

Compiled by Markit for Bank of Scotland, this 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 is carefully selected to accurately replicate the true structure of the Scottish economy.

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## BANK OF SCOTLAND PMI: RECOVERY IN SCOTLAND REMAINED TENTATIVE IN AUGUST, BUT OUTPACED UK TREND

- Activity rose in both manufacturing and services
- Scottish firms increased headcounts in line with higher output
- Input costs continued to rise at stronger pace than charges

Activity across Scotland's private sector economy rose at a stronger pace than that recorded for the UK as a whole for the first time in the current recovery period, according to the **Bank of Scotland PMI** report for August. However the report's headline index is unchanged from July at 53.0, signposting only a moderate rise in output.

Underlying data continued to highlight marked divergences between the performances of the manufacturing and services sectors, with by far the more robust recovery seen in the goods-producing sector. Meanwhile, new order growth was only marginal and remained below that seen at the UK-wide level.

Activity levels across the Scottish economy have now risen in each of the past fourteen months, with the rate of expansion broadly unchanged since May. In August, both manufacturers and service providers recorded higher output, but the underlying trends varied. The former posted slightly faster growth, while the latter posted a modest easing. Panellists widely linked expansion to growth in new business levels.

In turn, rising demand for lower-priced goods and services led to a mild overall increase in new orders during August. Panellists have reported rising new business levels in each of the past seven months.

Scottish private sector companies reported a further depletion of backlogs of work during August. This extended the current period of decline to three years.

Inflation of raw materials, fuel and wage costs all contributed higher input prices in August. Consequently, Scottish firms reported a considerable monthly rise in average costs during the latest survey period. In response to higher costs, Scottish firms raised their average charges during August.

Although higher tariffs were recorded across both manufacturing and services, the overall pace of charge inflation was muted and weaker than that recorded for the UK as a whole. Service providers' tariffs were little-changed from July.

**Donald MacRae, Chief Economist at Bank of Scotland, said:** "Scotland's recovery from recession was maintained in August with activity rising in both manufacturing and services. The recovery is more robust in manufacturing. However, new orders growth in both sectors remains weak and rising costs continue to exert pressure on Scottish business. Travel, tourism and leisure showed the strongest performance in the service sector. "

## **Component Summary**

### **Business Activity:**

The Scottish private sector economy recorded a modest rise in business activity during August. The rate of growth was at the same pace as that recorded in the previous survey period. For the first time in the current recovery, however, the pace of expansion signalled in Scotland was stronger than registered for the UK as a whole. Higher output was again firmly centred on the goods-producing sector. Survey respondents widely reported that growth in incoming new business levels had been the key factor underpinning expansion.

### **New Business:**

The level of new orders received by firms operating in the Scottish private sector economy rose for the seventh month in succession during August. Although the pace of increase slowed since July to the weakest in four months, overall growth was broad-based across both manufacturing and service sectors for the first time in three months. Reflecting the trend recorded for activity, however, the rise was again focused on the goods-producing sector, with anaemic growth registered at service providers. New business growth was linked by panellists to strong demand for lower-priced goods and services.

### **Employment:**

In contrast to the trend recorded for the UK as a whole (where a mild drop in staff numbers was recorded), Scottish private sector firms registered a mild increase in payroll numbers during the latest survey period. Panellists have now recorded employment growth in eight of the past eleven months. Matching the trends seen across the Scottish private sector, growth in employment was firmly centred on the goods-producing sector. Panel members which reported increasing employee numbers mainly linked gains to higher activity levels.

### **Backlogs:**

After adjusting for seasonal variance, the Business Outstanding Index pointed to a marked depletion of Scottish firms' holdings of work-in-hand (but not yet completed) in August. Moreover the pace of decline signalled by the index was the strongest since April, and greater than recorded at the UK-wide level. Survey respondents have reported falling backlogs of work in each month since September 2007, although the latest decline was markedly weaker than the average seen throughout this period. A number of panellists commented on productivity and efficiency gains.

### **Input prices:**

Strong inflation of raw materials, rising wage and fuel costs and the knock-on impact of higher commodity prices all contributed to higher average input costs in August, according to Scottish private sector firms. The pace of cost inflation signalled by the seasonally adjusted Input Prices Index accelerated since July, but remained below April's recent high. At the UK-wide level, latest data highlighted a mild acceleration of cost inflation, although costs continued to rise at a weaker pace than that recorded in Scotland.

### **Output prices:**

Companies operating in Scotland's private sector economy raised charges for the sixth time in the past seven months during August. Nevertheless, the rate of charge inflation signalled by the seasonally adjusted Output Prices Index was only modest and weaker than that recorded for the UK as a whole. Although both secondary and tertiary sector companies posted higher output prices during August, the stronger rise – by a wide margin – was seen in the manufacturing sector. Higher charges were frequently linked by panellists to strong input cost inflation.

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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).

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