Economic Commentary

January 2023

All data represent most recent available as of 24/01/2023

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

Economic output contracted across all major economies in December as high inflation, conflict in Ukraine and supply chain challenges all weighed on economic performance. However, inflation has started to ease across most economies.

The World Bank is forecasting a **sharp, long-lasting slowdown, with global growth declining to 1.7% in 2023**, a significant drop from the 3.0% expected just six months ago.

In the three months to November, **UK GDP contracted by 0.3%.** There was a 0.1% fall in services, a 1.4% fall in production, with the only growth coming from construction, which increased by 0.3%.

Business surveys for December show **UK private sector activity falling,** with signs that the economic slowdown is hitting a growing number of local labour markets.

Inflation in the UK continues to be high (10.5% in the year to December). To help combat rising prices, the Bank of England **raised interest rates** to 3.5% in December.

The **Scottish economy contracted** by 0.1% in the three months to October and **grew by 0.4%** in October, driven by increased service sector (+0.3%) and construction output (+0.9%), offsetting a **0.3% fall in manufacturing**.

More recent data show that **business activity declined** in December (for the fifth month in a row) as demand shortfalls continued to lead to a **decrease in new orders.** Factors such as the war in Ukraine, a slowdown in the housing market and inflation weighed heavily on **business confidence.**

Unemployment in Scotland remains low; however, **wages** are failing to keep pace with inflation despite an **increase in median earnings.**

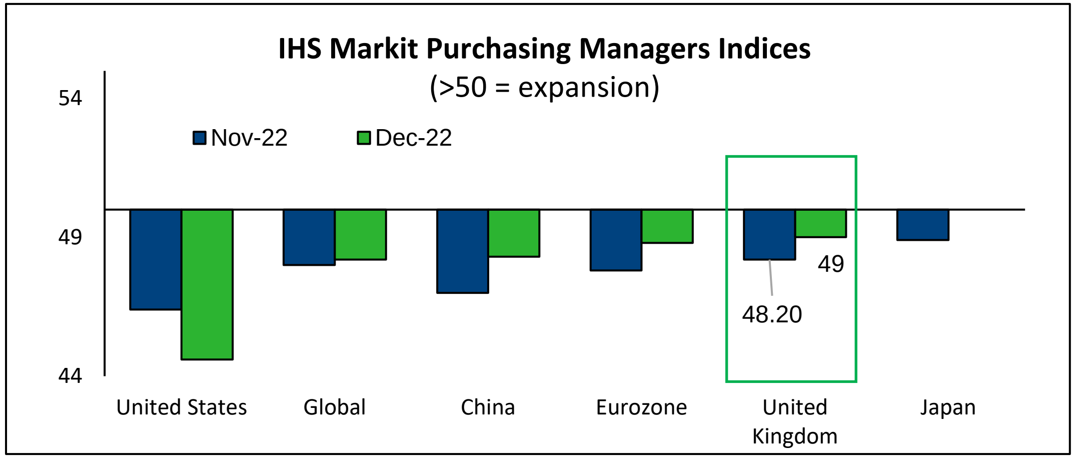
Scottish businesses across all sectors continue to report widespread **inflationary pressures and recruitment difficulties;** this is impacting the ability of some businesses to meet demand.

The Scottish Fiscal Commission is forecasting the **Scottish economy** will contract by **1.2% in 2023** and will not recover to its pre-recession peak until the **first quarter of 2025.**

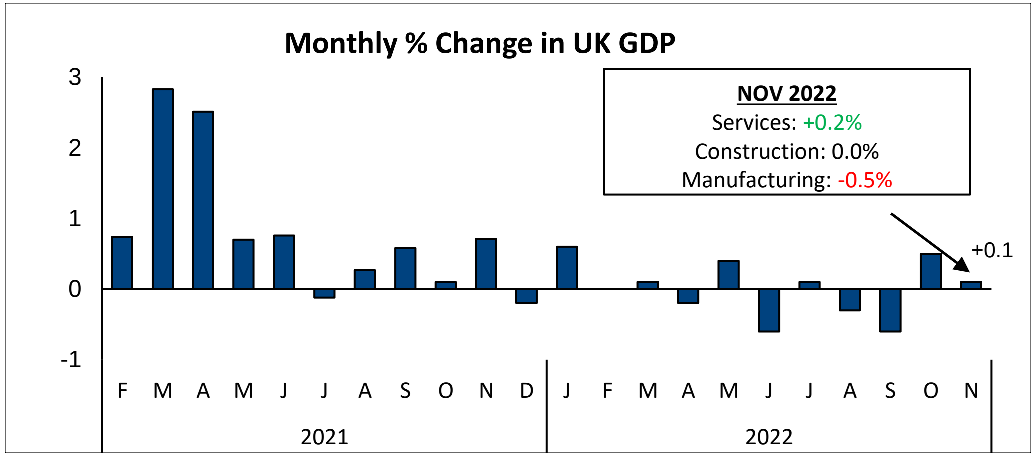
SUMMARY
RECENT ECONOMIC DATA
CURRENT BUSINESS SENTIMENT
FORWARD LOOK

Global/UK

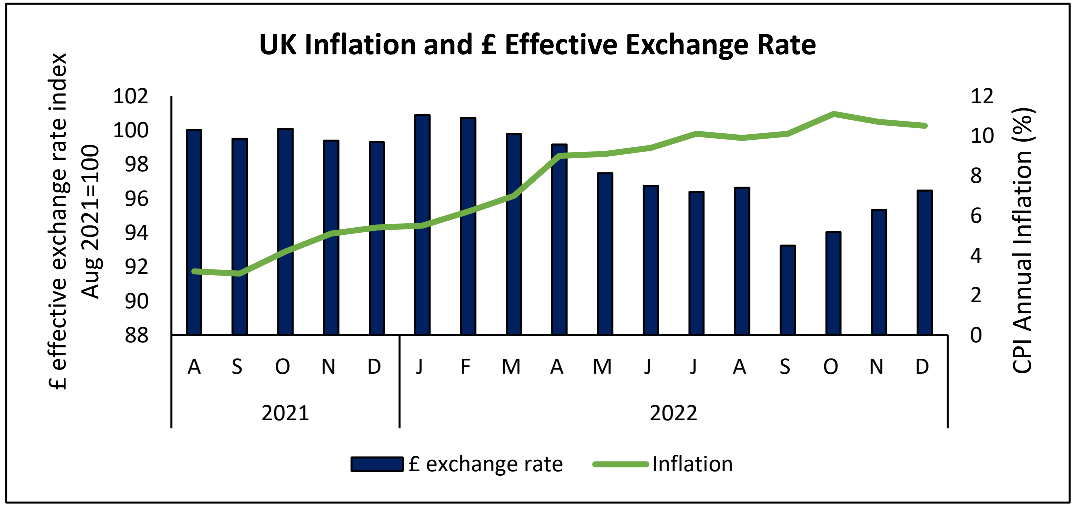
The latest business surveys show downturns in all major economies. In the UK, output fell for the fifth straight month in December, although the contraction was the softest for three months.



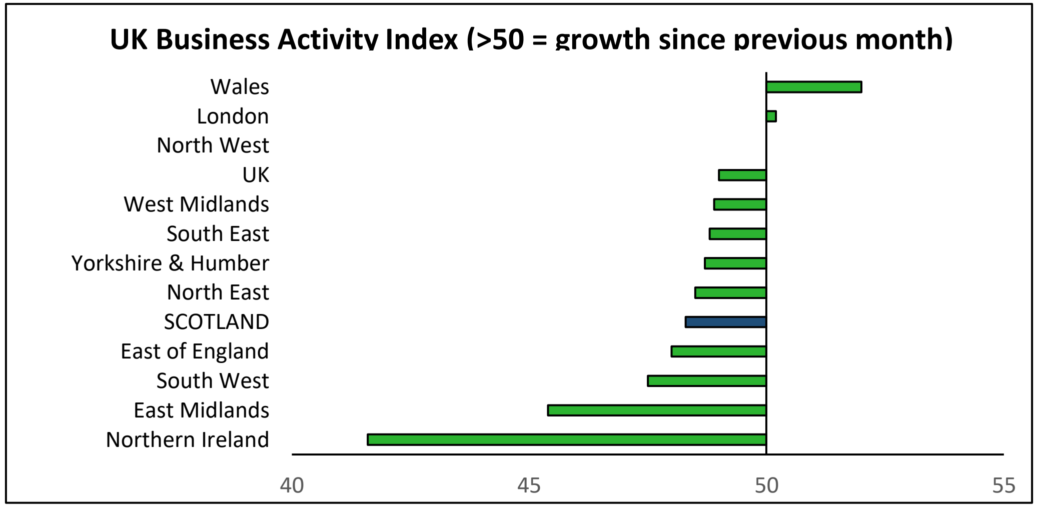
UK GDP is estimated to have grown by 0.1% in November 2022, although GDP fell by 0.3% in the three months to November.



Inflation, although easing slightly, remains high (10.5% in the year to December). To help counteract inflationary pressures, the Bank of England increased interest rates to 3.5% in December. A rise in the effective exchange rate implies imports will be less expensive and exports will be more expensive.

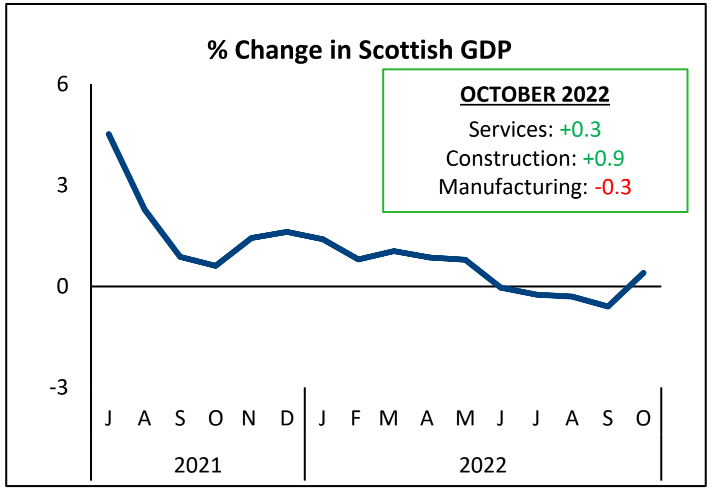


The majority of UK regions and nations saw business activity contract over December, with only Wales and London recording an increase.

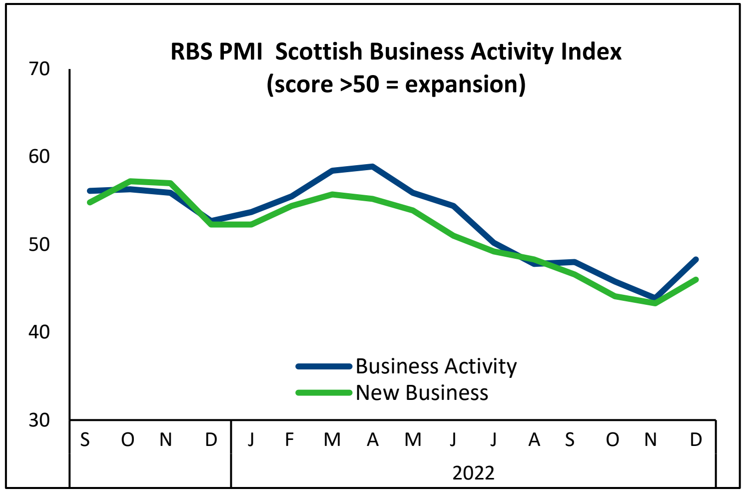


Scotland

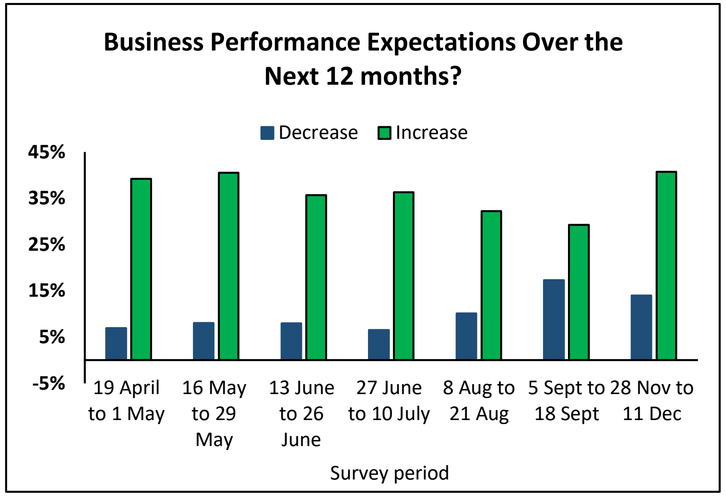
Scotland's GDP contracted by -0.1% in the 3 months to October. However, Scotland's GDP is estimated to have grown by 0.4% in October.



Private sector activity contracted at a softer pace in December. Economic uncertainty, the cost-of-living crisis and higher borrowing costs continued to stifle demand.



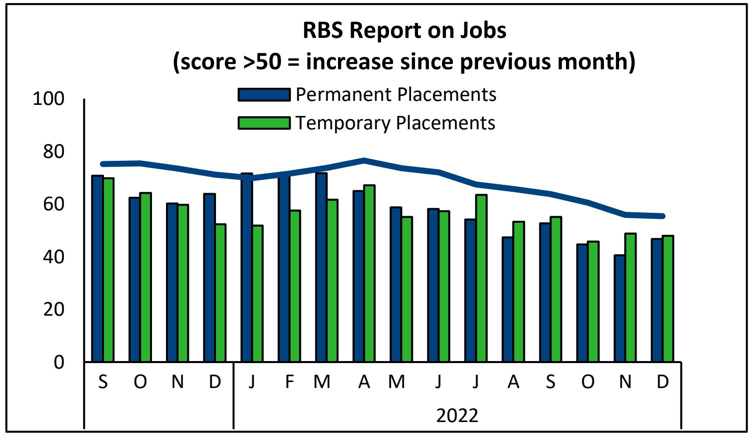
Expectations for future business performance picked up in December, with over 40% of businesses expecting an increase in performance in the coming year.



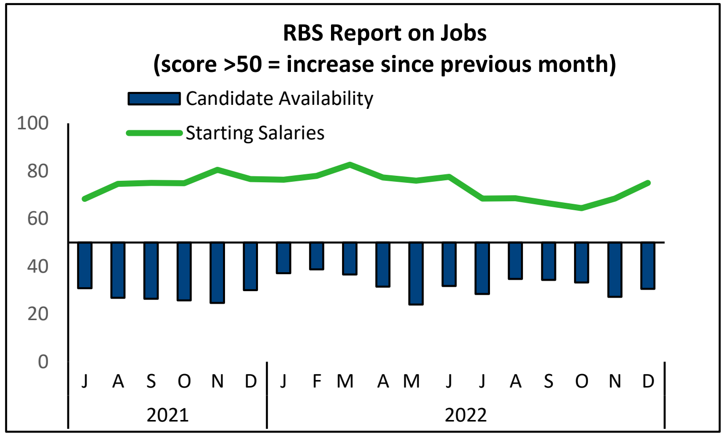
In the labour market, unemployment among 16-64 year olds remains low and the employment rate has increased by 1.1% pts in the year to November 2022.

	RATE (SEP – NOV 2022)	ANNUAL CHANGE
EMPLOYMENT	76.1%	+1.1%pts
UNEMPLOYMENT	3.3%	-0.4%pts
ECONOMIC INACTIVITY	21.3%	-0.8%pts

Permanent placements fell for the third month running in December as recession fears and market uncertainty dampened recruitment activity.

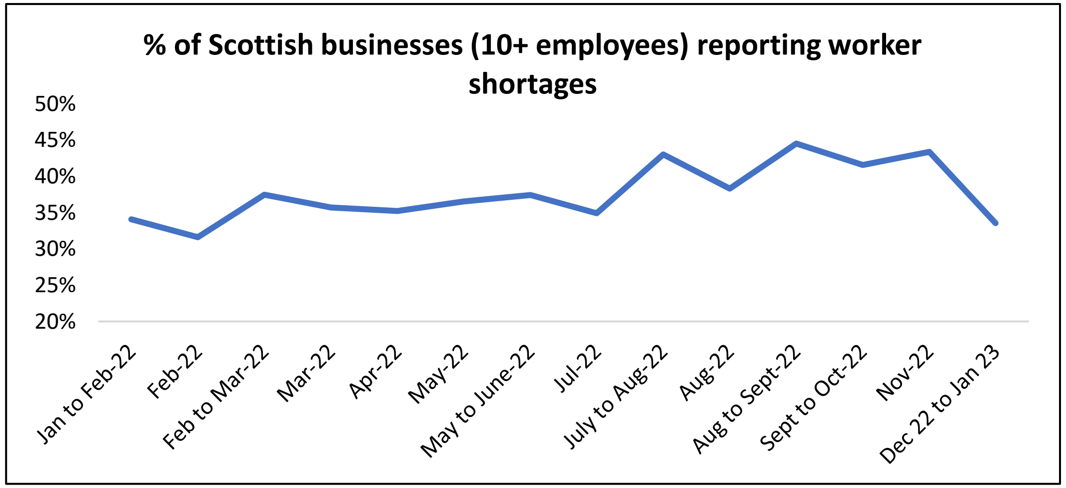


Reduced candidate availability continued, maintaining pressure on businesses to raise wages. December saw a rapid rise in starting salaries across Scotland.

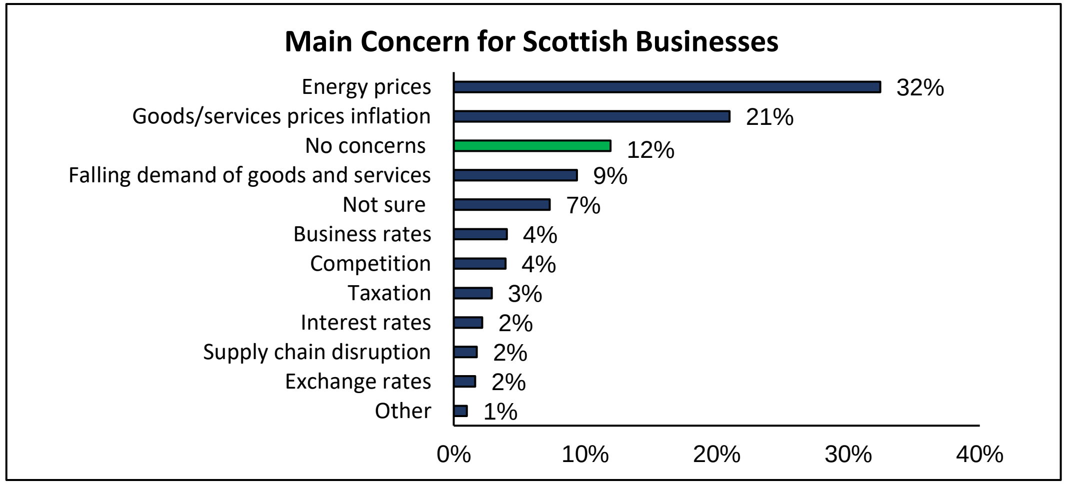


Scotland

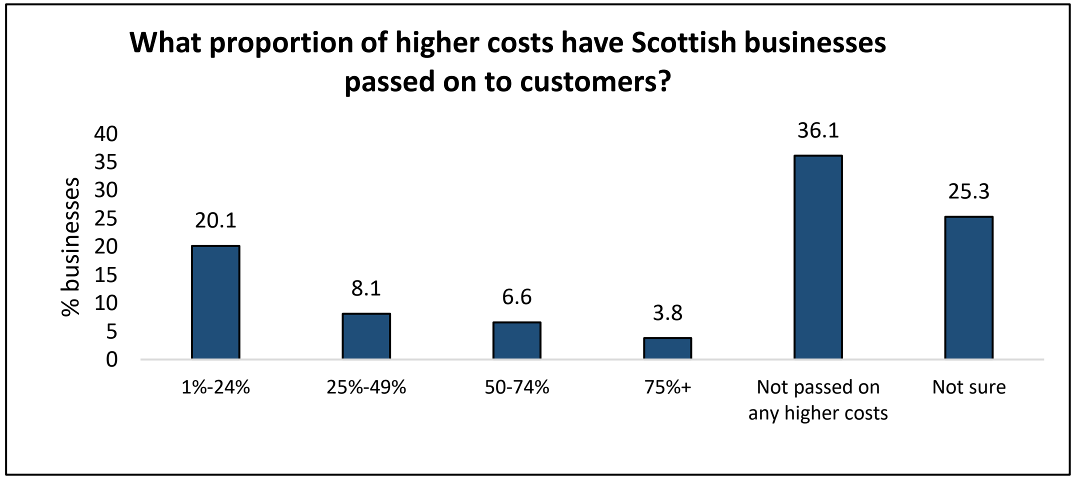
Although the proportion of Scottish businesses reporting worker shortages has decreased, this is still an issue for over a third of businesses, and they are having to increase employee hours/recruit temporary staff as a result. Nearly a third of those reporting shortages are unable to meet demand due to lack of staff.



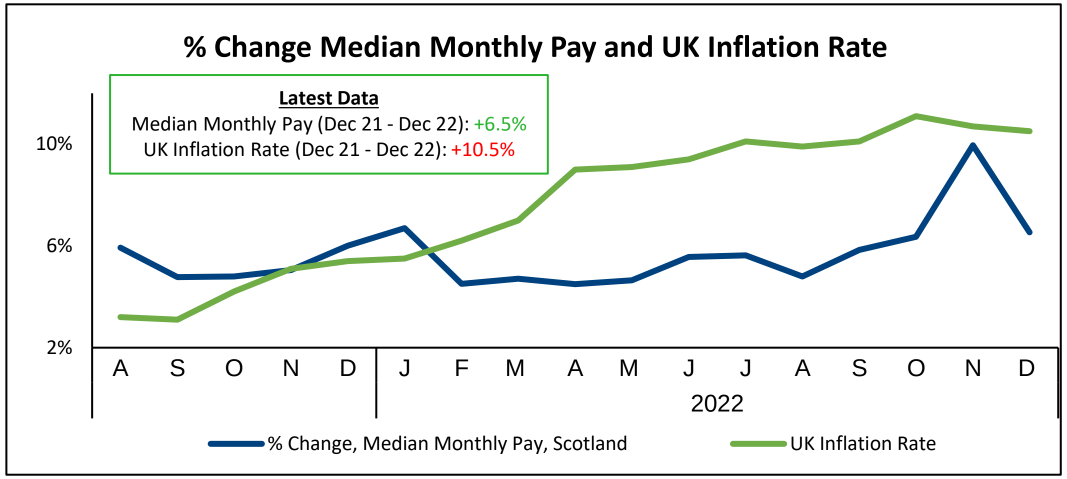
Beyond staff shortages, energy prices and inflation continue to be the other main challenges reported by Scottish businesses, and 9% are concerned about falling demand of goods and services.



Nearly 40% of Scottish businesses have passed on at least some higher costs to customers, whilst over a third are absorbing a significant proportion of higher input and operating costs themselves.



High inflation means most Scottish workers continue to experience a real wage cut. Median monthly pay increased by 6.5%pts in the year to December whilst inflation increased by 10.5%pts.



Feedback from Scottish Enterprise Customers

Key themes

- **Attracting and retaining staff** continues to be a key business challenge due to both a lack of suitable applicants and staff leaving for higher wages.
- **Higher prices** (energy and raw materials). While some businesses are struggling to **pass on increased costs**, many are planning to **increase prices** if they haven't done so already.
- Businesses are still considering **growth,** but plans are being **pushed back** due to ongoing economic challenges and lack of staff. Current business planning cycles tend to be **short term and projects are smaller.**

Workforce

- Businesses continue to report **staff shortages - chefs, engineers, electricians, plumbers, welders and IT staff** have been specifically mentioned.
- **Staff retention** remains an issue in a number of sectors (e.g. IT, Food & Drink) as workers are being offered better wages, conditions and flexibility elsewhere.
- Many businesses are having to **raise salaries,** offer attractive benefit packages and more flexibility to retain staff, especially in the IT sector.
- Some **digital businesses** are talking about offering **equity** in the business to employees as part of these packages.
- Some businesses are holding recruitment fairs with **guaranteed interviews** to attract staff**.**
- Some growth projects have been **put on hold** due to lack of staff. In some cases, it is difficult to plan projects, which may have implications for businesses who have funding packages in place, and it may also alter project completion dates.
- Businesses are increasingly **investing in automation** to address labour shortages and cost challenges, especially manufacturers.

Energy prices

- Many businesses are still on **fixed energy deals**, so are not being fully impacted by higher costs.
- The Energy Bills Discount Scheme comes into effect in April, and while businesses are aware of the scheme, we have yet to see how this will affect them.
- An increasing number of businesses are investing in **new plant and machinery** to reduce energy use and costs.
- Some **visitor attractions** are struggling as they cannot close off sections of a site and must heat the whole area. Some are opening "warm spaces" (safe, supportive areas people can visit during colder months) to attract visitors.
- Some high energy use businesses have **shutdown over** the winter as costs make operating uneconomic.

Workplace

- Some office landlords are struggling to get businesses to commit to **new contracts**. This could be due to the hybrid working, increased energy costs etc.

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

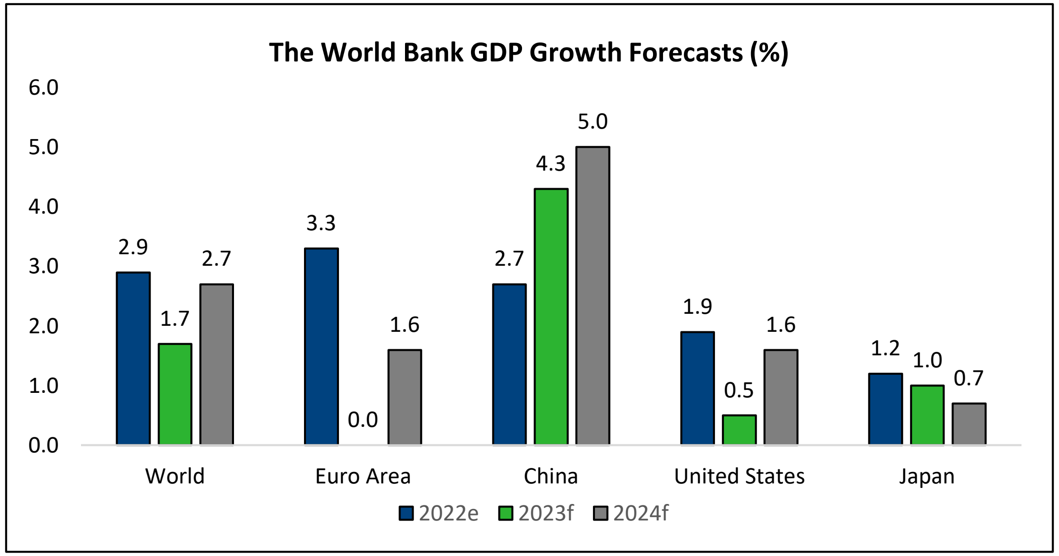
Economic Forecasts

Global Forecasts

The World Bank sharply **lowered its growth forecast** for the global economy this year as persistently high inflation has elevated the risk for a worldwide recession. The bank expects **global growth to slow to 1.7%** in 2023. That would mark the third-weakest pace of global growth in nearly three decades, overshadowed only by the 2009 and 2020 downturns. The forecast growth rate only narrowly **keeps the global economy out of recession** territory.

In 2023, 0% growth is expected for the euro-area, weaker than forecasts of +4.3% in China, +0.5% in the US, and +1.0% in Japan.

Decelerating growth reflects **significantly weaker domestic and export demand across major economies** that is compounded by high inflation, currency depreciation, tighter financing conditions, and other domestic headwinds.



UK & Scottish Forecasts

The Scottish Fiscal Commission's (Scotland's official, independent economic forecaster) December 2022 forecasts highlight that the **near-term economic outlook has weakened significantly**.

The SFC expects the Scottish economy to recover to its pre-recession peak by the first quarter of 2025, one quarter behind the UK. The SFC highlights **significant uncertainty** around the economic outlook, in particular the path of energy prices and inflation. Another important source of uncertainty is how **high inflation affects wages**: so far, pay awards have remained below inflation, resulting in falling real earnings. However, with unemployment relatively low, it is possible that workers can bargain for better pay awards, affecting both the real terms earnings outlook and potentially inflation.

Employment is forecast to fall by around 20,000 over 2023 and 2024, and unemployment is expected to peak at 4.9% in 2024.