

Economic Commentary

February 2024

Insights and Economics



Economic Commentary: Highlights

SUMMARY

- The IMF is forecasting global economic growth to **remain at 3.1% in 2024 and rise marginally to 3.2% in 2025**. Emerging and developing economies are expected to grow much faster than developed ones. **UK growth** is forecast at 0.6% and 1.6% for 2024 and 2025.

RECENT ECONOMIC DATA

- **Global business activity** picked up at the start of 2024, due to improved performance in both services and manufacturing sectors. Generally, emerging markets continue to outperform their developed counterparts.
- **The UK entered recession at the end of 2023 as GDP contracted by 0.3% in Q4, following -0.1% in Q3**. Output fell across services (-0.2), construction (-1.3%) and manufacturing (-0.9%).
- UK **service sector activity increased** in January at the fastest rate since last May; however, manufacturing output decreased at its fastest level for 3 months. Business growth increased across 10 out of 12 UK nations/regions, including Scotland.
- **Consumer price inflation remained at 4.0% in the 12 months to January**. Core inflation was higher (at 5.1). Producer input prices fell for the eighth consecutive month (-3.3%).

CURRENT BUSINESS SENTIMENT

- Scotland's onshore **GDP contracted by 0.1% in November (following -0.6% in October)**. Service sector output increased (+0.4%), but this was offset by declines in manufacturing (-1.7%) and construction (-0.2%).
- 31% of Scottish businesses reported a **decrease in monthly turnover** in December (44% for manufacturers). This is the fourth consecutive month where more businesses have reported a fall in sales than a rise.
- Scotland's labour market shows signs of softening as the **unemployment rate increased** 1.1ppts to 4.5% over the year in October - December, while the **employment rate fell** to 74.4%.

FORWARD LOOK

- A quarter of Scottish businesses reported **worker shortages** in January, though this proportion has dropped in recent months. Median monthly **wages rose by 6.1%** over the year to January 2024 (above 4.0% inflation).
- SE customers are becoming **more optimistic** about the year ahead and the prospect of lower inflation and falling interest rates. **Confidence to invest is rising**, and many are looking at **innovating to boost productivity**.
- Ernst & Young is **forecasting the Scottish economy will grow** 0.7% in 2024, rising to 1.4% in 2025. The Fraser of Allander Institute is slightly less optimistic, forecasting growth of 0.6% and 1.1%.



Global/UK

SUMMARY

[Global private sector output](#) growth reached a 7-month high at the start of 2024, with emerging continuing to outperform developed markets on average. Both services and manufacturing sectors improved with the latter expanding for the first time in 8 months. The UK has 4th highest overall growth out of the 14 nations with available data in January.

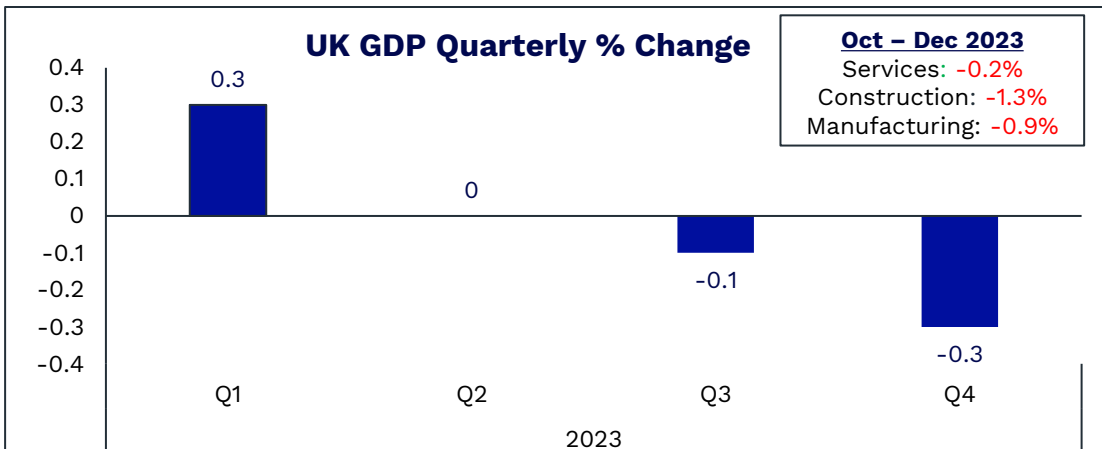
Business Activity Index (>50 indicates increase vs previous month)

2023	Aug	Sep	Oct	Nov	Dec	Jan
Global	50.6	50.5	50.0	50.5	51.0	51.8
China	51.7	50.9	50.0	51.6	52.6	52.5
US	50.2	50.2	50.7	50.7	52.3	50.9
UK	48.6	48.5	48.6	50.1	52.1	52.5
Japan	52.6	52.1	50.5	50.0	50.0	51.5
Eurozone	46.7	47.2	46.5	47.6	47.6	47.9

RECENT ECONOMIC DATA

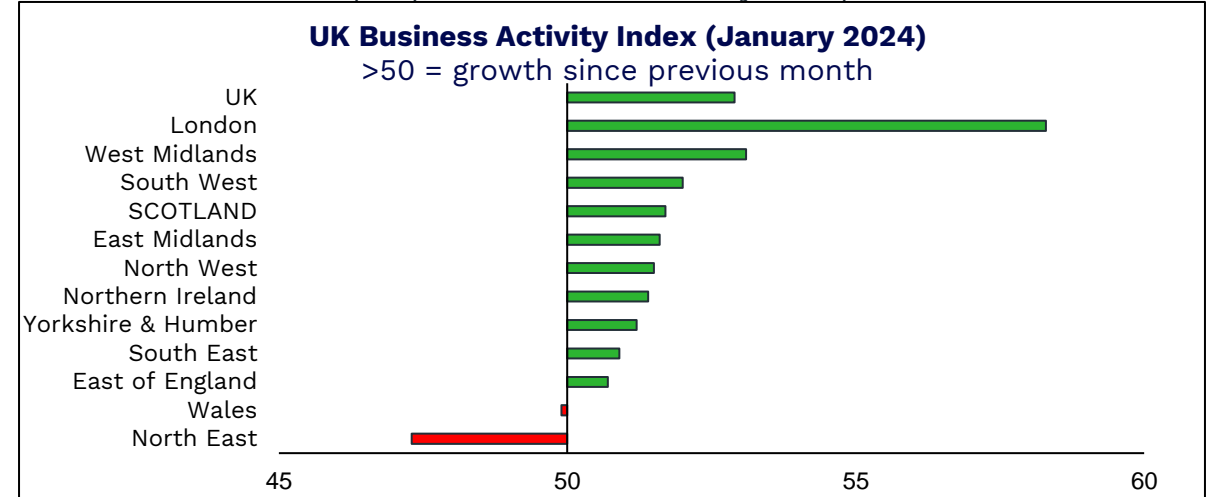
CURRENT BUSINESS SENTIMENT

The UK entered a recession (two consecutive quarterly declines in GDP) as [GDP](#) fell by 0.3% in Q4, following -0.1% in Q3. Within Q4, output fell across services (-0.2), construction (-1.3%) and manufacturing (-0.9%). Despite this, GDP for 2023 is +0.1% higher than 2022.

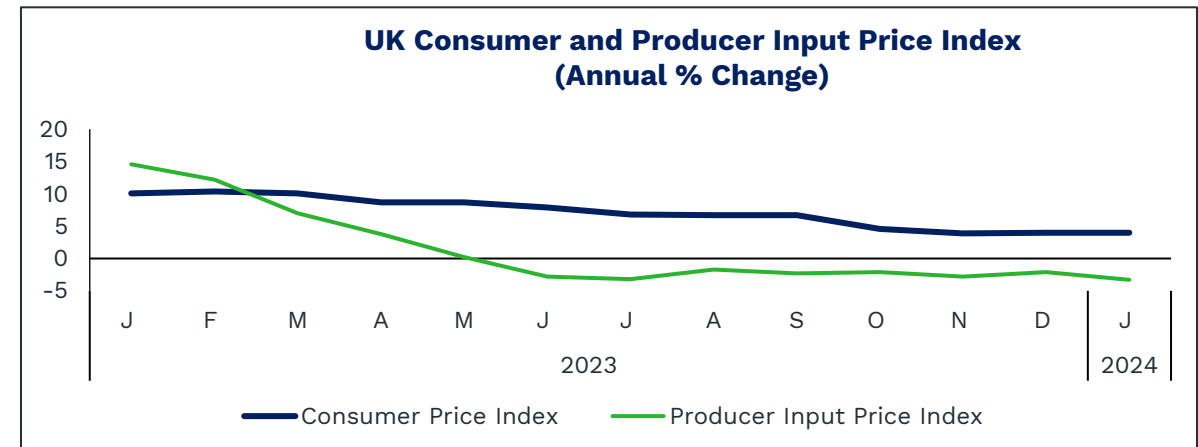


FORWARD LOOK

For the UK, the rise in [service sector activity](#) in January was the fastest since May 2023, but manufacturing production decreased. 10 out of 12 UK [regions/nations](#) saw a rise in business activity, with London once again leading. On average, business costs and output prices rose more slowly than previous months.

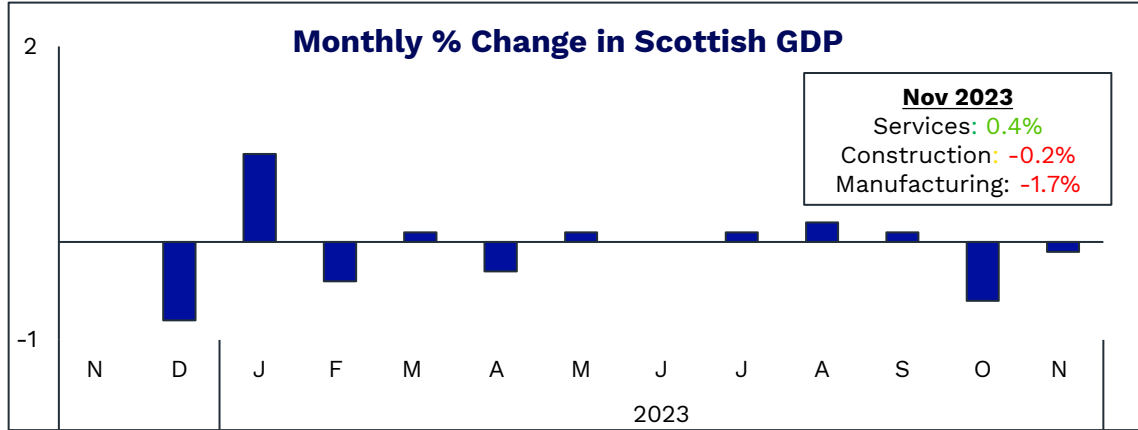


[Consumer price inflation](#) was 4.0% in the 12 months to January 2024, unchanged from December. The biggest upward factor was rising gas and electricity costs - the biggest downward factor was furniture and food. Core inflation rose by 5.1% over the year. [Producer input prices](#) fell for the eighth consecutive month in January (-3.3%).

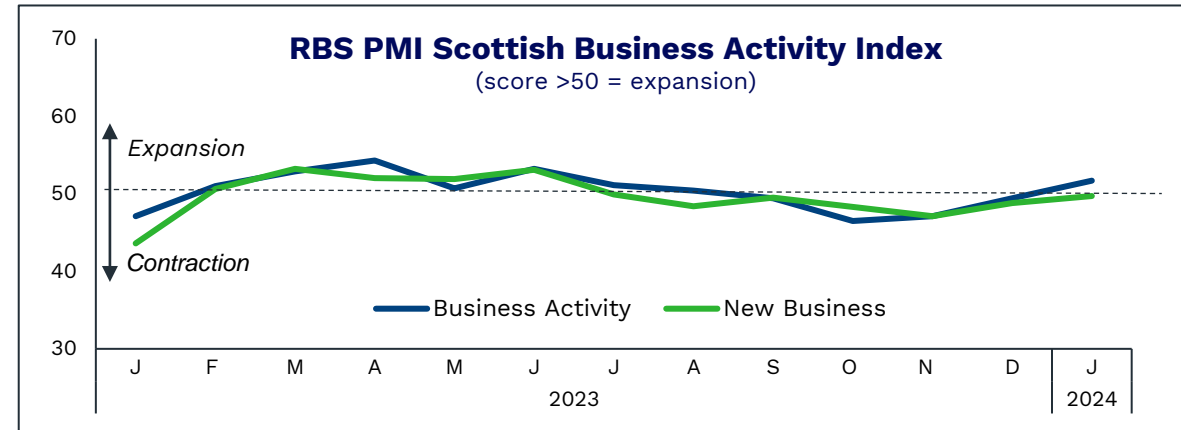


Scotland

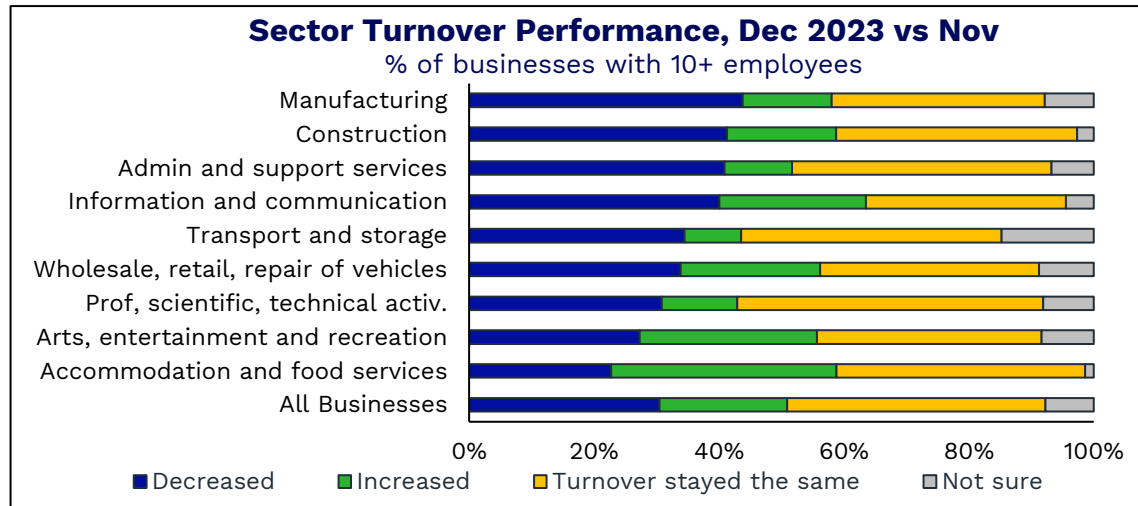
The [Scottish economy](#) contracted by 0.1% in November, following a 0.6% fall in October. Service sector output increased (+0.4%); however, construction output fell by 0.2% and manufacturing by 1.7%. In the 3 months to November, Scottish GDP has fallen by 0.2%.



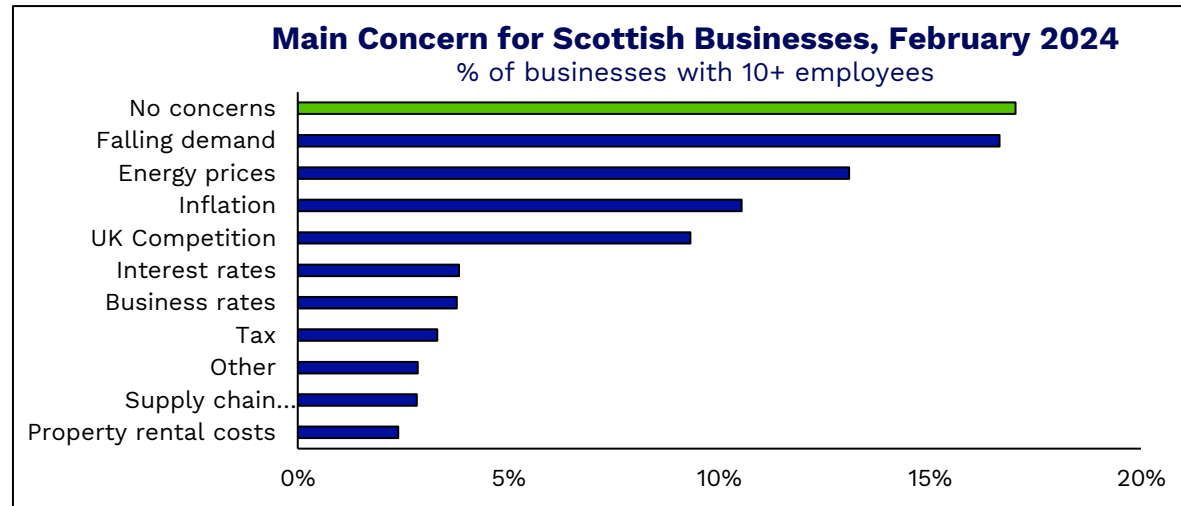
[Scottish private sector business activity](#) rose in January for the first time in 6 months. The upturn was solely reliant on services as manufacturers reported a sharp reduction in production for the 7th consecutive month, albeit the weakest rate since July.



31% of businesses reported a [decrease in monthly turnover](#) in December, with just 21% reporting an increase. This is the fourth consecutive month where more businesses have reported a fall than a rise. Manufacturing had the largest proportion reporting a decrease (44%). The main challenges affecting turnover remain the cost of materials and economic uncertainty.



Excluding labour market issues, the [main concern for businesses](#) is falling demand with 20% reporting that their domestic demand for goods and services decreased between November and December 2023. More promisingly, only 11% of businesses reported inflation as a main concern for February (vs 17% for Jan), dropping it from the most reported concern to 3rd.



SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

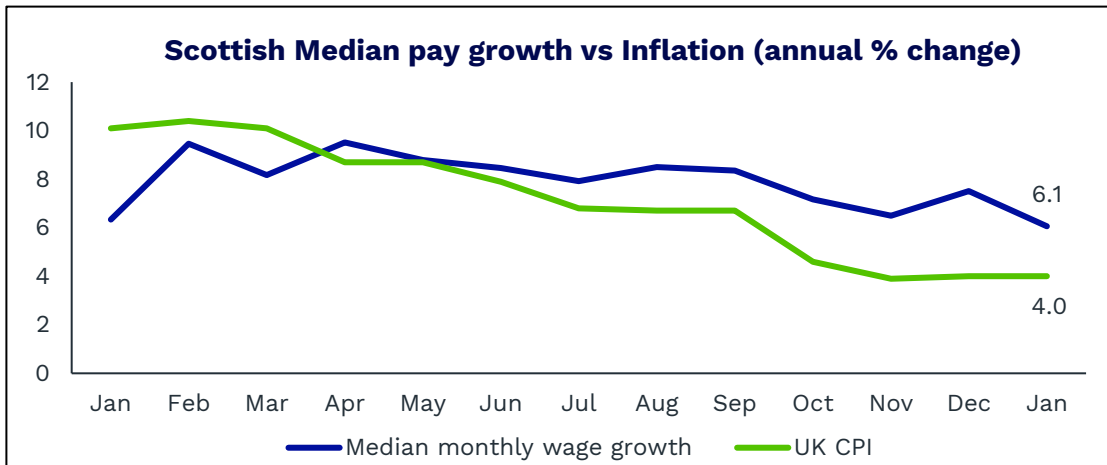
FORWARD LOOK

Scotland

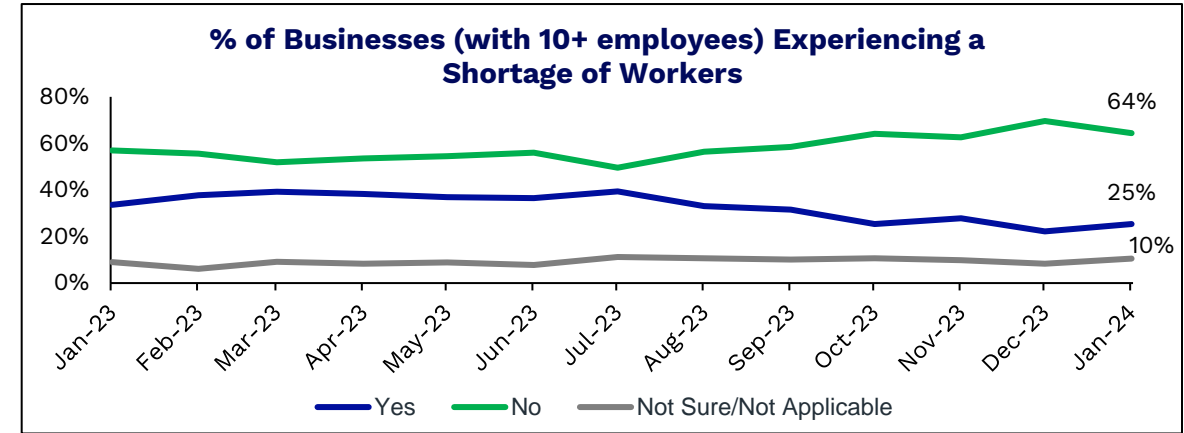
[Scottish unemployment](#) increased by 1.1ppts over the year to January to 4.5%, taking it above the UK rate of 3.8%. The employment rate also fell by 1.6ppts to 74.4% and is below the UK's (75.0%). Economic inactivity has risen over the year by 0.7ppts to 22.0% (vs the UK's 21.9%), driven by an increase in long term sickness.

	RATE (Oct – Dec 23)	ANNUAL CHANGE
EMPLOYMENT (16-64)	74.4%	-1.6%pts
UNEMPLOYMENT (16+)	4.5%	+1.1%pts
ECONOMIC INACTIVITY (aged 16-64)	22.0%	+0.7%pts

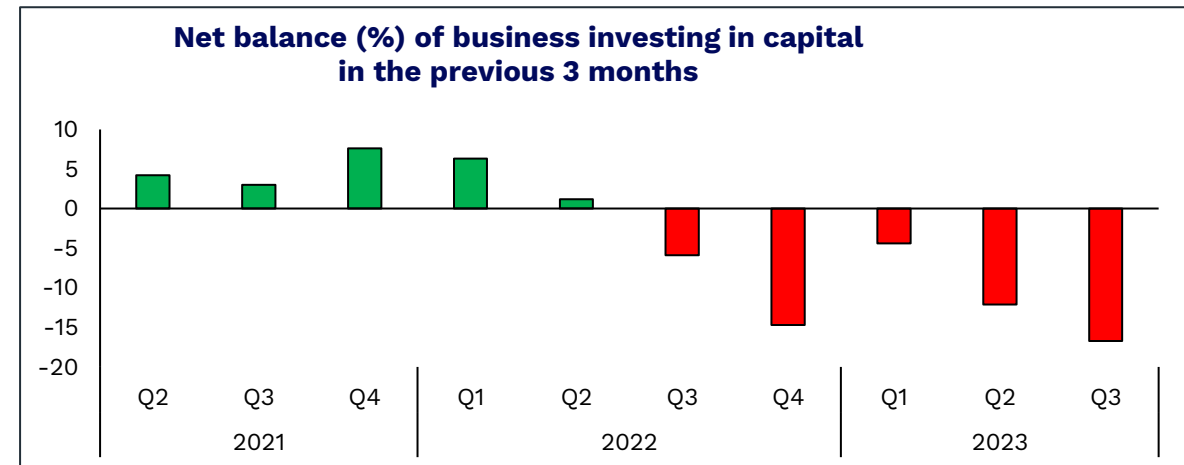
Despite [candidate shortages](#), starting salary growth in January was the weakest in nearly three years due to subdued demand. Wage growth slowed in January, reflecting the softening labour market, with the [median monthly wage](#) of payrolled employees in Scotland 6.1% higher than a year ago (vs +6.4% for the UK). With inflation falling, real wage growth has been positive for 10 consecutive months.



Fewer Scottish businesses are reporting [worker shortages](#), falling from a peak of 45% in August 2022 to 25% in January 2024. Some sectors are more affected than others, with 42% of Construction businesses experiencing shortages.



47% of Scottish businesses have [cancelled or delayed planned capital investment](#) in the 12 months to October 2023, and in Q3, again more businesses reported a fall in new capital investment than an increase (see chart below). More positively, 15% of businesses [expect capital expenditure](#) to increase between January and March, while 8% expect it to decrease.



Feedback from Scottish Enterprise Customers

General Sentiment

- SE customers are becoming **more optimistic** about the year ahead and the prospect of lower inflation and falling interest rates. **Confidence to invest is rising**, and many are looking at **innovating to boost productivity**

Labour and Skill Shortages

- **Recruitment and staff retention** continues to be an issue across all sectors and all occupations.
- A competitive labour market makes **attracting qualified candidates for interviews and retaining staff challenging**. To address this, businesses are:
 - offering higher salaries - however, large businesses have more capacity to do this than SMEs.
 - developing **partnerships with universities and colleges** to design courses that will deliver required skills
 - looking to **'grow their own'** by taking on apprentices, graduate trainees and/or upskilling existing staff
 - **offering enhanced employment packages**, including greater flexibility.
 - **recruiting from overseas**, although, obtaining visas can be a concern.

Cost of Doing Business

- **High transport, packaging costs and raw materials** remain issues for businesses. Some are able to pass these on to customers through higher prices. Competition, however, means this is not always possible.

Capital Investment

- An improved economic environment is providing **increased certainty** and more businesses are looking to take forward capital investment projects.

Access to Finance

- Businesses are hopeful that **servicing debt** will become easier as demand and interest rates fall, however many continue to face challenges in securing **debt funding** because of banks' risk averseness.
- Risk averseness amongst some investors means that raising **equity finance** can also be difficult.

Innovation

- Recent business challenges (e.g. high costs and labour shortages) and emerging opportunities (e.g. adopting net zero approaches and emergence of AI) are encouraging business to **invest in process and workplace innovation**. Examples include:
 - installing **new, cleaner, machinery and heating systems** that will reduce energy costs
 - investing in **automation and digitation** to streamline processes, address staff shortages and increase productivity
 - adopting **hybrid and remote working** to attract and retain staff
 - exploring the potential of **introducing AI** into business operations, although for many this is in the early stages.

Supply Chain

- Some construction, engineering and fabrication businesses have expressed concern about the **loss of steel-making capacity in the UK with the closure of the Port Talbot facility** – importing steel will potentially increase costs and supply chain vulnerabilities.
- Some businesses are highlighting that the **red sea crisis** is affecting delivery of computer chips, sensors and other components from Asia, and this is impacting ability to complete customer orders

Property

- A shortage of **modern, affordable premises**, especially for manufacturing and lab space, across Scotland continues to be highlighted by businesses.

Economic Outlook

Global Forecast

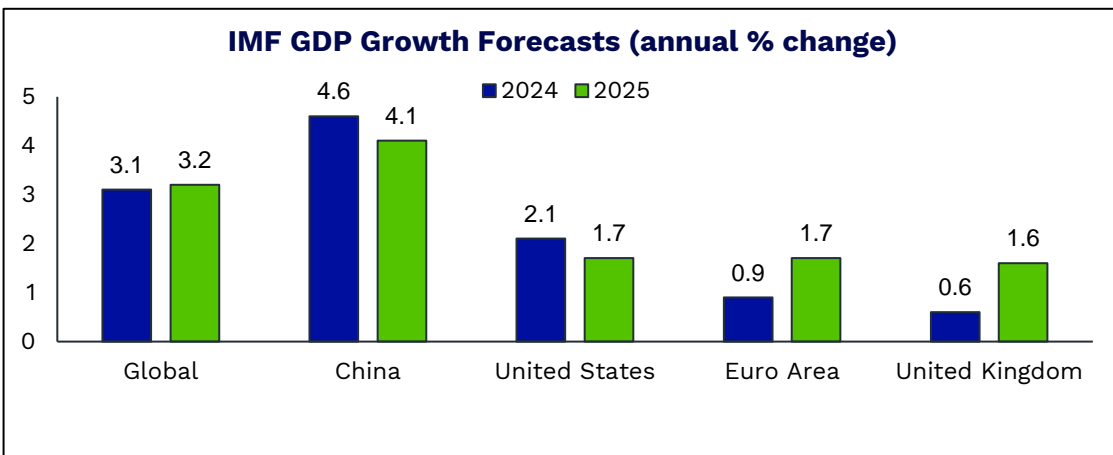
The [IMF](#) is forecasting global economic growth to remain at 3.1% in 2024, before rising modestly to 3.2% in 2025. The forecasts are higher than they were in last year's forecast (by 0.2ppts) due to improved performance in the US and increased government spending in China. The projections remain below the historical annual global average growth rate of 3.8% between 2000 and 2019.

Emerging market and developing economies are forecast to outperform advanced economies (+4.1% vs 1.5% growth in 2024). UK GDP is expected to rise modestly from an estimated 0.5% in 2023 to 0.6% in 2024, due to lagged negative effects of high energy prices; the forecast for 2025 (1.6%) is the result of improved inflation performance and reduced interest rates.

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

Risks to global growth are broadly balanced. The downside risks include:

- China's property sector crisis could deepen with real estate investment dropping more than expected
- A slower-than-expected decline in core inflation in major economies due, for example, to persistent labour market tightness
- Further climate and geopolitical shocks could cause additional food, energy and transportation price spikes due to supply shocks



UK and Scottish Forecasts

The [Ernst & Young ITEM Club](#) is forecasting UK economic growth of 0.9% in 2024, rising to 1.8% in 2025. This is more optimistic than previous forecasts due to falling inflation, potential interest rate cuts, and tax reductions.

Risks and uncertainties to future UK economic performance EY highlight include:

- Low unemployment leading to higher wages causing persistent inflation
- The lagged effect on households of past rises in interest rates subduing spending
- Policymakers keeping monetary policy too tight for too long
- Conflict in the Middle East increasing uncertainty around the economic outlook, particularly regarding energy prices.

For [Scotland](#), EY expects economic growth to accelerate from 0.1% in 2023 to 0.7% this year and 1.4% in 2025. This though would be lower than the UK's expected performance.

The [Fraser of Allander Institute](#) expects the Scottish Economy to improve a little in 2024, after virtually no growth over 2023 (0.2%); it forecasts growth of 0.6% in 2024, rising to 1.1% in 2025. Whilst these are slightly weaker than their October estimates, it still points to improving conditions in the economy this year.

