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: SHARPEST INCREASE IN OUTPUT IN 2015 SO FAR

- **Activity growth accelerates as new orders rise further**
- **Employment levels fall for first time since October 2011**
- **Companies raise their charges marginally**

Scottish private sector companies reported further growth of output and new orders at the start of the third quarter. Activity increased at the strongest rate in 2015 so far, while the pace of new order growth was little-changed since June.

However, employment levels fell for the first time in nearly four years and companies reported ongoing spare capacity. Meanwhile, input costs increased at a slightly weaker rate and charges rose for the first time since last December.

July data signalled a further rise in activity at Scottish private sector companies, as highlighted by the headline index – the seasonally adjusted Bank of Scotland PMI, a single-figure measure of the month-on-month change in combined manufacturing and services output – remaining above the 50.0 no-change mark. At 52.2, up from 51.2 in June, the index signalled the most marked rise in output since last December.

Sector data showed that manufacturers reported a stronger increase in activity than service providers. Moreover, output growth in the goods-producing sector was the strongest in nearly a year.

Meanwhile, companies reported further growth of new business in July, with the pace of expansion little-changed since June. Some panel members linked increased order intakes to higher marketing activity.

Scottish private sector firms reported the first decline in staffing levels since October 2011 during July, largely a result of job shedding in the service sector. Some panellists linked job cuts to internal restructuring efforts. The rate at which workforce numbers were reduced was modest. Ongoing spare capacity was signalled in the Scottish private sector in July. Moreover, the rate at which work outstanding was depleted accelerated slightly since June.

As has been the case throughout most of the survey history, input costs in Scotland's private sector increased in July. The rate of cost inflation slowed to a five-month low, with manufacturers reporting a decline in input prices. Some companies passed higher input costs on to their clients, resulting in the first rise in average charges since last December. However, the rate of output price inflation was only marginal overall.

Donald MacRae, Chief Economist at Bank of Scotland, said: "July's PMI at 52.2 was the highest so far this year. Activity grew in the services sector while manufacturing output showed a welcome return to growth after the contraction of the last three months. New orders rose in all sectors while the pace of decline in new export orders slowed. Although employment fell the Scottish economy continued the recovery from the slowdown in the first quarter of the year. Moderate growth is expected for the rest of 2015."

Component Summary

Output / Business Activity

July data signalled a fourth successive monthly rise in Scottish **service sector activity**. However, the pace of expansion was little-changed since June and remained below the long-run series average. Where panellists noted higher output, they partly linked this to increased new business. Scottish **manufacturers** reported a rise in **output** during July, thereby ending a three-month period of contraction. This was highlighted by the respective seasonally adjusted index posting above the 50.0 no-change mark. Moreover, the pace of expansion was the fastest in nearly a year, with around 23% of surveyed companies noting an increase. Panellists generally linked production growth to new contract wins.

New Business

The amount of **new business placed with service sector firms** operating in Scotland rose for the fifth straight month in July. However, the rate of growth in new work was the weakest since April. Companies that signalled increased new business commented on higher demand from both domestic and foreign markets, and higher marketing activity. After adjusting for seasonal influences, July data signalled a return of **new order growth in Scotland's goods-producing sector**, following a marginal decline in June. The rate of expansion was the strongest since August 2014, albeit modest overall.

Backlogs

The seasonally adjusted Business Outstanding Index registered below the crucial 50.0 threshold in July, thereby signalling some **spare capacity at Scottish service providers**. Around 19% of the survey panel noted a reduction in work outstanding, versus 12% that reported a rise. Overall, the rate of backlog depletion was modest. The seasonally adjusted Backlogs of Work Index remained below the no-change mark of 50.0 in July, signalling **ongoing spare capacity in Scotland's goods-producing sector**. However, the rate at which business outstanding was depleted eased since June. Around 21% of the survey panel noted a decline in backlogs, while 16% signalled an increase.

Input prices

As has been the case throughout the series history to date, **service sector companies** in Scotland reported a further increase in **input costs** at the start of the third quarter. However, the rate of inflation slowed for the second month running and was the weakest since February. Panel members attributed the latest rise to higher staff costs and increased prices for some foodstuffs. **Input costs faced by Scottish manufacturers** fell for the first time in three months during July, with around 9% of surveyed companies signalling a decline. The rate of deflation was modest overall, although the sharpest since February. There were some firms that linked lower costs to exchange rate factors.

Output prices

Output prices also rose further in July, as some **service providers** passed higher input costs on to their clients. The rate of charge inflation was marginal overall, however, with the vast majority of the survey panel (around 81%) signalling no change in average charges. Output prices rose for the second month in a row. **Manufacturing companies lowered their charges** for a sixth month running in July. This was highlighted by the seasonally adjusted Output Prices Index remaining below the neutral 50.0 threshold. The rate at which factory gate prices fell was the most marked since April. Nearly 7% of survey participants noted a reduction in selling prices, versus 4% that signalled an increase.

Employment

Service providers operating in Scotland reported the first decline in **staffing levels** in over three years. This was signalled by the seasonally adjusted index dropping below the neutral 50.0 threshold. The rate of job cuts was the most marked since January 2011, but modest overall. Some firms lowered their workforce numbers as part of internal restructuring efforts. With output rising, **manufacturers** were encouraged to add to their **payrolls** in July. However, the rate of job creation was marginal overall, with the vast majority of survey participants (around 83%) reporting no change. Some panel members hired additional workers in order to reduce business outstanding, according to anecdotal evidence.

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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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