PRESS RELEASE BANK OF SCOTLAND

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: OUTPUT GROWTH MODERATES AS NEW BUSINESS FALLS FOR FIRST TIME IN 2011

- **Activity increases for ninth consecutive month, but at slowest pace of year**
- **Mild job shedding persists**
- **Modest tariff increases contrast with sharp cost pressures**

September saw a further moderation of Scottish private sector output growth, as new business inflows fell for the first time in nine months. Further jobs were lost as a result, although the pace of staff cutting remained only slight. Stalling demand also meant that, despite sharp cost pressures, tariffs rose only modestly on average during the latest survey period.

Highlighting a further dip in the pace of growth of total activity in September, the seasonally adjusted Bank of Scotland *PMI* fell from 52.7 in August to 51.9 – its lowest posting in the current nine-month sequence of expansion. The latest slowdown primarily reflected weaker growth of goods production compared with August. That said, manufacturing output continued to expand solidly, and at a slightly faster pace than service sector activity.

Anecdotal evidence attributed the overall slowdown to a first (albeit moderate) fall in new business since December. The decrease in new work was underpinned by lower demand at services providers, while firms operating in the manufacturing sector registered broadly no change in new orders.

Employment across Scotland's private sector fell for the second month in a row in September. Staff cuts were confined to the service sector, where jobs were lost at a rate broadly unchanged since August. Cushioning the drop in total employment was a solid rise in headcounts at manufacturers – the sharpest for four months.

Reflecting a disparity between trends in production and new orders in September, outstanding business fell solidly. The decrease in backlogs was the steepest since April and underpinned by a marked reduction in work-in-hand at service providers. Manufacturers registered only a slight drop in outstanding business during the latest survey period.

With inputs such as energy, food and fuel reported as up in price by both service providers and good producers, cost inflation north of the border remained sharp in September. Moreover, Scotland saw the steepest monthly rise in input prices of all UK regions covered by PMI surveys.

Despite elevated cost pressure, charges on average increased only slightly in September, as tariff cuts in the service sector almost entirely offset a solid hike in average factory gate prices.

Donald MacRae, Chief Economist at Bank of Scotland, said: "Private sector activity in the Scottish economy increased for the ninth month running in September. However, the month-on-month growth was the slowest since the start of the year. Both jobs and new orders fell in the month but new export orders saw a modest increase. Manufacturers increased output at a solid rate despite strong cost pressures. This month's PMI suggests the Scottish economy continues to grow but is slowing in common with the rest of Europe."

Component Summary

Business Activity:
Scottish private sector activity increased for the ninth month running in September. The latest month-on-month expansion in output was, however, the slowest in current sequence, and weaker than both the long-run trend (52.5) and the UK-wide average. The overall slowdown was primarily underpinned by a weaker monthly increase in goods production than in the previous survey period. That said, overall growth of manufacturing output remained comparatively sharper than the rise in service sector activity, which was also slightly slower than in August.

New Business:
September saw the first decrease in new business at Scottish private sector firms since last December. Although only modest, the fall contrasted sharply with a solid rise in new work received across the UK as a whole. The overall weakness in Scotland was underpinned by the first reduction in new business at Scottish service providers since June. Manufacturers, meanwhile, registered broadly no change in the level of new orders received compared with August, ending an eight-month sequence of growth in the sector.

Backlogs:
Business outstanding fell solidly during September, after increasing in the previous survey period for the first time in four years. The latest rate of reduction in Scottish private sector backlogs was in line with both the long-run series average and the decrease recorded across the UK private sector as a whole. Service providers registered a sharper month-on-month drop in work-in-hand than their goods-producing counterparts, and commonly attributed declines to a fall in incoming new business. Indeed, backlogs of work at manufacturers dipped only slightly in September.

Input prices:
Cost inflation across Scotland eased slightly in September and was the weakest for nine months. That said, with inputs such as food, fuel and energy reported as up in price by both manufacturers and service providers, the overall increase in average purchase costs remained sharp and in excess of the UK-wide rate of inflation. By sector, cost pressures were similar to those in August, with manufacturers continuing to face slightly sharper cost increases than service providers. Across the Scottish private sector as a whole, input costs have risen consistently since December 1998.

Output prices:
Scottish private sector companies registered only a modest increase in tariffs in September – the weakest in the current 14-month period of inflation. Underlying the latest dip in output price pressure north of the border was a moderate reduction in service sector charges – the first for nine months. Elsewhere, despite easing in line with the overall trend in output prices, factory gate price inflation remained marked and above its historical trend. UK-wide charge inflation, meanwhile, was the lowest for a year-and-a-half, but comparatively stronger than in Scotland nonetheless.

Employment:
Latest data showed a second straight monthly decline in Scottish private sector employment. Little-changed since August, however, the rate of job shedding remained only modest. In contrast to the overall trend, manufacturing employment rose for the twentieth month in row, and at the sharpest pace since May. Service providers, however, cut payroll numbers for the fourth month running as part of efforts to lower cost and because of declining new business. UK-wide employment levels were, meanwhile, broadly unchanged since August.

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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.

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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.

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Markit is a leading global financial information services company with over 2,200 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 marketplace. For more information, see www.markit.com.

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