271.0
WRGTP	56.0	48.1	41.7	33.8	31.8	29.3	24.6	23.0	22.4	20.7	20.5	19.6	19.3	18.8	18.0
Armed Forces	20.1	20.1	19.8	18.5	17.8	17.2	15.4	15.0	14.8	13.9	13.5	12.2	12.4	12.2	12.3
ILO Unemployed	230.0	234.9	250.7	254.3	244.3	219.3	215.5	206.3	194.2	230.6	222.1	196.4	189.7	192.3	199.6
Rate (%)	9.3%	9.4%	10.0%	10.3%	9.7%	8.8%	8.7%	8.3%	7.9%	9.3%	8.9%	7.9%	7.6%	7.6%	7.9%
CC Unemployed	202.0	219.3	238.8	243.3	228.4	200.1	191.9	156.3	139.6	154.6	146.6	134.6	132.4	131.2	130.3
Rate (%)	8.2%	8.8%	9.5%	9.8%	9.1%	8.0%	7.8%	6.4%	5.8%	6.4%	6.0%	5.5%	5.4%	5.3%	5.3%
Economically Active	2,506.2	2,500.5	2,505.3	2,473.5	2,519.4	2,489.6	2,465.8	2,479.1	2,461.9	2,480.7	2,488.8	2,487.5	2,506.1	2,519.9	2,535.0
Rate (%)	78.9%	78.6%	77.7%	76.4%	77.7%	76.8%	75.8%	76.2%	75.7%	76.3%	76.5%	76.3%	76.8%	77.2%	77.7%

Source: Fraser of Allander Institute