

STATE OF THE NATION

SCDI's Economic Data Briefing

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

The next meeting of the Monetary Policy Committee will take place on 1 August. **The interest rate is expected to remain unchanged at 0.75%** for the time being.

In the event of a 'no-deal' Brexit on 31 October, which has grown in likelihood in recent weeks, a substantial reduction is inevitable in an effort to boost demand during a large-scale macroeconomic shock.

Source: Bank of England

INFLATION

UK Consumer Prices Index (CPI) Annual Rate	Jun	May	Apr	Mar	Feb
	2.0%	2.0%	2.1%	1.9%	1.9%

Inflation remained steady at 2% in June, hitting the Bank of England's target for the second consecutive month. Rising food and alcohol prices were offset by falling vehicle fuel costs.

A disorderly Brexit, however, is likely to fuel a significant rise in food prices and exert downward pressure on living standards. The UK's largest supermarket, Tesco, increased the price of more than 1,000 products by an average of 11% in July. The **diminishing value of Sterling continues to increase the costs of imports from the EU.** Sterling fell to a two-year low against the Euro and the US Dollar on 29 July amid intensifying fears of a 'no-deal' Brexit.

Sources: Office for National Statistics, Which?

PRODUCTIVITY

Recent analysis by Sheffield Hallam University illustrates the scale of divergence in productivity performance across the UK's nations and regions. **London has recently lost top spot to Eastern Scotland, a region centred on Edinburgh** and its financial services industry, **which is now the most productive area of the UK.** North Eastern Scotland, including the energy capital of Aberdeen, also performs strongly. The Highlands and Islands and West Central Scotland sit marginally above and below the UK average

respectively. **However, Southern Scotland is the least productive region of the UK by a substantial distance.**

The holistic picture for UK-wide productivity has shown little sign of improvement in recent months. In Q1 2019, labour productivity decreased by 0.2% compared with Q1 2018. This is the third consecutive quarter of decline.

Sources: Office for National Statistics, Sheffield Hallam University

ECONOMIC GROWTH

GDP Growth	Scotland
Q1 2019	+0.5%
Agriculture, forestry & fishing	+0.9%
Services	+0.1%
Production	+1.8%
Construction	+2.0%

The Scottish economy remains in a cycle of chronically low growth, with Brexit uncertainty overshadowing this stagnation and leading to subdued levels of business investment and consumer activity.

The increasing likelihood of a disorderly Brexit will be of significant concern to businesses and organisations in all sectors and all geographies of the Scottish economy. **A 'no-deal' Brexit is anticipated to precipitate a severe recession across the UK,** although estimates vary.

The Bank of England has forecast negative GDP growth of up to 8%, twice the size of the Great Recession of a decade ago. The International Monetary Fund has predicted a contraction of 2% in 2020. The Office for Budget Responsibility agrees – it expects that this would pushing UK Government borrowing up to almost £60bn from £29.3bn to plug a shortfall in revenue.

However, **the National Institute of Economic and Social Research believes that there was a one in four chance that the UK has already fallen into recession** as a result of Brexit-related uncertainty. Over the long-term, it expects UK GDP growth to be damaged by 5% annually.

There are further signs of growth slowing against expectations. For example, Scottish Government devolved income tax revenue increased by 1.8% in 2017/18 but was still £941m below original forecasts. This shortfall – together with the new fiscal framework by which the Scottish Government's future spending power will be closely related to the performance of Scottish GDP growth relative to that of the UK – presents a significant risk to the Scottish Exchequer.

Sources: Bank of England, HMRC, International Monetary Fund, National Institute of Economic and Social Research, Office for Budget Responsibility, Scottish Government

BUSINESS ACTIVITY AND CONFIDENCE

RBS Seasonally-Adjusted Purchasing Managers' Index	Jun	May	Apr	Mar	Feb	Jan	Dec
	51.3	48.9	51.0	49.6	49.4	49.2	49.3

The **Scottish private sector returned to growth in June, for only the second time in 2019**, according to the RBS PMI. Weakness in Manufacturing continued, with Services driving the upturn. Scotland was among the best performing nations or regions of the UK in June, with the UK as a whole experiencing contraction.

However, greater inflows of new business and the easing of price inflation were balanced with the slowing of new job creation and historically weak business confidence. In the face of Brexit, Scottish small business confidence remained below the UK average for the sixth month in a row.

Many businesses remain cautious, postponing or cancelling planned investment or expansion due to high levels of uncertainty about the final Brexit outcome and its impact on, for example, access to markets, access to talent or consumer activity and confidence.

Sources: FSB Scotland, IHS Markit, RBS

CONSUMER ACTIVITY AND CONFIDENCE

SRC-KPMG Retail Sales Monitor	Jun	May	Apr
Total Sales Growth	-2.3%	-3.1%	+4.4%
Food Sales Growth	+0.8%	+0.5%	+8.6%
Non-Food Sales Growth	-4.8%	-6.1%	+0.8%

June proved to be another challenging month for Scottish retailers. There was some positive news with food sales growth of 0.8%, but non-food sales were 4.8% lower than the same period last year. **Consumers' willingness to buy non-essential items in a period of prolonged political and economic instability remains low.**

Research by the Resolution Foundation suggests that **the Brexit process has already contributed to a bigger fall in living standards than the recession of the early 1990s** due to deteriorating household spending power since the referendum result in June 2016. The combination of the steep decline in the value of the pound and the continued long-term stagnation of wages has led to weak consumer activity.

Despite the ongoing paradigm shift from High Street shopping to online shopping, recent research suggests that consumers are still more likely to have greater trust in the in-store retail experience. UK consumers are more likely to feel that they receive better consumer rights protection when buying on the High Street (29%) against buying online (11%).

Sources: KPMG, Retail Economics, Resolution Foundation, Scottish Retail Consortium

EMPLOYMENT

	Mar 19- May 19	Feb 19- Apr 19	Jan 19- Mar 19	Dec 18- Feb 19
Economically Active	78.4%	78.5%	78.0%	78.2%
In Employment	75.8%	75.9%	75.4%	75.6%
Unemployed	3.3%	3.3%	3.2%	3.3%
Economically Inactive	21.6%	21.5%	22.0%	21.8%

Unemployment in Scotland (3.3%) remains near record lows and continues to outperform the UK average (3.8%), as it has consistently over the course of the past year.

Nonetheless, the historically tight labour market is creating significant challenges for employers as they increasingly struggle to identify, secure and develop the right people with the right skills. The Open University in Scotland's Business Barometer found that **skills shortages will cost Scottish businesses more than £360 million this year alone.**

In response, employers are paying out an average of £17,028 on a combination of temporary staff, recruitment fees and increased salaries. Scotland's shrinking working-age population as a result of our demography and the impact of Brexit on inward and outward migration is expected to exacerbate the situation. 64% of Scottish businesses believe that Brexit specifically will worsen skills shortages. Moreover, **the Bank of England estimates that unemployment would rise to 7.5% in the event of a 'no-deal' Brexit.**

The UK Government's current proposals for the UK's immigration system after Brexit have caused serious concern. The proposed salary threshold of £30,000 for all workers, including EU nations, could have a serious impact on Scottish employers and employees. The median wage in Scotland is circa £23,000. The result of such a policy would be a denial of access for some highly skilled talent and many much-needed occupations, including teachers, nurses, agricultural labour and early-stage academics. SCDI supports an open, inclusive and globally connected economy underpinned by inward migration and inward investment.

Sources: The Department for Business, Energy and Industrial Strategy, Office for National Statistics, Open University in Scotland

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 Policy Manager, David Kelly: david.kelly@scdi.org.uk.