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.

NOT FOR BROADCAST OR PUBLICATION BEFORE 00:01, MONDAY 14 MARCH 2016

BANK OF SCOTLAND PMI: OUTPUT IN SCOTLAND'S PRIVATE SECTOR CONTRACTS DURING FEBRUARY

- **Headline Output PMI posts below 50.0 no-change mark for first time in three months**
- **Backlogs of work decline at fastest pace in a year**
- **Output prices fall at sharpest rate since October 2009**

Scotland's private sector slipped into contraction during February, according to latest survey data. Output levels deteriorated for the first time in three months, driven by a marginal decline in new order levels. Meanwhile, employee numbers continued to drop as firms reported a lower volume of incomplete work. Finally, a faster drop in average tariffs was reported despite a rise in input prices.

The seasonally adjusted headline Bank of Scotland PMI - a single-figure measure of the month-on-month change in combined manufacturing and services output - scored 49.2 in February. Down from 50.3 in January, the latest reading pointed to a slight downturn in output in the Scottish private sector. Moreover, the decline in business activity was the first reported for three months.

New work received by private sector companies in Scotland contracted during February, ending an 11-month sequence of growth. Although service providers recorded broadly unchanged levels of incoming new work since January, Scottish manufacturers reported a substantial decline.

Workforce numbers continued to slide in the private sector of Scotland in February. That said, the rate of job shedding was slight and eased since January. The fall in staffing levels was driven by service providers, while manufacturers reported a fractional increase in employee numbers.

Meanwhile, private sector companies reported ongoing spare capacity in Scotland's economy last month. The rate at which backlogs of work deteriorated was substantial and accelerated to the sharpest since February 2015. Anecdotal evidence linked lower levels of work-in-hand to the current downturn in the Aberdeen region.

Latest survey data for February highlighted an increase in input costs faced by the private sector of Scotland. However, the rate of inflation was modest and weak in the context of historical data. While service sector companies recorded a solid increase in input prices, manufacturers faced lower average cost burdens.

Despite being faced with higher costs, Scotland's private sector firms lowered their output prices during February, continuing a trend which began in August last year. While goods producers lowered their average tariffs at the quickest pace in the series history, the decline was more muted in the service sector.

Alasdair Gardner, Bank of Scotland Regional Managing Director Scotland - Commercial Banking, said, "The downturns in the Aberdeen region and the oil and gas sector negatively impacted the Scottish economy during February, as firms struggled to cope with lower incoming new order levels and deteriorating volumes of incomplete work. The drop in business activity and the slide in workforce numbers also signals a challenging few months ahead for the region."

Component Summary

Output / Business Activity

Service sector companies in Scotland reported a contraction in business activity during February. The decline was the first recorded since September last year and was relatively slight. Meanwhile, production levels at **Scottish goods producers** remained in contraction territory during February, extending the current sequence of decline to four successive months. Companies that registered a drop in output reflected on a combination of reduced new orders and greater competition in the sector. That said, the rate of decline was slight, with nearly 19% of firms reporting a drop in output compared to around 18% that noted an increase.

New Business

Volumes of new business stagnated in the **service sector of Scotland** during February, ending an 11-month sequence of growth. This was highlighted by the seasonally adjusted New Business Index posting fractionally below the all-important 50.0 no-change mark. While some panel members reporting a fall in new work partly linked this to flooding issues, firms which received higher new order intakes attributed this to an upturn in the housing market. The volumes of incoming new orders received by **Scottish manufacturers** declined further during February, extending the current trend which began in September last year. While approximately 28% of firms recorded lower new work levels, nearly 20% reported an increase. Moreover, the rate at which new business contracted was sharp and quickened to the fastest in three months.

Backlogs

Scotland's service providers continued to work through their backlogs during February, extending a trend that has been observed in each of the past eight surveys. Moreover, the rate of depletion was the fastest in a year. There was some evidence that falling outstanding business was associated to the downturn in the Aberdeen area. Faced with fewer new projects, **Scottish goods producers** worked through their outstanding business during February. The rate of deterioration was marked and quickened to the most severe since November last year. Over one-quarter of panel members recorded a decline in their levels of work-in-hand last month, compared to only 8% that reported an accumulation.

Input prices

Input price inflation in **Scotland's service sector** accelerated during February, from January's all-time low. The rate of input price growth was solid, as around 15% of companies reported an increase compared to only 4% that recorded a decline. The seasonally adjusted Input Prices Index has posted above the 50.0 no-change mark in every survey since data collection began in January 1998. Moreover, February survey data also signalled a drop in input prices faced by **Scottish manufacturers**, continuing a trend that has been observed in every survey since July 2015. Moreover, the rate of deflation quickened to a three-month record, despite remaining relatively modest. According to survey participants, a fall in input costs reflected lower commodity prices.

Output prices

Latest survey data pointed to a further decline in output prices in the **Scottish service sector**. The rate of deflation quickened since the previous survey but was relatively modest. Panel members mainly attributed lower average charges to a fall in fuel prices. Meanwhile, the seasonally adjusted Manufacturing Output Prices Index dropped to an all-time low during February, with **Scottish manufacturing companies** commenting on increased competitive pressures in the sector. Average tariffs have fallen in each of the past 13 months. Anecdotal evidence also linked lower output charges to a sharp fall in oil prices.

Employment

Workforce numbers continued to slide at **service providers in Scotland** during February. The rate of job shedding accelerated to the quickest since July 2015, but was marginal overall. Anecdotal evidence suggested falling headcounts reflected a combination of lower activity and a requirement to cut costs by firms. Furthermore, employee numbers stabilised in the **manufacturing sector of Scotland** in February, ending a four-month sequence of job cuts. This was highlighted by the seasonally adjusted Employment Index posting slightly above the 50.0 no-change mark. However, the rate of job creation was marginal and weak in the context of historical data.

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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.

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