Economic Commentary

August 2023

Insights & Economics

Scottish Enterprise

SUMMARY

- Global growth is expected to be **3% in both 2023 and 2024, with persistent inflation and higher borrowing costs weighing down on activity**. UK Growth is expected to be just 0.4% in 2023 and remain subdued into 2026.

- Business surveys point to a **slowdown in global growth in July** for both the service and manufacturing sectors. The euro area was the main source of underlying global weakness, but activity slowed across many other major economies.

RECENT ECONOMIC DATA

- The UK economy continues to be subdued. GDP was up just **0.2% over Q2 2023**, marginally better than Q1 (+0.1%). More recent business surveys show activity **continuing to grow** in July **but at a slower page.** Performance was uneven, with activity rising in just six out of 12 nations/regions (including Scotland).

- In July consumer price inflation **declined slightly but remained high** at 6.8%, while core inflation remained unchanged at 6.9%. Producer input prices fell in June.

- Scotland's onshore GDP fell by **0.4% in the 3 months to May**, and there were monthly falls in output in March, April and May. Output fell in both the service and the manufacturing sectors which make up the majority of the economy.

CURRENT BUSINESS SENTIMENT

- A quarter of businesses reported increased in turnover in June. **This is down from 31% in May**. 17% reported a decrease, up from the previous month. 24% reported exporting less and just 16% exported more than a year ago.

- Scotland's **unemployment rate remains low** (4% in April to June), while the **employment rate fell over the year** to 74.2%. Over a third of Scottish businesses continue to report **worker shortages** which may have had a knock on affect on **wages which rose by 8.2%** over the year to July.

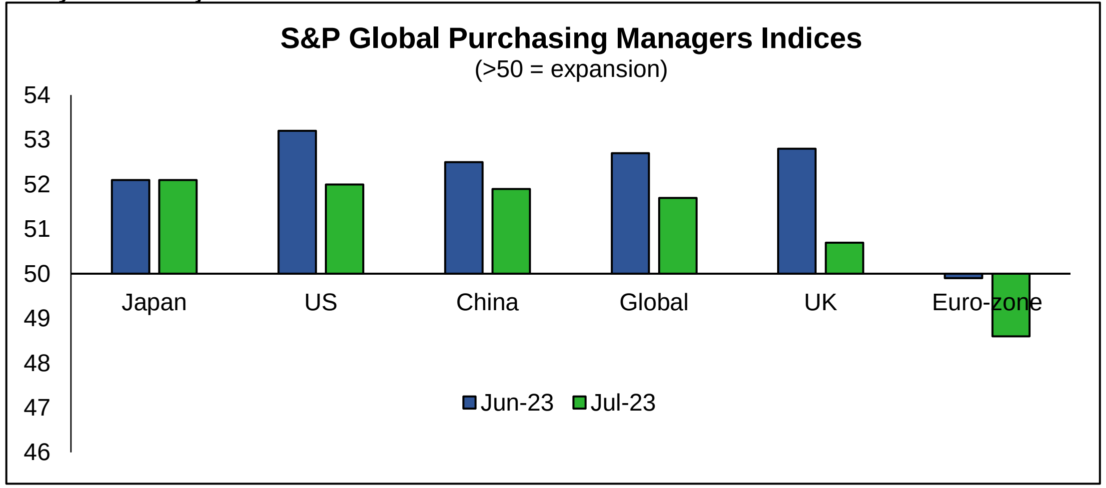
FORWARD LOOK

- Intelligence from SE customers suggests that despite **ongoing challenges** with recruitment, accessing raw materials and rising costs (and for start-ups accessing investment) **most businesses are cautiously optimistic and keen to grow.**

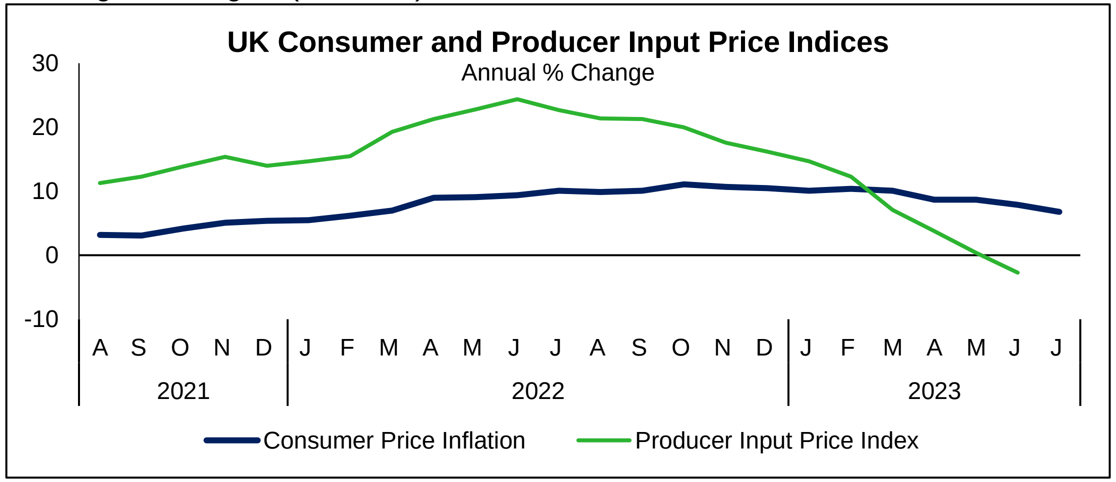
- The Fraser of Allander Institute **are predicting subdued economic growth into 2025** (+0.7% n 2024 and 1.2% growth in 2025) as inflation continues to remain high putting pressure on household incomes.

Global/UK

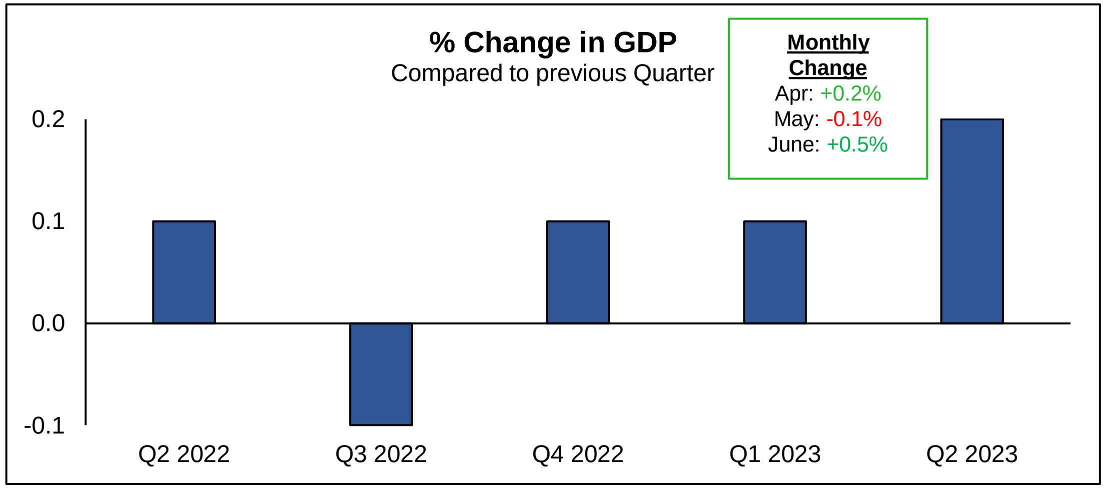
Recent business surveys show a slowdown in global output in July as new orders rose only marginally for both the service and manufacturing sectors. The euro area was the main source of the underlying weakness but growth also slowed across many other major economies.



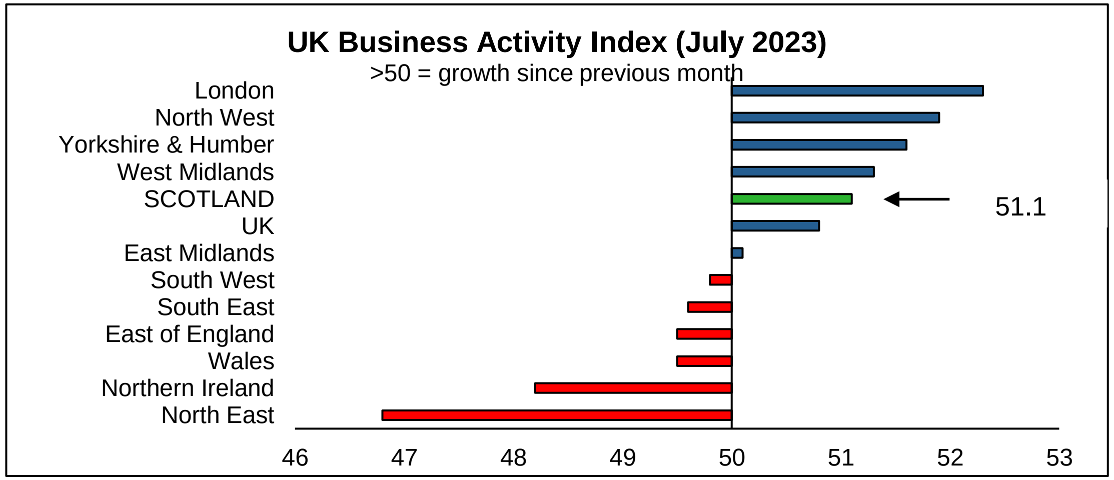
In July, consumer price inflation declined slightly but remained high at 6.8%, while core inflation remained unchanged at 6.9%. In the year to June producer input prices fell by 2.7%. High consumer inflation prompted the Bank of England to raise interest rates again in August (to 5.25%).



UK GDP grew by 0.2% over the second quarter, marginally higher than Q1 (+0.1%). Output was up across all the main sectors (+0.1% services, +1.6% manufacturing and +0.3% in construction).

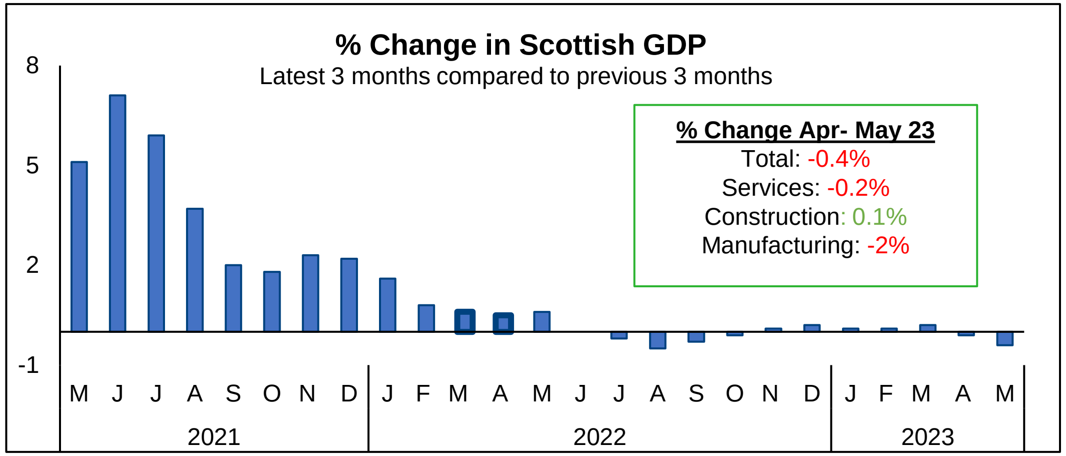


Business activity grew in only half of UK nations/regions in July as levels of new orders weakened. Where there was growth, the pace was generally weaker and was driven by work on outstanding rather than new orders. Hiring activity was more resilient with nine nations/regions seeing increased staffing levels.

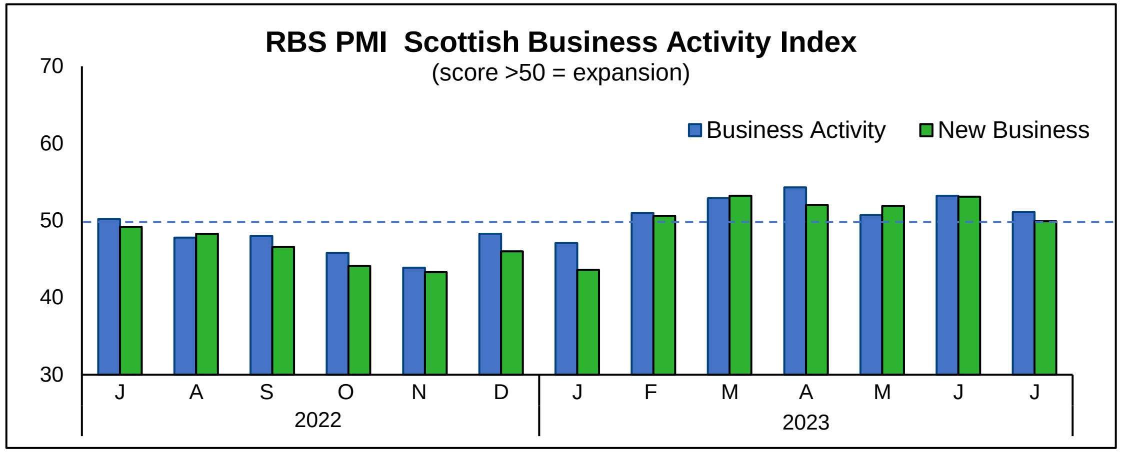


Scotland

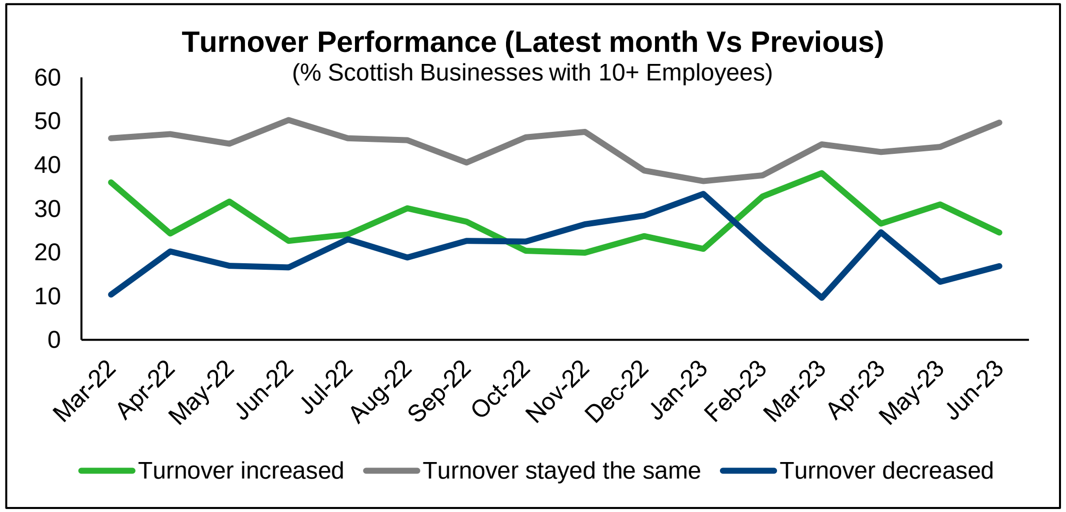
Scotland's onshore GDP fell by 0.4% in the 3 months to May, compared to the previous 3 months. Over the quarter, output fell in March, April and May. Output in both the manufacturing and service sectors, which make up the majority of the economy, have declined.



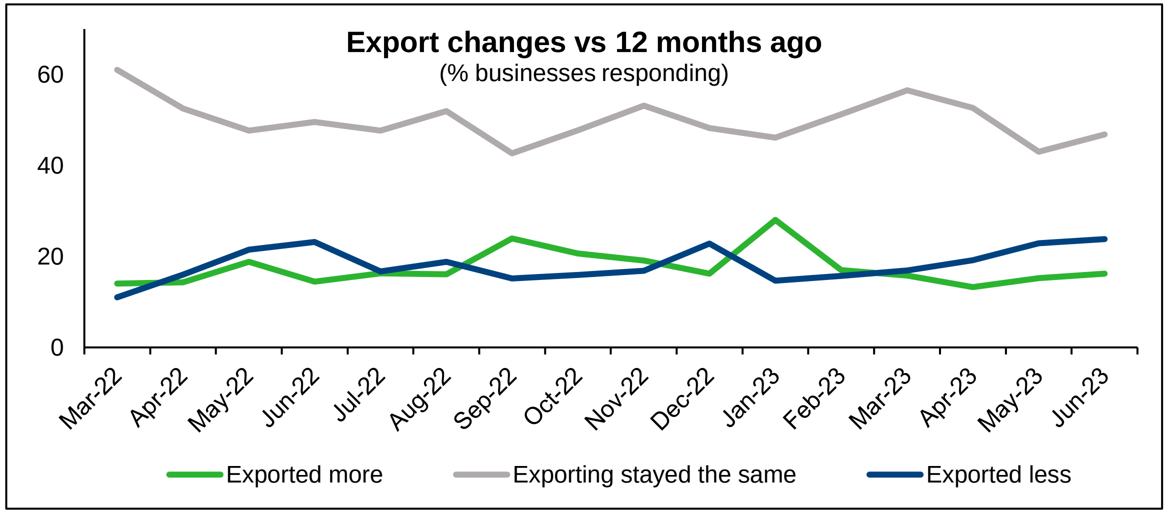
Business activity grew again in July but at a slower pace. However, performance was driven by the service sector as manufacturing output strongly contracted. Business optimism for the year ahead fell to its weakest since January due to easing demand, rising interest rates and the impact of cost of living pressures on consumers.



A quarter of businesses reported increased in turnover in June, down from 31% in May. 17% reported a decrease, up from the previous month (13%). The most commonly cited challenges impacting business performance are the costs of labour and materials (each highlighted by 35% of businesses).



19% of businesses had exported over the year to June, a rate that has remained relatively consistent since 2021. However of those, 24% reported exporting less and just 16% exported more than a year ago. Increased transportation costs, additional paperwork and higher custom levies are the most commonly cited export challenges.

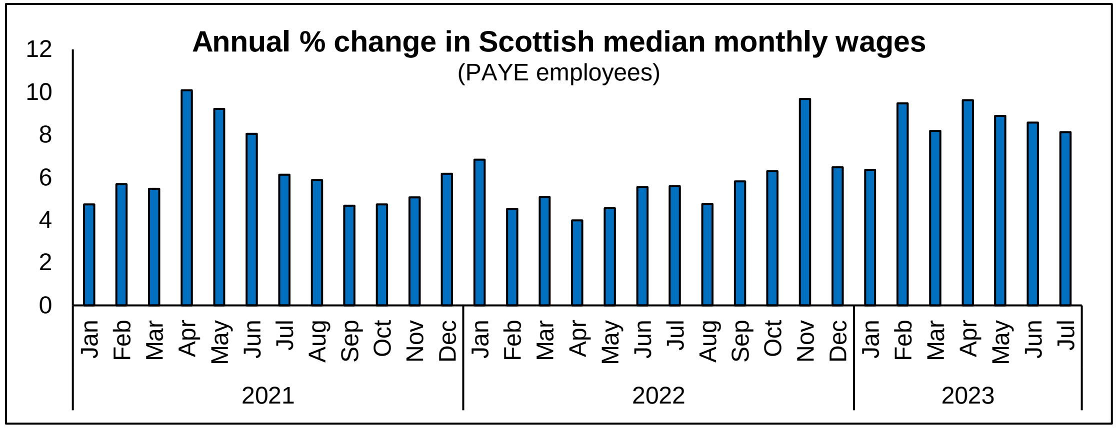


Scotland

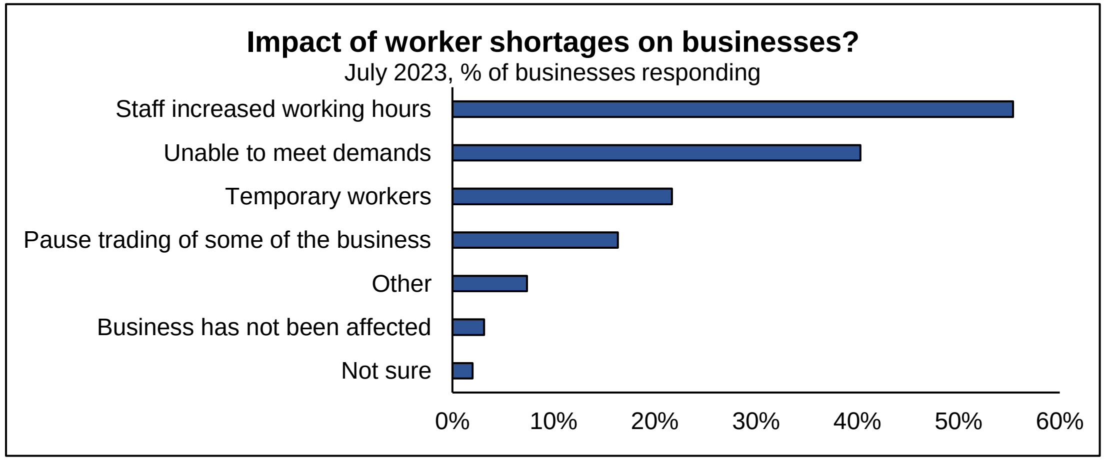
In the labour market, unemployment remains low but has risen 0.8 percentage points over the year. The employment rate fell by 1.2pp to 74.2% and is below the UK's (75.7%). Economic inactivity has risen over the year by 0.6pp. Overall, the data suggest that the Scottish labour market is still tight, but pressures may be easing.

	RATE (Apr - Jun 23)	ANNUAL CHANGE
EMPLOYMENT (aged 16-64)	74.2%	-1.2%pts
UNEMPLOYMENT (16+)	4%	+0.8%pts
ECONOMIC INACTIVITY (aged 16-64)	22.6%	+0.6%pts

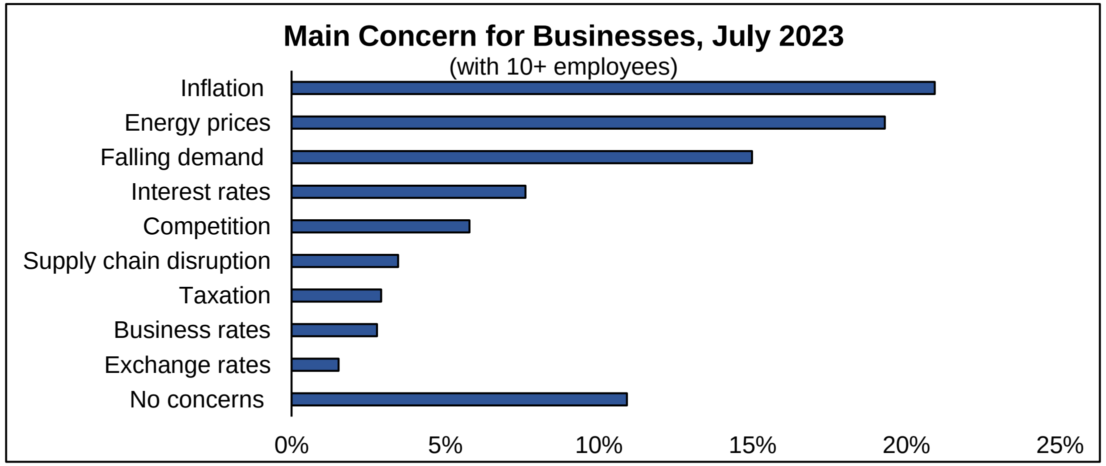
The number of payrolled employees in Scotland rose to 2.46 million in July, an increase of 35,000 over the year. The median monthly wage for payrolled workers was £2,922, 8.2% higher than July 2022 (vs +7.8% for the UK).



Access to skills and talent is a key challenge for many businesses, and 39% reported shortages of workers in July. Most affected businesses have asked staff to increase their hours, although 40% have reported being unable to meet demands while 16% have had to pause trading in some way (compared with 8% in June).



Along with the continued challenges around recruitment, inflation remains a key concern reported by businesses, followed by energy prices. Increasingly, falling demand is also being highlighted, as are rising interest rates.



Feedback from Scottish Enterprise Customers

General Sentiment

- Despite **ongoing challenges** with recruitment, accessing raw materials and rising costs, **most SE business customers are cautiously optimistic and keen to grow.**

Labour and Skills Shortages/Jobs

- **Staff and skill shortages** continue to be the main challenge cited by businesses across most sectors and for most occupation levels**.** For example**,** businesses in **green industries** are increasingly highlighting **recruitment difficulties** due to a lack of qualified heat pump and solar engineers.
- **Wage inflation** is making it difficult to recruit and retain staff for some lower skilled occupations (for example Food & Drink manufacturing operatives).
- To address recruitment challenges, businesses are:
  - investing in **automation** and **digitising processes** to increase capacity for staff to take on higher value activities.
  - **upskilling** existing staff and employing apprentices and graduates. However, some businesses are concerned that, once trained, staff may be poached by competitors.
  - employing **students during peak periods** e.g. in the food & drink sector.
  - **offering more competitive packages**, including greater flexibility, to attract and retain staff.

Business Costs and Supply Chains

- The **high cost of raw materials and energy** is still causing issues for some businesses. For example, those still **contracted to high cost fixed deals for energy** are unable to access lower cost deals on offer.
- Businesses are increasingly investing to **increase efficiency and productivity** to reduce energy and input use e.g. replacing inefficient plant and machinery.

International Trade

- Businesses are still reporting challenges in **exporting to Europe** (e.g. increased paperwork and costs), and some setting up distribution hubs there as a response**.**
- Also, challenges in **importing from Europe** is prompting some businesses to buy from suppliers in Asia and the Americas, which as well as increasing costs and time, increases their carbon footprint.

Investment

- Recent economic shocks and uncertainty means that some businesses are taking a **cautious approach to significant capital investment**.
- Also, rising **interest rates** are becoming more of a concern, and some businesses are **waiting for rates to fall** before actively seeking debt funding from banks.

Workplace

- Some businesses that have outgrown their current workplaces and want to expand report a **shortage of suitable available premises.**

SUMMARY
RECENT ECONOMIC DATA
CURRENT BUSINESS SENTIMENT
FORWARD LOOK

Economic Outlook

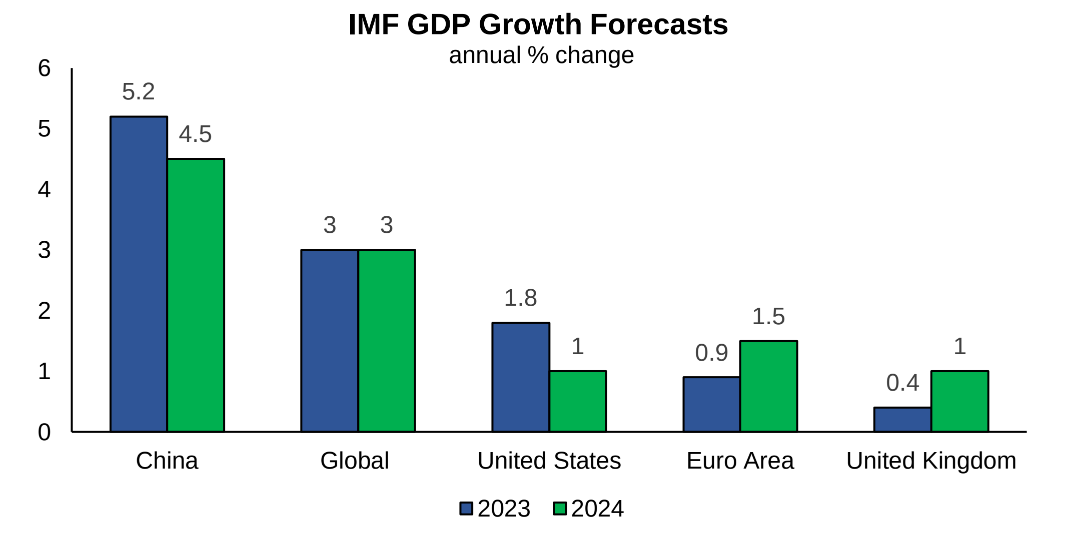
Global Forecasts

In their July Outlook, the IMF warns that the global economic recovery is slowing amid widening divergences across sectors and regions. Global growth is expected to be 3% in both 2023 and 2024, held back by persistent inflation and higher borrowing costs.

Growth in emerging/developing economies is forecast to be stronger than advanced economies, and the UK is expected to be one of the weakest performing performers, growing by just 0.4% this year and 1% in 2024.

A number of downside risks to the outlook are highlighted:

- Inflation could remain high, resulting in further monetary policy tightening
- China's recovery could slow, in part as a result of unresolved real estate problems, with negative cross-border spillovers.
- Sovereign debt distress could spread to a wider group of economies
- External shocks such as an intensification of the war in Ukraine or extreme weather events.



UK and Scottish Forecasts

Consistent with the IMF, the EY Item Club is forecasting growth of just 0.4% for the UK in 2023. This is an upward revisions to their Spring projections due to a stronger start to the year combined with lower expectations for inflation and a fall in energy costs.

UK growth is then forecast to be subdued through 2024 and 2025 as higher interest rates contribute to falling living standards and reduced household disposable income.

For Scotland, the Fraser of Allander Institute is also forecasting relatively weak economic growth over 2023. Although rising, growth is expected to remain weak over 2024 and 2025 as inflation and interest rates continue to remain high.

Factors impacting the economy are noted as:

- Interest rates increasing further than expected to tackle inflation, that significantly squeeze household incomes
- Tight labour market continuing to challenge businesses that cannot match skills required with candidates