Monthly Economic Brief

Office of the Chief Economic Adviser

March 2022

Scottish Government
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Office of the Chief Economic Adviser

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March 2022

Data up to 31 March 2022

Overview

This month's economic brief covers developments over the first quarter of 2022 during which the situation in Ukraine – first and foremost a humanitarian crisis - has presented a new and concerning shock to the global economy, which risks further slowing the recovery from the pandemic and exacerbating inflationary pressures which have already risen to their highest levels in 30 years.

Latest headline indicators in Scotland have shown encouraging improvements at the start of the year. GDP grew 1.1% in January and rebounded sharply from the fall in output in December at the start of the Omicron wave. Latest business survey data have indicated further growth and recovery over February and March, with the resumption of full trading patterns in hospitality and leisure sectors increasingly widespread as most of the remaining restrictions on sectors have been gradually removed.

Scotland's labour market has also continued to perform strongly, with unemployment falling to 3.8% in November to January, while the payroll employee level rose sharply to 34,000 above its pre-pandemic level. High vacancy rates and recruitment challenges have continued to persist in February and March, creating upward pressure on starting salaries and average earnings growth.

However, inflationary pressures have continued to strengthen with consumer price inflation rising to 6.2% in February. With the increase in the energy price cap, inflation is forecast to rise to around 8%, and to remain high throughout the year presenting an extremely challenging outlook for household finances, and particularly for those on low incomes. This concern was reflected in the Scottish Consumer Sentiment Indicator which fell sharply in February due to weakening sentiment regarding household finances, spending and the outlook for the economy over the coming year.

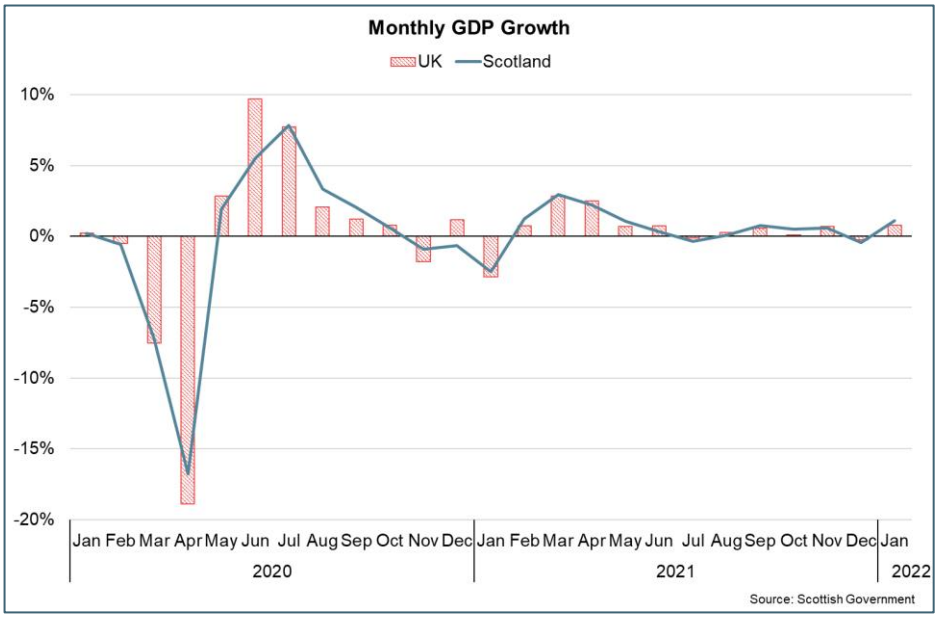
Since then, the situation in Ukraine has increased the level of uncertainty in the economic outlook and presented a new downside risk to growth at a time when the economy is still in recovery from the economic shock of the pandemic. Scotland's direct trade links with Russia and Ukraine are small, and as such the direct impacts of the situation are expected to be limited. However, the recent surge and volatility in the price of global commodities such as oil and gas, grains and metals in which Russia and Ukraine are key global producers, means the indirect impacts of higher inflationary pressures is something that all importing economy's, including Scotland, will be exposed to.

Looking ahead, as a result of recent developments, the economic outlook is less positive. The Office for Budget Responsibility forecast that UK inflation could now peak at 8.7% in the final quarter of 2022 with the negative impact on real incomes and consumption resulting in their UK GDP growth forecast for 2022 being revised down by 2.2 percentage points to 3.8%. Similar impacts are evident in Scotland and will result in lower GDP growth than previously forecast.

Output

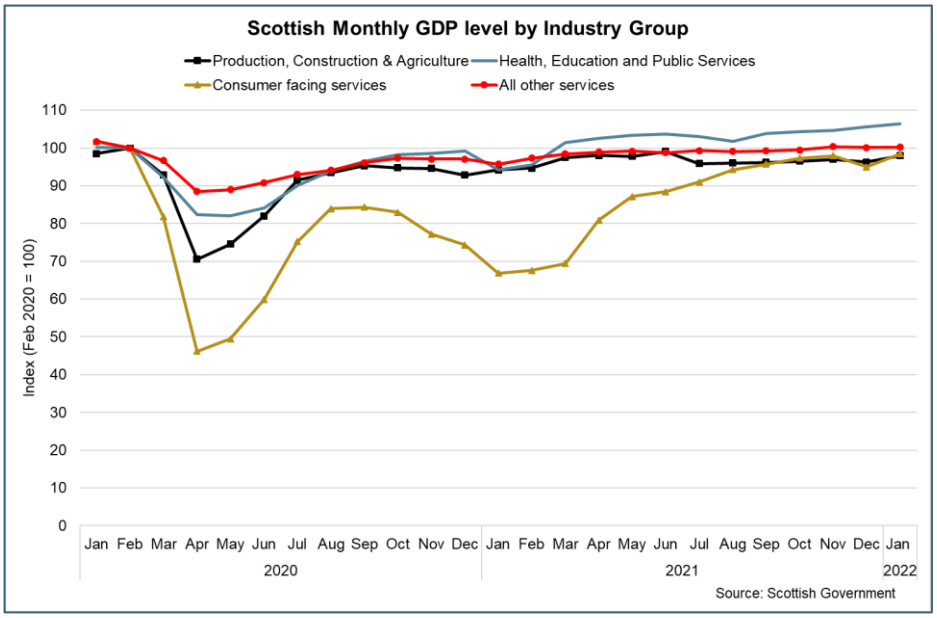
Scotland's GDP rebounded in January following the fall in December at the start of the Omicron wave.

- The Omicron restrictions introduced in December were eased over January enabling the resumption of large outdoor events, the removal of physical distancing restrictions in hospitality and leisure settings and working from home guidance.
- Reflecting this, Scotland's GDP grew by 1.1% in January (UK: 0.8%), and rebounded from the 0.4% fall in December at the start of the Omicron wave.[1]



- At a sector level, growth was broad based in January with the services sector growing by 0.9%, and the production and construction sectors by 1.8% and 1.1% respectively. However, the stage of recovery continues to vary across and within sectors.
- Within the services sector, output in consumer-facing services grew by 3.6%, rebounding from its 3% fall in December. Its output remained 1.5% below pre-pandemic levels, however has risen to its highest level since the start of the pandemic.
- In other parts of the services sector, health, education and public services output increased by 0.8%, in which the strong contribution from health is a reflection of the higher levels of test and trace and vaccination activity in response to the Omicron variant, while output from all other services increased by 0.1%. Output from health, education and public services is 6.5% above its pre-pandemic level, and output from all other services is 0.2% above.

[1] https://www.gov.scot/collections/economy-statistics/#gdpmonthlyestimates



- The growth in production in January (1.8%), was driven by the manufacturing sector (3.8%) which, following a fall in output over the second half of 2021, picked up at its fastest rate since January 2021.
- Overall output in the broader production, construction and agriculture group first returned to its pre-pandemic level in June 2021 before falling back over the third quarter, driven by volatile output across the manufacturing, construction and electricity and gas supply subsectors. Output in this group grew by 1.7% in January, however remained 2.1% below its pre-pandemic level.

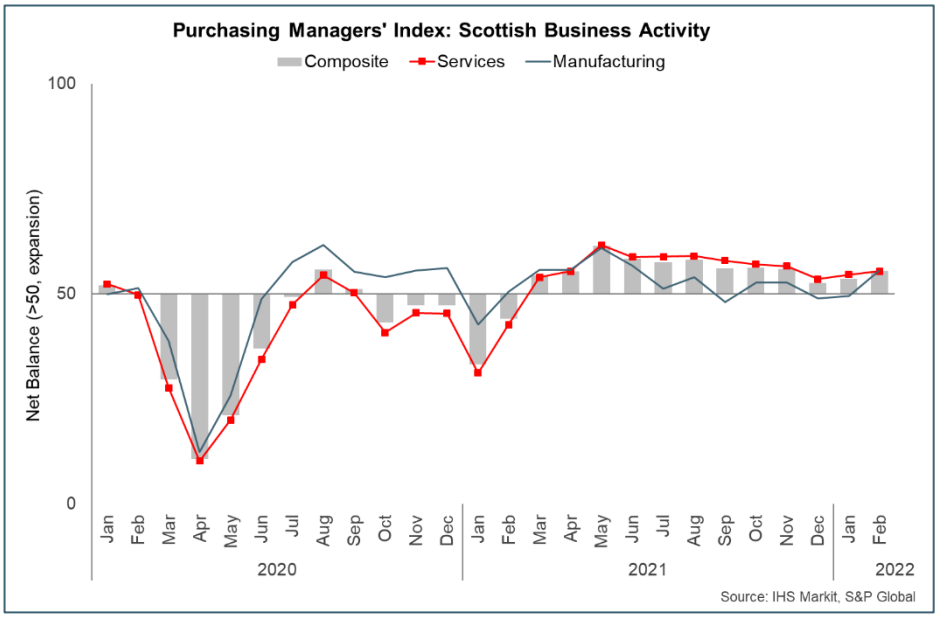
Business Activity

Business activity has strengthened with the removal of Omicron restrictions, however cost pressures continue to build alongside concerns about the situation in Ukraine.

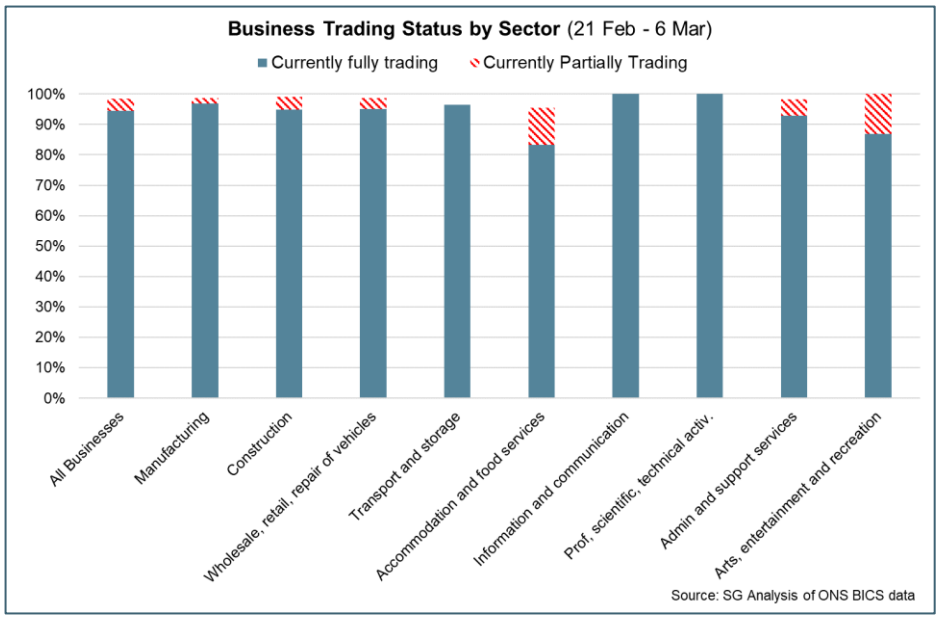
Business activity and trading status

- Covid restrictions continued to be eased over February and March with the removal of remaining legal requirements for business and services providers, except for the use of face coverings on public transport and most indoor public settings, while international travel restrictions for people coming to Scotland also ended.
- The Purchasing Managers Index (PMI) business survey signalled a strong pick-up in growth in February (55.5, up from 53.7 in January), with the momentum returning back towards similar levels of that in November 2021 prior to the Omicron wave.[2]

[2] IHS Markit, RBS Purchasing Managers Index: RBS | Scotland PMI survey report for February 2022 (rbsbusinesshub.com)



- The pick-up in activity was supported by growth across the services and manufacturing sectors, with the manufacturing indicator returning to growth for the first time since November 2021. Panellists cited stronger demand as a result of the ending of restrictions as a driver of growth while the rate of increase in new business/orders accelerated to a three-month high.
- Building on this, the trading capacity of sectors, particularly those most directly impacted by the Omicron restrictions (hospitality and leisure) have continued to strengthen. At the start of March 83% in Accommodation and Food and 87% in Arts, Entertainments and Recreation reported as fully trading (rather than partially), up from 63% and 57% respectively during January.[3]

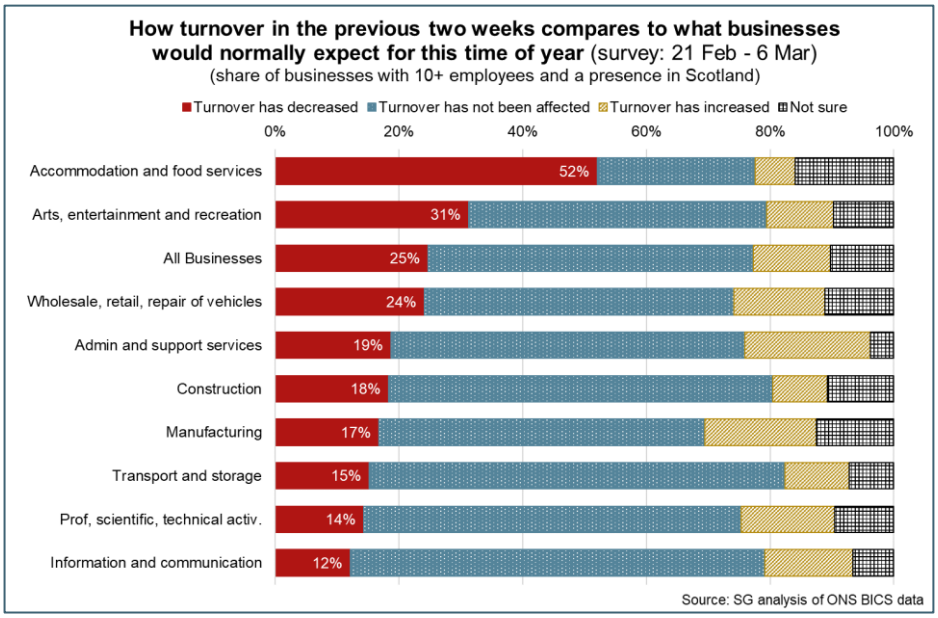


[3] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)

- These remain below the average for all businesses (95%), continuing to reflect the different pace in recovery across sectors, however the gap has naturally closed further as restrictions have eased.
- Most recently, flash UK PMI data for March indicated further robust UK private sector growth during the month, though at a slightly softer pace than in February (59.7, down from 59.9 in February) as the economy continued to rebound from the easing of restrictions.[4]

Business turnover and input costs

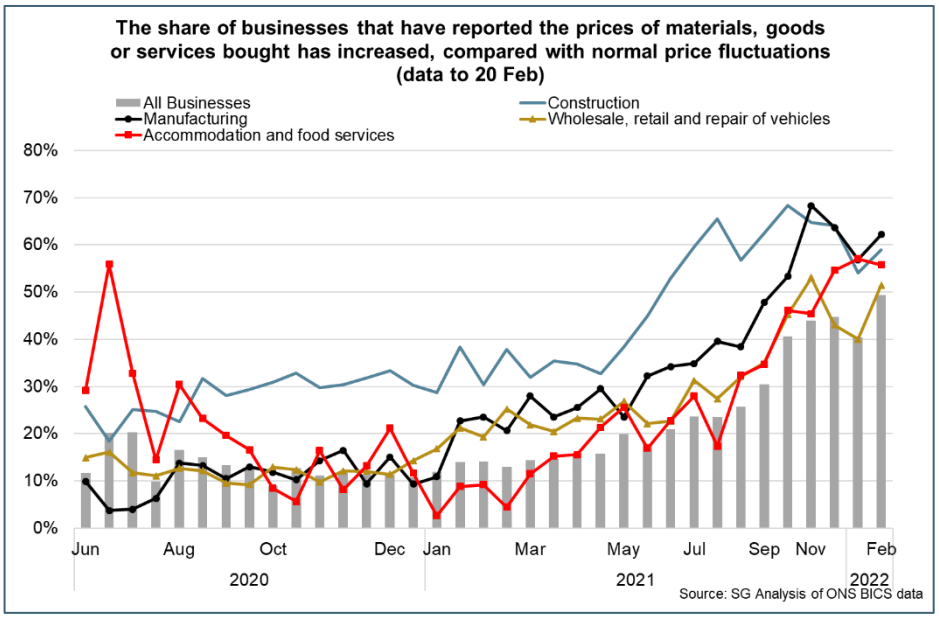
- Improved businesses activity in response to the loosening of restrictions across February and March has also been reflected in business turnover indicators.
- At the beginning of March, the proportion of all businesses reporting a decrease in turnover fell to 24.8%, its joint lowest rate in the time series and, down from around 30% at the beginning of 2022. Similarly the proportion of all firms reporting that turnover had increased improved to 13%, up from around 8%, while over 50% reported that turnover had not been affected.[5]



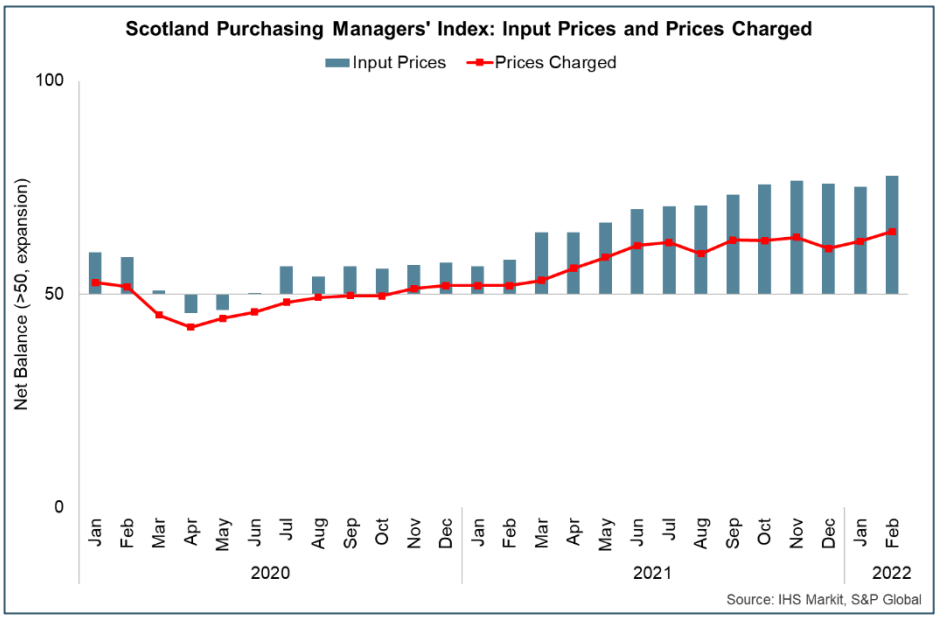
- As has been the general trend over the course of the pandemic, lower than normal turnover continued to be most widespread in the accommodation and food services sector, and picked-up in March to 52%. However, this is down from 59% at the beginning of 2022 and continues to be notably lower than earlier in the pandemic.
- However, input cost pressures for businesses continued to intensify in February with 49% of all businesses reporting that prices increased more than normal, its highest rate in the time series

[4] S&P Global/CIPS, Flash UK Composite PMI: https://www.markiteconomics.com/Public/Home/PressRelease/ce71b9c4fafa4456a9845182907c14c5
[5] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)

and up from 40% in January. Increased prices remained most widespread in manufacturing (62%), construction (59%) and accommodation and food services (56%).[6]



- Scottish PMI data also showed the indicator for input cost inflation continued to rise in February, to its highest level in the time series. A range of factors including higher fuel, energy, material and wage costs were the primary drivers of cost inflation. As a result, firms continued to pass higher costs through to customers, with prices charged also increasing at the sharpest rate in the series.[7]



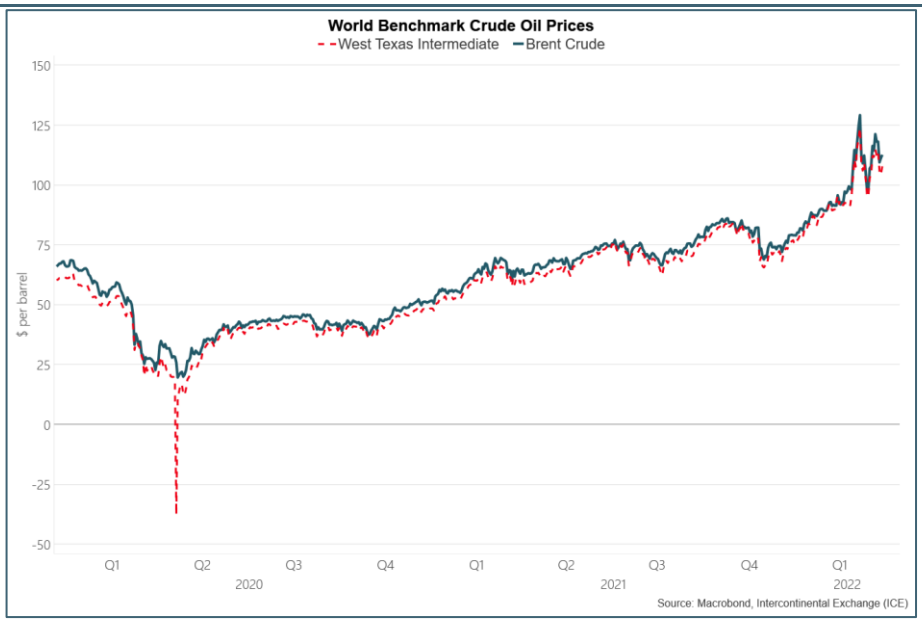
[6] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)
[7] IHS Markit, RBS Purchasing Managers Index: RBS | Scotland PMI survey report for February 2022 (rbsbusinesshub.com)

- The latest flash UK PMI for March signalled that alongside ongoing concerns around rising inflationary pressures, the situation in Ukraine also started to weigh on the outlook for businesses, with business optimism falling to its lowest level since October 2020.[8]
- Business Insights and Conditions Survey data show supply chain bottlenecks continued to present significant challenges going into March 2022, though slightly less so than around the turn of the year. 26% of all applicable businesses reported that their business had experienced global supply chain disruption over the previous month (down from 37% a month earlier), most notably in the manufacturing (48%), construction (36%), transport and storage (36%) and wholesale, retail and repair of vehicles (31%) sectors.[9]

Channels of economic impact from the situation in Ukraine

- The situation in Ukraine and the sanctions imposed on Russia are impacting on the global and Scottish economy through a range of channels. The overall impacts currently remain highly uncertain and will depend on how the severity and duration of the situation evolves.
- The direct economic impacts of the situation in Ukraine on Scottish output are expected to be relatively small. Less than 1% of Scotland's international exports are destined for Russia.[10] However, indirect economic impacts arising for businesses and households from intensifying inflationary pressures are expected to be more prominent.
- Russia and Ukraine are key producers of a range of global commodities such as oil and gas, grains and metals. For example, they together account for about 30% of global exports of wheat and around 11% of oil.[11]
- Since the start of the invasion, prices across a range of global commodities have increased sharply, reflecting concerns regarding future availability of supply and uncertainty over the scale of the economic implications. While some prices have since moderated, they remain significantly elevated. For example, since the start of the invasion, the Brent crude oil price remains 15% higher and wheat prices are 17% higher.[12]

[8] S&P Global/CIPS, Flash UK Composite PMI: https://www.markiteconomics.com/Public/Home/PressRelease/ce71b9c4fafa4456a9845182907c14c5
[9] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)
[10] Export statistics Scotland: 2019 - gov.scot (www.gov.scot)
[11] OECD Economic Outlook
[12] As at 30 March 2022.



- As these price rises feed through to consumers on the back of existing inflationary pressures as the global economy stabilised from the pandemic, this is expected to weigh significantly on real household incomes and consumption over the course of the year and ultimately dampen economic growth.

- In March, the Office for Budget Responsibility (OBR) revised down their UK GDP growth forecast to 3.8% in 2022 (revised down 2.2 percentage points from October) and 1.8% in 2023.
- The downward revision in the near term reflected higher inflation weighing on real incomes and consumption with inflation forecast to rise to almost 9% in Q4 2022, mainly reflecting higher global energy prices.[13]

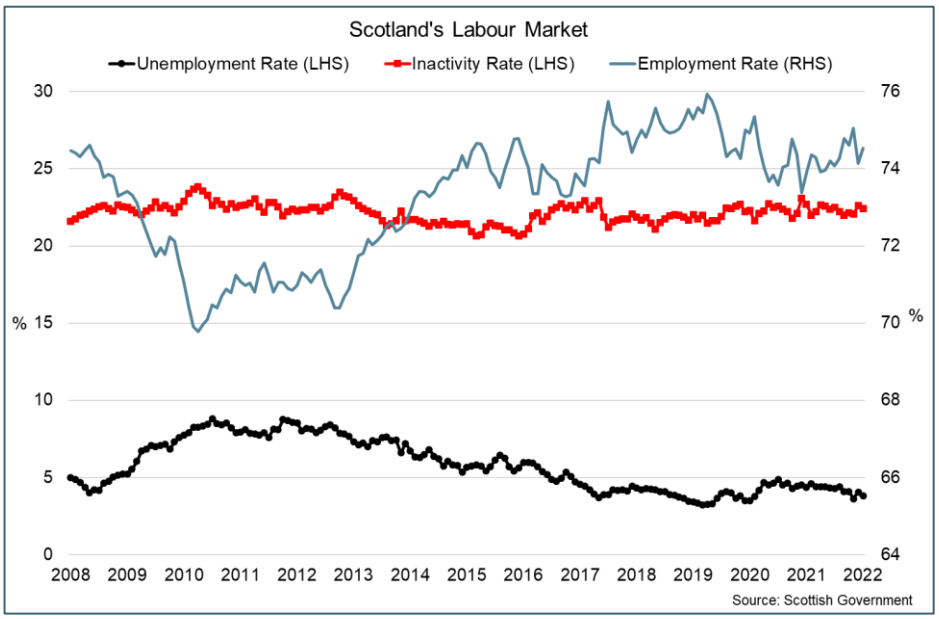
[13] Economic and fiscal outlook - March 2022 - Office for Budget Responsibility (obr.uk)

Labour Market

Unemployment remains at low levels while payrolled employment rose sharply in February.

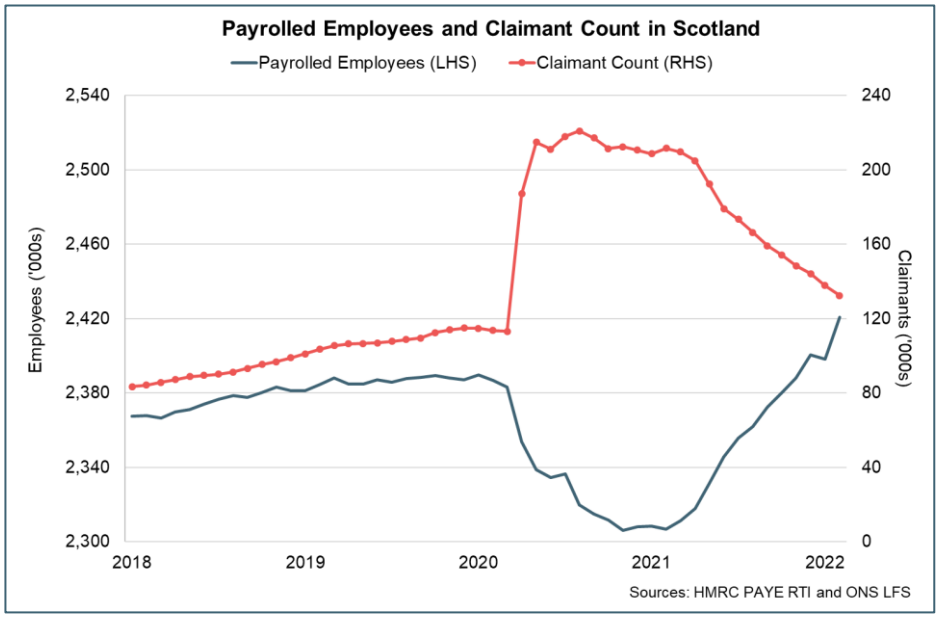
Official labour market statistics, payrolled employment and claimant count

- The latest labour market statistics for November 2021 to January 2022 in Scotland show there were 2.657 million people in employment (rate of 74.5%, up 0.6 percentage points over the year), 105,000 people unemployed (rate of 3.8%, down 0.5 percentage points) and 767,000 people economically inactive (rate of 22.4%, down 0.3 percentage points).[14]

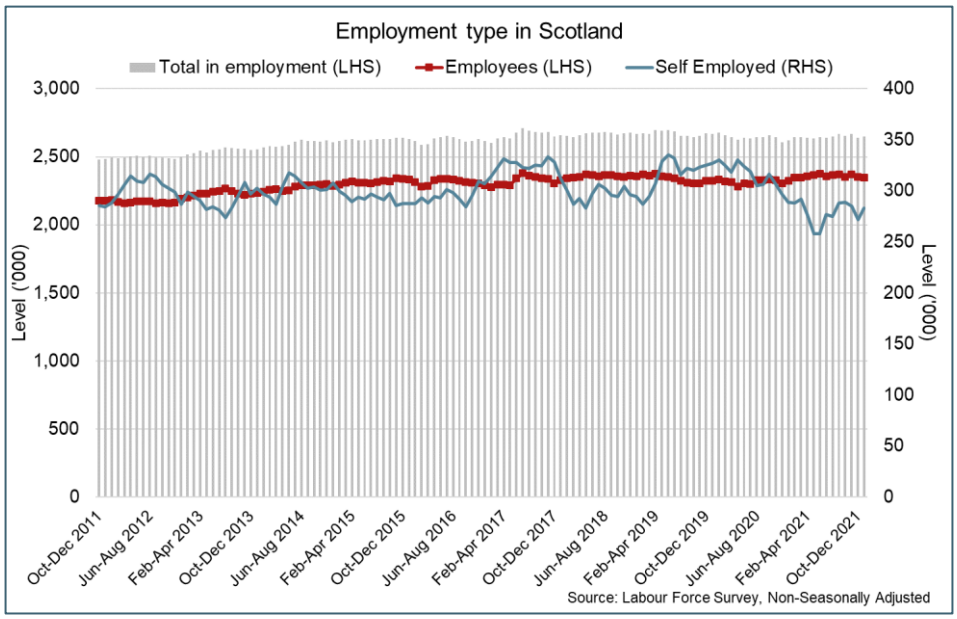


- Wider labour market indicators showed signs of further strengthening in February. Pay As You Earn (PAYE) Real Time Information flash estimates indicate the number of payrolled employees in Scotland increased by 22,000 in February to 2.42 million. This is 48,000 more than at the end of the Furlough scheme in September 2021 and 34,000 more than the pre-pandemic level in February 2020.[15]

[14] Labour market trends: March 2022 - gov.scot (www.gov.scot)
[15] Earnings and employment from Pay As You Earn Real Time Information, UK - Office for National Statistics (ons.gov.uk)

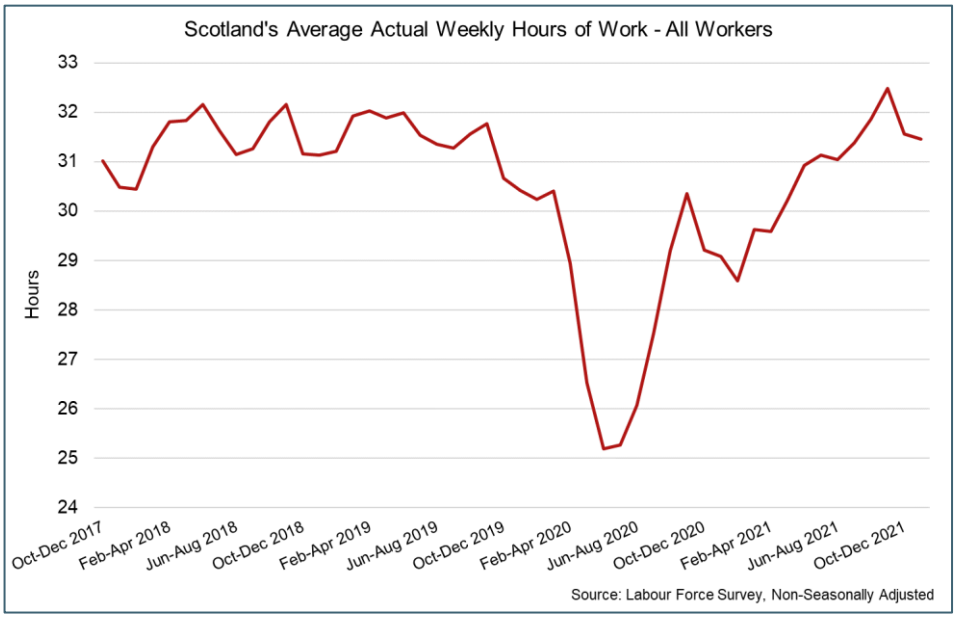


- Scotland's Claimant Count (the number of claimants of Job Seekers Allowance and claimants of Universal Credit claiming principally for the reason of being unemployed) also continued its downward trend in February, down 3.9% to 132,400; a claimant count rate of 4.1%.
- Overall, the claimant count has fallen 40.1% from its peak in August 2020 and 16.8% since September when the furlough scheme ended. However, it remains 18,700 (16.4%) higher than its pre-pandemic level in February 2020.[16]
- Further underlying changes continue to emerge in the labour market as it recovers from the pandemic. While employee numbers have risen above their pre-pandemic level, the overall level of employment remains below, reflecting that the number of self-employed has fallen.[17]



[16] Labour market trends: March 2022 - gov.scot (www.gov.scot)
[17] Scotland data (not seasonally adjusted) N21J - Office for National Statistics (ons.gov.uk)

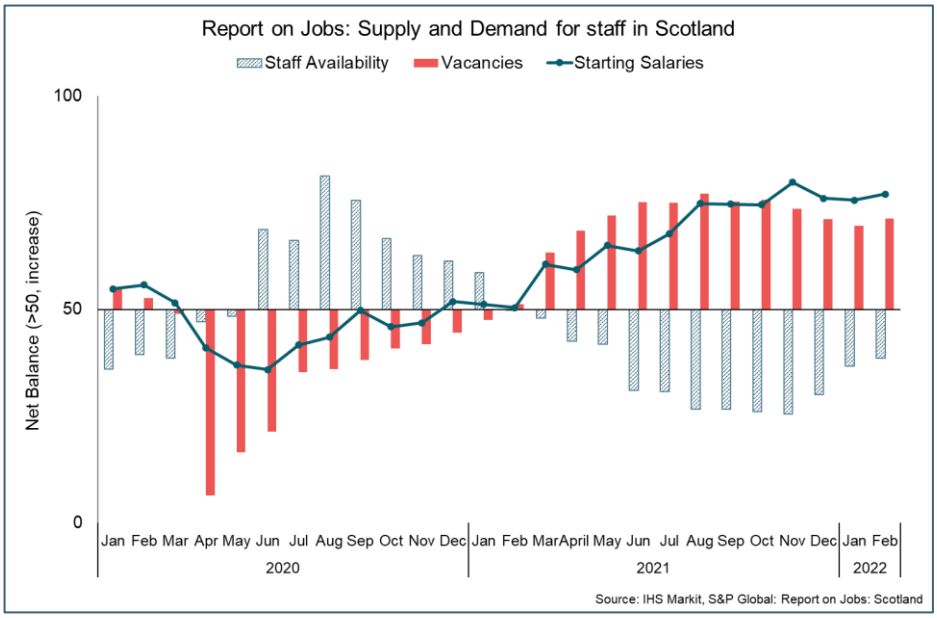
- One of the main impacts of the furlough scheme was that people worked fewer hours, even though they remained in employment. After falling heavily at the start of the pandemic, average actual weekly hours of work have now returned to around pre-pandemic levels. In November 2021 to January 2022, average total weekly hours was 31.5, up from 29.1 hours during the same period in November 2020 to January 2021 and up from 30.4 hours during the same period prior to the pandemic (November 2019 to January 2020).[18]



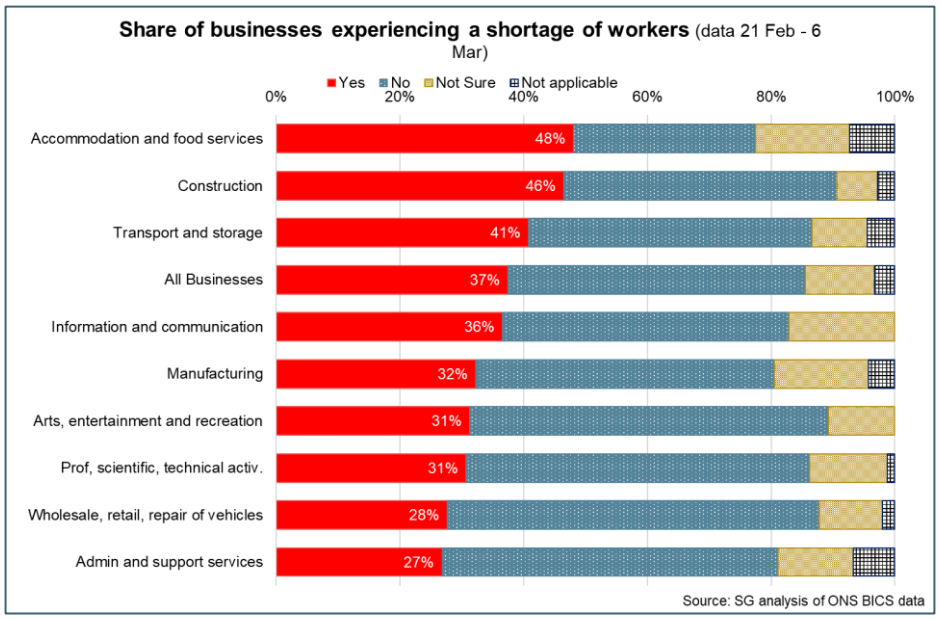
Demand for staff

- Business surveys have also signalled that labour market tightness has persisted into the start of 2022 with strong demand placing upward pressures on pay.
- The latest Report on Jobs signalled that overall demand for staff (vacancies) continued to grow in February (71.2, up from 69.6 in January) and remains high compared to historical standards. This is the first uptick in demand since October 2021, with demand for permanent staff stronger than that for temporary staff.[19]
- Supply side challenges in the labour market have also continued with candidate availability (labour supply) continuing to fall. However the rate of decline has moderated notably in recent months and is at its lowest rate since May 2021.

[18] Scotland data (not seasonally adjusted) N21J - Office for National Statistics (ons.gov.uk)
[19] IHS Markit, S&P Global: RBS Report on Jobs for March: d0000616a2954e02a4f80aeddacc1b45 (markiteconomics.com)

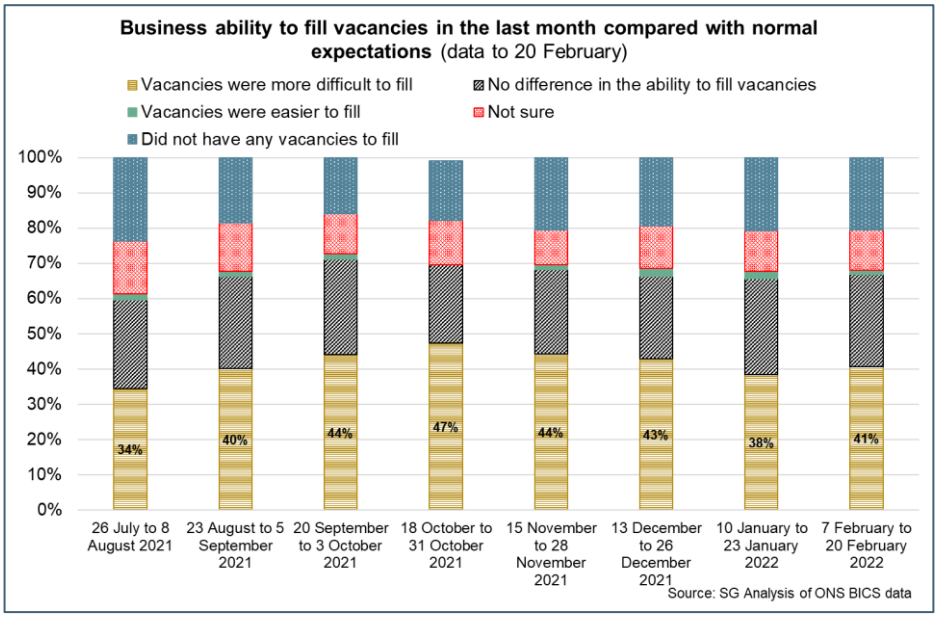


- More recent online vacancies data also signal that strong demand for staff continued throughout February, with online job vacancies 47.1% higher than in February 2020.[20]
- The strength in demand for staff, coupled with low unemployment, falls in candidate availability and anecdotal evidence of challenges in recruiting the necessary staff, meant upward pressure on starting salaries remained elevated in February, particularly for permanent roles.
- Labour shortages continue to affect a range of sectors with 38% off all businesses experiencing a shortage of workers into the start of March. The overall share has picked-up since the start of the year and remains most notable in accommodation and food services (48%), construction (47%), and the transport and storage (41%) sectors.[21]



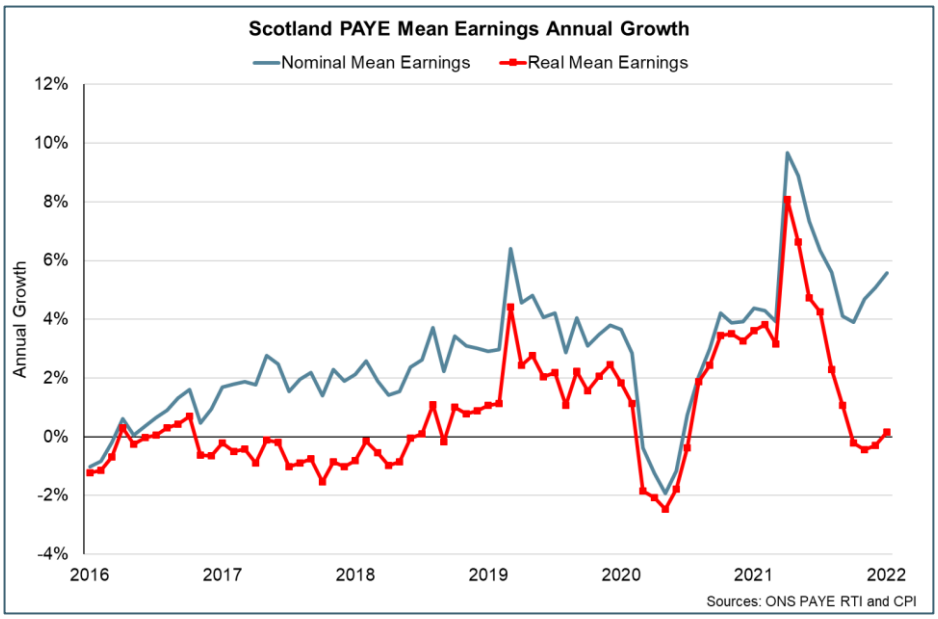
[20] Online job advert estimates - Office for National Statistics (ons.gov.uk)
[21] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)

- Similarly, 41% of all businesses in February, reported their ability to fill vacancies remains more difficult than normal for the time of year. The share is slightly higher than in January, however is down from 47% in October, while the share of businesses reporting no difference in their ability to fill vacancies increased to 26% (up from with 22% in October).[22]



Earnings

- Mean PAYE monthly pay growth has continued to stabilise at the start of 2022 following significant volatility during the pandemic when mean pay initially fell sharply, strengthened over the course of 2020 and rebounded back above its pre-pandemic level in August 2020.[23,24]



[22] BICS weighted Scotland estimates: data to wave 51 - gov.scot (www.gov.scot)
[23] Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)
[24] The rates of earnings growth during the pandemic need to be interpreted with caution as base effects, compositional factors and the furlough scheme have all influenced the data.

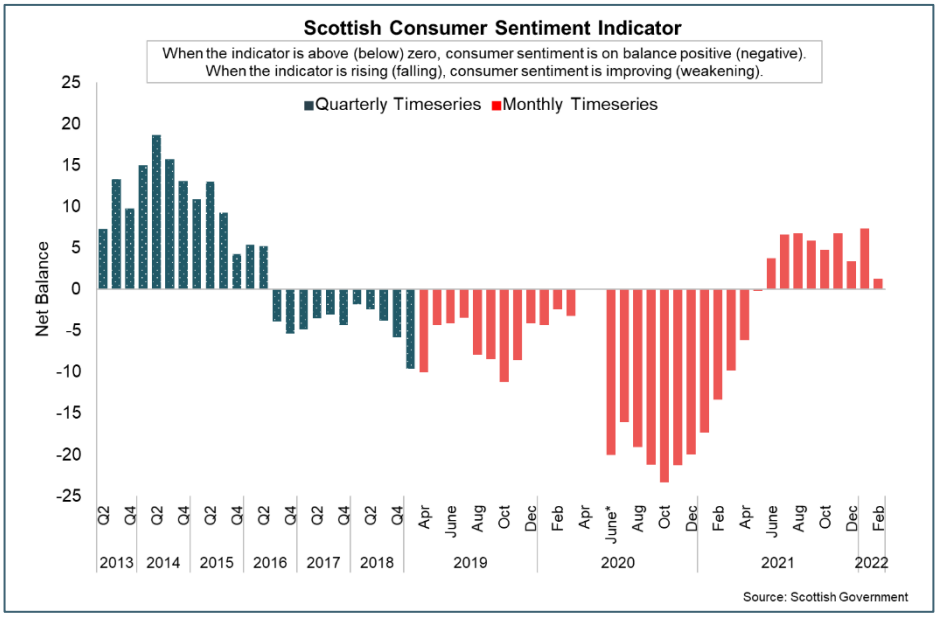
- Latest data show mean monthly pay grew by 1.2% over the month in January (UK: 1.8%), and grew 5.6% annually (UK: 7.3%) to £2,594 (UK: £2,854).
- Despite, the relatively high rate of pay growth, the CPI annual inflation rate was 5.5% in January and subsequently rose to 6.2% in February, and is weighing notably on real earnings growth.

Consumption

Consumer Sentiment fell sharply in February driven by a fall in household finance and spending indicators.

Consumer sentiment

- Consumer sentiment indicators continue to be highly sensitive to the rapidly changing economic environment and the unprecedented economic challenges that have occurred over the past few years.
- Having risen to its strongest monthly level in January (7.3), the composite indicator fell sharply to 1.3 in February, its lowest level since May 2021. While respondents' views of current economic performance improved over the month, the fall in February was driven by a broad based fall across the household finance and spend indicators and expectations for the economy over the coming year.[25,26]

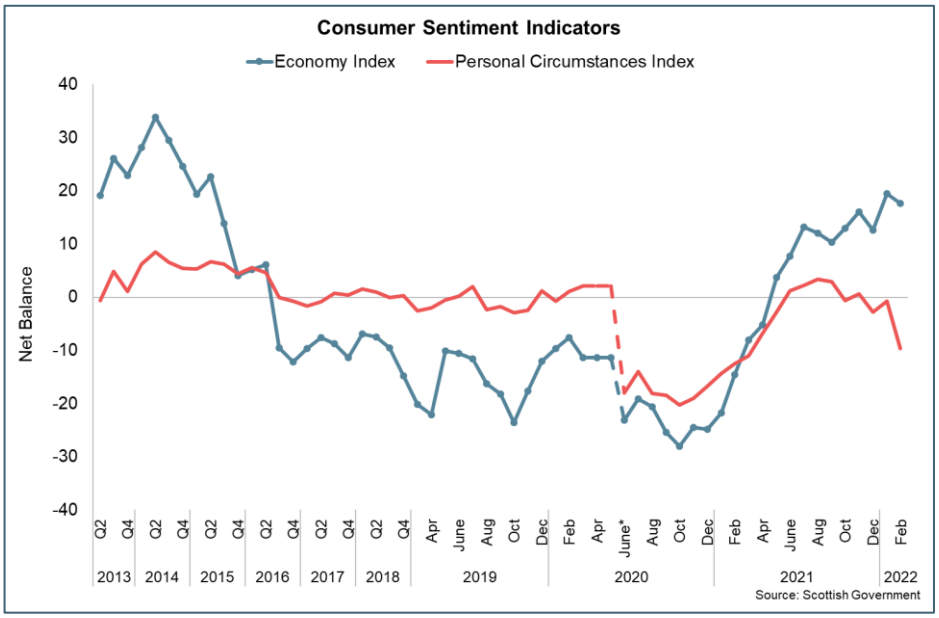


- In terms of the current indicators (comparing to 12 months ago), respondents' view of current economic performance was positive and rose 5.4 points, while views on security of household

[25] The latest consumer sentiment survey was undertaken between 2 – 27 February 2022.
[26] Scottish Consumer Sentiment Indicator : Monthly Data - gov.scot (www.gov.scot)

finances and attitude to spending fell by 3.1 points and 13.0 points respectively, remaining negative overall.

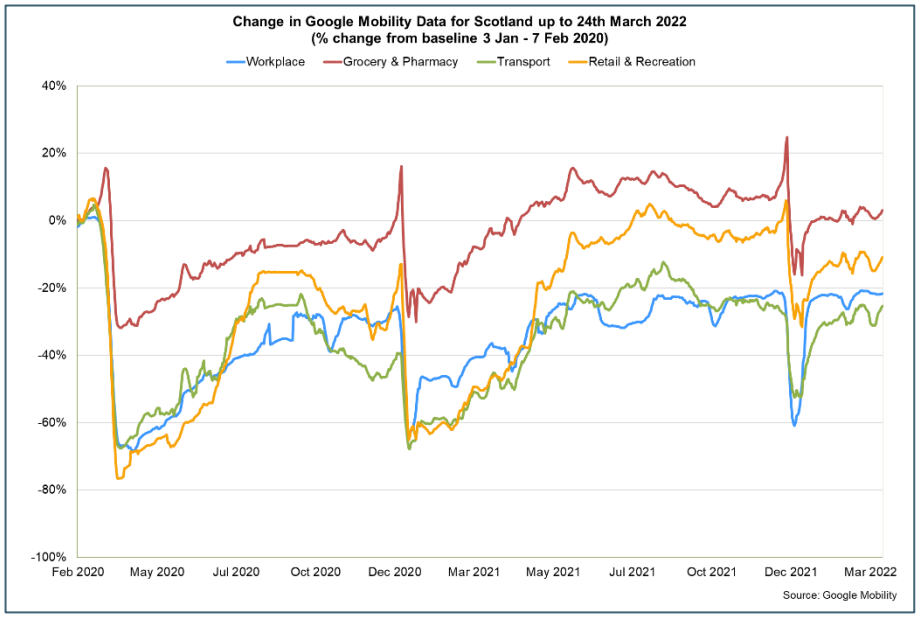
- Expectation indicators for economic performance and security of household finances over the next 12 months fell significantly in February with the indicators falling by 9.1 and 10.5 points respectively. The economy expectations indicator remained positive overall while the household finances indicator returned to negative levels.
- The overall economy index decreased by 1.8 points in February, remaining positive, however the overall personal circumstances index decreased by 8.9 points and remained negative.[27] This potentially reflects a combination of factors that are impacting consumer sentiment at this time with the economy continuing to recover from the pandemic while households are also facing increasing inflationary pressures which are impacting household finances and are likley to influence spending decisions.



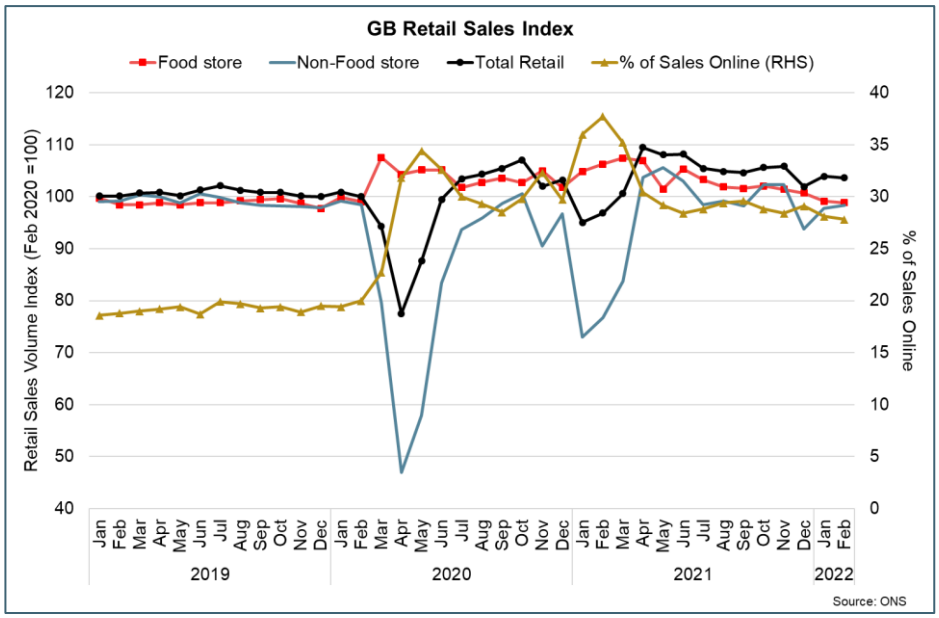
Retail Sales

- Google Mobility data indicates that movement around retail and recreation hubs is continuing to gradually recover from the sharp fall in January during the Omicron wave and holiday period.
- Having fallen 30% below pre-pandemic levels in January, movement around retail and recreation hubs has partially recovered in March to around 9% below pre-pandemic levels.

[27] The Economy Index is the average net balance of the current and expectation economy indictors. The Personal Circumstances index is the average net balance of the current and expected household finance indicators and attitude to spending indicator.



- Retail sales volumes in Great Britain continued to moderate in February 2022, and fell 0.3% over the month following a rebound of 1.9% in January.[28]
- Non-food stores sales rose by 0.6% over the month driven by an increase in clothing (+13.2%) and department stores (+1.3%), potentially driven by more socialising activity as restrictions eased. However, the increases were partly offset by a 7% fall in other non-food store sales including household goods stores which fell by 2.5%.



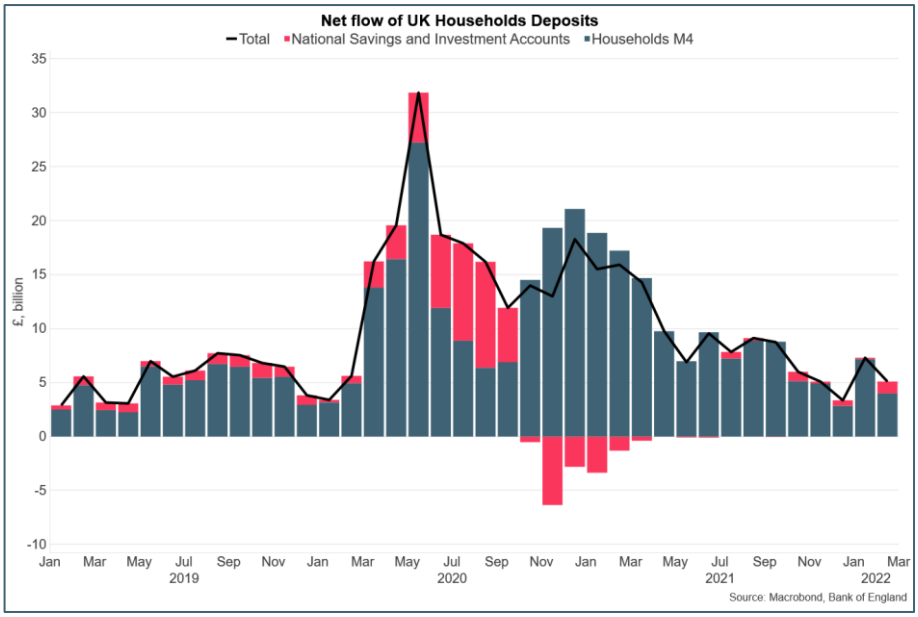
- Automotive fuel sales rose by 3.6% in February and were above their pre-pandemic level for the first time (+0.9%).
- Overall, retail sales have fallen 5.3% from their peak in April 2021, though remain 3.7% above their pre-pandemic level in February 2020.

[28] Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)

- Online retail as a proportion of all retail sales, fell to 27.8% (down from 28.1% in January). This continues the wider downward trend since its peak in February 2021 (37.7%) though remains significantly higher than in February 2020 prior to the pandemic (20%).

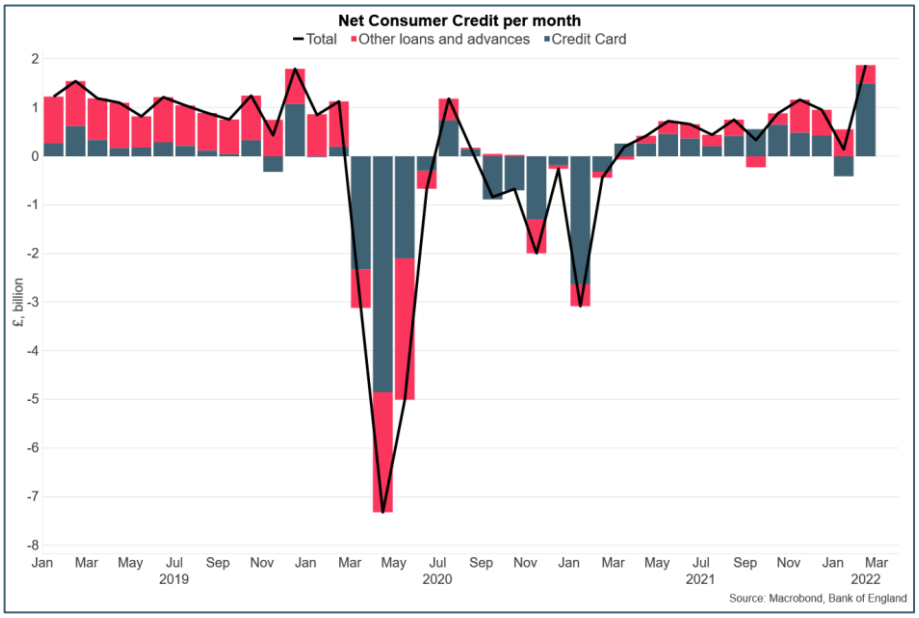
Household Savings and Consumer Credit

- At an aggregate level, households increased their levels of savings during the pandemic due to a reduction in expenditure coupled with a rise in disposable income through the retention of earnings. This was particularly evident during periods of lockdown in Q2 2020 and Q1 2021 when consumer facing services were largely closed.
- Bank of England data provides insights at an aggregate level of how savings and consumer credit flows have evolved as restrictions have been removed and economic activity has recovered alongside a rise in inflationary pressures.
- In recent months, at an aggregate level, net flows from UK households into deposit-like accounts have returned to a broadly similar position as they were prior to the pandemic. In February, net inflows eased slightly to £5.1 billion, down from £7.3 billion in January and is slightly lower than pre-pandemic flows which averaged £5.5 billion in the year to February 2020.[29]



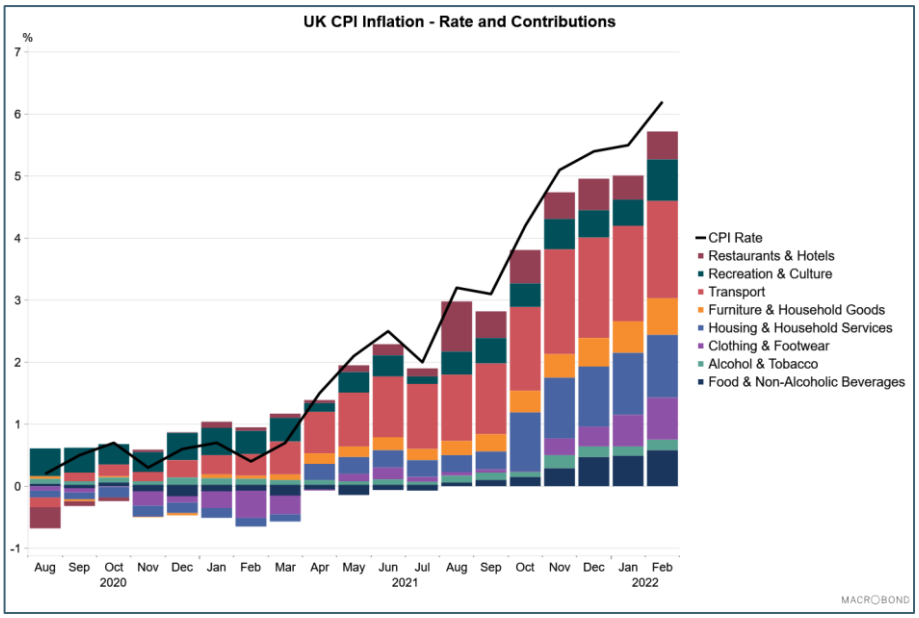
- Alongside this, net consumer credit fell significantly during the pandemic, however started to grow again over the course of 2021. In February, consumers' net borrowing picked up notably to £1.9 billion, its highest monthly level since 2017, reflecting predominantly a sharp rise in credit card borrowing to £1.5 billion while 'other' forms of consumer credit (such as card dealership finance and personal loans) was £0.4 billion over the month.

[29] Money and Credit - February 2022 | Bank of England



Inflation

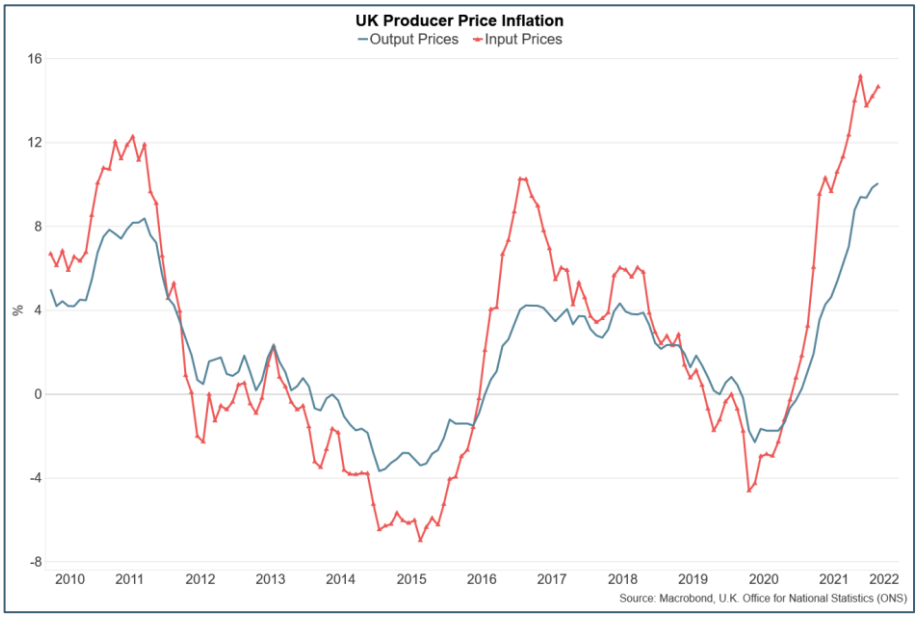
- UK CPI inflation rose to 6.2% in February 2022, up from 5.5% in January and has risen to its highest rate since 1992 when it stood at 7.1%, presenting increased cost of living challenges.[30] Inflation rates have also continued to rise in the US (7.9%) and in the Eurozone (5.9%), in part reflecting rising energy prices over the past year.



- In February, UK consumer prices rose over the year across almost all goods and services monitored. Most notably there was large increases in electricity and fuel prices (+23%), in transport (+11.5%, driven by second-hand car price increases +30.6%), clothing and footwear (+8.9%) and in furniture (9.1%).

[30] Consumer price inflation, UK - Office for National Statistics

- Further inflationary pressures are expected, exacerbated by the situation in Ukraine and the impact on global commodity prices, with the Bank of England forecasting inflation to rise to around 8% in the first half of 2022 and potentially rise further later in the year, intensifying the cost of living challenges.
- This is expected to impact through a rise in energy prices and the pass through of higher producer costs to consumers. Producer price inflation (changes in the prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased and factory gate prices) has risen over the past year and remained elevated in February with input price inflation at 14.7% in February (up from 13.6% in January) while output price inflation was 10.1% (up from 9.9% in January).[31]



- In response to the further rise in underlying inflationary pressures for the year ahead, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25 percentage points to 0.75% in March, having previously raised it by 0.25 percentage points in February 2022.[32]

GDP growth outlook

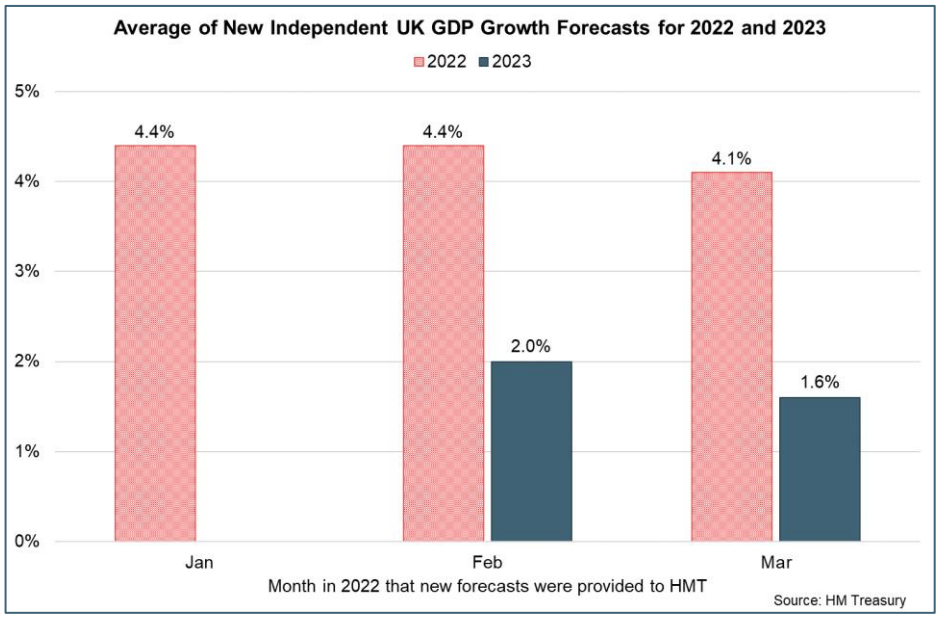
The economic outlook is more uncertain as a result of the situation in Ukraine, however higher inflationary pressures will slow growth in 2022.

- The situation in Ukraine presents significant uncertainty and risk to the global economic outlook. The initial economic impacts have been seen in an increase in global commodity prices in which

[31] Producer price inflation, UK - Office for National Statistics (ons.gov.uk)
[32] Bank Rate increased to 0.75% - March 2022 | Bank of England

Ukraine and Russia are key producers, however the wider economic implications are yet to fully emerge and continue to depend on how the situation and policy responses evolve.

- In December, prior to the situation in Ukraine, the OECD forecast further recovery from the pandemic with global GDP growth of 4.5% in 2022 and 3.2% in 2023, while inflation was forecast to rise to 4.2% in 2022 and ease to 3% in 2023. Subsequent OECD illustrative model simulations in March suggest that global growth could be reduced by over 1 percentage point, and global inflation raised by close to 2.5 percentage points in the first full year after the start of the conflict.[33]
- At a UK level the Office for Budget Responsibility (OBR) March forecasts, revised down the UK GDP growth forecast to 3.8% in 2022 (revised down 2.2 percentage points from October) and 1.8% in 2023 with the downward revision in the near term reflecting higher inflation weighing on real incomes and consumption.
- The OBR forecast inflation to rise to close to 9% in Q4 2022, mainly reflecting higher global energy prices, with higher inflation outpacing nominal earnings growth. Combined with net tax increases starting April, they estimate that this could result in real UK household disposable income per person falling by 2.2% in 2022-23.[34]
- The average of new independent forecasts in March (published monthly by HMT) forecast UK GDP growth of 4.1% in 2022 and 1.6% in 2023, which have fallen by 0.3 and 0.4 percentage points respectively over the month.[35]



[33] OECD Economic Outlook
[34] Economic and fiscal outlook - March 2022 - Office for Budget Responsibility (obr.uk)
[35] Forecasts for the UK economy: March 2022 - GOV.UK (www.gov.uk)

- At a Scotland level, the most recent Scottish Fiscal Commission (SFC) forecasts from December 2021 (prior to the latest outturn data following the Omicron wave and developments in Ukraine) expect the Scottish economy to continue recovering from the pandemic with growth of 3.8% in 2022 and 1.3% in 2023.[36]
- More recently in March, the Fraser of Allander Institute downgraded their forecasts for Scottish GDP growth in 2022 to 3.5% (down from 4.7% in their December forecast), reflecting the impacts on households and businesses of higher inflation, with growth forecast to moderate further to 1.5% in 2023 and 1.4% in 2024.[37]

[36] Scotland's Economic and Fiscal Forecasts – December 2021 | Scottish Fiscal Commission
[37] Outlook for growth in 2022 worsens as cost increases begin to bite | FAI (fraserofallander.org)

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