

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: SCOTTISH PRIVATE SECTOR GROWTH MODERATES BUT EMPLOYMENT CONTINUES TO RISE

- Marginal rates of new business growth seen in both manufacturing and services
- Input and output price inflation both eased to five-month lows
- Strongest rise in employment since February 2008

The Scottish private sector economy continued to grow in May, albeit at a reduced rate. This was signalled by the latest Bank of Scotland *PMI* posting a reading of 52.2, compared to 55.5 in the previous month. Inflationary pressures remained strong overall, but were the weakest during 2011 so far. Meanwhile, firms took on more staff at the fastest rate since February 2008, despite seeing only a marginal rise in the volume of incoming new business during the month.

Activity across Scotland's manufacturing and services sectors rose for the fifth successive month in May. The rate of expansion was only slightly weaker than the long-run survey average, but the slowest in the current sequence. Manufacturing output and services activity rose at broadly similar rates during the latest period.

Driving the moderation in output growth in May was a much weaker rise in new business levels. Latest data signalled only marginal gains in new contracts in both manufacturing and services. The overall rise in Scotland compared favourably with declines in Wales and Northern Ireland, but was weaker than the rates of growth shown in all English regions except for the South West.

The lacklustre rise in new business during May led to a further decline in the volume of outstanding work held at private sector companies. Backlogs have declined in every month since September 2007. That said, the latest rate of contraction was slower than the long-run trend.

Despite the slower rise in new work, private sector companies added to their workforces in May. Moreover, the rate of employment growth was the fastest since February 2008. Latest data indicated workforce growth in both manufacturing and services.

Cost inflationary pressures remained strong in the context of historic survey data in May. Input prices continued to rise sharply, more so in manufacturing than services, even though the overall rate of inflation slowed to a five-month low. Input cost inflation also remained greater than the UK-wide average.

The easing in input price inflation led to a slower increase in average prices charged for Scottish goods & services in May. Output price inflation remained greater than the long-run trend, but was the slowest since last December. In contrast to the trend for input prices, Scottish firms' charges rose at a weaker rate than the UK average in May.

Donald MacRae, Chief Economist at Bank of Scotland, said: "The Scottish private sector economy enjoyed a fifth consecutive month of growth in May, although the rate of expansion has moderated. Both manufacturers and service providers are taking on more staff with the fastest rate of job creation since February 2008. Workforce growth was also slightly faster than the UK average for the first time since last September.

"New business inflows have increased every month of 2011 so far, however the incoming new business index fell sharply during the latest period, to a level indicative of only a marginal rate of expansion."

Component Summary

Business Activity:

Private sector output in Scotland rose further in May. The current sequence of expansion now stretches to five months. The rate of growth slowed, however, and was weaker than the UK trend. The seasonally adjusted Business Activity Index was slightly below its long-run average of 52.5 during the month. Data for April and May suggest weaker growth in Q2 compared with Q1. Growth remained broad-based across manufacturing and services, but weaker rates of expansion were signalled in both sectors. Manufacturing registered the steeper deceleration during the month.

New Business:

The seasonally adjusted Incoming New Business Index remained above the no-change mark of 50.0 during May, signalling a rise in new contracts received by Scottish private sector firms. New business inflows have increased every month of 2011 so far. That said, the Index fell sharply during the latest period, to a level indicative of only a marginal rate of expansion. The pace was also much slower than the UK average. Growth of new orders was maintained in both manufacturing and services but, in line with the overall trend, slowed to marginal rates in both cases.

Backlogs:

The volume of outstanding business across Scotland's private sector economy contracted in May. Backlogs have declined every month since September 2007. The seasonally adjusted Business Outstanding Index rose from April's four-month low, to indicate a slower rate of reduction. But the pace remained sharper than that seen across the UK private sector economy as a whole. Backlogs fell in manufacturing for the fourth month running, and in services for the second straight month. Both sectors registered broadly similar rates of contraction in the latest period.

Input prices:

Average input prices paid by Scottish private sector companies continued to rise sharply in May. The seasonally adjusted Input Prices Index was little-changed from April, remaining well above its long-run average of 58.5. That said, the Index remained below January's 28-month high. Data signalled diverging trends between manufacturing and services. Manufacturing input cost inflation slowed sharply to a five-month low, while service providers saw their average input prices rise at a faster rate compared to April. Scotland registered greater cost pressures than the UK average.

Output prices:

Scottish private sector companies raised their output prices for the tenth month running in May. The rate of charge inflation eased since April to the weakest so far in 2011, but was nevertheless strong in the context of historic survey data. The weaker increase in charges was centred on the manufacturing sector, where output price inflation slowed more sharply than in any period since November 2008. This was partly offset by a slightly stronger increase in service providers' tariffs. The overall rate of output price inflation in Scotland's private sector economy remained weaker than the UK average.

Employment:

Private sector employment rose in Scotland for the fourth successive month in May. Moreover, the seasonally adjusted Employment Index moved higher, signalling the fastest rate of job creation since February 2008. Workforce growth was also slightly faster than the UK average for the first time since last September (although the current sequence of UK-wide employment growth now stretches to eight months). Both manufacturers and service providers expanded workforces on average in May, with the former registering the stronger pace.

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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.

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.

Revision to April data

Please note that owing to a data processing issue, Markit have slightly revised April's composite numbers (the underlying manufacturing and services figures are unaffected). The revisions are as follows: Output: -0.3, New Business: 0.0, Outstanding Business: -1.9, Input Prices: -0.9, Output Prices: -0.8, Employment: -0.1.

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