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: SCOTLAND'S PRIVATE SECTOR ECONOMY CONTRACTS SLIGHTLY IN SEPTEMBER

- **Output falls as downward trend in new work continues**
- **Employment broadly unchanged on month**
- **Input price inflation hits eight-month high**

September's Bank of Scotland *PMI* report showed private sector output north of the border decrease for the first time since December 2010, reflecting a sustained fall in incoming new work. Employment levels were kept broadly steady over the month, while excess capacity was signalled by a further reduction in backlogs. Businesses also took a hit on the costs front, as input price inflation accelerated to the fastest since January on the back of rising fuel and commodity prices.

Total output across Scotland's manufacturing and service sectors combined decreased slightly in September, as signalled by the Bank of Scotland PMI posting 49.6 – down from 50.3 in August. That contrasted with modest growth across the UK as a whole. There were negative developments in the performance of both broad sectors north of the border, with a marked and slightly accelerated decrease in goods production more than offsetting slower growth in services activity.

September saw a third straight monthly decrease in the amount of new business placed with Scottish private sector firms. The rate of decline eased since August, however, and was only modest overall. Sector data showed that a renewed (albeit marginal) increase in new business at services firms contrasted in a sharp drop in new orders for manufactured goods.

The level of employment in Scotland's private sector was virtually unchanged in September from one month before, bringing to an end a three-month sequence of job creation. The Scottish jobs market showed considerable resilience compared to the broader UK picture, with nine out of the other 11 regions monitored by PMI data recording decreases in employment.

September data meanwhile showed a further decrease in the volume of outstanding business at Scottish private sector companies, highlighting a degree of excess operating capacity. The pace of decline was solid, but the slowest in three months.

Input price inflation quickened again in September, and was the fastest in eight months amid rising prices for commodities and fuel. Stronger cost pressures led to a second consecutive monthly increase prices charged by private sector firms north of the border, though competition restricted pricing power to an extent and charge inflation was only modest overall.

Donald MacRae, Chief Economist at Bank of Scotland, said: "The PMI ended a twenty month run of positive readings showing the private sector of the Scottish economy contracting slightly in September. Growth in services activity did not quite offset a fall in manufacturing output. However employment did grow in the month while the rate of decline in new orders eased since August. The services sector recorded a rising level of new business. The Scottish economy is struggling to maintain growth momentum in the face of both the Eurozone and global slowdowns."

Component Summary

Business Activity:
September saw a marginal decrease in private sector activity in Scotland, thereby ending a period of continual growth that began at the start of 2011. The downturn reflected a marked and accelerated drop in goods production, the steepest since December 2010. Service sector activity meanwhile expanded at a reduced pace that was the slowest in four months. Anecdotal evidence suggested that decreased intakes of new work weighed on activity over the month. The UK in contrast saw a further (albeit weaker) increase in combined manufacturing and services output.

New Business:
New work placed with private sector businesses in Scotland fell for the third month in succession in September. The decline was weaker than August's 20-month record and only moderate overall, but still contrasted with further growth in new business across the UK economy as a whole. Weakness north of the border was centred on the manufacturing sector, which saw both total new orders and new export business decrease at sharp and accelerated rates. A marginal increase in new business was registered by service providers, reversing a downward trend in August.

Backlogs:
Latest data signalled a further decrease in the volume of outstanding business held at Scottish manufacturers and services firms combined in September. The rate of depletion was the slowest for three months, though still solid and faster than that registered at the UK level. Where work-in-hand was reduced, businesses frequently commented on resources being freed up as a result of decreased new business inflows. Sector data showed that backlogs fell sharply at manufacturers, but were stable on average at service providers.

Input prices:
Scottish private sector companies recorded an accelerated rise in their average costs in September. The rate of input inflation ticked up to the fastest since January, and was also notably stronger than the UK-wide average. Behind the strengthening cost pressures north of the border were increases in the prices of fuel, food and a range of other commodities. Service providers continued to face stronger input price inflation than their goods-producing counterparts, seeing average costs rise sharply and at the fastest pace in 2012 so far.

Output prices:
Prices charged by private sector businesses in Scotland increased on average for the tenth time in the past 11 months during September. Anecdotal evidence indicated that increased costs had led to firms raising charges to protect margins. Output price inflation was slightly weaker than August's eight-month high, however, and only modest overall. At the sector level, manufacturers' factory gate prices rose slightly quicker than services charges. Output prices meanwhile stagnated across the UK as whole.

Employment:
Employment across Scotland's private sector economy was virtually unchanged in September compared with one month before. The stagnation followed three consecutive months of job creation north of the border, and masked contrasting trends at the sector level. The size of the service sector workforce increased at a reduced pace, while payroll numbers at manufacturers fell marginally over the month. Across the UK economy as a whole there was a moderate decrease in employment, thereby ending an eight-month sequence of net job creation.

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.

About Bank of Scotland
Bank of Scotland is part of Lloyds Banking Group, the UK's largest retail bank and Scotland's largest financial services employer. Established in 1695, Bank of Scotland is the UK's oldest surviving clearing bank. 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.

About Markit
Markit is a leading global financial information services company with over 2,300 employees. The company provides independent data, valuations and trade processing across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency. Its client base includes the most significant institutional participants in the financial marketplace. For more information, see www.markit.com.

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