

Economic Commentary

August 2022

All data represent most recent available as of August 16th, 2022

All major global economies reported **weak growth or even contraction** in the second quarter of 2022 as high inflation, conflict in Ukraine, and supply chain challenges related to the pandemic all weighed on economic performance.

UK GDP fell by 0.1% in the second quarter as consumers cut back on spending and as pandemic-related activity such as test-and-trace came to an end. Business surveys suggest further loss of momentum in July as inflationary pressures continue to dampen demand.

Growth in the **Scottish economy** slowed to 0.7% in the three months ending May and just 0.1% over April and May. Business activity also appears to be stalling, with rising economic uncertainty resulting in reduced inflows of new orders in July.

Scottish businesses across all sectors continue to report widespread **inflationary pressures, recruitment difficulties** and **some supply chain disruption**. Impacts appear greatest among **small businesses**.

Unemployment remains near a record low and the number of payrolled workers in Scotland continues to grow. However, wages are failing to keep pace with inflation, and there are signs some businesses are becoming more hesitant to push forward with growth and recruitment plans due to an increasingly uncertain economic outlook.

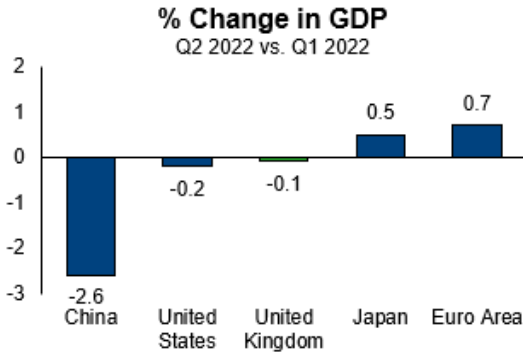
The outlook for the **global economy** has weakened considerably, with growth in 2022 now forecast at just **3%**, and all major economies expected to grow more slowly in 2022 and 2023.

The **UK** could fall into recession by the end of 2022 and is projected to have the weakest growth of the world's largest economies in 2023, largely as a result of higher inflation than in other large economies.

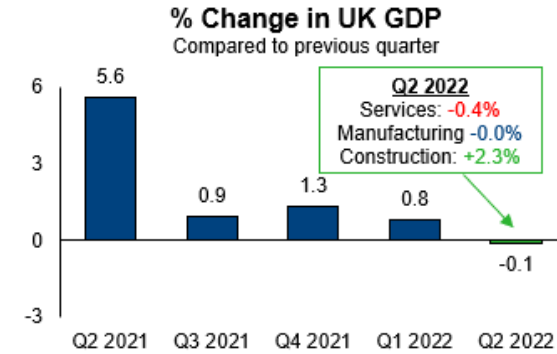
The **Scottish economy** is expected to grow by around **4% in 2022** but could **stagnate** in **2023** as consumers cut back on discretionary spending and businesses limit production due to high input costs.

Global/UK

Economic performance deteriorated in the [second quarter of 2022](#) as high inflation, conflict in Ukraine and supply chain challenges limited growth in some economies and caused output in others to decline.

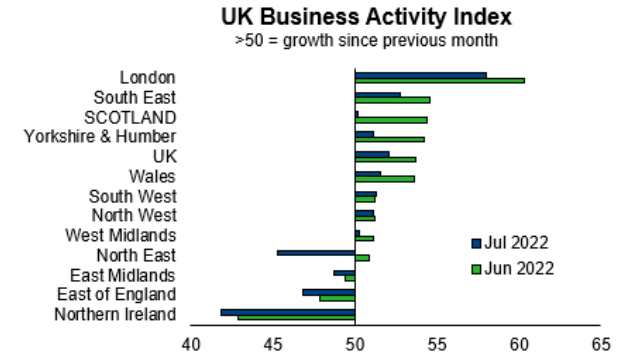
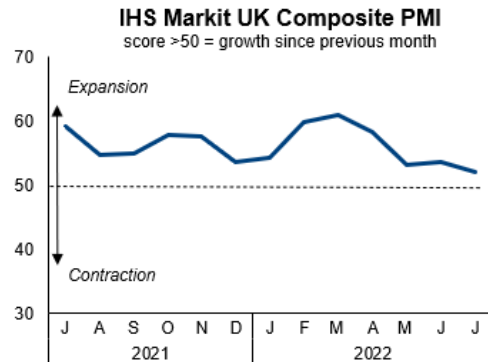


In the UK, [contraction](#) in GDP Q2 (-0.1%) was driven by a 0.4% decline in the dominant services sector, reflecting both a reduction in COVID-19 health activities and a drop in real household consumption.



Recent [business surveys](#) suggest UK private sector growth eased to a 17-month low in July as subdued demand in both domestic and overseas markets inched the economy closer to stagnation.

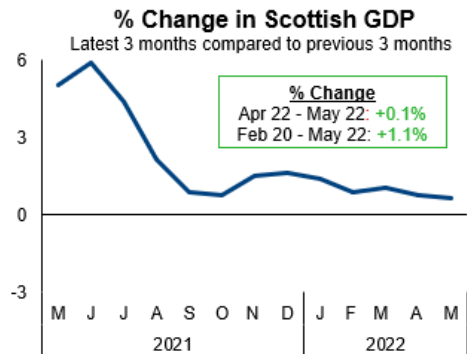
The slowdown was reflected across the UK, with all but one [region](#) reporting either a slower rate of expansion or a decline in business activity in July amid reduced inflows of new business.



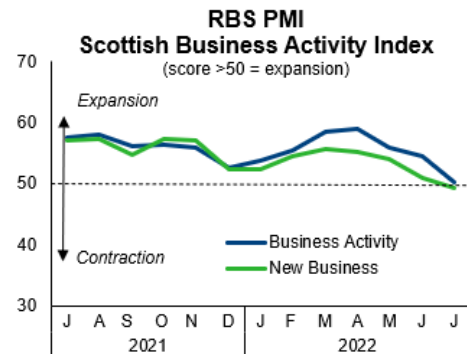
Scotland

SUMMARY

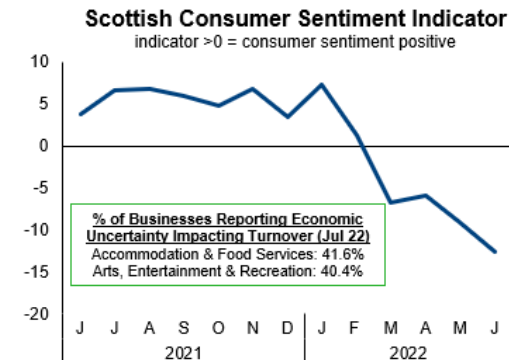
The latest [GDP data](#) (up to May) suggest slowing growth in the Scottish economy, although output remains above its pre-pandemic level.



[Private sector activity](#) came close to stalling in July, while new business declined for the first time since March 2021.



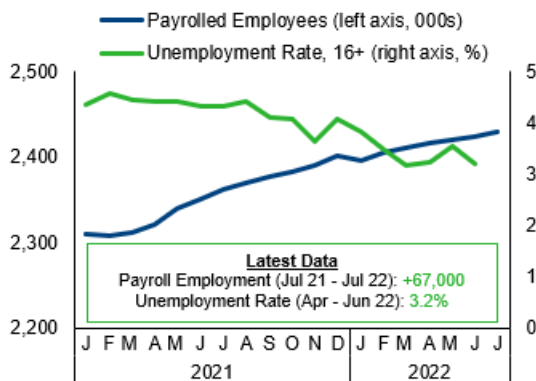
Close to half of businesses in some consumer-facing sectors say economic uncertainty is now impacting their [turnover](#) as consumer sentiment drops.



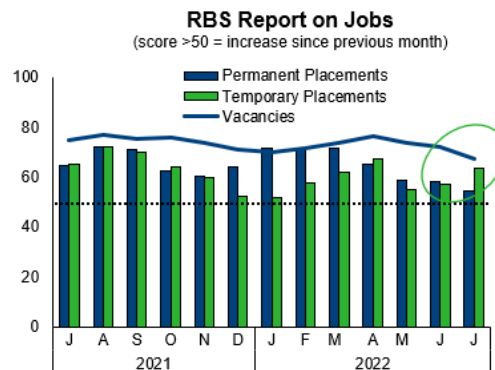
RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

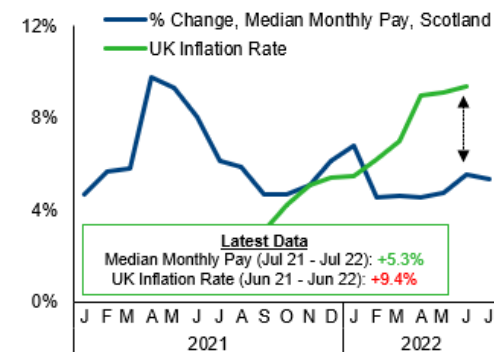
In the [labour market](#), sustained demand for staff continues to keep unemployment near a record low.



However, a slowdown in [vacancies](#) and a shift to temporary workers suggests some businesses are increasingly reluctant to push forward with recruitment plans.



Meanwhile, high inflation means most workers continue to experience a [real wage cut](#).

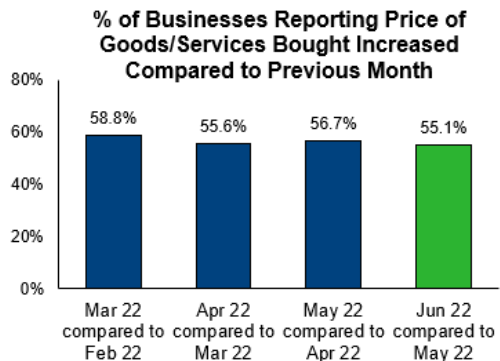


FORWARD LOOK

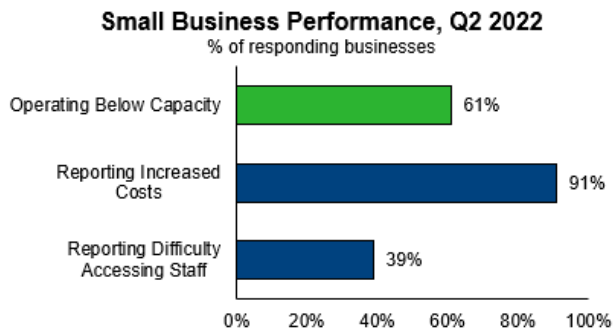
Scotland

SUMMARY

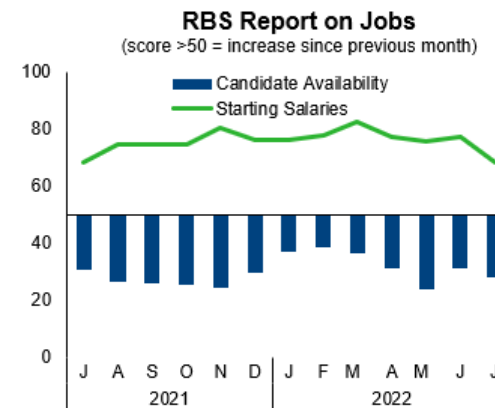
[Input cost pressures](#) continue, with over half of all businesses reporting that prices increased in June relative to May. Increased prices remain most widespread in manufacturing (69% of businesses) and construction (67%).



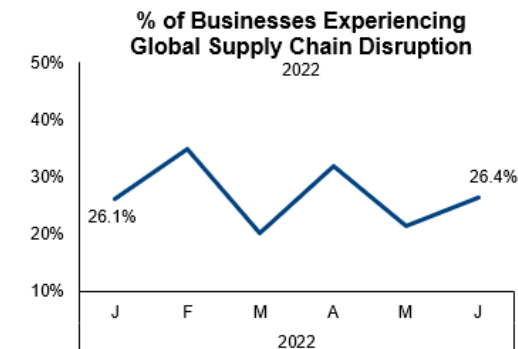
Rising overheads and workforce shortages appear to be impacting [small businesses](#) most acutely, with three in five small Scottish businesses running below capacity in the second quarter.



Reduced [candidate availability](#) intensified further in July, maintaining pressure on businesses to raise wages to attract and retain staff.



[Supply chain issues](#) remain stubbornly common, with the proportion of businesses reporting disruption broadly unchanged from the beginning of the year.



RECENT
ECONOMIC
DATA

CURRENT
BUSINESS
SENTIMENT

FORWARD
LOOK

Feedback from Scottish Enterprise Customers

- **Widespread inflationary pressures persist** - the **cost of materials, staff and utilities** have all increased significantly in recent months. There is increasing concern that increased costs could lead to **job losses**.
- More businesses are **delaying investment projects**, citing rising costs, their sales pipelines slowing and supply chain challenges.
- However, many businesses appear so far to be showing **resilience** and are still pursuing their **expansion and growth plans**.

Workforce

- Difficulties around **staff recruitment** and **retention persist** - businesses need to offer **elevated salaries** to attract and retain staff.
- There is intense competition for **IT and software** talent who can work from home for businesses based outside Scotland.
- **Tourism and hospitality businesses** are facing acute staffing problems as many have left the sector, either for better pay elsewhere or retiring early. A **decline** in the number of **European staff** following Brexit and fewer seasonal workers has compounded the problem.

- There are also challenges recruiting and retaining staff in **lower paid/lower skilled manufacturing** posts e.g. food processing.
- Other strategies being pursued to address skills issues include **training/upskilling existing staff** and enhancing links to **colleges/universities**; however, this does not fully address immediate challenges.

Workplace

- There continues to be a shortage of **laboratory space**; businesses are looking at the feasibility of converting warehouse or office space as alternatives.

Energy prices

- **Rising energy prices** are an increasingly big issue for Scottish businesses.
- Those most likely to be impacted are those in **energy-intensive sectors** (e.g. chemicals), **smaller businesses** (less likely to have fixed price energy in place and who generally pay more per unit of energy than larger businesses), and businesses in **highly-competitive sectors** (who have limited ability to pass on higher costs to customers).
- Some larger businesses are considering **investing** in on-site energy generation using wind and solar.

Supply costs and supply chains

- Global **supply chain** issues persist – e.g. components for **engineering** businesses. Lead times are also increasing – e.g. goods that were historically received in 6 months now can take 18-24 months.

Sustainability

- As demand for sustainable products increases, businesses continue to explore how they can demonstrate (e.g. via marketing) they are **acting responsibly in terms of the local community and environment**.
- As a result of environmental concerns there is a requirement to make offices more **environmentally compliant**. This is offering an opportunity for construction companies.

Sectors

- Higher costs and ingredient shortages are hitting the ability of **Food and Drink** manufacturers to produce at normal levels.
- **Construction** activity remains healthy, although **continued tight supply chains** and **labour markets** are pushing up **costs** (including materials and salaries) leading to project slippage and cost overruns.

- Some hotels and hospitality businesses are **reducing their opening hours or serving times** due to lack of staff. Some businesses continue to use automation solutions implemented during COVID - e.g. Digital self check-in.
- Tourism businesses are reporting a higher proportion of visits and bookings are being made **last minute**. This is making it hard to forward plan e.g. staffing levels and supply purchases.
- However, cities, particularly Edinburgh, are experiencing an **increase in visitors**; both business and holiday travel have increased.

Brexit

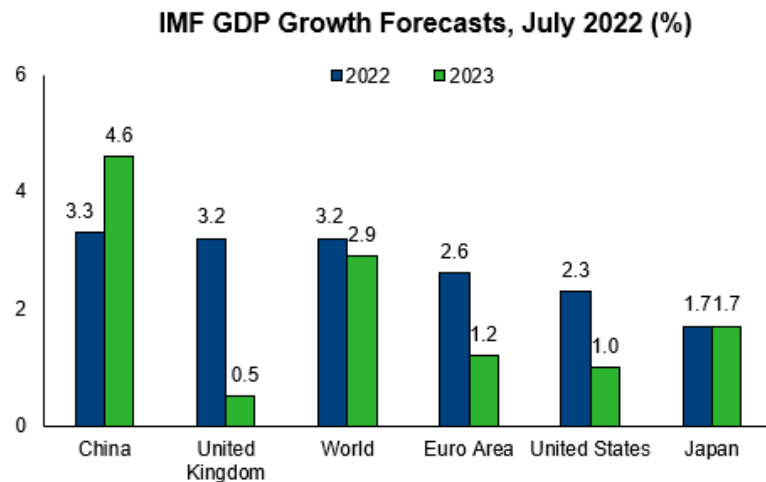
- **Businesses of all sizes continue to struggle with the increased complexities of post Brexit trade**. A number of larger businesses have set up operations in Europe and have legal representation to help with trade regulations.
- Businesses continue to be impacted by Brexit – e.g. some (particularly smaller businesses) report overseas customers returning goods after being faced with large custom charges. This involves customer refunds and potentially customs charges for the business on the returned goods. As a result, **some businesses have withdrawn sales to the EU**.

Economic Forecasts

Global Forecasts

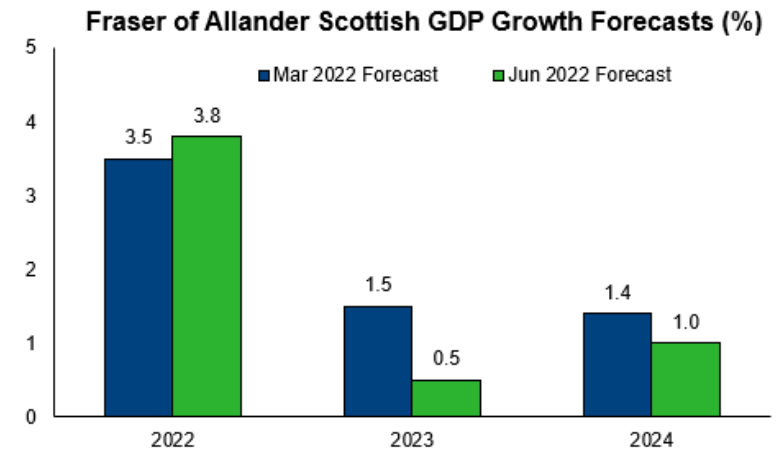
The [IMF](#) has downgraded its 2022 and 2023 forecasts for most major economies as higher-than-expected inflation, a slowdown in China from ongoing COVID-19 lockdowns, and fallout from the war in Ukraine impact a world economy already weakened by the pandemic. Global growth in 2022 is now expected to be 3.2%, 0.4 percentage points lower than forecast in April.

The UK is projected to have the weakest growth of the world's largest economies in 2023, largely as a result of higher inflation than in other large countries.



UK & Scottish Forecasts

The [Fraser of Allander Institute](#) has lowered its forecasts for **Scottish** growth in 2023 and 2024 due to the expected **impact of cost increases** on consumers and businesses (reducing both spending and production), and the likelihood high inflation will persist for longer than previously thought. The Institute forecasts growth of 3.8% in 2022 (following a strong recovery in the first quarter of the year) but **just 0.5% in 2023** and 1.0% in 2024.



The latest [Bank of England](#) forecast warns the **UK economy** could fall into recession in the final quarter of 2022 as businesses and households struggle with inflation that could rise as high as 13%. The Bank forecasts UK GDP to fall by 1.25% in 2023 and by 0.25% in 2024.