

This is the Bank of Scotland Index of Leading Indicators report. Compiled by Markit for the Bank of Scotland, the quarterly leading indicator is designed to provide an indication of turning points in the economic cycle up to three quarters in advance of official data.

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SLOWING OF ECONOMIC RECOVERY SEEN IN LATE 2010 AND EARLY 2011

Scotland's economic recovery is set to peak in Q3, according to the latest data from the Bank of Scotland Index of Leading Indicators. The indicator subsequently points to a slowing of economic growth in Q4, continuing into the start of 2011.

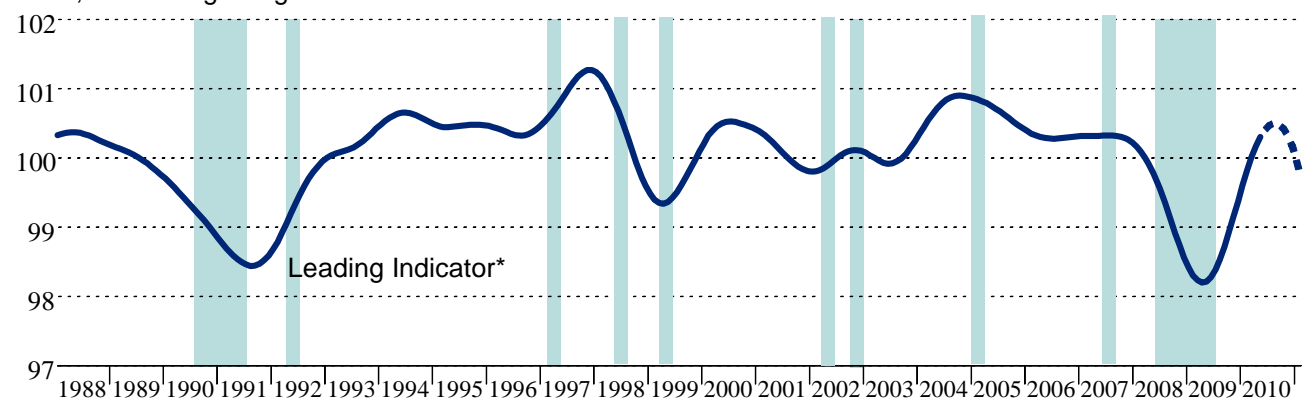
A key factor subduing growth prospects is weak consumer confidence, as highlighted by both survey-based indicators and shoppers' reluctance to purchase big ticket items. In fact, new car registrations fell at the fastest pace since early 2009 in October.

In contrast to the trends seen in the consumer sector, latest data from the CBI indicate that business confidence is growing North of the border. This, however, has not fed through to firms' employment intentions, as demand for permanent workers remains subdued. Pressure on Scottish manufacturers' current output levels also remains to the downside, as inventories of finished products have accumulated faster than orders have been received in recent months.

Despite weak consumer confidence and lacklustre demand for staff, a number of factors are likely to support growth in the Scottish economy. Interbank lending rates remain historically low (hovering around 0.75%), while latest official data pointed to a year-on-year rise in new housing starts for the first time since 2005.

Bank of Scotland - Index of Leading Economic Indicators

Index, 100 = long-run growth



* Shaded areas indicate periods of negative quarter-on-quarter GDP growth.

Sources: Markit; Bank of Scotland; Scottish Government

Donald MacRae, chief economist at Bank of Scotland, commented:

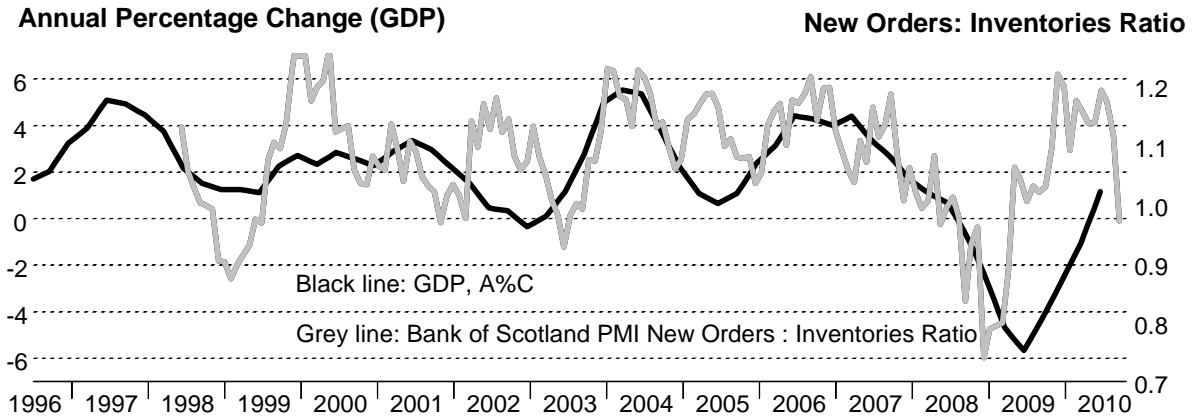
"The recovery of the Scottish economy looks set to peak this autumn with the slowdown extending into the first quarter of next year. Low levels of consumer confidence are driving moderate increases in retail sales whilst employers' appetite for creating permanent jobs remains muted. Manufacturing and construction are leading the subdued recovery. Low growth rather than no growth seems the most likely prospect for the Scottish economy in early 2011."

Q4 2010 – Leading Indicator Components Summary

- Scottish **consumer confidence** fell to its joint-lowest level since May 2009 in October (matching previous lows in June 2010 and July 2009). The Gfk NOP Consumer Confidence Index posted a net balance of -25 in October, down on -22 recorded in September and -23 in August.
- In contrast, the latest survey of Scottish industrial firms from the Confederation of British Industry (CBI) indicated that **business confidence** in Scotland rose to a six-year high in Q4 2010. The CBI's index monitoring Scottish manufacturers' sentiment rose considerably from a net balance of 0 in Q3, to +22 in Q4.
- Data from the Bank of Scotland PMI survey indicates that Scottish private sector companies saw a reduction in the volume of **new orders** received at their business units in October. New work contracted for the first time in Scotland since the start of the year and at the fastest pace since May 2009.
- As a result of the weaker new order flow, the **ratio of new orders to inventories** at manufacturing plants, as recorded in the Bank of Scotland PMI report, slipped below parity in September to indicate that stocks were falling at a slower pace than orders. The ratio rose in October, but remained below one, pointing to ongoing downward pressure on output requirements. See focus on page 3.
- **New car sales** fell 20.9% in October, compared with the same period in 2009. This marked the sharpest year-on-year drop since March 2009. The Scottish Motor Trade Association, which produces the figures, suggested that weak sales not only reflected the finalisation of the government's car scrapping incentives, but also a weakening in consumer confidence. New car registrations have fallen in each of the past five months, with the rate of decline generally quickening through this period.
- Scottish firms' employment plans have been broadly-flat over the past three months, following eight months of rising demand. The Bank of Scotland Report on Jobs' seasonally adjusted **Permanent Vacancies Index** signalled weaker demand for workers in August and September, but posted fractionally above the 50.0 no-change mark in October.
- According to the latest data from the Bank of England, **UK short-term interest rates** have remained broadly unchanged at 0.75% in each of the past four months. Although this is up on the rates seen earlier in the year, short-term interbank lending rates remain historically low.
- Latest data from the Scottish Government signalled a 2.6% year-on-year rise in **new housing starts** in Q2 2010. This marked the first annual rise since Q4 2005.

Leading Indicator Component		Latest	One year ago
CBI Scotland - Business Optimism	% balance of optimists less pessimists	22	1
Scotland Consumer Confidence	% balance of optimists less pessimists	-25	-12
Scotland Index of Production	Annual % Change	3.2%	-10.4%
Scotland New Housing Starts	Annual % Change	2.6%	-10.8%
Scotland Composite PMI - New Orders	Index, 50.0 = no-change	47.8	51.8
UK Short-term Interest Rates	%	0.75	0.56
SMTA Scottish New Car Registrations	Annual % Change	-20.9%	45.3%
Scotland Demand for Permanent Staff	Index, 50.0 = no-change	50.7	48.5
Scotland Manufacturing PMI - New Orders:Inventory	Ratio	0.99	1.09
UK Yield Curve	% spread (long-term – short-term interest rates)	3.14	3.49

Focus on... New Orders: Inventories Ratio



Source: Scottish Government; Markit/Bank of Scotland

The ratio of new orders to inventories tends to be a leading indicator of turning points in the economic cycle. The ratio acts primarily a gauge of production requirements in the manufacturing sector. If new orders are rising at a faster pace than stocks of finished goods, it suggests that manufacturers in the short-to-medium term will need to raise production levels to satisfy higher demand and restock warehouses. This also points to longer-term implications for spending on capital and employment.

The ratio, derived from the new orders and stocks of finished goods components of the Bank of Scotland PMI report, has shown to be a strong indicator of turning points in the cycle over time. This has been particularly evident in the current downturn, where the peak and trough of the cycle were signaled well in advance of official data.

Looking ahead, the ratio is signaling a turning point, suggesting that pressure to raise output and capacity at Scottish manufacturers is starting to wane.

Notes to editors

The Scottish Index of Leading Economic Indicators is derived from data that is available to 10th November 2010. The report is available online at: <http://www.lloydsbankinggroup.com/media.asp>

Sources:

New Housing Starts/ Industrial Production	Scottish Government
New Car Registrations	Scottish Motor Trade Association
Consumer Confidence	GfK NOP on behalf of the European Commission
Yield Curve	Bank of England; Office for National Statistics
Business Optimism	Confederation of British Industry
Short-term Interest Rates	Bank of England
Demand for Permanent Staff	Bank of Scotland Report on Jobs
New Orders / New Orders:Inventory Ratio	Bank of Scotland PMI

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Bank of Scotland

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