

*To AGCC Members:*

*Good quality market intelligence is critical to smart decision-making. Your Chamber has made arrangements with Mackay Consultants to distribute the North East Scotland Monthly Economic Report to all members of the Chamber. We hope that you find this service a useful additional benefit.*

*Bob Collier, CEO, AGCC*

# **NORTH EAST SCOTLAND: MONTHLY ECONOMIC REPORT for AUGUST 2012 by MACKAY CONSULTANTS**



FirstGroup win west coast rail franchise

## ○ HIGHLIGHTS

- FirstGroup win west coast rail franchise
- Development plan submitted for Mariner oil field
- Cygnus gas field development approved
- Value of Peterhead fish landings up +14%
- Unemployment down by -140

## ● LOWLIGHTS

- Threat to 60 jobs at P&J and Evening Express
- UK oil production down -30%

## !! THIS MONTH'S COMMENTS

- \* Another good month
- \* Scottish, UK and Eurozone recessions

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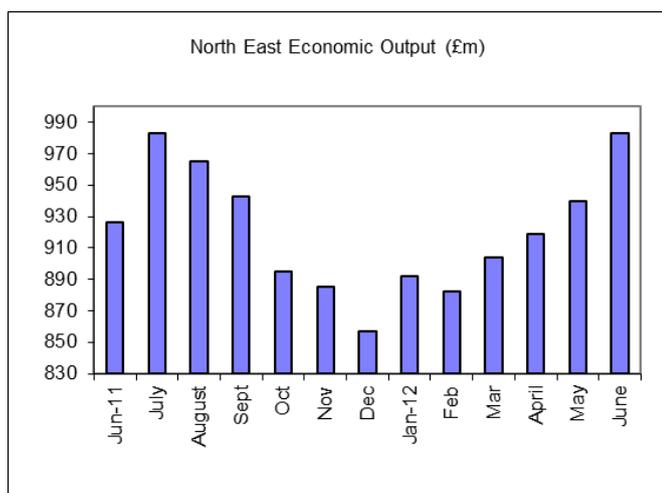
**Mackay Consultants, Albyn House, Union Street, Inverness, IV1 1QA**  
Telephone: 01463 223200, Fax: 01463 230869, E-mail: info@tonymackay.co.uk

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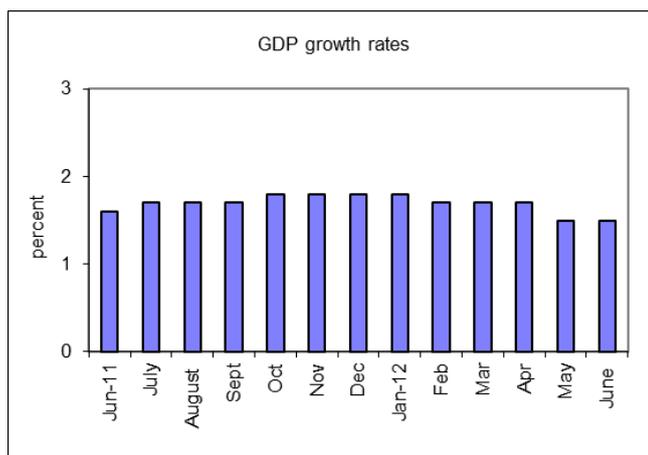
## ECONOMIC OUTPUT

We estimate that economic output in the North East in June was approximately £983 million. That is +1.5% higher in real terms than the June 2011 figure. Our estimates for the last twelve months are:

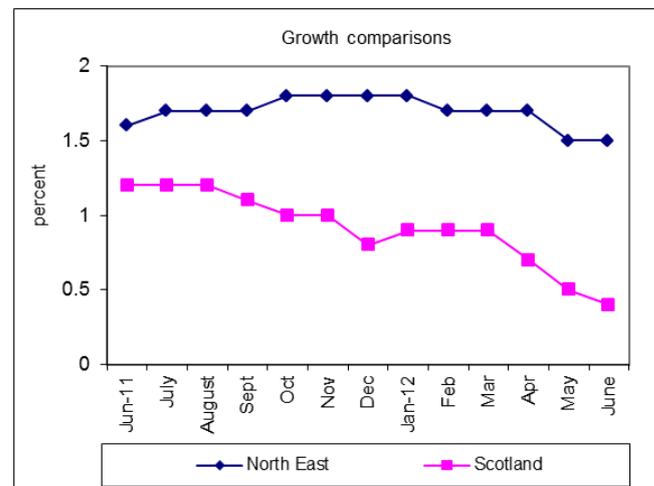
June 2011	£968 m	Jan 2012	£892 m
July	£983 m	February	£882 m
August	£965 m	March	£904 m
September	£943 m	April	£919 m
October	£895 m	May	£940 m
November	£885 m	June	£983 m
December	£857 m		



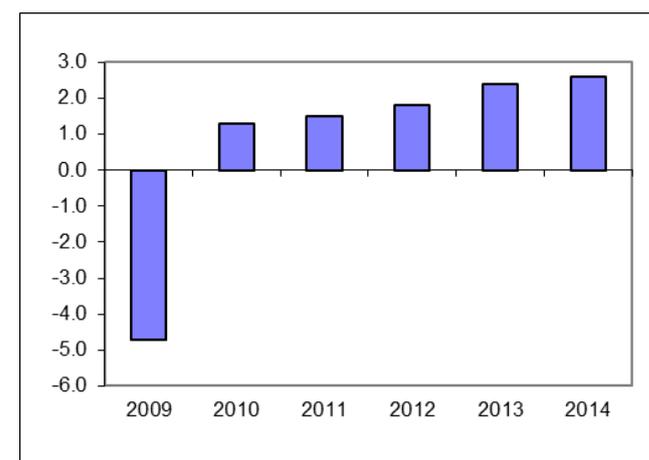
The growth rates for the last twelve months are illustrated in the figure below. These show the month-on-month comparisons, i.e. June 2012 compared with June 2011, May 2012 compared with May 2011 etc.



Economic output in the North East fell by a massive -4.7% in 2009. There was a modest recovery during 2010 and 2011 and our latest estimate is +1.5% growth, as shown in the figure below. Our estimate for Scotland as a whole is significantly lower at +0.4%.



Our current forecasts of North East GDP growth for the period to 2014 are:



Our latest forecasts are +1.8% in 2012, +2.4% in 2013 and +2.6% in 2014. All of those are well above our Scottish forecasts.

However, world oil and gas prices will inevitably be very important influences on the North East economy and they are very difficult to predict. Nevertheless, it is clear that the local economy is currently doing much better than the Scottish and UK economies.

## UK ECONOMY

We refer each month to the “Economist” magazine’s poll of GDP growth forecasts. The latest averages are:

	2012	2013
Britain	+0.1%	+1.5%
Euro area	-0.4%	+0.4%
USA	+2.1%	+2.2%

The forecasts for Britain have been revised downwards again, from +0.2% and +1.6% respectively. The range of forecasts for Britain in 2012 is now from -0.5% to +1.0%, and for 2013 from +0.6% to +2.3%.

There is even more pessimism about the Euro area economy, including a forecast -0.4% fall in output in 2012.

The Bank of England’s Monetary Policy Committee kept their base interest rate unchanged at just 0.5% at their July meeting. That continues to be the lowest level since the Bank was created in 1694!

Sterling was unchanged against the US dollar, ending July at \$1.55. It rose slightly against the euro to €1.27. The £ trade weighted index rose by +0.7% to 83.6.

### GDP

The Office for National Statistics’ (ONS) latest estimates show that UK GDP fell by -0.5% in the second quarter (Q2) of 2012.

### Manufacturing output

The index of manufacturing output was 102.2 in June, compared with 105.4 in May.

### Unemployment

The claimant count rate of unemployment is currently 5.2%. The wider rate (including the economically inactive) for the quarter March to May 2012 was 8.0%.

### Earnings

The annual growth in average earnings (“regular pay”) in June was +1.8%, unchanged from May in the previous month.

### Inflation

Inflation, as measured by the Consumer Price Index (CPI), was +2.4% in June, down from +2.8% in May. Retail Price Index (RPI) inflation was +3.2% in June, up from +3.1% in May.

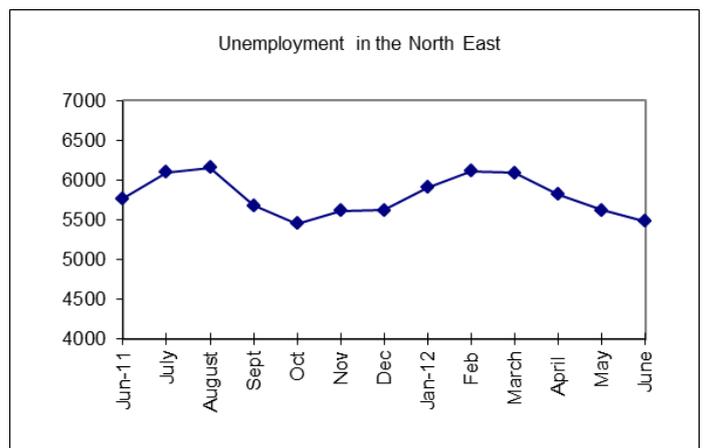
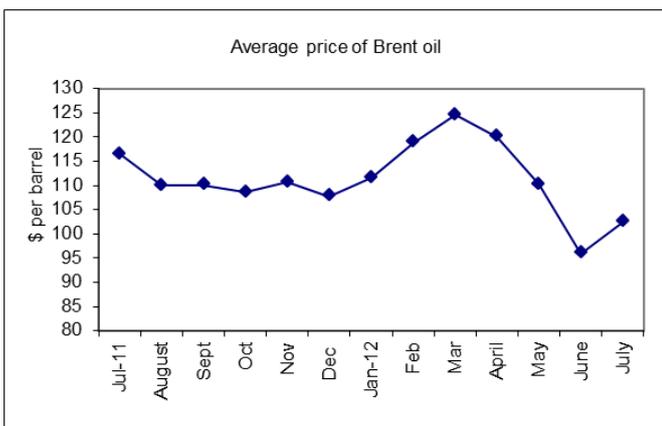
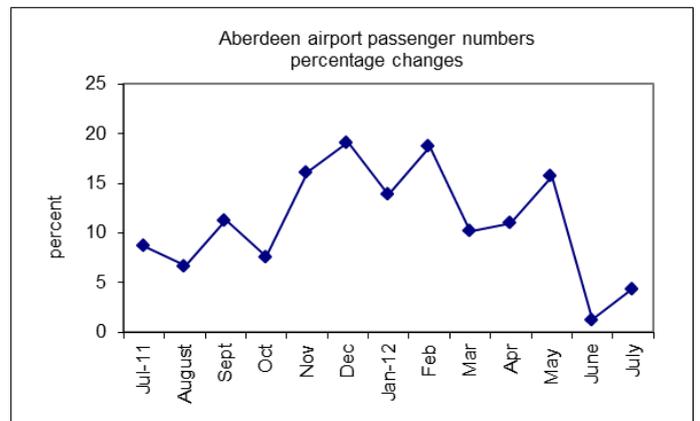
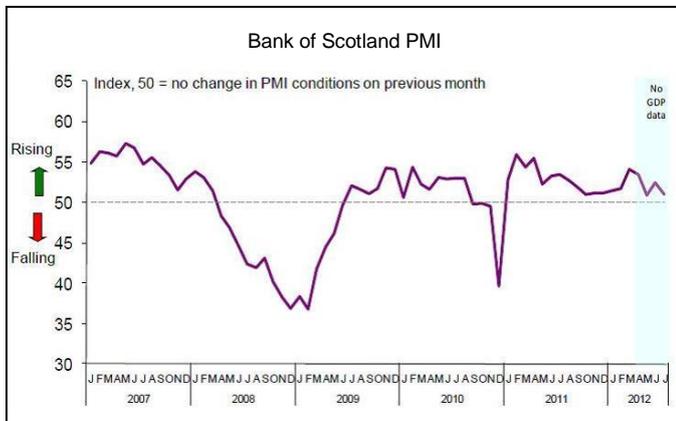
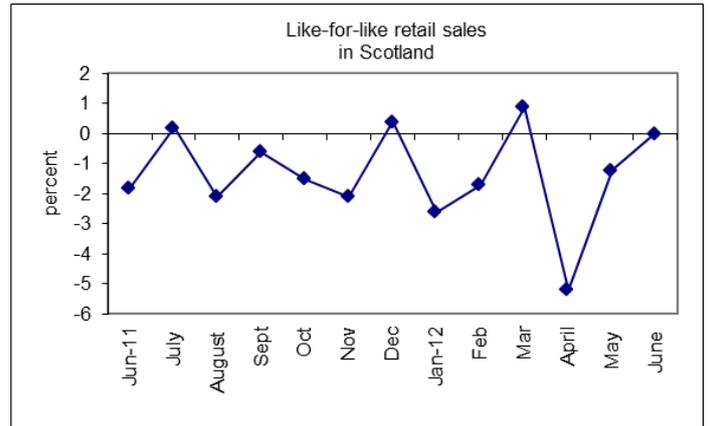
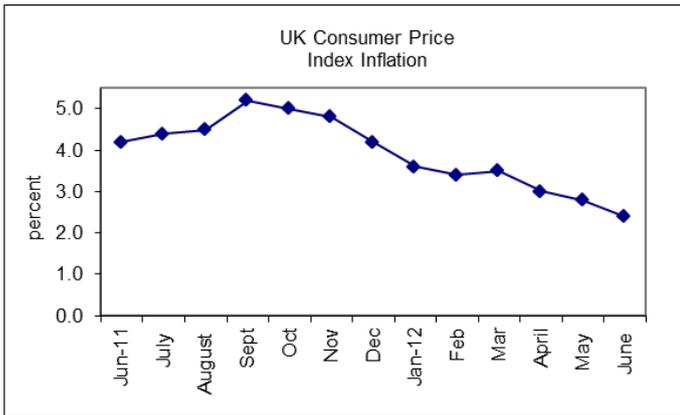
The CPI figure remains above the Government’s official +2% target.

The table below gives the main economic indicators.

	Real GDP (%)	CPI change (%)	Earnings growth (%)	Manufacturing output	Unemployment rate (%)
2008	0.4	3.7	3.7	101.3	2.7
2009	-4.9	2.2	2.3	89.3	4.7
2010	1.8	3.3	1.9	90.8	4.9
Q1 2009	-5.0	3.0	3.2	90.9	4.2
Q2	-5.5	2.1	2.6	88.5	4.7
Q3	-5.1	1.5	2.0	88.6	5.0
Q4	-3.1	2.1	1.2	89.2	5.0
Q1 2010	1.2	3.3	1.7	90.0	4.9
Q2	1.7	3.4	1.8	90.9	4.7
Q3	2.8	3.1	1.9	91.1	4.9
Q4	1.5	3.4	2.1	91.3	4.9
Q1 2011	1.8	4.1	2.2	92.8	5.0
Q2	0.8	4.4	2.1	91.9	5.2
Q3	0.5	4.7	1.9	95.1	5.4
Q4	-0.2	4.7	1.9	95.3	5.1
Q1 2012	-0.3	3.5	1.6	95.1	5.6
Q2	-0.5	2.7	1.8	100.7	5.2
April	n.a.	3.0	1.7	94.6	5.3
May	n.a.	2.8	1.8	105.4	5.2
June	n.a.	2.4	1.8	102.2	5.2

Note: GDP, CPI and earnings figures show the percentage growth over the same period in the previous year. The manufacturing output index is 2003 = 100.0.

# MONTHLY STATISTICS



## UNEMPLOYMENT

The unemployment level is probably the best single indicator of short-term changes in the local economy. There are various measures of unemployment, of which the wider rate including the economically inactive is probably the best. However, official statistics on that measure are not published monthly, so we have to rely on the narrower measure of the number of people claiming unemployment benefit.

The Scottish average for the latter is currently 5.2%. The wider rate (including the economically inactive) for the quarter March to May 2012 was 8.0%.

The latest monthly figures (June 2012) for the North East published by the Employment Department are:

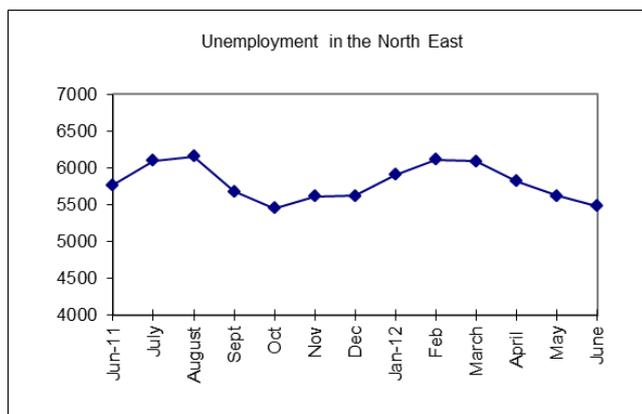
	male	female	total	male %	female %	total %
Aberdeen TTWA	2780	1275	4055			
Banff TTWA	247	120	367			
Fraserburgh TTWA	241	122	363			
Huntly TTWA	67	42	109			
Peterhead TTWA	327	166	493			
<b>Total TTWAs</b>	<b>3662</b>	<b>1725</b>	<b>5387</b>			
City of Aberdeen	2302	1038	3340	3.0	1.4	2.2
Aberdeenshire	1416	723	2139	1.8	0.9	1.3
<b>Total</b>	<b>3718</b>	<b>1761</b>	<b>5479</b>	<b>2.5</b>	<b>1.2</b>	<b>1.9</b>

The Aberdeenshire rate of 1.3% is the lowest of all the 32 local authority areas in Scotland and the Aberdeen City rate of 2.2% is the equal fourth lowest. The Scottish average is currently 4.2% on the same basis. The wider rate for Aberdeenshire is approximately 2.5% and for Aberdeen City 4.2%.

The figures for the two local authority areas since June 2011 are:

	City of Aberdeen		Aberdeenshire		Total for North East	
	Number	Change	Number	Change	Number	Change
June 2011	3,447	-101	2,320	-71	5,767	-172
July	3,644	+197	2,458	+138	6,102	+335
August	3,644	0	2,513	+55	6,157	+55
September	3,420	-224	2,257	-256	5,677	-480
October	3,334	-86	2,117	-140	5,451	-226
November	3,466	+132	2,148	+31	5,614	+163
December	3,394	-72	2,226	+78	5,620	+6
January 2012	3,545	+151	2,360	+134	5,905	+285
February	3,669	+124	2,447	+87	6,116	+211
March	3,637	-32	2,454	+7	6,091	-25
April	3,509	-128	2,312	-142	5,821	-270
May	3,399	-110	2,220	-92	5,619	-202
June	3,340	+1	2,139	-81	5,479	-140

Unemployment fell by -140 to 5,479. That compares with a fall of -172 in June 2011. The current total is -288 below the level of one year ago, as shown in the figure below.



The best comparisons are probably with the same period in 2011. The changes in unemployment in the TTWAs between June 2012 and June 2011 are shown below.

	June 2012	June 2011	diff	% diff
Aberdeen TTWA	4055	4226	-171	-4.2
Banff TTWA	367	380	-13	-3.5
Fraserburgh TTWA	363	397	-34	-9.4
Huntly TTWA	109	100	9	8.3
Peterhead TTWA	493	572	-79	-16.0
<b>Totals TTWAs</b>	<b>5387</b>	<b>5675</b>	<b>-288</b>	<b>-5.3</b>

The total number is -5.3% lower. Unemployment fell in four of the five TTWAs, with the exception being Huntly. The average change in Scotland as a whole was +1.6%.

## NEW DEVELOPMENTS

### Non oil-related

#### FirstGroup win west coast rail franchise

FirstGroup of Aberdeen have been selected by the UK Government as the new operators of the west coast mainline route from Scotland to London, taking over from Virgin Rail who have operated the service for about 15 years. Virgin's 260 employees in Scotland would all transfer over when the contract changes hands on December 9.



#### City Gardens development rejected

Aberdeen's City Garden Project has been narrowly rejected after a council debate. The vote focused on the proposed £140 million plan - backed by £50 million from businessman Sir Ian Wood and family - to transform the historic Union Terrace Gardens. New proposals for improvements to Union Terrace Gardens, and landmark buildings, were backed by 22 councillors, with 20 against and one abstention.

#### Aberdeen happiest city in UK

The Office for National Statistics revealed the results of a nationwide poll which asked how cheerful and satisfied people are with their lives. Aberdeen ranked top in all categories among the major urban populations of Britain.

#### Brussels cash snub for Buchan energy scheme

The bid to build Britain's first carbon capture and storage (CCS) plant at Peterhead was dealt a blow when it was placed on a reserve list for EU funding of up to £1.2 billion. Eight other projects have made it to the shortlist for the first round of the NER300 competition, according to a new European Commission report. Only the first two or three bids are likely to win financial support.

#### Slains Castle housing plans revived

Plans to transform an iconic north-east castle into a holiday homes complex have been resurrected. Developers are planning a fresh public consultation for the site of the 16th-century Slains fortress. Eight years ago, the Slains Partnership sparked a row by unveiling a £6 million plan for the cliff-top ruin.

#### Plans for new business park at Mintlaw

Aberdeenshire Council have tabled plans to build a new business park on land off Newlands Road in Mintlaw. The two acre site, near the village's Aden Country Park, would have space for around four units.

#### Fishermen told to pay £1.2 million for "black fish" landings

A total of 10 North East fishing skippers have been ordered to pay almost £1.2 million, after admitting their involvement in a "black fish operation". The group previously pled guilty to the illegal landing of undeclared catches at two processors, Fresh Catch and Alexander Buchan, in Peterhead.

#### Bypass contract awarded

Aberdeen City Council have awarded a £235,000 contract to Edinburgh-based Headland Archaeology to assess the impact the Aberdeen Western Peripheral Route could have on historical sites.

#### Law firm expand into Central Belt

Law firm Aberdeen Considine and Co have opened their first full legal office in the central belt at Ochil House in Livingston. They will also have a presence in Glasgow from next month after taking on premises there. The two new locations mean the firm, who employ 270 people, will have 14 offices in total.

#### Northern Oils acquire Caley Oils

Northern Oils have acquired Peterhead-based Caley Oils for an undisclosed sum. Including Caley's depots at Peterhead, Fraserburgh, Ullapool and North Shields on Tyneside, the enlarged company will have 12 depots nationwide and employ around 75 people, although Northern have plans to add 15 to the workforce.

#### International Fish Cannery make another loss

International Fish Cannery, the Fraserburgh-based canned seafood processors, reported pre-tax losses of £137,275 in the year to 31 March, down from £248,500 in the previous year. Turnover increased +23% to £15.7 million.

#### Retail sales show no growth in June

Like-for-like retail sales in June did not show any growth compared with June 2011, according to the Scottish Retail Consortium. The equivalent like-for-like retail sales in the UK as a whole were up +1.4%.

#### Aberdeen Airport passenger numbers up +4.4%

314,300 passengers used Aberdeen Airport in July, which was +4.4% more than in the same month of 2011. That was in contrast to falls at Edinburgh and Glasgow airports.

#### Value of Peterhead fish landings up +14%

Fish landings at Peterhead in June were valued at £11.0 million, up +14% on June 2011. White fish accounted for 57%, shellfish 5% and pelagic 38%, according to the latest statistics from the Peterhead Port Authority.

#### New car sales up +24% in July

New car registrations in Scotland in July totalled 12,036, an increase of +24% compared with July 2011. The overall British figure showed an increase of +9%, according to the Scottish Motor Trade Association.

#### St Magnus House sold

St Magnus House on Guild Street in Aberdeen has been sold by Apia Regional Office Fund Partnership to British Airways Pension Fund for £18.3 million. The office building is let to Canadian oil company CNR.

#### Threat to 59 jobs at DC Thomson

DC Thomson, the media group, are considering outsourcing distribution of the Press and Journal and Evening Express newspapers in Aberdeen in a move which could affect 59 members of staff. A redundancy consultation will begin with staff who work in the transport, circulation and finance departments in both Aberdeen and Inverness.

### **Oil-related**

#### £1.4 billion Cygnus gas project sanctioned

GDF Suez with partners Centrica and Bayerngas have announced development sanctioning of the £1.4 billion Cygnus gas field in the UK Southern North Sea. Initial contracts worth £375 million were signed. Among the companies to benefit are Fife-based Burntisland Fabricators, which will manage the fabrication contract of the platform topsides and jacket, with the creation of 100 new jobs. The contracts will bring a further 50 jobs to GDF Suez's operational headquarters in Aberdeen, with an additional 100 jobs created when offshore platform operations are manned from 2015.

#### Development plan for Mariner oil field

Statoil have applied to the Department of Energy and Climate Change for permission to develop the Mariner field, 81 miles south-east of Shetland. Statoil want to install a platform and a floating production vessel as part of the project. They plan to start development work in 2015, with first production in 2016. The Mariner area, one of the UK's largest untapped oil finds, is estimated to hold up to 400 million barrels of recoverable oil. As part of the plans to develop the field, Statoil want to build an operational base in Aberdeen and create 1,000 onshore and offshore jobs.

#### Ithaca awards £146m North Sea contract to Technip

Ithaca Energy have awarded a £146 million contract to oil service group Technip. The engineering, procurement, installation and construction contract covers subsea work on the Greater Stella Area in the Central North Sea.

#### Work starts on new oil industry business park

Construction has begun on Drum Property Group's Prime Four business park in Kingswells, four miles west of Aberdeen city centre, with an estimated 1200 jobs to be located there. Oil and gas companies Apache North Sea, Nexen and Transocean will be based on the new business park. .

#### Aker win contract extension with Perenco

Aker Solutions announced their maintenance; modifications and operations business have won an £18 million contract that will guarantee the future of 80 jobs in the North East. The three year contract extension to support Perenco's North Sea operations will be overseen by their Aberdeen base. The contract, which could be extended for a further two years, is for work on Perenco's onshore and offshore assets in the Southern North Sea.

#### Prosafe's £37million contract

Prosafe, the accommodation platform operators, have won a £36.9 million contract in the UK North Sea for an undisclosed client. The 187 day contract is due to start next April.

#### Technip win £79 million ConocoPhillips contract

Technip have won a contract worth up to £79 million with ConocoPhillips. The five year inspection, repair and maintenance frame agreement covers various assets of ConocoPhillips in the Central North Sea and East Irish Sea and will involve diver repair and maintenance work. Technip's operating centre at Westhill will execute the contract, which will run from 2012-2016, with two two-year options to extend.

#### Wood Group PSN win Australia contract

Wood Group PSN announced a £6.7 million contract for Shell off the coast of Western Australia for the oil company's Prelude floating LNG plant. It is to build a computerised maintenance management system. The contract will be delivered by teams in Perth, Australia, and Aberdeen.

#### Proserv win £6 million subsea contracts

Proserv have won two contracts worth more than £6 million to provide subsea control systems. One of the contracts with Maersk Oil UK is to develop a subsea tieback to the Clyde platform in the Central North Sea. The other is to work on a development in the Southern North Sea for an unnamed company.

#### Petrofac win Iraq contract worth £63 million

Petrofac have won their first offshore operations contract in Iraq with South Oil Company. The energy services group will provide operations and maintenance services for the Iraq crude oil export expansion project under the contract, worth about £63 million. There is also an option to extend the 12 month contract by a further two years.

#### Helix Well Ops to recruit after fleet expansion

Helix Well Ops plan to recruit 60 people after adding a third vessel to their fleet. The subsea well-intervention specialist need to take on 50 offshore workers and 10 staff onshore in the coming months after signing a three year charter for the Skandi Constructor.

#### Geoships to recruit 40 staff

Geoships, the Westhill-based marine and subsea services providers, are planning to recruit 40 people after finalising a deal with Singapore-based Teras Offshore to charter a new vessel, the Loch Seaforth, for operations in the North Sea.

#### Meta Downhole expansion

Meta Downhole are creating nine jobs in a new electronics hydraulic division to be based at their headquarters in Aberdeen after winning new contracts worth over £10 million in the past few months.

#### Aberdeen Drilling Contractors expansion

Aberdeen Drilling Consultants have unveiled plans to double their headcount to 120 workers after securing financing to buy larger premises. The firm are moving from their current 1,000 sq ft site into 4,500 sq ft premises after securing a £1 million loan from the Clydesdale Bank.

#### EnerMech's £5 million Saudi investment

EnerMech, the engineering group, are investing up to £5 million in a joint venture with the Shoaibi Group in Saudi Arabia. The new business will employ about 40 people and provide services such as cranes, hydraulics, valves, pipelines and umbilicals to the Saudi Arabian energy sector.

#### Enquest looking for new headquarters in Aberdeen

Enquest, the independent oil and gas firm, are looking for an Aberdeen city centre site for new headquarters. The firm have quadrupled staffing in two years to 1,500, and are now want to have all onshore workers under one roof.

#### Senergy Holdings profits down -25% to £2.1 million.

Senergy Holdings reported pre-tax profits fell -25% to £2.1 million in the 12 months to 31 May 2011. Turnover rose +34% to £107.7 million.

#### ATR reduce losses

ATR Holdings reported pre-tax losses narrowed from £894,000 to £541,000 in the 12 months to 31 October 2011. Turnover increased +8% to £15.2 million. ATR were bought in March this year by the ATR Offshore Group.

#### UK North Sea oil production down -30%

UK oil and gas production both fell in April 2012, compared with the same month of 2011. Average daily oil output was 788,645 barrels per day, which was down -30% compared with April 2011. Average daily gas output was 4,006 million cubic feet per day, a fall of -23% compared with March 2011.

#### Oil prices

Brent crude began July at US\$96.27 per barrel and ended it at \$105.59, an increase of +9.5%. The monthly average was \$102.45, which was +7% higher than the \$95.95 average in June. Prices traded between \$96.27 and \$107.27.

#### Talisman to sell North Sea stake sale to Sinopec for £968 million

Talisman Energy have agreed to sell a 49% equity stake in their North Sea operations to Chinese energy firm Sinopec for £968 million. Talisman's Aberdeen-based operation has about 2,500 staff and contractors, and involves 11 North Sea installations.



#### Melrose and Petroceltic to merge

Melrose Resources the Edinburgh-based oil company, have agreed a merger with Petroceltic of Dublin. The new company will be called Petroceltic and their headquarters will be in Ireland. Each Melrose share held will receive 17.6 Petroceltic shares.

#### Asco acquire Scrabster Port Services

Asco, the oil and gas logistics group, have taken full control of Scrabster Port Services as they seek to develop a major hub for offshore exploration and production support west of Shetland. The firm, which already owned 50% of Scrabster, bought the rest of the company from Port Services of Invergordon for an undisclosed

### Screw Conveyor sold

Energy Environmental Group have sold Screw Conveyor to private equity firm Azure Investments in a £5 million deal. Screw Conveyor design, manufacture and supply engineering components used in the onshore and offshore drilling sector.

### ICR buy Moss Mechanical

ICR Integrity, who specialise in integrity and maintenance, have acquired Moss Mechanical On Site Services, a Cumbria-based mechanical service business with an operation in Aberdeen. The deal is understood to be worth several million pounds.

### Parkmead complete DEO Petroleum acquisition

The Parkmead Group have completed the purchase of DEO Petroleum for £12.7 million.

### RB Farquhar buy Stopsave in £2.5 million deal

RB Farquhar, the former bathroom pod manufacturers, have acquired oil and gas safety and product suppliers and training providers Stopsave for around £2.5 million, in their first acquisition since emerging from administration earlier this year.

### ATP Oil and Gas file for bankruptcy

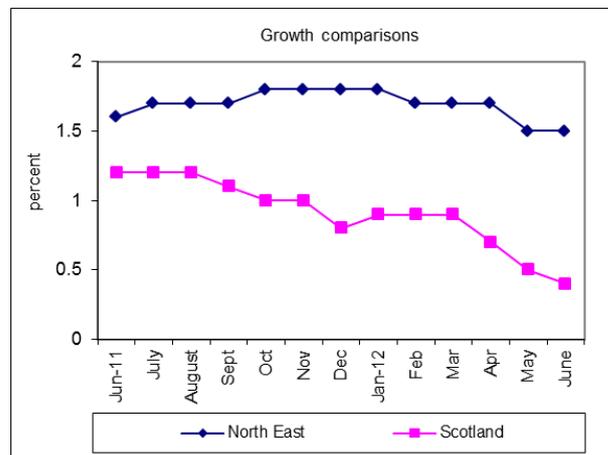
ATP Oil and Gas have filed for bankruptcy after failing to recover from a ban on deep sea drilling in the Gulf of Mexico following the Deepwater Horizon explosion. The US firm, who are developing the North Sea Cheviot field, have signed multimillion pound contracts for the project. Earlier this year Petrofac were awarded a pre-operations contract for a floating production facility, while Subsea 7 agreed a £100 million plus contract for work on the development, about 75 miles east of Shetland.

## **THIS MONTH'S COMMENTS**

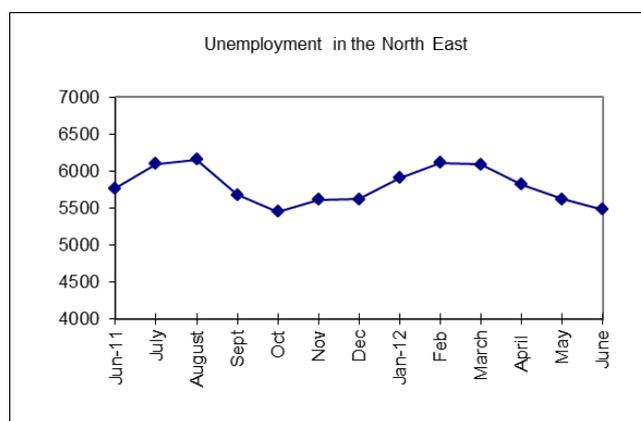
### **Another good month**

July was another good month for the North East economy, with plenty of positive developments and very little bad news. The local economy continues to outperform its Scottish and UK counterparts.

We estimate that monthly economic output in the North East was approximately £983 million, which was +1.5% higher than one year ago. That growth rate is more than treble our +0.4% estimate for Scotland as a whole, as illustrated in the figure below, and the latter estimate is probably too high.



Unemployment fell by -140 to 5,479. The current total is -288 below the level of one year ago, as shown in the next figure.



The local unemployment rates remain well below the Scottish and UK averages. The Aberdeenshire rate of 1.3% is the lowest of all the 32 local authority areas in Scotland and the Aberdeen City rate of 2.2% is the fourth lowest. The Scottish average is currently 4.2% on the same basis.

Most of the good news came – yet again – from the oil and gas industry, which continues to go through a boom because of high oil prices. However, the development which attracted the greatest attention was FirstGroup's success in winning the west coast rail franchise, succeeding Virgin Rail who has operated it for about 15 years.

Virgin Rail had appealed the decision at the time of writing so the final outcome was not known. The general opinion in the rail industry seems to be that FirstGroup have overbid for the franchise and that their growth forecasts are too optimistic.

There were few other new developments in the non-oil sector and they were mixed on the whole. The value of fish landing at Peterhead was up +14% on the same month of last year. Passenger numbers at Aberdeen

airport were up +4%, in contrast with declines at both Glasgow and Edinburgh.

However, there is a threat to about 60 jobs at the Press and Journal and Evening Express in Aberdeen.

Most of the good news during the month came from the oil and gas industry, as usual. We have reported many times recently on the boom in the industry, because of high oil prices, and that continues. The price of Brent crude rose again during July and at the time of writing was trading above \$110 per barrel.

The latest developments include:

- go-ahead for the Cygnus gas field
- development application for the Mariner oil field.

The latter development by Statoil is likely to involve an investment of about £10 billion and create up to 1,000 jobs onshore in Aberdeen and offshore.

Various companies announced expansion plans, including:

- Aberdeen Drilling Contractors
- Geoships
- Helix Well Ops
- Meta Downhole.

Other companies announce new contracts. Most of those were on the UKCS but a few were overseas, including a Petrofac contract in Iraq and a Wood Group PSN contract in Australia.

It was a busy month for deals. Talisman Energy agreed to sell 49% of their UKCS interests to Sinopec of China for just under £1 billion; Melrose Resources and Petroceltic agreed to merge; and Parkmead completed their takeover of DEO Petroleum.

On the downside, UK oil production fell by -30% and gas production by -23%. I wrote about these massive declines in last month's report and they continue.

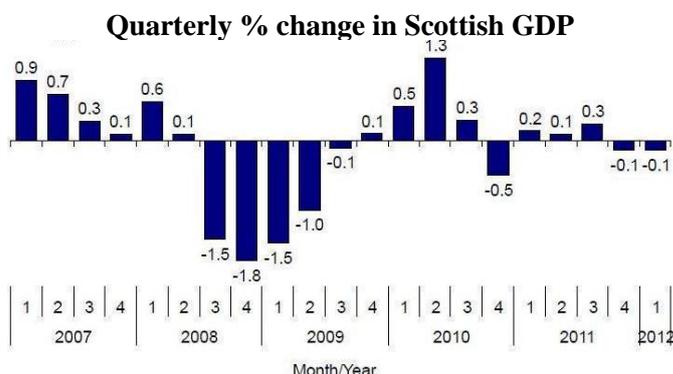
Nevertheless, it was another good month for the North East economy which continues to outperform the rest of Scotland and the UK.

## Scottish, UK and Eurozone recessions

Economic recessions are usually defined as two successive quarters of falling economic output (or negative growth, according to some people). The Scottish and UK economies went into a serious recession in 2008 and 2009 because of the global

financial crisis. The Royal Bank of Scotland (RBS) and Bank of Scotland were both instrumental in that crisis.

There was then a recovery in 2010, as set out in the figure below which shows the quarterly changes in Scottish GDP.



However the recovery has stalled, to the surprise of many economists and politicians. The figure shows a -0.5% fall in economic output in the fourth quarter (Q4) of 2010. Growth in the first three quarters of 2011 was very low.

The Scottish Government's official statistics show declines of -0.1% in both Q4 of 2011 and Q1 of 2012. They are very small declines but nevertheless indicate that the Scottish economy has fallen back into recession.

The official UK statistics show a similar, indeed slightly worse picture. The Office for National Statistics (ONS) latest estimate show a -0.5% fall in UK GDP in Q2 of 2012, which is the third consecutive decline.

The -0.5% estimate was much worse than generally expected and undoubtedly a big shock to the Chancellor of the Exchequer George Osborne and the UK Government.

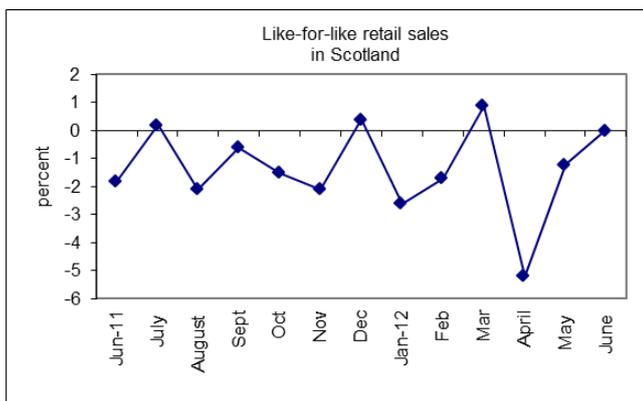
Why are the Scottish and UK economies back in recession? Millions of column inches have been written about these problems but I believe that some of the fundamental reasons have been widely ignored.

In simple terms, economic output can be defined as domestic demand + exports - imports. In Scotland domestic demand accounts for about 80% of the total.

Exports can be defined as including or excluding the English/Rest of UK market but usually regarding it as domestic demand. There can be no doubt that domestic demand has been depressed over the last few years. The reasons for that include low consumer confidence, reduced lending by the banks and the cuts in UK public spending.

The international financial crisis in 2008 and 2009 turned into the sovereign wealth crisis in some countries, notably Greece and Spain in the Eurozone. One of the main reasons for that was governments bailing out troubled banks. That happened in the UK, with the Government rescuing RBS, HBOS and others, but has had much more serious consequence in other countries, particularly in the Eurozone.

Consumer confidence and spending remain low in Scotland, as demonstrated by the monthly statistics from the Scottish Retail Consortium. The figure below shows like-for-like retail sales. These are in nominal terms and in real terms, taking account of inflation (which has been up to 5% during the period shown), have been even worse.



Consumer confidence is low for a variety of reasons, including: falls in house values, share prices and the value of pensions; high unemployment; and the general doom and gloom.

I agree with many economists that there is an urgent need to simulate the Scottish and UK economies but disagree with most about how that should be done. There has been far too much emphasis on increasing public spending, particularly on infrastructure projects, in my opinion. I believe that the main objective should be to boost consumer spending, for example through a reduction in VAT.

Increased public spending might help but it must be done without sabotaging the long term goals of reducing the size of the public sector in Scotland, which is much too large. It is also important to bear in mind that many of the proposed infrastructure projects will take years to come to fruition and will do little to boost the economy in the short term.

The Bank of England believes it has made a substantial contribution through its quantitative easing (QE) programme but I disagree. There are very few signs of the benefits of QE reaching small businesses and individuals. Most of the banks have used the money to improve their balance sheets rather than increase lending.

There seem few significant differences between the current Scottish and UK recessions. The Scottish Government's official estimate of Scottish GDP in 2012 Q2 will not be published for a few more weeks but is unlikely to be significantly different from the -0.5% for the UK as a whole.

The Scottish estimates for 2011 Q4 and 2012 Q1 were slightly better than the UK estimates but I do not put much significance on that. The margins for error in the Scottish estimates are higher and there have been significant errors in the past, notably in relation to construction output, which have led to subsequent revisions.

The public sector continues to be much larger in Scotland than in the UK as a whole and that inevitably has an adverse impact on the growth rate. If the Scottish economy is doing less worse than the UK economy, the main reason for that is without doubt the oil and gas industry in the Aberdeen area which is experiencing a boom because of high oil prices.

There are few other bright spots. They include the Scotch whisky industry, which is benefitting from higher exports to "emerging markets" such as China, India and South America rather than mature markets such as the EU and USA.

Exporters dependent on the EU and USA markets are clearly having a very difficult time. The ongoing Eurozone crisis has been very badly handled by the politicians involved and the European Central Bank. It has dragged on for months and the indecision has been one of the main reasons for the drastic falls in consumer confidence, in my opinion at least.

There is little or nothing that we can do to help solve the Eurozone crisis. The emphasis must therefore be on implementing effective measures to boost the domestic economy in both Scotland and the rest of the UK.

It is difficult to see that happening at the UK level while George Osborne continues to be Chancellor of the Exchequer. His Budget earlier this year was very poor and a missed opportunity. There are rumours that he will be replaced soon but the Prime Minister seems very loyal to him.

The Scottish Government has very limited opportunities. Because of that, the emphasis on new infrastructure projects is understandable, although they will be of little benefit in the short run.

In my opinion the main objectives must be to boost consumer confidence and spending. A cut in VAT to 15%, for example, may be the best way of doing that.

**Tony Mackay**