

Economic Commentary

December 2023

SUMMARY

- Business activity across most major global economies has **been slowing or contracting over the second half of 2023** (particularly in the eurozone). However, activity performance in **November indicates that the worst of the downturn may have passed**.
- The **UK economy** continues to be subdued with GDP growing by **just 0.2% in September**, with zero growth for Q3 as a whole. Performance was poor across most of the UK with only London, the West Midlands and South-West showing increased business activity.
- **Consumer price inflation eased in October but remained high** at 4.6%. Core inflation was higher (at 5.6% over the year) but again the rate of increase has slowed. Producer input prices fell for the fifth consecutive month.
- Scotland's onshore **GDP grew by 0.1% in September** - service sector output fell (-0.4%) while output expanded in the production (+2.7%) and construction (+0.4%) sectors. In Q3 (Jul to Sept), GDP grew by 0.4%, after a fall of 0.3% in Q2.
- **17% of businesses reported an increase in monthly turnover in October**, this is down from 31% in August. The main challenges affecting turnover continued to be around recruitment and costs.
- Scotland's labour market weakened slightly over the year. **The unemployment rate remained low** (3.9%) but rose over July-Sept, while the **employment rate fell slightly** to 74.3%. A quarter of Scottish businesses reported **worker shortages** in October, though the proportion has dropped in recent months. **Wages rose by 6.7%** over the year to October 2023 (above inflation).
- SE customers are cautiously optimistic despite **ongoing challenges** with skills shortages, availability of suitable property and access to finance/investment for some.
- Global economic growth is expected **to be 2.7% in 2024** (slightly down from 2.9% in 2023) **before rising again to 3% in 2025**. Slowing growth in 2024 was largely down to the impacts of inflation, high interest rates, weaker trade growth and lower business and consumer confidence.
- The OBR is forecasting the **UK economy will gradually recover** growing by 0.7% in 2024 and 1.4% in 2025. Ernst & Young forecasts for **Scotland are less optimistic** with growth of just 0.3% forecast for 2024 and 1.3% in 2025.

RECENT ECONOMIC DATA

CURRENT BUSINESS SENTIMENT

FORWARD LOOK

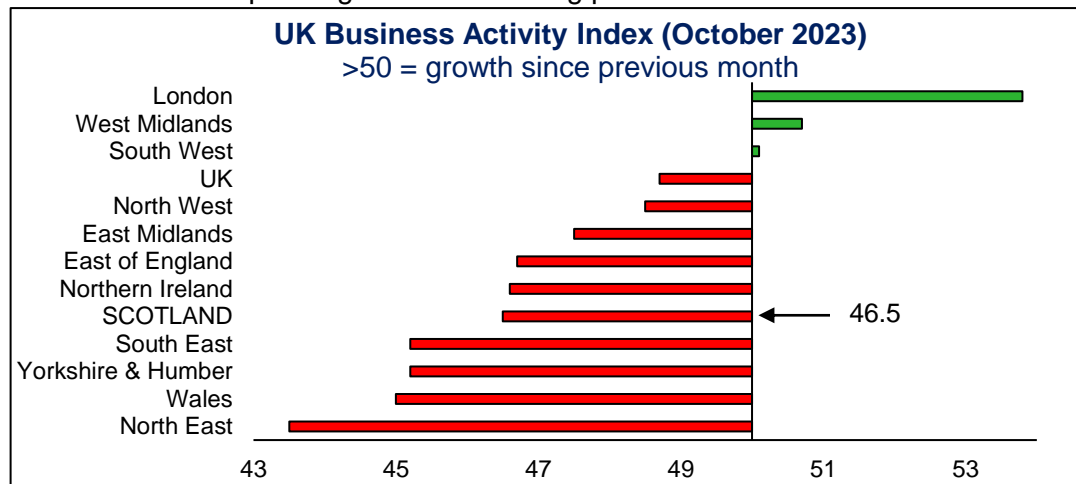
Global/UK

[Private sector activity](#) slowed over the second half of 2023, and contracted in the eurozone and the UK. Weak manufacturing performance has been the main cause as high inflation, rising interest rates and reduced optimism impacted demand. However, business activity generally improved in November.

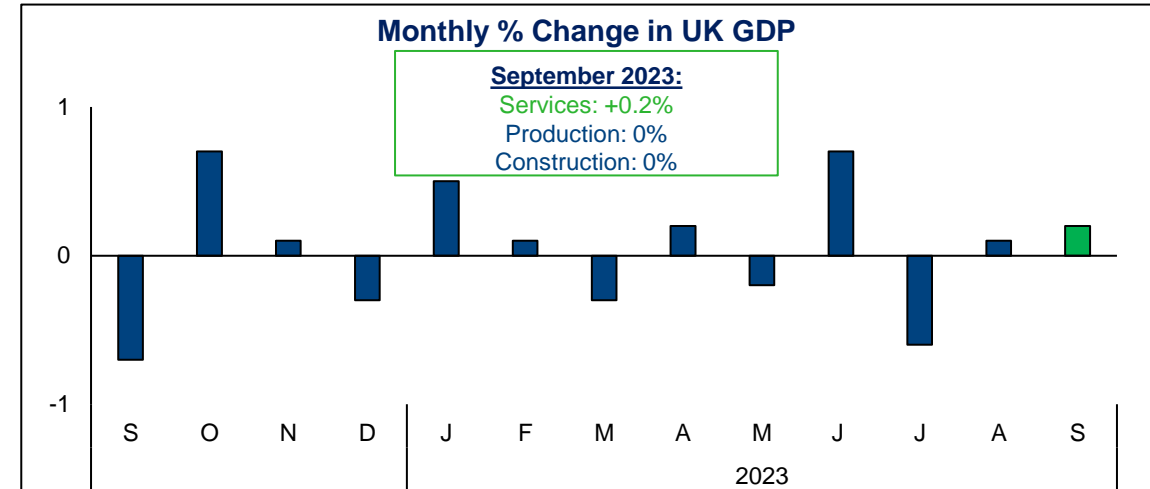
Business Activity Index (>50 indicates increase vs previous month)

2023	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov
China	53.6	55.6	52.5	51.9	51.7	50.9	50.0	51.4
US	53.4	54.3	53.2	52.0	50.2	50.2	50.7	50.7
UK	54.9	54.0	52.8	50.8	48.6	48.5	48.6	50.1
Japan	52.9	54.3	52.1	52.1	52.6	52.1	50.5	50.0
Eurozone	54.1	52.8	49.9	48.6	46.7	47.2	46.5	47.6

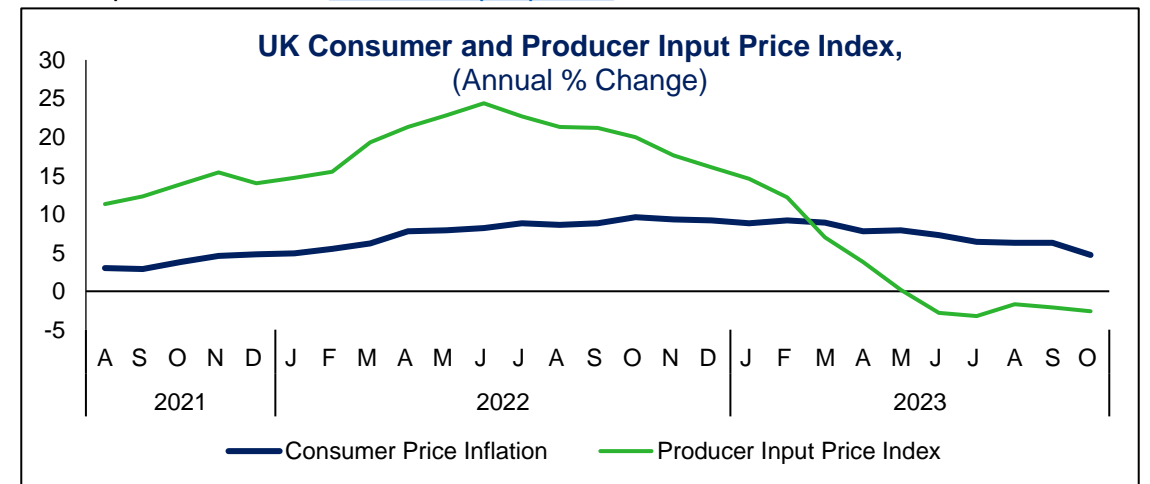
Within the UK, only three regions/nations posted growth in [business activity](#) in October, with strong performance in London. Across other areas activity contracted as demand for goods and services weakened, with businesses citing lower consumer spending and cost-of-living pressures as factors.



[UK GDP](#) grew by 0.2% in Sept following growth of 0.1% in August. Services output drove growth (+0.2%), whilst output in both the production & manufacturing and construction sectors both flatlined over the month. Over Q3, GDP flatlined (0%) after growth of just 0.2% in Q2.

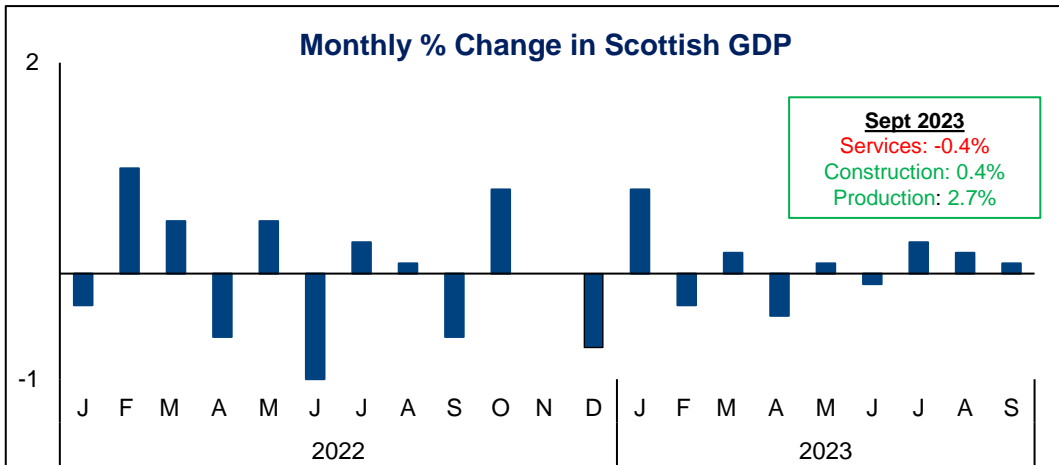


In October, [consumer price inflation](#) was 4.6% in the 12 months to Oct 2023, down from 6.7% in Sept with housing costs and food and non-alcoholic drinks having the largest downward contribution. Core inflation rose by 5.6% over the year, down 0.3pp on the previous month. [Producer input prices](#) fell for the fifth consecutive month.

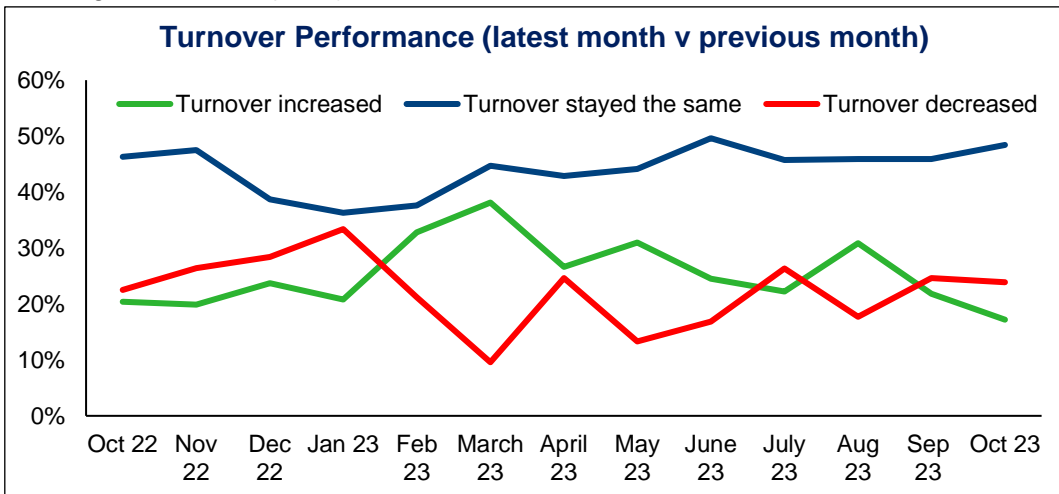


Scotland

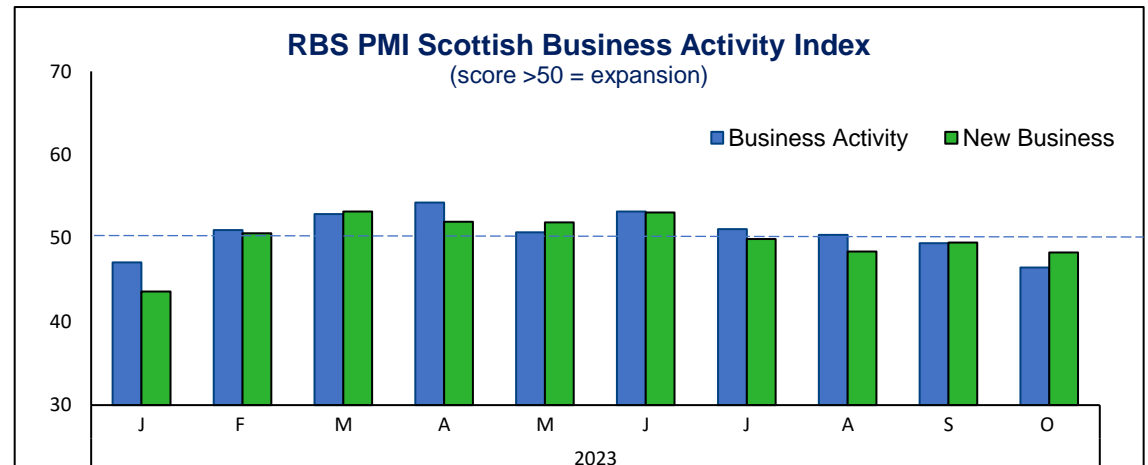
The [Scottish economy grew](#) by 0.1% in September, following +0.2% in August. Over the month, service sector output (-0.4%) fell, whilst construction output rose (0.4%) along with production (2.7%) though within this manufacturing output fell (-1.1%). Over Q3 as a whole, GDP grew by 0.4%, reversing the fall of 0.3% in Q2.



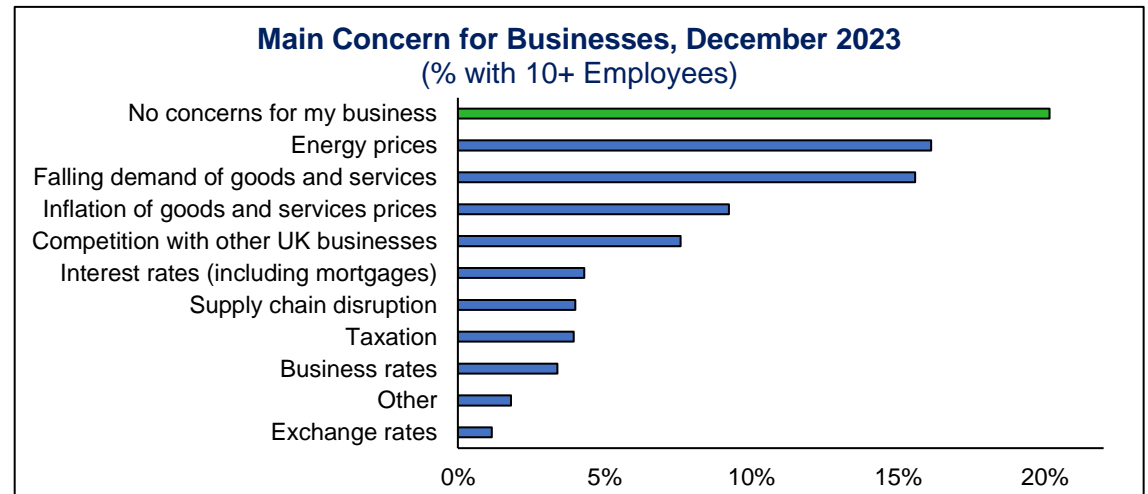
[48% of businesses](#) reported no change in monthly turnover in Oct, whilst 24% reported a decrease and 17% reported an increase (down from 31% in Aug). Challenges affecting turnover continued to be linked to costs- around labour (32%) and materials (24%) along with general economic uncertainty (20%) and shortages of labour (19%).



[Private sector business activity](#), however, declined during October and at the strongest rate in 11 months triggered by worsening underlying demand conditions and the cost-of-living crisis. Inflows of new work also fell again reflecting weakening demand. Despite this, business sentiment remained positive whilst subdued.



Excluding labour market issues, the [main concerns for businesses](#) continue to be energy prices, falling demand of goods and services and rising input costs. 36% of businesses reported that high energy prices has affected suppliers, their own production or both.

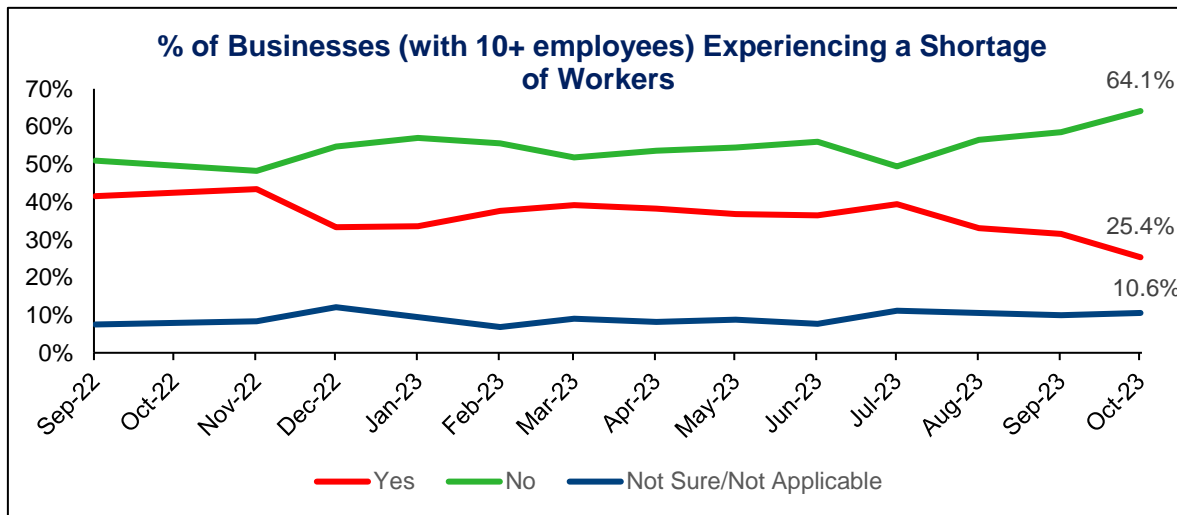


Scotland

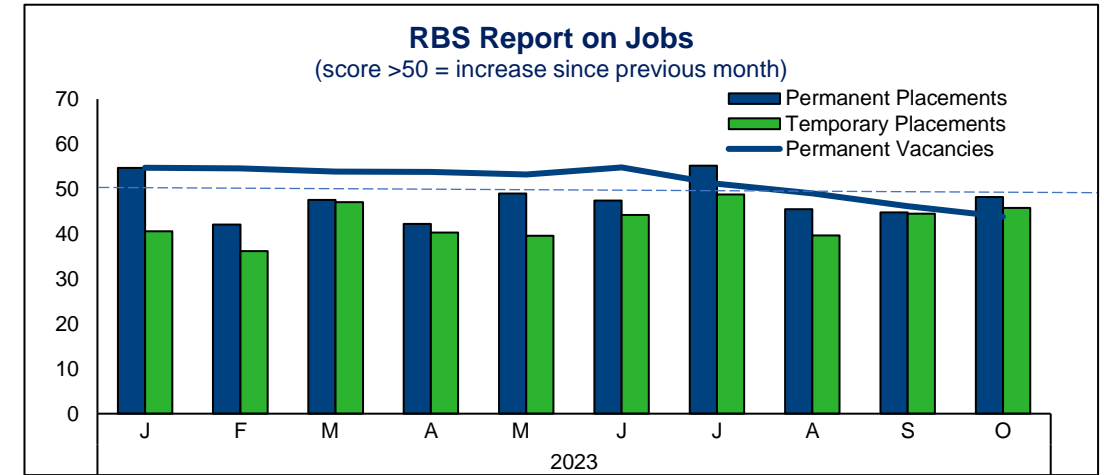
In the [labour market](#), unemployment remains low but has risen 0.4 percentage points over the year to 3.9% (below the UK rate of 4.2%). The employment rate fell by 1pp to 74.3% and is below the UK's (75.7%). Economic inactivity has risen over the year by 0.8pp to 22.7%. The [median monthly wage](#) of payrolled employees in Scotland was £2,307 in October, 6.7% higher than a year ago (vs +5.8% for the UK).

	RATE (Jul- Sep 23)	ANNUAL CHANGE
EMPLOYMENT (aged 16-64)	74.3%	-1%pts
UNEMPLOYMENT (16+)	3.9%	+0.4%pts
ECONOMIC INACTIVITY (aged 16-64)	22.7%	+0.8%pts

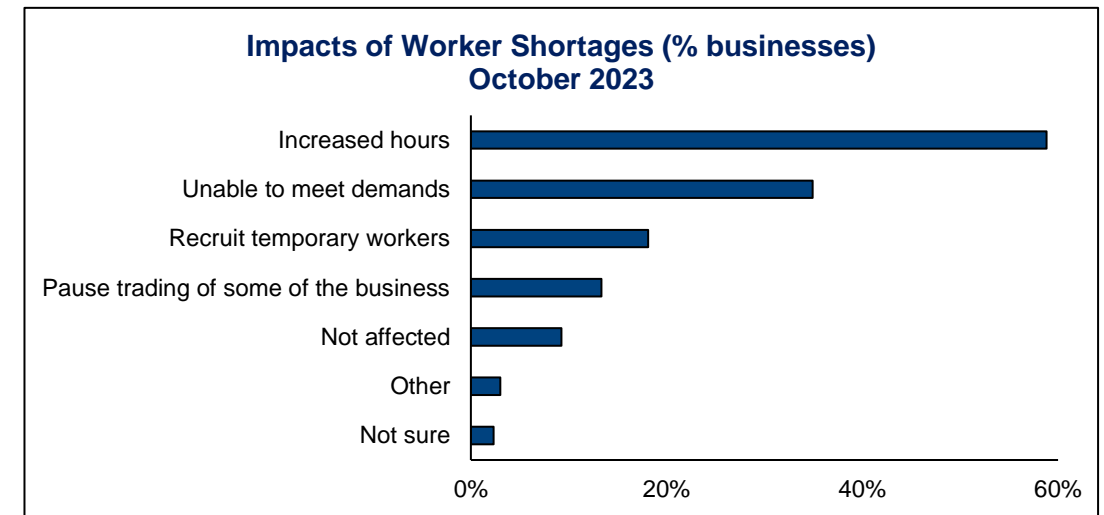
Fewer businesses are reporting [worker shortages](#), falling from a peak of 45% in Aug 22 to 25% in Oct 23. Some sectors are more affected than others with 39% of Construction and 38% of Accommodation & Food businesses experiencing shortages. Smaller businesses are also more likely to report this as an issue.



[Recruitment activity](#) continued to weaken in October. Both permanent and temporary placements fell on the previous month, albeit at a softer rate. This reduction in hiring activity was accompanied by a fall in vacancies. Starting salaries continued to rise for the 35th month running.



[Worker shortages are affecting businesses](#) in different ways. Of those reporting shortages, nearly 60% have employees working increased hours, 35% are unable to meet demands, and 18% have taken on temporary staff as a result.



Feedback from Scottish Enterprise Customers

General sentiment

- SE customers are **generally optimistic**. However, there can be delays to **growth projects** due to **funding challenges** caused by high business costs (such as energy and raw materials, higher interest rates driving up the cost of borrowing and difficulties accessing risk funding) impacting margins.

Labour and Skill Shortages

- Businesses in the North-East report **difficulties in recruiting engineering and technical skills** as they are often competing with **high salaries offered by the Oil & Gas sector**.
- Skills shortages** means that some businesses (e.g. life science and technology) are looking to source **workers from overseas**. However, **strict eligibility criteria** means there can be **difficulties in obtaining worker visas**.
- Some businesses are having to **provide basic 'work ready' skills** to new, young recruits before specific job-related training can start.

Cost of doing Business

- Energy costs** continue to be challenging, particularly for **large manufacturers that use energy intensive machinery**. Many are looking to invest in onsite **renewable energy generation** but obtaining funding can be difficult.
- Repaying **Covid loans** are adding to cost challenges facing some businesses.

Net Zero

- Many businesses that are replacing their car fleet are looking at zero emission vehicles

International

- High costs of international travel and accommodation** means that some exporters are being **selective about attending trade events**. The option of **online meetings with customers** is often preferred as it is more cost effective, both in terms of time and money.
- Additional costs for exporting live seafood** (e.g. requirements for vet certification and a certificate of origin as a third country exporting to the EU) have driven businesses that only export small amounts of product to stop exporting to the EU.

Workplace

- Some businesses that are opting for permanent home working for staff are **giving up their office space** and using rental meeting space as required.
- Businesses continue to highlight a **shortage or modern, affordable premises** across Scotland. The **high cost of new builds** mean that smaller businesses often cannot afford them.

Investment

- Businesses looking to increase efficiency and productivity are actively **investing in new equipment and machinery...**
- ...however, **economic uncertainty** means that others are **delaying investment** to preserve cash reserves.
- Some early-stage businesses are still finding it hard to secure **Angel and Venture Capital equity investment**. In the current economic climate, many investors are preferring less risky investment opportunities.

Economic Outlook

Global Forecast

The [OECD](#) is forecasting global economic growth will slow from 2.9% in 2023 to 2.7% in 2024 before rising to 3% in 2025. Growth has been stronger than expected in 2023 but is beginning to moderate due to higher interest rates, weak trade growth and lower business and consumer confidence. Projections remain below the historical annual growth of 3.4% between 2013 and 2019.

Emerging markets are generally expected to fare better than advanced economies. Europe's growth, though is forecast to lag North America and major Asian economies. Inflation, while easing, remains a concern.

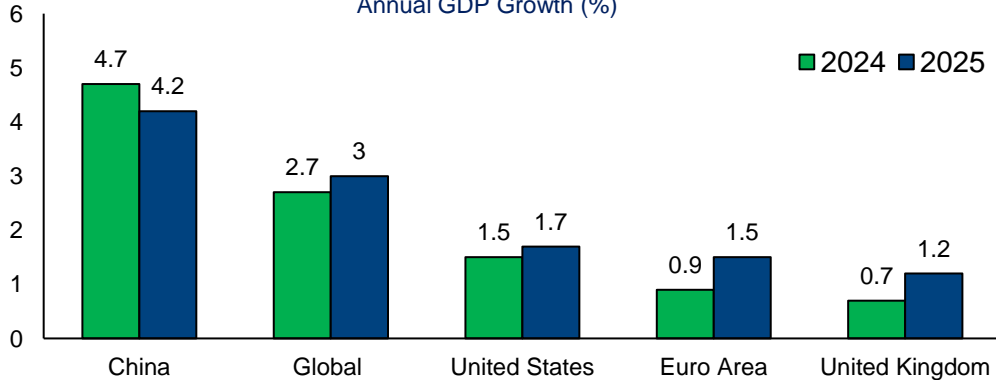
Growth in the UK is expected to pick up from 0.7% in 2024 to 1.2% in 2025 (still below the Euro and OECD averages) as monetary policy is expected to remain restrictive.

A number of downside risks to global growth are highlighted:

- geopolitical tensions, particularly if current conflicts broaden to other regions
- global trade uncertainties
- an upward drift in inflation expectations
- the impact of higher interest rates reducing consumer spending, a significant driver of growth, more than expected.

OECD GDP Growth Forecasts

Annual GDP Growth (%)



UK and Scottish Forecasts

The [OBR](#) are also forecasting the UK economy to gradually recover with growth of 0.6% in 2023, rising to 0.7% in 2024 and 1.4% in 2025. This is a downgrade to its March forecasts, but more optimistic than the [Bank of England's](#) expectations of 0% growth in 2024. The OBR expect unemployment to rise over 2024 before stabilising in 2025, while inflation is forecast to fall significantly 1.8% in 2025.

Risks and uncertainties to future economic performance include:

- High inflation- resulting in higher interest rates and reducing real incomes.
- Weak productivity- negatively impact growth via reduced incomes.
- Higher labour force inactivity - reducing earnings/taxes and increasing welfare spending.

Forecasts for Scotland are weaker. [Ernst & Young](#) is expecting economic growth of just 0.2% in 2023 rising marginally to 0.3% in 2024 then 1.3% in 2025 as inflation eases, real incomes rise, and interest rates begin to fall. This is below their projections for the rest of the UK. E&Y is also forecasting employment remaining broadly flat in 2024 before increasing in 2025 and 2026 as the pick-up in growth feeds through to jobs.

The [Fraser of Allander Institute](#) is also forecasting relatively weak growth of 0.2% in 2023, 0.7% in 2024 and 1.2% in 2025. High interest rates and economic uncertainty impacting business investment decisions are reasons for their subdued outlook.

Scottish Growth Forecasts

Annual GDP Growth (%)

