

STATE OF THE NATION

SCDI's Economic Data Briefing

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INTEREST RATE **0.75%** Official Bank of England Rate

The Monetary Policy Committee of the Bank of England decided unanimously to maintain interest rates at 0.75%. The Committee noted that "Brexit uncertainties" had "intensified considerably", resulting in lower retail spending, subdued business investment, reduced growth expectations and a further depreciation in the value of Sterling.

The UK's economic outlook, and future interest rate decisions, will depend to a significant extent on the nature of the UK's departure from the EU. Barring a highly disruptive or disorderly Brexit, "an ongoing tightening of monetary policy over the forecast period, at a gradual pace and to a limited extent" is anticipated to bring down inflation further. The next meeting of the Monetary Policy Committee is scheduled for 7 February.

Source: Bank of England

INFLATION

UK Consumer Prices Index (CPI) Annual Rate	Nov	Oct	Sept	Aug	Jul
	2.3%	2.4%	2.4%	2.7%	2.5%

Inflation fell from 2.4% to 2.3% in November. Housing costs, domestic fuels such as electricity and gas and motor fuels such as petrol and diesel exerted a strong upward pressure on prices. However, with oil prices undergoing a marginal fall, inflation is likely to fall further in December and January towards the Bank of England's long-standing 2% target.

The effect of higher prices in November in these areas was offset, however, by downward pressure on the rate of inflation from smaller rises in the cost of recreational and cultural goods and activities. For the online and offline sales of Black Friday and Cyber Monday in late November, and in the highly competitive lead-in to Christmas and Hogmanay, many retailers slashed prices to encourage reluctant consumers to spend, albeit with mixed results.

In the event of a 'no-deal' Brexit, the Bank of England expects inflation to surge as high as 6.5%, forcing interest rates to rise in response.

Sources: British Retail Consortium, Office for National Statistics

ECONOMIC GROWTH

	SFC forecast	FAI forecast
2018	1.2%	1.4%
2019	1.0%	1.4%
2020	1.0%	1.5%
2021	1.0%	1.4%
2022	1.1%	
2023	1.2%	

The Scottish Fiscal Commission provides independent and official forecasts to inform the Scottish Government's Budget, including estimates of changes in GDP, productivity and earnings and of fiscal policy, social security expenditure and tax receipts. It released its third report to coincide with the Finance, Economy and Fair Work Secretary's Draft Budget 2019-20 statement to the Scottish Parliament in December.

The Commission expects that the divergence between the higher rate income tax thresholds between Scotland and the rest of the UK will lead to a minimal change in "taxpayer residence" and a consequent revenue reduction for the Scottish Government of £13m in 2019-20. The Commission also revised its growth forecasts marginally upwards after the **"strong performance" of the production sector and Scottish exports** fuelled by a weak pound. However, after growth of 1.4% in 2017, **growth will be "subdued in the longer term"** due to:

- low working-age population growth;
- volatile oil prices;
- low household income growth; and,
- the threat of Brexit to the Scottish economy.

The Fraser of Allander Institute, however, is significantly more optimistic than the Commission about Scotland's growth prospects, provided that the UK and the EU agree a "broad-based agreement" to facilitate a smooth, orderly transition to Brexit.

The House of Commons will vote on the UK-EU Withdrawal Agreement on 15 February. If MPs, as expected, reject the Prime Minister's Brexit deal, a 'no-deal' scenario when the UK leaves the EU on 29 March is possible. **The impact of a 'no-deal' Brexit on the Scottish economy would be disastrous. According to the Bank of England, 'no-deal' could precipitate a recession twice as severe as that which followed the financial crisis a decade ago.** UK GDP could fall by up to 8% in 2019.

The UK Government, the Scottish Government, the European Commission and the EU27 have intensified their preparations for a 'no-deal' outcome, which would mean that UK-EU trade would be conducted under the terms of the World Trade Organisation. Tariffs on exports to the EU would be expected at an average of around 3%. New non-tariff barriers such as additional customs checks, technical requirements and regulatory standards are likely to be more significant and highly disruptive, causing large delays of goods at ports and airports. A third of the UK's food supply is from EU countries.

Sources: Bank of England, Food and Drink Federation, Fraser of Allander Institute, Scottish Fiscal Commission, UK Parliament

BUSINESS ACTIVITY AND CONFIDENCE

RBS Seasonally-Adjusted Purchasing Managers' Index	Nov	Oct	Sept	Aug	Jul	Jun	May
	52.2	53.4	53.4	55.5	55.1	54.5	53.7

Growth in Scotland's private sector weakened in November but remained stronger than the PMI rate across the UK as whole. New order growth slowed, allowing firms to clear backlogs and ease the scale of recruitment. Higher labour costs, higher prices for raw materials and a weak pound have continued to squeeze margins and put pressure on profits. Business confidence improved slightly in November, but the outlook has likely worsened since then as Brexit-related uncertainty has not only failed to dissipate but has intensified.

For example, **the Federation of Small Businesses Scotland's quarterly confidence index hit its lowest ever recorded level in December**, falling from -13.2 in Q3 2018 to -32.6 in Q4. The FSB said that the data demonstrated that small businesses were "distressed" at the state of the Brexit process in Brussels and at Westminster. Intentions to invest decreased and difficulties with skills shortages increased. The UK-wide measure of small business confidence also deteriorated to -9.9, its lowest level since 2011.

Sources: Federation of Small Businesses Scotland, IHS Markit

CONSUMER ACTIVITY AND CONFIDENCE

SRC-KPMG Retail Sales Monitor	Nov 2018	Nov 2017
Total Sales Growth	-1.6%	-0.6%
Food Sales Growth	+2.8%	+4.2%
Non-Food Sales Growth	-5.0%	-4.4%

2018 was a challenging year for Scotland's retailers as, despite near record high levels of employment and a return to wage growth, Scottish consumer spending remained weak. **Scottish retail sales dropped to their lowest-level in 21 months in November**, according to data from the Scottish Retail Consortium-KPMG Retail Sales Monitor. Total sales fell by 1.6% in November 2018 compared to the previous year, when sales also dropped. Food sales grew strongly, but non-food sales continued to decline steeply.

Scotland lost 1.5% of all its shops in the first half of 2018, bringing the average shop vacancy rate in our town centres to 11%. Finance Secretary Derek Mackay MSP announced a new £50m fund to revitalise town centres in his draft Budget.

20 Scottish companies are predicted to go bust every week in 2019. A total of 2,692 shops shut across the UK in the first six months of 2018, with 1,569 new stores opening.

Several British brands with a significant presence on the High Street and a sizeable employee footprint across the country collapsed, including Maplin, HMV and Toys R Us. Debenhams, Mothercare, Laura Ashley, Carpetright, Prezzo and others announced large-scale store closures and job losses.

Sources: French Duncan, PwC, Scottish Retail Consortium

EMPLOYMENT

	Aug – Oct	May – Jul	Feb – Apr	Nov 17 – Jan 18
Economically Active	77.9%	78.3%	78.6%	78.1%
In Employment	75.0%	75.1%	75.2%	74.8%
Unemployed	3.7%	4.1%	4.3%	4.3%
Economically Inactive	22.1%	21.7%	21.4%	21.9%

Employment in Scotland remains high by historic standards and above the UK average, with over 2.6 million people in work. Scotland is also outperforming the UK on female employment (71.3%) and youth employment (58.8%).

Unemployment in Scotland fell to 3.7% in October, the lowest level ever recorded. 13,000 fewer Scots are jobless compared to the previous quarter, a drop of 0.4%. However, economic inactivity has continued to rise slightly, suggesting that some of the long-term unemployed are leaving the labour market.

As a result of low unemployment and chronically low growth in Scotland's working-age population, **the supply of labour is increasingly constrained for employers.** Skills shortages cost UK businesses an estimated £6.3bn every year. However, this is likely to be good news for employees' bargaining power – the Scottish Fiscal Commission expects nominal earnings growth to rise from 2% to 2.3% in 2019 and real earnings growth to return to positive territory.

Scotland's economy needs more working-age adults to drive GDP growth amid largely stagnant levels of productivity growth, and to support the ever-rising expenditure on the NHS and social security required by an ageing population. On average, EU migrants living in Scotland are more likely to be young, skilled and economically active. There are over 460,000 EU nationals living in Scotland, including 74,000 from Poland, 24,000 from Ireland and 23,000 from Germany. EU nationals make up approximately half of the total non-UK resident population. Ensuring Scotland remains an open, inclusive economy will be a key challenge in the context of Brexit. **All of Scotland's future population growth is forecast to come from immigration**, which the UK Government proposes to greatly restrict after Brexit as per its White Paper published in December.

Sources: Office for National Statistics, Scottish Fiscal Commission, Scottish Government, The Open University, UK Government

This briefing presents and analyses the most authoritative and up-to-date statistics about the Scottish economy to give an at-a-glance view of the **State of the Nation**. It is produced to inspire and inform an evidence-based conversation about how we grow all sectors and all geographies of the Scottish economy.

To discuss this briefing, or for further views on the data, contact SCDI's Director of Policy & Public Affairs, Matt Lancashire: matt.lancashire@scdi.org.uk.