Scottish Enterprise

Economic Commentary

August 2024

Insights and Economics

SUMMARY

ECONOMIC DATA

SE CUSTOMER SENTIMENT

OUTLOOK

Economic Commentary: Highlights

- The IMF is forecasting global GDP growth of 3.2% over 2024 and 3.3% in 2025. Emerging and developing market economies are expected to grow much faster than advanced economies.
- Business activity continued to increase across all major global economies in July, with the US showing the strongest growth and the Euro-zone the weakest. However, growth is being driven by the service sector, with manufacturing generally contracting (except in the UK).
- The UK economy grew for the second quarter running in Q2 (+0.6%), continuing recovery from the recession at the end of 2023.
- The Scottish economy grew by 0.3% in May, following +0.2% in April. In the three months to May, GDP was up 0.9%, slightly below the UK (+1.0%).
- Business activity rose across ten out of twelve UK nations and regions in July, with Scotland the fifth strongest performer. In Scotland, business activity growth was driven exclusively by the service sector, as manufacturing output continued to decline.
- Headline consumer price inflation rose to 2.2% in July, although core inflation eased. The Bank of England cut interest rates by 0.25 percentage points to 5.0% in August.
- In June, the proportion of businesses reporting a growth in monthly turnover fell to 24% (vs 30% over February-May). The main challenges affecting turnover continue to be the cost of labour, competition, and economic uncertainty.
- High interest rates, coupled with weak economic growth forecasts, may be impacting Scottish business' confidence to invest – just 16% of plan to increase capital investment between July and September 2024.
- The Scottish labour market is showing signs of cooling: unemployment increased over the year to June to 4.4% (vs 4.2% for the UK), whilst the employment rate fell to 73.4%. Worker shortages and recruitment difficulties remain an issue for Scottish businesses.
- The main challenges exerting pressure on SE customers include staffing, issues related to property availability and suitability, the cost of raw materials and the cost of labour. Despite this, general sentiment among SE customers remains positive.
- The Bank of England is forecasting UK GDP growth of 1.25% this year, falling to just 1% in 2025. For Scotland, the EY Item Club expects growth of 0.9% in 2024, strengthening to 1.7% in 2025.

SUMMARY

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

OUTLOOK

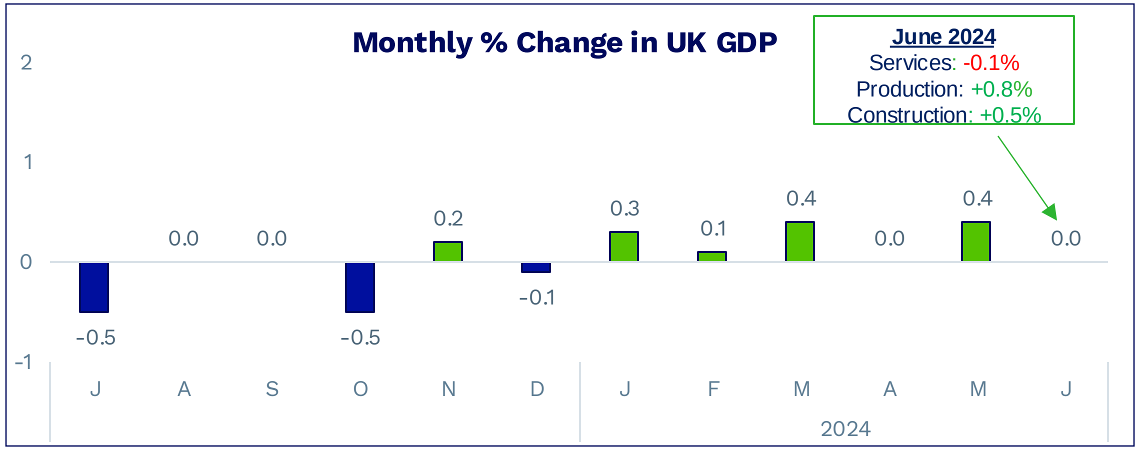
Global/UK

Global economic output slowed in July as service sector activity improved but manufacturing growth eased, and input price inflation accelerated. Across the major economies, the US showed the strongest growth whilst the Eurozone was the weakest. The manufacturing sector contracted in all major economies, bar the UK where activity reached a 29-month high.

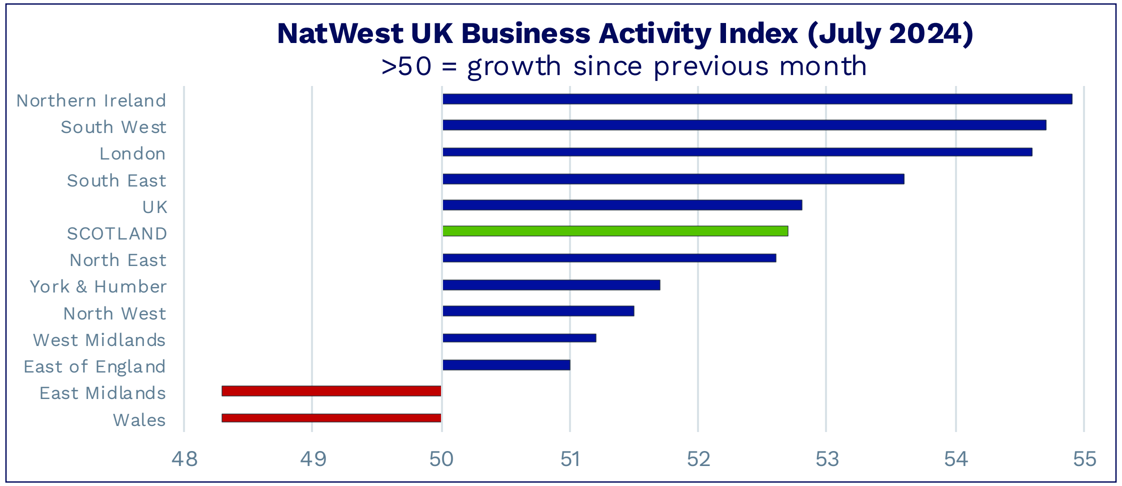
Business Activity Index (>50 indicates increase vs previous month)

	Dec	Jan	Feb	Mar	April	May	June	July
US	52.3	50.9	52.5	52.1	51.3	54.4	54.8	55.0
UK	52.1	52.5	53	52.8	54.1	52.8	52.3	52.7
Japan	50.0	51.5	50.6	51.7	52.3	52.4	49.7	52.6
Global	51.0	51.8	52.1	52.3	52.4	53.7	52.9	52.5
China	52.6	52.5	52.5	52.7	52.8	54.1	52.8	51.2
Eurozone	47.6	47.9	49.2	50.3	51.7	52.2	50.9	50.2

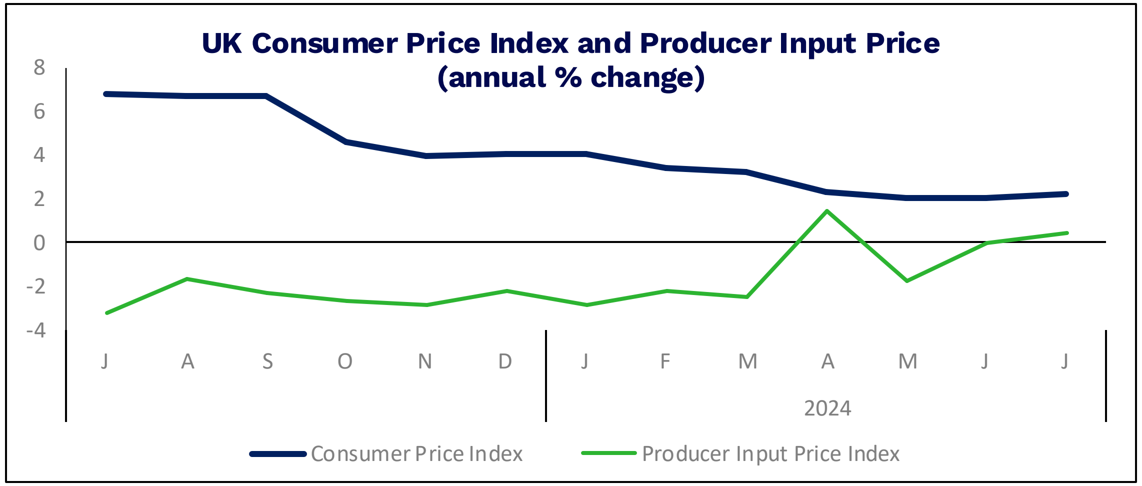
UK GDP grew by 0.6% in the three months to June, following an increase of 0.7% in Q1 and continuing recovery from the recession at the end of last year. Services was the main driver of growth over the quarter. Monthly GDP was flat in June, following +0.4% in May. Services output fell by 0.1%, whilst production (+0.8%) and construction (+0.5%) rose.



UK business output rose across most nations/regions in July. Growth expectations were generally positive, and July had the highest number of nations/regions reporting increases in employment in over a year, though price pressures are still above long-run trends in most areas.



Annual consumer price inflation rose to 2.2% in July, up from 2% in June and is now above the Bank of England's target of 2%. Both core inflation (down 0.2pp to 3.3%) and services inflation (down 0.2pp to 5.2%) are showing a downward trend. Producer input prices rose by 0.4%.

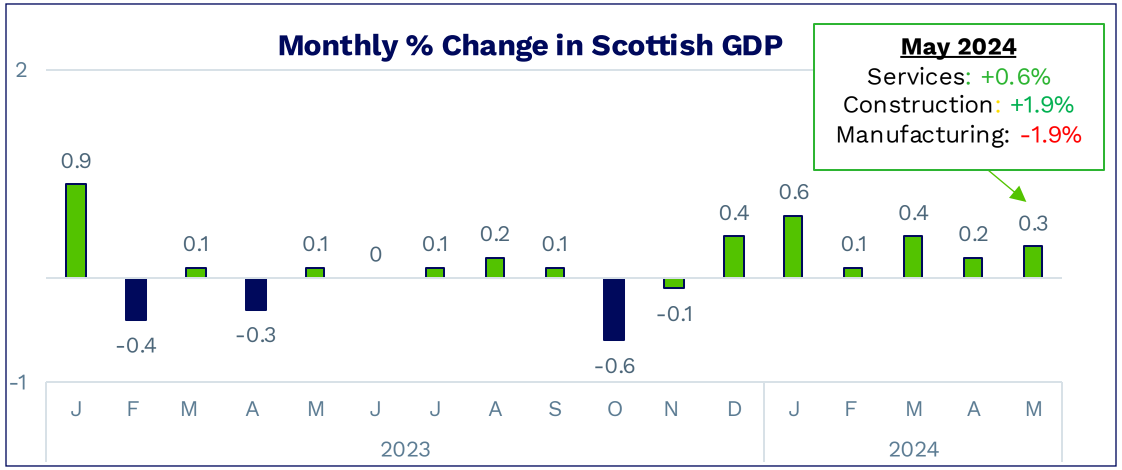


SUMMARY

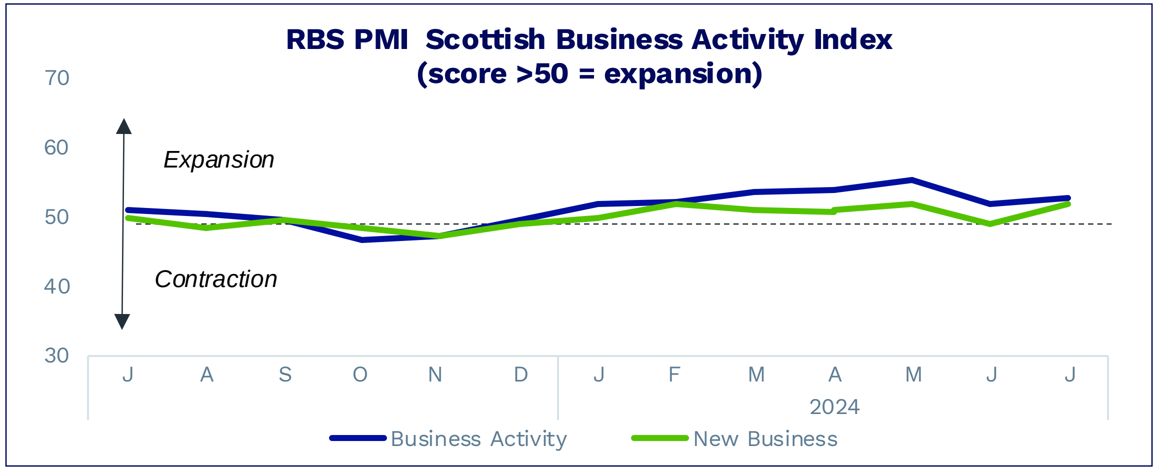
RECENT ECONOMIC DATA

Scotland

The Scottish economy grew by 0.3% in May, following +0.2% in April. Output was up in services (+0.6%) and construction (+1.9%) but down in the production sector (-2.2%). In the three months to May, GDP grew by 0.9%, slightly below the UK's rate (+1.0%).

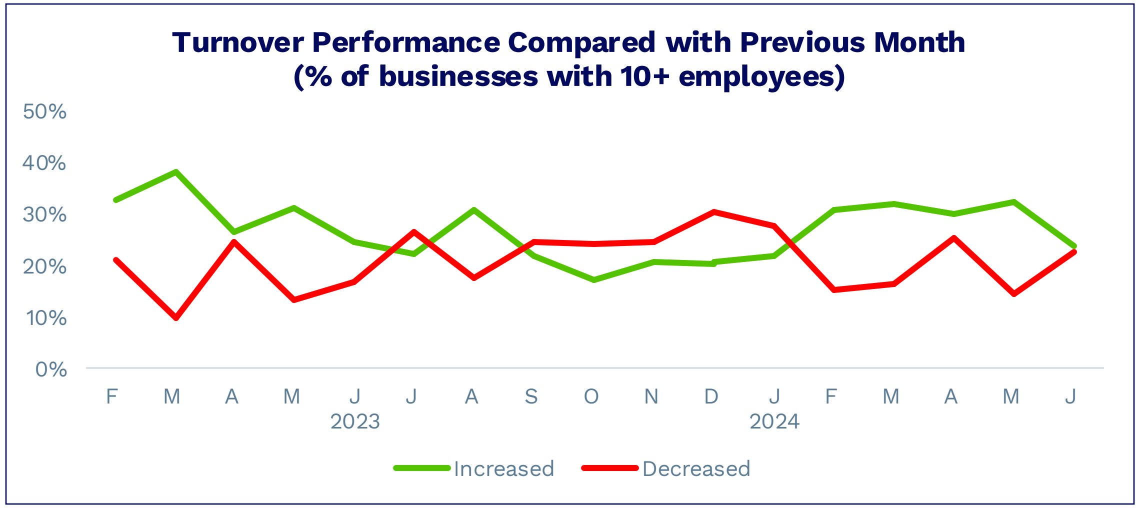


Scottish business activity rose in July for the 7th consecutive month and at a solid pace, driven by the services sector as manufacturing contracted for the 13th successive month (vs continued manufacturing recovery across the UK). Businesses are optimistic for the year ahead despite inflationary pressures, and employment increased.

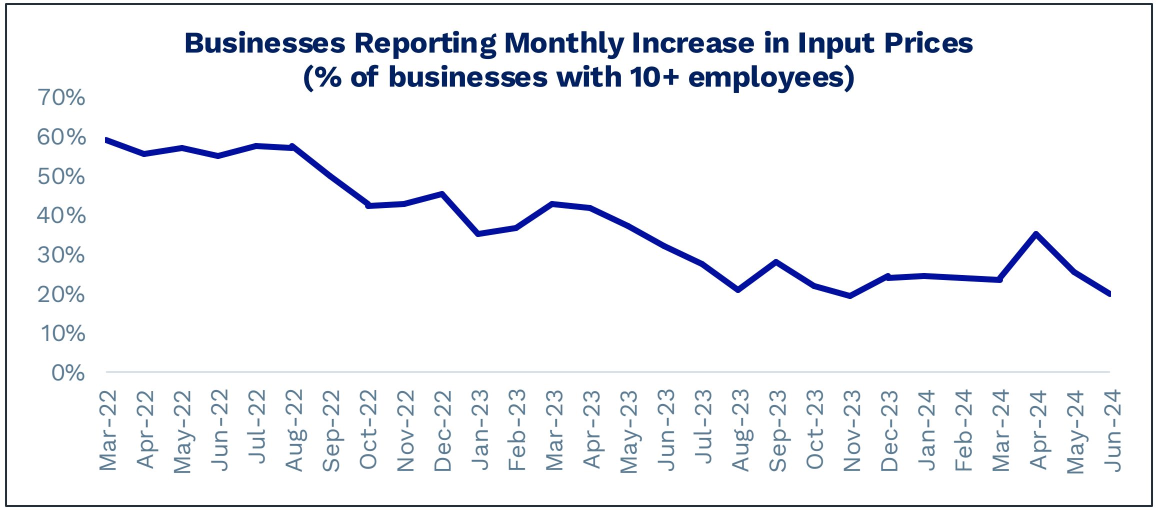


CURRENT BUSINESS SENTIMENT

In June, the % of businesses reporting a rise in monthly turnover fell to 24% (vs 30% over February-May), whilst 22% reported a decrease. The main challenges affecting turnover continue to be the cost of labour, competition, economic uncertainty, and cost of materials. Over one quarter of businesses expect turnover to increase in August 2024.



Cost pressures for Scottish businesses appear to be easing: 20% reported input prices increased in June v May (-15ppts since April and down from 32% a year ago). Just 9% expect to increase the price of goods/services *sold* in August 2024. Labour costs are the main factor causing businesses to consider increasing their prices.



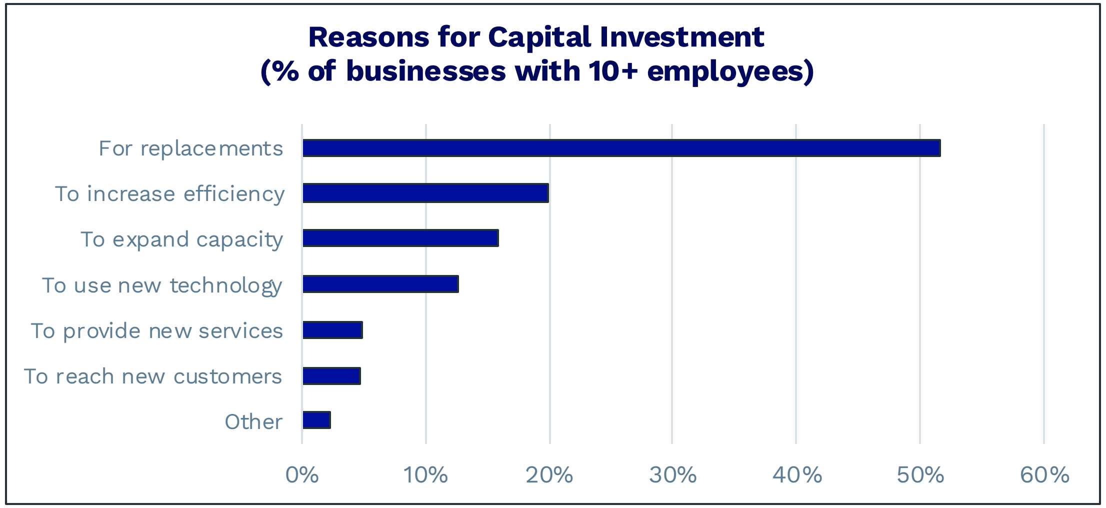
OUTLOOK

Scotland

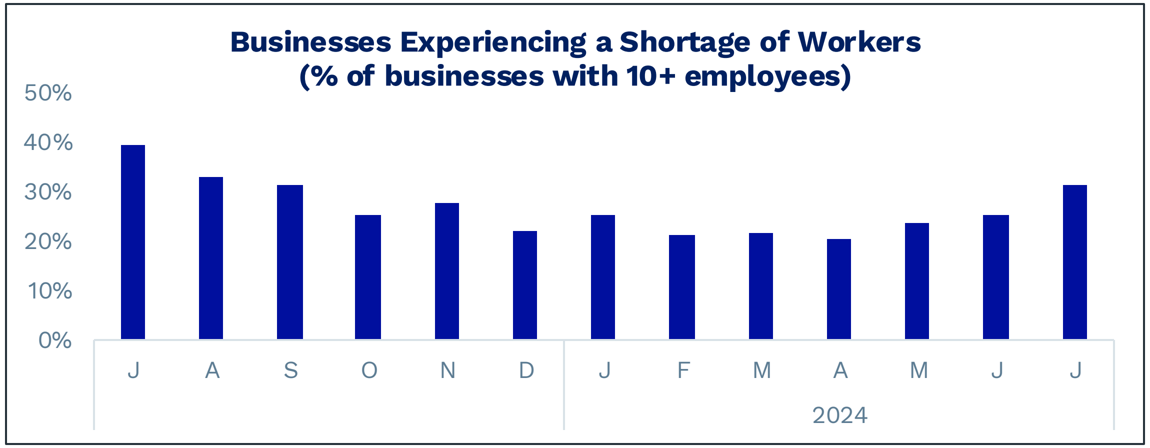
The Scottish labour market is showing signs of cooling. The unemployment rate increased by 0.4ppts over the year to June 2024 to 4.4% (vs 4.2% for the UK). The employment rate fell by 0.3ppts to 73.4%, below the UK (74.5%). Economic inactivity was down 0.1ppts to 23.1% (vs the UK's 22.2%). Median monthly wages increased by 5.8% to £2,427 in the year to June 2024 (vs 5.6% for the UK).

	RATE (April – June 24)	ANNUAL CHANGE
EMPLOYMENT (16-64)	73.4%	-0.3%pts
UNEMPLOYMENT (16+)	4.4%	+0.4%pts
ECONOMIC INACTIVITY (aged 16-64)	23.1%	-0.1%pts

Business investment intentions remain weak. Between July and September 2024, just 16% of businesses expect to increase capital expenditure. Replacing existing equipment, increasing efficiency and expanding capacity are the main factors driving investment, whilst uncertainty about demand and a shortage of funds are the key challenges.



31% of Scottish businesses reported worker shortages in July (+5ppts since June), the fourth consecutive monthly rise. 40% are unable to meet demands as a result. Around a third of businesses are also experiencing recruitment difficulties, with a lack of qualified applicants and a low number of applications the main challenges.



Scottish international goods exports (excl. services) were £23.0 billion in the year to March 2024, down by 6% in real terms (taking inflation into account). The decrease was largely driven by a fall in drinks exports (-15%). The EU is Scotland's top international goods export destination (40% of total value), followed by the US (17%).

Feedback from Scottish Enterprise Customers

General Sentiment

- The general sentiment among SE customers remains positive, despite challenges with staffing and recruitment (particularly for specialist and experienced workers), and issues related to property availability and suitability.

Labour and Skills

- Businesses across all sectors and sizes are continuing to face staffing challenges, for both higher-skilled and lower-skilled positions, for example difficulties recruiting experienced staff.
- More businesses are exploring automation, AI, and cobots (robots that can safely work alongside humans) as potential solutions to labour shortages. However, limited understanding of these technologies is slowing their adoption.

Cost of Doing Business

- Businesses have largely adapted to higher energy prices, and many are actively looking at investing in renewable energy (e.g. solar panels, heat pumps) to help manage energy costs in the future.
- However, high raw material and labour costs continue to exert pressure, and input prices are still rising (although the rate is easing).

Access to Finance

- Early-stage businesses can encounter significant challenges in securing equity investment due to increased caution from investors who are expecting stricter performance milestones which is extending and complicating the funding process.
- Securing loans remains difficult for some businesses (across all sectors) with banks described as being 'cautious'. Although interest rates are gradually declining, they are still high enough to discourage many businesses from taking on debt.

Exporting

- Overseas sales have generally remained stable in recent months, and there is a growing eagerness among businesses to participate in trade events and to seek support for expanding in international markets.

Property

- The lack of suitable property is leading some businesses to consider locations outside Scotland for parts of their operations. Others are investing in retrofitting existing or available space to meet their needs. However, this can be expensive and can divert funds from product development and other growth plans.

Capital Investment

- Many businesses are actively looking to improve productivity by investing in capital, often in innovative and new technologies as well as automation equipment. Where investment has taken place, businesses are reporting increased productivity and capacity.
- Some businesses, however, are scaling back rather than increasing investment due to factors such as uncertainty around both the economic outlook and policy decisions of the new UK government (e.g. potential changes to taxation, labour market regulations etc). The main barrier to investment is availability of internal/external funding.

Innovation

- Some businesses are delaying innovation investment as it is not currently a priority for them as they are focusing on more immediate pressing priorities (e.g. addressing cost of doing business, responding to labour shortages, upgrading or looking for new premises).

Net Zero

- More businesses are interested in taking Net Zero actions and developing comprehensive sustainability strategies. Some are investing in Net Zero consultants or in-house sustainability specialists, but costs (e.g. wages) can be prohibitive, particularly for smaller firms.

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Economic Outlook

Global Forecasts

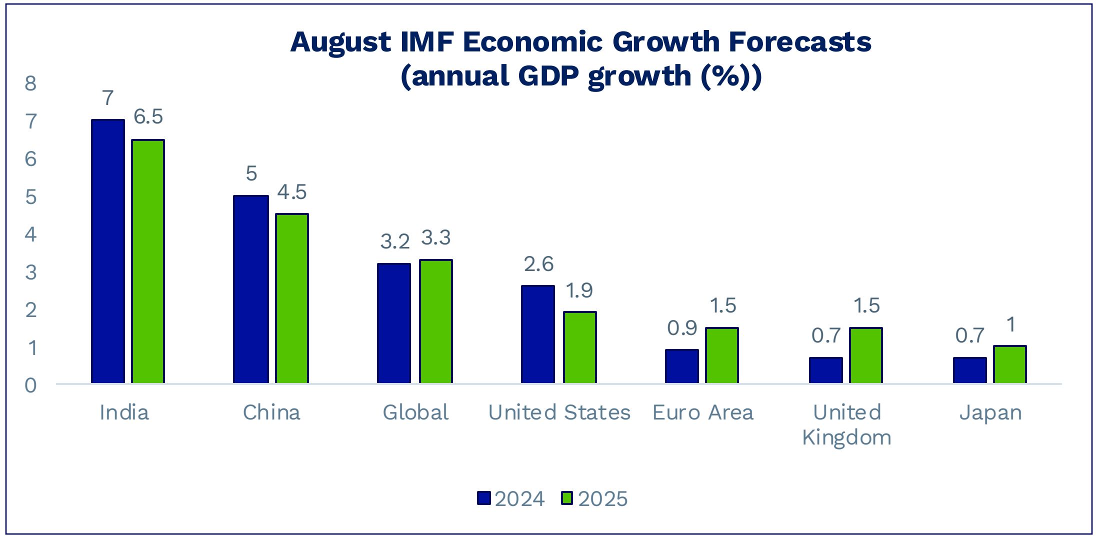
The International Monetary Fund is forecasting global GDP growth of 3.2% in 2024, rising slightly to 3.3% in 2025. Emerging and developing economies (e.g. China and India) are expected to grow by 4.3% in both 2024 and 2025, significantly faster than advanced economies (1.7% in 2024 and 1.8% in 2025).

The UK is forecast to grow by just 0.7% in 2024 (likely due to higher interest rates than in some other economies), rising to 1.5% in 2025.

With slowing labour markets and a decline in the cost of energy, inflation is expected to reach target levels by 2025.

The IMF notes the following key risks to the global economy:

- price instability from global conflicts, as well as high national debts, could decrease economic activity and confidence
- sticky services inflation (via high wages) could contribute to persistent inflation, raising interest rates and borrowing costs.
- potential for significant swings in economic policy due to elections this year, with negative spillovers to the rest of the world.



UK and Scottish Forecasts

The Bank of England is forecasting UK GDP growth of 1.25% this year, falling to just 1% in 2025 before rising to 1.5% in 2026. The pick-up in 2026 reflects the fading impact of high interest rates which will boost growth, and domestic spending is expected to increase steadily over the forecast period.

CPI inflation is expected to increase to around 2.75% (from 2.2% in July) in the 2nd half of this year, as declines in energy prices last year fall out of the annual comparison.

Key risks to UK growth include:

- higher commodity prices and disruption to trade flows, in addition to geopolitical tensions, weakening economic activity and increasing inflationary pressures.
- weaker global growth if domestic demand in China is below expectations.

For Scotland, the EY ITEM Club is forecasting 0.9% GDP growth in 2024, rising to 1.7% in 2025. Consumer-facing sectors are expected to show strongest output growth and drive recovery, with weaker performance in manufacturing.

Unemployment is forecast to peak at 4.5% this year, then decrease to 4.1% in 2026. The ITEM Club note that lagged effects of past monetary policies (e.g. high interest rates) may slow the recovery of the Scottish economy.