Economic Commentary

March 2022

All data represent most recent available as of March 22nd, 2022

Insights & Economics

Scottish Enterprise

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

Recent global economic performance continues to vary according to the level of coronavirus restrictions present in each country, with the U.S. and Europe outperforming Asian economies at the start of 2022 after the latter was impacted by the arrival of the Omicron variant.

The global economic outlook has been impacted by **conflict in Ukraine,** which could cut growth by more than a percentage point over the next year. Economies closest to the conflict are likely to be most impacted.

UK GDP expanded by 1.0% in January and is now 0.8% above its pre-coronavirus level (February 2020). Recent business surveys suggest business activity has accelerated following disruption caused by the Omicron outbreak in December.

The **Scottish economy** expanded by 1.3% in the final quarter of 2021, bringing annual growth to 6.9% (UK, 7.5%). Business activity also appears to have rebounded following the Omicron outbreak and easing of restrictions, but at a more modest pace than elsewhere in the UK.

Demand for employees remains strong and 34,000 more workers in Scotland are now in payroll employment than before the pandemic. However, employment growth has been uneven across regions and lower than in the UK as a whole.

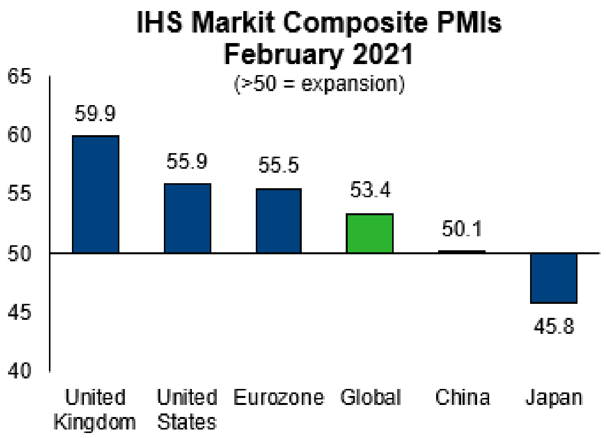
Businesses across sectors continue to report **inflationary pressures** (rising energy, staff and raw materials costs), **recruitment difficulties** and **some supply chain disruption**.

The biggest opportunities reported by businesses over the next year are **increased demand** for products and services as the economy recovers, the **launch of new products** and **entry to new markets**.

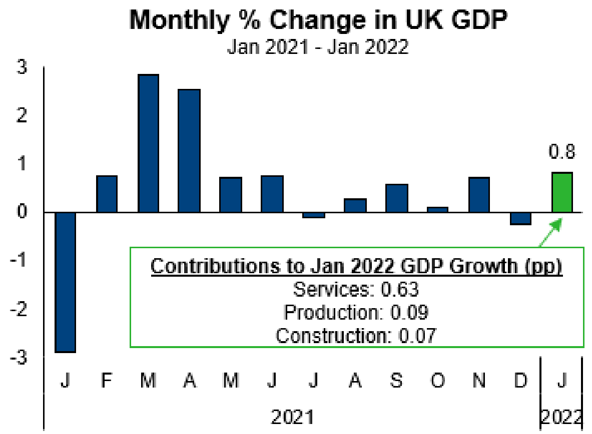
The latest forecasts for the UK predict GDP growth of **4.0% or less in 2022**, a slower pace than previously forecast amid a **deteriorating outlook for consumer spending** and a **weaker-than-expected rebound in business investment.**

Global/UK

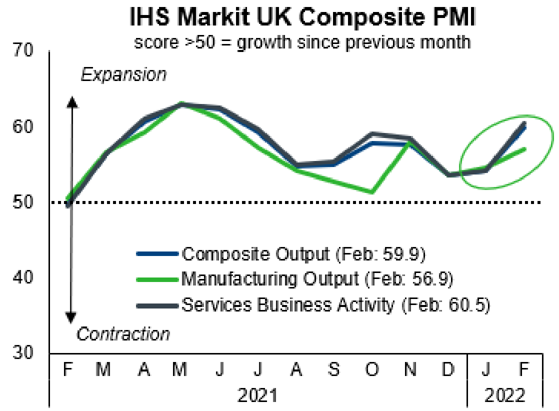
The latest business surveys signal strong expansion in the U.S. and Europe, but slower growth in China and contraction in Japan due to the later arrival of the Omicron variant in Asia.



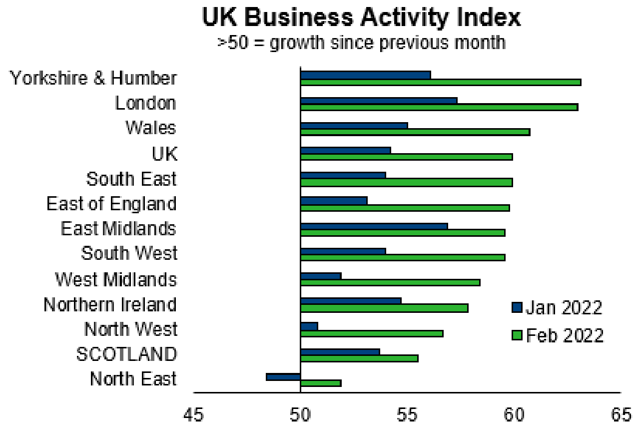
In the UK, services was the main contributor to growth in January as the economy rebounded from the impact of the Omicron wave.



UK private sector growth accelerated further in February as Plan B restrictions were scaled back, allowing faster growth across both the manufacturing and services sectors.



All UK regions reported stronger increases in business activity than in January, although the rise in Scotland (although still elevated) was modest compared to some regions.



SUMMARY

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CURRENT BUSINESS SENTIMENT

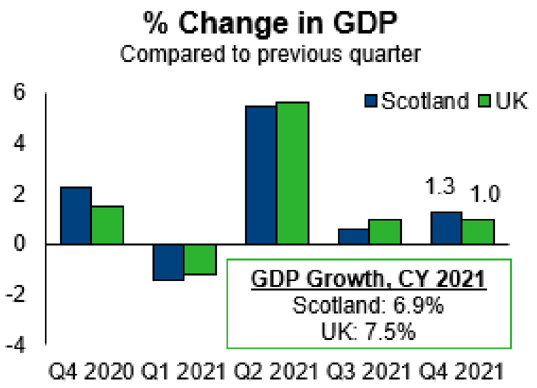
FORWARD LOOK

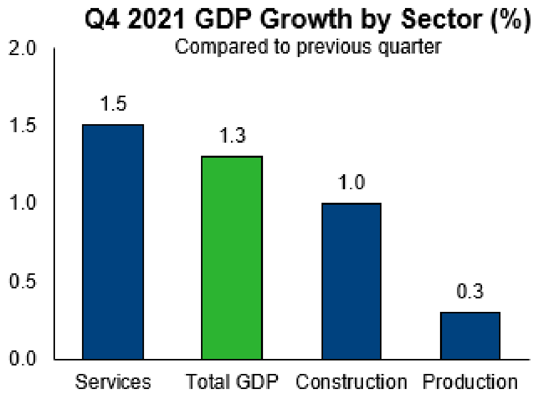
Scotland

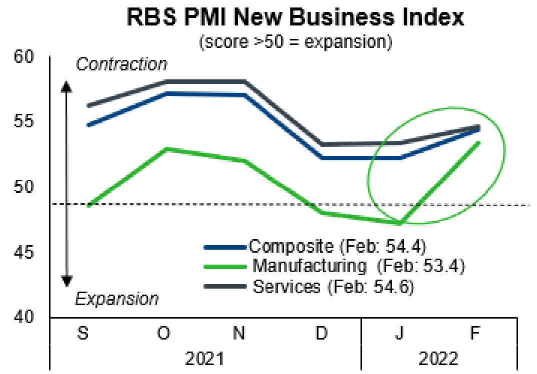
The latest quarterly GDP data suggest Scottish economic performance continues to closely mirror that of the UK.

Growth in the final quarter of 2021 was broad-based, despite supply chain challenges weighing on manufacturers and Omicron impacting service providers in December.

Business surveys suggest the easing of restrictions in early 2022 has led to greater inflows of new work across both manufacturing and services.



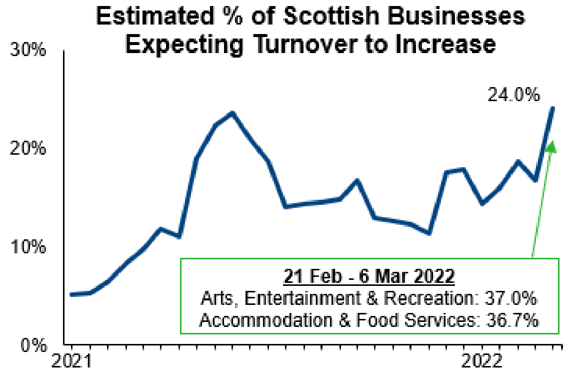


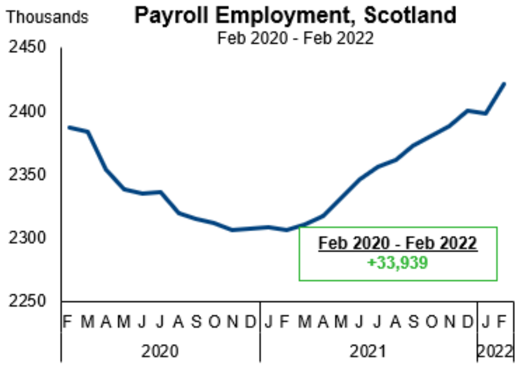


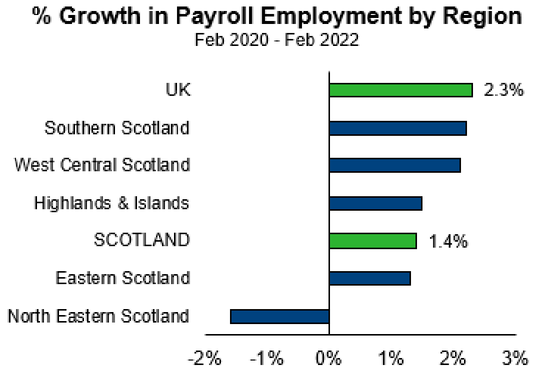
The proportion of Scottish businesses expecting turnover to increase in the next month has also increased, particularly in consumer-facing sectors.

In the labour market, 34,000 more workers were in payroll employment in February than before the pandemic as employers continue to add staff.

However, employment growth in Scotland has been lower than in the UK and not all Scottish regions have returned to their pre-pandemic levels of employment.

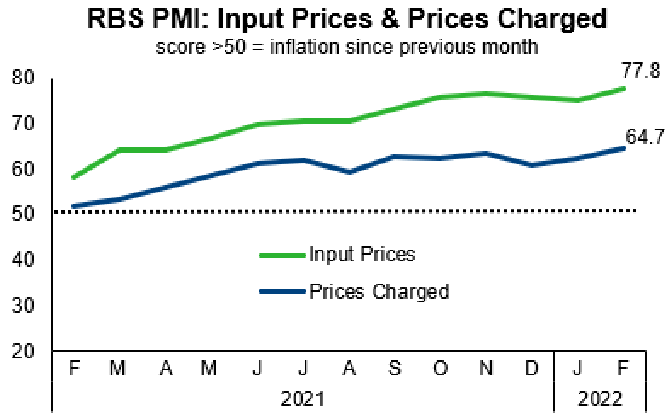




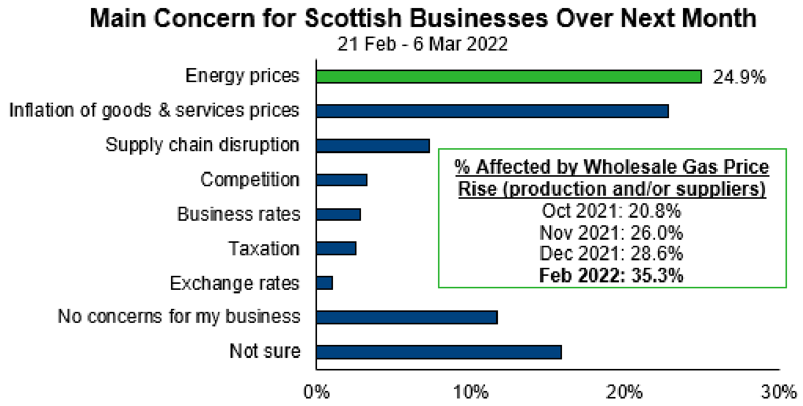


Scotland

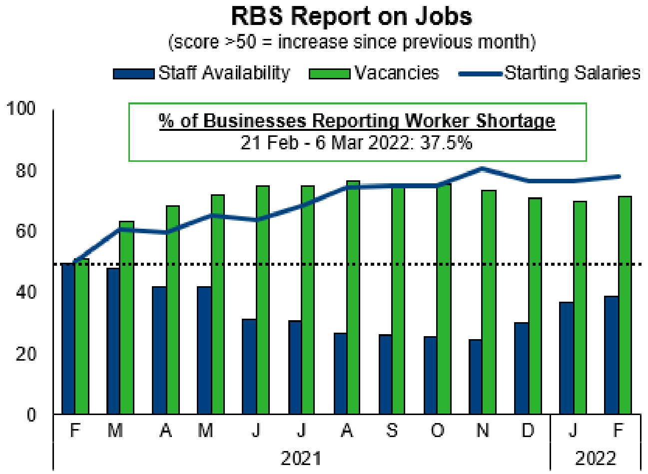
Cost pressures rose to another record high in February, prompting Scottish businesses to pass more of the increased costs on to customers.



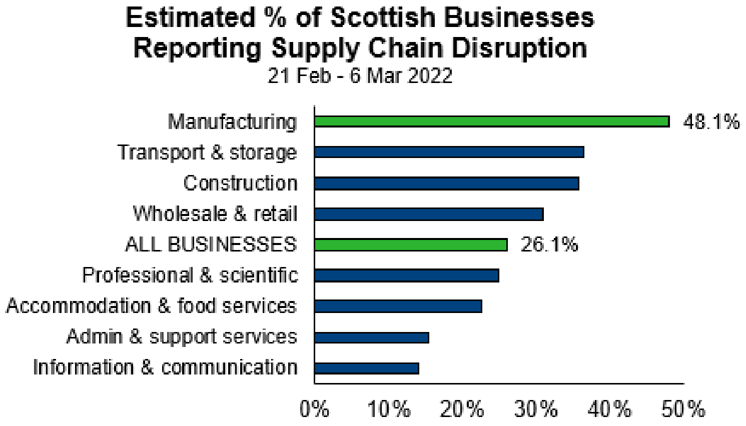
Energy prices have quickly become the main concern for Scottish businesses, and a growing proportion report already being affected.



Businesses also report being forced to increase salaries at a near-record pace to fill vacancies amid an ongoing shortage of candidates.



Despite evidence supply chain challenges are now easing, almost half of Scottish businesses in some sectors still reported disruption in late February/early March.



Feedback from Scottish Enterprise Customers

SE Business Trends Survey Findings

- As of 14th March, **42%** of responding businesses were **fairly confident** in Scotland's economic outlook, although **39%** were not very confident.
- The biggest opportunities outlined for the next 12 months are **increased demand** as the economy recovers, **launch of new products and services** and **entry to new markets**.
- The biggest **challenges** are expected to be **rising costs/managing cash flow**, **recruiting staff** and **supply chain disruptions.**
- **70%** of businesses reported **energy costs** had increased in the last 3-6 months - **55%** have absorbed these increases while **38%** have passed them on to customers.

Net Zero

- Businesses are becoming **more aware of their own environmental sustainability** with some applying for SE grants to recruit Sustainability Officers.
- Businesses are opting to become greener for a number of reasons: demand from consumers for '**greener**' products, a sense of '**doing the right thing**', a means of attracting staff and government support being offered to sustainable initiatives.

Workforce

- Businesses are having issues recruiting staff due to shortages of applicants and people wanting **flexible working** when, in some cases, businesses need people on site.
- Businesses are facing higher, **above inflation**, **salary demands** from both new and existing staff. Many Scottish businesses, are now having to offer "London wages" to attract skilled workers particularly in IT. Smaller companies struggle to offer higher wages.
- Due to increased home working, overseas businesses have been **recruiting Scottish based workers** (e.g. in IT), often paying higher wages than Scottish businesses can offer. This is **increasing competition for staff for Scottish businesses.**
- Projects and **expansion plans** have been **put on hold** by some businesses as they cannot get staff.

Workplace

- Demand is still high for **high quality, new or refurbished office space in city centres** and **for lab and specialised office spaces** that for example may include wellness facilities or co-working space.
- Hybrid working allows businesses to consider **downsizing** their premises and move to more **flexible space**, in some cases **sharing premises**.

Energy prices, supply costs and supply chains

- A number of **cost pressures** are impacting businesses – energy, raw materials/supplies, increased salaries, deferred VAT and bounceback loans now needing to be paid.
- The full impacts of **rising energy prices** are likely to feed through in the next 6 months as fixed price deals set in 2021 expire. However, some businesses are reporting **energy costs** tripling, and some are reconsidering growth plans as a result.
- **Intensive energy users** procure differently, buying ahead, so are better protected until later in 2022.
- Increased energy prices are encouraging some businesses to explore **alternative energy sources** (e.g. installing solar panels and hydrogen biomass).
- **Availability of transportation containers** and issues getting slots/space on transport shipping vessels continues. One result has been continuing significant cost increases of containers from China which can be up to $10,000 - up ten-fold since 2020.

Finance

- Businesses are **more aware of their cash position.** COVID-19 exposed the limited cash reserves some had, and they trying to build up reserves where possible.

Sectors

- In the **tourism sector**, hotels are seeing increased demand as people are wanting to travel again and **extended short stays** (e.g. long weekends) are becoming popular.
- However, some **inbound tour operators** are still experiencing international cancellations, possibly due to the pandemic. For other businesses also dependent on international visitors, overseas bookings also remain slow.
- Declining confidence to travel from North America and European markets due to the conflict in Ukraine may have a significant impact on the recovery of tourism in 2022.
- The supply and cost of materials remains a concern within the **construction sector** with few opportunities to pass costs on**.**
- Issues remain in the global distribution sector: there is a shortage of **specialist paper** for packaging and labelling, and a **shortage of ink**.

Sectors continued

- Phosphoric acid (crucial in the production of **fertiliser** and therefore in many supply chains) remains limited in supply, with increased prices as a result and could impact agriculture/food and drink sectors.
- Similarly, **soda ash (**a key raw material in **glass)** has seen a >50% increase in prices, that are being passed through the supply chain.
- For **glass production** lead time on materials for new build furnaces and furnace repair is now 18 months, twice as long as normal.
- Lead times for materials and finished products e.g. **engineering tech** are extending, and price volatility is severe; suppliers holding quotes for very short periods as a result.

Brexit

- Brexit-related issues (e.g. freight/customs costs and supply chain difficulties) continue to impact **exports to the EU.**
- Whilst most exporters have not changed the destination of their exports as a result of Brexit, continuing to export to both EU and non-EU customers, some businesses are now looking to **other markets** e.g. Asia.
- Exporters are either exporting less than normal or about normal levels. Over the next 6 months, **export sales are expected to increase.**
- The main **challenges** remain **transportation costs**, **additional paperwork**, **customs** and a lack of **hauliers**. The transition period following Brexit is cited as the main cause of these challenges, although COVID-19 has also been mentioned as a reason. These continue to be the **same challenges** as in the immediate aftermath of Brexit.
- Most businesses are not planning to make any changes to their business model at present due to Brexit; for those that are, **opening an office in the EU** and doing more business **online** are being explored.
- Exporters continue to look for **financial support** as well as help with **customs/tariffs** and finding **new overseas contacts** and **customers**.
- The requirement for businesses exporting goods to get **export health certificates** has led to a surge in demand for vets. However, there is a **shortage of vets** which is due both to the pandemic and the end of free movement between Britain and the EU following Brexit.

Economic implications Ukraine/Russia conflict

- Global **food prices** could **increase by more than 20%** because of the war in Ukraine – e.g. Ukraine and Russia are responsible for a significant proportion of global cereals production.
- This has led to significant **disruption to some supply chains** for Scottish businesses – most immediately felt in food & drink industry, but likely to extend wider in the future.
- The **salmon farming industry** relies heavily on **wheat** and **rapeseed oil** from Ukraine which are key components of feed pellets. It is difficult to switch to other suppliers quickly and pellet price rises are likely.
- Several large Scottish seafood producers/distributors rely on **importing significant volumes of Russian fish**; without this supply they may struggle to operate, and this if being further impacted by UK retailers delisting seafood originating from Russia.
- Major **price increases** with items such as **sunflower oil** and breadcrumbs will not be sustainable.
- It is **not possible** to **switch raw product sourcing to UK** or EU markets as these are covered by **long contracts**.
- The **bakery industry** is facing potential **shortages of fats, oils and flours** - Ukraine is the world's fourth largest exporter of wheat, and Russia the top wheat exporter.
- Due to the conflict, there have been significant **price increases** and low availability of **aluminium**. Some Scottish businesses are able to stockpile to cover future production, although this has impacts on working capital and cash flow in the short term.
- **Steel prices** have increased to £1,400 per tonne from around £1,000 and many steel mills are no longer taking orders. Shortages are arising because both Russia and Ukraine produce steel billets, used as inputs for European mills.

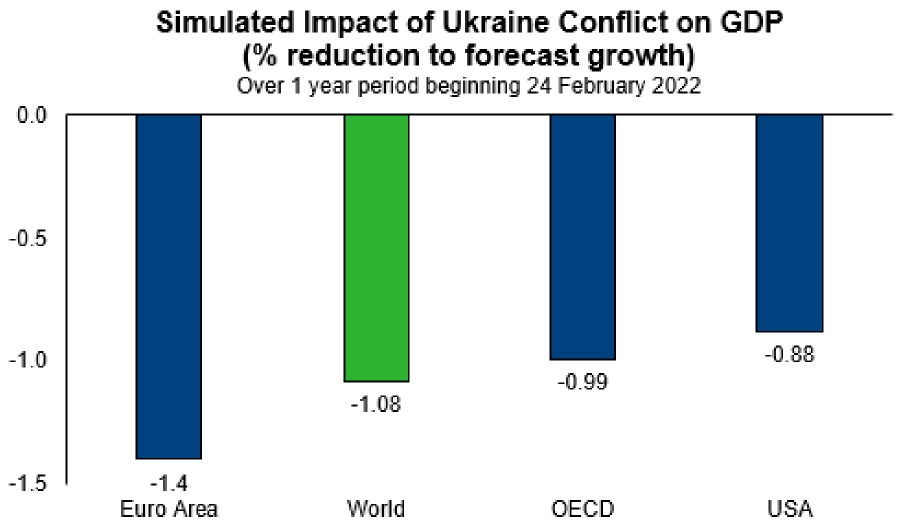
Economic Forecasts

Global Forecasts

The OECD highlights that the most important **consequence** of the war in Ukraine is the lives lost and the humanitarian crisis. There are also, however, significant economic implications, and the OECD has estimated global growth could be cut by more than a percentage point this year as a result of the conflict's impact on both **commodity prices** and **Russia's economy**.

Although Russia and Ukraine are relatively small in output terms, the OECD notes they are **large producers and exporters of key food items, minerals and energy**. The war has already resulted in sizeable **economic and financial shocks**, particularly in commodity markets, with the prices of oil, gas and wheat soaring.

European economies are projected to be hardest hit, reflecting greater expected gas price rises and the relative strength of business and energy linkages with Russia. Growth elsewhere will be less impacted because of lower trade and investment links with Russia but will still be hit by **weaker global demand** and the impact of **higher prices** on household incomes and spending.



UK Forecasts

The British Chambers of Commerce (BCC) has downgraded its expectations for UK growth in 2022 from 5.9% to 3.6%, citing a **deteriorating outlook for consumer spending** as inflation outpaces wage growth and a **weaker-than-expected rebound in business investment** amid rising cost pressures, higher taxes and global shocks, including Russia's invasion of Ukraine.

The National Institute of Economic & Social Research (NIESR) has also cut its forecast for UK growth from 4.8% to 4%, suggesting Russia's invasion of Ukraine will drive UK inflation even higher through **additional energy price increases**, further reducing the spending power of UK households.