PRESS RELEASE

CPPR ANALYSIS OF THE SCOTTISH GOVERNMENT PUBLICATION – GROSS DOMESTIC PRODUCT FOR SCOTLAND FOR THE 3rd QUARTER OF 2007

LEISURE AND FINANCIAL SERVICES WORRIES GROW

HEADLINES

- Scotland growing above its long run trend but below UK growth for both the last quarter and for the last year
- Slower Scottish quarterly and annual growth (vs UK) in all major industry sectors except 'Distribution, Hotels and Catering' (for the last Quarter) and 'Transport, Storage and Communications' (for the past 4 quarters on the previous 4 quarters)
- **Hotels and Catering** in Scotland continue to decline as opposed to the UK's continuing fast growth. Over the last four quarters (year-on-year) Scotland has now experienced a fall of 3.4% in contrast to the UK's rise of 5.4%. In other words, this appears to be one of the fastest growing industry sectors in the UK but one of the fastest falling sectors in Scotland.
- **Transport, Storage and Communications** the biggest Scottish success story over the past year, rising by a whopping 11.2% (last 4 quarters on previous 4 quarters).
- **Financial Services** shows another worrying quarterly fall of over 3%, now over 6% below 2007 Q1 peak (and technically putting it into recession) whereas UK has continued to grow by 6% over the same period
- Recent **Public Sector** revisions have considerably downgraded the performance of the Education sector but improved that of Health and Social Work in Scotland
- In light of the Scottish Governments **new economic targets** more resources are needed in order to acquire a better understanding of the GVA data and trends and of the reasons why certain industry sectors underperform so badly
- When the **Council of Economic Advisers** (CoEA) next meets on the 8th of February there views should be recorded on problem areas like Hotels and Catering, Financial Services as well as on the public services revisions.

SECTOR BY SECTOR

THE RETAIL SECTOR

The figures for retail sales were dramatically revised up last quarter This means there is now estimated to have been growth of 26% between 1998 and 2006, instead of the old 12%.

However, an explanation is still needed for the substantial differences that remain between Scotland and the UK during this period (26% vs 44%). We understand that new figures, back to 1995, have recently been obtained by the Scottish statisticians and will be analysed in time for the 2007 Q4 publication. We will look again at this sector in April in the light of the new data.

HOTELS AND CATERING

This sector continues to perform very poorly in Scotland. Q3 2007 saw another fall of over 1% on the previous quarter. Over the last four quarters Scotland has now experienced a fall of 3.4% in contrast to the UK's rise of 5.4%. In other words, this appears to be one of the fastest growing industry sectors in the UK but one of the fastest falling sectors in Scotland.

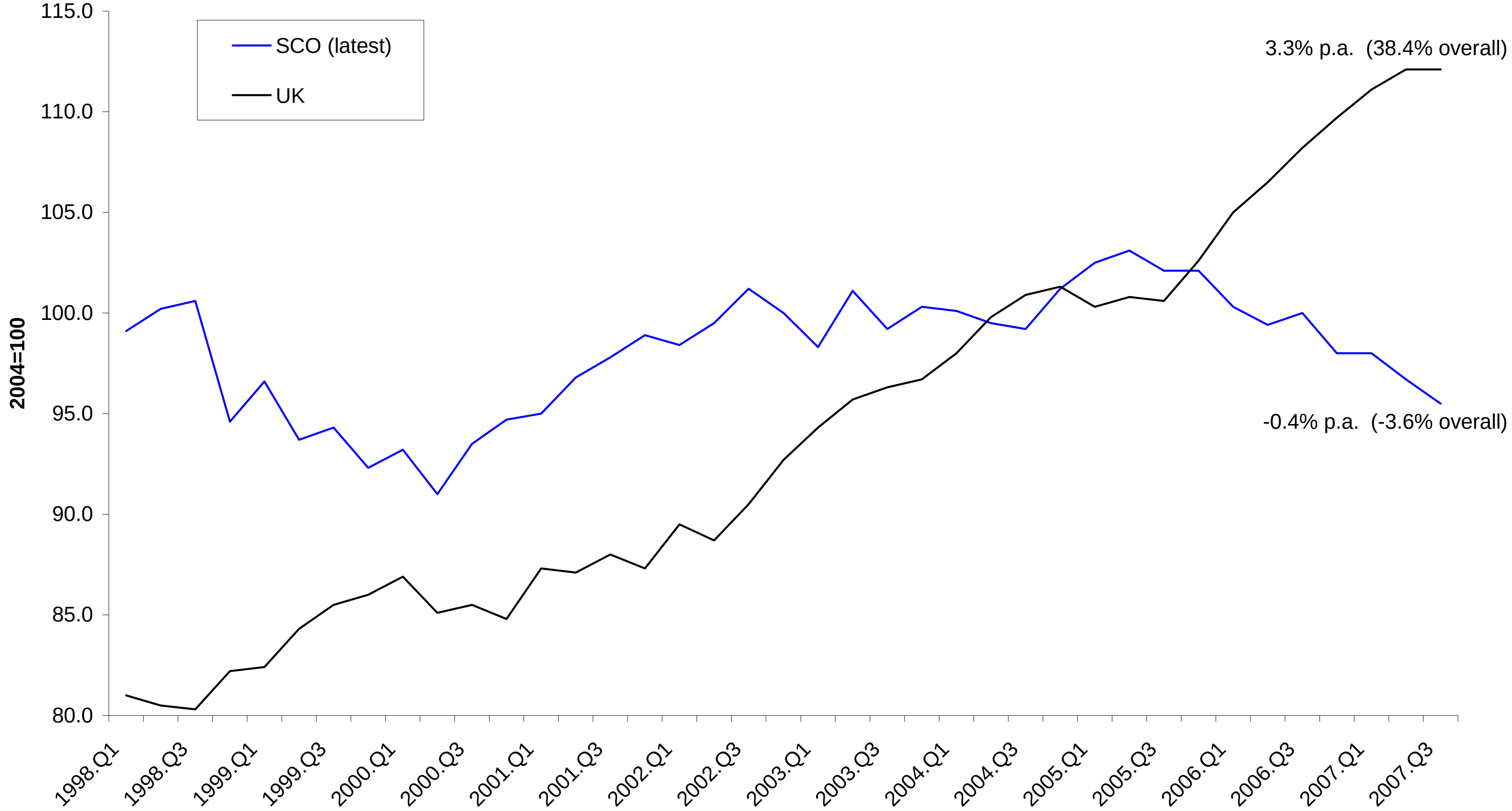
In addition, between 1998-2006 the sector in Scotland has grown overall by less than 1%, while in the UK it has grown by over 32% (Chart 2[1]). While it remains difficult to understand why this huge divergence in economic performance has come about, Scottish Executive statisticians have discovered what appears to be a structural difference between Scotland and the UK. Applying UK-wide price deflators to these different structures has the effect of slowing the growth in constant price GVA for Scotland much more heavily than the UK growth. However, the government statisticians are continuing to monitor the situation and investigate further the veracity of the data in this sector. In addition, if the growth in Scottish prices is lower than UK prices (perhaps dominated by London), this implies that Scottish price data is needed for deflation (a development being looked at by ONS).

It does seem particularly worrying that much of the difference between the two series comes from two distinct periods. In 1998 Q4 alone there was a 6% fall in GVA for Hotels and Catering, followed by further quarterly falls amounting to 3% upto 2000 Q2, while in the UK it rose by 5% over this period (even more if Scotland was adjusted for). This is very odd indeed and not perhaps consistent with the different deflators argument where one might have expected a more gradual divergence of performance.

The second big divergence occurred post-2005Q2; there has been a trend fall in Scottish output of 7.5%, set against a trend rise in UK output of 11.3%. This is a particularly worrying event and, if it continues, threatens to make the meeting of growth targets more difficult. It is also problematic to understand in that there have been few signs and reports of hard times in this sector stretching back to 2005.

[1] Note, growth figures in the Charts refer to 2007.Q3 compared to 1998.Q1.

Chart 1: Hotels & catering GVA in UK and Scotland



Indeed some recent analysis of the Hotels sector (by PKF) suggested that Scottish yield per room grew faster in Scotland than elsewhere in the UK in 2007.

Problems of understanding and interpretation remain, therefore, in this sector

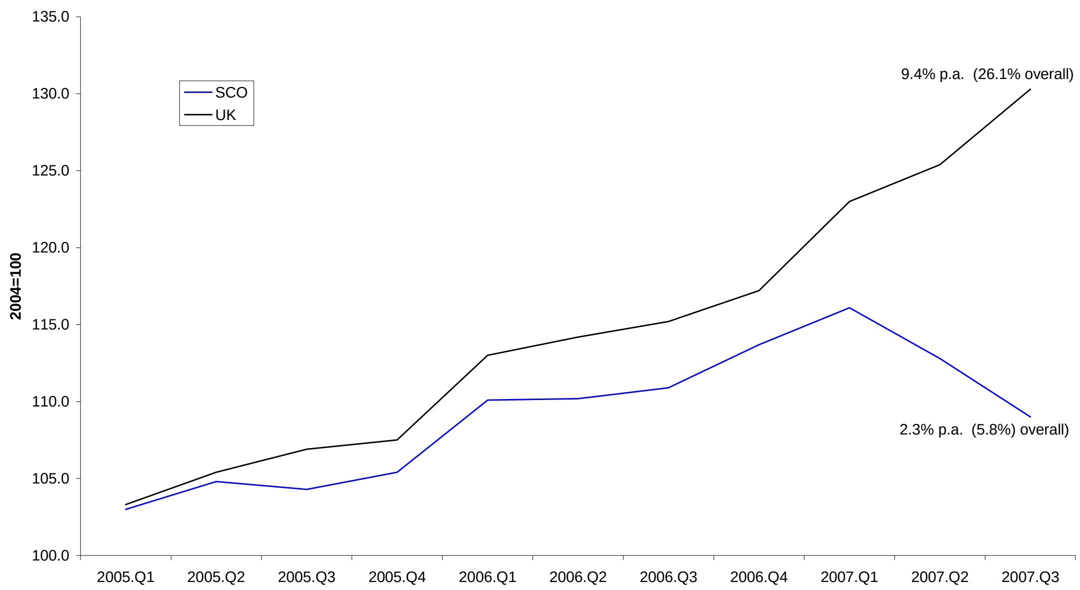
TRANSPORT, STORAGE AND COMMUNICATIONS

The biggest Scottish success story over the past year has been in this sector, rising by a whopping 11.2% (last 4 quarters on previous 4 quarters). This has been in turn driven by large increases in Transport (+9%) and Communications (+14.7%), although these growth rates slowed in the last quarter and in the case of Transport fell.

FINANCIAL SERVICES

Financial services fell for the second consecutive quarter, which technically puts this sector into recession. Output is now down by over 6% in Scotland Q3 on Q1, against a rise of 6% in the UK. This continues a worrying trend seen over the last few years (see Chart 2). In contrast, Scotland outgrew the UK in this sector from 1998 to 2002, increasing output by 50%, as against a UK rise of 17%. However since 2002 UK output has grown by 50% while Scotland has only seen growth of 23%, slower by almost one-percentage point in each quarter.

Chart 2: Financial Services GVA in UK and Scotland



Financial Services is both a very important sector for the Scottish economy but also one where it is difficult to collect good statistical information for at least two reasons. First, because the profits/output associated with such Financial Services can be difficult to measure. Second, because it can then be difficult to apportion these profits between countries, especially within the UK.

This seems to be an area where greater resources might need to be spent to ensure the quality of the data in what has been a rapidly growing sector.

PUBLIC ADMINISTRATION, EDUCATION AND HEALTH

These figures were revised for the Q2 publication such that, since 1998, Scotland now grows slightly more slowly rather than slightly more quickly than the UK. In addition, output has remained virtually unchanged in Scotland for the last 6 quarters, in an area that has traditionally shown steady growth.

These revisions were "*due to enhancements to data sources and methodology which move from employment measures to direct measures of output and enhance comparability with UK measures*". This sector accounts for 23% of the Scottish economy, containing Public Administration and Defence (PAD) Education and Health within it, so greater detail was necessary on what had changed. That information is now available from the statisticians and the detail is shown in Table 1 below.

Table 1: Public Services annual growth rates 1998-2006

%	UK	Sc (old)	Sc (new)	Differential* (Old)	Differential* (New)
Overall	2.1	2.2	1.9	-0.1	0.2
PAD	1.6	1.4	1.4	0.2	0.2
Education	1.0	2.8	0.65	-1.8	0.35
Health	3.4	2.3	2.95	1.1	0.45

* Differential = UK minus Scotland

From this it can be seen that while the revisions had little impact on the growth of public services this 'overall' position hides very large shifts within Health and Education.

On Education, Scotland had surprisingly, given the demographics, been outperforming the UK, growing at an annual 2.8% per annum. After the revisions this position has been reversed with, at 0.9% p.a., the UK now outgrowing Scotland (0.65% p.a.).

On Health, the UK is still outgrowing Scotland but the differential in growth rates has narrowed appreciably, from 1.1% p.a. faster to only 0.45% p.a. faster.

The much improved quality of this data is to be welcomed as not only does it improve the reliability of the GVA data but it also allows for more meaningful work to be done in the area of public sector productivity as output no longer directly relates to employment.

THE PRODUCTION SECTOR

The production sector fell by 0.8% in Scotland (latest 4 quarters on preceding 4 quarters), whereas in the UK it rose by 0.4%. However, once again the performance of this sector did not reflect the outturn of its principal component, manufacturing. Manufacturing output rose by 0.7% but both Energy and Mining industries experienced large falls of over 6%.

In the UK, Manufacturing rose by more (1.2%) and Energy and Mining fell by less (-2.1 and -4.2 respectively).

However, Scottish Manufacturing has fallen in each of the last two quarters, mainly due to a further deterioration in the performance of electronics in Q2 and in Chemicals and Textiles in Q3.

THE CONSTRUCTION SECTOR

After outgrowing the UK sector from 2002 to 2006 (25% vs 12%) Scotland's Construction industry has slowed down over the last year, falling by 2% since a year ago. In contrast the UK has continued to grow, up 3.5% over the same 4 quarters.

CONCLUSION

The latest GVA publication for Scotland exhibits some worrying trends. The Hotels and Catering and in Financial Services sectors are pulling Scotland's overall performance down and the economic explanation of them is difficult to fathom.

This is all the more important in the light of the Scottish Governments new economic targets. The data suggests that Scotland's economic performance is being dragged down in the long term by the Hotels and Catering sector and more recently by the Financial Services sector. But would any policy maker want to make recommendations to try and revive these sectors based on the quality of information currently available? It would seem to us to be unwise to do so.

We believe that more resources are needed in order to acquire more understanding, whether it be more government statisticians or commissioned research. This is more important than ever given the 'Targets' environment we now live in. If judgements are to be made based on whether we succeed or fail to meet targets then such targets need to be reliably measured.

The Council of Economic Advisers (CoEA) next meets on 8th February and while much of their deliberations will rightly look at the longer term picture for growth some time would be profitably spent reviewing the GVA data. Their views on areas like Hotels and Catering, Financial Services and on the public services revisions would be welcome.

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