

*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 OCTOBER 2012 by MACKAY CONSULTANTS



FirstGroup lose West Coast rail franchise

○ HIGHLIGHTS

- Value of Peterhead fish landings up +15%
- Wood Group in USA shale oil acquisition
- New schools for Alford and Aberdeen
- Plans for 4,700 houses at Danestone in Aberdeen
- Unemployment down by -102

● LOWLIGHTS

- FirstGroup lose West Coast rail franchise
- Two JJB Sports outlets in Aberdeen close

!! THIS MONTH'S COMMENTS

- * A quiet month
- * West Coast rail franchise fiasco
- * UK oil and gas production continue to plummet

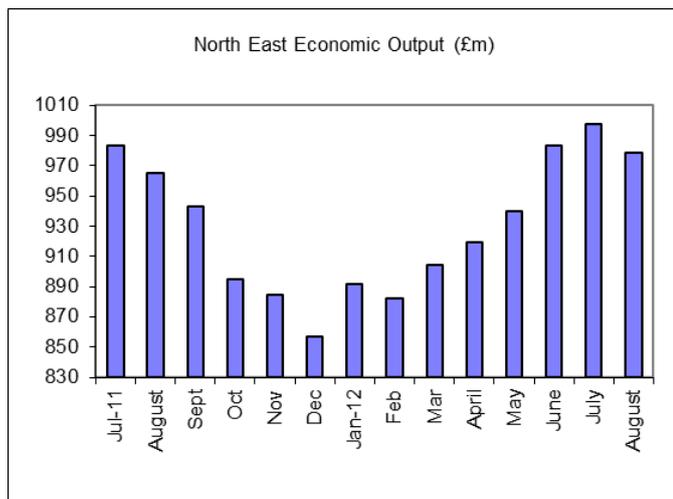
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- business development strategies
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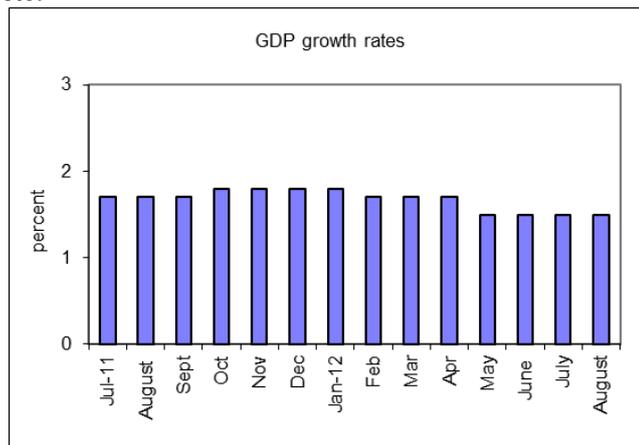
ECONOMIC OUTPUT

We estimate that economic output in the North East in August was approximately £979 million. That is +1.5% higher in real terms than the August 2011 figure. Our estimates for the last twelve months are:

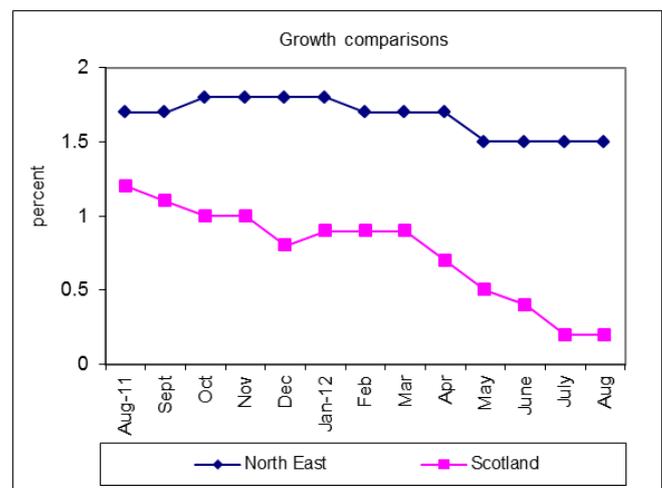
Aug 2011	£965 m	March	£904 m
September	£943 m	April	£919 m
October	£895 m	May	£940 m
November	£885 m	June	£983 m
December	£857 m	July	£998 m
Jan 2012	£892 m	August	£979 m
February	£882 m		



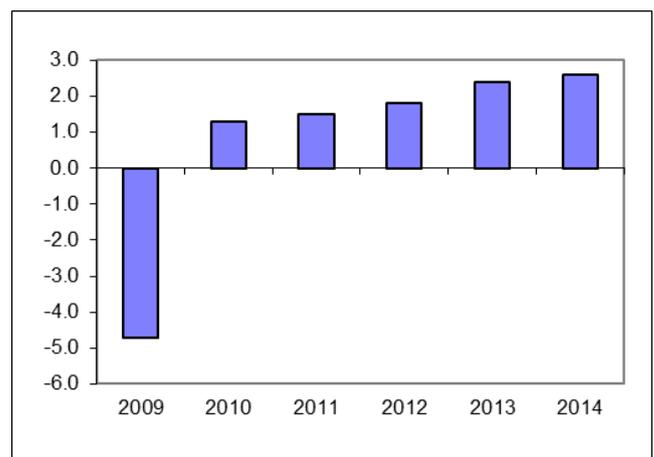
The growth rates for the last twelve months are illustrated in the figure below. These show the month-on-month comparisons, i.e. August 2012 compared with August 2011, July 2012 compared with July 2011 etc.



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 +0.2%.



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	-0.2%	+1.1%
Euro area	-0.5%	+0.1%
USA	+2.1%	+1.9%

There have only been minor changes to these forecasts since last month, but they continue to give a very gloomy picture. The range of forecasts for Britain in 2012 is now from -0.7% to +0.5%, and for 2013 from +0.5% to +1.9%.

There is even more pessimism about the Euro area economy, including a forecast -0.5% fall in output in 2012 and very little growth in 2013.

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

Sterling rose by +1.9% against the US dollar, ending September at \$1.62. However, it fell by -1.6% against the euro to €1.24. The £ trade weighted index fell by -0.4% to 84.2.

GDP

The Office for National Statistics’ (ONS) final estimates show that UK GDP fell by -0.4% in the second quarter (Q2) of 2012. That compares with the first estimate of -0.7%.

Manufacturing output

The index of manufacturing output was 104.6 in August, compared with 105.9 in July.

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 July was +1.9%, up +0.1% from June.

Inflation

Inflation, as measured by the Consumer Price Index (CPI), was +2.5% in August, down from +2.6% in July. Retail Price Index (RPI) inflation was +2.9% in August, down from +3.2% in July.

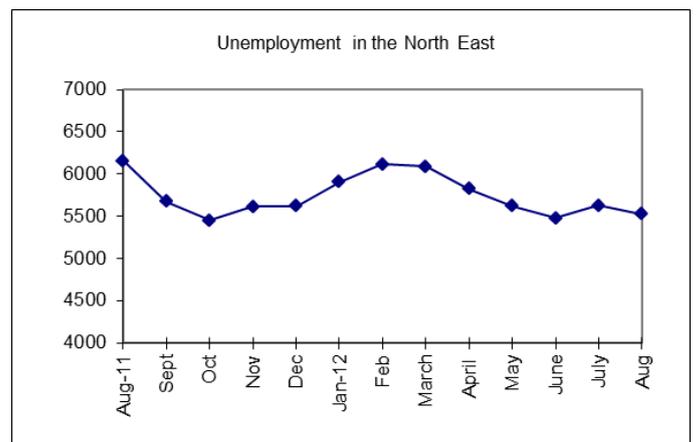
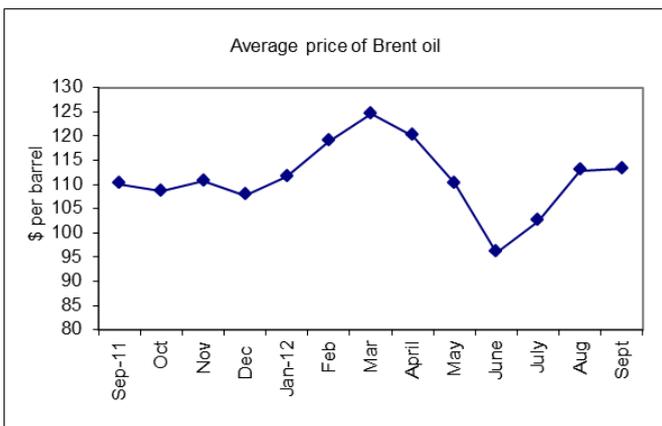
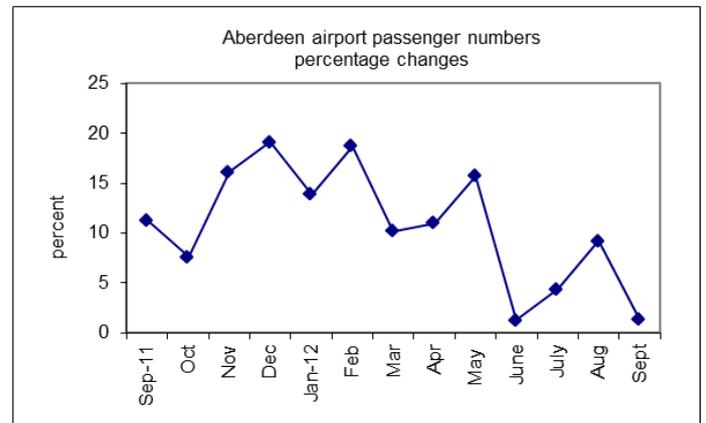
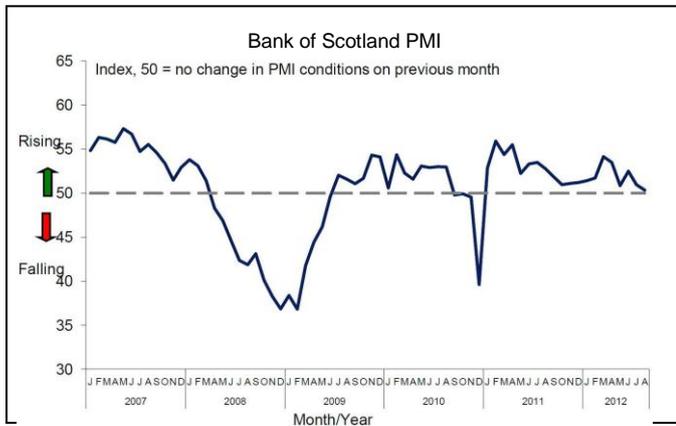
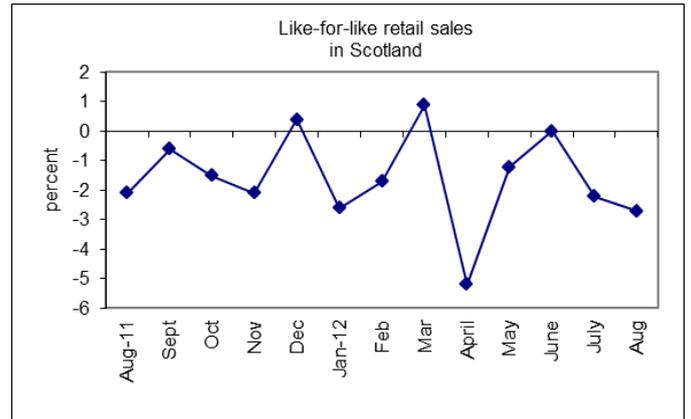
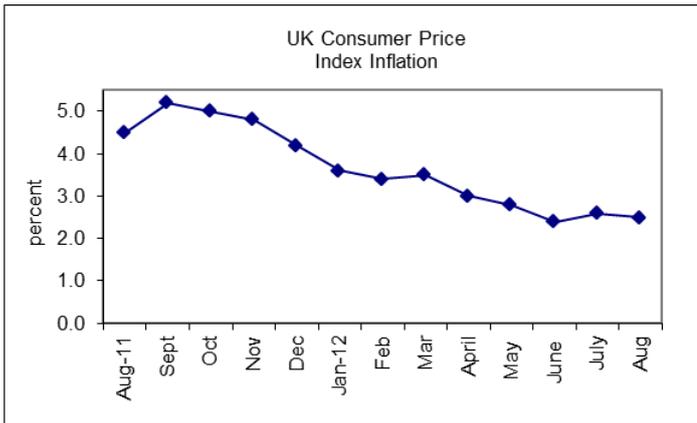
The CPI figure remains above the Government’s official +2% target.

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
June	n.a.	2.4	1.8	102.2	5.2
July	n.a.	2.6	1.9	105.9	5.3
August	n.a.	2.5	n.a.	104.6	5.3

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 5.3%. The wider rate (including the economically inactive) for the quarter May to July 2012 was 8.2%.

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

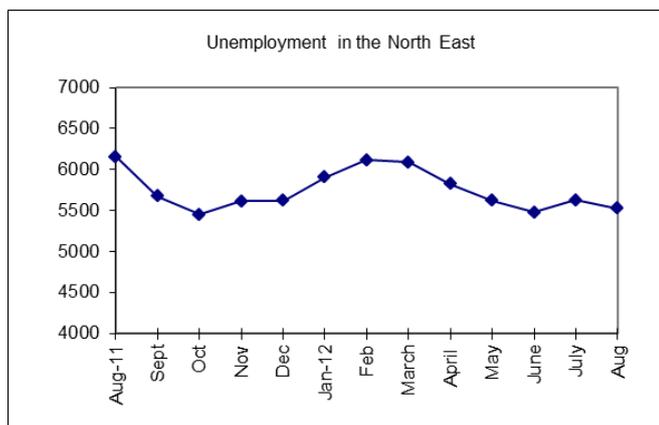
	male	female	total	male %	female %	total %
Aberdeen TTWA	2730	1394	4124			
Banff TTWA	223	116	339			
Fraserburgh TTWA	227	120	347			
Huntly TTWA	81	39	120			
Peterhead TTWA	317	190	507			
Total TTWAs	3578	1859	5437			
City of Aberdeen	2253	1128	3381	2.9	1.5	2.2
Aberdeenshire	1375	767	2142	1.7	1.0	1.3
Total	3628	1895	5523	2.4	1.3	2.0

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 4.3% on the same basis. The wider rate for Aberdeen City is approximately 4.2% and Aberdeenshire 2.5%.

The figures for the two local authority areas since August 2012 are:

	City of Aberdeen		Aberdeenshire		Total for North East	
	Number	Change	Number	Change	Number	Change
August 2011	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
July	3,401	+61	2,224	+85	5,625	+146
August	3,381	-20	2,142	-82	5,523	-102

Unemployment fell by -102 to 5,523. That compares with a rise of +55 in August 2011. The current total is -634 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 August 2012 and August 2011 are shown below.

	August 2012	August 2011	diff	% diff
Aberdeen TTWA	4124	4488	-364	-8.8
Banff TTWA	339	409	-70	-20.6
Fraserburgh TTWA	347	439	-92	-26.5
Huntly TTWA	120	114	6	5.0
Peterhead TTWA	507	604	-97	-19.1
Totals TTWAs	5437	6054	-617	-11.3

The total number is -11.3% lower. Unemployment fell in four of the five TTWAs and rose in one – Huntly TTWA (+5.0%). The average change in Scotland as a whole was -1.7%.

NEW DEVELOPMENTS

Non oil-related

West Coast franchise fiasco

First Group, who won the contract in the summer for the cross-border West Coast Main Line rail services from current operators Virgin Trains, has had the contract revoked after the Department for Transport admitted significant technical flaws in the decision award. FirstGroup were due to take over running the Glasgow to London line in December. **See Comments.**



New schools for Alford and Aberdeen

The Scottish Government announced a list of 30 new schools, for which they will provide most of the finance required. They include:

- Alford Community Campus
- A replacement for Torry and Kincorth Academies in Aberdeen.

Jamie Oliver to open restaurant in Aberdeen

Jamie Oliver, the well-known tv chef, is to open one of his restaurants in the former Esslemont and McIntosh building on Union street in Aberdeen. The restaurant is expected to create up to 90 jobs.

Original Penguin to open store in Aberdeen

Original Penguin, an US clothing chain, are to open a store in the Union Square complex in Aberdeen. It will be their first venture in Scotland.

Highland Chocolatier open store in Aberdeen

The Highland Chocolatier has expanded from its Perthshire home and opened a new retail outlet in the Bon Accord Centre in Aberdeen.

Scottish Open Golf to be held in Aberdeen in 2014

The Scottish Open golf championship will be held at the Royal Aberdeen golf course in 2014.

Craigdon invest £2.5 million in outdoor centre

Gordon Lee, co-owner of Inverurie-based Craigdon Mountain Sports, has received planning approval to redevelop the former Fairmile Inn south of Edinburgh into the Pentland Outdoor Centre. The £2.5 million transformation of the building, expected to be open next year, will be the Inverurie-based company's fifth outlet.

Plans for 4,700 houses at Danestone in Aberdeen

The Grandhome Trust have submitted a proposal of application notice with Aberdeen City Council for a new town at Danestone. The plans include 4,700 homes, a town centre, including retail and leisure uses and a hotel, as well as 12 acres of employment land, four primary schools, a community-use secondary school and library, energy centre, open spaces and play areas.

Twelve bids for St Nicholas House

Aberdeen City Council have received twelve bids for St Nicholas House, their former headquarters. The proposals include a hotel and 600 space car park.

£334,000 grants for fisheries projects

Seven Aberdeenshire European Fisheries Fund (AEFF) projects have been awarded grants worth £334,000 as part of a programme to create sustainable development in the region's fisheries areas. The projects incorporate adding value to seafood produce, eco-tourism, skills development, infrastructure improvements and the promotion of fisheries heritage. They are financed by the European Commission and administered locally by the FLAG partnership.

Strachans profits rise to £4.5 million

Strachans, the Peterhead catering firm the firm who were bought by Danish company Wrist Ship Supply last year, reported pre-tax profits of £4.5 million in the nine months to 31 December 2011. Turnover was £42.6 million.

Richard Irvin profits up +43% to £517,000

Richard Irvin and Sons, the diversified service company, reported pre-tax profits up +43% to £517,000 last year. Group turnover rose +5% to £44.1 million.

Salmon group make -£811,000 loss

Grieg Seafood Hjalmland UK, the Aberdeen-based but Norwegian owned salmon group, reported a pre-tax loss of £811,000 in the year to 31 December 2011. Turnover fell nearly -19% to £57.9 million.

Losses continue for Pelikan Hardcopy

Pelikan Hardcopy Scotland of Turriff, who manufacture and distribute film products and office consumables, reported pre-tax losses of -£2.6 million in 2011, compared with a deficit of -£2.0 million the year before. Turnover was down -13% to £9.2 million.

Paull and Williamsons lawyers in merger

Paull and Williamsons, the Aberdeen law firm, are to merge with Edinburgh-based Burness to create a business with 400 people and an annual turnover of £38 million. The new firm will be named Burness Paull and Williamsons.

Retail sales fall -2.7% in August

Like-for-like retail sales in August fell -2.7% compared with August 2011, according to the Scottish Retail Consortium. The equivalent like-for-like retail sales in the UK as a whole were down -0.6%.

Aberdeen Airport passenger numbers up +1.4%

302,900 passengers used Aberdeen Airport in September, which was +1.4% more than in the same month of 2011.

Aberdeen-Baku flights to stop

Azerbaijan Airways are to end their Aberdeen-Baku flights on October 28th. They began about 17 months ago.

Value of Peterhead fish landings up +15%

Fish landings at Peterhead in August were valued at £16.7 million, up +15% on August 2011. White fish accounted for 39%, shellfish 4% and pelagic 57%, according to the latest statistics from the Peterhead Port Authority.

New car sales up +10% in August

New car registrations in Scotland in August totalled 5,755, an increase of +10% compared with August 2011. The overall British figure showed an increase of +0.2%, according to the Scottish Motor Trade Association.

Two JJB Aberdeen outlets close, with 30 job losses

More than 30 jobs have been lost with the closure of two JJB outlets in Aberdeen after the owners failed to find a buyer for 26 of their outlets in Scotland. Four branches in Elgin, Cumbernauld, Airdrie and at the Silverburn shopping centre in Glasgow will continue to operate after being rescued by SportsDirect.

50 job losses at May and Gurney in Aberdeen

May and Gurney, the outsourcing company, are to cut 50 jobs in Aberdeen after losing a major contract with Scotia Gas Systems.

Oil-related

Devenick gas field begins production

BP have started gas production from the Devenick field in the Central North Sea. The £650 million subsea development contains about 74 million barrels of oil equivalent. New equipment has been installed on Marathon Oil's East Brae platform in order to export the gas to St Fergus. Production is expected to last until 2025.

First oil from Huntington a step nearer

First oil from the Huntington field is a step closer after the floating production vessel the Voyageur Spirit recently left the Nymo upgrade yard at Eydehavn, Norway, for the field in the Central North Sea. First oil is anticipated by the end of the year.

Xodus invest £2 million in Middle East operation

Xodus, the oil and gas and renewable energy consultancy, have invested £2 million establishing an office in Dubai in the United Arab Emirates as part of plans to capitalise on the surge in activity in the Middle East.

Dana in charge of Triton

Dana Petroleum has taken control of the Triton floating production vessel – the first time they have been in charge of a major offshore installation.

Fairfield Energy move to new Westhill base

Fairfield Energy, the independent oil and gas operators, have moved their North Sea operations to larger premises on the Arnhall Business Park in Westhill. Fairfield have signed a 10 year lease for the 25,000 square foot building and plan to recruit up to 20 people in the next 12 months.

Ithaca buy stakes in Cook and MacCulloch oil fields

Ithaca Energy have agreed to buy stakes in two Central North Sea oil fields from Noble Energy for £24 million. The Shell-operated Cook field and the MacCulloch field, operated by ConocoPhillips, are expected to add 1100 barrels of oil equivalent per day to Ithaca's production in 2012.

Wood Group approval for US acquisition

Wood Group have received anti-trust approval from the US Federal Trade Commission for the acquisition of Mitchell's Oil Field Services for an initial £83 million. The deal could be worth up to £112.2 million because of further payment linked to future performance. Mitchell's provide maintenance, installation and fabrication services to the onshore oil and gas market.

TCO acquire i-Quip

I-Quip Technology have been acquired for an undisclosed sum by Aberdeen business TCO In-Well Technologies UK and their Norwegian parent, TCO. TCO group provide well completion technologies to the global oil and gas industry, while i-Quip are involved in chemical injection technology. The deal is expected to lead to 15 jobs in Aberdeen.

UK North Sea oil production down -23%

UK oil and gas production both fell in June 2012, compared with the same month of 2011. Average daily oil output was 775,179 barrels per day, which was down -23%. Average daily gas output was 3,748 million cubic feet per day, a fall of -9%.

Oil prices

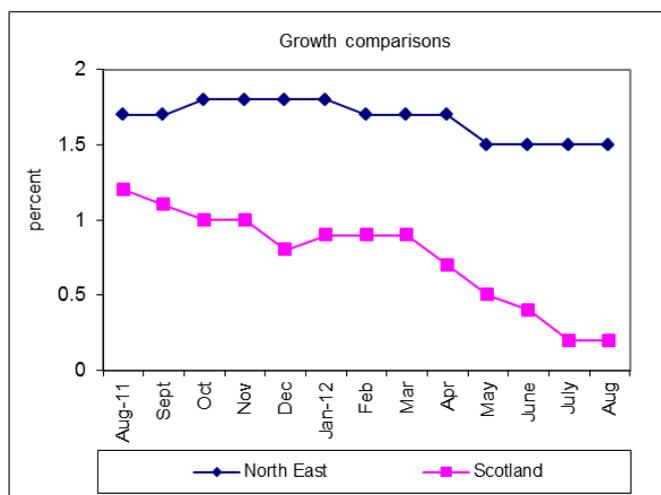
Brent crude began September at US\$115.51 per barrel and ended it at \$112.24, a decrease of -3%. The monthly average was \$113.20, which was +0.3% higher than the \$112.83 average in August. Prices traded between \$108.35 and \$117.17.

THIS MONTH'S COMMENTS

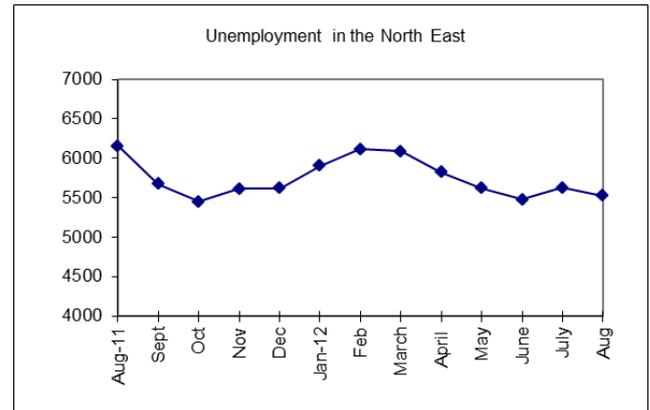
A quiet month

September was a surprisingly quiet month for the North East economy, with very few new developments, particularly in the oil and gas industry.

We estimate that monthly economic output in the North East was approximately £998 million, which was +1.5% higher than one year ago. That growth rate is much higher than our +0.2% estimate for Scotland as a whole, as illustrated in the figure below, and the latter estimate is probably too high.



Unemployment fell by -102 to 5,523. The current total is -634 below the level of one year ago, as shown in the figure below.



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 4.3% on the same basis.

There was a mixture of good and bad news from the non-oil sector of the economy. The latter included the cancellation of the West Coast rail franchise recently awarded to FirstGroup, which is discussed in more detail in the next comment.

Job losses announced included:

- 50 at May and Gurney in Aberdeen
- 30 following the closure of two JJB Sports stores in Aberdeen.

On a positive note, Jamie Oliver announced that his chain will open a restaurant in the former E&M premises on Union Street in Aberdeen, creating up to 20 jobs. The Highland Chocolatier has opened an outlet in the Bon Accord Centre and Original Penguin, an US clothing chain, announced plans to do the same in Union Square.

The retail industry in Scotland is undergoing a serious recession, as illustrated by the JJB Sports and other closures. However, the North East seems to be avoiding the worst because the economy is doing much better than the rest of Scotland.

Other positive developments included:

- Scottish Government approval for new schools in Alford and Aberdeen
- Scottish Open Golf to be held in Aberdeen in 2014.

Plans were announced for up to 4,700 new houses at Danestone in Aberdeen but it will presumably take many years for that development to come to fruition.

A few local companies announced their annual financial results. There were excellent ones from Strachans of Peterhead; mixed from Richard Irvin and Sons; poor from Grieg Seafood; and very poor from Pelikan Hardcopy of Turriff.

There were surprisingly few new developments in the oil and gas sector. They included first gas from the Devenick field, operated by BP, and a £2 million investment by Xodus in a new office in Dubai.

Oil prices remained high, with Brent crude averaging \$113.20 per barrel. However, UK oil and gas production continue to decline, as discussed in the last comment below.

The North East economy continues to outperform the rest of Scotland, with much higher growth and much lower unemployment. I do not see that changing in the near future.

West Coast rail franchise fiasco

In August the UK Department for Transport (DfT) announced that FirstGroup of Aberdeen had won the franchise to operate the West Coast main line railway services between Glasgow and London. They would take over from Virgin Rail – a joint venture between the Virgin Group and Stagecoach of Perth (49%) - who have operated the services for the last 14 years.

Richard Branson of Virgin protested strongly about the decision but most people thought that was sour grapes and that he was just a bad loser. However, Virgin Rail asked for a judicial review of the decision.

In the early hours of the morning before a court was due to consider that request, Patrick McLoughlin, the new Secretary of State for Transport, announced that the award of the franchise to FirstGroup had been cancelled because of “completely unacceptable mistakes” by officials in his department. Three of those officials have been suspended.

There is a strong Scottish interest in UK rail services because FirstGroup and Stagecoach are very successful Scottish businesses. FirstGroup’s share price fell by about -25% following the announcement.

The Minister has agreed to reimburse the four bidders for the franchise their costs, estimated at about £40 million.

However, other estimates have put the costs at closer to £100 million, which will obviously be a major embarrassment to a Government determined to reduce public spending.

In addition to the cancellation of the contract, the Minister also announced two reviews – one into the West Coast fiasco and the second into the franchise system as a whole. Decisions on other franchises will be delayed.

I travel by train as much as I can, both in Scotland and elsewhere, mainly because I can work whilst travelling or even just read in comfort. I believe that the rail services in Scotland and most of the rest of the UK are generally good, although far too expensive, despite the public subsidies.

I have long been sceptical about the franchise system, however, so the West Coast fiasco has reinforced my doubts and those of many other people.

I am certain that the wider review will lead to major changes. In addition to this latest development the East Coast main line franchise had to be handed back by both GNER and National Express when they ran into serious financial difficulties.

Those services are now operated by Directly Operated Railways (DOR), a public body which might be described as a reincarnation of the former British Rail. It could be argued that the services have been re-nationalised after unsuccessful privatisation.

In addition there have been many problems with Network Rail and predecessor Railtrack, who are responsible for the infrastructure.

As an economist, I find the current franchise system deeply flawed and some parts of it difficult to understand. Westminster politicians must have had similar difficulties.

From the information that has leaked out so far, it appears that the DfT officials seriously underestimated the risks to the taxpayer from the FirstGroup bid, which promised most of the “premiums” or revenue to the Government during the last few years of the franchise. They also appear to have made simple mistakes such as forgetting to take account of inflation.

I am astonished that they could make such mistakes, particularly after the problems with GNER and National Express. One of the officials suspended was reported as being paid £150,000 per year, which is more than the Prime Minister.

There have also been suggestions that the Department for Transport has long been anti-Virgin Rail or at least anti-Richard Branson. I do not know if that is true but I suspect that the politicians involved put pressure on officials to accept what appeared to be the highest bid – from FirstGroup in this case - regardless of the risks.

I obviously do not know the likely outcome of the new reviews but am confident that they will result in better value for money for both rail passengers and taxpayers than under the current arrangements.

It would also be amusing if the Conservative/LibDem Government decided to take more rail services back into public ownership.

%	Oil	Gas
June 11	-14.2	-36.1
July	-12.4	-26.5
Aug	-33.0	-35.5
Sept	-26.0	-25.0
Oct	-26.0	-10.0
Nov	-26.0	-21.0
Dec	-27.0	-27.0
Jan 12	-27.0	-9.5
Feb	-36.0	-28.0
Mar	-19.0	-32.0
April	-30.0	-23.0
May	-18.0	-33.0
June	-23.0	-9.0

UK oil and gas production continue to plummet

I wrote a few months ago about the alarming decline in UK oil and gas production, and the implications for the UK economy. The UK is now a net importer of both oil and gas, with negative impacts for both government revenues and the balance of payments.

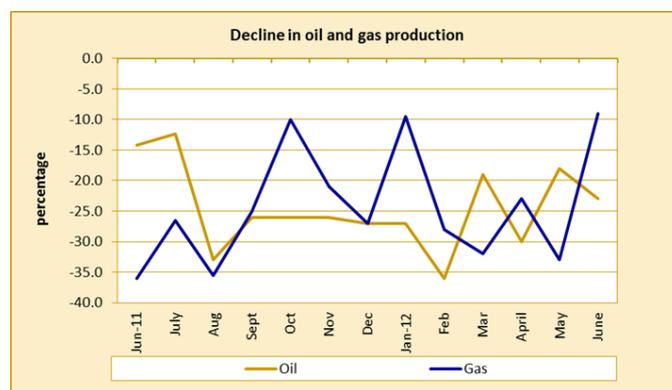
There are also implications for Scotland because future oil and gas revenues are a vital part of the SNP's case for independence. That case will be weakened if North Sea oil and gas output continue to plummet.

Our earlier report was generally very well received, particularly by the oil and gas industry in the Aberdeen area. However, it was criticised by both the Department of Energy and Climate Change (DECC) in London and Oil & Gas UK, the industry's representative body, also based in London.

Both bodies claimed that our report was far too pessimistic and that the decline in production was not as bad as I wrote. Those criticisms are ludicrous because the statistics used were the official ones from DECC, based on data provided by Oil & Gas UK member companies.

The alarming decline in UK oil and gas production continues. The latest monthly statistics from DECC show oil output down -23% on 2011 and gas output down -9%. The changes for the last twelve months – according to the official DECC statistics - are illustrated in the table and figure below.

The average monthly declines in both oil and gas production have been just over -25%.



The last twelve months may have been unusually difficult for the UK industry. In a recent report we forecast average annual declines of -7% for the period to 2016. That is clearly less worse than the current -25% but nevertheless should be very worrying to DECC and Oil & Gas UK...and also the SNP Government.

Tony Mackay