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: SCOTTISH PRIVATE SECTOR RETURNS TO GROWTH IN JANUARY, FOLLOWING WEATHER-HIT DECEMBER

- **Activity rose for both manufacturers and service providers**
- **Input and output prices both rise at fastest rate since September 2008**
- **New order levels rose but growth still below UK**

The Scottish private sector economy returned to growth during the first month of 2011, following a weather-hit end to 2010. Nonetheless, the rates of expansion of both activity and new orders signalled by the latest Bank of Scotland PMI report were only modest. January data also highlighted growing inflationary pressures across the Scottish economy, as input cost and output price inflation rates both rose to post-crisis highs.

The return to expansion was signalled by the Bank of Scotland PMI – a seasonally adjusted index monitoring activity across Scotland's manufacturing and service industries – rising from 36.9 in December to 52.9 in January. Although this marked the strongest increase since last August, when averaged over December and January the index posted a reading below the 50.0 no-change mark – suggesting that output lost at the end of last year was not fully recouped in January. Where higher output was recorded in January, this was often linked to the improvement in weather conditions.

New order levels also increased during January, with manufacturers and service providers recording similar rates of expansion. Overall, however, new order growth was only modest and well below that seen across the UK as a whole. Panellists commented on improving weather conditions as the principal factor underpinning higher order levels.

Job losses in the Scottish private economy were extended to a third straight month during January. Although only modest, overall job cuts in Scotland contrasted with mild payroll growth at the UK-wide level. Service providers and manufacturers registered divergent trends, with robust growth at goods producers contrasting with solid cuts in the tertiary sector. Where staff numbers were reduced, firms reported that this was primarily driven by low workloads.

Reflective of this, panellists continued to draw down backlogs of work during January. However, the latest monthly depletion was the weakest in over three years.

Overall price pressures in the Scottish private sector accelerated sharply during the first month of 2011. Input costs rose at the fastest pace since September 2008, driven by a combination of higher fuel, energy and food prices. The need to pass on rising costs, alongside the adjustment of charges in line with higher sales taxes, led to the strongest rise in average output prices for twenty-eight months..

Donald MacRae, Chief Economist at Bank of Scotland, said: "The Scottish private sector economy made a return to growth in January reducing fears of a "double dip" and increasing expectations for a continuing recovery in 2011. During the month, the volume of new business received from export markets rose at the fastest pace since last June.

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"Manufacturing companies increased their staffing levels further, extending the current period of job creation to one year. Overall new orders rose for the first time in four months, although the Index pointed to only a mild rise.

"Particularly welcome is the return to growth in all three service sectors: business, financial and travel, and tourism and leisure. However, the sharp increase in input prices highlights the threat from high levels of cost inflation. 2011 looks like being a year of low growth rather than no growth".

Component Summary

Business Activity:
The Scottish private sector economy posted renewed growth during January, following severe disruptions from adverse weather conditions in December. This was signposted by the seasonally adjusted Business Activity Index rising from 39.6 in December to 52.9 in January – the highest reading since last August. Growth was recorded across both manufacturing and service sectors although, in each case, the average reading for December and January was below 50.0 – indicating that output lost in December was not fully recouped in January.

New Business:
The level of new business received by firms operating in the Scottish private economy rose for the first time in four months during January. Nevertheless, at 51.1, the seasonally adjusted Incoming New Business Index pointed to only a mild rise. Anecdotal evidence from the survey panel indicated that new order growth primarily reflected a pick up from December's weather-related slump, rather than an improvement in underlying demand conditions. Modest growth in Scotland contrasted with the UK as a whole, where new order growth accelerated to a ten-month high.

Backlogs:
Latest data highlighted a further depletion of outstanding business in the Scottish private sector economy. However, the overall pace of reduction signalled by the seasonally adjusted Business Outstanding Index slowed to a thirty-seven month low. Manufacturers and service providers continued to report diverging trends, as a record accumulation of work-in-hand at manufacturing firms (attributed to the ongoing impact of last month's weather disruptions) contrasted with a marked depletion in the service sector.

Input prices:
Latest data highlighted a strong acceleration of average cost inflation faced by Scottish private sector firms. This was signalled by the seasonally adjusted Input Prices Index rising to a twenty-eight month high. Furthermore, the seasonally adjusted Input Prices Index signalled a rate of inflation that was slightly above the average seen across the UK as a whole. Both Scottish manufacturers and service providers registered a considerable acceleration of cost inflation during the month, with higher fuel, energy and food prices widely commented on.

Output prices:
Reflecting a considerable pick up in cost inflation, Scottish private sector firms raised their average charges at the strongest pace since September 2008 during January. Higher tariffs were recorded in both manufacturing and service sectors, with goods producers recording by far the stronger rise. Mirroring the trend registered for costs, charge inflation in Scotland was slightly stronger than recorded for the UK as a whole. Alongside strong inflation of raw material costs, panel members indicated that prices had been adjusted to account for changes in VAT and insurance premium tax rates.

Employment:
Overall employee numbers in the Scottish private sector were cut for the third month running during January. However, the pace of decline was only modest. As in December, employment trends varied considerably between manufacturing and service sectors. The former posted a solid monthly rise (the twelfth in a row), and the latter a robust decline. Where headcounts were raised, this was often linked to investment strategies aimed at boosting capacity. A number of firms, particularly those in the service sector, indicated that low workloads had driven job cuts.

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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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