

Monthly Economic Brief

Office of the Chief Economic Adviser

July 2022

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July 2022**

Data up to 29 July 2022

Overview

This month's economic brief provides an update on the latest economic data during the second quarter, providing further insights on the current headwinds facing Scottish households and businesses as the economic outlook continues to weaken.

Following a fall of 0.5% in April, Scotland's output grew by 0.6% in May and although the economy has returned to growth, over the latest two months there has been cumulative growth of just 0.1%, with business survey data pointing to further slowing in June across sectors. However, this is currently most evident in the manufacturing sector which is facing a range of challenges, largely driven by high input costs and a slowing of new orders. Following a fourth consecutive monthly fall in manufacturing output in May, businesses surveys currently point to a further fall in June.

Over the period March to May, Scotland's labour market remained tight with unemployment at 3.5%, near record lows, while the payroll employee level continued to rise in June and there has been further falls in the claimant count. High vacancy rates remain a key feature of the labour market with labour and skills shortages continuing to affect Scottish businesses in June.

Inflation rose to 9.4% in June, the highest UK rate since 1982. Although driven by large increases in energy, fuel and food prices, inflation has become increasingly broad-based, with 80% of items seeing annual price growth above 3%, and continues to be exacerbated by the impacts of the war in Ukraine on global energy and commodity markets. The Bank of England forecast inflation to gradually decline back to its 2% target rate at the end of 2024, as price increases slow. However many of the recent price increases will not be reversed, with prices for many goods and services permanently higher.

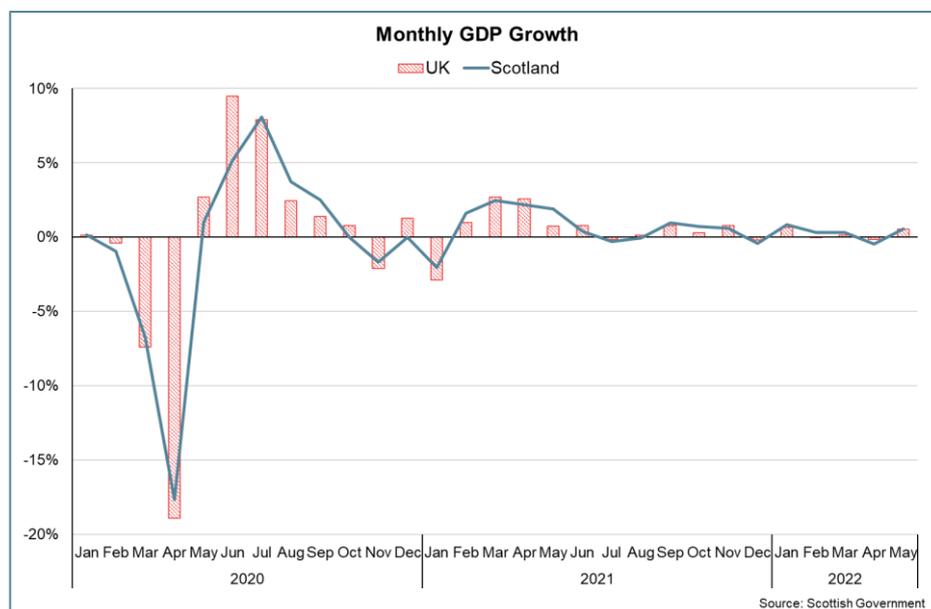
The combination of supply shortages and rising inflation is presenting significant cost challenges for businesses and cost of living pressures for households. Although labour market tightness is contributing to rising nominal wages, earnings growth is still well short of inflation, with mean real PAYE earnings falling over the year in May. The impact on household incomes is reflected in Scotland's consumer sentiment indicator which has fallen sharply since the start of the year. Household attitude to spend indicator in particular has fallen to its lowest level since December 2020 and further raises the likelihood that current supply side challenges in the economy are soon to be accompanied by a notable weakening in demand.

That said, annual GDP growth in 2022 as a whole is expected to be relatively strong, primarily reflecting the impact of the pandemic in 2021, but growth in the second half of the year is expected to weaken sharply going into 2023. The full extent of the forecasts for high inflation and slow growth over the coming period are yet to emerge, however, the recent downgrading of the latest IMF forecasts further highlight the global nature of the challenge that lies ahead.

Output

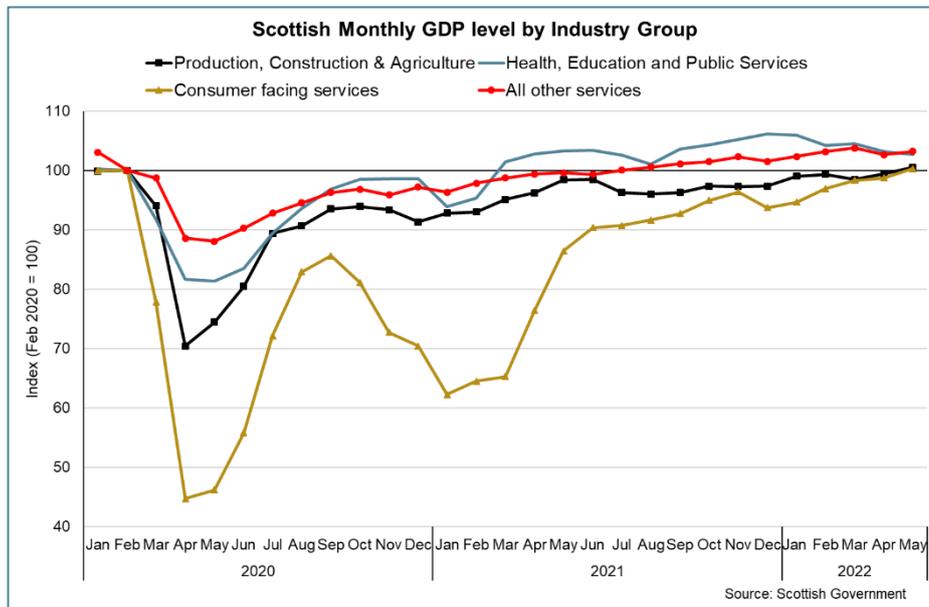
Scottish GDP growth picked up in May, however has generally slowed from the first quarter with growth of just 0.1% over April and May.

- In May, Scottish output grew by 0.6% (UK: 0.5%), and GDP is now 1.1% above its pre-pandemic level in February 2020 (UK: 1.7%).¹



- Although the economy returned to growth in May after the fall in April, over the two months there has been cumulative growth of just 0.1%.
- In the three months to May, GDP is estimated to have grown by 0.7% compared to the previous three month period, with the pace of growth slowing compared to the first quarter of the year. This slowing of growth is consistent with the results for the UK as a whole.
- At a sectoral level, GDP growth was broad based in May. Services output grew by 0.4%, while construction grew by 1.7% and production grew by 1.1%.
- Within the services sector, output in consumer facing services grew by 1.6% and has surpassed the pre-pandemic level of February 2020 for the first time. Growth in sectors such as professional, scientific and technical services (+4.2%) outweighed the slowing in retail (+0.2%) and hospitality growth (0.5%) observed over recent months. Health, education and public services output fell by 0.4%, and output in all other services grew by 0.5%.

¹ [GDP Monthly Estimate: May 2022 - gov.scot \(www.gov.scot\)](https://www.gov.scot/publications/gdp-monthly-estimate/may-2022/pages/2-3-4-5-6-7-8-9-10-11-12-13-14-15-16-17-18-19-20-21-22-23-24-25-26-27-28-29-30-31-32-33-34-35-36-37-38-39-40-41-42-43-44-45-46-47-48-49-50-51-52-53-54-55-56-57-58-59-60-61-62-63-64-65-66-67-68-69-70-71-72-73-74-75-76-77-78-79-80-81-82-83-84-85-86-87-88-89-90-91-92-93-94-95-96-97-98-99-100-101-102-103-104-105-106-107-108-109-110-111-112-113-114-115-116-117-118-119-120-121-122-123-124-125-126-127-128-129-130-131-132-133-134-135-136-137-138-139-140-141-142-143-144-145-146-147-148-149-150-151-152-153-154-155-156-157-158-159-160-161-162-163-164-165-166-167-168-169-170-171-172-173-174-175-176-177-178-179-180-181-182-183-184-185-186-187-188-189-190-191-192-193-194-195-196-197-198-199-200-201-202-203-204-205-206-207-208-209-210-211-212-213-214-215-216-217-218-219-220-221-222-223-224-225-226-227-228-229-230-231-232-233-234-235-236-237-238-239-240-241-242-243-244-245-246-247-248-249-250-251-252-253-254-255-256-257-258-259-260-261-262-263-264-265-266-267-268-269-270-271-272-273-274-275-276-277-278-279-280-281-282-283-284-285-286-287-288-289-290-291-292-293-294-295-296-297-298-299-300-301-302-303-304-305-306-307-308-309-310-311-312-313-314-315-316-317-318-319-320-321-322-323-324-325-326-327-328-329-330-331-332-333-334-335-336-337-338-339-340-341-342-343-344-345-346-347-348-349-350-351-352-353-354-355-356-357-358-359-360-361-362-363-364-365-366-367-368-369-370-371-372-373-374-375-376-377-378-379-380-381-382-383-384-385-386-387-388-389-390-391-392-393-394-395-396-397-398-399-400-401-402-403-404-405-406-407-408-409-410-411-412-413-414-415-416-417-418-419-420-421-422-423-424-425-426-427-428-429-430-431-432-433-434-435-436-437-438-439-440-441-442-443-444-445-446-447-448-449-450-451-452-453-454-455-456-457-458-459-460-461-462-463-464-465-466-467-468-469-470-471-472-473-474-475-476-477-478-479-480-481-482-483-484-485-486-487-488-489-490-491-492-493-494-495-496-497-498-499-500)



- Within the production sector, growth over the month was largely driven by growth of 8.9% in the electricity and gas supply industry due to record levels of wind power generation during May, while manufacturing output fell by 0.3%, its fourth consecutive monthly decline in output. Overall output in production, construction and agriculture grew by 1.1% compared to the previous month.
- Recovery in output back to pre-pandemic levels continues to vary by sector. Output in the production, construction and agriculture group is 0.6% above its pre-pandemic level, however this is driven by the construction sector (4.7 above) while production output remains 1.2% below. In the services sector, despite contracting in the most recent months (mostly due to the reductions in NHS test and trace activities throughout April), health, education and public services remains 2.7% above while consumer facing services is 0.3% above and output in all other services was 3.2% above its pre-pandemic level.

Businesses

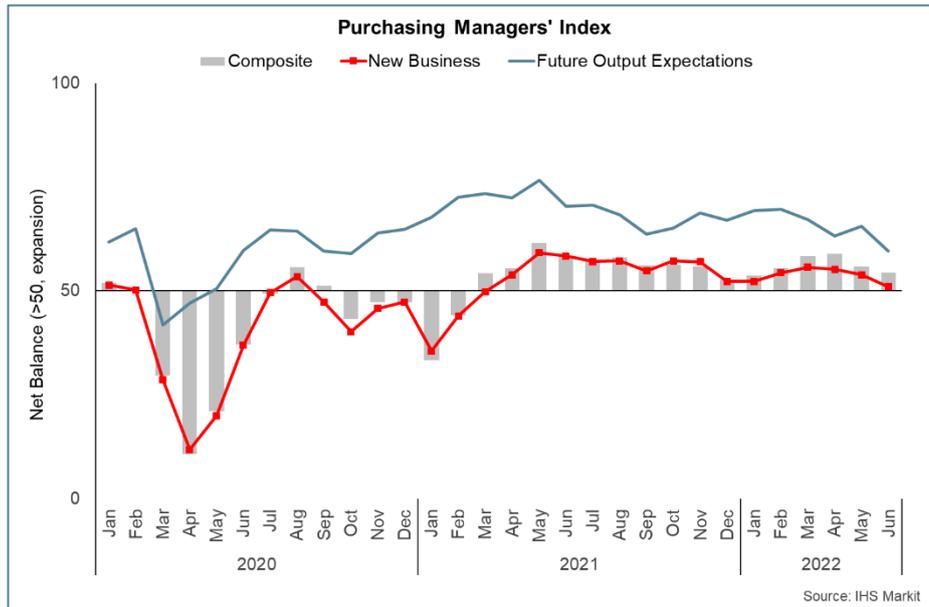
Businesses growth momentum continues to ease with new orders and business confidence weakening most notably in the manufacturing sector.

Business activity and expectations

- The Purchasing Managers Index (PMI) business survey signalled that Scottish business activity continued to expand in June (54.4). However, the rate of expansion was the softest since January and was driven by the services sector (55.4) while manufacturing activity recorded a slight decline (49.9).²

² IHS Markit, RBS Purchasing Managers Index: [Royal Bank of Scotland PMI report for June 2022 | Royal Bank of Scotland \(rbs.co.uk\)](https://www.rbs.co.uk/press-releases/2022/06/royal-bank-of-scotland-pmi-report-for-june-2022)

- Growth in new business in June was the slowest since March 2021, with manufacturing new orders falling for a second consecutive month while new business in the services sector increased at a notably more moderate rate than in recent months. Business optimism overall remains positive with further recovery and a boost in economic conditions expected over the coming year, however cost of living concerns and falling consumer confidence eased the level of optimism to its lowest level since October 2020.



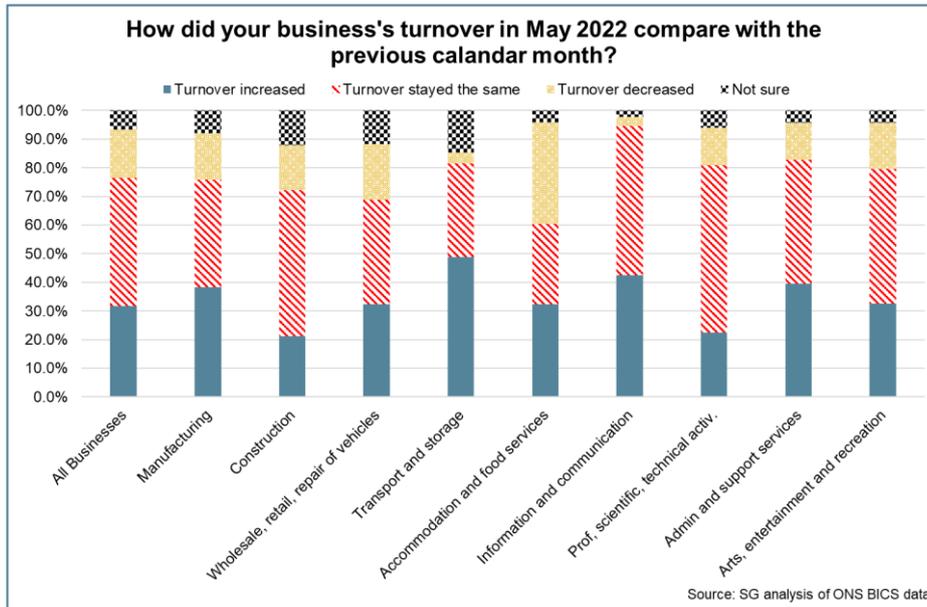
- Flash UK PMI data for July indicates that new order volumes continued to fall for manufacturing businesses with a lack of new work to replace completed orders, while business optimism remained stronger in the services economy and continued to moderate in the manufacturing sector.³

Business turnover and input costs

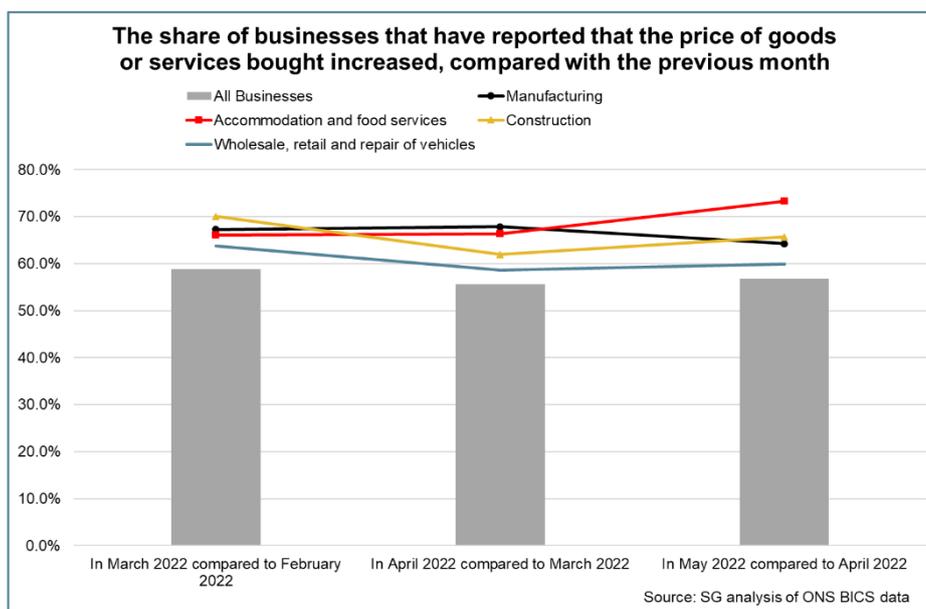
- The Business Insights and Conditions Survey (BICS)⁴ provides regular insight into business financial performance as the economy continues its recovery from the pandemic and in the face of current headwinds.
- BICS data up to the start of May indicates that at an aggregate level, business turnover has been improving as Covid restrictions on the economy have been removed with a declining share of business reporting that turnover has decreased compared to normal and a rising share reporting that turnover has increased.

³ S&P Global/CIPS, Flash UK Composite PMI: [spglobal.com](https://www.spglobal.com)

⁴ [BICS weighted Scotland estimates: data to wave 59 - gov.scot \(www.gov.scot\)](https://www.gov.scot/data-to-wave-59)

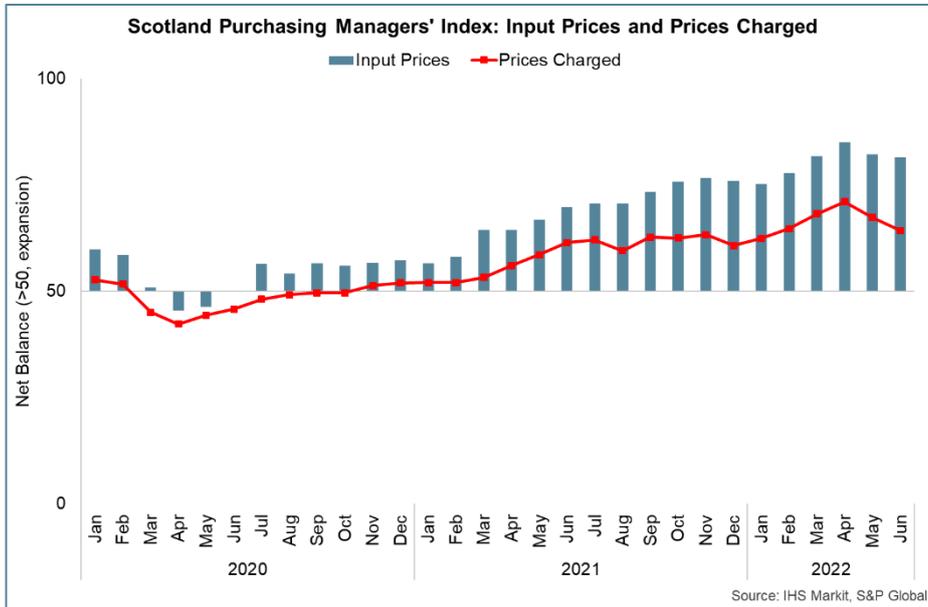


- When asked how business turnover in May compares to the previous month, 32% of respondents reported that turnover had increased (up from 24% in April), 45% reported it had stayed the same (down from 47%) and 17% reported it decreased (down from 20%).⁵
- Supply side challenges continue to be key factors impacting business activity with 36% and 26% of respondents respectively reporting that material costs and labour costs are impacting their business turnover.
- Intense input cost pressures continued in May with over half of all businesses reporting that prices had increased relative to April, (57%, up from 56% in April). Increased prices remained most widespread in accommodation and food services (73%), construction (66%), manufacturing (64%), and wholesale, retail and repair of vehicles (60%).



⁵ [BICS weighted Scotland estimates: data to wave 59 - gov.scot \(www.gov.scot\)](https://www.gov.scot/data/bics-weighted-scotland-estimates)

- In response to price rises, 58% of all businesses in May reported having to absorb costs (up from 50% in May), while 38% had to pass increased costs onto consumers. Scottish PMI data also indicated a further pass through of higher input costs to customers in June. Both the input costs indicator (81.4) and prices charged (64.3) continued to ease back from their series high levels in April, however remained elevated and reflected that firms are facing higher energy, materials and labour costs and have raised prices to offset the squeeze on margins.



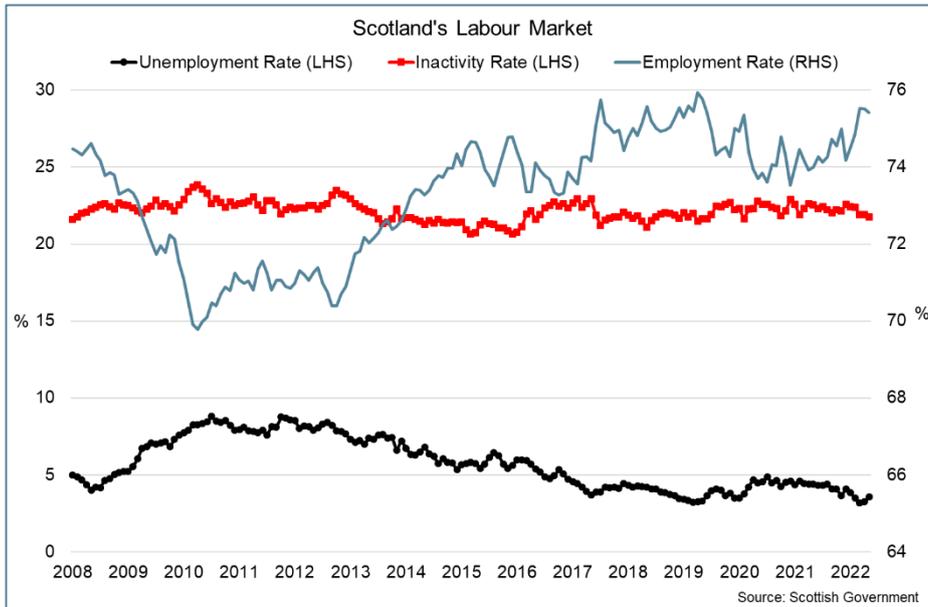
Labour Market

Scotland's labour market remains tight with continuing high vacancy rates and declining staff availability.

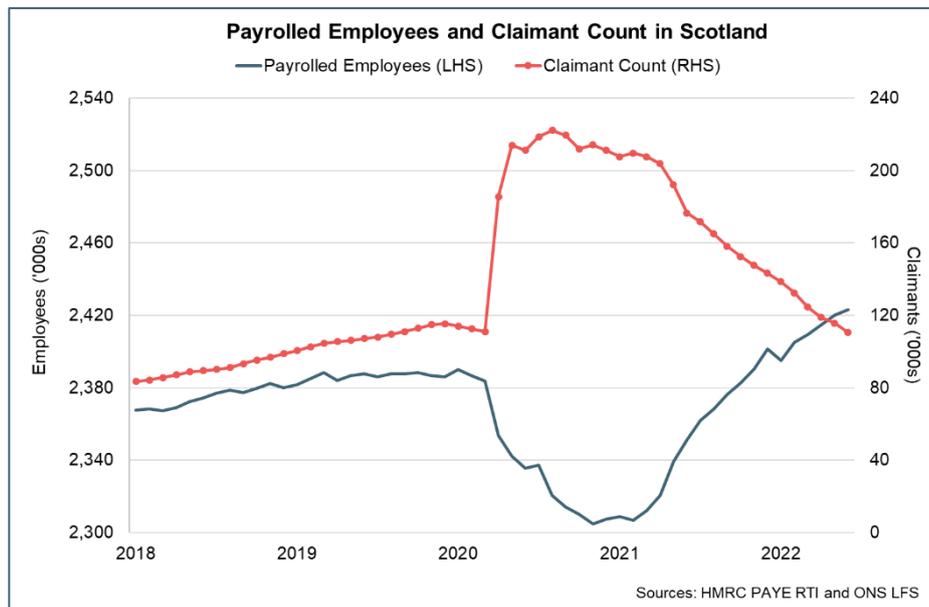
Official labour market statistics, payrolled employment and claimant count

- The latest labour market statistics for March to May 2022 in Scotland show there were 2.7 million people in employment (rate of 75.4%, up 1.4 percentage points over the year), 99,000 people unemployed (rate of 3.5%, down 0.9 percentage points) and 748,000 people economically inactive (rate of 21.8%, down 0.8 percentage points).⁶

⁶ [Labour Market Trends: July 2022 - gov.scot \(www.gov.scot\)](http://www.gov.scot)



- Pay As You Earn (PAYE) Real Time Information estimates indicate the number of payrolled employees in Scotland continued to increase in June, rising by 3,000 over the month to 2.42 million, 37,000 more than the pre-pandemic level in February 2020. The rate of growth over the month eased to 0.1%, and is slightly below the the average monthly rate of growth over the past year (0.3%).⁷



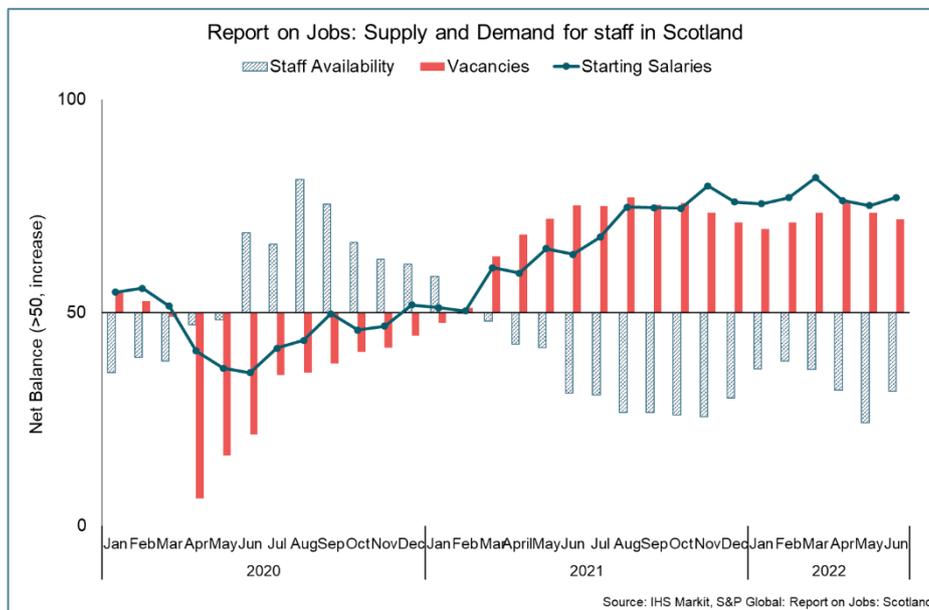
- Scotland's Claimant Count (the number of claimants of Job Seekers Allowance and claimants of Universal Credit claiming principally for the reason of being unemployed) also continued its downward trend in May, falling 4.4% over the month to 110,600; a claimant count rate of 3.6%.

⁷ [Earnings and employment from Pay As You Earn Real Time Information, UK - Office for National Statistics \(ons.gov.uk\)](https://ons.gov.uk/earnings-and-employment-from-pay-as-you-earn-real-time-information)

- Overall, the claimant count has fallen 50% from its peak in August 2020 and is 1,900 claimants below its pre-pandemic level in February 2020.⁸

Demand and supply of staff

- Business surveys signalled that labour market tightness continued to persist in June with high vacancy rates and falling candidate availability.
- The latest Report on Jobs signalled that overall demand for staff (vacancies) continued to grow in June (71.9) and although the pace of growth slowed over the month, it remained high compared to historical standards.⁹
- Supply side challenges in the labour market have also continued with candidate availability (labour supply) continuing to fall. The rate of contraction in June eased slightly with ongoing skill shortages, the tight labour market and Brexit all linked to the decrease.



- More recent online vacancies data also signal that strong demand for staff continued throughout July, with weekly online job vacancies 33% higher than in February 2020.¹⁰
- The strength in demand for staff, coupled with low unemployment, falls in candidate availability and challenges in recruiting the necessary staff, meant upward pressure on starting salaries remained elevated in June, with the report on jobs overall pay index rising the month and remaining elevated.
- Labour shortages continue to affect a range of sectors with 38% off all businesses experiencing a shortage of workers in June. The overall share has picked-up since the start of the year and

⁸ [Labour Market Trends: July 2022 - gov.scot \(www.gov.scot\)](http://www.gov.scot)

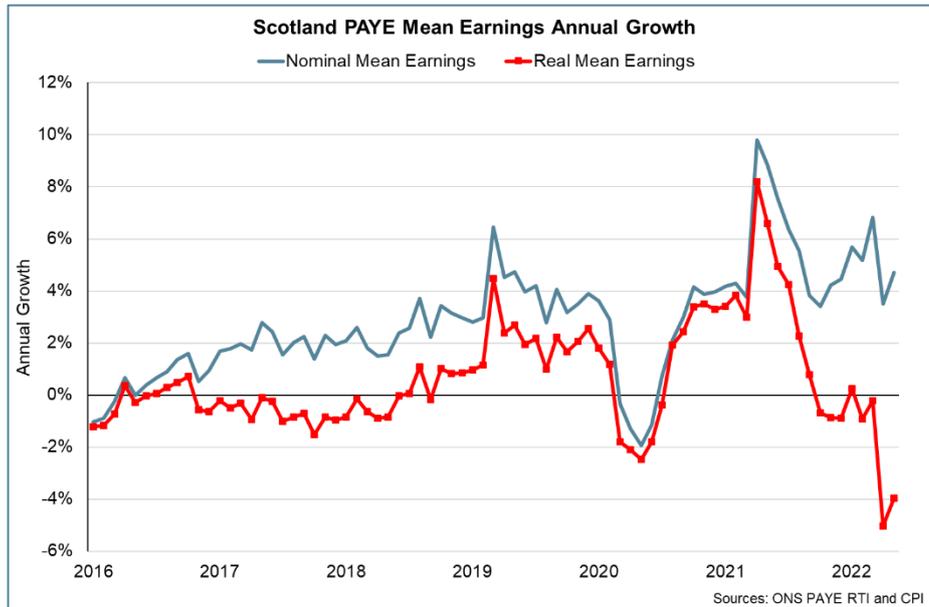
⁹ [Royal Bank of Scotland PMI report for June 2022 | Royal Bank of Scotland \(rbs.co.uk\)](http://rbs.co.uk)

¹⁰ [Online job advert estimates - Office for National Statistics \(ons.gov.uk\)](http://ons.gov.uk)

remains most notable in accommodation and food services (44%), construction (43%), and the arts, entertainment and recreation (43%) sectors.¹¹

Earnings

- Nominal mean earnings annual growth has stabilised slightly after a sharp fall during the pandemic and then a strong rebound, in part driven by workers moving into and then out of furlough.¹²



- Latest data show mean monthly nominal pay grew 0.1% over the month in May (UK: -0.9%), and grew 4.7% (UK: 5.3%) annually to £2,601 (UK: £2,842).¹³
- The pace of annual nominal earnings growth in May was similar to annual growth rates in 2019. However, adjusting for inflation, which rose to 9.1% in May, real mean earnings fell 4.0% on an annual basis, the fourth consecutive month of negative annual growth.

Consumption

Consumer sentiment continued to weaken in June and is now at its lowest level since February 2021.

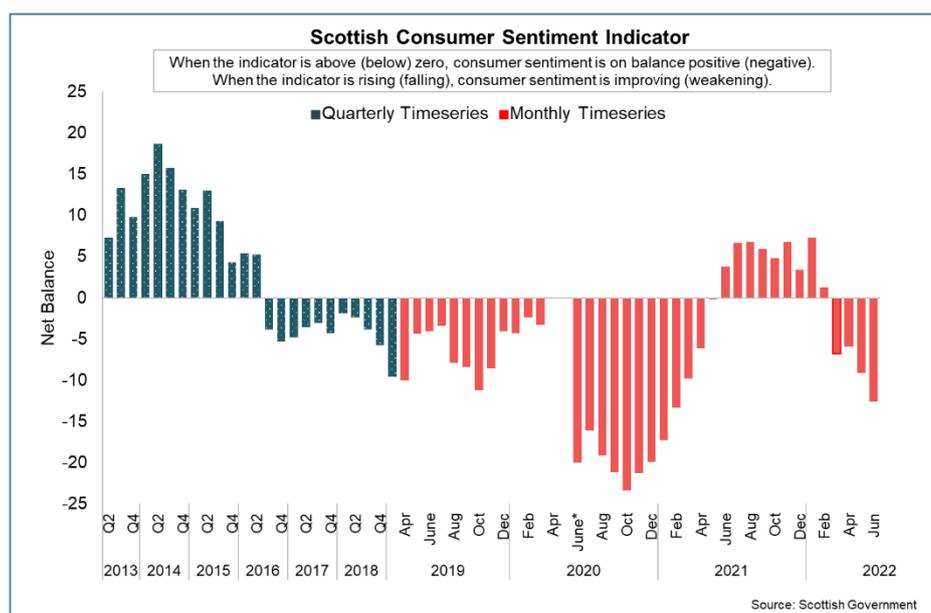
Consumer sentiment

¹¹ [BICS weighted Scotland estimates: data to wave 59 - gov.scot \(www.gov.scot\)](https://www.gov.scot/data/bics-weighted-scotland-estimates-data-to-wave-59)

¹² 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.

¹³ [Earnings and employment from Pay As You Earn Real Time Information, UK - Office for National Statistics \(ons.gov.uk\)](https://ons.gov.uk/earnings-and-employment-from-pay-as-you-earn-real-time-information-uk)

- Consumer sentiment indicators continue to be highly sensitive to the rapidly changing economic environment as the economy recovers from the pandemic while at the same time households and consumers are facing significant challenges from the sharp rise in inflation and cost of living.
- These challenges have intensified since the start of the year, which has been reflected in a sharp drop off in the Scottish Consumer Sentiment Indicator.
- Latest data show consumer sentiment declined considerably over the month to June (-12.6 down from -9.1 in May). Overall, consumer sentiment has fallen 19.9 points since the start of the year and is at its lowest level since February 2021.^{14,15}

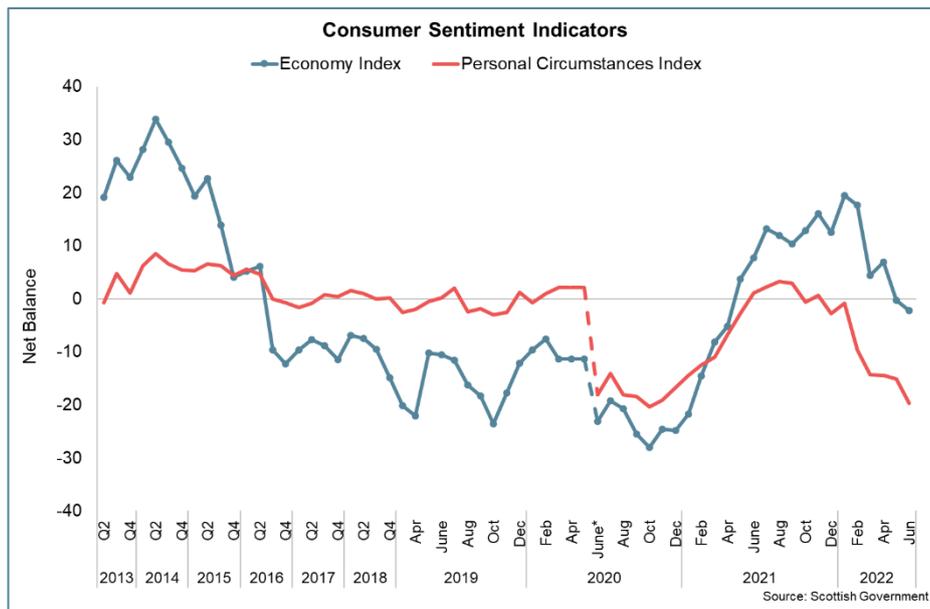


- On the economy, respondents on balance consider current economic circumstances to be worse than last year (-15.5 down from -11.8 in May). Looking ahead, respondents expect the economy to improve over the coming year relative to the current situation (+11.2). Although the level of optimism has been on a downward trend since July 2021, it remained broadly stable over the month.
- In terms of households personal finances, respondents on balance continued to report that their household finances are less secure than 12 months ago (-19.7, down from -16.5 in May). Looking ahead, sentiment towards expected finances fell significantly over the month (-8.7 down from -0.1).
- Both the outlook for the economy and household finances influence the extent to which households are relaxed about spending money. Since the beginning of the year, households have been increasingly uneasy about spending money as inflationary and cost of living

¹⁴ The latest consumer sentiment survey was undertaken between 1 – 27 June 2022.

¹⁵ [Scottish Consumer Sentiment Indicator : Monthly Data - gov.scot \(www.gov.scot\)](https://www.gov.scot/scottish-consumer-sentiment-indicator-monthly-data)

pressures have increased, with the indicator falling to -30.4 in June; its lowest level since December 2020.

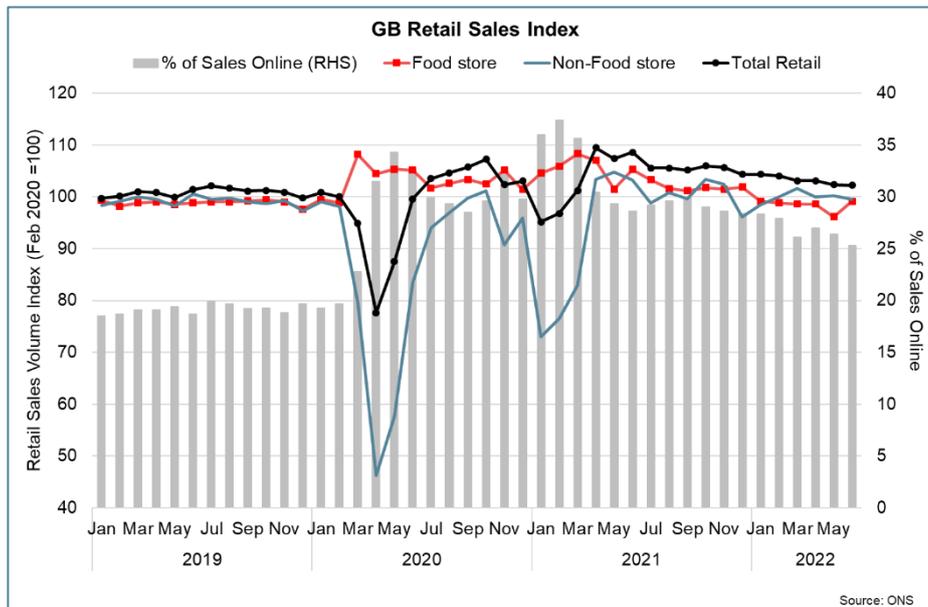


- Overall, the fall in sentiment since the start of the year has been driven by a combination of falling sentiment regarding the economy as a whole, and falling sentiment regarding personal household financial circumstances and personal relaxedness to spending money.
- This reflects the challenging economic environment households are facing and the risks to consumption growth over the months ahead.

Retail Sales

- Retail sales volumes fell by 0.1% in June 2022, following a fall of 0.8% in May and have fallen 5.9% over the year. However, sales volumes remain 2.2% above their pre-pandemic level.¹⁶
- Non-food stores sales fell 0.7% over the month driven by falls in clothing stores (-4.7%) and household goods stores (-3.7%). Food stores rose by 3.1% over the month with retailers attributing increased sales due to the Queen’s Jubilee celebrations.

¹⁶ [Retail sales, Great Britain - Office for National Statistics \(ons.gov.uk\)](https://ons.gov.uk)



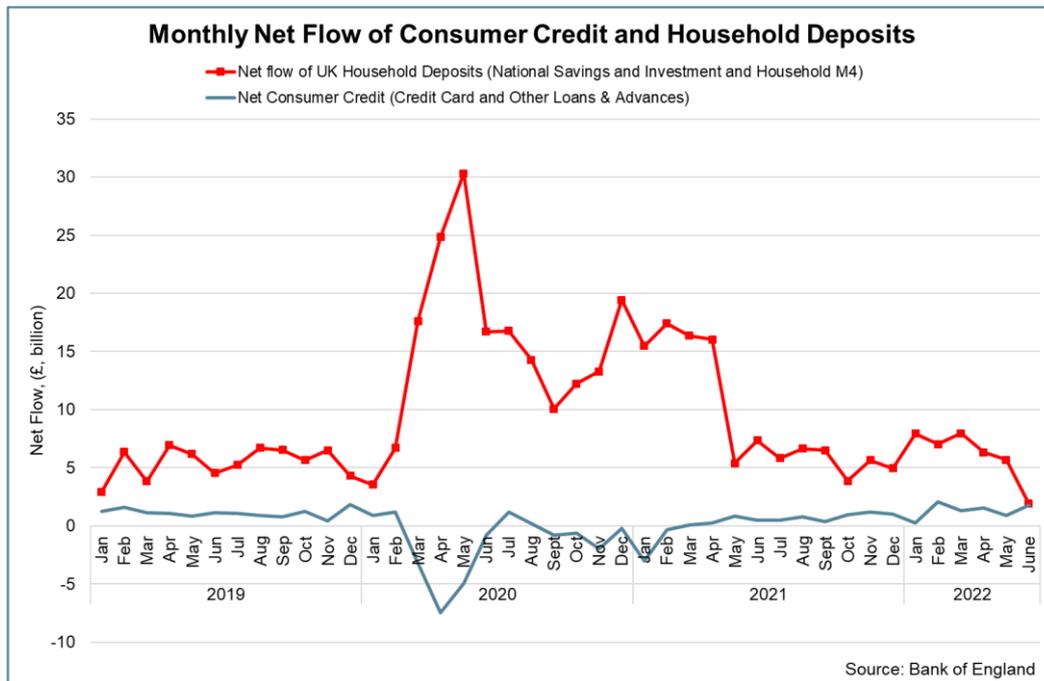
- Automotive fuel sales volumes fell by 4.3% in June, down from growth of 0.8% in May, with sales volumes 7.6% below their pre-pandemic February 2020 level. The ONS retail sales publication suggests that record high prices of petrol and diesel was reducing the volume of sales.
- Online retail as a proportion of all retail sales, fell to 25.3% (down from 26.4% in May). This continues the wider downward trend since its peak in February 2021 (37.4%) and is at its lowest proportion since March 2020 (22.8%).

Household Savings and Consumer Credit

- At an aggregate level, households increased their levels of savings during the pandemic and reduced net credit levels, due to a reduction in expenditure coupled with a rise in disposable income through the retention of earnings.
- Data from the Quarterly National Accounts show that household savings in Scotland in the first three months of 2022 had fallen to 6.4% from their peak of 26.4% in 2020 quarter 2 during the pandemic, meaning they had returned levels similar to before the pandemic levels.¹⁷ Data from the Bank of England data show a similar pattern and provides insights at an aggregate level of how savings and consumer credit flows have evolved in the latest months as economic activity has recovered alongside a rise in inflationary pressures.
- At an aggregate level, net flows from UK households into deposit-like accounts fell significantly in June. Net inflows eased to £1.9 billion, down from £5.6 billion in May and below the average monthly net flow of £4.7 billion during the 12-month pre-pandemic period up to February 2020.¹⁸

¹⁷ [GDP Quarterly National Accounts: 2022 Quarter 1 \(January to March\) - gov.scot \(www.gov.scot\)](https://www.gov.scot/publications/gdp-quarterly-national-accounts-2022-quarter-1-january-to-march/pages/10-to-12.aspx)

¹⁸ [Money and Credit - June 2022 | Bank of England](https://www.bankofengland.co.uk/money-and-credit/money-and-credit-june-2022)

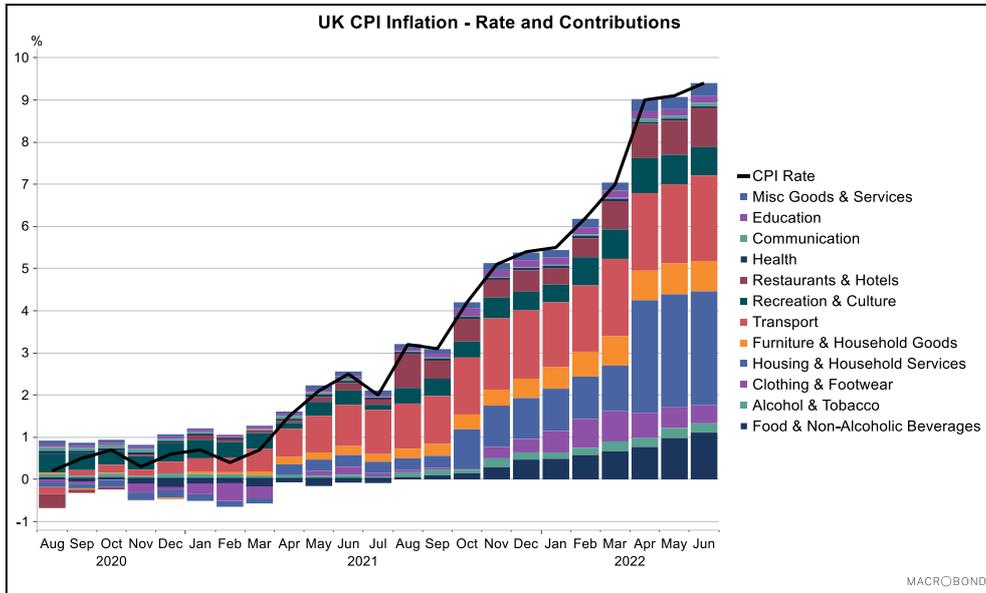


- Alongside this, net consumer credit fell significantly during the pandemic, however started to grow over the course of 2021. In June, consumers' borrowed an additional £1.8 billion, following £0.8 billion of borrowing in May. This is above the pre-pandemic average up to February 2020 of £1.0 billion. The annual growth rate for all consumer credit increased to 6.5% in June; the highest rate since May 2019.

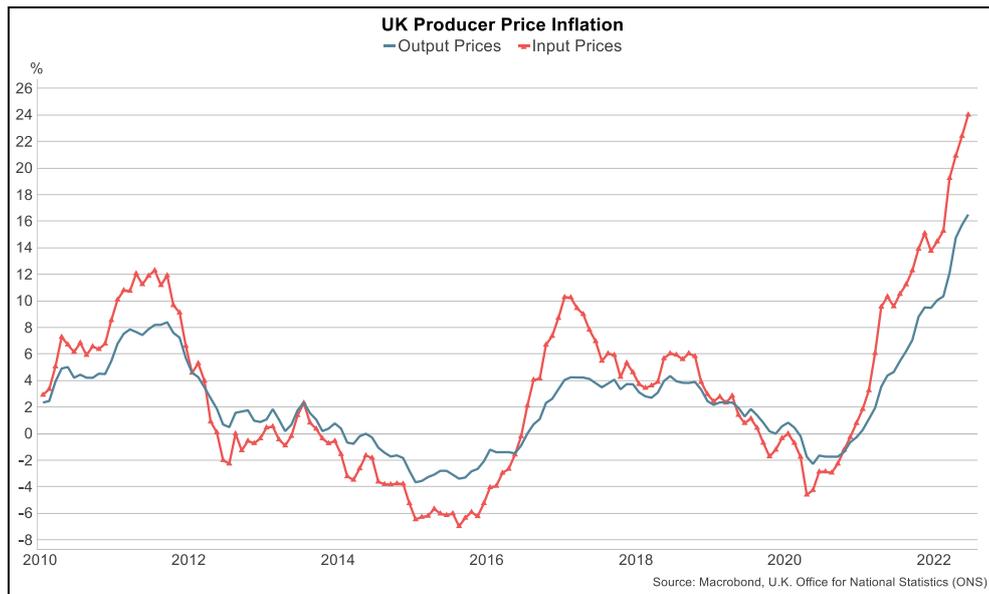
Inflation

- UK CPI inflation rose to 9.4% in June 2022, up from 9.1% in May and has risen to its highest rate since 1982.¹⁹ Inflation rates have also continued to rise in the US (8.6%) and in the Eurozone (8.6%), in part reflecting rising energy prices over the past year.
- In June, UK consumer prices rose over the year across almost all goods and services monitored. Most notably there was large increases in electricity, gas and fuel prices (+70.2%), transport (+14.9%), furniture (+14.9) and in food and non-alcoholic beverages (+9.8%).

¹⁹ [Consumer price inflation, UK - Office for National Statistics](#)



- Looking ahead, the Bank of England forecast inflation to rise to over 11% in October 2022, reflecting higher food, core goods and services price inflation and a prospective large increase in the Ofgem price cap, which are expected to intensify cost of living challenges.
- The pass through of higher energy and material prices from producers to consumers is an important aspect of this. 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 has remained elevated. In June input price inflation rose to 24.0% (up from 22.4% in May) and is at its highest rate since records began in January 1985, while output price inflation was 16.4% (up from 15.8% in April) its highest rate since September 1977.²⁰



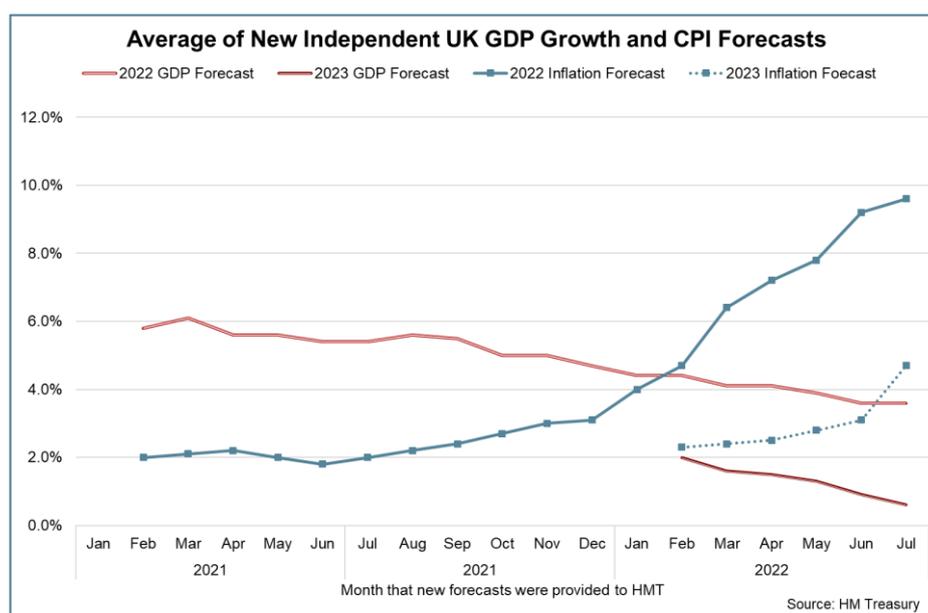
²⁰ [Producer price inflation, UK - Office for National Statistics \(ons.gov.uk\)](https://ons.gov.uk/producer-price-inflation)

- 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 1.25% in June; its fifth consecutive rate rise since December and up from 0.1% over this period.²¹

Economic outlook

Latest output growth forecasts continue to be revised down as the inflationary outlook continues to sharpen.

- At a global and domestic level, the economic outlook has weakened significantly since the start of the year as rising inflationary pressures, exacerbated by the war in Ukraine, are expected to weigh on the GDP growth outlook over this year and next.
- At a global level, in July, the IMF forecast the global economy to grow 3.2% in 2022 (down from 3.6% forecast in April) and 2.9% in 2023 (down from 3.6%) commenting that the downward revisions reflects stalling growth in the world's three largest economies – the US, China and the euro area. The IMF also uprated their inflation forecasts with the risks to the forecasts weighted to the downside.²²
- At a UK level, the average of new independent forecasts in July (published monthly by HMT) highlights the combination of the upgrades to inflation forecasts and downgrades to growth forecasts. UK GDP is forecast to grow 3.6% in 2022 (unchanged over the month) and 0.6% in 2023 (down 0.3 p.p over the month).²³



²¹ [Bank Rate increased to 1.25% - June 2022 | Bank of England](#)

²² [World Economic Outlook Update, July 2022: Gloomy and More Uncertain \(imf.org\)](#)

²³ [Forecasts for the UK economy - GOV.UK \(www.gov.uk\)](#)

- In contrast, the average independent projected CPI inflation rates have been revised up to 9.6% in Q4 2022 (up 0.4 p.p over the month) and 4.7% in Q4 2023 (up 1.6 p.p). This points to current expectations that as inflation will potentially peak at the end of this year and start to ease back over 2023, the GDP growth outlook for 2023 and 2024 is notably weaker than for 2022. For example, the Bank of England project inflation to rise above 11% in October 2022 and for UK GDP growth to ease from 3.75% in 2022 to around -0.25% growth in 2023 and 0.25% growth in 2024.
- Forecasts for Scotland's economy have followed a similar pattern. The most recent Scottish Fiscal Commission (SFC) forecasts in May forecast Scotland's economy to grow 4% in 2022, slowing to 1% in 2023. The SFC forecast CPI inflation to peak at 8.7% in Q4 2022 and forecast real average earnings to decrease by 2.7% in 2022-2023.²⁴
- Most recently in June, the Fraser of Allander Institute forecast Scottish GDP growth in 2022 of 3.8%, however in the face of higher and more persistent inflation, have revised down the growth outlook for 2023 to 0.5% (previously 1.5%) and for 2024 to 1% (previously 1.4%).²⁵

²⁴ [Scotland's Economic and Fiscal Forecasts – May 2022 | Scottish Fiscal Commission](#)

²⁵ <https://fraserofallander.org/publications/fai-economic-commentary-2022-q2/>



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St Andrew's House
Edinburgh
EH1 3DG

ISBN: 978-1-80435-797-2 (web only)

Published by The Scottish Government, July 2022

Produced for The Scottish Government by APS Group Scotland, 21 Tennant Street, Edinburgh EH6 5NA
PPDAS1133142 (07/22)

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