

This is the Bank of Scotland PMI report. Compiled by Markit for Bank of Scotland, the report is based on data compiled from monthly replies to questionnaires sent to purchasing executives in around 600 private manufacturing and service sector companies. The panel has been carefully selected to accurately replicate the true structure of the Scottish economy.

NOT FOR BROADCAST OR PUBLICATION BEFORE 00:01, MONDAY 9 AUGUST 2010

## BANK OF SCOTLAND PMI: SCOTTISH RECOVERY CONTINUES, HOWEVER UNDERLYING TRENDS WEAKENED

- Activity in manufacturing and service sectors rose in July
- New order growth increased but at slowest pace in three months
- Staffing levels at private firms flat after previous five months of growth

The slow and steady recovery in the Scottish private sector economy was maintained in July, according to the latest Bank of Scotland PMI report. This was highlighted by the headline Bank of Scotland PMI – a seasonally adjusted index monitoring activity across Scotland's manufacturing and service sectors – posting 53.0, up from 52.9 in the previous survey period. Elsewhere, the survey pointed to sluggish growth momentum, with employment being maintained in July, and new orders increasing at the weakest pace in three months.

The headline figure continues to mask a marked divergence in the performances of the manufacturing and services sectors, with the former recording by far the more robust recovery.

Activity levels across the Scottish economy increased for the thirteenth straight month in July, with the pace of expansion broadly unchanged in the past three months. The disparity between the performance of Scottish firms and those across the UK as a whole narrowed. Growth in output was frequently linked to higher new order levels.

The volume of new business received by private sector companies rose for the sixth month in a row during July, albeit at a weaker pace. Steep growth in new orders received by manufacturers was partially offset by a decline in the service sector.

Following five months of job creation, Scottish firms reported that staffing levels were unchanged during July. This contrasted with a fractional rise in employee numbers across the UK as a whole. Where increased employment was recorded, greater capacity requirements were commented on. The level of outstanding business held at private enterprises fell at an accelerated pace during July. This extended the period of depletion to just under three years.

Sharp increases in raw material costs (compounded by supply-chain pressures) and higher wage and transportation costs all contributed to another month of input price inflation in July. Although slower than June, the rate of cost inflation was above the long-run average seen in Scotland. Despite this, survey respondents lowered their average tariffs fractionally during July, as strong competition placed downward pressures on output prices.

**Donald MacRae, Chief Economist at Bank of Scotland, said:** "This month's data shows a thirteenth consecutive rise in business activity across Scotland, with recovery remaining manufacturer led and service sector growth moderate in comparison. New orders rose for the sixth month in a row, however only mildly, indicating a moderate pace of recovery. There has been a welcome increase in growth in the key services sector and in particular in business and financial services. Activity in travel and tourism continues to grow, although with a slight fall in the rate. Overall, there is positive news in most areas, signaling Scotland's economy is in recovery, albeit somewhat subdued."

## **Component Summary**

### **Business Activity:**

Latest data highlighted a thirteenth successive monthly rise in activity across Scotland's private sector economy, with the pace of expansion accelerating fractionally since June. Although growth was again weaker than seen at the UK-wide level, the disparity in performance narrowed. July data indicated that the recovery remained manufacturing led, with service sector growth modest in comparison. Anecdotal evidence from survey respondents linked the latest rise in output to growth in incoming new business levels.

### **New Business:**

Extending the current sequence to six months, Scottish private sector companies registered a rise in the flow of new orders received at their business units in July. However, the pace of increase signalled by the seasonally adjusted New Orders Index was only mild, and the weakest since April. Mirroring the trend registered for activity, the rise in new business levels was manufacturing-led. Scottish service providers recorded a mild decline in new contracts during July. Those panellists which reported higher new orderbooks linked the rise to improving demand.

### **Employment:**

The number of workers employed in the Scottish economy was unchanged in July, according to the latest survey data. This contrasted with a fractional rise in headcounts seen across the UK as a whole. Growth in manufacturing workforces was offset by a slight drop in service sector employment. Those respondents which raised staffing levels reported that greater capacity requirements had led to fresh hiring activity, while those which reduced staffing levels commented on ongoing cost reduction policies.

### **Backlogs:**

Scottish firms reported a further overall reduction in their levels of work-in-hand (but not yet completed) in July, thereby extending the current period of backlog depletion to just short of three years. A disparity between manufacturing and service sector performances was again apparent, with a fractional drop in manufacturing backlogs contrasting with a marked depletion in the tertiary sector. In the services economy, muted flows of new orders was suggested by panellists as the key reason for backlog reduction. Manufacturers indicated that they had raised production (and therefore reduced backlogs) to offset supply-chain disruption.

### **Input prices:**

The seasonally adjusted Input Prices Index signalled a further rise in the average prices paid by Scottish private sector firms for inputs. Although the index signposted a slowing in the pace of cost inflation, it remained above the long-run series average. Cost inflation in Scotland remained sharper than that seen for the UK as a whole for the twenty-seventh consecutive month. According to survey participants, the key sources of purchase price inflation were sharp increases in raw material costs (compounded by supply-chain shortages) and higher wage and transportation costs.

### **Output prices:**

Following five months of charge inflation, Scottish firms decreased their average tariffs during July. Anecdotal evidence indicated that, where charges were lowered, intense competitive pressures had been the driver. That said, the seasonally adjusted Output Prices Index posted a reading only fractionally below the 50.0 no-change mark that separates rising from falling tariffs. Reflecting the generally stronger performance in the goods producing sector, manufacturers were able to raise tariffs during July, while service providers embarked on further discounting.

**The Bank of Scotland PMI** is compiled by Markit for Bank of Scotland and is based on data compiled from monthly replies to questionnaires sent to purchasing executives in around 600 private manufacturing and service sector companies. The panel has been carefully selected to accurately replicate the true structure of the Scottish economy.

Survey responses reflect the change, if any, in the current month compared to the previous month based on data collected mid-month. For each of the indicators the 'Report' shows the percentage reporting each response, the net difference between the number of higher/better responses and lower/worse responses, and the 'diffusion' index. This index is the sum of the positive responses plus a half of those responding 'the same'.

Diffusion indexes have the properties of leading indicators and are convenient summary measures showing the prevailing direction of change. An index reading above 50 indicates an overall increase in that variable, below 50 an overall decrease.

The Purchasing Managers' Index (PMI) survey methodology has developed an outstanding reputation for providing the most up-to-date possible indication of what is really happening in the private sector economy by tracking variables such as sales, employment, inventories and prices. The indices are widely used by businesses, governments and economic analysts in financial institutions to help better understand business conditions and guide corporate and investment strategy. In particular, central banks in many countries use the data to help make interest rate decisions. PMI surveys are the first indicators of economic conditions published each month and are therefore available well ahead of comparable data produced by government bodies.

Markit do not revise underlying survey data after first publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series. Historical data relating to the underlying (unadjusted) numbers, first published seasonally adjusted series and subsequently revised data are available to subscribers from Markit. Please contact [economics@markit.com](mailto:economics@markit.com).

#### **About Bank of Scotland**

Bank of Scotland is part of Lloyds Banking Group, the UK's largest retail bank and Scotland's largest financial services employer. Established in 1695, Bank of Scotland is the UK's oldest surviving clearing bank. Our goal is to be the best financial services provider in Scotland. We believe this means we must build a leadership position not on the basis of scale but on the foundations of reputation and recommendation.

#### **About Markit**

Markit is a leading global financial information services company with over 1,900 employees. The company provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency. Its client base includes the most significant institutional participants in the financial market place. For more information, see [www.markit.com](http://www.markit.com).

#### **About PMIs**

Now available for 26 countries and key regions including the Eurozone and BRIC, Purchasing Managers' Indexes™ (PMIs™) have become the most closely-watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends. To learn more go to [www.markit.com/economics](http://www.markit.com/economics).

#### **For further information, contact:**

Zoe Redhead, Bank of Scotland Press Office  
Tel: 0131 243 7005 / 07809 551491  
Web: [www.lloydsbankinggroup.com/media.asp](http://www.lloydsbankinggroup.com/media.asp)

#### **For technical enquiries, contact**

Andrew Self, Markit economist  
Tel: 01491 461 006  
Email: [andrew.self@markit.com](mailto:andrew.self@markit.com)

The intellectual property rights to the Bank of Scotland PMI provided herein is owned by Markit Group Limited. Any unauthorised use, including but not limited to copying, distributing, transmitting or otherwise of any data appearing is not permitted without Markit's prior consent. Markit shall not have any liability, duty or obligation for or relating to the content or information ("data") contained herein, any errors, inaccuracies, omissions or delays in the data, or for any actions taken in reliance thereon. In no event shall Markit be liable for any special, incidental, or consequential damages, arising out of the use of the data. Markit, PMI and Purchasing Managers' Index are all trademarks owned by The Markit Group.