

Royal Bank of Scotland PMI®

Private sector business activity falls for first time in ten months

Key Findings

Renewed declines in activity and sales

Employment grows only marginally

Inflationary pressures intensify

Scotland Business Activity Index



Last six months SC / UK



By sector	Dec-18
Manufacturing	48.4
Services	49.6

According to the latest Royal Bank of Scotland PMI®, private sector businesses in Scotland observed a renewed drop in activity during December. This coincided with a fresh decline in new sales, while backlogs of work also fell. Nonetheless, firms continued to hire extra staff, albeit at just a marginal pace. Cost burdens continued to rise sharply, prompting firms to raise selling prices to offset margin pressures.

The seasonally adjusted headline Royal Bank of Scotland PMI fell to 49.3 in December, from 52.2 in November, pointing to the first drop in private sector business activity since last February. Panellists attributed the decline to competitive pressures and a weaker underlying economic environment. Sector data indicated a broad-based fall in output, with both goods producers and service providers recording renewed decreases.

This contrasted with the overall UK level, where output increased moderately. Scotland was only one of two areas to record a contraction in December, the other being the North East.

Demand

Also weighing on business activity was weaker demand. New orders placed with privately-run firms in Scotland fell during December. Both manufacturers and service providers recorded lower new sales, with the former observing a more pronounced reduction. As was the case with output, the trend diverged from that seen at the UK level, where new business receipts increased.

Capacity

With inflows of new work dropping, firms were able to allocate resources to clearing backlogs. Outstanding business declined for a third successive month in December. That said, the rate of depletion eased from November's 25-month record.

Nonetheless, firms continued to hire additional staff, extending the current run of job creation to ten months. However, the rate of recruitment recorded in December was the weakest observed over the current sequence of rising workforce numbers. Efforts to reduce costs reportedly hampered the expansion in payroll numbers.

Prices

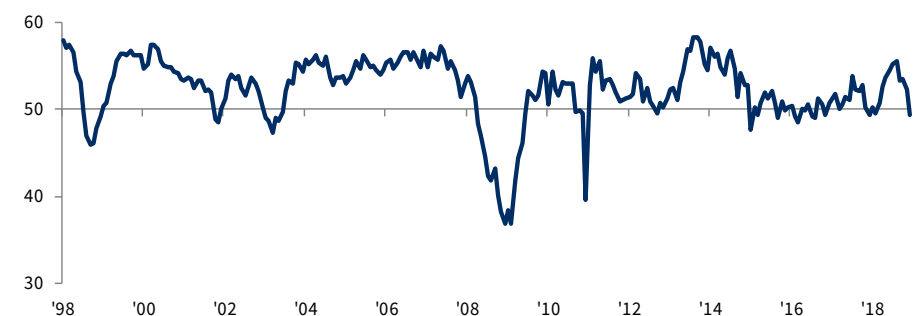
Scottish private sector firms continued to feel the squeeze on their margins, with costs rising sharply in December. Increased utility prices, unfavourable exchange rate variation and greater labour expenses reportedly drove inflation. In response, selling charges were raised. The increase was solid overall and the fastest since September.

Outlook

Despite the downturns in activity and demand, firms remained upbeat on their growth prospects for the coming year. New business wins from abroad, and planned company expansion were cited as reasons underpinning confidence.

Scotland Business Activity Index

sa, >50 = growth since previous month



New Business Index

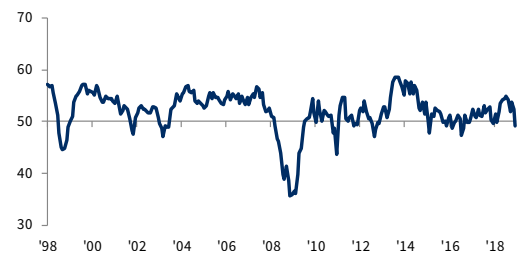


Demand drops for the first time in ten months

December survey data pointed to the first monthly decline in new sales in Scotland since last February. The reduction in new business contrasted to that seen for the UK overall, where demand increased modestly. Scotland was one of just two UK areas to record lower order book volumes, the other being the North East. Furthermore, sector data revealed the downturn in demand was broad-based across both manufacturing and service sectors. According to panellists, competitive pressures and greater business uncertainty weighed on new work inflows.

New Business Index

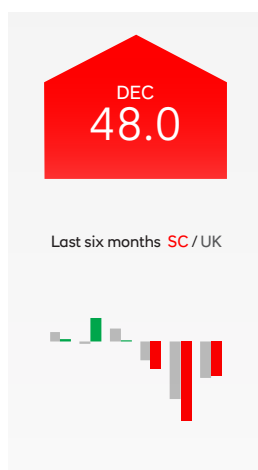
sa, >50 = growth since previous month



By sector

	Manufacturing	Services
Dec-18	48.1	49.3

Outstanding Business Index



Capacity pressures continue to ease

Amid reduced volumes of new work, outstanding business declined for a third successive month during December. The rate of backlog depletion was modest overall and broadly in line with that seen for the UK as a whole. At the sector level, incomplete orders fell sharply at manufacturers, but only mildly for service providers. Improved productivity was also mentioned by some survey respondents that reported reductions in unfinished work.

Outstanding Business Index

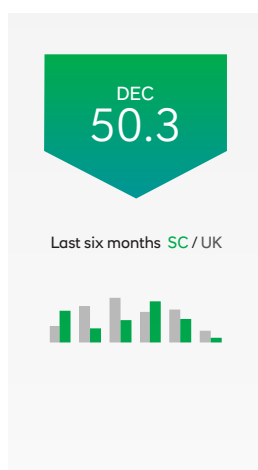
sa, >50 = growth since previous month



By sector

	Manufacturing	Services
Dec-18	43.7	49.0

Employment Index



Staffing levels rise only marginally in December

Employment in Scotland's private sector increased at the end of 2018, continuing a run of job creation that started last March. The latest expansion in staffing levels was only marginal, however, and the weakest seen across the current upturn. Lower workloads and efforts to curb costs reportedly weighed on the rise in payroll numbers. Slower increases in recruitment were observed in both the manufacturing and service sectors.

Employment Index

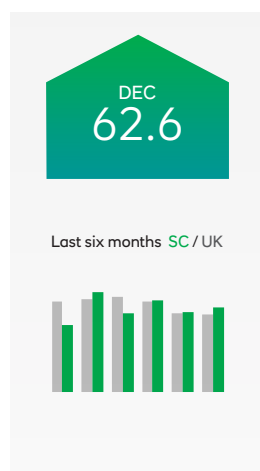
sa, >50 = growth since previous month



By sector

	Manufacturing	Services
Dec-18	50.4	50.2

Input Prices Index



Operating costs increase sharply

Scottish private sector companies faced further sharp cost inflationary pressures during the final month of 2018. Unfavourable exchange rate variation, higher labour costs and increased utility prices were blamed on the up-tick in expenses. According to sector data, firms in the goods-producing sector experienced sharper cost increases than their service-providing counterparts.

Input Prices Index

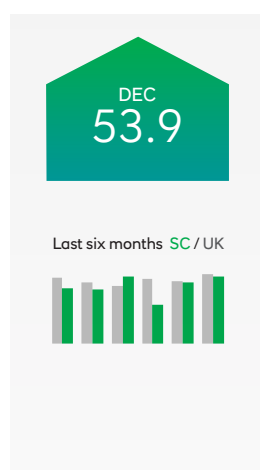
sa, >50 = inflation since previous month



By sector

	Manufacturing	Services
Dec-18	67.0	61.5

Prices Charged Index



Selling prices increase at faster rate in December

In order to offset part of the increased cost burden, privately-run firms in Scotland increased output charges during December. The rate of inflation was solid overall and accelerated to a three-month peak. The rise in selling prices was broadly in line with that seen for the UK overall. As has been the case since November 2017, manufacturers hiked their charges quicker than service providers.

Prices Charged Index

sa, >50 = inflation since previous month



By sector

	Manufacturing	Services
Dec-18	56.7	53.3

Future Output Index



Businesses remain upbeat on output prospects

Firms cast an optimistic outlook towards output over the coming 12 months during December. Although the level of positive sentiment was slightly weaker than in November, it was robust overall. New product launches, new business wins from abroad, planned company expansion and new marketing initiatives were cited as reasons underpinning confidence.

Future Output Index

>50 = growth expected over next 12 months

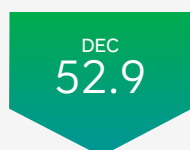


By sector

	Manufacturing	Services
Dec-18	59.5	62.7

Scotland Export Climate Index

Note: Export markets are defined as non-UK.



Last six months



Growth at key trading partners continues to ease

The Scotland Export Climate Index is calculated by weighting together national PMI output data according to their importance to the manufacturing exports of Scotland. This produces an indicator for the economic health of Scotland's export markets.

The Export Climate Index fell for the fourth successive month in December to 52.9, from 53.3 in November, thereby signalling a further loss of growth momentum at Scotland's key international markets for goods.

While Scotland's largest trading partner for goods, the Netherlands, observed the sharpest expansion in output since September, growth in the USA eased to a three-month low.

Meanwhile, Germany observed the weakest rise in output for five-and-a-half years, while protests in France dragged business activity into contraction.

Export Climate Index

sa, >50 = improving export climate since previous month



Top export markets, Scotland

Rank	Market	Weight	Output Index, Dec-18
1	Netherlands	15.0%	56.4
2	USA	11.6%	54.4
3	Germany	9.7%	51.6
4	China	7.7%	52.2
5	France	6.3%	48.7

Scotland Industry Specialisation









Location quotients (LQs) are useful measures of regional economic specialisation and offer a means to identify industry clusters at a local level. They are ratios derived by comparing the share of sector output (or gross value added) in regions with the national share of output in the same sector.

Focusing on the manufacturing and service sectors in isolation, a location quotient is calculated by taking a sector's proportion of regional output and comparing it with the UK-wide share of output in the sector. An LQ of 1.0 in a sector means that the region and the UK as a whole are equally specialised in that

sector. An LQ greater than 1.0 indicates that the sector has a greater economic footprint in the region than it does for the UK as a whole.

The tables below rank the location quotients for Scotland, broken down by manufacturing and services sub-sectors. The UK Output Index for each sub-sector is also displayed.

Manufacturing specialisation: Scotland

Rank	Sector	LQ	UK Output Index, Dec-18 (3mma)
1	Food & Drink	1.97	
2	Textiles & Clothing	1.22	
3	Wood & Paper	1.03	
4	Electrical & Electronic	1.00	
5	Metals & Metal Products	0.95	
6	Machinery & Equipment	0.88	
7	Chemicals, Rubber & Plastics	0.88	
8	Other Manufacturing	0.65	
9	Transport Equipment	0.34	

40 45 50 55 60 65

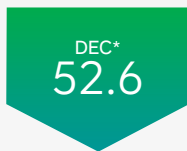
Services specialisation: Scotland

Rank	Sector	LQ	UK Business Activity Index, Dec-18 (3mma)
1	Hotels, Restaurants & Catering	1.25	
2	Other Personal / Consumer Services	1.07	
3	Financial Intermediation	1.03	
4	Transport & Communication Services	1.03	
5	Business-to-Business Services	0.95	
6	Computing & IT Services	0.68	

45 50 55

UK Sector Focus: Chemicals, Rubber & Plastics

Output Index



Last six months*



*3mma

Sharp rise in stockpiling across UK chemicals, rubber & plastics sector

The final quarter of 2018 saw businesses across the UK's chemicals, rubber & plastics sector ramp up stockpiling in preparation for the country's exit from the EU. Inventories of raw materials were accumulated at the fastest rate for almost a quarter of a century.

The overall performance of the sector meanwhile continued to falter, with the rate of output growth in the three months to December being the lowest recorded for over three years. This reflected a sustained soft patch in demand, particularly from clients abroad. Export orders contracted in the final quarter to continue the sector's worst period for international sales for six years.

More positively, latest data indicated a softening of costs pressures, linked to the recent fall in oil prices. Although input costs rose on average, the rate of inflation was at a 29-month low.

Output Index

sa, >50 = growth since previous month (3mma)



Stocks of Purchases Index

sa, >50 = growth since previous month (3mma)



UK Regional Rankings

Business Activity

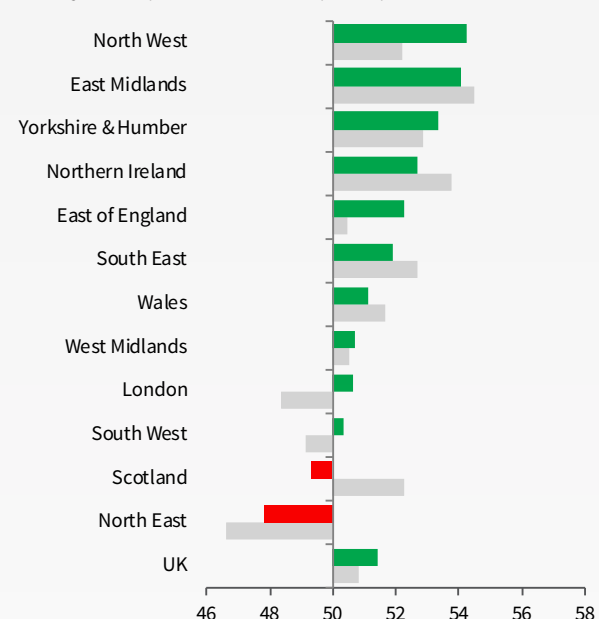
The North West led growth of business activity in December, having seen its output of goods and services rise at the quickest rate for three months. The East Midlands slipped to second in the rankings as growth in the region eased to a near two-year low, though still recorded the strongest average expansion of all regions in the fourth quarter of 2018 and across the year as a whole. The worst performer in December was again the North East, where business activity fell for the fourth straight month. Scotland recorded the only other decrease in output, its first since last February. London and the South West both saw only modest recoveries in business activity following contractions in November.

Employment

Firms in the North West also recorded the steepest rise in employment in December. However, as was the case in almost all regions, the rate of job creation slowed compared to November. Northern Ireland was ranked second overall and also recorded a solid rise in workforce numbers, its second-fastest in the past seven months. The only decrease in employment came in the North East, where staffing levels fell at the quickest rate since 2009.

Output Index by region

sa, >50 = growth since previous month, Dec-18 (Nov-18)



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Methodology

The Royal Bank of Scotland PMI® is compiled by IHS Markit from responses to questionnaires sent to a panel of around 500 manufacturers and service providers. The panel is stratified by detailed sector and company workforce size, based on contributions to GDP.

Survey responses are collected in the second half of each month and indicate the direction of change compared to the previous month. A diffusion index is calculated for each survey variable, for the manufacturing and services sectors. The index is the sum of the percentage of 'higher' responses and half the percentage of 'unchanged' responses. The indices vary between 0 and 100, with a reading above 50 indicating an overall increase compared to the previous month, and below 50 an overall decrease. The indices are then seasonally adjusted. Comparable manufacturing and services indices are then weighted together to form a composite index, with the weights based on official value added data.

The headline figure is the Business Activity Index. This is a composite index calculated by weighting together the Manufacturing Output Index and the Services Business Activity Index. The Scotland Business Activity Index is comparable to the UK Composite Output Index. It is sometimes referred to as the 'Scotland PMI', but is not comparable with the headline UK Manufacturing PMI figure.

Underlying survey data are not revised after publication, but seasonal adjustment factors may be revised from time to time as appropriate which will affect the seasonally adjusted data series.

For further information on the PMI survey methodology, please contact economics@ihsmarkit.com.

About PMI

Purchasing Managers' Index® (PMI®) surveys are now available for over 40 countries and also for key regions including the eurozone. They are the most closely watched business surveys in the world, favoured by central banks, financial markets and business decision makers for their ability to provide up-to-date, accurate and often unique monthly indicators of economic trends. To learn more go to ihsmarkit.com/products/pmi.html.

About Royal Bank of Scotland

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The bank has commitment to retain its close connections with the Scottish communities it serves.

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