

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: SHARPEST INCREASE IN BUSINESS ACTIVITY SINCE APRIL 2011

- Growth of output hits 25-month high
- Faster increases in new work and employment
- Input price inflation weakest since June 2012

Latest *PMI* data from **Bank of Scotland** showed a marked improvement in the health of the private sector economy north of the border. May saw solid and accelerated increases in both output and new work inflows at Scottish businesses, as well as the fastest rise in employment for over a year. Input price inflation meanwhile weakened to an 11-month low, though output prices rose to the greatest extent since last September.

Growth of private sector **business activity** in Scotland accelerated to a robust pace in May, and one that was the fastest since April 2011. This was signalled by the Bank of Scotland PMI posting 54.4, up from 53.1 in April. Both factory production and service sector business activity rose at faster rates, the sharpest in 12 and 13 months respectively. The pace of economic expansion was broadly in line with the average across the UK as a whole.

Behind the overall increase in output north of the border was a further improvement in **new work** inflows. The level of new business has now increased for six months running, and the latest rise was the most marked in over two years. Stronger demand across domestic markets was the main factor underlying growth of new business, as **new export orders** placed with manufacturers fell fractionally on the month.

In line with the improved trends in both output and new business, the pace of job creation at Scottish firms quickened to the fastest in 13 months. Furthermore, Scotland posted a stronger increase in **employment** than any other part of the UK except for the West Midlands.

The amount of **work-in-progress** (but not yet completed) at Scottish businesses decreased slightly during the latest survey period, extending the ongoing spell of depletion to four months.

May data pointed to a further drop in **input price inflation** in the Scottish private sector economy, to the slowest since June 2012. The rate of inflation was below the long-run series average, although still much faster than the modest pace registered at the UK level. According to anecdotal evidence, lower fuel prices was one factor that dampened overall inflationary pressures in Scotland.

**Output prices** meanwhile rose for the fifth straight month in May. The rate of inflation was the fastest since last September, albeit still only mild overall.

**Donald MacRae, Chief Economist at Bank of Scotland, said:** "At 54.4 May's PMI is not only the highest for 25 months but has now been above the no-growth level of 50.0 for eight months in a row. Output grew in manufacturing and activity was strongly up in the large services sector with an encouraging rise in new orders across the economy evident for the sixth month in succession. However, growth appears confined to the domestic market with new export orders falling slightly in the month illustrating the effects of the recession in the Eurozone. These results show the recovery in the Scottish economy is becoming more strongly embedded with every passing month."

## Component Summary

### Output / Business Activity

The level of business activity in the **service sector** rose sharply in May, stretching the current sequence of growth to almost two-and-a-half years. The latest increase was the most marked since April 2012, and often attributed by panellists to higher intakes of new work. There was also mention from respondents of business expansion initiatives, which in some cases included the recruitment of additional staff.

**Manufacturing** output increased for a second straight month in May. Furthermore, the pace of expansion quickened since April to the fastest in 12 months (although it remained only modest in the context of historical survey data). Behind the latest increase in production levels was a rise in new order intakes.

### New Business

May saw a marked and accelerated increase in the level of new business placed with **services firms** – the sharpest since March 2011. A variety of reasons were provided by panel members for the rise in new work, including increased marketing efforts, stronger client confidence and a widening of product ranges.

**Goods producers** registered another slight increase in intakes of new orders in May, which they attributed to improved marketing, new product launches and entry into new markets. New orders have risen at a marginal but steady pace since the start of the year, with the latest increase fractionally slower than that recorded in the preceding survey period.

### Backlogs

Despite facing a rise in incoming new work, **service providers** reported virtually no change in the amount of business outstanding compared with the situation one month previously. This stabilisation in work-in-hand followed a marginal increase during the previous survey period.

With **manufacturers** raising production levels and capacity faster than the increase in new work, May saw a further reduction in the amount of outstanding business in the sector. The rate at which backlogs were depleted was solid, and slightly faster than in the previous month.

### Input prices

Input price inflation in Scotland's **service sector** eased again in May, to the slowest in over three-and-a-half years. While some panellists mentioned paying more for utilities, food and a range of consumables, a number of firms indicated that lower fuel prices had helped subdue inflationary pressures over the month.

Input cost inflation facing **manufacturers** decreased further from March's 14-month high in May, to slowest since the start of the year. The rate of inflation was also below the long-run average. Among the roughly 15% of panellists that did report higher average purchasing costs, there was frequent mention of wood and related products, such as paper and pulp, being up in price.

### Output prices

In contrast with a slower rate of cost inflation, prices charged by **services firms** increased at a broadly stable pace in May. Although only modest overall, the rise in average output prices was the most marked in eight months.

**Manufacturers** continued to pass on part the burden of higher costs to clients in May, raising their factory prices for fifth time in as many months. Although more marked than in the preceding survey period, the latest increase in output prices was nonetheless still only moderate.

### Employment

The size of Scotland's **services** workforce increased during May, in line with the trend observed in each of the past 12 months. Furthermore, the pace of job creation picked up for the third straight month, to the fastest in the current spell of rising employment.

In line with a sharper increase in factory output, the rate of job creation at **manufacturers** accelerated in May. Workforce numbers expanded at the fastest rate since February, and have now risen in each of the past four months.

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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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