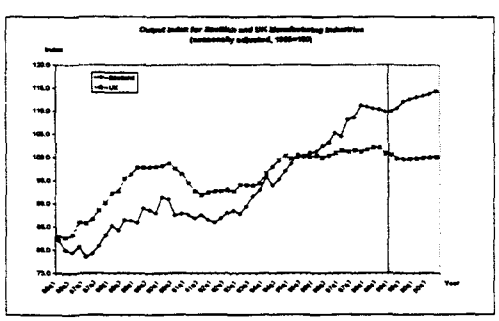
The SCOTTISH Economy

SHORT-TERM FORECASTS*

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

The present forecasting period extends to 2000q4. 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 1986q1 to 1998q4 and the forecasts for 1999q1 to 2000q4. The Scottish Office Index of Production has been re-based with 1995=100 and this change has been incorporated



into our Short Term Model. The results are presented in Table 1 below.

The National Institute notes that UK manufacturing has declined since 1998q2 and is forecasting that UK manufacturing will continue to decline from 1999q1 through to 1999q3. The forecast growth in UK manufacturing however is very fragile with growth between 1999q2 to 2000q4 being only 0.3%. Scottish manufacturing output in 1998q4 fell by 0.4% compared to a 1.3% decline in the UK. When the latest four quarters are compared to the preceding four quarters Scottish manufacturing output fell by 2.1% compared to 0.3% for the UK. Our forecasts are now more optimistic for Scottish manufacturing with no growth forecast for 1999q1 but growth picking up in 1999q2 and remaining positive throughout 1999 and the year 2000. The annual growth rate for Scottish manufacturing output for 1999 and the year 2000 is now forecast to be 0.8% and 2.1% respectively. The strength of sterling and the economic slowdown (in particular the effect on electronics) has contributed significantly to the slowdown in Scottish manufacturing.

TABLE 1. QUARTERLY GROWTH OF SCOTTISH MANUFACTURING OUTPUT (%)

91/90	-2.7
92/91	0.2
93/92	3.6
94/93	5.6
95/94	4.7
96/95	3.1
97/96	4.8
98/97	2.1
95Q1/94Q4	1.7
95Q2/95Q1	2.0
95Q3/95Q2	-0.6
95Q4/95Q3	0.9
96Q1/95Q4	0.4
96Q2/96Q1	1.2
96Q3/96Q2	0.6
96Q4/96Q3	2.0
97Q1/96Q4	-0.8
97Q2/97Q1	3.5
97Q3/97Q2	0.5
97Q4/97Q3	2.4
98Q1/97Q4	-0.3
98Q2/98Q1	-0.4
98Q3/98Q2	-0.2
98Q4/98Q3	-0.4
FORECASTS	
99Q1/98Q4	0.0
99Q2/99Q1	0.7
99Q3/99Q2	1.3
99Q4/99Q3	0.5
00Q1/99Q4	0.4
00Q2/00Q1	0.3
00Q3/00Q2	0.4
00Q4/00Q3	0.5
99/98	0.8
00/99	2.1

* 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.

DELOITTE & TOUCHE SCOTTISH CHAMBERS' BUSINESS SURVEY

The Deloitte & Touche Scottish Chambers' Business Survey, which is conducted by Strathclyde University's Fraser of Allander Institute together with the Scottish Chambers' of Commerce, is the largest and most comprehensive regular survey of business, employment and other issues affecting the Scottish business community. In the present survey, which was conducted in March, 764 firms responded to the questionnaire.

MANUFACTURING

Optimism

The decline in business confidence continued through the first quarter, although the rate of decline eased. A balance of 27% reported being less confident about the general business situation than in the previous quarter, compared to a net decline of 35% in the third and fourth quarters of 1998.

Orders and Sales

For a further quarter these were weaker than anticipated, the decline in total orders and sales continued (net balances of –29% and –30% respectively), however, respondents are confident of an easing in the rate of decline in the second quarter.

Concerns as to the levels of orders and sales continue to increase, and concerns as to the level of competition remain high, being reported by 66% and 42% respectively as the two factors thought most likely to limit output. In contrast the importance attached to interest and exchange rates continued to ease.

Finance

The cash flow trends deteriorated further, however the net of firms expecting profitability to fall over the next twelve months has eased to 5%. Anticipations of price decreases over the next three months eased slightly.

Investment

Changes to investment plans again affected less than 40% of respondents. Investment in the first quarter was again primarily authorised towards reducing labour [37%] and replacement of equipment [24%].

Employment

Employment continued to fall, a net decline of 24%, and this net rate of decline is expected to continue. Recruitment activity eased as slightly less than 45% sought to recruit staff in the first quarter. 27% reported increasing pay by an average of 3.57%, compared to an average of 3.64% in the previous quarter.

CONSTRUCTION

Optimism

The slight decline in business confidence ended as the trends in orders were better than anticipated. Optimism is at the strongest level since the fourth quarter of 1997.

Orders

The net decline in total orders was again less than anticipated, with a net of 4% of respondents reporting a decrease. For a further quarter the rate of decline in Central Government and other public sector orders was less than expected.

Unexpectedly, the upward trend in private sector orders continued and strengthened to a net 9%. Respondents expect a further increase in private sector orders in the second quarter.

The percentage citing the low level of demand as the factor most likely to restrict activity in the next quarter fell from 84% in quarter four to 78%.

Investment

Changes to investment affected slightly less than 30% of respondents, nevertheless, the decline in plant/equipment investment ended. Of those investing in the first quarter 53% directed investment towards the replacement of equipment and 26% to increasing efficiency.

Employment

The rise in construction employment continued at a net of 9%, and this increase is expected to continue at more modest rates through the second quarter. A quarter increased pay by an average of 5.2%, and 50% sought to recruit staff in the first quarter, mainly skilled manual staffs.

WHOLESALE DISTRIBUTION

Optimism

The decline in business optimism eased to a net decline of 22%, as the fall in sales was less than anticipated.

Sales

Respondents had forecast a further deterioration in sales for the first quarter, however, the net decline of 11% was less than had been anticipated. Nevertheless, for a further quarter wholesale respondents continue to expect a further weakening of demand in the next quarter. Concerns as to competition were cited by 68% as the factor thought most likely to limit activity in the second quarter, whilst 23% cited business rates.

Investment

Changes in investment plans were reported by less than 40%, nevertheless the upward trend in investment ended.

Finance

Cash flow trends remained weak, with 13% reporting rising cash flow and 38% lower cash flow trends. A net of 1% expect turnover to fall over the next year and a net of 8% expect profitability to decline, compared to the net of 27% expecting profitability to fall three months earlier. In contrast, expectations of price increases in the second quarter were reversed and a net of 8% expect to reduce prices in the second quarter. Pressures to raise prices increased slightly, reflecting increased costs of pay settlements and increased transport costs

Employment

Changes to employment levels affected less than 30%, and the trends were as expected, a net decline of 13%. Respondents continue to anticipate a decline in employment in the next quarter. 30% reported increasing pay by an average of 3.2% compared to an average increase of 4.19% in the previous quarter.

RETAIL DISTRIBUTION

Optimism

Changes in business confidence affected 46%, and the decline in business confidence continued, easing considerably to a net of 27% reporting being less confident than at the end of the fourth quarter.

Sales

The decline in sales was markedly less than had been anticipated, and less than had been reported in the fourth quarter, and a further easing is forecast for the second quarter. Whilst 23% reported increased sales 53% reported a fall in sales, and 40% anticipate a decline in sales in the second quarter (compared to 61% who anticipated a fall in sales in the first quarter).

Investment

The downward revision in investment plans continued, but were more broadly based at a net decline of 1%.

Finance

The deterioration in cash flow trends eased fractionally to a net balance of 31% reporting a decrease. Both turnover and profitability are expected to decrease over the next twelve months, but the anticipated rate of decrease is less than in the previous quarter (net declines of 9% and 20% respectively).

Employment

The decline in employment was largely as anticipated (a net decline of 19%), and little improvement is forecast, although once again changes only affected a third of respondents. 16% increased pay by an average of 4.09%, compared to an average increase of 4.71% in the previous quarter.

FINANCIAL INSTITUTIONS

Personal advances

Personal advances rose strongly during the three months to the end of March for a net balance of respondents and little change in the rate of increase is forecast for the second quarter.

Corporate advances

The increase continued through the first quarter, and again corporate demand for credit was most evident for working capital. The demand for credit for plant/equipment remained level, whilst the demand for credit for buildings declined for a net of respondents.

Sectoral demand

Demand for credit increased modestly from construction and the service sectors, but demand declined from manufacturing. This pattern is expected to continue through the second quarter.

Employment

Changes to employment were limited, affecting a third of respondents. 17% reported increasing pay by an average of 3.75%.

TOURISM

Optimism

Changes in business confidence were widely reported, and the decline in confidence continued but eased sharply as 9% (compared to 52% of respondents in the previous quarter) reported being less confident than three months earlier.

Demand

The decline in demand was less than anticipated, demand from all areas continued to fall for a net balance of tourism respondents, but the decline in demand from all areas was less than anticipated. Average capacity used was two percentage points lower than in the first quarter of 1998, but three percentage points higher than the first quarter of 1997.

Investment

Investment continued to rise, although for more than 85% the main reasons for authorising investment were to replace/renew facilities or to improve facilities.

Finance

Increased pressures on margins were again evident, although possibly less so than in the previous quarter. Turnover continued to fall, costs again rose slightly more than had been anticipated, and the slight decline in prices continued.

Employment

Less than 50% reported and expect no change to overall employment levels but a net of tourism firms expect employment to increase in the second quarter.

Recruitment

Recruitment activity remained high with 79% seeking staff. 40% reported increasing pay by an average of 5.2% (compared to 4.0% in the previous quarter).

CONSTRUCTION

The index of Construction for Scotland for the fourth quarter stood at 102.28 (1995=100). This represents a 1.3% rise compared to quarter three and a 4.3% rise over the year to Q4.

The latest Deloitte & Touche Scottish Chambers' Business Survey for the first quarter of 1999 showed that slightly more than half reported changes in business confidence, overall 35% reported increased confidence, a net balance of +18% which is the first recorded rise in confidence since the second quarter of 1998. Rising optimism was evident for a net of firms in all size bands.

Once again the decline in total orders was less than anticipated, a net balance of -4%, and respondents expect a rise in the second quarter. Rising total orders were reported by a net of firms employing 20-99. Public sector orders continued to decline, however the rise in private sector orders, a net of +9%, reflected 31% reporting increased orders. The rise in private sector orders is expected to continue rising to a net balance of +23%. Rising private sector orders were a feature for a net of firms employing less than 100. Overall 78% cited the low level of demand as the factor most likely to restrict activity in the first quarter, a slightly lower percentage than in previous quarters, in contrast the percentage citing shortages of skilled labour was slightly higher.

The weak trends in investment in plant/equipment were slightly better than anticipated, with 15% each reporting a rise and a fall. The level trend is expected to continue through to the next quarter. Of those investing, 53% of respondents reported that the main reason for new investment was to replace existing capacity and 26% cited increasing efficiency.

Changes to employment levels affected 46%, and the trends were again stronger than anticipated with a net balance of 9% reporting an increase. 25% reported increasing pay by an average of 5.2%. Once again half of respondents sought to recruit.

According the Halifax House Price Index house prices in Scotland during the first quarter showed a decline of 1.9% compared to a 0.2% rise in the UK. Year-on-year Scottish house prices rose just 1.1% against the UK increase of 4.4%. There were contrasts within Scotland with Glasgow and Edinburgh being fairly buoyant though other parts were depressed.

In its state of trade survey for the first quarter of 1999 the Federation of Master Builders said it was 'cautiously optimistic' about the industry's short-term prospects. Overall workload for the first quarter remained fairly stable although the level of enquiries increased. The survey found that the most active sector was private housing improvement with public sector work remaining depressed. Skill shortages remained evident. Construction Forecasting and Research (CFR) raised its construction output forecast for 2000 due to an expected more rapid upturn in the economy.

Miller, the Edinburgh-based construction group, increased pre-tax profits by 12% to £14.8 million. The Group's property development business raised profits 49% to £10.1 million and housing raised profits 75% to £4.4 million.

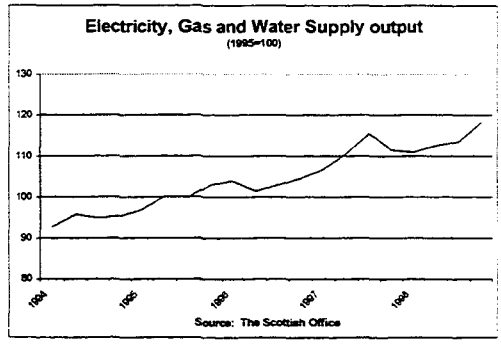
A strong performance by its construction division and a first time contribution from its new facilities management business led to a increase in pre-tax profits for Inverness-based Tulloch. Profits for 1998 reached £1.5 million on a turnover of £75 million. Pre-tax profits for the previous year were £621,000.

ENERGY

OIL AND GAS

The Royal Bank of Scotland Oil and Gas Index indicates that oil production increased by 2.7% for 1999q1 on 1998q1 but there was little change on a quarterly basis. Gas production increased by 9.8% on an annual basis and by 11.8% for 1999q1 on 1998q4. Combined production of oil and gas increased by 5.6% over the year and by 5.2% for 1999q1 on 1998q1.

There is some hope for the oil price as it has risen slightly but for 1999q1 on 1998q1 it is still 20% down. The Average Daily Oil Value has increased by 5.1% for 1999q1 on 1998q4 (a 17.5% decrease in annual terms). The Total Daily Average Value (£ million) has increased by 7.8% for 1999q1 on 1998q4, a fall of 8.6% on an annual basis. A 23% rise in the oil price (Brent) was observed in March, up to $12.53. Consequently UK daily oil revenues increased by 24% to average £20.6 million (the highest since May 1998). While this is encouraging expectations play an important role in the oil price and supply is still greater than demand. It will probably be some time before reductions in supply work their way through the supply-demand balance to affect price.



The principal reason for the price rise is that many oil producing countries are demanding higher revenues – the implementation of the OPEC cuts in April has achieved this and may provide the incentive to adhere to quotas. The rise in revenues will not increase North Sea investment however and cost reductions will continue to lead to employment losses especially in the contracting sector.

The market may believe that the removal of 2.5% of the world's oil supply will see the oil price settle at about $15 (Brent). The International Energy Agency estimates that during February OPEC compliance with quotas was only 77%. OPEC members also fear that "doing nothing" would see prices coming under further pressure.

Elf Exploration are to sell off their mature North Sea assets (Piper Bravo, Saltire, Claymore and the Flotta oil terminal in Orkney). They will concentrate on the Elgin/Franklin deepwater project that comes on stream next year. Expro issued an earnings warning that will result in the loss of 130 jobs world-wide to save £3 million per annum. BP Amoco announced a 41% fall in profits for the first quarter of 1999 before exceptional items. Exceptional items include $1.15 billion for restructuring costs (including $722 million in severance payments for 6,000 employees made redundant due to the merger). The company will shed another 4,000 jobs this year. Premier Oil, the Scottish based exploration group, has recorded a £137.2 million loss for 1998 forcing it to pull out of

the Balal project in Iran, where they would have had access to estimated reserves of over 100 million barrels of high quality oil.

The Government has announced investment incentives to safeguard 100,000 jobs in the oil and gas sector. The deal includes approval for new exploration to be completed within a month, a two-month review of taxation for the industry and a plan to offer half of the unallocated drilling territory around the UK in a series of licensing rounds. While the move was welcomed by industry sources it is doubtful that it will make any significant change this year.

The Aberdeen Chamber of Commerce and Deloitte & Touche Oil and Gas Survey for the Oil and Gas Related Sector 1999q1 revealed that optimism was extremely depressed (65% less confident and only 7% more confident than they were in 1998q4). Almost 90% of respondents were less optimistic than they were a year ago. 77% reported reduced exploration work and about 70% expect a reduction in exploration over the next six months. The decline in Scottish based activity is expected to be extensive over the next six months. Only a small percentage of respondents expect a slight increase in activity over the third and fourth quarters of 1999 but the majority still anticipate a decline in activity. The decline in investment is expected to continue into the first half of 1999 and 44% of respondents reported reducing employment levels with 55% stating employment had remained constant for 1999q1.

BP Amoco is to enter into a second merger just eight months after the initial merger. They have agreed to purchase Atlantic Richfield (Arco) for $26.8 billion (£16.7 billion). This will leave them the second largest company behind Exxon-Mobil (£158 billion) and ahead of Royal Dutch/Shell (£111 million) with a market capitalisation of $118 billion. Significant savings could be made particularly in Northern Alaska, the UK and the US. Industry analysts expect Arco to save $500 million by cost cutting by the year 2000 but now the figure may be over $1 billion. The new company will be the largest oil producer outside OPEC with 3.5% of global output (2.66 million barrels per day) and have the most oil reserves with 11.8 billion barrels. BP Amoco will also now be the largest operator of North Sea assets. Arco headquarters in Surrey will close with the loss of 300 jobs but there may be up to 1000 new jobs in Aberdeen.

Lasmo are to take-over Monument Oil & Gas for £600 million following the collapse of talks between them and Enterprise Oil. Estimated annualised cost savings of £6 million and tax benefits of £10 million are forecast for four years. The Wood Group is looking for a large acquisition to boost company growth after operating profits of £32.7 million last year. Floatation would be a possibility if the right opportunity came along. The group's UK workforce has remained around 2,300 although the company may shed between 100-500 contracting jobs this year.

UTILITIES

The Scottish Office Index of Production for Electricity, Water and Gas Supply grew by 4.2% for 1998q4 on 1998q3 compared to a more modest 1.5% growth in the UK. For the latest four quarters on the preceding four quarters growth was 2.4%, similar to the UK figure of 2.1%. The quarterly figures reflect the exports of electricity over the winter but overall annual growth is similar because of over capacity in the electricity generating sector.

Scottish Power's £3.6 billion PacifiCorp deal has received further backing from the US State authorities. So far only one state has objected. Powergen has lost its battle to build a gas-fired power station at Gartcosh in Lanarkshire. The Secretary of State refused the application on the grounds it was against local economic development plans. Powergen felt an opportunity to introduce further competition into the Scottish market had been missed.

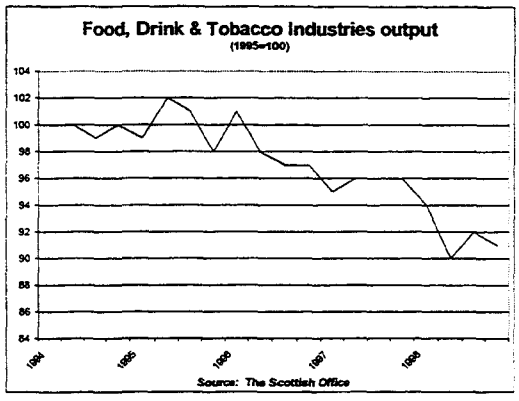
British Energy is to buy a third US nuclear power reactor as part of a $20 million deal in Illinois with its partner PECO Energy of Philadelphia. The plant currently has operating expenses of $18 million per month but returning it to operation would see Illinois Power guarantee to take 75% of its output until 2004 and the $95 million decommissioning fund would be transferred to the operators. British Energy is also to buy the Three Mile Island for $23 million and the Vermont Yankee Reactor.

MANUFACTURING

FOOD, DRINK & TOBACCO

The Index of Production for the Food, Drink and Tobacco sector in Scotland stood at 91 in the fourth quarter of 1998 (1995=100), a 1.1% drop from the third quarter. However, the two constituent parts behaved very differently in the final part of last year, with output in Food & Tobacco down by a

very modest 0.1% compared to a fall of 2.3% in Drink. Both sectors also fell over the year to the fourth quarter, however, with Food and Tobacco down by 3% and Drink down by 6.6%, this resulted in a net fall across the whole sector of 4.7%. This compares with a fall in output of 1.3% for the industry across the UK.



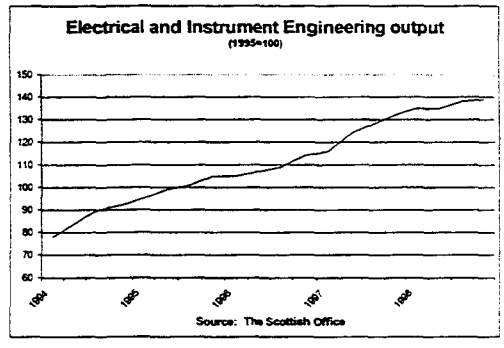
The more recent (Q1 1999) results from the Deloitte & Touche Scottish Chambers' Business Survey shows a reduction in business confidence in the sector. A net 14.3% of companies reported a drop in confidence over the three months preceding the survey, and the exact same number reported falling confidence compared to the same point in 1998. However, this drop in confidence does seem to be caused by short term factors which most companies believe will work their way out of the system. This upward trend in orders is also expected to continue, with a net 21.4% expecting these to rise, and a majority of companies expect both turnover and profitability to improve over the coming year. Capacity utilisation measured 72%, which represents no change across the sector from one year previously, and investment intentions were also unchanged across the sector.

Among companies in Scotland, Wiseman Dairies has announced a 6% increase in profits, which occurred despite a 5.6% drop in turnover, caused by depressed milk prices. The company remains committed to longer-term expansion in the South of England, although it has again shelved plans to build a new dairy because long term contracts with the major supermarkets are proving difficult to finalise.

Elsewhere, whisky producers have been reporting difficulties caused by the strength of sterling and problems in the Far East. Highland Distillers reported level profits despite these problems and despite a reported 40% drop in sales in Asia. Diageo also reported reduced sales in Asian markets, with sales for some brands also reported to be down as much as 40% in these areas.

ELECTRICAL & INSTRUMENT ENGINEERING

The latest Index of Production figure for the Electrical & Instrument Engineering sector in Scotland shows that output stood at 139 in the final quarter of 1998 (1995=100). This figure represents a rise from the revised third quarter figure of 138, and means that the two successive falls seen in the previous two quarters have now been reversed. Output in the sector also rose by 9.5% over the year to the fourth quarter, and both increases therefore somewhat belie what might have been expected, given the recent run of poor news about the industry. Output also increased across the UK industry, by 1.4%.



The findings of the latest Deloitte & Touche Scottish Chambers' Business Survey, which reports results for the first quarter of this year, however, shows a degree of nervousness amongst firms which may indicate some more bad news on the horizon. Most notable is perhaps the sharp reduction in confidence amongst firms. Not only is short term confidence down - a net 21.4% of respondents felt less confident in March than they had done three months previously - but there has also been a much more substantial change in the level of confidence compared to that seen in Q1 1998. Here, a net 49.4% of respondents felt less confident than at the same time in 1998, and a total of 64% of firms reported falling confidence, so there has clearly been a major downward shift in the position over the year. In addition, a net 49.5% of firms reported a downward shift in orders in the last three months of 1998, with 66% reporting a reduction. Some 43% expect these to fall further in the coming quarter (a net 15.7% expect new orders

to fall), although one positive spot is that new orders in the more important export markets are not expected to fall as fast as in the UK - here, only 19% of firms expect these to be reduced, which compares to 36.3% for the UK. Firms also report that capacity utilisation, which averaged 75.3%, is down in 70% of cases and investment intentions (for plant and equipment) had been revised downwards for a net 12% of companies. A small net of companies, 1.1%, expect that turnover will worsen in the coming twelve months, and a larger number of companies, some 6.4%, expect that profitability will worsen. The root cause of these results is quite simply the lack of orders or sales, which 59.1% of companies cite as having become more of a concern since the previous survey.

Among companies in Scotland, the major news has been the severe profits warning posted by Compaq. The company announced that it expected its earnings per share to fall to half that expected by markets, and blamed both a reduction in demand and keener competition, leading to price cuts. Compaq's CEO resigned following the announcement of its results.

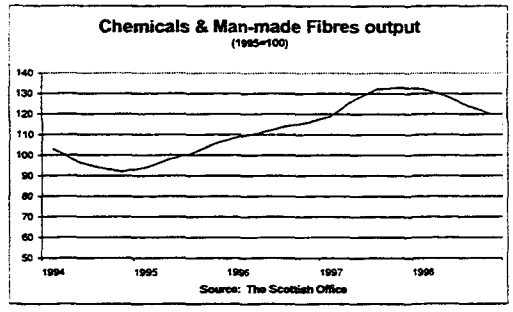
The industry was also dealt more bad news with the announcement by Mitsubishi that it is to close its PC factory in Glenrothes with the loss of 125 jobs. The company, which was condemned as "secretive" by local politicians, has said simply that the current economic situation has made the closure necessary. Mitsubishi globally is in the throes of a restructuring programme, which it expects will result in the shedding of up to 14,500 jobs. This is the Mitsubishi's second plant closure in Scotland in the last year, the television plant in Haddington having been closed down in 1998.

CHEMICALS

Evidence from the latest Index of Production for the chemical and man-made fibres sector showed a fall in output for the fourth quarter over the third quarter of 3.1 per cent while year on year output fell by 0.9 per cent. For the UK as a whole output fell by 0.8 per cent in the fourth quarter however annualised growth increased by 1.5 per cent.

Results from the latest Deloitte & Touche Scottish Chambers' Business Survey suggest that firms remain less confident about the general business situation. Changes in confidence were reported by more than half of firms although the fall in confidence eased marginally (a net of -29%).

The decline in total orders, a feature since the third quarter of 1997, continued at a net of –57%. Demand continues to be weaker than anticipated with the decline in both Scottish and rest of UK orders accelerating. The decline in export orders, which had been expected to rise, showed only a slight easing in the rate of decline. Changes in the level of sales affected 86% and the sharp decline continued with 71% reporting falling and only 14% rising sales. Rest of UK and Scottish sales again fell steeply; the decline in sales to export markets was not as severe. Concerns as to the level of orders/sales and exchange rates remained high.



Average capacity used rose five percentage points to 70% and this was regarded by 50% as lower than in the same period one year ago.

Trends in cashflow continued to weaken with no respondents reporting improving but 71% worsening cashflow trends; a net balance of 14% expect both turnover and profitability to decrease over the next year. Again little change to prices is anticipated and pressures to raise prices were less evident than three months earlier.

Changes to investment plans were at the margin being reported be fewer than half of the respondents however the declining trend in investment continued. Investment authorised in quarter one was more commonly directed towards replacement of equipment and reduction of labour.

Changes to employment were more widespread and 43% reduced employment. The net decline is expected to continue but ease in the second quarter.

In the company sector Shield Diagnostics, the Dundee-based company, is developing a genetic test to identify likely sufferers of osteoporosis. The company has signed an exclusive deal with Cambridge based Gemini Holdings, which specialises in the diagnosis and treatment of age

related diseases and has identified a gene associated with brittle bones.

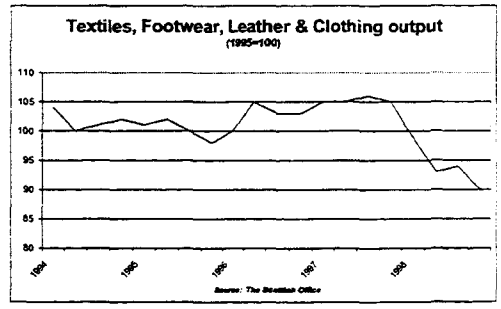
Shares in Scotia Pharmaceuticals, the Stirling based drug company dropped 9% of their value after it revealed that it is dropping its treatment for pancreatic cancer as it offered no 'survival benefit'. Following this however shares rose when the company announced details of a two-year agreement with the pharmaceutical giant Bristol-Myers Squib to develop its drug delivery systems. The deal does not involve additional cash for the Scottish company however Bristol-Myers Squib will fund the Scottish company's initial feasibility studies into new products. If these prove successful then Scotia will negotiate development and licensing agreements with Bristol- Myers Squibb.

In the next month PPL Therapeutics is to announce whether its new manufacturing plant will be based in Scotland or the US. The location will depend on development funding so far offered in the US but not in Scotland. The plant, estimated at £45 million, will manufacture PPL's lead product for cystic fibrosis as it seeks to become a fully-fledged pharmaceutical company. The company, which currently employs around 60 people in Edinburgh, will require 150 people for the new plant.

TEXTILES, LEATHER, CLOTHING AND FOOTWEAR

The Index of Production for the Textiles, Leather, Footwear and Clothing sector in Scotland measured 90 (1995=100) in the fourth quarter of 1998, which represents a 4% drop from the third quarter and a more substantial 10.4% reduction in output over the year to the fourth quarter. Textiles therefore continue to perform poorly in output terms. The fourth quarter figures do show it bearing up slightly better than its UK counterpart, where output fell by 5.4% in the final quarter. The 10% reduction seen since last year is probably more significant, since it appears to confirm that the industry has seen a step-reduction (see graph) from which it shows, as yet, no prospect of recovering.

The more recent findings of the Deloitte & Touche Scottish Chambers' Business Survey confirm the worrying picture seen from examination of the Index of Production data. They show a reduction in business confidence in the first quarter of this year, with a net 22.6% of firms reporting that confidence in the general business situation facing the industry had fallen since the final quarter of 1998. A greater source of concern, however, is that the level of reported confidence seems to have fallen much more sharply over the year to the end of Q1, with a net 48.9% of respondents reporting a drop. The main reason appears to be that the level of both sales and new orders were down for a substantial majority of companies in the industry. A net of 41.2% reported a downward trend in sales, while a net 40.3% reported a downward trend in new orders. The expected trend in both was also negative in all markets (Scottish, Other UK and exports), although the prospect in export markets does appear to be a little brighter, which 24.8% of companies expected to pick up in the coming quarter. However, capacity utilisation is just over 70%, and this represents a fall for 57.1% of companies. Not surprisingly, investment intentions were flat, and plant and equipment investment plans had been revised downwards for a net 31.5% of firms. The balance of expectations in the sector is that both turnover and profitability will fall in the coming year, and so firms themselves do not appear to see any major changes in prospects over the medium-term.

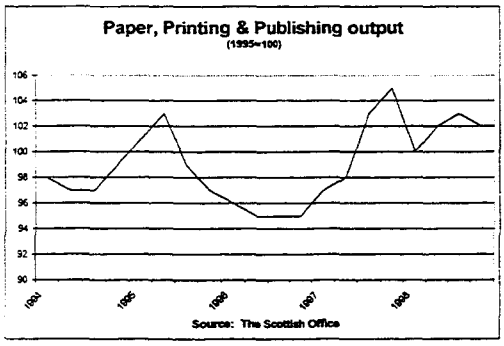


The outcome of the "banana war" is still inconclusive, with the USA having effectively had its case that the EU's treatment of banana imports flouts global free trade laws. The effects on the Scottish cashmere industry, one of the US's prime targets for retaliatory sanctions, remain uncertain.

PAPER, PRINTING AND PUBLISHING

The most recent Index of Production and Construction for the Paper, Printing and Publishing sector in Scotland reveals a small fall (-0.5%) in output for the fourth quarter of 1998. This follows the previous quarter 3 rise of 0.3 per cent. However, annualised growth for this sector in Scotland remained positive with year on growth of 1.2 per cent. The corresponding UK figures reveal that quarterly and annualised output growth for this sector decreased by –0.1 and –0.2 per cent, respectively.

The results from the most recent Deloitte & Touche Scottish Chambers Business Survey (DTSCBS) suggest that trading conditions remain difficult in this sector. The general business outlook for respondents in the 1st quarter of 1999 remains downbeat with 40 per cent of respondents less optimistic about the general business outlook than three months previously. Overall the balance between business expectations is a net -8% of all respondents. In comparison with one year previously over one half of all respondents and a net 28 per cent are less optimistic about the current business climate.



The trends in total orders and sales over the previous quarter confirm this outlook with domestic demand falling for a positive balance of respondents. Thus, declining Scottish and UK orders and sales affected a broad band of respondents over the previous quarter. In contrast, export orders and sales increased, overall, for a relatively small net balance of respondents. The trends in both orders and sales, anticipated by respondents in the second quarter of 1999, suggest that domestic demand, particularly Scottish orders, should bounce back somewhat. Export orders are also forecast to remain positive.

The average level of capacity utilisation for the Paper, Printing and Publishing sector decreased by over 2 per cent to 76%, in the first quarter of 1998, which marks the second consecutive quarterly fall in capacity utilisation in this sector. Investment intentions in this sector, over the past quarter, were revised downward again for both land and buildings and plant and equipment, as anticipated by respondents in the previous survey. This trend is forecast to continue over the forthcoming quarter.

The latest DTSCBS also reveals that changes in total employment affected 48% of respondents, as the decline in employment increased (relative to the previous quarter) to a net 32% of respondents, over the past quarter. This decline in total employment is forecast to increase into the next quarter with a net 44 per cent of respondents anticipating a fall in existing employment levels. Over the same period, one fifth of all respondents increased wages and salaries by an average 3.25 per cent.

In summary trading conditions remain difficult within this sector with both the Scottish and UK trends in orders and sales within the industry the key concern for respondents. Cashflow and profitability also worsened for a net 20 and 36 per cent of respondents over the past quarter. Accordingly, growth will remain difficult for this sector over the forthcoming quarter unless the expected trends in export orders and sales are realised, or domestic demand picks up.

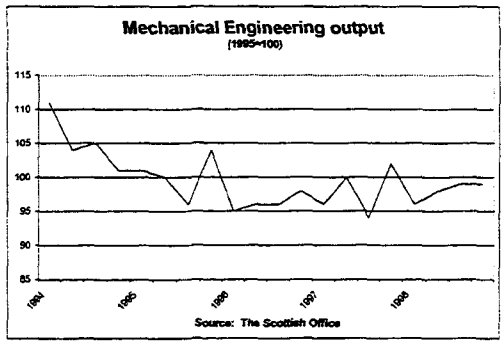
In the company sector, Johnson Press (Edinburgh-based Regional Newspaper Group) has won control of Portsmouth and Sunderland Newspapers in a deal worth around £266 million. The acquisition will make Johnston the fourth-largest local newspaper publisher in Britain, after Trinity, Northcliffe and Newsquest. Further consolidation in this sector is likely. Scottish Media Group (SMG) reported profits for 1998 that were up 12% to a record £46m. However, it could prove to be a difficult year for SMG to maintain its independence with its portfolio of newspapers and t.v. products attracting attentions from possible suitors. Hence, the recent purchase of an 18.6% stake in the SMG by Granada.

Finally, profits at Macfarlane (Clansman) packaging fell 31 per cent to £15.1 million and were blamed largely on the reduced margins in business with electronics manufacturers and the fall in whisky exports last year. Other smaller packaging and logistics firms throughout the Scottish sector have felt the impact of Electronics companies having to cut input costs following the Asian financial crisis. Recall that as a necessary input to both Whisky and Electronics production in Scotland, packaging firms are largely dependent on the continued success of these sectors.

MECHANICAL ENGINEERING

The most recent Index of Production and Construction for the Mechanical Engineering sector in Scotland reported a 0.3% increase in output for the fourth quarter of 1998. Although modest, the latest reported quarterly rise in Mechanical Engineering output marks the third consecutive quarterly increase in output growth for this sector. Year on year growth for this sector in Scotland also

remained positive with a small 0.1 per cent rise recorded. The corresponding UK figures reveal that output growth fell by 1.3% to the fourth quarter of 1998 and annualised growth, over the previous four quarters, fell by –0.1 per cent.



The results from the most recent Deloitte & Touche Scottish Chambers' Business Survey (DTSCBS) suggest that trading conditions in the first quarter of 1999 remain particularly difficult in this sector. Despite the recorded quarterly increases in output growth, over the second to fourth quarters of 1998, business confidence remains increasing shallow, with over half of all DTSCBS respondents less confident about the current business conditions than three months previously. In fact, business confidence has worsened considerably with less than 10 per cent of respondent firms more optimistic about the current business climate than in the previous quarter. Moreover, nearly 80 per cent of all respondents in this sector are less confident about the general business climate than one year previous.

Not surprisingly, the trends in total orders and sales over the previous quarter confirm this outlook. Declining orders across all markets were reported by DTSCBS respondents, with 50% reporting falling Scottish, 47% declining rest of UK and 31% falling export orders, which marks a substantial deterioration from the previous quarter. The trend in the total volume of sales followed a similar pattern, with both Scottish and UK sales down for over half the sample of DTSCBS respondents. Export sales were also down for around one third of the sample. This downward trend in orders and sales, which were anticipated by respondents in the previous Survey, is forecast to continue with RUK orders and sales anticipated to fall for a wide band (over one third net) of respondents.

The average level of capacity utilisation for the Mechanical Engineering sector decreased by nearly 6 to 72.3% for the first quarter of 1998. Investment intentions in this sector, over the past quarter, were revised downward for both land and buildings and plant and equipment, by a net balance of around one quarter of respondents. However, investment intentions over the forthcoming quarter are forecast to worsen with a larger net band of respondents anticipating further downward revisions.

The Deloitte and Touche Scottish Chambers' Business Survey also reveals that changes in total employment affected 42% of respondents (a net of 31%) an increase compared to the previous quarter. Over the next three months, respondents expect the employment situation in this sector to ease, with a net 20 per cent of respondents reducing total employment. Over the same period, one third of all respondents increased wages and salaries by an average 3.39 per cent.

In summary trading conditions in the first quarter of 1999 have deteriorated within this sector with very few firms expecting either sales or new orders, across all markets, to increase over the forthcoming quarter. The key concern for respondents in the Mechanical Engineering sector is the current level of order and sales. Moreover, cashflow, turnover and profitability all worsened for almost half of all respondents to the first quarter of 1999, which underlies the low levels of business confidence in this sector. Accordingly, given the current trading conditions in this sector future output growth is difficult to envisage.

In the company sector, Kvaerner, the troubled Anglo-Norwegian Conglomerate, which employs 1,200 workers at its Kvaerner shipyard in Govan, is to stop shipbuilding following a major restructuring of the multi-national engineering group. The company, which posted losses of over £100 million in 1998, its first since 1967, has announced a major restructuring package, which could lead to more than 20,000 jobs being lost world-wide. The Conglomerate cites over capacity in Shipbuilding in Europe and fierce competition from Asia as the main factors behind their decision to pull out of 13 shipyards worldwide. The potential employment loss in Scotland could be as high as 3,000 jobs with other Kvaerner interests in Scotland also threatened.

However, Kvaerner is prepared to sell the loss-making Govan shipyard to another potential operator. A government-backed taskforce has identified a number of potential buyers although no formal deal has yet been agreed. Whether such a deal can save the yard may depend on both the

conditions of sale imposed by Kvaerner and the possible transfer or creation of orders to Govan by the UK ministry of defence. The Kvaerner Group is thought to favour a merger of its other profitable shipyards as its preferred option for a phased withdrawal from shipbuilding. Any such deal could impose conditions on the sale of the Govan yard in order to restrict its potential as a future competitor. Whatever the outcome of these discussions, the closure of the Kvaerner Govan Shipyard would be a massive blow to shipbuilding on the Clyde, and Scottish engineering in general.

SERVICES

RETAIL & WHOLESALE DISTRIBUTION

The Scottish Retail Consortium/Royal Bank of Scotland Retail Sales Monitor for April shows the value of sales fell by 4.3% on a like-for-like basis compared with April 1998. Total sales increased by 0.4%. As in the UK, where BRC data showed a fall of 4.6% in like-for-like sales, the April figures were depressed by the change in the timing of Easter. If the March and April figures are averaged, so that Easter is included in the two month period in both years, growth in like-for-like sales for the two months would average -0.2% compared with 0.1% for the UK. Total sales across the two months grew by 3.2% compared with 3.4% in the UK. The three month moving average showed sales growing at 0.2%, compared with 2.3% for January to March.

The Office of National Statistics claimed that in April the seasonally adjusted estimate of retail sales volume is 113.1.This is 0.5 per cent below the March figure but 1.6 per cent higher than the April 1998 level. In February to April the volume of sales was 0.6 per cent higher than in the previous three months and 1.8 per cent higher than in the same period a year earlier. Based on non-seasonally adjusted data, the average weekly value of retail sales in April was £3,620 million, 0.6 per cent higher than in April 1998. [Note that this comparison is affected by the timing of Easter: in 1998, the holiday fell entirely in April; in 1999 it straddled the March and April reporting periods]. In February to April the value of sales in current prices was 2.8 per cent higher than in the same period a year earlier.

In February to April the seasonally adjusted volume of sales by predominantly food stores decreased by 0.1 per cent compared with the previous three months; sales by predominantly non-food stores increased by 1.2 per cent. The all items retail prices index (RPI) rose by 0.7 per cent over the month to stand at 165.2 for April.

In the twelve months to April, the all items RPI rose by 1.6 per cent, down from 2.1 per cent for March. The 12-month rate of change for the all items excluding mortgage interest payments index stood at 2.4 per cent for April, down from 2.7 per cent for March. In the 12 months to April, the UK harmonised index of consumer prices (HICP) rose by 1.5 per cent, down from 1.7 per cent in March.

Survey evidence from the latest Deloitte & Touche Scottish Chambers' Business Survey (Quarter 1 1999) showed that changes in business confidence affected almost 50% of wholesalers and confidence continued to fall, albeit at a slower rate as 35.1% reported being less confident, a net decline of -22%. Business confidence fell for a net of firms employing less than 100. Changes in business confidence affected 54% of retailers and the decline in confidence continued though eased from –50% to –27%. Declining confidence was a feature for a net of firms in all size bands.

A net of 27% of wholesale respondents from the fourth quarter survey had forecast a fall in sales though only a net of 11% reported a fall. Once again declining wholesale sales trends were a feature for a net of firms employing less than 100. Respondents expect a further deterioration in sales in the first quarter. Sales among retail respondents continued to decline though the rate of decline (-30%) was not as steep as had been forecast. Falling sales were reported by a net of firms in all size bands. Concerns as to competition continued alongside the level of business rates as the two factors thought most likely to limit activity for wholesalers in the second quarter. Concerns as to the levels of competition were evident for all size bands, whereas concerns over business and interest rates tended to decrease with firm size. Competition and business rates were identified as the two factors most likely to restrict retail activity with concerns over interest rates easing. Concerns as to competition featured in all size bands.

The fall in investment plans resumed with a net of 5% of wholesalers revising plans downwards. Investment plans continued to affect around 40% of retailers, and a net of 1% reported revising investment plans downwards. Cashflow trends remained weak, with 38.2% of wholesalers reporting lower cashflow and only 13% rising cashflow trends. Deteriorating cashflow trends were reported by a net of firms in all size bands. The cashflow position of retail firms continued to

deteriorate with a net balance of 31% reporting a decrease. Declining cashflow trends were reported by a net of firms in all size bands.

A small net balance of respondents continue to expect declining wholesale turnover over the next twelve months, 31.6% anticipate declining turnover, a net balance of -1%. Expectations of declining turnover were only reported by a net of smallest firms. The percentage of wholesalers expecting profitability to decline over the next year eased from a net of -27% in quarter four to a net balance of -8%. Profitability declined for a net balance of firms employing less than 100. Both turnover and profitability are again expected to fall over the next twelve months for a net of retailers, though the rates of decline are expected to ease. Expectations as to increasing prices over the next three months continued. Expectations of declining turnover were only evident amongst the smallest firms.

Expectations of price increases in the second quarter declined with a net of 4% of wholesale respondents expecting to decrease prices, compared to a net of 23% expecting to raise prices in quarter four. Transport and other overheads remained the main pressures on prices.

Changes to employment levels were reported by 29% of wholesale respondents, and the trends were, as expected, a net of 13% reporting a decline. The percentage of wholesalers seeking to recruit staff rose to 42% and 30% reported increasing pay by an average of 3.23% (compared to an average of 4.19% in quarter four). Retail employment trends were as anticipated, although again changes affected only a third. Less than a fifth increased pay by an average of 4.09% (compared to an average increase of 4.71% in quarter four).

The latest CBI Distributive Trades Survey, (all UK) covering sales from 1 to 27 April, shows 41 per cent of retailers reporting sales increases, and 26 per cent reporting sales were down, giving a positive balance of 15 per cent. This is little changed from a balance of plus 14 per cent last month, and compares with a positive balance of 26 per cent a year ago. The three monthly average suggests that sales are starting to edge up, with an improved positive balance of 10 per cent, in comparison to last month's positive balance of two per cent and last year's positive balance of 24 per cent. Retailers of footwear and leather goods, specialists' foods and off-licences reported strong increases in sales volumes compared to last year. While booksellers, confectioners and furniture and carpet stores reported a downturn compared to the same time last year. The growth in wholesalers' sales volumes did not meet their expectations, but rose slightly in the year to April. Sales are expected to increase more slowly in May. Volumes of orders placed with suppliers fell in April, but are also expected to increase this month. Motor traders reported a significant fall in volumes of sales in April, following the large increases seen in March. The March increase resulted from the new date for the new car registration plate. April's fall in sales was much greater than expected. Motor traders are now more cautious, and this is reflected in their expectations for sales in May.

TRANSPORT

Air

BAA announced a 7.5% rise in annual profits in June this year. Pre-tax profits for the year to 31st March rose to £516 million with operating profit increasing to £605 million, up 15.5%. The interest charge doubled from £52 million to £98 million of which most related to the Heathrow Express Rail Service. This suffered a £2 million loss in its first 9 months despite carrying 12,000 passengers per day. Abolition of duty free sales could cost BAA up to £30-40 million in the first year but they expect to recoup this loss by increasing sales. BAA also plans to expand capacity at Gatwick to handle an additional 10 million passengers a year because of the delay in planning permission at Heathrow Terminal 5. This would mean 40 million passengers in five years compared to 29 million passengers last year. The Government is to ask the MMC to investigate ownership of the UK's airports in order to review the degree of competition in the industry.

Federal Express (Fedex), the US freight company, is threatening to end it services to Scotland unless it receives permission to fly onward from Scotland to third countries. Fedex operates 7 flights a week from the US to Scotland and so far is only allowed to fly on to nine other countries. The company now wants unrestricted access to third countries.

British Midland has blamed a drop in the number of business travellers for a 34% drop in pre-tax profits. Profits fell from £16.7 million to £11 million despite turnover increasing 3% to £558.8 million. Glasgow and Edinburgh had both bucked the trend with business class sales growing.

Rail

Railtrack has announced a ten year plan worth £27 billion for investment of which £2 billion will be spent in Scotland. According to Railtrack this is £10 billion higher than the previous plan due to increased traffic forecasts but political pressure must have been a major factor in this reassessment. Railtrack also claims to meet the requirements of double the amount of freight traffic in Scotland in ten years time. The additional spending is broken down as £3 billion to maintenance and renewal; £1 billion to easing of bottlenecks; £2.5 billion on station improvements. The Deputy Prime Minister highlighted the fact that only £11 billion will be used to enhance the network and not all of the £11 billion is Railtrack's money. In Scotland the priorities appear to be a 15-minute service between Glasgow and Edinburgh, reducing journey times between Glasgow and London, which include the use of 120mph tilting trains, and the introduction of a rail link to Glasgow Airport.

In Scotland a study of the priorities for investment in the rail network by independent experts revealed that fourteen major investments totalling £1 billion were required to make the rail network an efficient and modern transport system. This excludes the West Coast Main Line upgrade and the East Coast Main Line improvements that are costed at £2.2 billion and £1.5 billion respectively. To have an effective rail link to Glasgow Airport (£27 million) would really need a Glasgow "super-station" tunnelled under George Square (£400 million) effectively scrapping the two current stations. Glasgow-Edinburgh electrification (£30 million), Larkhall Link (£30 million), Aberdeen-Inverness improvements (£20 million), Dunfermline-Alloa-Edinburgh line (£30 million), Edinburgh-Lothian links (£5 million), and the Dornoch Link (£20 million) are all major track and signalling improvements. In the Edinburgh area the Waverley Line could be re-opened (£30 million), the Edinburgh cross-rail link could be built (£12 million), and the South suburban line could also be re-opened (25 million). A guided rail link to Edinburgh Airport would cost £50 million, countrywide park and ride schemes total £20 million while the Abbeyhill Station for the Scottish Parliament would cost £6 million. These fourteen schemes would total £705 million and a further £295 million is required for track and signalling upgrades. It is extremely unlikely that Railtrack will ever undertake this programme of work and definitely not in a short timescale.

Railtrack has been heavily criticised for failing to tackle train delays, considerable signalling schemes and station improvements by the Rail Regulator. A recent study by Booz-Allen and Hamilton finds that Railtrack's investments are focused on assets that provide short-term returns rather than long term investments or quality of investment. The report, which covers the last four years and Railtrack's prospective performance up to 2001 states that there has been a "virtual absence of any improvement at all." Railtrack fared better on track renewal, operational and management processes, productivity and cost efficiency but was very poor on signalling, station maintenance and renewal of assets. Railtrack defended their position stating "no other privatised utility had achieved such a degree of efficiency improvements in the first few years." John Prescott, the Deputy Prime Minister made it quite clear that this was "a sorry picture of Railtrack's performance while Save Our Railways (a pressure group) claimed that Railtrack have deceived the public by systematically under-investing.

The Strategic Rail Authority (SRA) believes that all rail investment plans should be co-ordinated through it in order to deal with the inefficiencies of the fragmentation that privatisation has brought. It also views ten years as the minimum time period for the private-public partnership to work to bring about the growth of a sustained quality rail service. An incentive for operators should be some extension to their franchise in return for investment in the service they operate and for meeting stringent operating targets. The SRA has criticised Railtrack's £27 billion investment package, as £6.5 billion of the funds earmarked should be regarded as an operating expense, not investment. Railtrack should also employ stricter tests as to what qualifies as an investment.

Road

Stagecoach is to quit its old headquarters in Perth to share the premises occupied by Scottish and Southern Energy in the city. The move is seen as a symbolic reassurance as less than 5% of all their business is now in Scotland and Scottish bus operations account for just under 10% of all bus operations. National Express is to buy a large US operator after returning a 77% increase in annual pre-tax profits to £95.6 million. The US group operates 1,750 buses transporting 170,000 pupils a day on school contracts. If the group were to obtain control of 5,000 buses then it would become the third largest operator in the US.

Sea

Clydeport have announced annual pre-tax profits of £11 million, a rise of 40.4%, a result that was considerably ahead of city expectations. Hunterston, bought for £5.6 million at the end of 1993, saw total tonnage increase by 80.1% to 2.9 million tonnes. Most of the group's profits comes from imported coal operations. Future plans include a roll-on roll-off ferry terminal for Glasgow-Ireland traffic and a £250-300 million leisure and entertainment development on the city's waterfront. The group plans to invest in their core businesses also, the ports at Hunterston, Greenock and Glasgow, as well as investing into shipping and road haulage.