Economic Commentary

October 2023

Insights & Economics

Scottish Enterprise

SUMMARY

- Global economic growth remains slow and is expected to be **3% in 2023, falling to 2.9% 2024.** Developing and emerging economies are expected to grow much faster than advanced. **UK growth** is expected to be the lowest of G7 economies at just 0.5% in 2023 and 0.6% in 2024, as tighter monetary policy to combat inflation slows economic activity.

- Business surveys also point to **slowing global activity.** Performance in the UK and Euro-zone economies was particularly weak in September as both service and manufacturing sector output declined.

RECENT ECONOMIC DATA

- The UK economy continues to be subdued. GDP was up just **0.2% in August**, after a fall of 0.6 in July. Performance was poor in 11 out of UK 12 nations and regions in September as business activity fell, with only London showing growth.

- In the year to September, **consumer price inflation remained high** and unchanged from August at 6.7%, and core inflation fell by 0.1pp to 6.1%. Annual producer input price inflation fell by 2.6% in September – the fourth consecutive monthly fall.

- Scotland's onshore **GDP grew by 0.1% in July,** as manufacturing output rose, whilst service sector and construction output both fell.

CURRENT BUSINESS SENTIMENT

- The value of Scotland's **goods exports increased by 12.6%** in the year to June, although 20% of Scottish exporters reported selling less overseas than a year ago, and just 17% sold more.

- Scotland's **unemployment rate remains low** (4.3%), while the **employment rate fell slightly over the year** to 75.1%. Around a third of Scottish businesses continue to report **worker shortages** which may have had a knock-on effect on **wages which rose by 8.2%** over the year to September 2023.

FORWARD LOOK

- Intelligence from SE customers suggests that despite **ongoing challenges** with skills shortages, availability of suitable property and access to finance/investment for some, most are generally **positive, optimistic** and able to identify **growth opportunities.**

- The Fraser of Allander Institute is **predicting subdued economic growth for Scotland into 2025** (+0.7% in 2024 and +1.2% in 2025) as inflation and interest rates remain high, putting pressure on household incomes.

SUMMARY

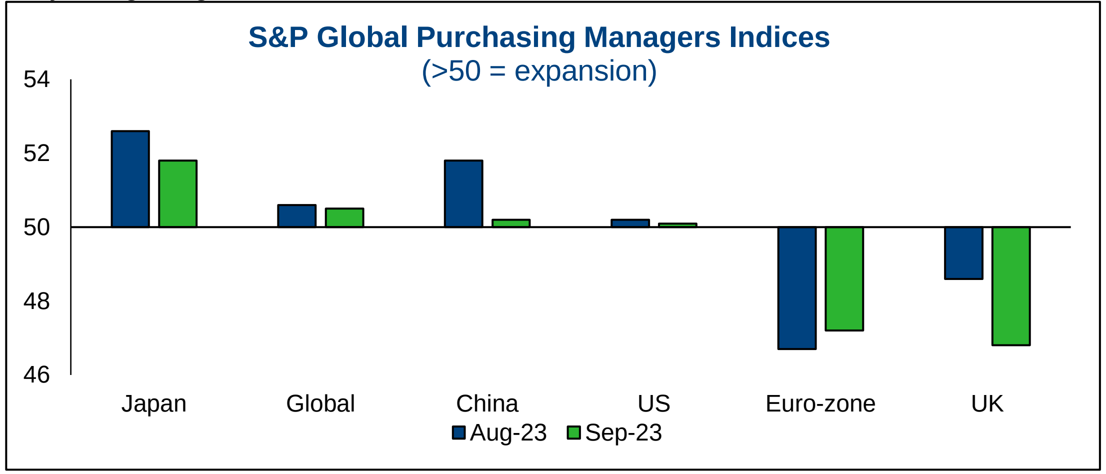
RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

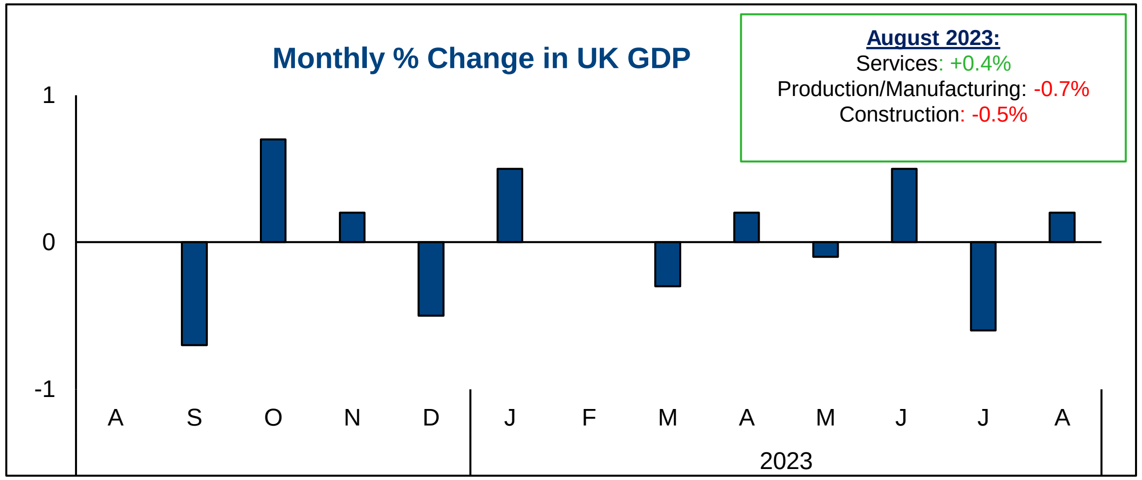
FORWARD LOOK

Global/UK

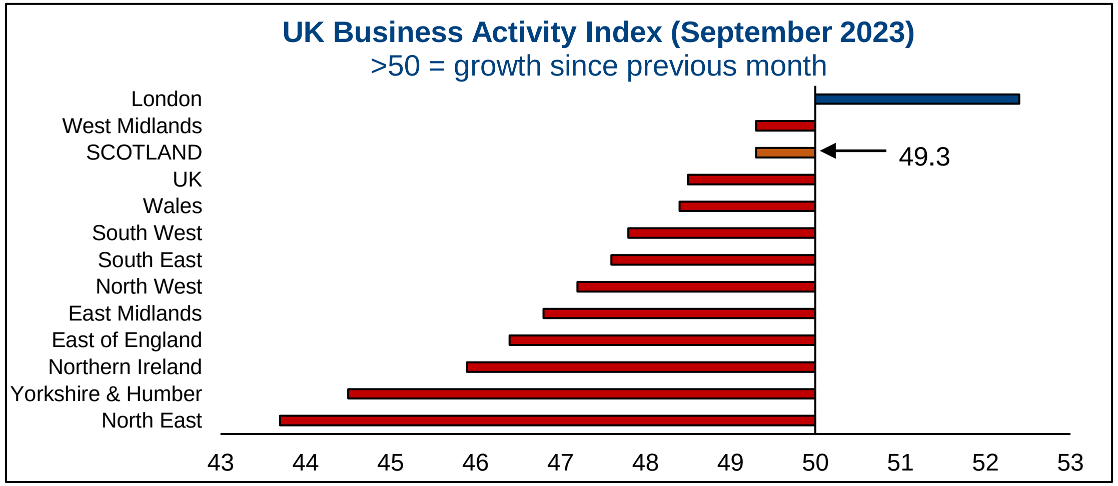
Recent business surveys show the continuing difficulties facing the UK and Euro-zone economies as both the manufacturing and service sector contracted in September, with the former leading the decline. Other major economies posted only marginal growth.



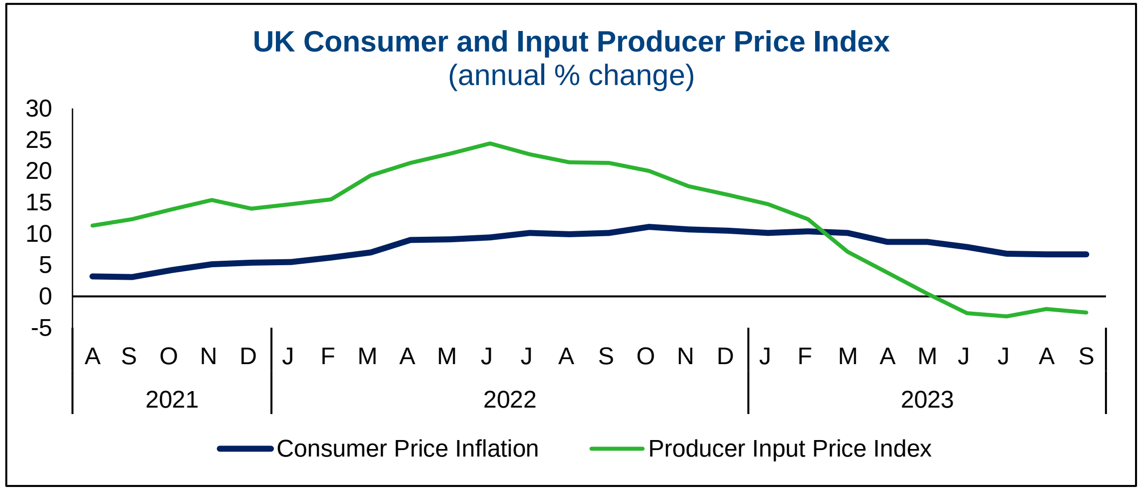
UK GDP grew by 0.2% in August following a fall of 0.6% in July. Services output was the main contributor to growth (+0.4%), whilst output in the production & manufacturing (-0.7%) and construction sector (-0.5%) contracted over the month.



In September, private sector business activity fell across all parts of the UK bar London, as demand dropped, resulting in decreased new orders. Business cost pressures eased, however, as input prices increased more slowly.



In September, annual consumer price inflation stayed at 6.7% (unchanged from August), while core inflation fell slightly to 6.1%. Motor fuel prices kept inflation high while the largest downward contribution came from food and non-alcoholic drinks. Producer input price inflation fell for the fourth consecutive month in September.



SUMMARY

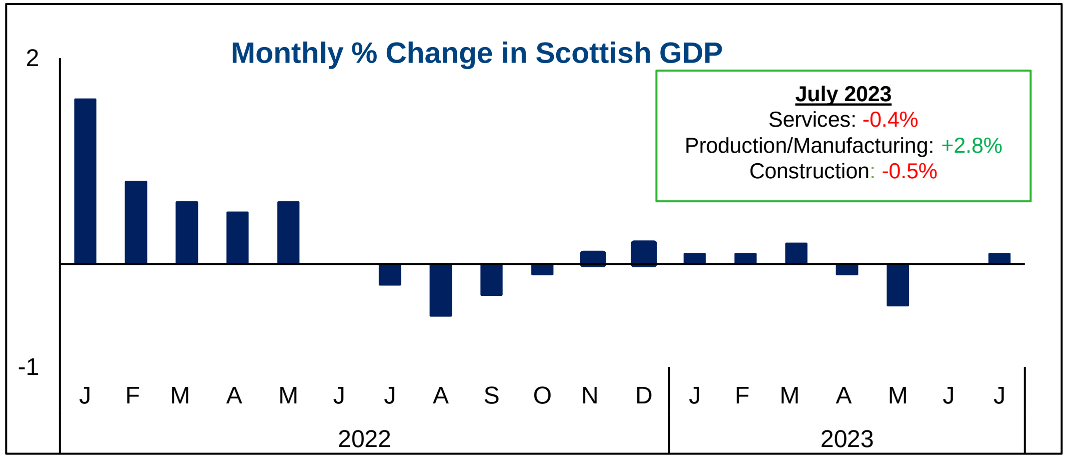
RECENT ECONOMIC DATA

BUSINESS SENTIMENT

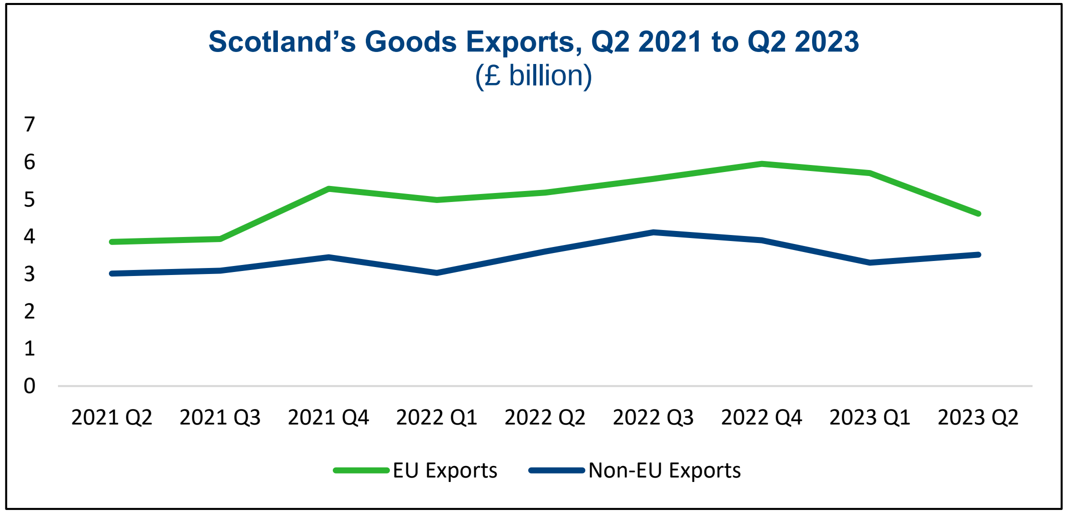
FORWARD LOOK

Scotland

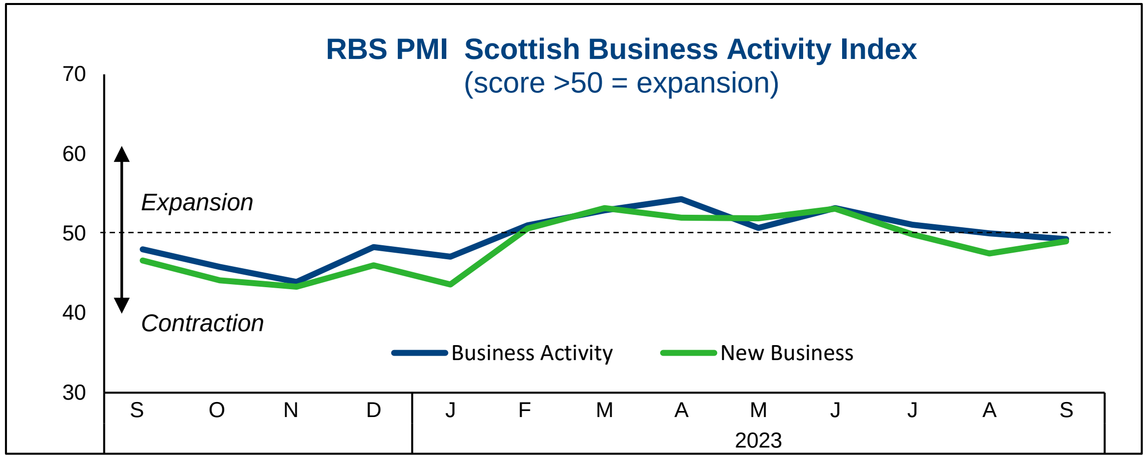
GDP grew by 0.1% in July, following zero growth in June. Over the month, service sector output (-0.4%) and construction output (-0.5%) fell, whilst production & manufacturing (+2.8%) rose. In the three months to July, GDP fell by 0.1% compared to the previous 3-month period.



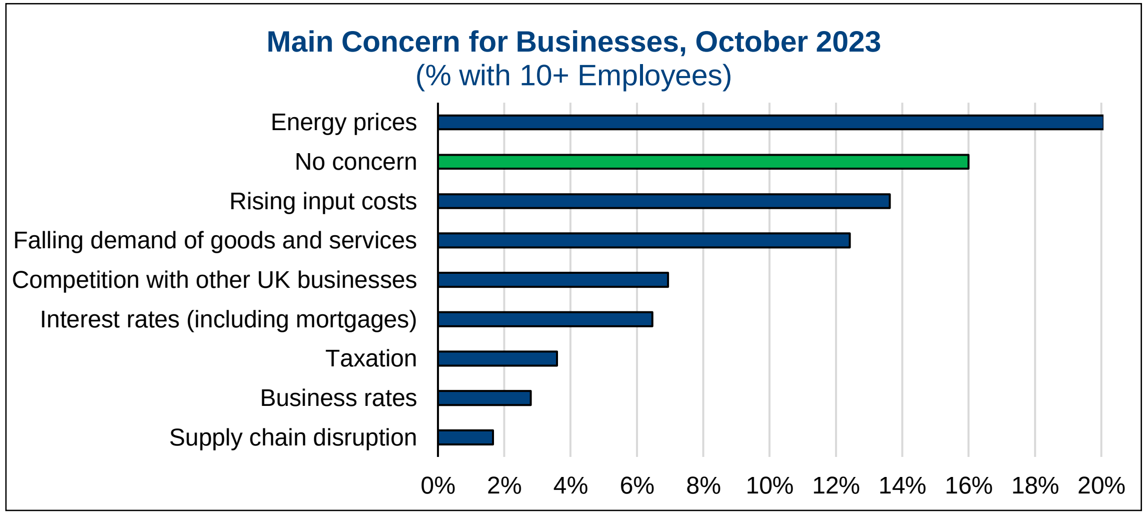
Scotland's international goods exports increased by 12.6% to £36.7 billion between June 22 and June 23. However, given recent high inflation, in volume terms the rises may be much lower. The value of EU exports has exceeded the value of non-EU exports consistently in recent quarters.



Private sector business activity declined during September for the first time since January as ongoing weakness in manufacturing extended to services activity. Inflows of new work fell reflecting weakening demand. Despite this, business sentiment moved to a 3-month high (although still low by historical standards), driven by hopes of improved demand, launch of new products and general market growth.



Excluding labour market issues, the main concerns for businesses continue to be energy prices (20% of businesses), rising input costs (14% of businesses, rising to 23% in the Construction sector), and falling demand of goods and services (12% of businesses, rising to 17% in the Manufacturing sector).



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RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

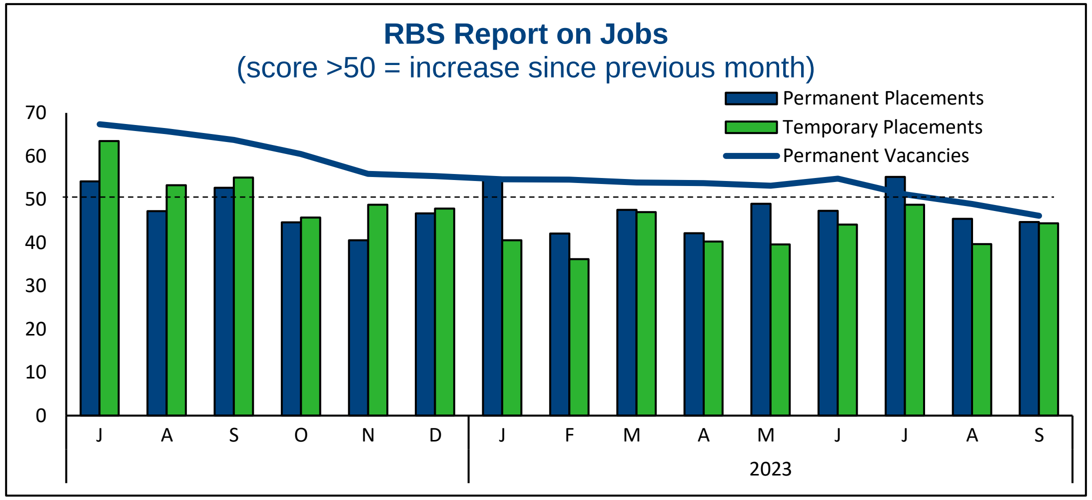
FORWARD LOOK

Scotland

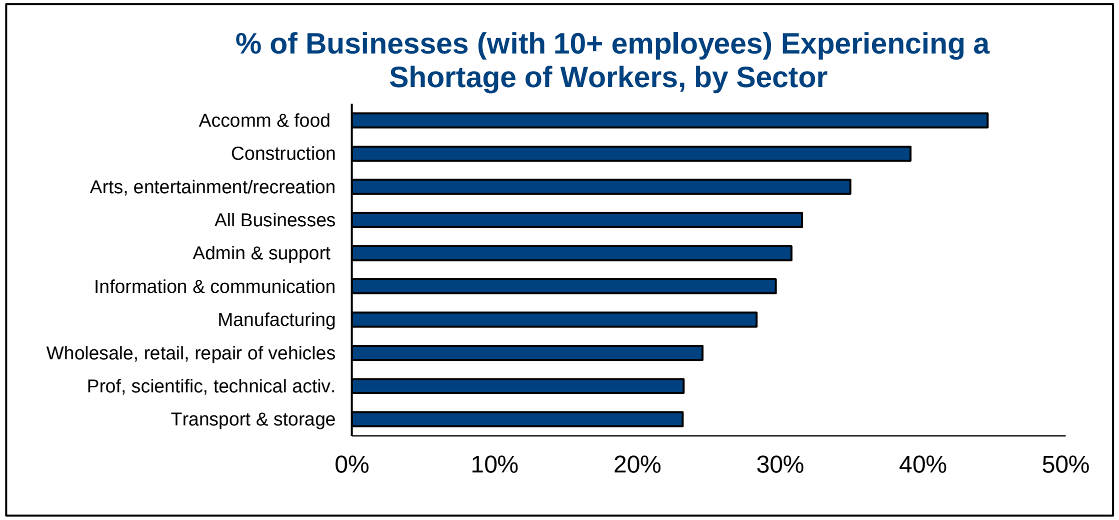
In the labour market, unemployment remains low but has risen 1.3 percentage points over the year and is the same as the UK rate. The employment rate fell by 0.1pp to 75.1% and is below the UK's (75.5%). Economic inactivity has fallen over the year by 0.9pp and is above the UK rate of 21.1%. The median monthly wage of payrolled employees in Scotland was £2,318 in September, 8.2% higher than a year ago (vs +5.7% for the UK).

	RATE (Apr - Jun 23)	ANNUAL CHANGE
EMPLOYMENT (aged 16-64)	75.1%	-0.1%pts
UNEMPLOYMENT (16+)	4.3%	+1.3%pts
ECONOMIC INACTIVITY (aged 16-64)	21.4%	-0.9%pts

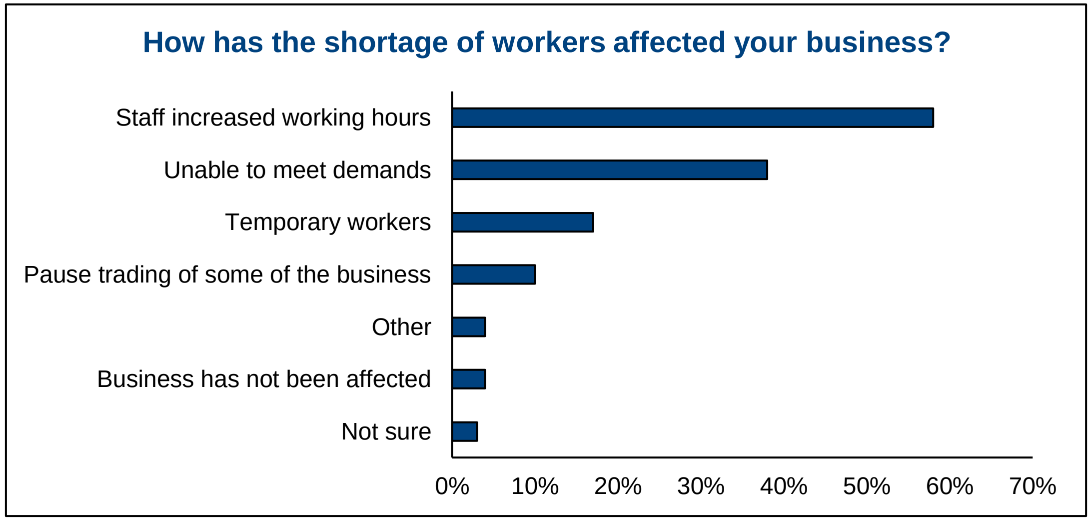
Both permanent and temporary staff recruitment contracted sharply in September due to fewer vacancies, weaker economic confidence, and shortages of suitably-skilled candidates. Competition for skilled and scarce labour led to further increases in starting pay.



There is a downward trend of businesses reporting worker shortages, falling from a peak of 45% in September 2022 but this is still an issue for around a third of Scottish businesses. Sectoral variations are apparent, rising to 45% in Accommodation & Food Services and 39% in the Construction sector.



Worker shortages are affecting businesses in different ways. Of those businesses reporting shortages, nearly 60% have employees working increased hours, 38% are unable to meet demands, and 17% have taken on temporary staff as a result.



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RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

Feedback from Scottish Enterprise Customers

General sentiment

- Scottish Enterprise customers are generally **positive, optimistic** and able to identify **growth opportunities**. Some are reporting being at full capacity so cannot take on new orders.
- However, challenges still exist including:
  - **Skills shortages** across all sectors;
  - **Lack of suitable property** for expansion, especially, manufacturing, warehousing and lab space;
  - **Accessing funding taking longer** because of investor caution.
- Some businesses report that although **turnover is recovering** to pre-pandemic levels, increased costs means that **margins are still lower.**

Labour and skills shortages/jobs

- Attracting and retaining staff is an ongoing issue resulting in **wage inflation** and **staff poaching.**
- **Worker and skills shortages** cover **many occupation levels,** for example challenges recruiting lower-skilled food manufacturing operatives and senior managers in life sciences businesses.
- To **address recruitment challenges**, businesses are:
  - **investing in automation** to increase capacity of staff;
  - **upskilling** existing staff and employing apprentices and graduates;
  - **offering more competitive packages** to attract and retain staff.

Access to Finance

- The current economic environment is contributing to **investor and lender caution** which is impacting the ability of some businesses to fund and start growth projects.

Workplace

- A **lack of suitable industrial property** is restricting expansion and growth plans for some businesses and impacting productivity and efficiency.
- There is also a **shortage of suitable and affordable office space in city centres** and there is a reluctance to relocate outside the centres because of poor transport links and workers preference for city centre locations.
- Lack of property can, in some cases, force businesses to **invest in improvements at their current site**, which can be sub-optimal.
- The building of new facilities can be delayed because of the time it takes to connect to the **National Grid for energy supplies.** Some businesses report this can take several years.

International Trade

- Some **exporters are looking to widen their global reach** by exploring new markets and opportunities, especially in EMEA (Europe, Middle East and Africa).
- Others, however, **do not have the financial resources to enter new markets** so are focusing on existing markets.
- The **exporting process post-Brexit (**e.g. increased paperwork, costs and time) has made many **European buyers look for suppliers outside Great Britain**. To address this, more Scottish businesses are setting up European hubs.

Net Zero

- Businesses are being more proactive in reducing **their carbon footprint,** e.g. by recycling and introducing biomass heating. They are also looking at **zero emission vehicles** when replacing their car fleet**.**

Economic Outlook

Global Forecast

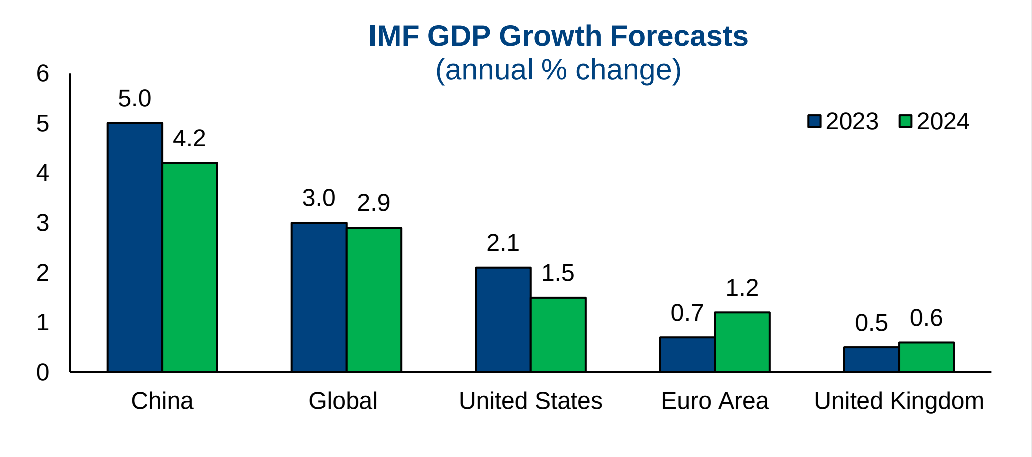
The IMF is forecasting global economic growth will slow to 3.0% in 2023 and 2.9% in 2024 as monetary policy tightening to combat inflation and the long-term consequences of the pandemic and the war in Ukraine impact activity. The projections remain below the historical annual average growth of 3.8% between 2000 and 2019.

Emerging market and developing economies are forecast to perform much better than advanced economies (+4% growth vs 1.4% in 2024). The UK is expected to be the weakest performer in the G7, growing by just 0.5% this year and 0.6% in 2024, as tighter monetary policy here slows economic activity.

Global inflation is forecast to decline steadily from 6.9% in 2023 to 5.8% in 2024.

A number of downside risks to global growth are highlighted:

- China's property sector crisis could deepen, with global spill overs, particularly for commodity exporters.
- Near-term inflation expectations have risen and could contribute, along with tight labour markets, to core inflation pressures persisting.
- More climate and geopolitical shocks could cause additional food and energy price spikes.



UK and Scottish Forecasts

The EY Item Club is forecasting growth of 0.6% for the UK in 2023 and 0.7% in 2024. Growth is then forecast to increase by 1.7% in 2025 as lower inflation lifts real incomes and interest rates are cut.

Inflation is expected to fall to around 4.5% by the end of 2023, before meeting the Bank of England's target of 2% in the second half of 2024. This will be driven by falling energy bills, easing food price inflation and weaker pipeline price pressures.

The Item Club also highlights that:

- Given the strong start to 2023, business investment is expected to rise by almost 6% this year despite higher borrowing costs.
- The labour market has shown signs of weakening and unemployment is expected to peak at 4.8% early next year.
- Wage growth has been strong and average wages have started to rise again in real terms but pay growth is expected to ease, reflecting lower inflation, a weaker jobs market and a fall in job moves.

For Scotland, the latest Fraser of Allander Institute forecast from June shows 0.5% growth in 2023, a significant upwards revision from their March forecast of a shallow recession. However, 2024 and 2025 forecasts have been revised downwards to 0.7% and 1.2% respectively, reflecting high inflation and increasing interest rates.