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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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OUTLOOK AND APPRAISAL

The growth of GDP rose to 0.6% in the third quarter. As the UK recovery continues the Scottish economy is turning in a relatively poor performance. In the medium-term Scottish quality textiles manufacturers and the Whisky industry should benefit from the impending GATT trade agreement.

The latest figures for the Scottish economy suggest that our earlier optimism was misplaced. The production industry was expected to grow by between 2.7% and 2.9% in our previous forecast in September. Unfortunately, since the re-basing to 1990 prices and retrospective revisions, the index recorded a total fall of over 3% in the first two quarters of the year. The impressive growth that we outlined in previous quarters peaked in the final quarter last year and has fallen throughout this year. In the United Kingdom, output bottomed out in the second quarter and has been growing quite steadily ever since - just over 1% in the three months to October.

While we are seeing a reasonably wide-based recovery in the UK sectors of production, in Scotland the picture is much more confined to the electronics industry. But even this area of Scottish manufacturing slipped back in the second quarter, and contracted by 2.1%.

The new revised Standard Industrial Classifications now mean that the production industry includes refined petroleum products and the nuclear fuel industries and in the three months to June they grew by 25%. Were it not for this the overall growth record in Scotland would have been much worse. The other growth exceptions in Scotland were the Chemicals and the Paper, printing & publishing industries which grew by 7% and 2% respectively.

The growth of the Production industry in the last four quarters, compared with the previous four, was 0.8% in Scotland and 1.4% in the United Kingdom. The manufacturing industry grew by 1.1% in Scotland and by 1.2% in the UK over the same period. The fastest growing sector in Scotland was the Electrical and Instrument Engineering industry which grew by 23% over the period, while in the UK the industry expanded by only 7%. The worst performing sectors in Scotland were mechanical engineering and transport equipment which contracted by 12% and 5%.

Other information, of more up to date flavour, from the Scottish Chambers Business survey suggests that the economy-wide revival of business optimism slowed in the third quarter after a couple of false dawns in the EU economy. But the general level of Scottish demand - including exports - in the manufacturing and construction industries grew in the third quarter, even though the growth in domestic and central government orders was much weaker than in the early part of the year.

The current story that the recovery in the United Kingdom is becoming more consumer based appears to relate to Scotland as well. The last SCBS survey shows an accelerating level of sales in the distribution industry. Furthermore, the SCBS data produces evidence that Scottish businesses are once again beginning to borrow to finance investment in plant and equipment.

The Scottish labour market, like its UK counterpart has continued to confound those who deny that the structure of the labour market has changed. In the three months to October, total claimant unemployment fell from 246,700 to 239,000 or 9.4% of the workforce. However, since the number of employees in employment began to grow in the second quarter of the year the majority of jobs that have been created have been part-time and in the service sector. There is little evidence, as yet, of any sustained rejuvenation of full-time job creation.

In general it seems that, contrary to previous evidence, Scotland is following - rather than accompanying - the southern regions out of recession. Conditions there continue to improve as the number of vacancies continue to increase. But in Scotland, even though the U/V ratio is one of the

lowest in the UK, survey evidence is still showing job uncertainty rather than any firm improvement in labour market conditions. It appears that *Last in, last out* is still with us.

The United Kingdom

The six quarter long recovery has yet to gather any significant pace and all indications are that real GDP will grow at an annual rate of 1.5% - 1.8% in the current year. While M0, the narrow monetary aggregate and alleged co-incident indicator of demand, is currently growing above its monitoring range, all other indications suggest that the upturn is still very weak.

Unlike the Scottish economy, all sectors of the UK production industry - except maybe the Chemicals industry - seem to be leaving the recession behind. Industrial production grew by 1% in the third quarter of the year and is expected to expand by around 2.8% over the year as a whole.

It does appear, however, that consumption is the main driving force behind the recovery, rather than increased investment or net exports (The new trade data simply does not have a proven track record with which we can accurately gauge recent export performance). Consumers' expenditure increased by 0.9% in the third after rising by 0.5% in the second quarter and retail sales grew by 0.9% in the three months to October to 3.5% above their level at the same period in 1992.

However, the latest Banking statistics reveal an increased desire amongst the population for credit. Net lending more than doubled in September to £489bn. Moreover, the demand for credit would hopefully rise if there was evidence of greater job security. And we saw, in October, the largest monthly and seasonally adjusted fall for four and a half years. Employment also rose in the three months to June - by 42,000 (0.2%) - for the first time since June 1990.

There is room to maintain at least a reasonable level of optimism about a recovery which is unfortunately beginning to resemble the experience of the another G7 country, the USA.

Prospects for the Scottish economy

The situation in Europe has certainly not helped the performance of the main Scottish export industries, namely electronics, chemicals & whisky. Euro-watchers are expecting an upturn on the continent now that most economists claim to have seen the bottom of the German industrial recession. Given the state of the French economy, the resilience of the monetary authority's attempts to shadow the Deutschmark is admirable and will certainly help to maintain confidence in the French economy once its current tribulations come to an end.

In addition, the conclusion of the 115 nation GATT trade talks seems in sight, with the French still holding out for compensation from the Germans if its farmers suffer, and it is widely believed that Scotland's knitwear and whisky industries should be well placed to benefit from the lowering of tariffs[1]. With sustained efforts to boost competitiveness and increased expenditure on R&D investment, Scottish manufacturing could benefit substantially from the seven year old Uruguay Round, although the implications for our farmers are much less clear cut.

In terms of the British mainland, and thinking especially of the tenuous consumer led recovery, the effect of the recent budget on expectations is critical to forecasts. The general consensus view is that the Chancellor's proposals contained more tax increases than had immediately been thought and will probably lead to a downward revision of spending plans in the new year. The measures introduced in the budget are designed to reduce the PSBR from 8% of GDP in 1993-1994 to 2.75% in 1996-1997[2].

Our short-term forecast model is predicting growth of between 0.7% and 1.0% for the production industries in Scotland in 1993. This should then rise to 1.6% in 1994. In comparison, the NIESR is predicting growth of 2.7% in the UK industry in 1993.

This hefty downward revision to our forecast is the result of two revisions to the raw data. Growth for last year was revised up to -1.5% and then the 1.9% expansion of activity in the first quarter was revised down to an actual contraction of 1.1%. The net result of both these revisions is that growth expectations for the current year have fallen by some 2%. Were Scotland to grow by nearly 2.5% in the third and fourth quarters then its growth rate would be comparable to that of the UK. Unfortunately we do not expect this to happen since our survey evidence shows a downward movement in estimates of capacity utilisation in the third quarter.

In the medium-term the prospects for UK - and Scotland - are not good given the rise in personal

taxation in the budget and fear that the drop in wage inflation has come to an end. We are expecting to see two further years of +2% growth and then a tightening of policy as inflation begins to rise again. But increased trade from the likely GATT agreement would go a long way to mitigate the negative effects of the recent budget which took measures to combat a deficit whose long-term effects on activity are in dispute and one which the monetary authorities are currently having no problem in funding.

Another cut in interest rates, to lower real short-term interest rates, is desperately needed to stimulate investment now that the Chancellor has done little to stimulate investment and improve the skills of the workforce.

1. Econometric simulations are suggesting that the agreement could boost world trade by $200bn by the end of the century.

2. In 1994-1995 the fiscal stance can be expected to tighten by a further 5.5bn than had been announced in the previous Chancellor's last budget.

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