

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: JANUARY SEES MODERATE IMPROVEMENT IN BUSINESS CONDITIONS

- Output growth quickens to four-month high on solid rise in new business
- Employment creeps up at modest pace
- Input price inflation weakest since September 2010

The January Bank of Scotland *PMI* report pointed to further increases in output, new business and employment in Scotland's private sector economy. Moreover, the rates of growth were slightly faster than in the previous survey period. A further drop in input price inflation was also encouraging news for businesses, although average costs still rose markedly on the month overall.

At 51.4 in January, up from 51.2 in December, the Bank of Scotland *PMI* – a seasonally adjusted index monitoring activity across Scotland's manufacturing and service industries – showed a moderate and slightly quicker increase in output at Scottish firms. Growth was underpinned by a rise in service sector activity, as goods production fell marginally on the month.

Incoming new business increased solidly for the second month in succession, and at a slightly faster rate as manufacturers received more new work for the first time in five months. Scottish service providers nevertheless registered the stronger increase in business wins, with latest anecdotal evidence suggesting that they had benefited from favourable weather conditions.

In line with the trends in both output and new business in January, employment within Scotland's private sector increased at a slightly quicker pace. The rate of job creation remained only modest, however, with a faster rise in headcounts in the service sector negated by weaker recruitment at manufacturing companies. Employment across the UK as a whole increased at a stronger rate compared with Scotland.

Outstanding business fell only slightly in January, as a build up of backlogs in the service sector – the first for five months – partly offset a marked decrease in work-in-hand at manufacturers.

January data showed input price inflation easing to the weakest since September 2010. That said, cost pressures remained sharp overall as a number of inputs, including food, fuel and utilities, increased in price on the month. Firms operating in the service sector continued to face the stronger rate of input cost inflation, but nevertheless reduced their charges for the fourth time in five months. A further (albeit weaker) increase in factory gate prices, however, meant that overall output prices increased slightly during January.

Donald MacRae, Chief Economist at Bank of Scotland, said: "The January *PMI* edged upwards suggesting the private sector of the Scottish economy continues to show modest growth. The first increase in new orders at manufacturers for five months was particularly encouraging. New export orders weakened but at the lowest rate for four months while the service sector grew for the thirteenth month in a row. The Scottish economy is struggling to maintain growth momentum in the face of a global slowdown but is, so far, avoiding a return to recession."

Component Summary

Business Activity:

Activity in Scotland's private sector economy increased for the thirteenth month running in January. The overall pace of expansion picked up to the fastest for four months, but remained below the long-run series average (52.5) and was only modest overall. A rise in service sector output was again behind the overall increase in activity north of the border, as goods production contracted marginally on the month. Business activity across the UK as whole meanwhile increased at a marked pace – the sharpest since March 2011.

New Business:

January saw incoming new business in Scotland increase at a solid rate. Reflecting the first (albeit modest) increase in new orders placed at Scottish manufacturers for five months, the overall rate of growth crept up since the previous survey period and was the sharpest since last April. Service providers saw the stronger month-on-month increase in new business, as new work received in the sector grew at a robust pace. Across the UK as a whole in January, incoming new business rose at a marked and accelerated rate.

Backlogs:

Scottish private sector companies continued to reduce their outstanding business during January, extending the current period of backlog clearing to five months. That said, with goods producers cutting work-in-hand at a slower rate, and their service-providing counterparts seeing the first accumulation of outstanding business since last August, the overall reduction was the weakest in the current sequence. UK-wide data for January meanwhile pointed to a moderate decrease in levels of work-in-hand – the weakest for eight months.

Input prices:

Input price inflation eased for the second month running, and was the weakest since September 2010. Nevertheless, average costs continued to grow at a sharp pace, and one that was considerably faster than the 27-month low rate of input price inflation faced by firms across the UK as a whole. A number of costs were up on the month in Scotland, with food, fuel, a range of raw materials and utilities highlighted in particular. Service providers reported slower input price inflation in January, but cost pressures in the sector overall still remained stronger than those faced by manufacturers.

Output prices:

In January, the seasonally adjusted Composite Output Prices Index fell from December's five-month high, and signalled only a marginal increase in prices charged by firms operating in the Scottish private sector. Factory gate prices were again raised solidly (albeit at the weakest rate for two years), but this was almost entirely offset by cuts in service providers' charges. Service sector panellists attributed this to increasing levels of competition. Businesses across the UK as a whole meanwhile kept output prices broadly unchanged from the previous survey period.

Employment:

Latest data showed a modest rise in employment in Scotland's private sector during January. The overall rate of job creation was faster than in December, and also slightly stronger than the historical series average. The UK as a whole saw a comparatively sharper increase in staffing levels, however, with jobs growth hitting a ten-month high. Scottish service providers led the overall rise in employment north of the border with a faster increase in headcounts, while recruitment at manufacturers was the weakest since employment in the sector began rising two years ago.

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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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For further information, contact:

Zoe Redhead, Bank of Scotland Press Office
Tel: 0131 655 5405 / 07809 551491
Email: zoeredhead@bankofscotland.co.uk
Web: www.lloydsbankinggroup.com/media.asp

For technical enquiries, contact:

Phil Smith,
Markit
Economist
Tel: 01491 461 009
Email: phil.smith@markit.com

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