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The Fraser of Allander Institute for Research on the Scottish Economy was established in the University of Strathclyde on 1 January 1975, as the result of a generous donation from the Hugh Fraser Foundation. Its principal function is to carry out research on the Scottish economy and its research programme includes the analysis of short term movements in economic activity. Along with the Quarterly Economic Commentary the Institute also publishes a series of Research Monographs and a series of Discussion Papers to provide an outlet for original research on medium term and long term aspects of the Scottish economy. The Institute is a research unit in the Strathclyde Business School, a faculty of the University of Strathclyde.

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Notes to contributors

The editors welcome contributions to the Briefing Paper, Feature Article and Economic Perspective sections. Material submitted should be of interest to a predominantly Scottish readership and written in a style intelligible to a non-specialist audience. Footnotes and references should conform to recent issues of the Commentary. Contributions should be typed and two copies submitted to the Editor.

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OUTLOOK AND APPRAISAL

First quarter GDP figures signal the end of the recession. Recent falls in unemployment and rising house prices should stimulate greater expenditure from consumers now that the threat of redundancy has receded.

The Scottish economy, traditionally one of the *last in last out* regions, has exhibited an impressive resilience to the Southern based recession. The UK economy entered the current recession in the 1990Q2 and only emerged in 1992Q4. Output in the Scottish manufacturing sector only seems to have gone into reverse in 1992Q2 and business survey evidence would suggest that recovery began towards the end of 1993Q1.

The latest Scottish Chambers Business Survey (SCBS) suggests that output continued to decline throughout 1992. Since then confidence has risen and export orders from outside the UK have improved. In 1993Q1 the year-long contraction of demand in the manufacturing and construction industries appears to have ceased and financial lending to the corporate sector showed signs of life. Both indicate a generally healthier perspective than seen in 1992H2.

This outlook does not however sit comfortably alongside the latest Scottish index of production, released in May, which at first glance shows a 4.7% rise in industrial production in 1992Q4. The manufacturing sector, buoyed up almost entirely by a 30% rise in the Electrical and Instrument Engineering sector, grew by 4.8% over the same period. However, at the 2 digit level, every sector in manufacturing other than the fore mentioned and transport equipment stayed put or registered a fall in output. When these outliers are excluded the picture that emerges shows a degree of symmetry in the performance of the Scottish and UK economies in 1992H2.

Once we look at the annualized series - the latest four quarters over the preceding four - the performance of the Scottish economy is pretty much inferior to its UK counterpart. Even with the rather

spurious quarterly growth recorded in 1992Q4 the Scottish production and manufacturing sectors declined by some 1.7% and 2.6% respectively compared with falls of only 0.3% and 0.8% recorded for the corresponding UK industries.

The performance of the Scottish labour market is documented in the last Commentary's editorial and in the present Regional Review. While unemployment figures continue to mask the true fall in the number of redundancies, the Scottish rate of claimant unemployed in April 1993 was the third lowest in the UK. Only the South East and East Anglia had a lower percentage of the workforce out of work. Over the recession Scottish unemployment has risen by only 19% compared with an average rise of 86% in Great Britain. In March 1993 female unemployment was a mere 2.5% higher than it had been in the same month three years previously. In Great Britain the comparative figure is 64%.

The overall view, as we recommended in the previous survey, would incorporate both survey and output indicators. Such an analysis would suggest that the Scottish economy experienced a steep decline in 1992 and that the beginnings of a shallow export led recovery were under way in 1993Q1. It seems unlikely that there was a growth explosion in 1993Q1 as implied by the index of production.

The UK economy

The evidence, for the first time, points clearly to an economy slowly emerging from recession. Non-oil Gross Domestic Product is provisionally estimated to have risen by 0.8% in 1993Q1, the largest quarterly rise since 1990Q4. Total GDP growth has been positive since 1992Q3, but for the first time since the recession began, both non-oil and total GDP registered positive growth. To add to this, the Nationwide and Halifax Building Societies are both reporting rising house prices around the country, good news for all those hit by negative equity. Given this new found optimism, how strong is the recovery?

A more detailed look at the current situation confirms the widely held view that the recovery is still very tentative, with consumer expenditure again

showing signs of weakness. After a strong performance in the first two months of the year, Manufacturing output growth fell back a little leaving growth for the year at 2%. The star performers within sectors 2-4 were those producing investment goods.

A indication of the reluctance to spend can be seen in the latest money supply figures. In April M0 grew by only 3.3% compared with 4.8% in March and 4.9% in February. All indications are that the consumer's taste for not only credit, but spending in general, is still restricted by the seemingly omnipresent spectre of redundancy and negative equity. The subsequent decline in retail and automobile sales in recent weeks, after a blustery start to the year, is evidence of this phenomenon.

The onset of another huge rise in the equilibrium rate of unemployment during the latest recession has resulted in 1993 being named 'Full Employment Year' by the Employment Policy Institute. Unemployment fell in the February-April period by 52,700 and now stands at 10.5% of the workforce. Over the period March 1990 - March 1993 unemployment has risen most in the South East (223%), East Anglia and the South West (141%) and London(139%). Hardly, "*A price worth paying!*"

On the whole, however, the present economic climate is an improvement on six months ago, when post-ERM Britain seemed on the verge of a slump as a plummeting pound and imported inflation threatened to push up interest rates and postpone recovery once again. Non-EC export trade expanded in April and inflated import costs as yet have not fed through into factory gate prices. Retail Price Inflation (all items) currently stands at its lowest level for thirty years. Moreover, an indication of confidence in the sustainability of low inflation in Britain, now that the infamous 7% earnings growth barrier has been breached, can be seen in the yields on long bonds. With such a large depreciation one would have expected the price of long dated bonds to have fallen as investors marked up their medium term inflation forecasts.

Prospects for the Scottish economy

Given that it is only two months since the last Commentary, where we dealt with the budget proposals, the only extraneous factor which has changed is the slowdown in the US economy in the three months to March.

The latest surveys of business expectations from the Scottish Chambers Business Survey and the CBI reveal a general improvement in confidence in all sectors of the Scottish economy. In the manufacturing sector businesses are expecting the improved performance of the United Kingdom economy to generate an increase in both new orders and sales. In contrast, previous studies of the Scottish manufacturing industry found that businesses were looking to overseas markets for trade. In the past six months this has started to change and the export market is in danger of drying up in the wake of Bundesbank intransigence and a temporary relapse in US growth. Most of all, a sustained expansion of the inflation prone UK economy requires an export led growth, rather than one born of consumer tentacles. The difficulty in relying on consumer demand is that this increases the probability of future higher interest rates to counter a trade deficit and a depreciating currency.

The SCBS survey also provides a rather depressing employment forecast in contrast to the fall in claimant unemployment in the three months to April. Traditionally, in the recovery phase, businesses which have just survived the recession lay off workers in an attempt to keep costs and factory gates prices under control. The current SCBS reveals that, while the downward trend in unemployment was expected to recede, there was little hope for renewed job creation, other than part-time and temporary employment in the service sector and a slight upturn in male employment in the construction industry.

Of course, the Scottish economy will benefit from renewed activity in the UK and World economies. At present the huge rise in unemployment and the negative equity problem faced by a multitude of home owners has served to hold back any rejuvenation in consumer confidence. The recent falls in unemployment and the upward movement in house prices - not yet evident in Scotland - should eliminate some of the fears. The post-ERM policy of low, but not too low, interest rates coupled with measures to deal with a projected £50bn budget deficit, will certainly help to boost export performance. These measures will keep inflation in check and protect a once-and-for-all boost to competitiveness. Tackling the budget deficit by means of higher taxes would certainly help to reduce import volumes and the likelihood of another boom and bust episode.

The more optimistic climate this quarter has led us to revise up our forecast for the Scottish Production

sector. The data-based forecast in the 'Industrial Performance' sector projects growth of 2.1% in the current year over 1992, up by 1% point on the previous forecast.

June 4th 1993