PRESS RELEASE

This is the Bank of Scotland Index of Leading Indicators report. Compiled by Markit for the Bank of Scotland, the quarterly leading indicator is designed to provide an indication of turning points in the economic cycle up to three quarters in advance of official data.

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ECONOMIC RECOVERY IN SCOTLAND TO CONTINUE

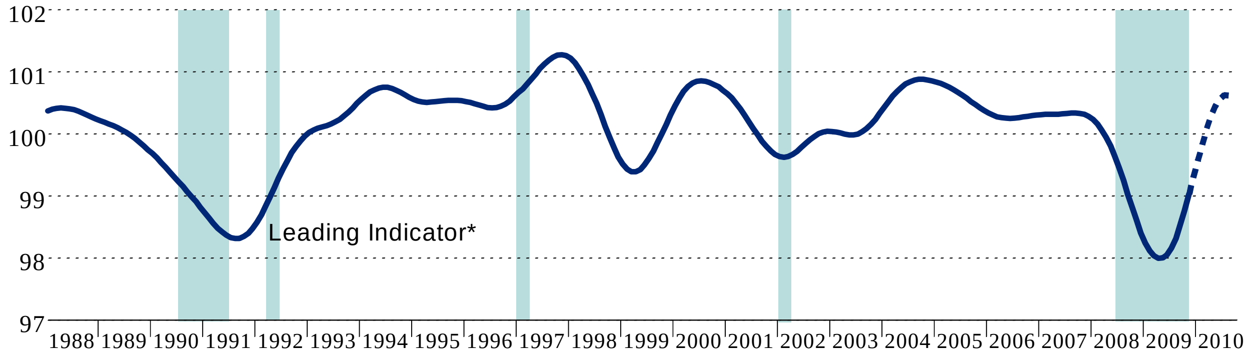
May's update of the Bank of Scotland Index of Leading Indicators continues to point towards economic recovery throughout the period monitored by the indicator (up to August 2010). However, the pace of improvement in growth looks set to moderate into the second half of the year.

Economic growth over the coming months is set to be driven by a number of key factors. Principal support comes from historically low short-tem lending rates, which could provide a boost to business investment over the coming months. There is also growing pressure in the Scottish private sector to raise output, with orders rising throughout the economy and eradicating some of the spare capacity built up in the recession (see focus on page 3).

Despite continued reports of subdued consumer confidence (which remains a drag on the index), improving private sector labour market conditions could support spending, as concerns regarding job security wane, and those laid-off in the recession seek a return to the workplace.

Bank of Scotland - Index of Leading Economic Indicators

Index, 100 = long-run growth



**Shaded areas indicate periods of negative quarter-on-quarter GDP growth.*

***Sources**: Markit; Bank of Scotland; Scottish Government*

Donald MacRae, chief economist at Bank of Scotland, commented:

"The Bank of Scotland Index of Leading Indicators points to economic recovery in the private sector of the Scottish economy up to the end of August this year with a moderation in the rate of improvement in the second half of the year.

"Historically low short-term interest rates and improving business sentiment will support the recovery but low levels of consumer confidence will act as a drag on growth.

"While the public sector should contribute to the recovery in growth in the Scottish economy this year, pressure on future government spending will limit its contribution in the future."

Q2 2010 – Leading Indicator Components Summary

- The Bank of Scotland PMI signalled a third straight rise in the volume of **new orders** received by firms operating in Scotland's private sector economy in April. However, the pace of increase signalled by the Composite Incoming New Business Index was only fractional.

- Scottish firms' **business sentiment** improved during the first quarter of 2010, according to latest data from the Confederation of British Industry. The index monitoring Scottish manufacturers' sentiment regarding the current economic climate posted +20 in Q1 2010, its highest reading since Q3 2004.

- In contrast, Scottish consumers have remained pessimistic through 2010-to-date. Furthermore, the Gfk NOP **Consumer Confidence** Index posted -16 in March and April, well below February's 25-month high reading of -9.

- Despite the deterioration in consumer confidence and the finalisation of the car scrappage scheme in March, latest data highlighted another sharp year-on-year rise in **new car registrations** in Scotland. Data from the Scottish Motor Trade Association, which produces the figures, signalled a 12.3% annual rise in new car sales in April, moderately down from a scrappage scheme inflated15.6% rise in March.

- The latest Bank of Scotland PMI report indicated that the **ratio of new orders to inventories** at manufacturing plants remained above parity in April. Although the ratio posted the lowest reading in three months, any reading above one indicates that new orders are rising at a faster pace than inventories. This suggests that manufacturers will need to raise output to satisfy higher demand, as stocks of finished goods become depleted.

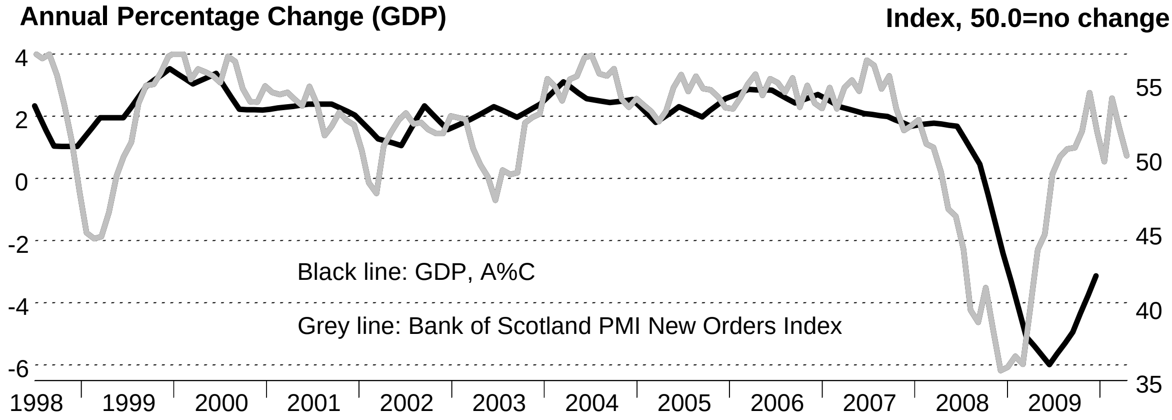
- Latest data from the Bank of England indicated that **UK short-term interest rates** remained unchanged at 0.60 for the fourth month in a row during April. In contrast, long-term rates eased fractionally since March, resulting in a mild reduction in the yield curve.

- **Demand for permanent workers** in Scotland, as reported by recruitment agencies in the Bank of Scotland Report on Jobs, improved for the fifth month in a row during April. Furthermore, the pace of vacancy growth, as signalled by the seasonally adjusted Permanent Vacancies Index, was the sharpest since September 2007.

- Official data from the Scottish Government pointed to a strong contraction of **industrial production** at the end of 2009. Nevertheless, the 6.3% year-on-year decline was the weakest since Q4 2008, and signalled a second consecutive quarterly moderation in the pace of decline.

Leading Indicator Component		Latest	One year ago
CBI Scotland - Business Optimism	% balance of optimists less pessimists	20	-36
Scotland Consumer Confidence	% balance of optimists less pessimists	-16	-24
Scotland Index of Production	Annual % Change	-6.3%	-4.3%
Scotland New Housing Starts	Annual % Change	-7.8%	-7.1%
Scotland Composite PMI - New Orders	Index, 50.0 = no-change	50.2	43.8
UK Short-term Interest Rates	%	0.60	1.48
SMTA Scottish New Car Registrations	Annual % Change	12.3%	-18.5%
Scotland Demand for Permanent Staff	Index, 50.0 = no-change	58.7	32.1
Scotland Manufacturing PMI - New Orders:Inventory	Ratio	1.14	1.06
UK Yield Curve	% spread (long-term – short-term interest rates)	3.94	2.79

Focus on… New Orders



***Source**: Scottish Government; Markit/Bank of Scotland*

New orders placed with companies are a key indicator of future growth of an economy. If new business is rising over a sustained period, businesses are likely to experience fuller order books and an increase in output as they try and satisfy higher demand. Likewise, falling new orders point to lower production over the coming months as spare capacity increases, inventory builds and companies are forced to reduce output.

The chart above highlights how turning points in new order levels can precede similar changes in the business cycle. For example, the negative trend in new business seen during 2001 due to the bursting of the dot-com bubble and 9/11 was accompanied by a similar slowdown in growth over this period which bottomed out in mid-2002.

More recently, the chart clearly illustrates that the marked reduction in GDP seen in 2009 was preceded by a collapse in new business levels in the Scottish economy throughout 2008. Recent data, however, suggest that new order levels have picked up, pointing towards a recovery of GDP in the coming quarters.

Notes to editors

The Scottish Index of Leading Economic Indicators is derived from data that is available to 17th May 2010. The report is available online at: http://www.lloydsbankinggroup.com/media.asp

Sources:

New Housing Starts/ Industrial Production	Scottish Government
New Car Registrations	Scottish Motor Trade Association
Consumer Confidence	GfK NOP on behalf of the European Commission
Yield Curve	Bank of England; Office for National Statistics
Business Optimism	Confederation of British Industry
Short-term Interest Rates	Bank of England
Demand for Permanent Staff	Bank of Scotland Labour Market Report
New Orders / New Orders:Inventory ratio	Bank of Scotland PMI

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Bank of Scotland

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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.

Makit Economics

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