Scottish Economic Bulletin

Office of the Chief Economic Adviser

Dr Gary Gillespie
Chief Economist
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Scottish Government
Riaghaltas na h-Alba

Contents

Data up to: 6 March 2024
Contact: OCEABusiness@gov.scot

Cover page Image of peat sampling at Blawhorn Moss © Dougie Barnett NatureScot

Overview

The first estimates of GDP for Q4 2023 show that the Scottish economy contracted in the final quarter of the year by 0.6%, although unlike the UK as a whole, it avoided falling into a technical recession over the second half of the year after growth of 0.4% in the third quarter.

That said, the latest data rounds off a subdued year of growth in which the Scottish economy grew only 0.2% over the calendar year (UK: 0.1%) and overall growth has been relatively flat since the start of 2022. Furthermore, the slow down and contraction in the final quarter of the year was broad based across the services, production and construction sectors.

After this period of weakness, economic growth is forecast to strengthen this year, albeit moderately, and the slight improvement in business activity in January has provided an encouraging start given the falls in activity in the second half of 2023. Business concerns around inflationary pressures and weak demand have converged in recent months reflecting that the challenges facing businesses are evolving as inflationary pressures continue to ease and expectations for the year ahead continue to adjust. Businesses remain optimistic for growth over the coming year and continue to retain and add to staffing levels on aggregate, which is positive.

However, the ongoing disruption to commercial shipping in the Red Sea has started to impact on UK business conditions at the start of the year, particularly manufacturers, who are reporting facing longer delivery times and increased shipping costs. The scale and persistence of the overall impact remains uncertain at this stage and will depend on how circumstances evolve over the coming months and is a downside risk for the economy.

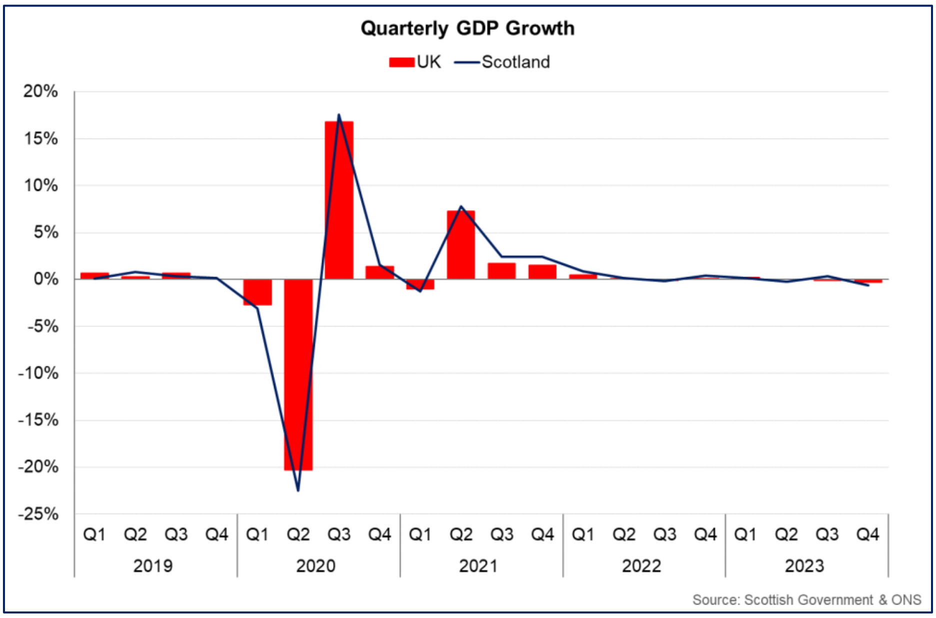
Inflation remained at 4% in January however is forecast to fall back to the 2% target over the course of the year providing scope for interest rate cuts and strengthening consumer demand and business investment. The improvement in consumer sentiment in January is encouraging in this regard, albeit that it remains negative on balance, reflecting that households continue to be impacted by cost of living challenges.

Furthermore, the resilience in the labour market also provides a strong basis for improved growth this year with the number of payrolled employees at their highest level since the series began in 2014. The claimant count unemployment level is at its lowest since 2019 with a rate of 3.5%. Annual earnings growth has been positive in real terms since April 2023 and although the pace of growth has eased, this has contributed to provide some positive relief to households in the face of cost of living challenges. The outlook for growth remains balanced with global economic conditions improving and opportunities for Scotland in terms of external investment remaining strong. However labour supply challenges - reflecting skills and more broadly higher levels of economic inactivity – means businesses need to invest and innovate to drive productivity.

Output

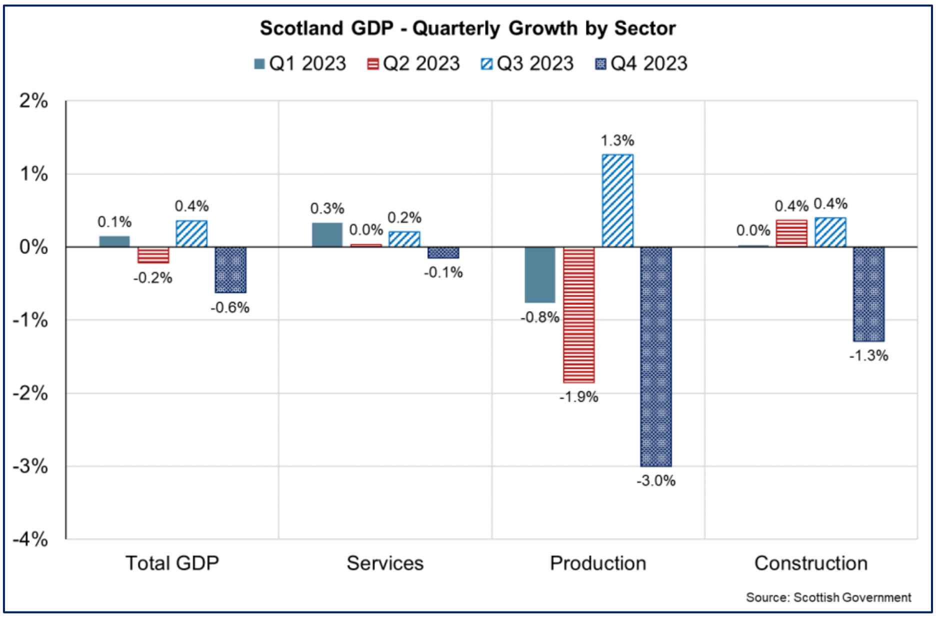
Scotland's GDP grew in December but contracted over the fourth quarter.

- Scotland's economic output grew 0.4% over the month of December 2023 however fell 0.6% over the fourth quarter as a whole. This follows 0.4% growth in Q3 and a fall of 0.2% in Q2, meaning that while Scotland's GDP fell in two of the last three quarters, it avoided entering a technical recession in the second half of 2023, unlike the UK as a whole where GDP fell for two consecutive quarters.[1]



- However economic growth over 2023 as a whole (compared to 2022) has been subdued across both Scotland (0.2%) and the UK (0.1%). Furthermore, the 0.6% fall in output in the fourth quarter was broad-based across the services (-0.1%), production (-3%) and construction (-1.3%) sectors and was the largest quarterly contraction since the start of 2021.
- In the services sector, the fall in output was marginal overall (-0.1%) with key drivers being falls in financial and insurance activities (-1.1%) and retail and wholesale (-1.6%). More broadly, growth in consumer facing services was flat over the fourth quarter and fell 0.2% over 2023 as a whole indicating that inflationary pressures are continuing to impact on economic activity in those industries.
- Within the production sector, the main driver of the 3% fall over the quarter was in the manufacturing sector in which output fell -3.7% over the quarter and 5.6% over the past year.

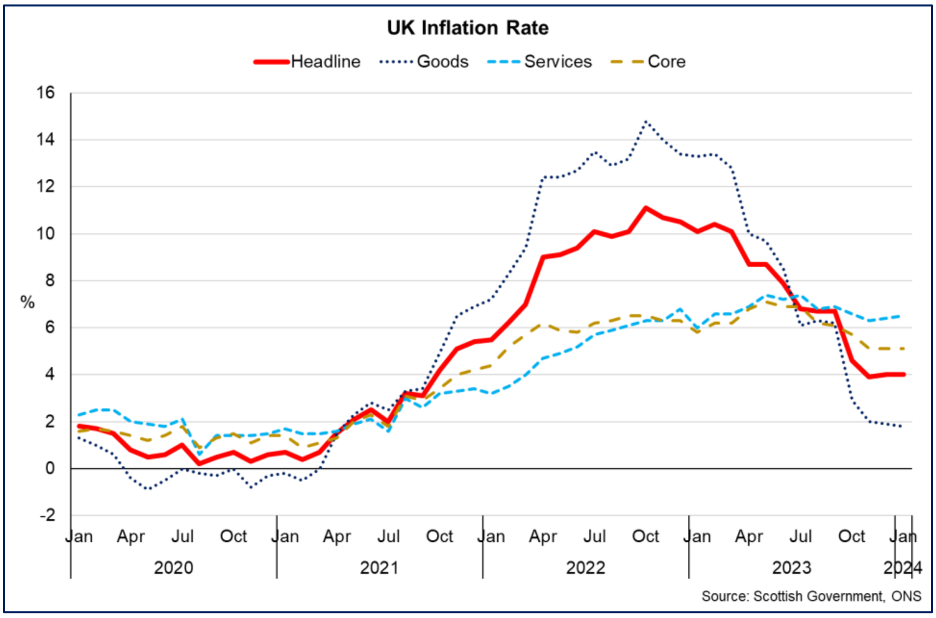
[1] Economy statistics - gov.scot (www.gov.scot) , GDP monthly estimate, UK Statistical bulletins - Office for National Statistics (ons.gov.uk)



Inflation

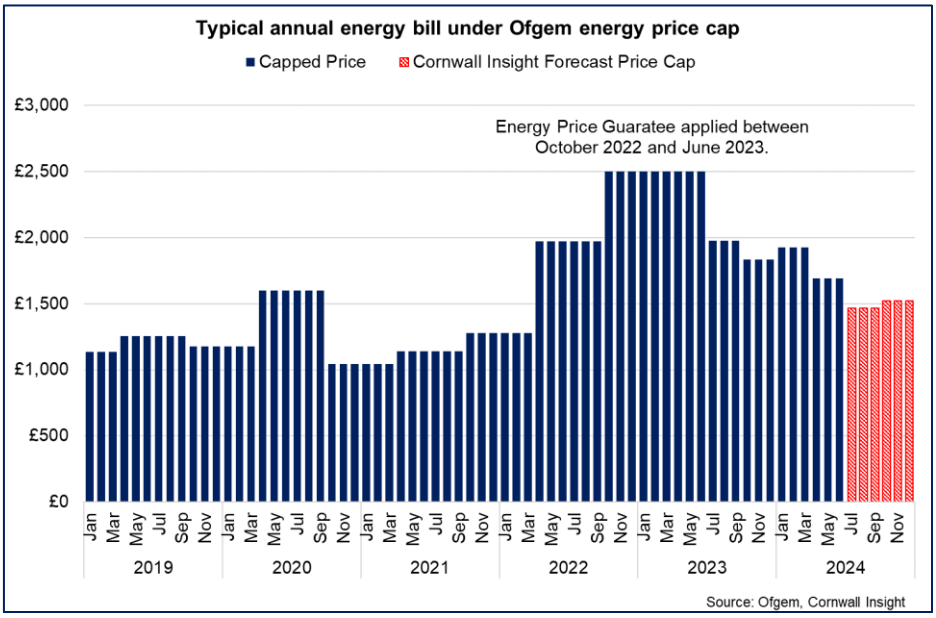
Inflation was unchanged in January at 4%, whilst core inflation also held steady.

- The inflation rate was unchanged in January at 4% as inflationary pressures continued to stabilise at the start of the year.[2]
- Key downward contributions to the inflation rate over the month came from furniture and household goods (0.4%, down from 2.5%) and food and non-alcoholic beverages (6.9%, down from 8%). In contrast, the largest upward contribution came from housing and household services, mainly higher gas and electricity charges, in which the annual inflation rate rose from -3.4% to -2.1%.



[2] [Consumer price inflation, UK - Office for National Statistics](#)

- Core inflation, which excludes energy, food, alcohol and tobacco, was unchanged in January at 5.1% and continues to reflect the current persistence of services prices inflation which rose slightly from 6.4% to 6.5% while goods prices inflation continued its downward trend from 1.9% to 1.8%.
- The recent upward contribution in gas and electricity price inflation partly reflects the 5.1% quarterly increase in the Ofgem Energy Price Cap in January. The capped price is 23% lower over the year compared to the Energy Price Guarantee in place during the same period in 2022, however remains 51% higher compared to two years ago in January 2022. The Energy Price Cap is scheduled to fall 12.3% in April and is forecast to fall a further 13.3% in July, supporting a fall in the headline inflation rate below 3% during 2024.[3,4]



Business Conditions

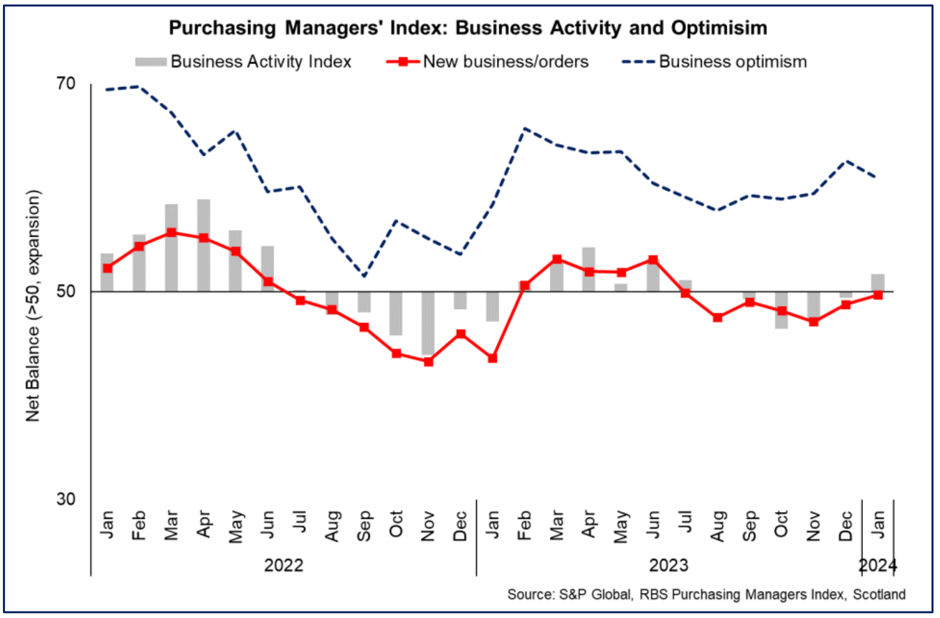
Business activity strengthened in January however some manufacturers are facing supply chain disruption.

Business Activity

- The Purchasing Managers Index (PMI) business survey indicates that business activity in Scotland's private sector increased in January for the first time in six months (51.7). This was largely driven by a pick-up in service sector activity while manufacturing sector activity continued to weaken.[5]

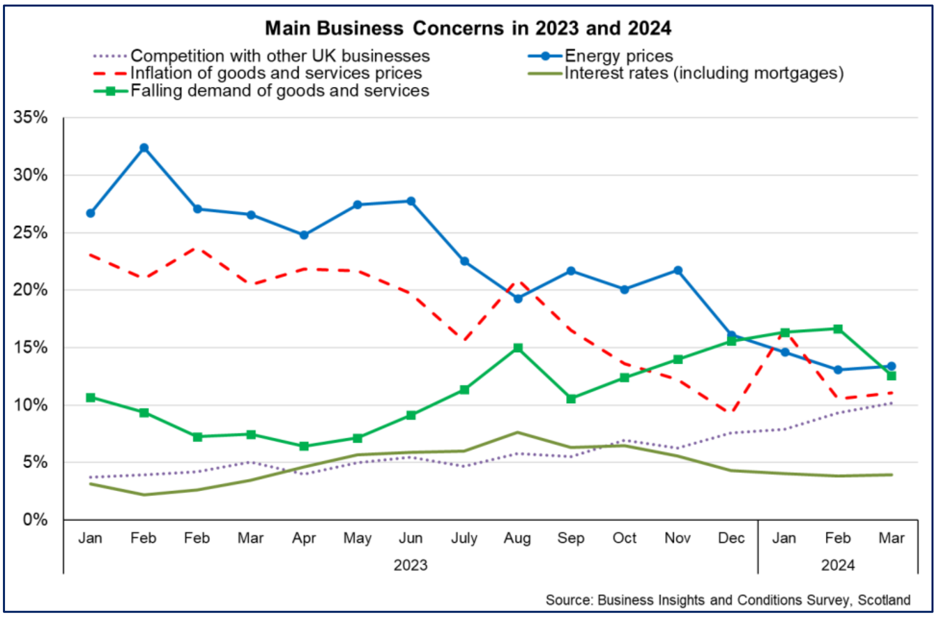
[3] Energy price cap | Ofgem
[4] Cornwall Insight's final forecast for the April price cap - Cornwall Insight (cornwall-insight.com)
[5] Royal Bank of Scotland PMI report for January 2024 | NatWest Business (rbs.co.uk) , 6237afe8e6fb4a248477d4bfe1537cd8 (spglobal.com)

- While overall business activity increased, new business orders continued to fall, albeit at a more marginal rate than in recent months and business optimism for the year ahead remained positive but softened slightly.



Business Concerns

- Business concerns have continued to evolve at the start of the year as trading conditions have remained challenging but with signs of improvement for the year ahead.
- The Business Insights and Conditions Survey (BICS) for March indicates that businesses concerns around energy prices (13.4%) and falling demand (12.6%) have largely converged as the two main business concerns at the start of the year. This is followed by inflation of goods and services (11%) and competition with other UK businesses (10.2%).[6]

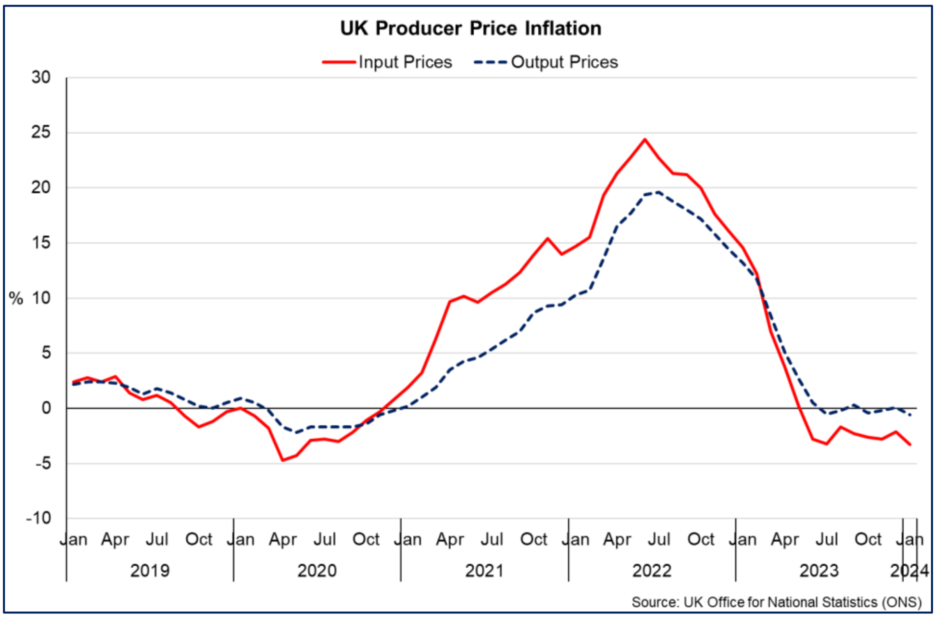


[6] Business and innovation statistics - gov.scot (www.gov.scot)

- Concerns regarding interest rates eased over the second half of 2023 and have stabilised at the start of 2024 likely reflecting increased expectations that interest rates have peaked and may start to fall over the coming year.

Business Costs

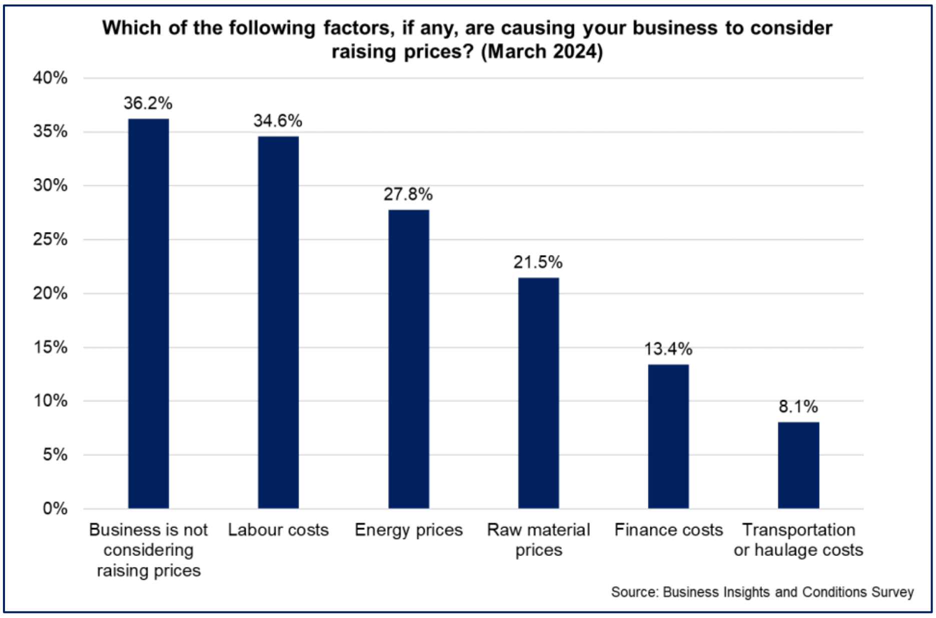
- At a headline level, producer input price inflation has continued to decline with producer input prices falling on an annual basis for an eighth consecutive month and by 3.3% in January. The change in input prices has also been reflected in fall in producer output prices which decreased 0.6% over the year to January. [7]



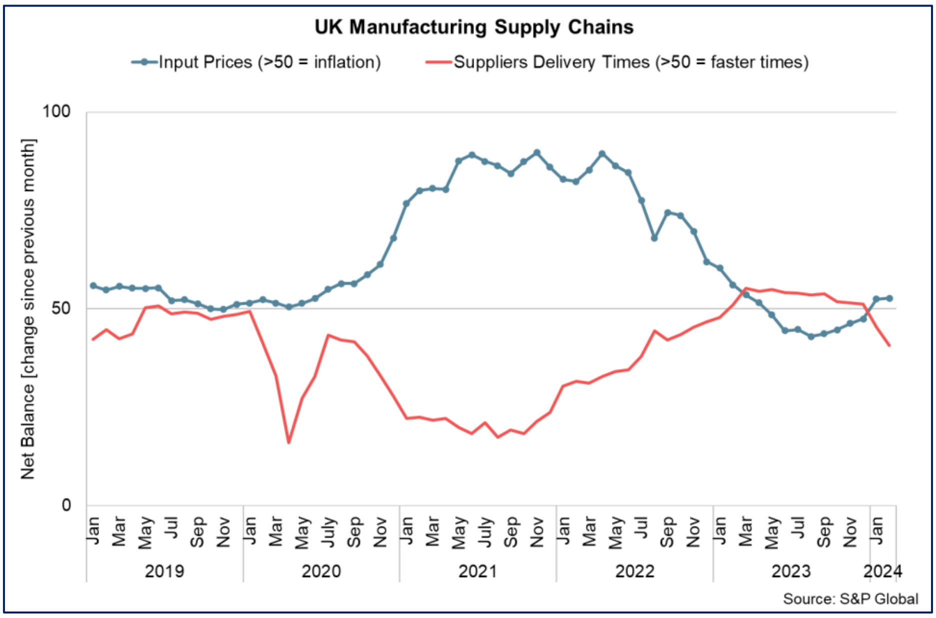
- Overall, input and output price levels have been relatively stable since June 2023, albeit they are significantly higher than at the start of 2021 (c. +25%) prior to the spike in inflation. The largest downward contributions to the annual input inflation rate for producers in January came from inputs of chemicals (-8.5%) and crude oil (-11.4%). Domestic food input prices have also continued to fall on an annual basis (-2.2%), however imported food input price inflation has remained more persistent (4.6%) alongside fuel inputs (3.3%).
- Looking at a broader range of input costs across the manufacturing and services sectors, PMI business survey data indicates pace of business input cost inflation has returned to around its lowest rates since the start of 2021. However, higher fuel, energy, supplier and salary costs contributed to an increase in input costs in January and at its fastest rate in five months.[8]
- BICS data for Scotland shows that many businesses (36.2%) are not considering raising prices in March. It also provides insights on which costs remain most challenging to absorb: labour

[7] Producer price inflation, UK Statistical bulletins - Office for National Statistics (ons.gov.uk). Prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased and factory gate prices.
[8] Royal Bank of Scotland PMI report for January 2024 | NatWest Business (rbs.co.uk) , 6237afe8e6fb4a248477d4bfe1537cd8 (spglobal.com)

costs (34.6%) is the main factor causing businesses to consider raising prices; followed by energy prices (27.8%); and raw material prices (21.5%).



- 8.1% of businesses reported that transportation or haulage costs are causing business to consider raising prices. This potentially reflects in part the increase in shipping and supply chain costs and delivery times that businesses are facing due to the attacks on commercial shipping in the Red Sea and the rerouting of shipping routes from Asia to Europe round the Cape of Good Hope rather than through the Suez Canal.
- In February, PMI business survey data show that the UK manufacturing supplier delivery time indicator weakened to its lowest rate since the middle of 2022 while the increase in input prices partly reflected the increase in transportation costs.[9]

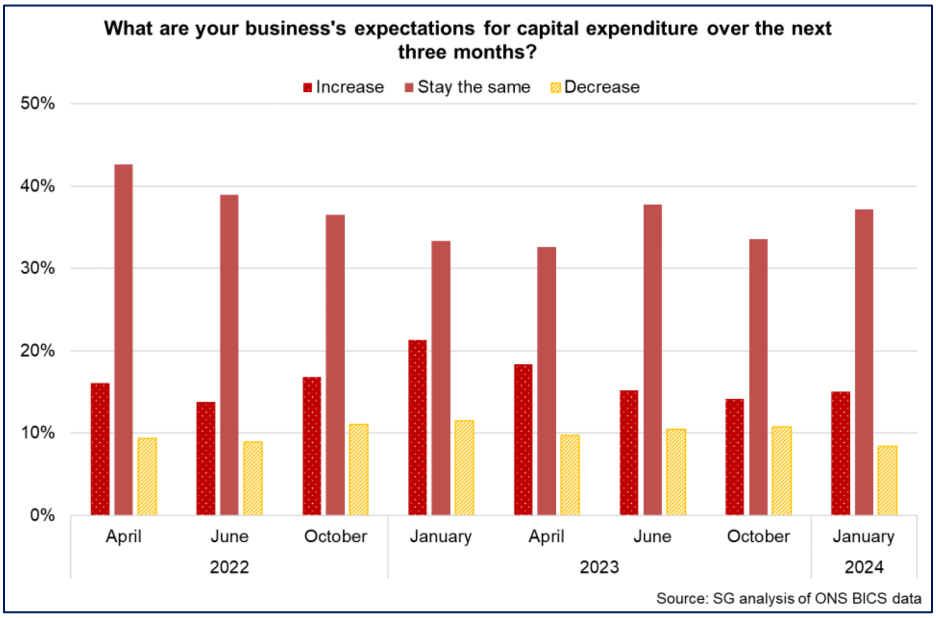


[9] https://www.pmi.spglobal.com/Public/Home/PressRelease/cfdb22421d2c48f597d3ae31114739c4

- There remains significant uncertainty over the persistence and impacts of the current supply chain disruption. BICS data for Scotland show that only 4% of businesses in January experienced global supply chain disruption, remaining below the average for the past year (7.5%).
- This indicates that businesses, particularly in manufacturing and retail, are reporting that they are being impacted by international supply chain disruption, however the scale of impact at this stage remains moderate and will ultimately depend on the persistence and scale of supply chain disruption over the coming year.

Business Investment

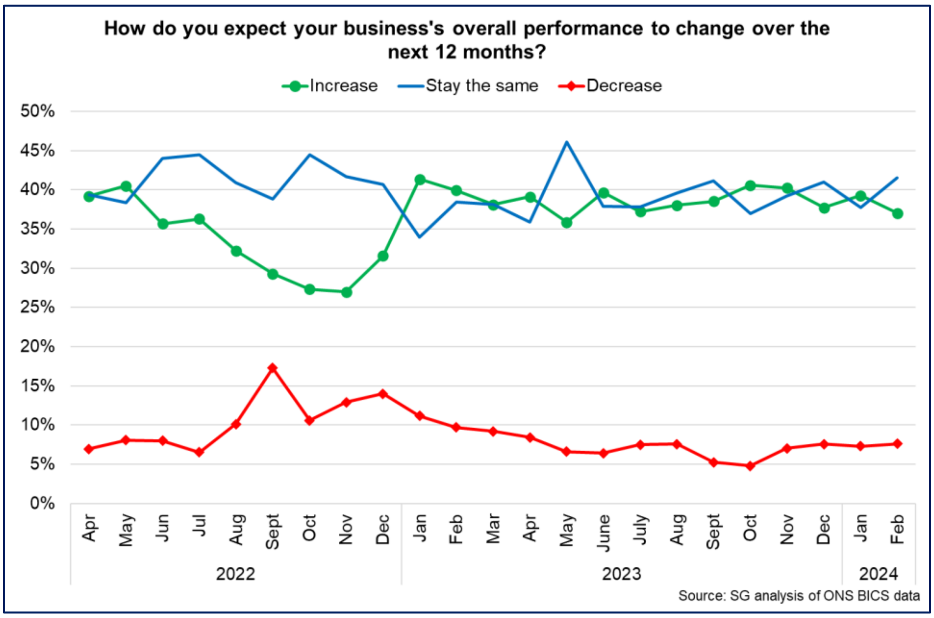
- The combination of business concerns around weakening demand, inflationary pressures and higher interest rates continues to weigh on business investment decision making.
- The SCC Quarterly Economic Indicator for Q4 2023 reported that while on balance firms continue to increase rather than reduce investment, over half of firms continued to report no changes to both total (55%) and training (54%) investment.[10]
- BICS data for Scotland in January show 15% of respondents thought their capital expenditure would increase over the next three months, lower than at the start of 2023, while 8.4% of respondents continue to expect to decrease capital expenditure over the coming year. Overall compared to the start of 2023, there has been an increasing share of businesses reporting that capital expenditure will stay the same.



[10] Quarterly Economic Indicator - Scottish ChambersScottish Chambers

Business Optimism

- Despite the current weakness in business activity, order books and investment intentions, PMI business survey data indicates that business optimism for the year ahead improved over the second half of 2023, rising to a seven-month high in December before easing back slightly in January. Optimism remains firmly positive on balance however, with firms in the services sector continuing to add to staffing levels in expectation of growth over the coming year.[11]
- BICS data for Scotland indicates that at the start of 2024, most businesses expect their overall business performance to stay the same (41.5%) or increase (37%) over the coming year. On aggregate, this has remained broadly stable compared to the start of 2023, while the share of businesses expecting their performance to decrease has fallen slightly over the year to 7.6%.



Labour Market

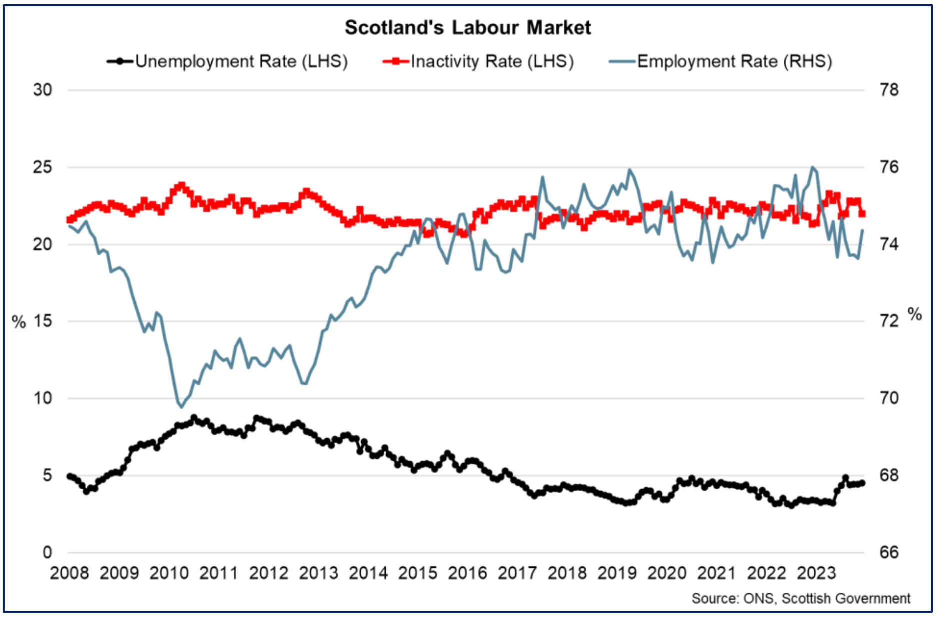
Payrolled employees continue to rise while the claimant count is at its lowest level since 2019.

Employment, Unemployment and Inactivity

- Labour market conditions have been tight since the start of 2022 and have been resilient in the face of subdued GDP growth and inflationary pressures. This has been characterised by low unemployment, strong demand for labour with elevated vacancy rates and some companies reporting staffing shortages.

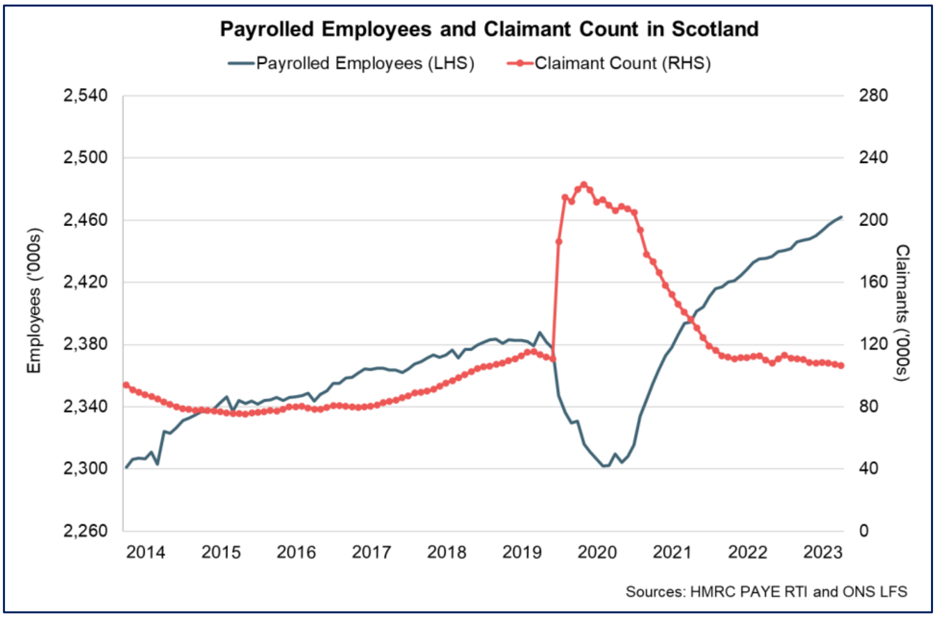
[11] Royal Bank of Scotland PMI report for January 2024 | NatWest Business (rbs.co.uk) , 6237afe8e6fb4a248477d4bfe1537cd8 (spglobal.com)

- Latest data for October to December show that Scotland's unemployment rate rose 0.1 percentage points over the quarter to 4.5%, while the employment rate rose by 0.6 percentage points to 74.4%, and inactivity rate fell by 0.8 percentage points to 22.0%.[12]
- Labour market conditions have softened slightly over the last year with the employment rate falling 1.6 percentage points while the unemployment rate has increased 1.1 percentage points, and the inactivity rate has risen 0.7 percentage points.



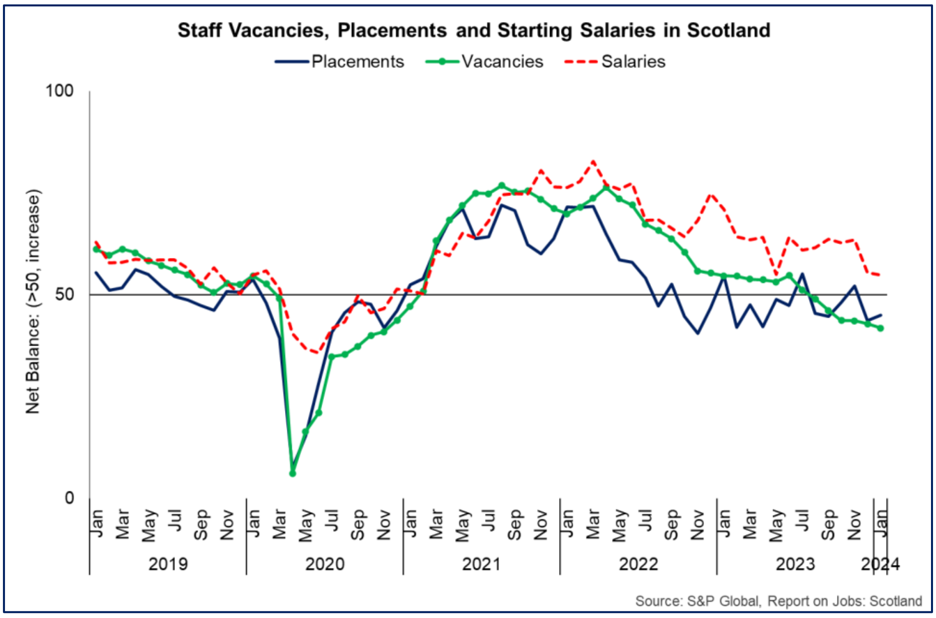
- However wider labour market data further emphasises the resilience in the labour market. The number of PAYE employees in Scotland continued its upward trend since the start of the 2023, rising 0.1% in January to 2.46 million, its highest level in the timeseries back to 2014.[13]
- Scotland's claimant count rate also remained stable in January at 3.5% with the number of claimants falling 0.9% over the month to 106,500, its lowest level since May 2019.[14]

[12] Labour market statistics - gov.scot (www.gov.scot)
[13] Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)
[14] Nomis - Official Census and Labour Market Statistics (nomisweb.co.uk)



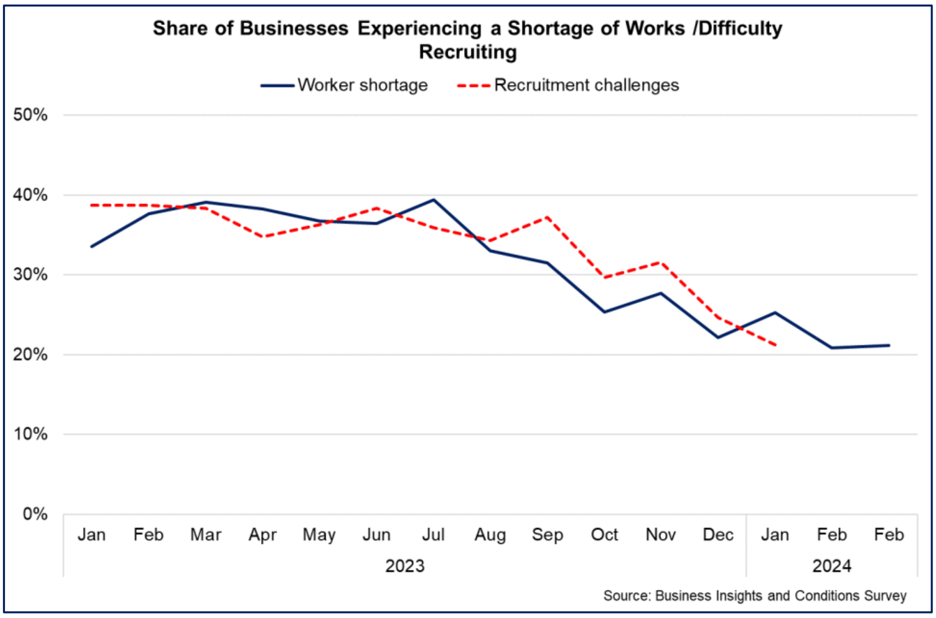
Recruitment Activity

- Business survey data also signals that the extent of tightness in the labour market has continued to cool in recent months. The RBS Report on Jobs indicated a further fall in permanent staff placements in January (45.0) while business demand for staff fell for a sixth consecutive month and at its quickest rate since the end of 2020 (41.9).[15]



- BICS data provides further insights on labour shortages and recruitment challenges which have been gradually easing over the past year as the labour market has loosened. In February, 21% of businesses reported experiencing a shortage of workers, down from the average rate of 34% at the start of 2023, while 21% of businesses reported experiencing difficulties recruiting in January, down from 39% at the start of 2023.

[15] S&P Global, RBS Report on Jobs: [Royal Bank of Scotland Report on Jobs – January 2024 (natwestgroup.com)](natwestgroup.com)

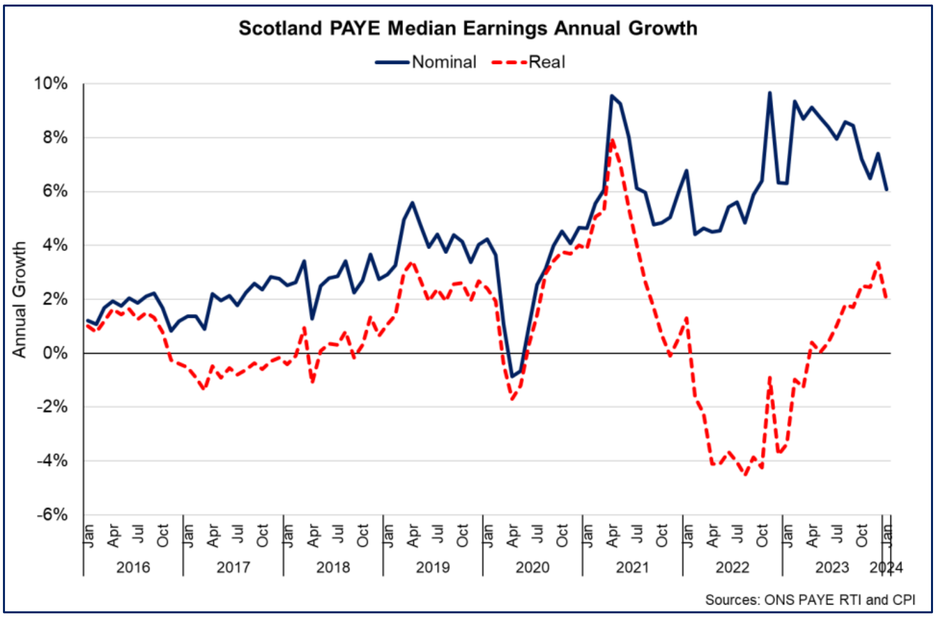


- At a sector level, worker shortages in February were most reported in construction (30%), professional, scientific and technical activities (29%) and the manufacturing sector (26%). 60% of businesses reported that worker shortages led to employees working increased hours, while 40% reported being unable to meet demands and 33% reported having to recruit temporary workers.
- Recruitment difficulties were most reported in construction (27%), manufacturing (25%) and accommodation and food services sectors (24%). Latest data from January show most businesses responded that a lack of qualified applicants (63.1%) alongside a low number of applications (49.1%) were reasons why they experienced difficulties in recruiting employees while 20.1% reported not being able to afford an attractive pay package for applicants.

Earnings

- Recruitment challenges, staffing shortages and inflationary pressures have generated upward pressure on earnings growth over the past year, however the pace of growth has been easing in recent months.
- The RBS Report on Jobs for January indicates that growth in starting salaries remained positive (net balance of 54.9), though the pace of growth has significantly softened to its lowest rate since February 2021.
- More broadly, nominal median monthly PAYE pay in Scotland was £2,359 in January, down 0.1% over the month and up 6.1% over the year. This remains above the average annual growth rate over the past eight years (4.2%), however has slowed from higher rates of growth of around 9% in 2023 and is its slowest annual rate of growth since September 2022.[16]

[16] Earnings and employment from Pay as You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)



- Adjusting for inflation, which was 4% in January, real median earnings grew 2% on an annual basis. This was the tenth consecutive month of positive annual growth following the period of falling real pay during 2022 and the start of 2023, reflecting the increase in nominal pay growth and easing in inflationary pressures.

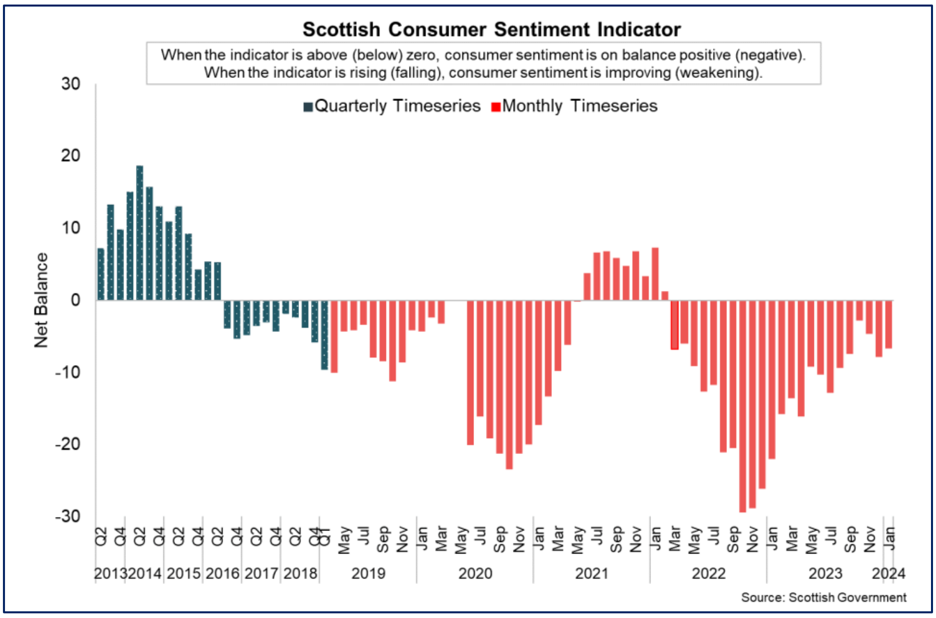
Consumer Activity

Consumer sentiment improved in January but remains negative overall.

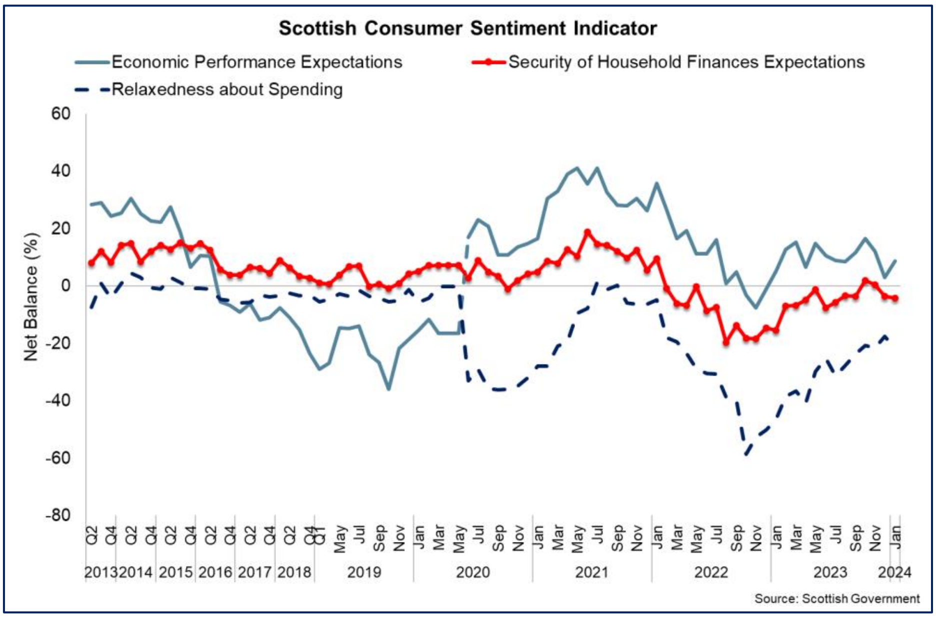
Consumer Sentiment

- The Scottish Consumer Sentiment Indicator reflects how households think the economy is performing, how secure they feel about their household finances and how relaxed they feel about spending money.
- Consumer sentiment fell sharply during 2022 to -29.4 as inflationary pressures increased and the economic outlook weakened. However sentiment strengthened significantly over 2023 as inflationary pressures reduced and latest data for January show sentiment increased by 1.2 points over the month and by 15.3 points over the year to -6.7.[17]

[17] Economy statistics - gov.scot (www.gov.scot)



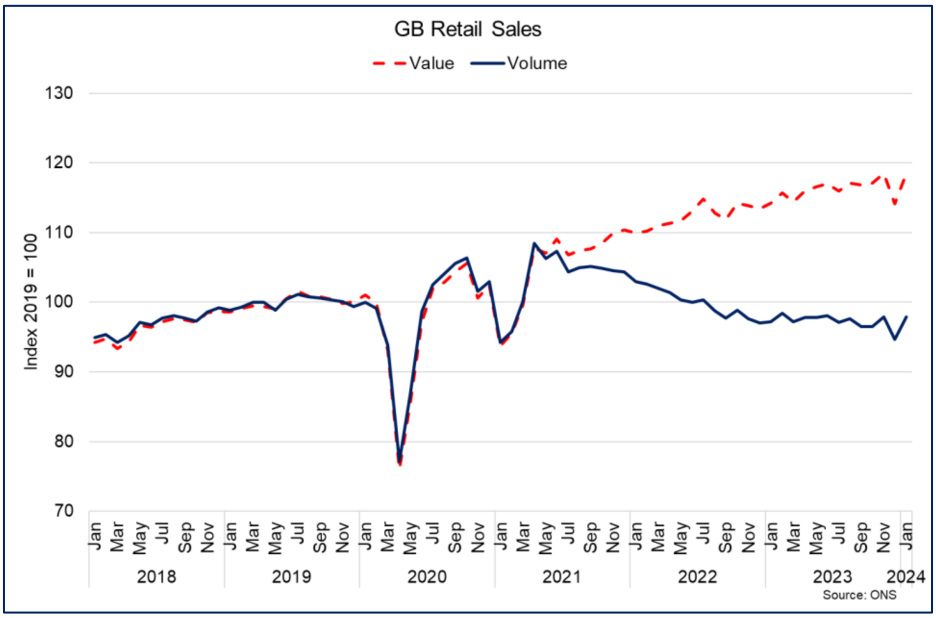
- While all the sentiment sub-indicators have strengthened over the past year, households continue to report on balance that the economy is performing less well than last year (-6.8) and their personal financial secuity is weaker (-9.4). Looking ahead to the coming year, households expect the economy to improve (8.8) however continue to expect their personal financial security to weaken (-4.2).
- This is reflected in the spend indicator which remains significantly negative (-21.6) and reflects that households are not currently relaxed about spending money.



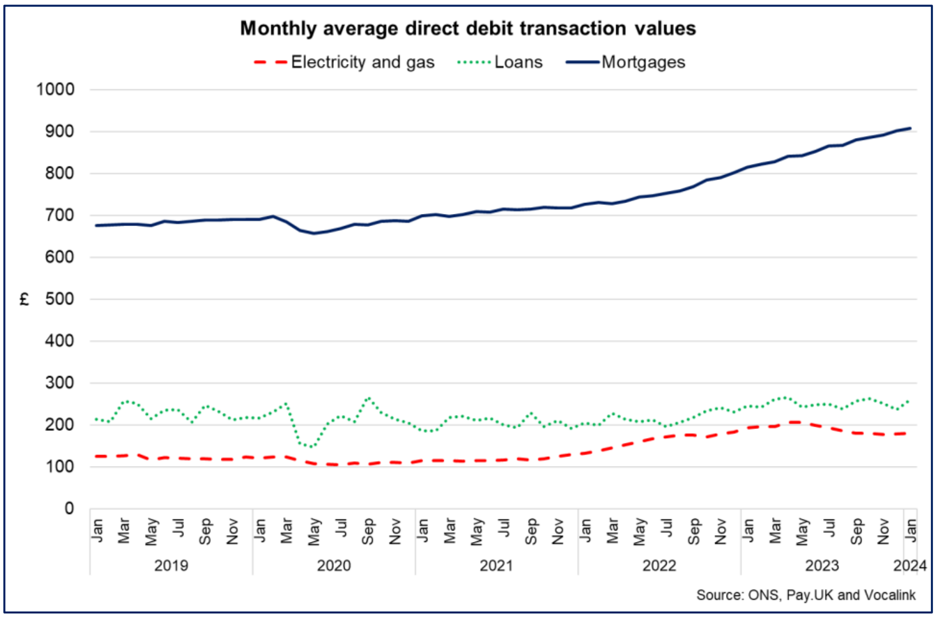
Cost of Living and Spending

- The rate of inflation has reduced significantly over the past year, however the sharp rise in cost of living and higher interest rates continues to impact household decisions on spending (essential and non-essential), saving, and borrowing (including financing outstanding borrowing).

- For example, retail sales volumes in Great Britain have settled below their 2019 level over the past year and rose 0.7% over the year to January while sales value grew 3.8% with the divergence reflecting the pace of rising prices.[18]

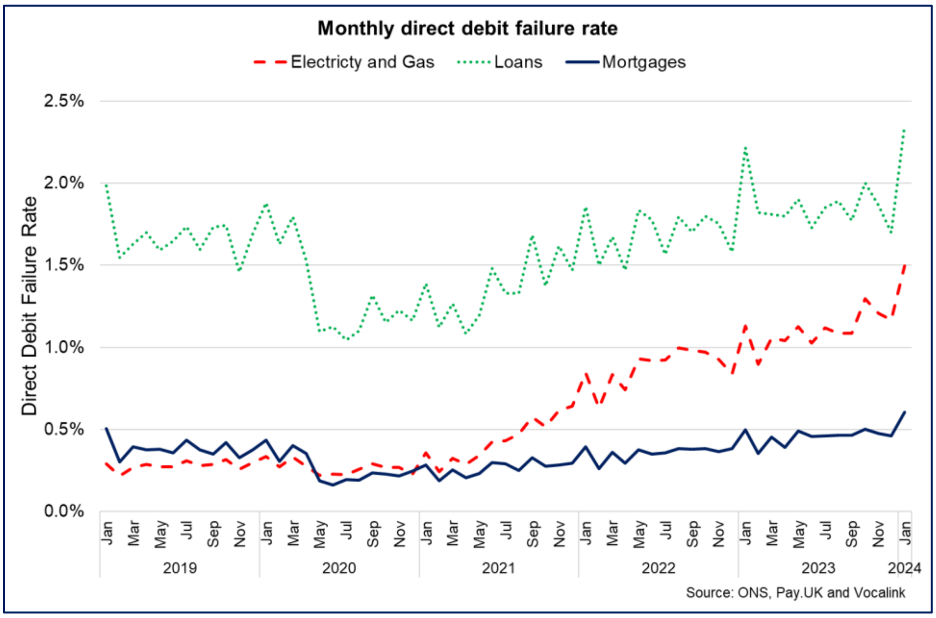


- Similarly the change in prices and interest rates have had a significant impact on the amount UK conumers are paying for their energy costs, mortgages and other loans. In January the average monthly direct debit payment for electricity and gas was £180.05, down 7.3% compared to January 2023 however was up 35.4% compared to January 2022. This in part reflects that the Energy Price Cap has fallen over the past year, however remains significantly higher compared to two years ago.[19]



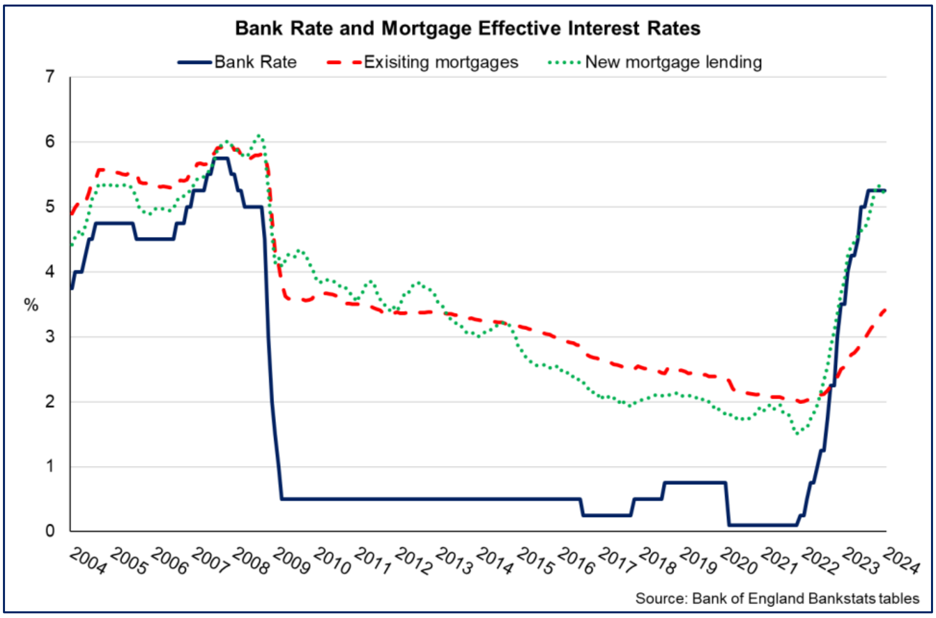
[18] Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)
[19] Monthly Direct Debit failure rate and average transaction amount - Office for National Statistics (ons.gov.uk)

- However, the average monthly direct debit payment for mortgages was £907.70 in January (up 11.3% over the year and 24.8% since the start of 2022) and £260.30 for loans (up 6.1% over the year and 27% since 2022). Ths in part reflects that higher interest rates are continuing to progressively feed through to higher borrowing costs.
- The sharp increase in prices has been accompanied by an increase in the direct debit failure rate (the percentage of transactions that fail due to insufficient funds), reflecting the challenges facing some household budgets. For electricity and gas payments, the payment failure rate has risen to 1.5% (up from 1.13% in January 2023), while for mortgages it has risen to 0.61% (up from 0.5% in January 2023).

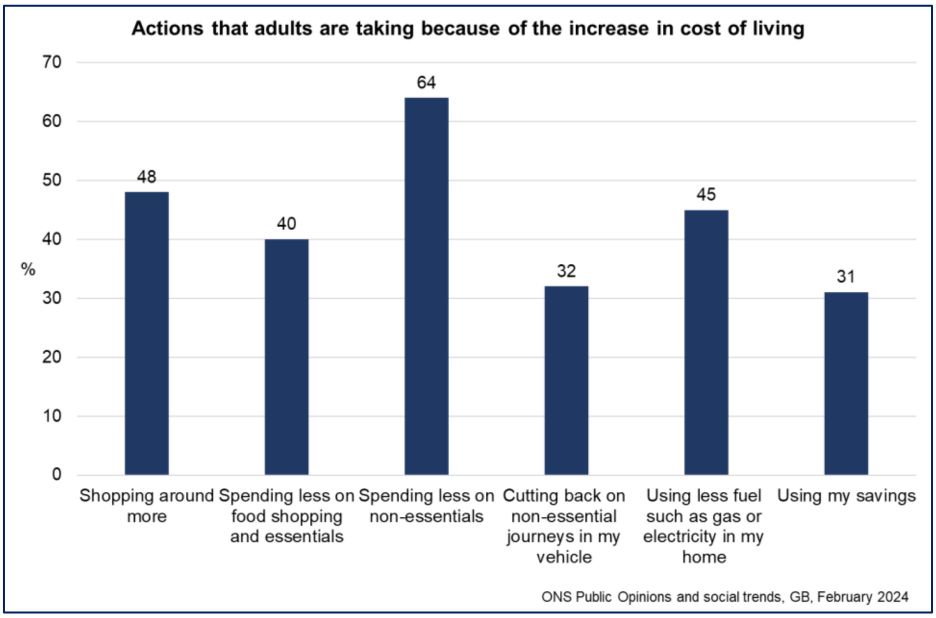


- More broadly in February, the ONS Public Opinions and Social Trends survey showed that 41% of respondents were finding it very or somewhat difficult affording energy bill payments and 39% for mortgage and rent payments. For energy bills, this was slightly lower than at the same point in 2023 (48%), however has risen for mortgages payments from 33%.[20]
- The more gradual impacts of higher interest rates on mortgage payment challenges compared to energy payments reflects the sharp rise in the Bank Rate between the end of 2021 and middle of 2023 and the time it takes for the full impact of the increases to be felt at an aggregate level due to the high share of mortgages that are on a fixed rate.
- Reflecting this, the 'effective' interest rate – the actual interest paid – on newly drawn mortgages remains elevated but fell for a second consecutive month in January to 5.19%, in part reflecting increased market expectations that interest rates may have peaked. Rates on the outstanding stock of mortgages however continued to rise to 3.41%.[21]

[20] Public opinions and social trends, Great Britain - Office for National Statistics
[21] Effective interest rates - A visual summary of our data | Bank of England



- In response to the change in cost pressures facing households, ONS Public Opinions and Social Trends survey data from February show that the most common actions people are taking in response to the increased cost of living were spending less on non-essentials (64%) and shopping around more (48%). 45% reported using less fuel such as gas or electricity in their home and 40% reported spending less on food shopping and essentials.

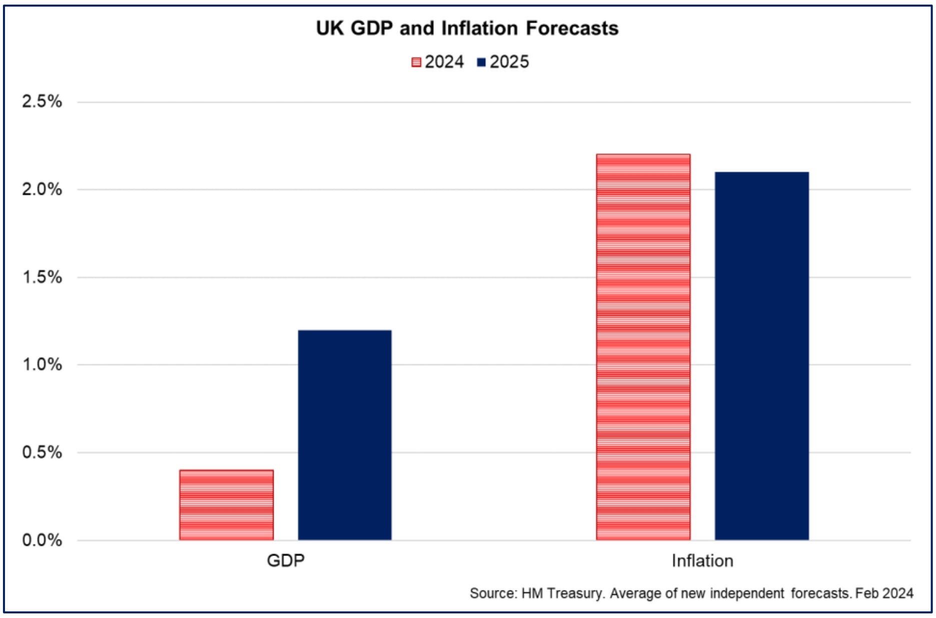


Economic Outlook

Economic conditions are forecast to improve with stronger growth and lower inflation.

- The outlook for economic growth in 2024 remains subdued however is expected to strengthen while inflationary pressures are forecast to moderate further.

- In December, the Scottish Fiscal Commission forecast Scottish economic growth to strengthen from 0.1% in 2023 to 0.7% in 2024, rising to 1.1% in 2025. Most recently in March, the OBR forecast the UK economy to grow 0.8% in 2024 rising to 1.9% in 2025.[22,23]
- In February, the Bank of England forecast inflation to fall from its current rate of 4% to temporarily meet the 2% target in Q2 2024, before rising to 2.7% in Q4 2024 and to 2.5% by the end of 2025. This reflects a further moderation in inflationary pressures although the persistence of above target inflation over the coming year.[24]



- The average of independent UK forecasts further illustrates the expectation of stronger growth and falling inflation with UK GDP growth forecast on average to rise to 0.4% in 2024 and 1.2% in 2025, while inflation is forecast to fall on average to 2.2% in Q4 2024 and 2.1% at the end of 2025.
- There remains significant uncertainty in the economic outlook however the resilience of business and consumer sentiment, low unemployment, real earnings growth and falling inflationary pressures provide an improved basis for the stronger growth forecast for 2024. However, supply chain disruption through the Red Sea has presented a downside risk into the new year with businesses increasingly reporting that they are being impacted by longer delivery times and increased shipping costs.

[22] Scottish Fiscal Commission – Scotland's official, independent economic and fiscal forecaster
[23] Home - Office for Budget Responsibility (obr.uk)
[24] Monetary Policy Report - February 2024 | Bank of England

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