Economic Commentary

October 2022

All data represent most recent available as of October 14th, 2022

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

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

The IMF and OECD are both projecting that the UK will have **among the weakest growth rates of the world's largest economies in 2023**, mostly due to higher inflation levels and the impacts of the UK Government's fiscal and monetary policy alignment.

In the three months to August**, UK GDP contracted by 0.3%** fueling concerns of a recession. Business surveys for September show UK private sector activity **falling** at its quickest rate since early 2021 as inflationary pressures continue to dampen demand.

Inflation in the UK continues to be high (10.1% in the year to September), while the value of the pound has depreciated, pushing up import prices and further fuelling inflation. To help combat rising prices, the Bank of England increased interest rates to 2.25% in September.

The **Scottish economy contracted** by 0.2% in the three months to July. More recent data shows that **business activity declined** in September (for the second month in a row) as new orders fell (for the third consecutive month), as did business confidence.

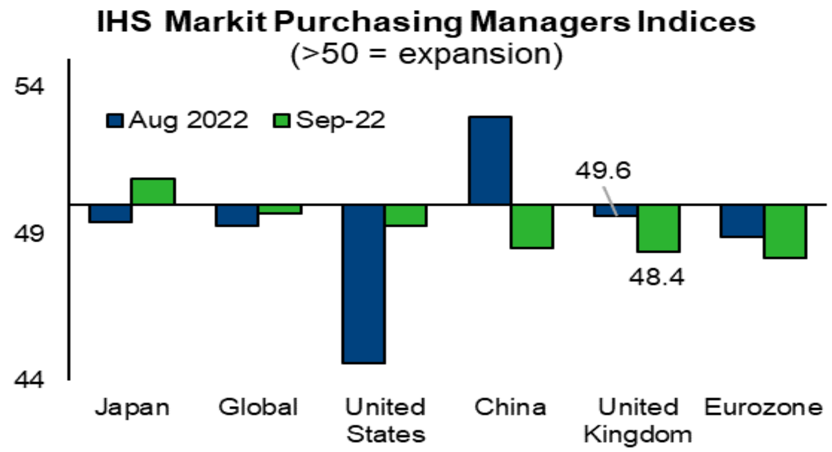
Unemployment in Scotland remains near a record low and the number of payrolled workers continues to rise. However, **wages** are failing to keep pace with inflation.

Scottish businesses across all sectors continue to report widespread **inflationary pressures, recruitment difficulties** and **some supply chain disruption**. This is impacting the ability to meet demand for some businesses.

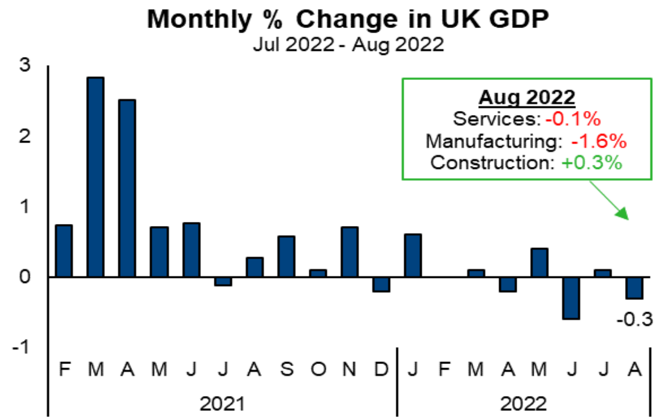
The **Scottish economy** is forecast to grow by **3.6% in 2022** but with contractions in the last two quarters of the year, meaning Scotland would be in recession by the end of the year. Output is forecast to **further contract** in 2023 (-0.6%), before returning to growth in 2024 (+0.8%).

Global/UK

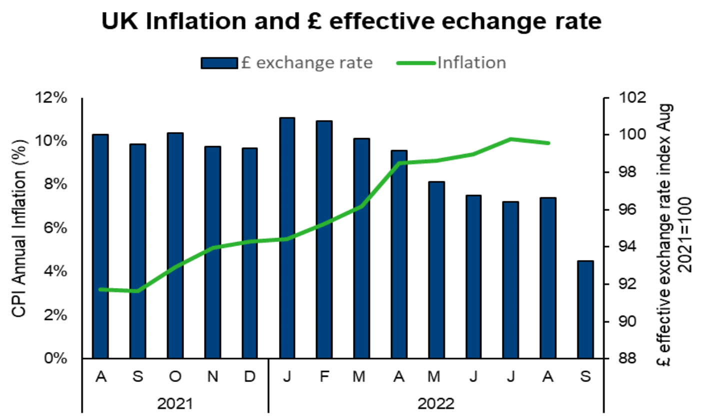
The latest business surveys show a decline in activity for the second consecutive month with downturns registered for all major economies except Japan. In the UK, private sector activity has declined at the quickest rate since January 2021.



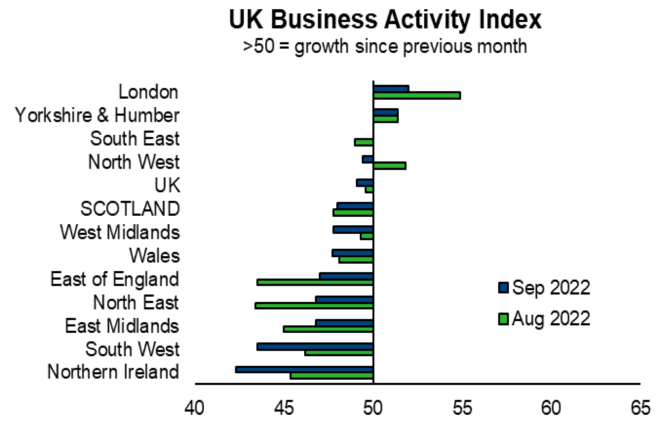
UK GDP contracted by 0.3% over the three months to August, and by 0.3% in August alone. This has further added to concerns of a recession.



High inflation continues in the UK, while the value of the pound has depreciated. To help counteract inflationary pressures, the Bank of England increased interest rates to 2.25% in September.



All UK regions and nations, except London and Yorkshire & Humber, recorded contractions in business activity over September. Demand for goods and services fell due to increased inflationary pressures and economic uncertainty.



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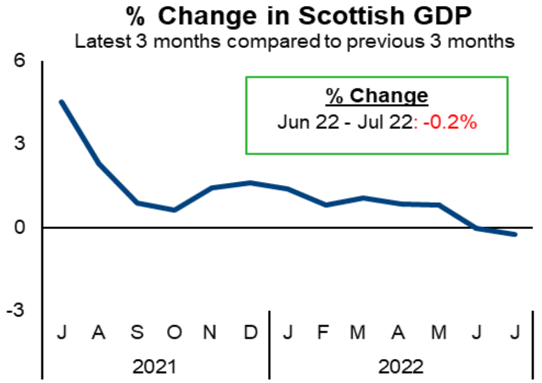
Scotland

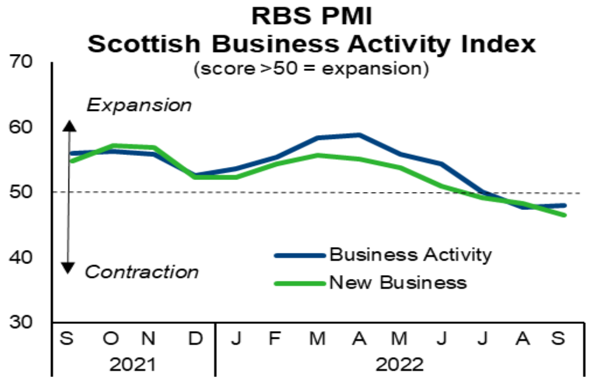
The latest Scottish GDP data showed a contraction (-0.2%) in the 3 months to July, although output remains above its pre-pandemic level.



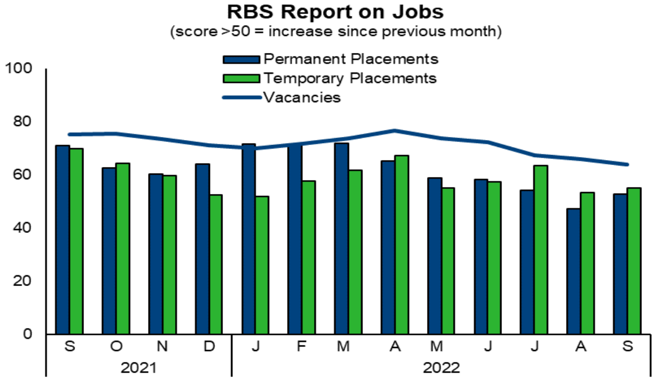
In the labour market, unemployment amongst 16-64 year olds remains at a record low as employers continue to add staff.

	RATE (JUN – AUG 2022)	ANNUAL CHANGE
EMPLOYMENT	75.8%	+1.5%pts
UNEMPLOYMENT	3.3%	-1.1%pts
ECONOMIC INACTIVITY	21.6%	--0.7%pts

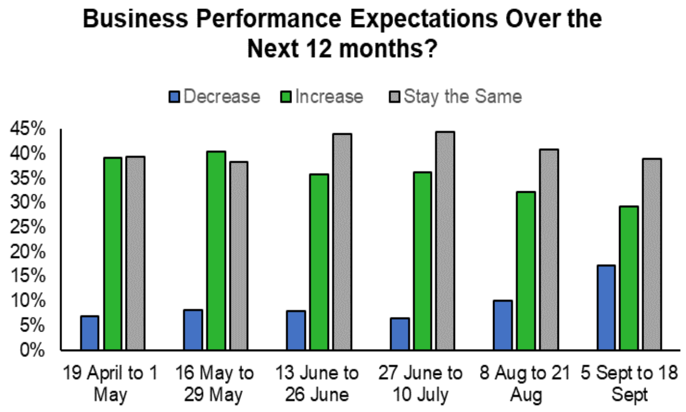
Private sector activity contracted for the second consecutive month in September, with levels of new business contracting for the third consecutive month. Challenging conditions also had a negative impact on business outlook.



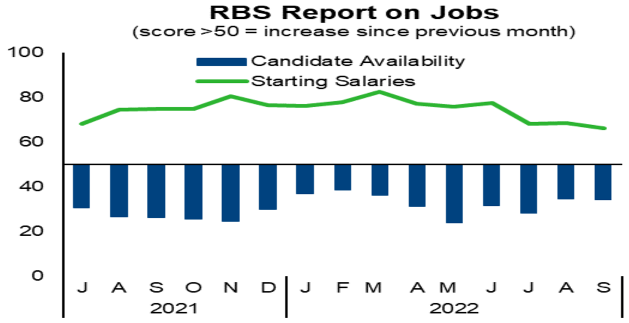
The level of both permanent and temporary appointments rose slightly in September, suggesting that businesses are still activity recruiting.



Businesses are becoming increasingly negative about their future performance.



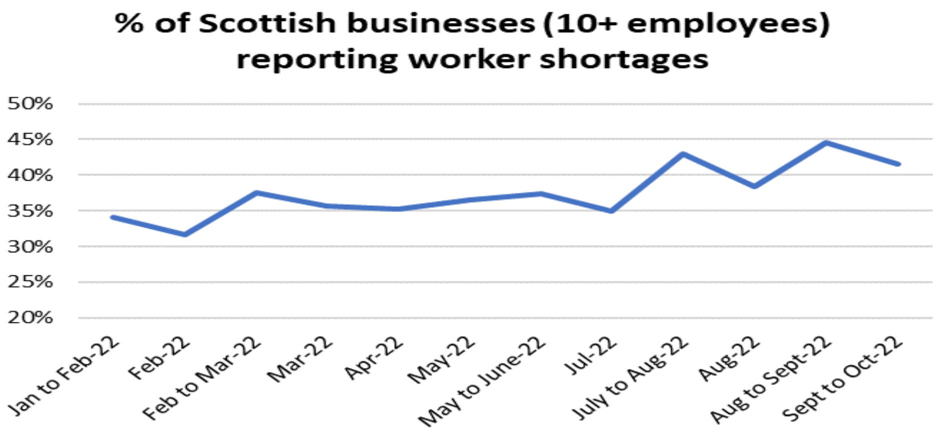
However, reduced candidate availability continued, maintaining pressure on businesses to raise wages to attract and retain staff.

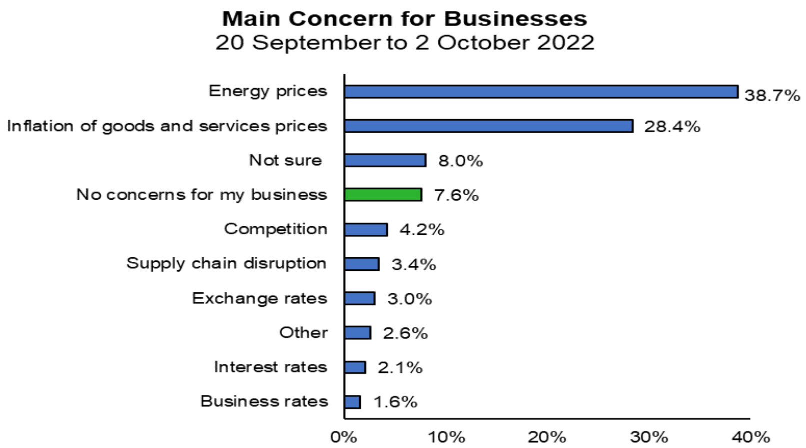


Scotland

Over 40% of businesses report worker shortages and are having to increase employee hours/recruit temporary staff. A third are unable to meet demand due to lack of staff .

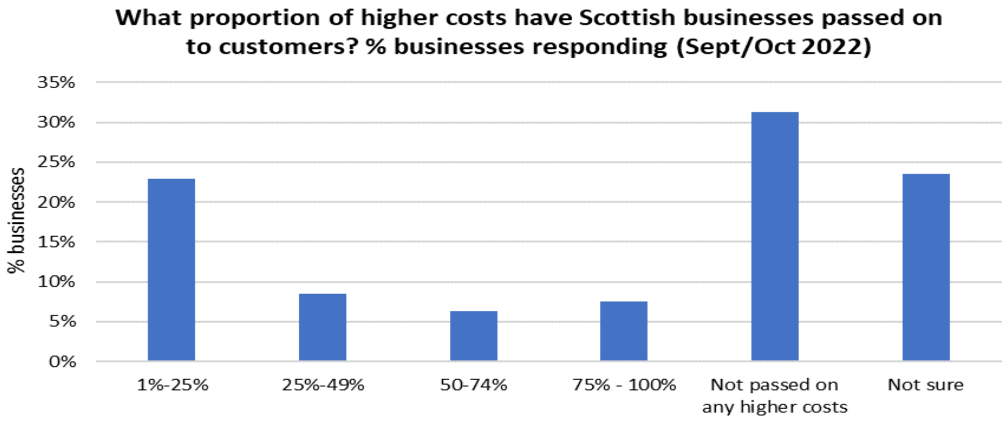
Energy prices and inflation continue to be the main challenges faced by businesses in Scotland. The proportion citing these has been increasing.

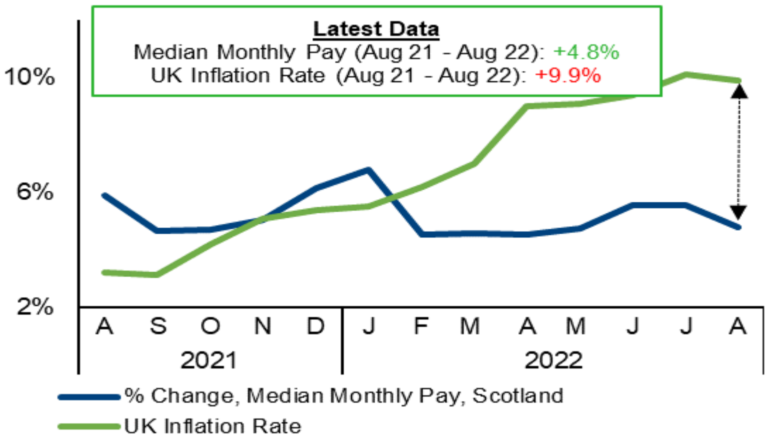




Around 45% of Scottish businesses have passed on at least some higher costs. This suggests that many businesses are absorbing a significant proportion of higher input and operating costs.

High inflation means most Scottish workers continue to experience a real wage cut.





Feedback from Scottish Enterprise Customers

- **Higher energy and raw material prices** and **recruitment difficulties** continue to be the key challenges reported by businesses.
- Increased costs have **reduced business optimism.** In particular, many businesses are now **less willing** to look at **overseas markets** or to **develop new products/services**, preferring to focus on existing markets and products/services.
- Growth and Investment projects are generally being **delayed or re-phased** rather than cancelled at the moment.

Workforce

- **Attracting staff remains difficult** – e.g. poor responses to job advertisements (both number of and quality of applicants). As a result, it is taking longer to fill posts.
- It is also difficult to **balance pay expectations** of new staff with the wages and salaries of existing staff.
- **Retaining staff** is difficult especially for skilled and experienced workers – again higher wages elsewhere is often the catalyst to move.
- These challenges are **pushing up wage and salary costs** for many businesses.

Businesses are having to be **more creative and flexible** in attracting and retaining staff:

- ➢ offering enhanced packages
- ➢ increased hybrid working (working from home/remotely)
- ➢ recruiting and developing young employees (e.g. apprenticeships and graduate schemes)
- ➢ recruiting overseas nationals including **Ukrainian refugees**, who tend to be highly qualified.
- ➢ investing in automation (including ‘cobots’ – robots that work alongside humans).

- However, some businesses are reporting **challenges recruiting staff from the EU** via the UK Government Skilled worker shortage route e.g. due to **English language requirements.**
- The current business environment and challenges are **impacting the health and wellbeing** of owners and management teams of some businesses.

Workplace

- There is strong demand for **good quality, flexible, environmentally sustainable office space.**
- Some businesses are encouraging staff to **return to the office**. However, this is raising challenges where staff prefer to work from home and are prepared to leave the job if this is not available.

Energy prices

- Businesses are facing greater difficulty in sourcing and negotiating **energy contracts**. Where available, contracts are generally being offered for **shorter fixed terms** (e.g. one year are now common vs four years previously).
- However, some businesses are **struggling** to obtain fixed-term contracts, increasing the level of uncertainty and making it **difficult to plan** operations.
- Energy suppliers are increasingly requesting significant **cash deposits** prior to agreeing contracts.
- Businesses are **assessing energy usage**, such as reviewing shut down processes at ends of shifts and overlapping shifts to reduce shop floor operating/opening hours.
- Some hotels and high energy users are considering **shutdowns over** winter period as high energy costs could make operating uneconomical.
- Past **savings** from productivity improvements are **being offset by higher energy costs**, requiring businesses to re-baseline cost-reduction targets and look at further initiatives to generate savings.
- Businesses are generally supportive of the **Energy Bill Relief Scheme** but have concerns about what happens after the six-month period. The general view is that it is offering some short-term stability, but they are still not able to plan longer ahead.

Deposit Return Scheme

- Business have raised concerns about the proposed **Deposit Return Scheme,** in particular the implementation costs and the operational challenges caused by this being implemented only in Scotland in 2023.
- The scheme will impact a **wide range of industries**, from soft and alcoholic drinks producers to those in tourism/events, hospitality and retail.
- Registration for the scheme opens in three months and producers will **not be able to sell their drinks in Scotland** without registering. All drinks (both soft and alcoholic) that come in polyethylene terephthalate (PET) plastic, metal and glass are part of the scheme.

Finance

- Many businesses are struggling to pass on some or all increased energy, supplies and staffing costs. This is impacting on **margins and cash reserves,** both of which are still recovering from the impacts of COVID-19.
- **Cash flow** is an issue for a number of small businesses and, as a result, some are putting off making long term growth plans.

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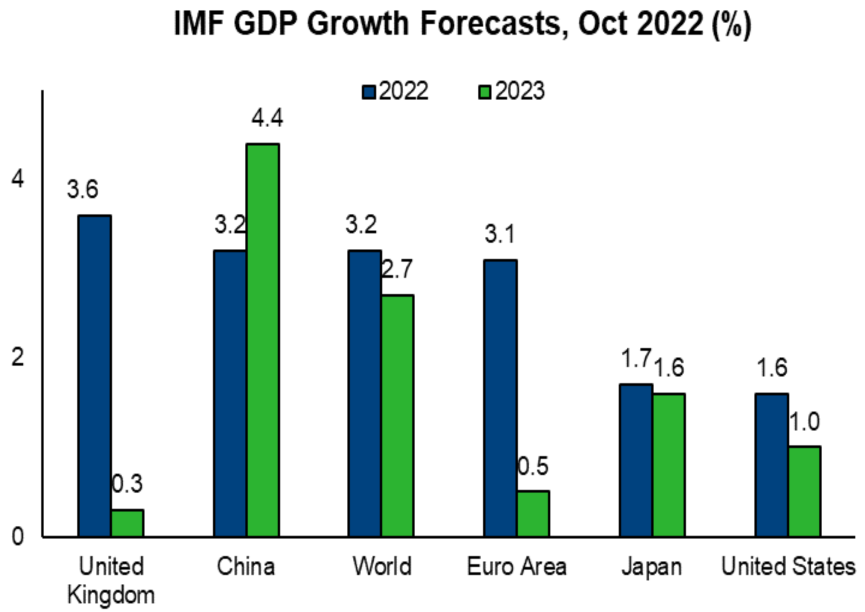
Economic Forecasts

Global Forecasts

The IMF has downgraded its 2023 GDP forecasts for most major economies citing higher-than-expected inflation and the cost-of-living crisis as the main reasons. Global growth in 2023 is now expected to be 2.7%, 0.2 percentage points lower than forecast in July.

The UK economy is projected to grow by just 0.3% in 2023, lower than most other advanced economies. GDP in Germany, Italy and Sweden is forecast to contract. The IMF raised concerns that the UK government's fiscal policies, while improving growth in the short term, could undermine the Bank of England's plan to stabilise inflation in 2023.



UK & Scottish Forecasts

The Fraser of Allander Institute has significantly lowered its forecasts for Scottish economic growth in 2023 due to the impacts of rising costs, falling consumer confidence and weakening demand.

The Institute expects overall growth of 3.6% in 2022 but with contractions in the last two quarters, which will tip the economy into recession by the end of the year. This is expected to be followed by further contraction in output in 2023 (-0.6%) before a return to growth in 2024.