# Economic Commentary

## April 2023

Insights & Economics

Scottish Enterprise

SUMMARY

- **Business activity rose across all the world's largest economies** in March. The upturn was driven primarily by the service sector, with manufacturing performance weaker.
- However, the IMF is describing the **economic outlook as 'uncertain again'** and has slightly **downgraded its forecast for global economic growth** this year to 2.8%, rising modestly to 3.0% in 2024. The UK is still expected to be the worst performing G20 economy in 2023, with output declining by 0.3%.

RECENT ECONOMIC DATA

- **UK GDP flatlined in February**, following growth of 0.4% in January. In the three months to February, the UK economy grew by just 0.1%.
- More recent data showed **UK business activity** increasing in nearly all nations and regions in March. There was a continued softening of cost inflation and **business optimism** rose.
- The Bank of England increased **interest rates to 4.25%** in March to help combat **high inflation which rose to 10.1% in March**. The BoE expect inflation to fall just below 4% by the end of 2023.

CURRENT BUSINESS SENTIMENT

- **Scotland's onshore economy** grew by 0.9% in January, after contracting by 0.8% in December. **Service sector** output, which accounts for around three quarters of the economy, increased by 0.5%, and **manufacturing** output was up 3.9%. **Construction** output, however, declined (-1.8%).
- A third of Scottish businesses reported **an increased turnover** in February and business **performance expectations** for the coming year have picked up since the end of 2022.
- Scotland's **employment rate** rose to 75.7% in February, and the **unemployment rate** fell to 3.0%. **Worker availability** declined in March for the 26th month in a row, and 38% of businesses in Scotland are reporting **worker shortages.**

FORWARD LOOK

- Scotland's **tight labour market** is **pushing up wages;** however, pay rises are failing to keep pace with **inflation**.
- The Fraser of Allander Institute is **forecasting** that the **Scottish economy will contract by 0.7% in 2023** before returning to **growth in 2024 (+0.9%).** Similarly, the EY Item Club forecasts **a fall in economic output of 0.6%** over 2023**,** with **growth of +1.6% expected in 2024.**

SUMMARY

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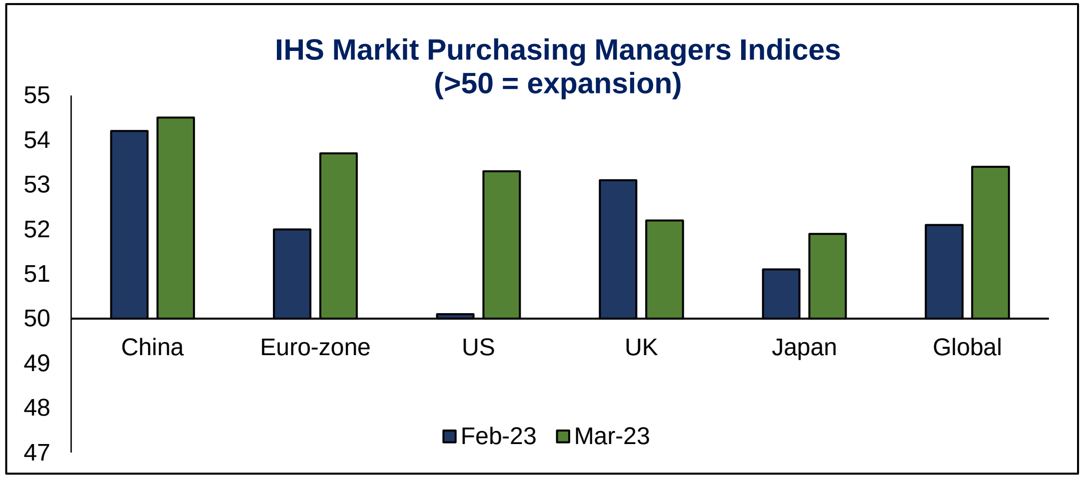
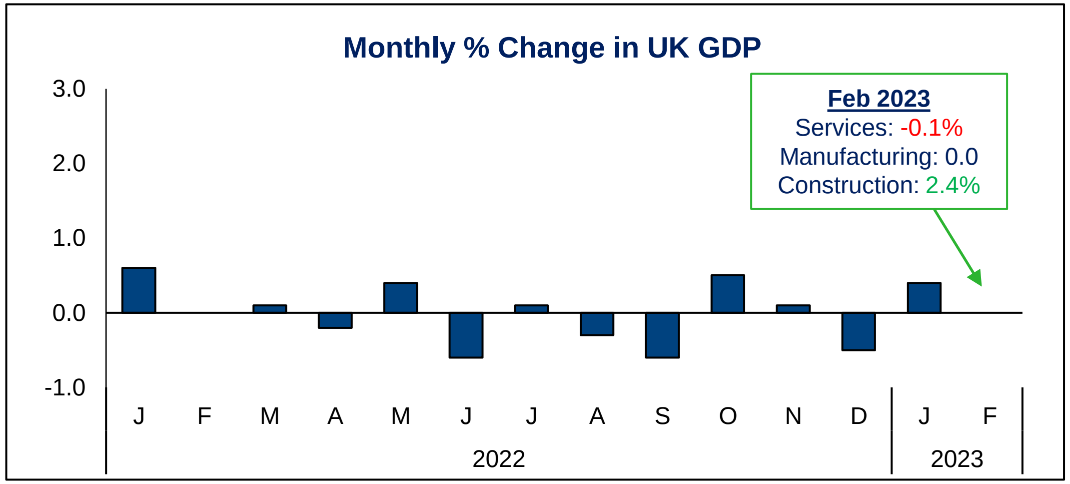
FORWARD LOOK

## Global/UK

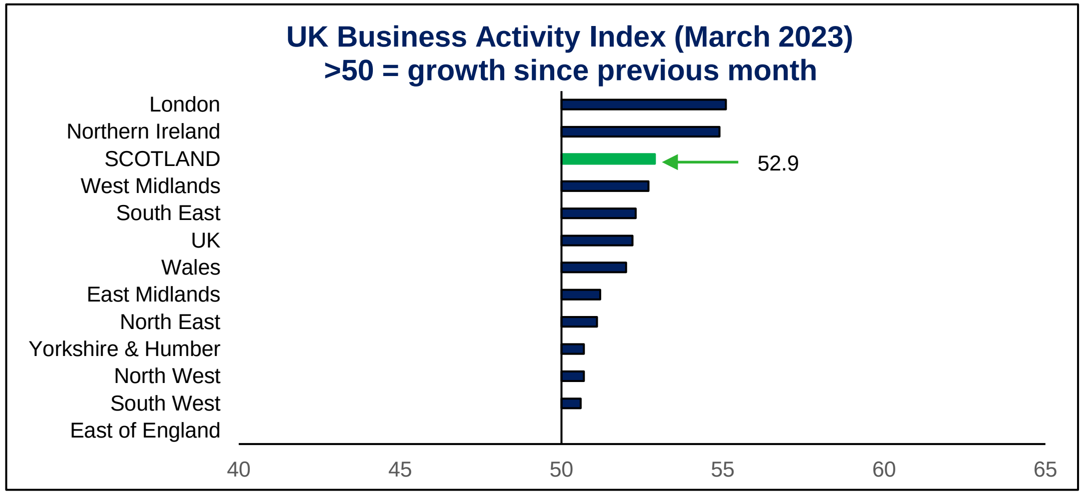
Recent business surveys indicate a sustained increase in private sector output across all major economies in March, particularly in China. The upturn was primarily driven by the services sector.



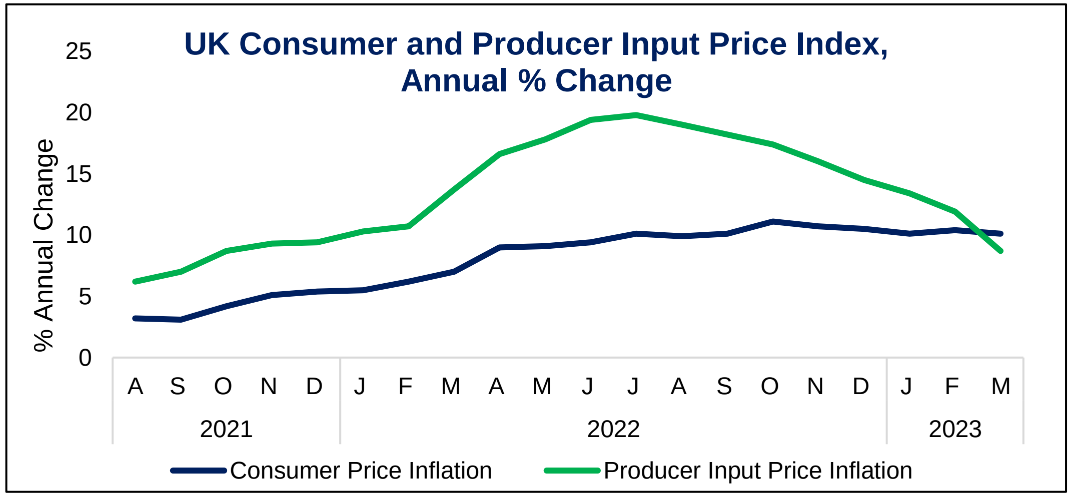

UK GDP flatlined in February. Falls in services (in part due to public sector strikes) and production sector output were offset by growth in construction. Looking longer term, GDP grew by just 0.1% in the three months to February.




Nearly all UK regions and nations saw business activity grow in March due to improved demand and a cooling of input cost inflation. There was also an improvement in business confidence.

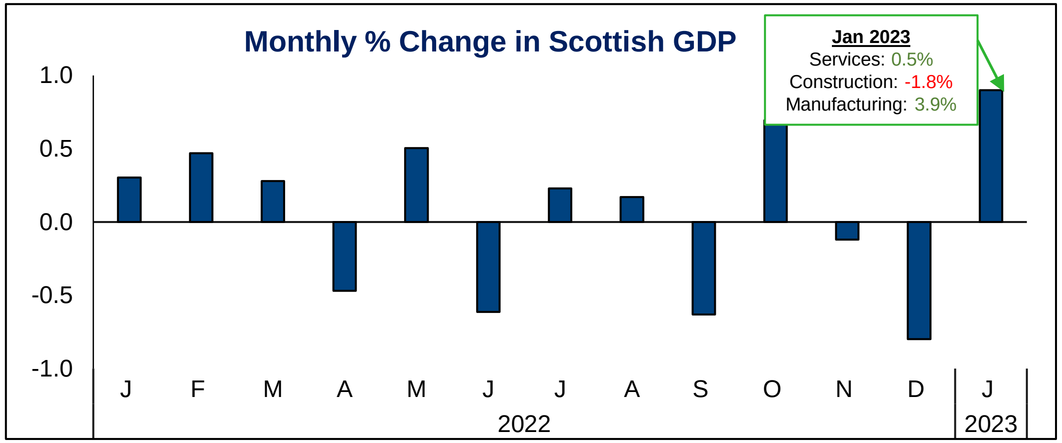



In March, consumer price inflation declined slightly but remained high at 10.1%, whilst producer input price inflation fell to 8.7%, continuing a downward trend but still above the longer-term average.

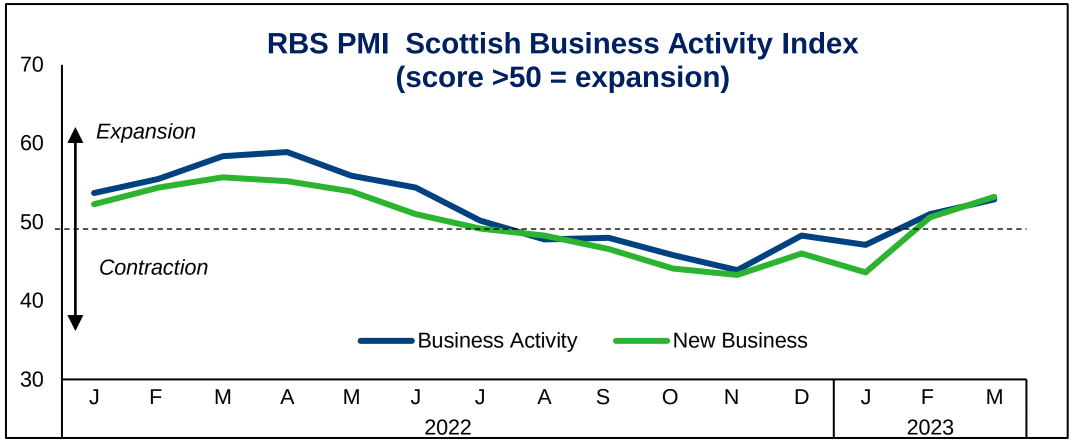


## Scotland

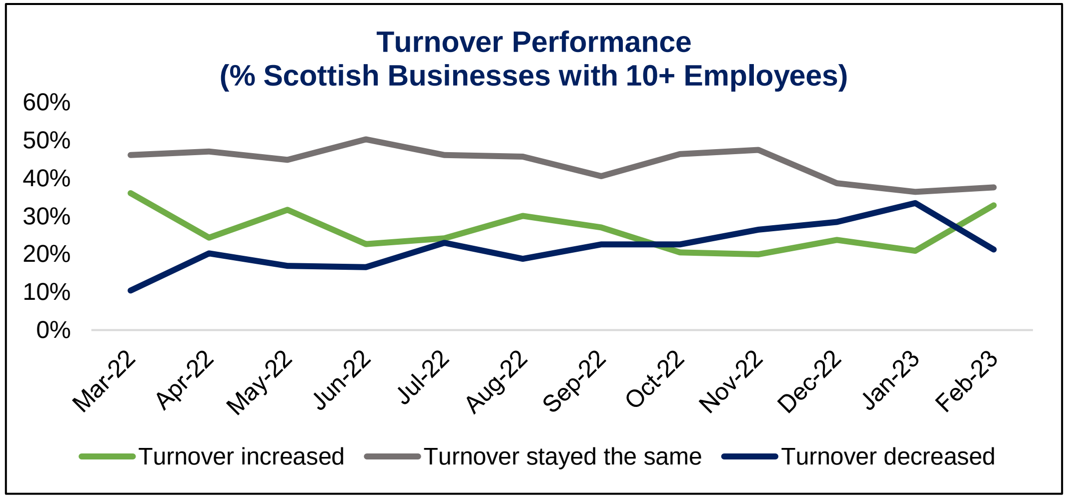
Scotland's onshore GDP grew by 0.9% in January, after falling by 0.8% in December. Of the main sectors, services increased by 0.5% and manufacturing increased by 3.9%, offsetting a fall in construction sector output of 1.8%.



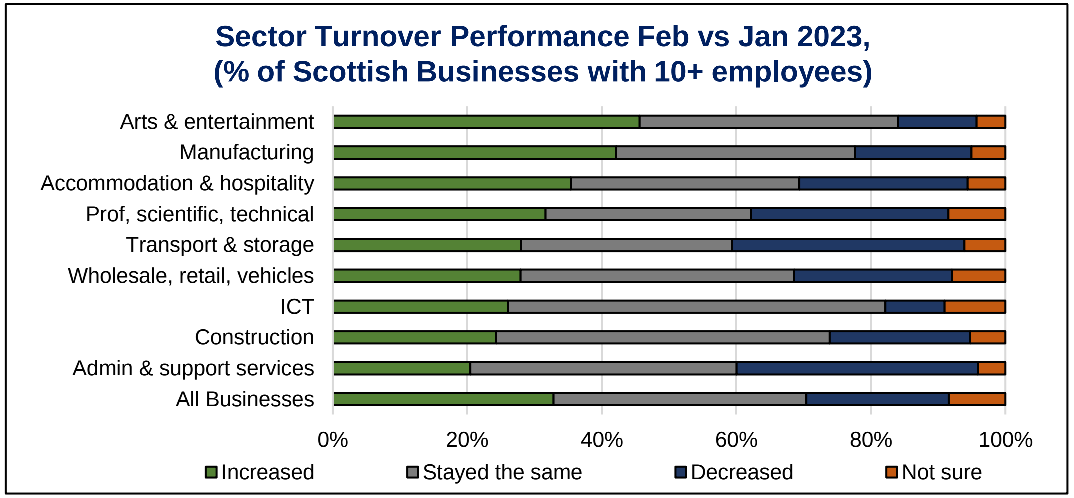

Business activity increased in March for the second month running, as companies reported an accelerated rise in new business orders driven by improved demand, and increased advertising and investment.




A third of businesses experienced a rise in turnover in February, reversing a five-month trend of more businesses reporting a decrease than an increase. Looking ahead, almost 40% of businesses expect their overall performance to increase in the next year.




However, turnover performance varies by sector - the arts & entertainment sector (46%) and manufacturing sector (42%) had the highest proportion of businesses reporting increased turnover in February, whereas over a third of transport & storage and admin & support service businesses reported a decrease.



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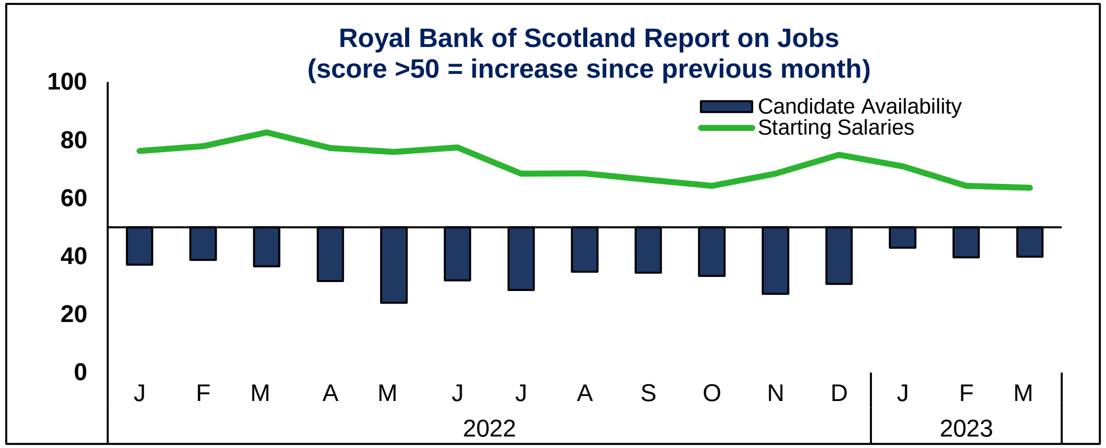
## Key Themes – Scottish Labour Market

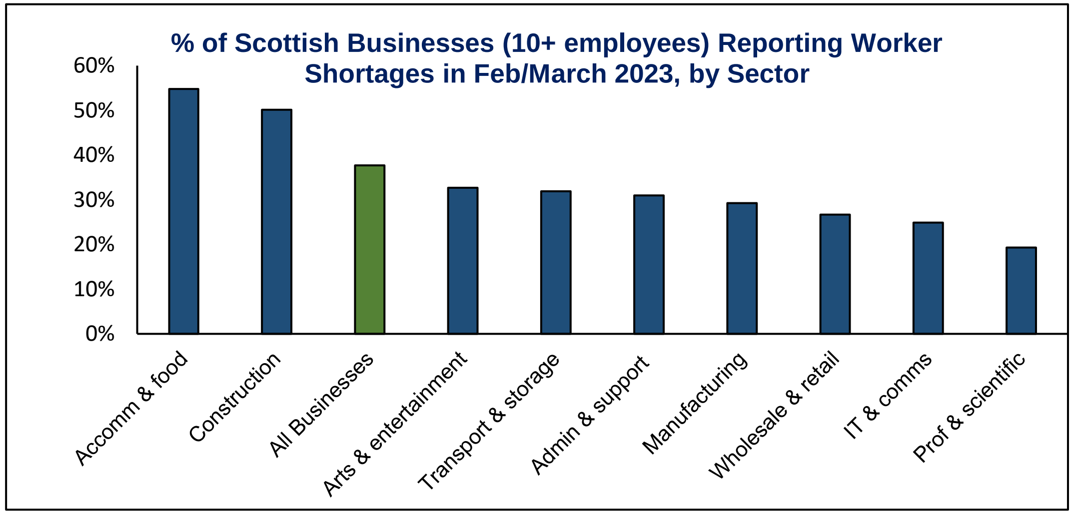
In the labour market, unemployment remains low and is down 0.5 percentage points over the year. The employment rate was up by 0.8pp over the year and is 0.3pp above pre-pandemic levels. Economic inactivity continued its downward trend, falling by 0.4pp over the year although it did rise slightly over the quarter.

| | RATE (Dec 22 - Feb 23) | ANNUAL CHANGE |
|---|---|---|
| EMPLOYMENT (aged 16-64) | 75.7% | +0.8%pts |
| UNEMPLOYMENT (16+) | 3.0% | -0.5%pts |
| ECONOMIC INACTIVITY (aged 16-64) | 22.0% | -0.4%pts |

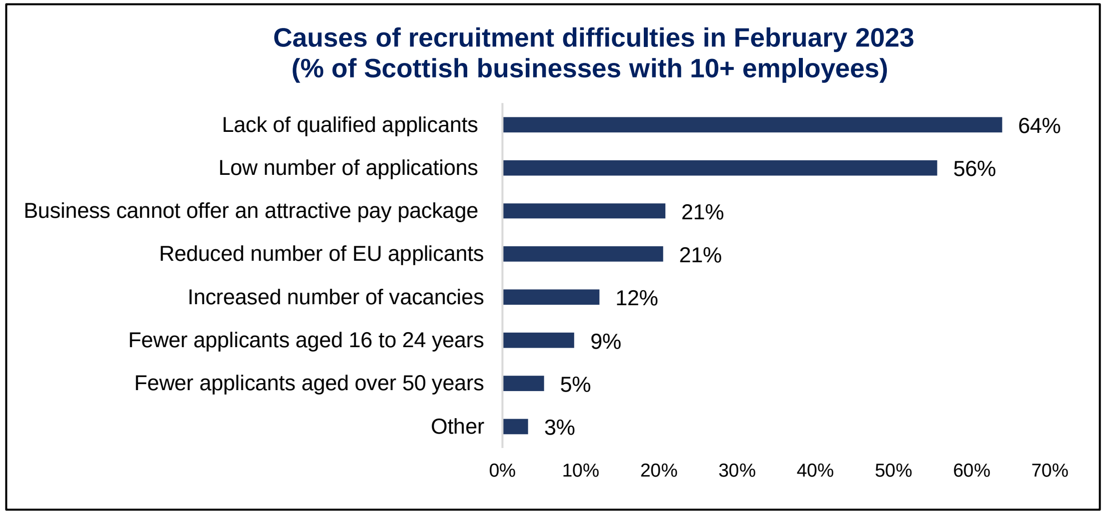
Staff availability fell in March (for the 26th month in a row), reflecting the tight labour market. Salaries for new permanent posts rose across Scotland (albeit at a softer pace) with competition for skilled staff, the cost-of living crisis and labour shortages driving up salaries. Pay rises, however, are not keeping pace with inflation.




Labour shortages were reported by 38% of Scottish businesses in Feb/March (up 4pp since December) and are affecting a range of sectors, most notably the accommodation and food services sector (55%). As a result, 62% of all businesses have employees working extra hours and 27% are unable to meet demands.




Nearly 40% of businesses reported experiencing recruitment difficulties in February. A lack of qualified applicants (64%) and a low number of applications (56%) were the leading causes of this.



## Feedback from Scottish Enterprise Customers

### General Sentiment

- Scottish Enterprise customer sentiment continues to be '**cautiously optimistic**' about **demand** levels but **less so** about being **able to meet demand due to recruitment challenges.** Businesses able to automate their processes are more optimistic than those that cannot.
- **Skills shortages** is the main issue being raised by businesses followed **by rising costs** and **supply chain** challenges.
- However, despite challenges, many businesses that are engaging with SE are still looking for **opportunities** to **grow** and **expand**.

### Labour and Skills Shortages/jobs

- **Recruitment issues** continue to be the **biggest challenge** for most businesses with reported shortages of engineers, fabricators, welders and hospitality staff.
- Whilst **high-skilled posts** are generally advertised on **social media (e.g. Linkedin),** some businesses are returning to more traditional advertising routes (e.g. radio and open days) to attract lower-skilled staff.
- Proactively **poaching staff** from other businesses continues, and salaries especially for technical skills, are **highly competitive**.
- However, some businesses are finding it challenging paying all their staff at least the **real living wage** due to other cost pressures. This is affecting their ability to access some public sector funding support.
- Whilst not widespread, **hiring in advance of need** is being considered by a few digital companies as a way of preparing to tender for a new contract and which allows them to be fully skilled before a potential contract begins. However, if they fail to win the contract, they may let the new staff go.
- The **loss of Eastern European** workers means that hotels are having to use **agency staff at up to three times the cost**.
- Staff shortages continue to force some restaurants to **reduce their opening times** (although there is no indication how long this may continue for), **hotels to not open all their rooms** and some **food and drink manufacturing** businesses are **unable to fulfill orders**.
- Staff shortages are driving businesses to **review operating hours** e.g. some manufacturing plants are running longer shifts over four-day weeks rather than five. This also **helps reduce overheads**.
- Also, businesses continue to explore introducing **automation and digitisation** where possible to address staff shortages. However, not all can afford this level of investment.
- Some large global businesses with bases in Scotland are concerned that home working is resulting in a **loss of informal employee collaboration** and **social interaction** which is affecting productivity and staff wellbeing; they would like to see staff back in the office.
- However, this causes **challenges for local Scottish management** who are concerned that employees will leave if they are forced back into an office full time. Some businesses are therefore aiming for **2 or 3 days per week** and using **compulsory meetings** and **social events** to encourage staff in.

# Feedback from Scottish Enterprise Customers

## Supply Chain

- The **Aerospace** industry is reporting ongoing supply chain issues with the **lead time for steel** currently **double** what it once was about a year ago.
- **Continuing delays** in getting manufacturing parts means delays to projects and cost implications for multiple sectors.
- A small number of businesses are reporting that large customers are taking **longer to pay invoices**. This is impacting cash flow, and management teams are spending more time chasing payments
- The price of **raw materials** continues to rise. For example, a timber frame company reported an increase of 30% over the last 12 months in the cost of wood which cannot be absorbed and needs to be passed on to customers.

## Exports

- **Increased time, costs** and **administration** continue to pose challenges for exports to the European Union. With **delays** on the **border crossing to France** some businesses are looking at **less congested alternatives** e.g. **via The Netherlands**. Other businesses are looking at **new markets** altogether outside the EU.
- **Additional bureaucracy** has resulted in some European businesses showing **less desire to trade with UK businesses**.
- **Small batch manufacturers** will tend to ship goods on pallets shared with other businesses to reduce **transport costs**. However, there are challenges if pallets are not filled as it becomes too costly. There are also challenges if there are issues with **paperwork** for any of the pallet batches, which is then causing shipment delays.

## Net Zero

- Businesses are increasingly identifying **business benefits** of investing in net zero and sustainability e.g. being able to access supply chains with low emissions requirements.
- Some businesses are hoping to **reduce their energy costs** by replacing older equipment/machinery.
- **Brewers** have identified opportunities in **$CO_2$ capture.** $CO_2$ is produced through the fermentation process and capturing this in **cannisters and selling** to, for example pubs, generates revenue and reduces overall emissions.
- There is a shortage of consultants that businesses can use to help produce **net zero plans.** As a result, more businesses are looking to work with **Scottish Enterprise sustainability specialists** to develop and take forward their net zero plans.
- Oil & gas supply chain businesses are increasingly identifying **energy transition opportunities**.

## Access to Finance

- Businesses that have been able to **maintain liquidity** during the last few years have found it easier **to fund growth projects.**
- However, if liquidity has been an issue, getting **bank funding for projects** can be **challenging**. Businesses need a very **good business case** and to maintain **good relationships with banks.**

# Economic Outlook

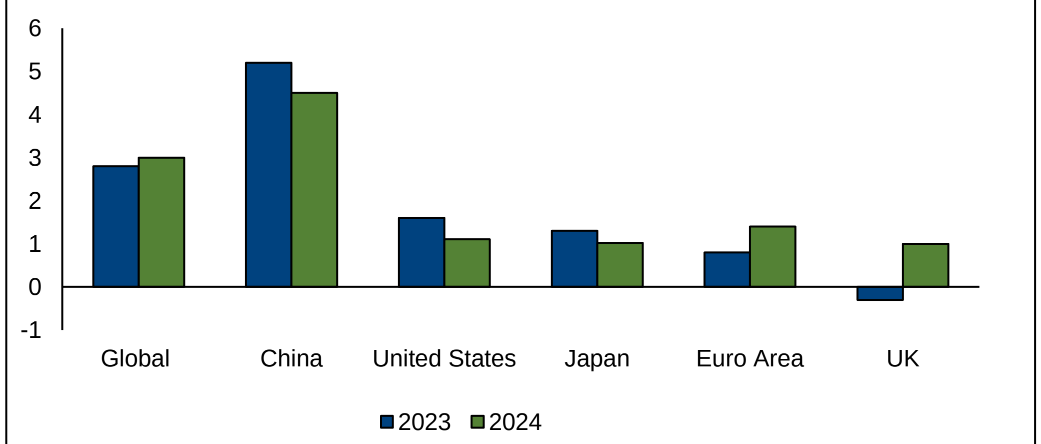
## Global Forecasts

The IMF is less optimistic for 2023 and 2024 due to increased uncertainty and has slightly revised down its global economic forecasts. It now expects global growth to fall from 3.4% in 2022 to 2.8% in 2023 before rising modestly to 3.0% in 2024.

Overall, the IMF expects about 90% of advanced economies to see a slowdown in growth over 2023, with the UK expected to be one of the worst performers: output forecast to decline by –0.3% in 2023 before returning to growth of 1.0% in 2024.

The IMF also projects global inflation to decrease, although more slowly than initially anticipated, from 8.7 percent in 2022 to 7.0 percent in 2023 and 4.9 percent in 2024.

Downside risks to the economic outlook highlighted by the IMF include sharper and more persistent tightening of global financial conditions than anticipated, along with uncertainty surrounding the war in Ukraine and its broader consequences.




IMF GDP Growth Forecasts (annual % change)

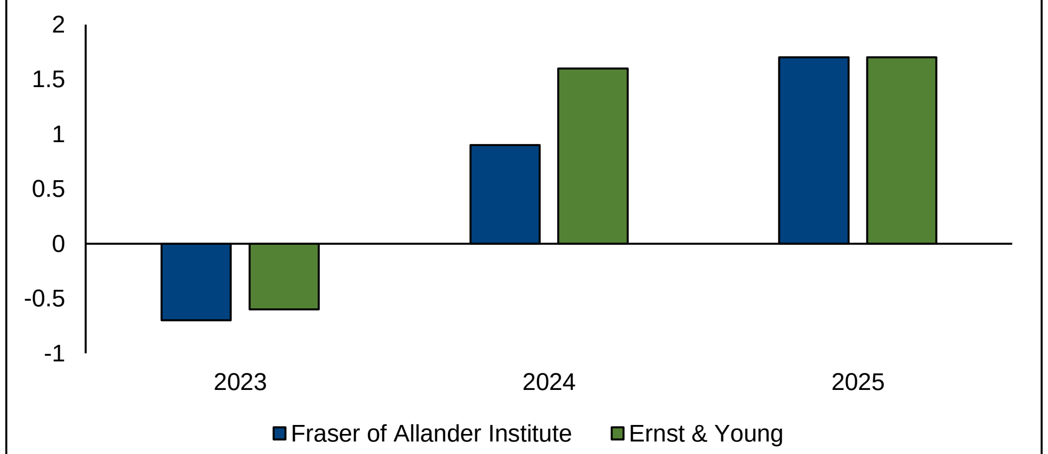
## Scottish Forecasts

The Fraser of Allander Institute is forecasting Scotland's economy will contract by 0.7% in 2023, before returning to growth in 2024 of 0.9%. This is a slight upward revision up from its February forecasts, reflecting more positive recent economic data.

The Institute also notes that uncertainty has increased due to global banking challenges, and that inflation, although falling, will still be high over 2023.

Ernst & Young's forecasts are broadly similar. Scotland's economy is expected to contract by 0.6% during 2023, with the fall largely concentrated in the first six months. Lower energy prices and improved business confidence should see some improvement in the economy in the second half or the year.

Economic output is expected to return to growth in 2024, rising by 1.6%, with key service sectors such as information & communications leading the way. Scottish growth is anticipated to lag the UK as a whole, due to long-term demographic challenges – e.g. the older profile of Scotland's working age population, and greater impact from reported labour shortages.




Fraser of Allander Institute and EY Scottish Growth Forecasts (annual % change)