

Monthly Economic Brief

Office of the Chief Economic Adviser

June 2020

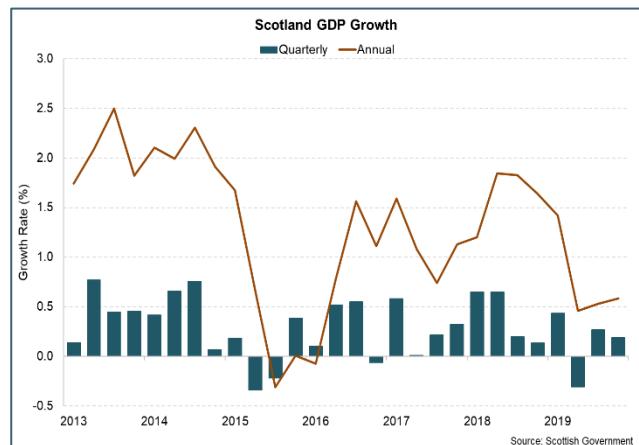
Overview

- This Monthly Economic Brief provides a summary of latest economic data for Scotland. It shows the scale of the economic crisis that has been unfolding since the coronavirus outbreak and the unprecedented impact on business and consumer activity during the past 10 weeks of lockdown.
- The impact on the economy and the labour market has been rapid and severe. Latest business surveys have shown record falls in business activity in April, reflecting that an estimated 19% of businesses have been temporarily closed in Scotland. We also estimate that these closures (and wider knock on effects) have impacted over 750,000 jobs in Scotland between those furloughed and the self-employed that are unable to work.
- The latest official labour market data for Scotland still broadly reflects the pre-COVID-19 position with the unemployment rate (albeit rising) at 4.1% in the first quarter. We know from the sharp rise in the claimant count for Scotland in April, which was up nearly 70 per cent on the month, that the unemployment rate will be closer now to 7 per cent.
- This rise in the claimant count is significant (around 75,000 higher than in March) and will impact young workers and those in the affected sectors. The unemployment level and rate will also be affected by the unwinding of policy support (particularly the Job Retention Scheme) and the extent to which sectors are able to come back to previous levels of activity.
- Our updated economic modelling suggests a longer recovery phase is increasingly likely given the loss of productive capacity and the change in market conditions for many sectors of the economy.
- While lockdown measures in Scotland have continued throughout May, the latest business turnover data for April which is published today, highlights significant falls in turnover which is likely to reflect the low point for output in the economy during the lockdown period. The gradual phased reopening of previously closed parts of the economy has seen some activity pick up since then.
- The continuation of support for business to restart safely and retain employment will be critical through the recovery phase to ensure the scarring effects of this economic crisis are kept to a minimum.
- In that regard, public and private partnerships will play a key role – both in ensuring a sustainable recovery that continues to support the efforts to minimise ongoing coronavirus risks, but also to adapt to new ways of working and enable a step change in activity in many areas, such as the transition to net zero.
- Finally, the pace and scale of the contraction in economic activity in Scotland reflects both the measures required to deal with the public health crisis and the global impact of the pandemic. The policy response has been unprecedented with over 10 million workers supported directly by the State across the UK, which has resulted in record borrowing levels to finance this support. The pace of unwinding this support and dealing with the debt overhangs will be crucial in influencing the path of the recovery.
- As our modelling shows, the Job Retention Scheme is playing a key role in reducing unemployment. Phasing the withdrawal of this support to match the recovery, alongside wider support, is crucial in ensuring we minimise unemployment and protect and support firms whilst the economy transitions and markets and business places change to the new norms which are emerging.

Output¹

Scotland's economic activity has been significantly impacted by the coronavirus pandemic and the introduction of lockdown measures both domestically and internationally. Latest GDP estimates for Scotland are for Q4 2019 and so are prior to the outbreak of the pandemic. GDP for Q1 2020, and monthly GDP for April, will be published on 17 June. First estimates of UK GDP for Q1 2020 provide insight into the impacts on UK output as the coronavirus spread across continents and UK physical distancing guidance and lockdown measures introduced in March.

- **Scottish GDP** (second estimate) grew by 0.2% in Q4 2019, down from 0.3% in Q3 2019.
- **UK GDP** (first estimate) contracted by 2.0% in Q1 2020, its largest contraction since 2008.
- The fall in UK GDP in Q1 was driven by a 5.8% contraction in March with broad based falls in output across Services (-6.2%), Production (-4.2%) and Construction (-5.9%) sectors.



Quarterly GDP Growth (%)	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020
Scotland	0.4	-0.3	0.3	0.2	-
UK	0.7	-0.2	0.5	0.0	-2.0

The coronavirus pandemic has resulted in a global economic crisis with significant impacts on the GDP of Scotland's key trading partners.

- **Euro Area GDP** contracted by 3.8% in Q1 2020 (-3.2% annually), its sharpest contraction since the series started in 1995.
- **US GDP** contracted by 1.2% in Q1 2020, its sharpest contraction since the financial crisis.



¹ Sources in this section include: Scottish Government, Office for National Statistics, Eurostat, US Bureau of Economic Analysis.

Medium Term Outlook

Since the economic update in the State of the Economy in April, the Scottish Government's route map through and out of the coronavirus crisis has been published providing an indication of the order in which current restrictions will be carefully and gradually lifted.

As the economy restarts, not all sectors will come back immediately as external demand, consumer tastes, and business models will have changed.

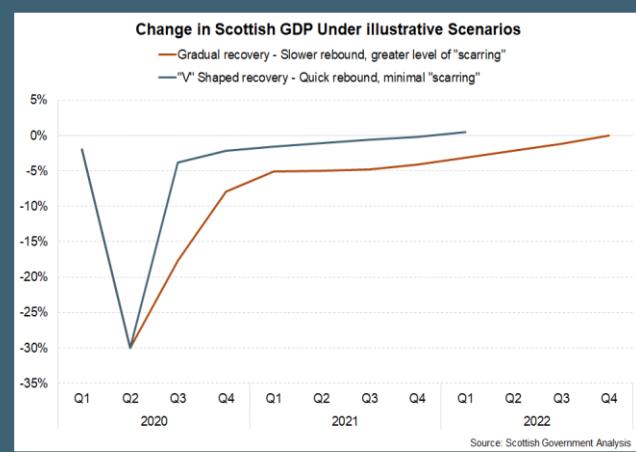
Although some of these changes may be temporary or could begin to reverse over time, it seems increasingly likely that there could be some permanent structural changes to the economy, which may reduce productive capacity in the economy in the short term and our updated analysis explores this.

Updated Modelling

The modelling presents two illustrative scenarios for the economy, not forecasts or predictions, but scenarios that reflect key policy variables and potential recovery paths for the economy.

In the first scenario, "V-shaped Recovery", there is a swift recovery across all sectors, with minimal loss of productive capacity or scarring on the economy. In the second scenario, "Gradual Recovery", a greater degree of scarring is assumed and sectors recover at different speeds as restrictions are gradually lifted.

Despite both scenarios having the same profile up



to 2020 Q2, the medium term pathway looks very different. In the 'Gradual Recovery' scenario, the slower rebound in demand causes the short-term downturn to be more protracted, and more importantly the greater degree of scarring means economic output does not recover to pre-crisis levels until the start of 2023.

Labour Market Uncertainty

Furlough Schemes and Official Labour Market Data

As of 31 May there are 8.7 million furloughed jobs in the UK,² representing around a quarter of the labour force. It remains uncertain how many furloughed workers may eventually become unemployed as the scheme unwinds.

² Source: HMRC.

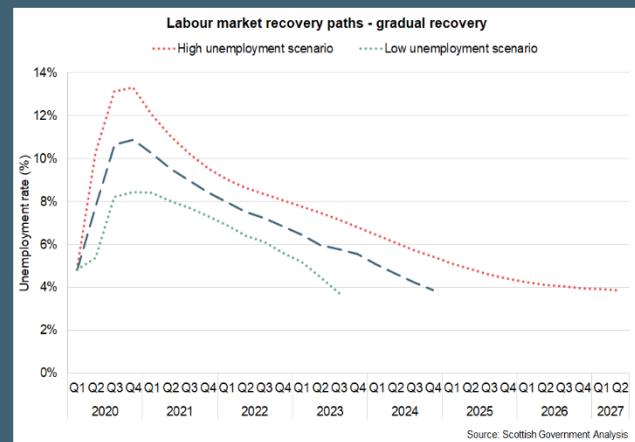
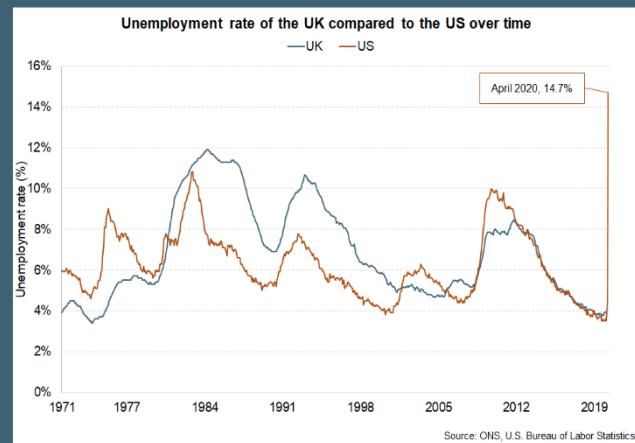
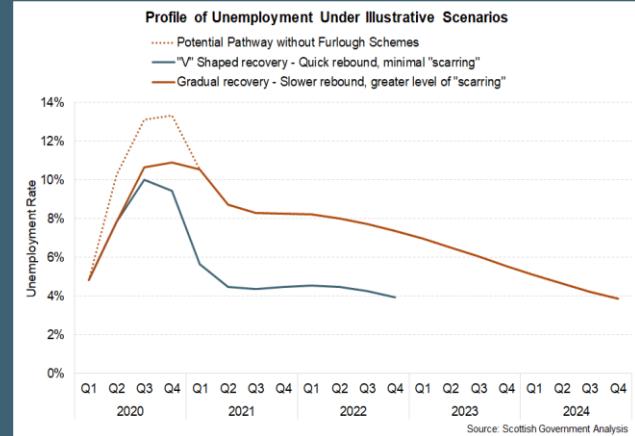
The adjacent chart illustrates the impact the Job Retention Scheme could have on headline unemployment rates in Scotland. Even with the current levels of government fiscal support, in the absence of the scheme, it is estimated that unemployment could have reached around 14%. This is similar to what has already been seen in the US, where there is no equivalent scheme.

Ultimately, the level of unemployment will depend on how many people currently furloughed become unemployed as the scheme is unwound. This highlights the importance of withdrawing the scheme gradually.

Medium term labour market recovery

There is still a significant amount of uncertainty over how the labour market may recover. For example, during the financial crisis, there was evidence of employees willing to accept pay cuts in order to maintain employment. Alternatively, firms may prefer to maintain wages to retain experienced staff in the short-term, whilst keeping fewer staff to cut costs. The impact of previous recessions on the labour market is discussed later in the report.

To illustrate how the labour market may recover under the “Gradual Recovery” scenario, sensitivity analysis has been undertaken around the impact of the policy response and the speed of the labour market recovery. Depending on how the recovery progresses, unemployment could take between 3 to 6 years to recover to pre-crisis levels.



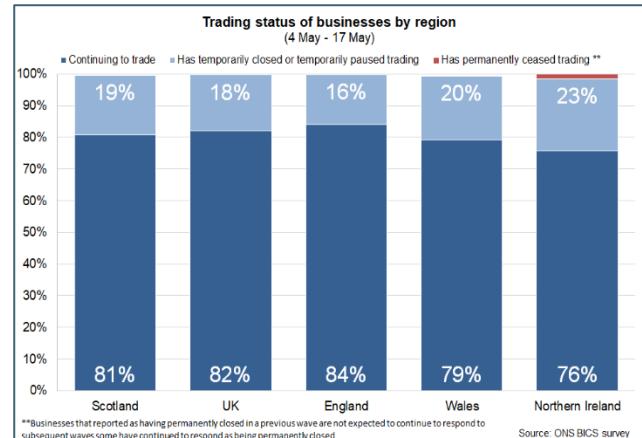
Business Activity

Business surveys are providing timely insights into the current impacts on business activity in Scotland amid the coronavirus pandemic, physical distancing guidelines and lockdown measures. They provide early insights into the extent and scale to which business activity is continuing, the

impact on business turnover and cashflow, and provide essential context for the wider range of indicators on economic output and the labour market.

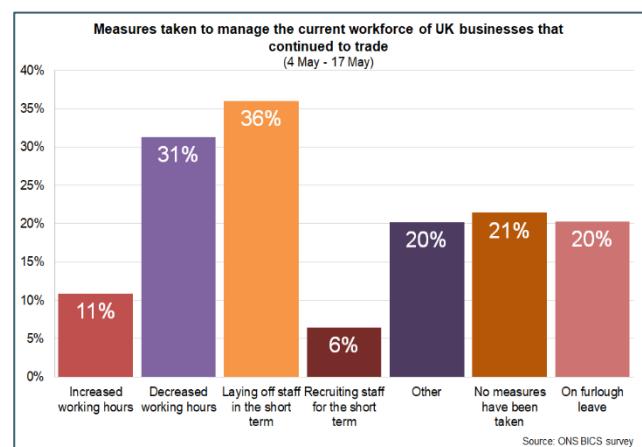
Proportion of business still trading³

- The pandemic and introduction of physical distancing and lockdown measures has resulted in many businesses requiring to temporarily close – either directly or indirectly through a collapse in demand.
- Between 4 May and 17 May, 19% of businesses reported that they had temporarily closed (UK: 18%) and 81% reported they were continuing to trade (UK: 82%).



Workforce measures

- Many business that have continued to trade have had to change the scale and approach of their business operations, particularly around their workforce.
- 36% of responding UK companies that were continuing to trade had been laying off staff in the short term – most prominently in the Construction sector - while 31% had decreased working hours.
- Responding UK companies that were continuing to trade, reported that 20% of their workforce were on furlough leave. This was most prominent in sectors such as Arts, Entertainment & Recreation (63%) and Accommodation & Food (62%).



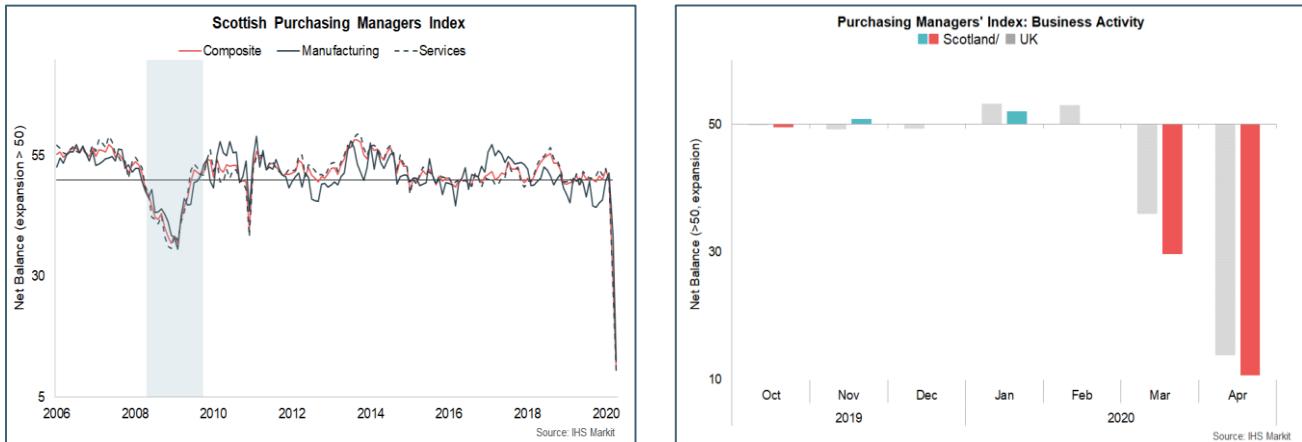
Business activity

- The RBS Purchasing Managers Index⁴ for April reported that business activity across Scotland's private sector fell to its lowest level (10.7) since the survey began in January 1998.
- At a sector level, the services sector recorded a faster decline (10.3) than the manufacturing sector (12.4), although both sectors saw the most marked falls in activity on record.
- Businesses linked the fall in activity to the fall in demand resulting from the pandemic.

³ ONS Business Impacts of COVID-19 Survey (4 – 17 May).

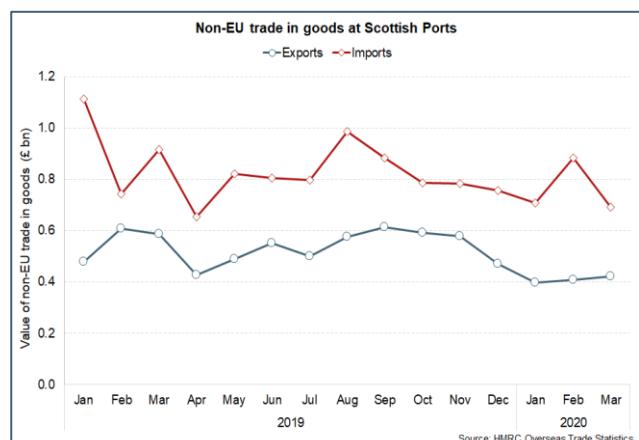
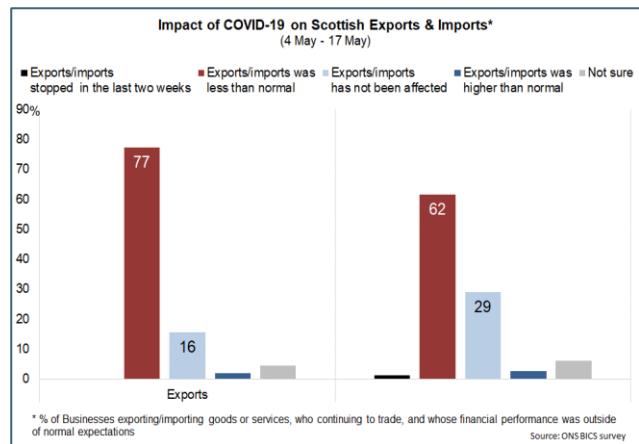
⁴ IHS Markit, RBS Purchasing Managers Index, April.

- Latest UK PMI survey data for May reported a further sharp fall in UK output over the month (30), though had picked up from April's record low (13.8).



Trade

- On the back of significant global trade headwinds in 2019, many businesses have faced supply chain disruption and a fall in demand for exports in 2020 as the coronavirus pandemic has spread internationally and lockdown measures across countries have impacted on demand and output.
- Between 4 May and 17 May, 77% of Scottish exporters (whose financial performance was outside normal expectations) reported that they are exporting less than normal compared to 62% of importers (UK: 74% of exporters and 60% of importers).
- 16% of Scottish exporters (UK: 17%) during the pandemic reported that their exports had not been affected, compared to 29% of importers (UK: 28%).³
- HMRC data for trade in goods in the UK, showed that in March 2020 the total value of exports of goods (EU and non-EU) have fallen by 15% to £28.8 billion compared to March 2019.
- HMRC also published data on Scottish ports activity for non-EU trade only⁵. Scottish port data shows a slight drop in activity in Scottish ports



⁵ HMRC Overseas Trade Statistics

compared to March 2019, and provides an early indication of the impact of COVID-19 on Scottish trade in goods.

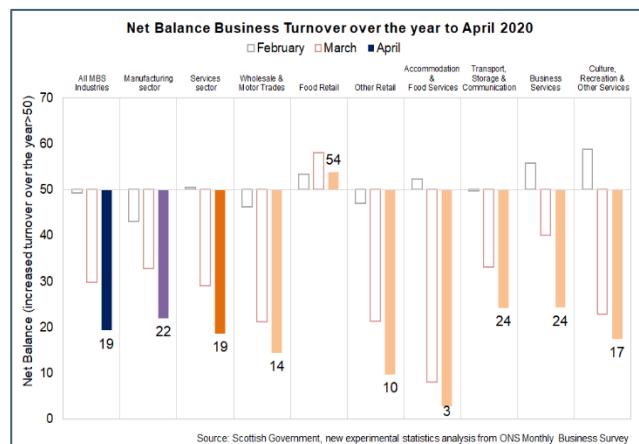
- Compared to March 2019, non-EU exports leaving Scottish ports fell by 28% and non-EU imports entering Scottish ports fell by 24%.

Business Turnover

The coronavirus pandemic and the implementation of physical distancing and lockdown measures has had a rapid and severe impact on business turnover and cashflow across the economy as business have been required to close temporarily or scale down activity while demand has collapsed. Government support packages have been designed to retain as much capacity as possible, however there has been an increased risk of businesses ceasing to trade permanently.

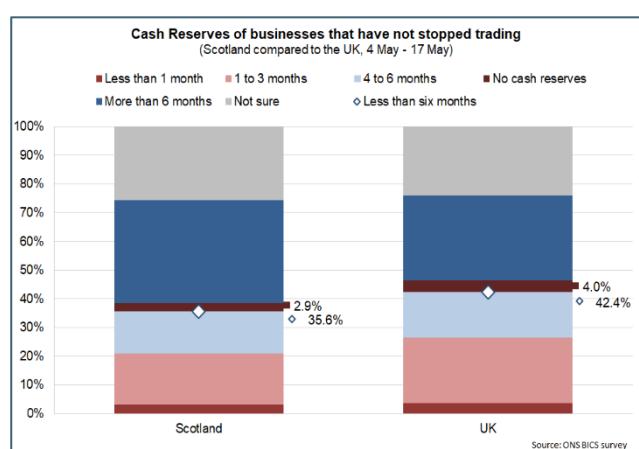
Monthly Business Turnover Index⁶

- Over the year to April 2020, business turnover in Scotland has decreased for most companies across almost all sectors and decreased to a larger extent than in March (19, down from 30), capturing the full month of lockdown measures.
- The ‘Food Retail industry’ was the only industry with most businesses reporting an increase in business turnover, however also to a lesser extent than in March.
- The industry with most businesses reporting a decrease in turnover was in the Accommodation & Food services industry, followed by ‘Other Retail’.
- Sectors suffering large shocks to turnover are more likely to face cashflow challenges going forward.



Cash Reserves of Business³

- The BICS survey reported that, of the businesses that had not permanently stopped trading between 4 May – 17 May:
- 36% of Scottish businesses had cash reserves to last between zero to six months (UK: 42%).

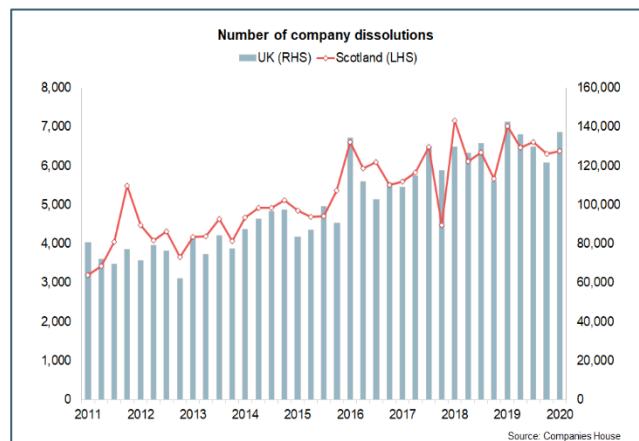


⁶ Source: Scottish Government

- 36% of Scottish businesses had cash reserves to last more than 6 months (UK: 30%).
- 2.9% of Scottish businesses reported they had no cash reserves at all (UK: 4%).

Business Dissolution

- Quarterly Companies House data for Scotland reported a slight increase in the number of company dissolutions in Q1 2020.
- Between January and March 2020, there were 6,378 dissolutions in Scotland (UK: 136,978). Compared to Q4 2019, the number of dissolutions increased slightly by 1% (UK: +13%).
- Monthly data, which is only available for the UK as a whole, for March 2020 showed that the number of dissolutions increased by 7,453 (23%) compared to March 2019.



Labour Market

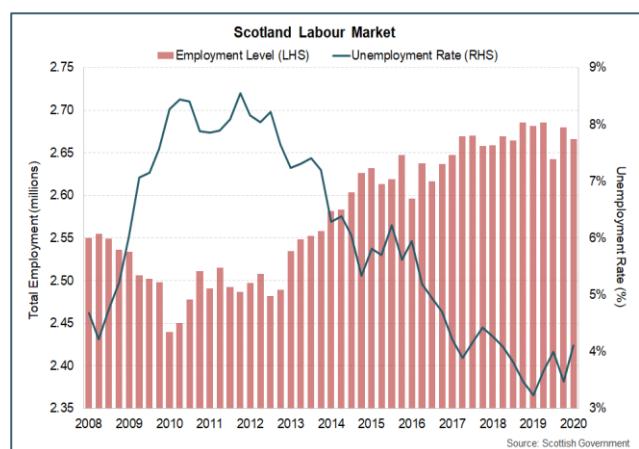
Scotland's labour market has been significantly impacted by the coronavirus pandemic with the closure of some businesses, the furlough of workers on the Coronavirus Job Retention Scheme and changes in working practices (e.g. home working) in organisations which have been able to continue operating.

Latest official labour market statistics are for the period January to March 2020 and so include only the start of lockdown measures introduced in March. They do not yet reflect significant differences for employment, unemployment and inactivity yet (despite the collapse in economic activity) as furloughed workers (currently estimated at 8.7 million across the UK), are classed as employed.

Latest official labour market statistics⁷

Over the year to January to March 2020 the Labour Force Survey showed:

- The employment level decreased by 16,000 and the employment rate fell by 0.8 percentage points to 74.7% (UK: 76.6%).
- The unemployment level increased by 23,000 and the unemployment rate increased by 0.8



⁷ Office for National Statistics

percentage points to 4.1% (UK; 3.9%). Youth unemployment increased by 5.4 percentage points to 12%⁸.

- The economic inactivity (those neither in employment or ILO unemployed) level increased by 2,000 and the inactivity rate increased by 0.1 percentage points to 22.1 (UK; 20.2%).

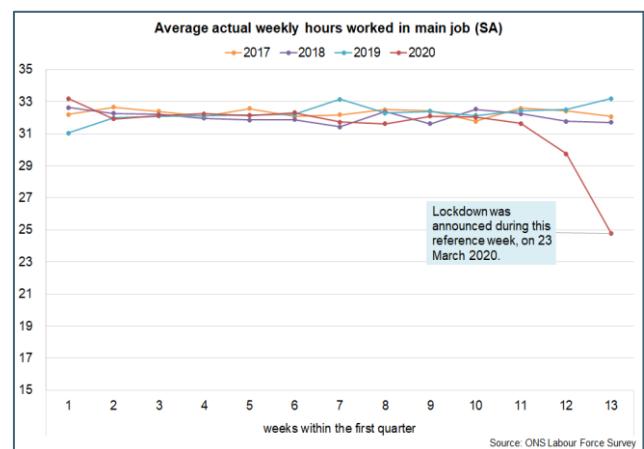
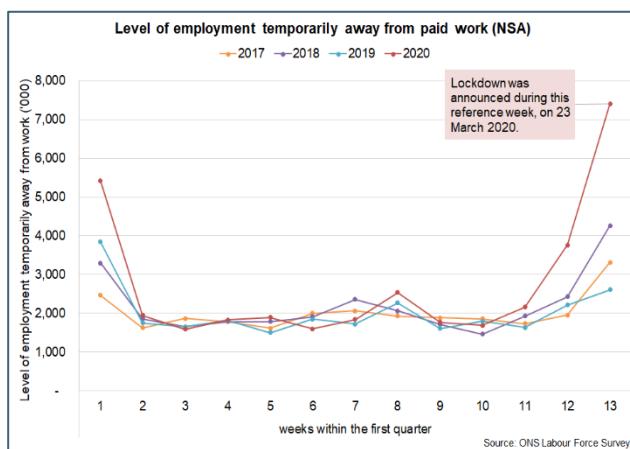
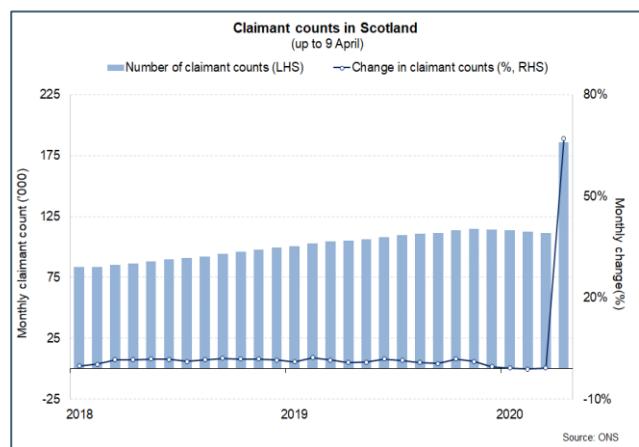
Experimental labour market data (ONS) and business survey data provide further insights into other indicators for unemployment, reduced activity through the claimant count (Jobs Seekers Allowance and Universal Credit), hours worked and demand for workers. Collectively they signal that there has been a fall in hours worked and incomes and a rise in unemployment in the second half of March and since the lockdown measures were introduced.

Claimant Count ⁷

- Scotland's claimant count increased by 67% to 186,000 (claimant count rate of 6.6%) over the month to April, signalling that incomes are falling and unemployment is rising. At a UK level, the claimant count increased by 69% to 2.1 million over the month to April.

Hours Worked

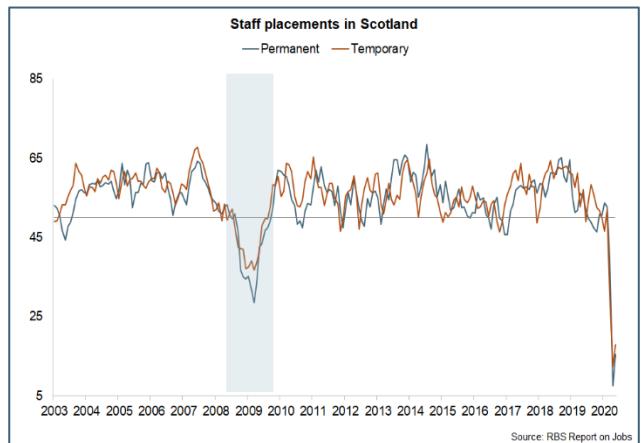
- Weekly ONS Labour Force survey data (published for Great Britain as a whole) showed a significant drop in hours worked and a sharp increase in the number of people temporarily away from work in the second half of March as lockdown measures in the UK started to be implemented.



⁸ These estimates are from the Labour Force Survey, but due to the relatively small samples sizes and subsequent sampling variability, the figures should be used with caution and are designated Official statistics. National Statistics of employment by age band across regions can be obtained from the Annual Population Survey.

Demand for Staff in Scotland

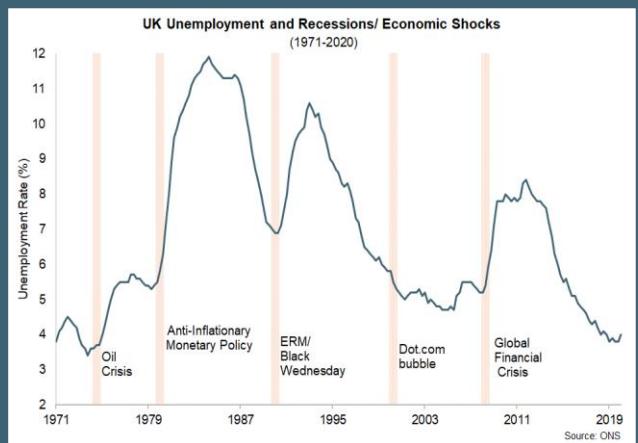
- The RBS Report on Jobs survey for May⁹ reported further sharp falls in demand for permanent and temporary staff in Scotland, albeit to a lesser extent than in April.
- This reflects the fact that many firms have frozen hiring permanent and temporary staff during the pandemic and the fall in staff placements in Scotland is mirrored across the UK.



Historic Recessions and Downturns and their effects on the Labour Market

Historically, economic downturns or recessions have tended to have relatively persistent impacts on the UK labour market. The adjacent chart shows the major historic recessions or downturns and the UK unemployment rate over the past five decades.¹⁰

Although each recession and recovery is different, both in cause and duration, the labour market usually takes a long time to recover. Since 1970, the labour market has often taken more than 6 years to fully, or only partially, recover to a pre-crisis level.



Scottish labour force survey data only goes back to the 1990's which is why the UK series was used for this analysis to show a longer term perspective, however, the two labour markets are highly correlated and Scotland shows a similar pattern since 1990.

There are many reasons why high levels of unemployment can be persistent. For example there can be job matching issues, where those made unemployed have different skill-sets to the vacancies that are then available. This can result in a loss of skills and specialist knowledge, demotivation and time to re-train or find opportunities that do match a skill set. Furthermore, vacancies tend to decrease as firms go bankrupt and it takes time to allow for demand to recover and for new businesses and job opportunities to be created to meet this demand.

It is still unclear how persistent labour market impacts from the COVID-19 crisis may be, as the downturn is unprecedented in both magnitude and cause. The impact on the sectors of the economy has not been uniform, with certain industries hit much worse than others, and this may

⁹ Source: IHS Markit Jobs Report for Scotland.

¹⁰ The "Dot.com bubble" technically wasn't a recession, but did create a slowdown in growth and a small spike in unemployment.

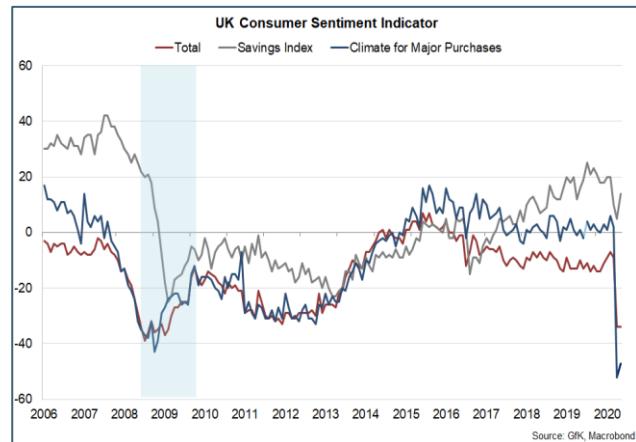
or may not exacerbate any barriers for those affected to re-enter the labour market. However, despite this uncertainty, there is at least some historical evidence to suggest that a labour market rebound may not be swift, and that there could be a degree of persistence in any recovery.

Consumption

Physical distancing measures, alongside more fragile household finances and weakening consumer sentiment is impacting demand in the economy and overall saving and consumption patterns.

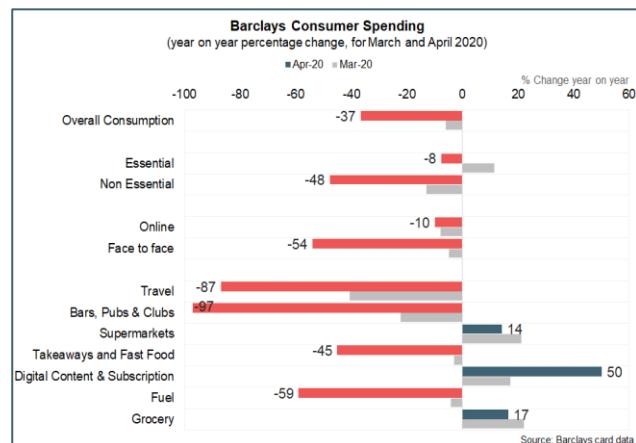
Consumer Sentiment

- UK consumer sentiment has fallen sharply since the end of March, reflecting weaker expectations about the performance of the economy and personal household finances.
- UK Consumer Sentiment in May remained low at -34 and is 5 points higher than its level during the financial crisis.
- Compared to April, households in May reported small improvements in economic and household financial expectations for the next 12 months and a pick-up in attitudes towards savings.



Consumer Spending

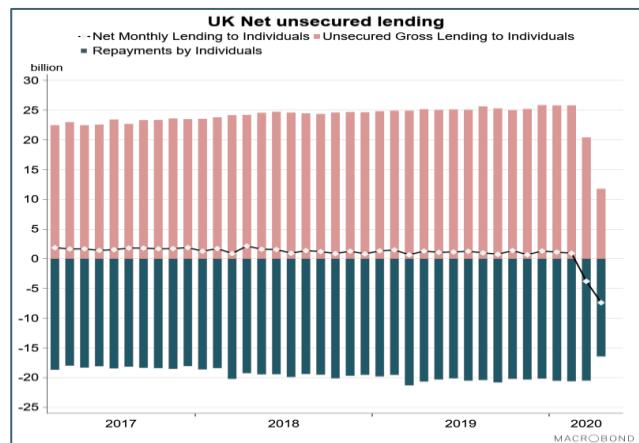
- Consumer spending data¹¹ showed a 36.5% fall in UK consumer spending over the year to April 2020 following a fall of 6% in March.
- Spending on essentials declined by 7.5% due to a 59% drop in fuel spend, while non-essential spending declined by 48% driven by large falls in travel spend (-87%) and spending in bars, pubs and clubs (-97%).
- Digital subscriptions continued to increase in popularity with strong growth of 50% potentially reflecting increased demand through home working, learning and entertainment. Spending in supermarkets rose 14% as people prepared more meals at home.



¹¹ Source: Barclaycard data.

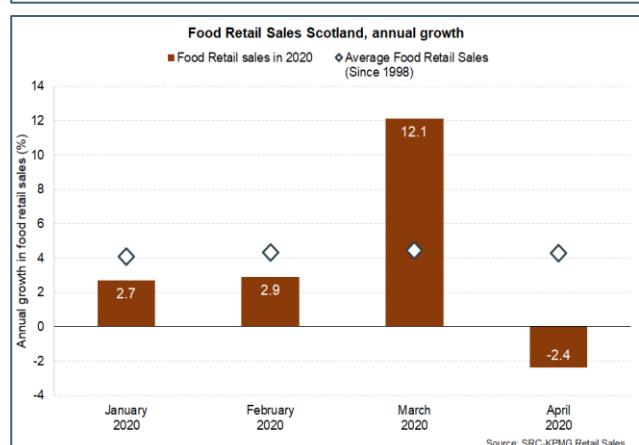
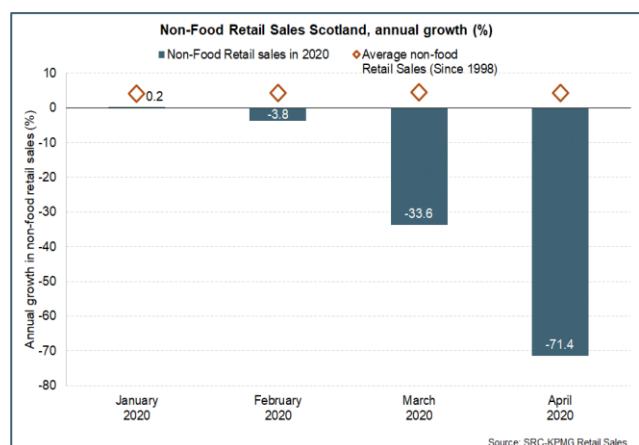
Consumer Lending and Repayment¹²

- The fall in consumer spending in April amid lockdown, has contributed to a sharp fall in UK net unsecured lending.
- Gross lending to consumers fell to £11.8 billion in April, almost half its level than at the start of the year, while repayments on credit cards and other loans also fell in April (by 19%).
- Overall the level of gross lending to consumers in April was more than offset by the level of repayment and net unsecured lending to households fell by £7.4 billion over the month.



Retail Sales

- Scottish Retail Consortium data¹³ on retail sales for April reported an annual decrease of 40.3% in total retail sales in Scotland; its biggest fall on record.
- The decline in retail sales in April was mainly driven by a fall in non-food retail sales. Over the year to April, non-food retail sales fell by 71.4%, while food retail sales fell by 2.3%.
- The fall in food retail sales in April likely reflects the unwinding of stockpiling undertaken in March, however the combination of lockdown measures, increased pressure on incomes and weaker sentiment are likely impacting the overall fall in retail sales.



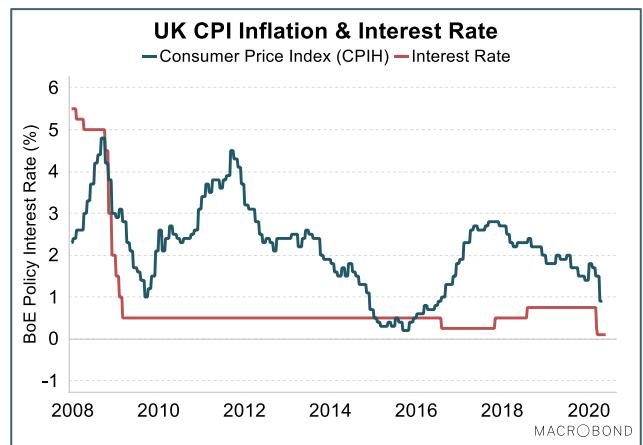
Inflation and Interest Rates

- The fall in demand, alongside the fall in oil price to record lows has placed downward pressure on inflation at the start of 2020.
- The Consumer Prices Index including owner occupiers' housing costs (CPIH) 12-month inflation rate was 0.9% in April 2020, down from 1.5% in March 2020.

¹² Source: Bank of England data.

¹³ Source: Scottish Retail Consortium.

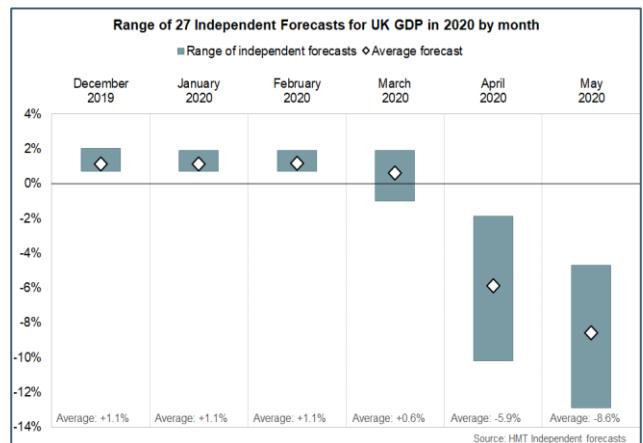
- Key downward contributions to the rate came from falling energy and fuel pump prices. The largest offsetting upward contributions came from a rise in recreational goods.
- The Bank of England reduced the Bank Rate to 0.1% in March 2020 and in their current central scenario analysis project inflation to fall to 0.6% in 2020 and 0.5% in 2021 before picking up to target at 2.0% in 2022.



GDP Growth Outlook

The economic outlook for 2020 has deteriorated significantly as a result of the coronavirus pandemic and the necessary restrictions on economic activity to minimise the spread of the virus.

- The scale and duration of the economic impacts remains uncertain, however the degree of pessimism in forecasts has increased over the course of the year.
- Scotland's scenario analysis published in this edition, suggests GDP could fall by 14% in 2020.
- Scenario analysis from the Bank of England estimates UK GDP could fall by 14% over the year while HM Treasury's monthly summary of independent GDP forecasts reports UK GDP is forecast to contract by an average of -8.6% in 2020 (down from -5.9 in April 2020).



COVID-19 Regional Exposure and Resilience

Regional exposure to the impacts from COVID-19 will vary due to the varied composition of industrial, workforce and wider population structures.

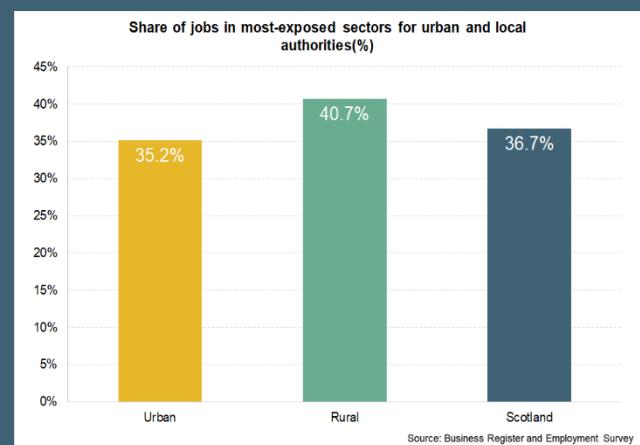
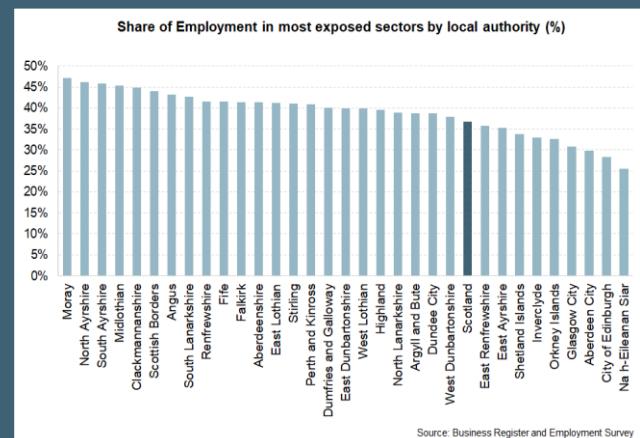
Recent Scottish Government analysis developed a sectoral risk rating based on exposure to international supply, international and domestic demand and labour market disruptions¹⁴. The adjacent chart shows the share of employment in these sectors where overall risk exposure to the economic effects of COVID-19 may be greatest across Scotland's 32 local authorities. Island local authorities and some urban areas have lower shares of employment in the most exposed sectors.

Overall, local authorities that are rural or mainly rural have slightly higher shares of jobs in the most-exposed sectors.

However, the number of jobs in the most exposed sectors is highest in Glasgow, Edinburgh and Fife.

Other factors, such as the level of international exports, the structure of the business base, and the existing health status of the local population will also impact on the regional exposure to the impacts of COVID-19. There were significant variations in regional social and economic outcomes prior to the current crisis and local resilience and recovery will be influenced by a range of factors, such as the existing levels of deprivation, labour market performance, and qualifications of the population.

For example, areas such as Glasgow, Dundee, Inverclyde and North Ayrshire have higher levels of income deprivation and median hourly earnings for employees in 2019 ranged from £10.79 in Dumfries and



Area	Number of jobs in sectors most exposed to COVID-19 risks
Scotland	958,000
Glasgow City	128,000
City of Edinburgh	100,000
Fife	57,500
North Lanarkshire	53,500
Aberdeen City	52,500
South Lanarkshire	51,000
Highland	50,000
Aberdeenshire	47,500
Renfrewshire	36,500
West Lothian	30,750
Dundee City	29,250
Perth and Kinross	28,000
Dumfries and Galloway	27,500
Falkirk	27,500
South Ayrshire	22,000
Scottish Borders	21,250
Stirling	20,500
North Ayrshire	20,000
Moray	18,500
Angus	17,000
Argyll and Bute	15,250
East Ayrshire	15,250
Midlothian	14,400
East Lothian	13,500
West Dunbartonshire	12,250
East Dunbartonshire	10,900
Inverclyde	9,350
East Renfrewshire	8,050
Clackmannanshire	6,850
Shetland Islands	5,350
Orkney Islands	4,250
Na h-Eileanan Siar	3,950

¹⁴ <https://www.gov.scot/publications/state-economy-april-2020/>

Galloway and £19.32 in East Renfrewshire^{15,16}. The proportion of the population with degree qualifications also varies significantly, from 11.6% in Shetland to 50.7% in Edinburgh¹⁷. There is considerable uncertainty regarding the economic outlook and understanding the regional impacts and recovery paths will be important to ensuring that the specific needs of Scotland's regions are supported.

¹⁵ Scottish Index of Multiple Deprivation 2020.

¹⁶ Annual Survey of Hours and Earnings.

¹⁷ Annual Population Survey.



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St Andrew's House
Edinburgh
EH1 3DG

ISBN: 978-1-83960-802-5 (web only)

Published by The Scottish Government, June 2020

Produced for The Scottish Government by APS Group Scotland, 21 Tennant Street, Edinburgh EH6 5NA
PPDAS739266 (06/20)

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