Economic Commentary

April 2022

All data represent most recent available as of April 20th, 2022

Insights & Economics

Scottish Enterprise

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

Measures to tackle COVID in China and the early impact of war in Ukraine are beginning to weigh on **global economic performance,** although most major economies continue to report strong expansion.

The outlook for the **global economy** has also weakened considerably since the outbreak of the conflict, with growth in 2022 now forecast at **3.6%**. All major economies are expected to grow more slowly than previously expected as the war adds to inflation, although the impact will be greatest in Europe.

Growth in **UK GDP** slowed to just 0.1% in February as ongoing supply chain disruption undermined strong tourism-related gains. Business confidence has also eased due to cost pressures and conflict in Ukraine, although recent business surveys suggest further expansion in business activity in March.

The **Scottish economy** was 1.3% above its pre-pandemic level of output in February. Business activity continued to grow through the first quarter, but growth has become increasingly reliant on service providers, which may now be impacted by the cost-of-living crisis.

In March, the number of payrolled workers in Scotland was 21,000 higher than before the pandemic. However, wages are failing to keep pace with inflation, and there has been a sharp **rise in economic inactivity** as some workers leave the labour force.

Scottish businesses continue to report widespread **inflationary pressures** (rising energy, staff and raw materials costs), **recruitment difficulties** and **some supply chain disruption**. In some cases, these challenges are forcing businesses to operate at reduced capacity, or to pause production.

Conflict in Ukraine is likely to compound these issues by adding to cost inflation and further disrupting supply chains.

Forecasts for UK and Scottish GDP growth in 2022 have been **downgraded to 4.2% and 3.5% respectively**, amid global uncertainties and inflation hitting both consumers and businesses.

SUMMARY

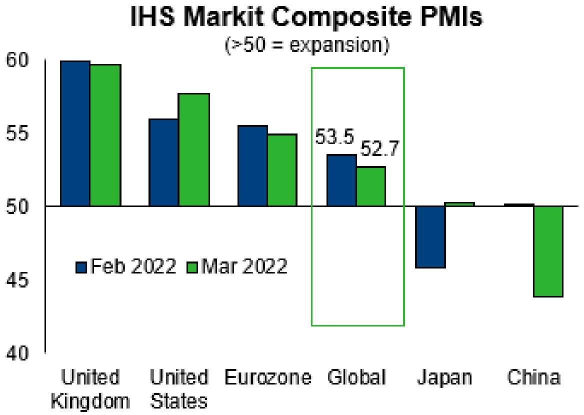
RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

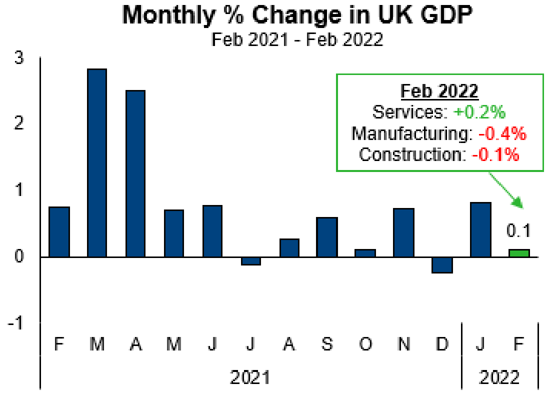
FORWARD LOOK

Global/UK

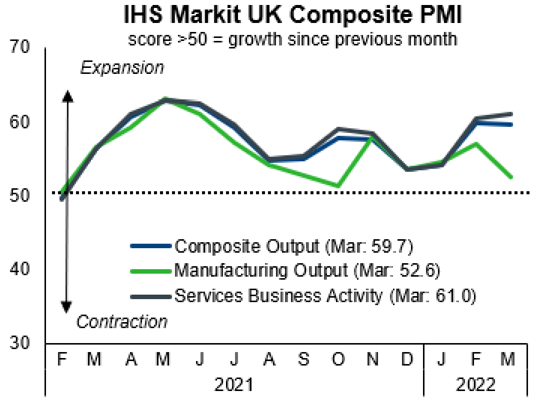
The latest business surveys signal a slight loss in momentum for the global economy, as the impact of COVID measures in China and the war in Ukraine on Europe weigh on overall expansion.



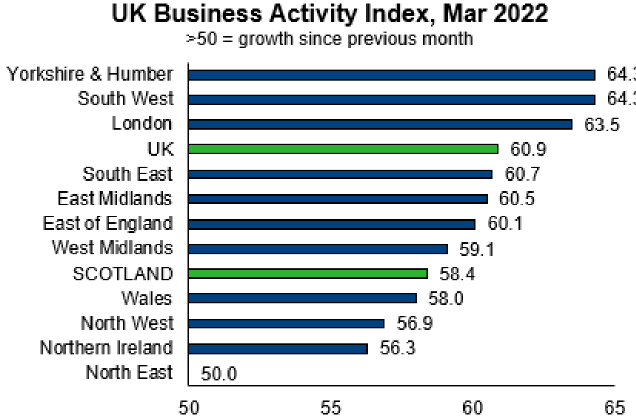
In the UK, growth slowed to just 0.1% in February as supply chain disruption among manufacturers and storm disruption at construction sites offset a recovery in holiday bookings following the easing of COVID travel restrictions.



However, UK private sector activity appears to have maintained its recovery through the first quarter, with accelerating growth in services offset only partially by the slowdown in manufacturing growth.

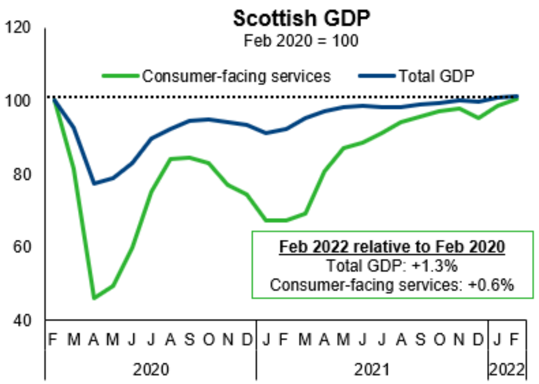


Nearly all UK regions reported strong increases in business activity in March, although expectations eased in each area amid inflationary pressures and concerns related to the conflict in Ukraine.

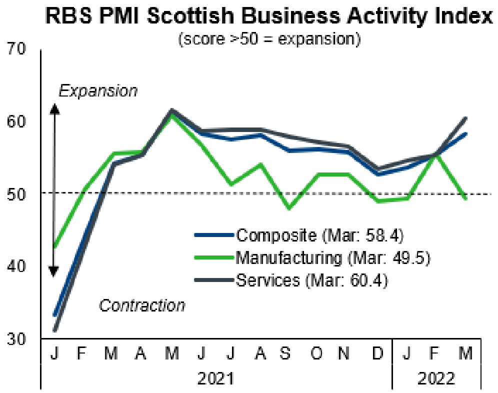


Scotland

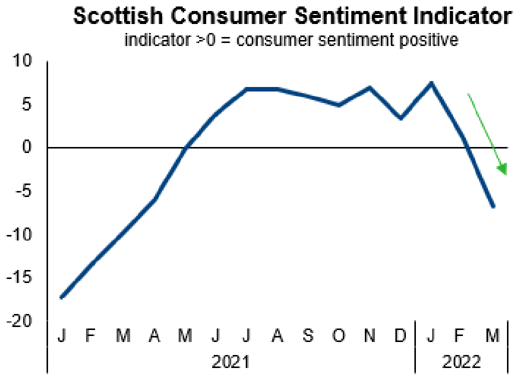
The latest monthly GDP data show the Scottish economy was 1.3% above its pre-pandemic level of output in February, although sectoral disparities persist.



Growth in private sector activity has become increasingly reliant on services as manufacturers continue to struggle with supply chain challenges.



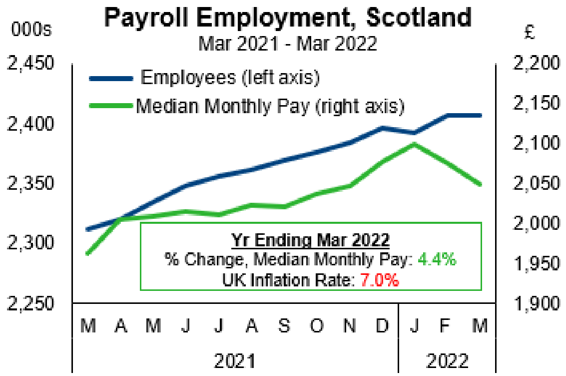
However, recent gains in consumer-facing sectors in particular may prove tough to sustain if households cut back on discretionary spending, as looks likely.



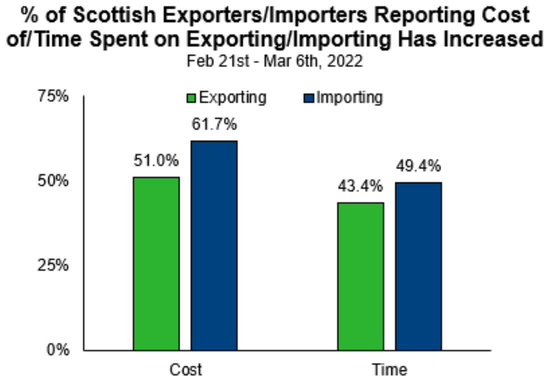
In the labour market, gains in employment mask a rise in economic inactivity driven in large part by fewer older people in work (either voluntarily leaving the labour market or due to long-term sickness).

	RATE (DEC 2021 - FEB 2022)	ANNUAL CHANGE
EMPLOYMENT	74.7%	+0.4%pts
UNEMPLOYMENT	3.5%	-1.1%pts
ECONOMIC INACTIVITY	22.5%	+0.5%pts

There are also early signs growth in payroll employment *may* be beginning to slow, while wages are failing to keep pace with inflation.

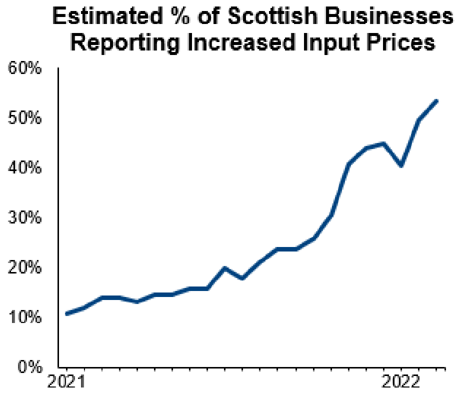


Meanwhile, international trade continues to be more expensive and time-consuming as a result of both Brexit and the pandemic.



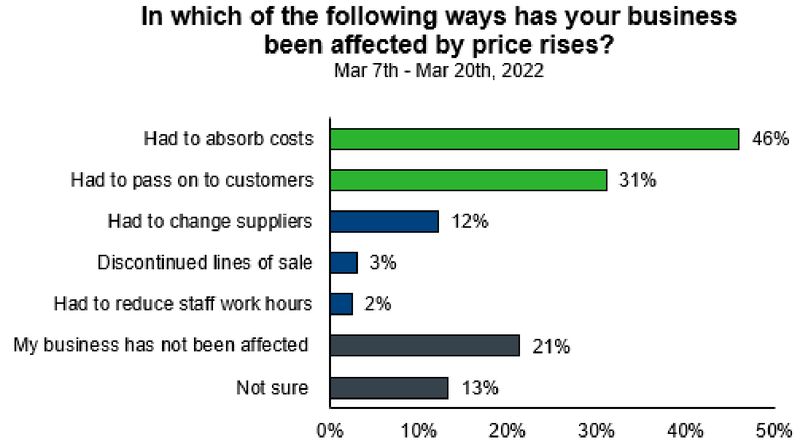
Scotland

The proportion of Scottish businesses reporting cost increases rose to another series high in March, with manufacturing and construction businesses most likely to be impacted.

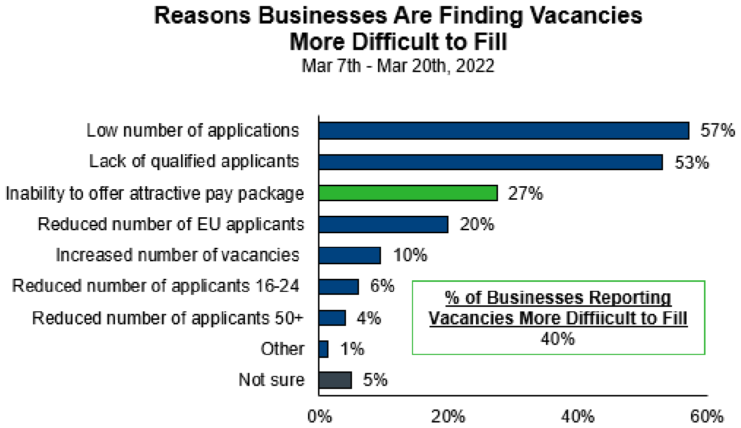


Mar 7th - Mar 20th, 2022
Manufacturing: 69%
Construction: 67%
Accommodation & food: 56%
Arts & recreation: 54%
ALL BUSINESSES: 53%
Transport & storage: 53%
Wholesale & retail: 51%
Administrative & support: 46%
Professional & scientific: 34%
Information & communication: 21%

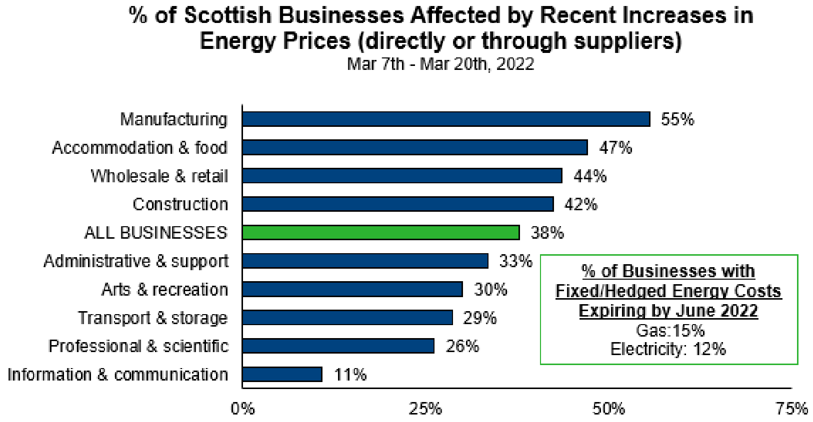
A majority of businesses are simply absorbing increased costs or passing them on to customers, but close to 1 in 5 have been forced into more significant action such as changing suppliers.



The inability to offer higher wages is also contributing to hiring difficulties, although skills shortages and low candidate availability remain the primary drivers.



At least 40% of Scottish businesses (probably more, as 23% are 'not sure') have now been directly or indirectly affected by energy price increases, rising to more than half of manufacturers.



Feedback from Scottish Enterprise Customers

Workforce

- Businesses across a range of sectors continue to report staff shortages and recruitment challenges. Examples include airports, tourism/hospitality (especially chefs), bus drivers, IT staff and agricultural workers (a significant proportion of **seasonal workers** come from Ukraine).
- Businesses report losing IT staff who are being offered **higher salaries** by London-based employers but can work from home in Scotland.
- Some Scottish businesses are recruiting IT staff from overseas (primarily India/Middle East). Starting salaries have increased by as much as 15% while existing staff salaries are expected to increase by at least 5% this year.
- Labour shortages in **tourism/hospitality** will be a particular challenge as demand increases with the spring/summer visitor season starting and COVID restrictions easing. This may result in periods of closure or restricted opening hours.
- Businesses highlight one reason for recruitment difficulties in **rural areas** is a shortage of affordable homes.
- The **impact of COVID** continues e.g. staff self-isolating can result in businesses temporarily closing or reducing their opening hours.
- Some business growth projects are being put **on hold** or **slowing down** as businesses cannot get staff.

Workplace

- Some businesses have closed their offices and gone **fully remote**. In addition to keeping costs down this allows them to recruit globally more easily.
- Businesses with large offices that have adopted hybrid working are **repurposing office space** for storage and, in some cases, laboratory/engineering space.
- There has been **mixed feedback** about the return to face-to-face meetings with customers and attendance at trade shows - some businesses are happy to do this in person while others are preferring online. For some businesses, it is easier and **more cost effective** to attend virtual tradeshows.
- **Out-of-town locations**, especially manufacturing plants, can have issues recruiting staff where **transport links** are poor e.g. being unable to operate night shifts as there is often no public transport.

Energy prices, supply costs and supply chains

- Higher **energy prices** are hitting most businesses - **increases of 400%** are not uncommon, which may lead to price rises and even threaten the viability of some businesses.
- However, some businesses are **unable to pass on rising costs** to customers – either because of contractual reasons or because of the impact it would have on demand.

- Scotland's **large industrial manufacturing** sites are typically heavy gas/electrical users (manufacturers of food, pulp/paper, chemicals etc) for whom energy bills account for around 20% of operating costs. Fortunately, many large **energy-intensive** businesses tend to procure energy through in-house specialists and **hedge** purchasing months ahead.
- Some **manufacturers** are **pausing activity** due to supply chain issues e.g. getting components from Eastern Europe, and/or the ongoing global shortage of semi-conductor chips.

Sectors

- Some businesses may be impacted by the ending of public sector **COVID-related contracts**. For example, the closure of test-and-trace centres and the reduction in COVID test manufacturing could result in affected businesses downsizing or even closing.
- As inflation rises and household budgets are squeezed, there is concern about the impact on both summer **tourism** bookings and, ultimately, **tourism spending** - visitors may still come but spend less.
- Forward bookings for **cruise operators** coming to Scotland look strong. However, availability of onshore services remains problematic e.g. restaurants are taking no/fewer bookings due to reduced capacity (as a result of staff shortages).
- **VAT** has increased by 12.5% to 20% which may result in rising prices for all sectors.
- Start-up companies that sold online during the pandemic are increasingly looking for **pop-up shops** to showcase their goods - bucking the trend away from physical retail.
- The **plastic packaging tax** that came into effect in the UK on 1 April 2022 (affecting any packaging that does not contain at least 30% recycled plastic) is impacting many businesses due to its scope - e.g. packaging in manufacturing, consumer goods, and food and drink amongst others.

Economic implications of Ukraine/Russia conflict

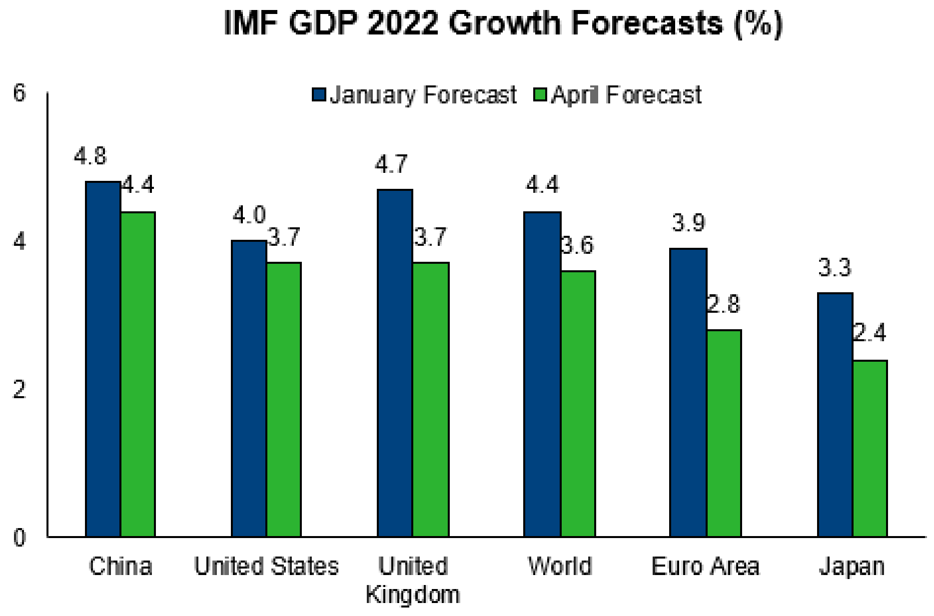
- Increases in fuel, energy and raw materials **prices** as a result of the Ukraine conflict are likely to result in further pressure among Scottish businesses to raise prices - particularly in **input-intensive sectors** such as manufacturing and construction.
- Scottish businesses may also face **disruption** because of Russia and Ukraine's role in the supply of key global commodities - e.g. delays in the procurement of **basic metals** (nickel, aluminium, and palladium) could hit industrial producers, while food producers could be affected by disruption to supplies of **fertiliser, wheat and vegetable oils**.

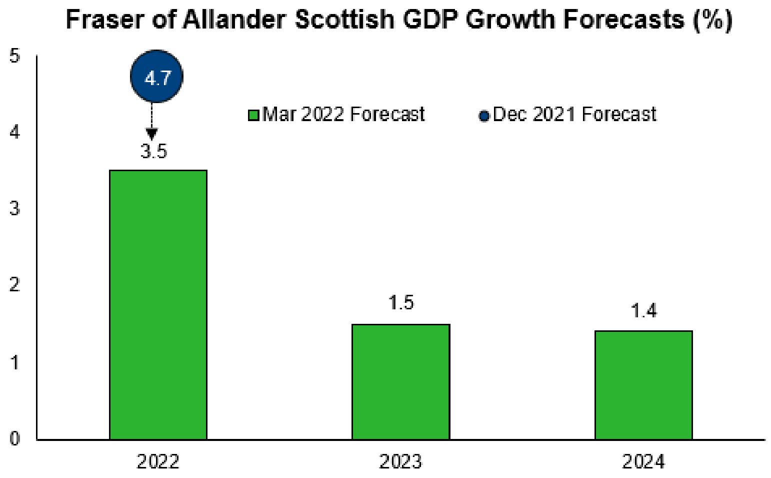
Economic Forecasts

Global Forecasts

The IMF has revised down its forecast for **global growth** in 2022 to **3.6%**, indicating war in Ukraine will disrupt global commerce and add to inflation. Europe suffered the greatest downgrade, although all major economies are expected to be impacted through commodity markets, trade, and financial linkages.

Similarly, the WTO has reassessed its projections for **world trade**, citing Russia and Ukraine's role as key suppliers of essential goods including food, energy, and fertiliser as well as the impact of lockdown in China on global supply chains. World merchandise trade volume is now expected to grow **3.0%** in 2022 (down from 4.7% previously forecast) and 3.4% in 2023.





UK and Scottish Forecasts

The Fraser of Allander Institute has **downgraded** its expectations for Scottish economic growth in 2022 to **3.5%,** citing global uncertainties and inflation hitting both consumers and businesses. The Institute also noted that although Scotland's economic output had returned to pre-pandemic levels, **there were differences among sectors with the hospitality and leisure sectors** still to catch up in January.

EY has also revised its forecast for the **UK**, downgrading growth in 2022 to **4.2%.** Inflation and the war in Ukraine were quoted as the main reasons for the downgrade.