

# **Monthly Economic Brief**

**Office of the Chief Economic Adviser**

**April 2023**

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**Office of the Chief Economic Adviser**

**Gary Gillespie  
Chief Economist  
April 2023**

**Data up to 28 April 2023**

## Overview

The start of 2023 has seen a slight improvement in economic activity and optimism compared to the second half of 2022 during which economic output remained broadly flat and inflation rose to its highest rate since 1981. However, economic conditions are extremely challenging and the outlook for the year ahead remains subdued.

Latest GDP estimates show the Scottish economy grew 0.4% over the three months to February with the pace of growth strengthening in recent months to its highest rate since May last year. While the increase in growth is moderate overall, the recent pick-up has been most evident in the Production (0.9%) and Construction (1.1%) sectors while Service sector growth has remained more modest (0.2%). That said, consumer facing services growth (1.4%), has strengthened despite the ongoing challenges facing households from high inflation.

The inflation rate fell to 10.1% in March and is on a downward trend with further falls expected over the year, in particular in April and October, as the impacts of the rise in the energy prices cap over 2022 fall out of the headline rate. The recent easing in inflation has been driven by a fall in motor fuel prices, however this has been partly offset by a further surge in food price inflation which rose to 19.6% in March, its highest rate since 1977, further highlighting the challenges for household budgets.

Consumer sentiment strengthened for a fifth consecutive month in March to its highest level since July last year with respondents expecting the economy to strengthen over the coming year. However, households remain notably less optimistic about the outlook for their household financial security which is reflected in ongoing concerns about spending money. Furthermore, PAYE median earnings fell 1.8% on annual basis in March, despite growing 8.1% in nominal terms, emphasising that pay continues to lag behind inflation.

More broadly, Scotland's labour market continues to perform strongly at the headline level, with unemployment falling to 3.0% at the turn of the year, its lowest rate on record. Tightness in the labour market is persisting, however recruitment activity has continued to slow and in part reflects the ongoing economic uncertainty facing businesses for the year ahead.

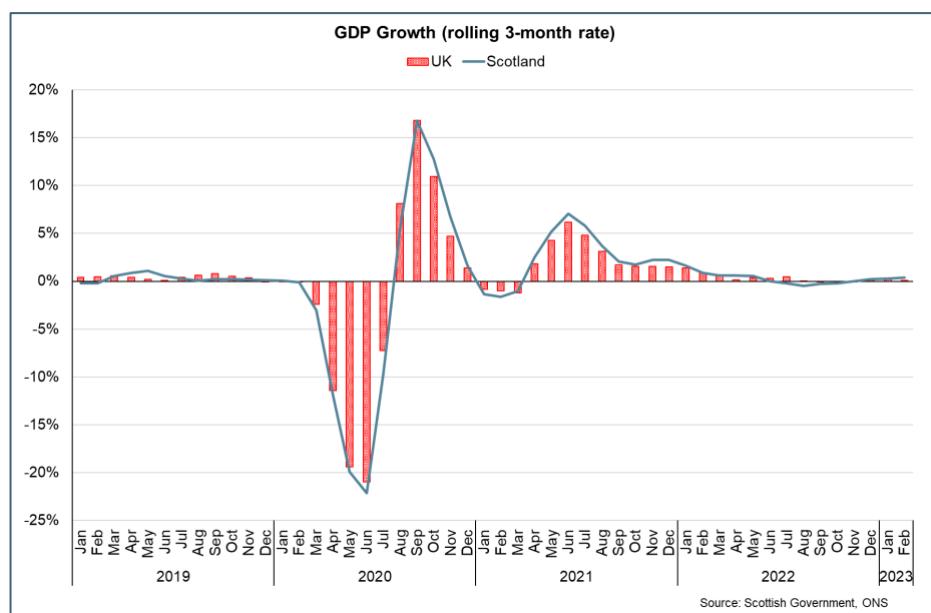
Cost challenges remain a key part of that concern as businesses face higher energy and staffing costs in the face of an outlook of subdued demand for the year. Like other key indicators, business confidence has improved in recent months following a drop during the second half of last year, reflecting that while conditions are challenging, there is a greater degree of resilience than previously forecast and the economy is progressing through this current downturn.

The forecast of weaker global growth presents an ongoing headwind, particularly in the face of higher interest rates, however the fall in inflationary pressures forecast for this year should further strengthen sentiment and prospects for growth.

## Output

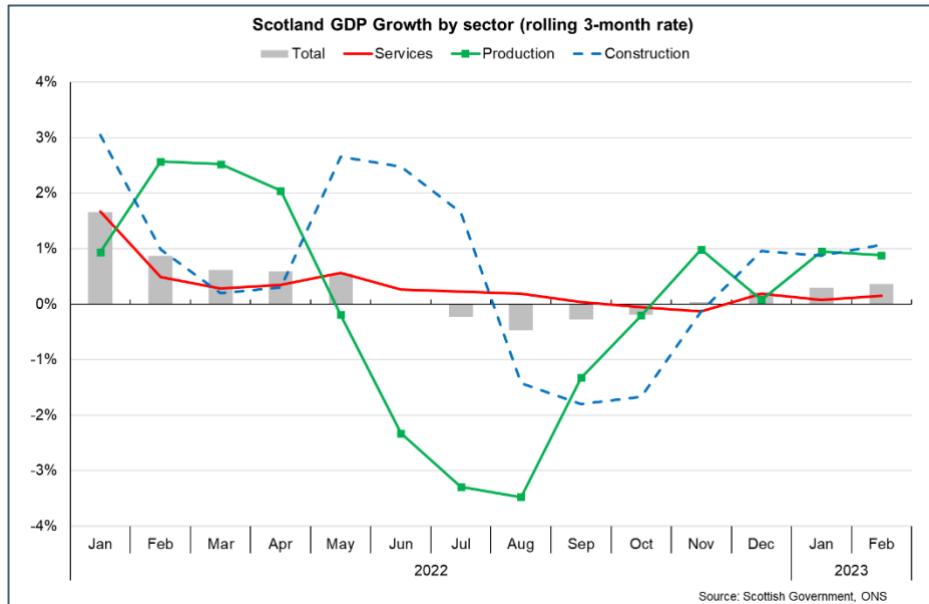
GDP growth at the start of 2023 has strengthened from the second half of last year.

- The Scottish economy grew by 4.9% in 2022, following growth of 8.4% in 2021 as the economy continued to adjust following the pandemic and the impacts of the inflationary shock exacerbated by the war in Ukraine.
- The pace of growth slowed sharply over the course of the year however with growth largely confined to the first quarter. Latest data show the Scottish economy grew 0.2% in February 2023 (UK: 0.0%) and more broadly grew 0.4% in the 3-months to February, indicating that the underlying pace of growth has strengthened slightly from the second half of last year.<sup>1</sup>



- At a sector level, growth was broad based in the 3-months to February across the services (0.2%), production (0.9%) and construction (1.1%) sectors. Service sector growth was partly driven by consumer facing services (1.4%) while health, education and public services output fell 1.1%. Production sector growth was driven by the manufacturing sector (1.2%) which picked up to its fastest 3-month growth since April 2022, however, remains 2.5% lower over the year.

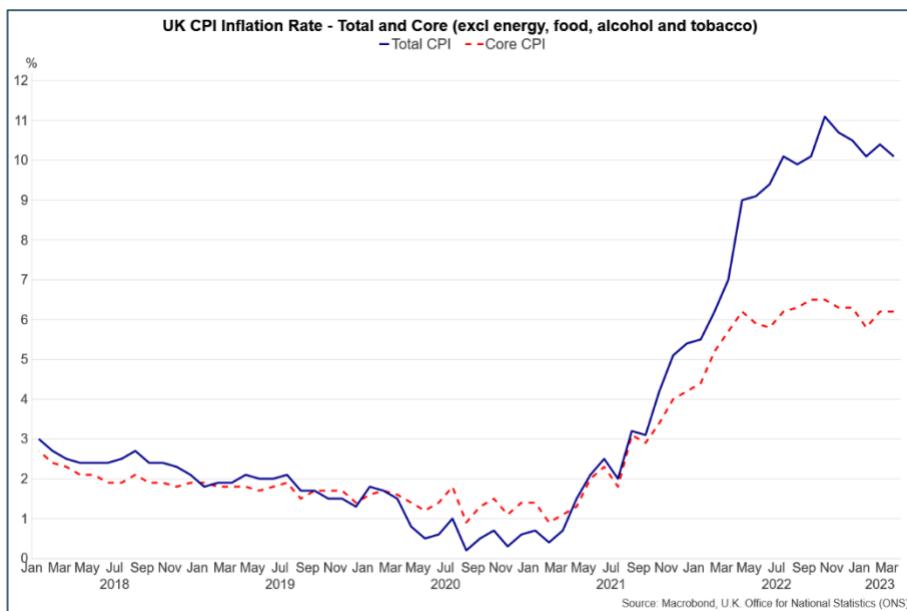
<sup>1</sup> [Economy statistics - gov.scot \(www.gov.scot\)](http://Economy statistics - gov.scot (www.gov.scot))



## Inflation

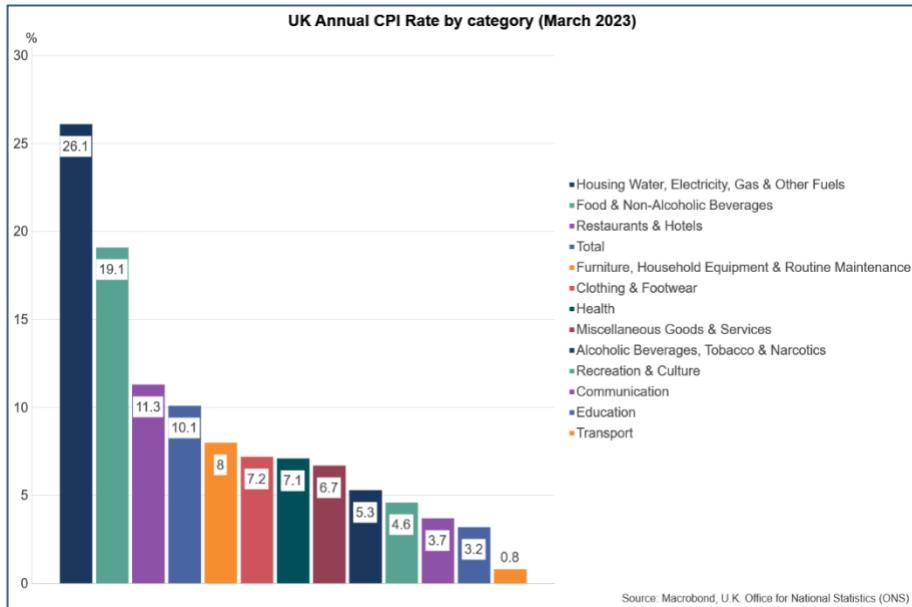
Inflation continued its downward trend in March.

- UK CPI inflation fell to 10.1% in March, following a rise in February to 10.4%, and is on a downward trend from its recent peak of 11.1% in October.<sup>2</sup>

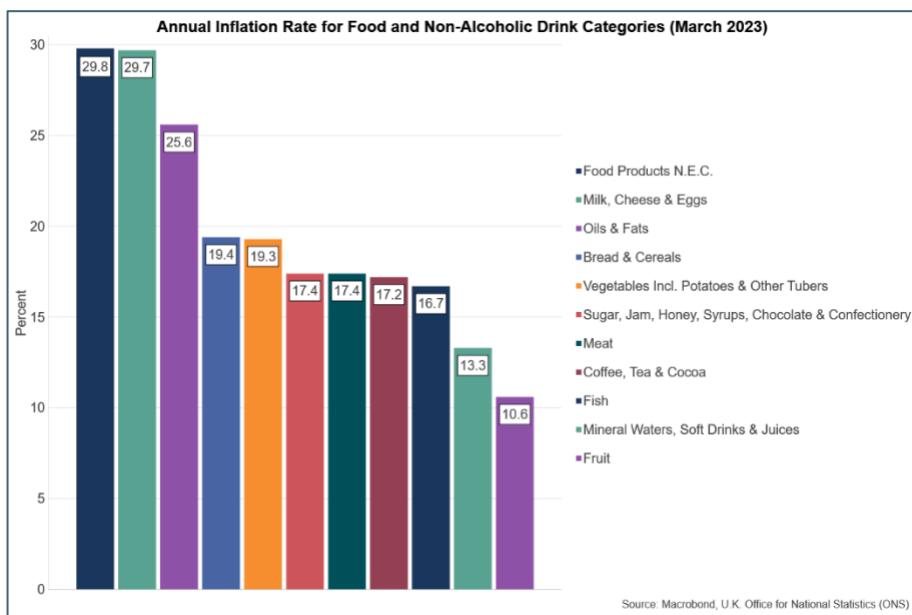


- A key driver of the fall in March was in motor fuel prices which fell 5.9% annually, however this was partially offset by a further increase in food and non-alcoholic drink prices with their annual rate rising to 19.1%, the highest rate since 1977.

<sup>2</sup> [Consumer price inflation, UK - Office for National Statistics](#)



- The rise in food price inflation has been broad based in the UK. Annual inflation rates in March include: milk, cheese and eggs (29.7%), bread and cereals (19.4%), vegetables (19.3%), meat (17.4%). Food price inflation has also risen sharply internationally in part reflecting the ongoing feed through of supply side factors over the past year exacerbated by the war in Ukraine. Food price inflation in the EU was 19.6% in March, including 22.9% in Germany, 18.4% in the Netherlands, 17.2% in France and 13.3% in Italy.<sup>3</sup>



- Prices for housing, water, electricity, gas and other fuels continued to have the largest increase over the year (26.1%) and within that, electricity, gas and other fuels (85.6%), however the annual inflation rate for these are expected to fall sharply in April as the large increases in energy prices which occurred last year drop out of the annual inflation calculation.

<sup>3</sup> [Food price inflation: interactive visualisation tool - Products Eurostat News - Eurostat \(europa.eu\)](https://ec.europa.eu/eurostat/web/eurostat-news/-/products-eurostat-news/-/europa.eu)

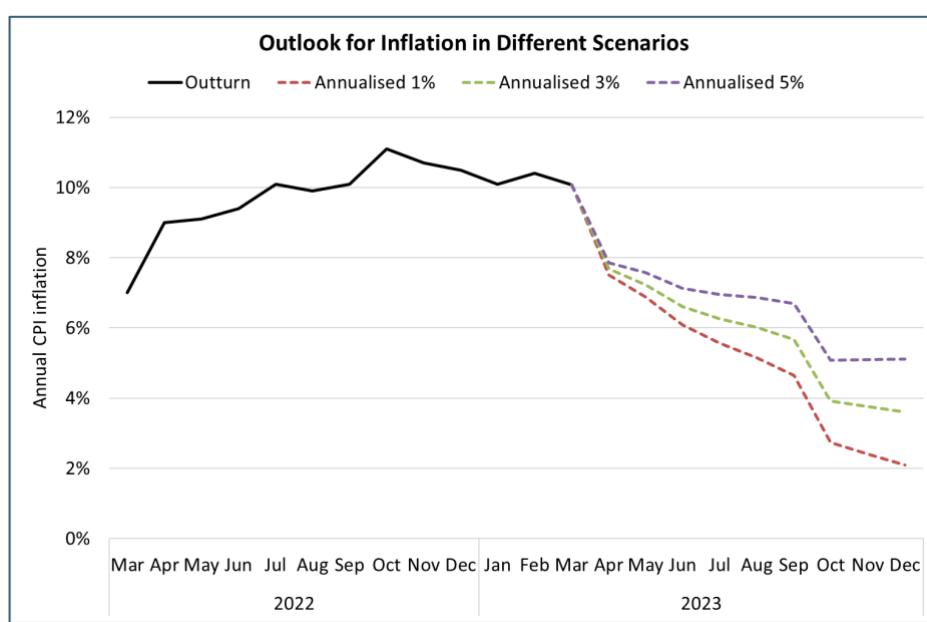
- Core inflation, which excludes food, energy, alcohol and tobacco, was unchanged at 6.2% in March and is slightly lower than its recent peak of 6.5% in October 2022. Core inflation has been around 6% since April 2022, highlighting that energy price rises have been the main driver of overall inflation over this period. However, over the longer term, core inflation has risen from 1.4% at the start of 2021 and its persistence reflects that inflation has been broad based.

## The Outlook for Inflation

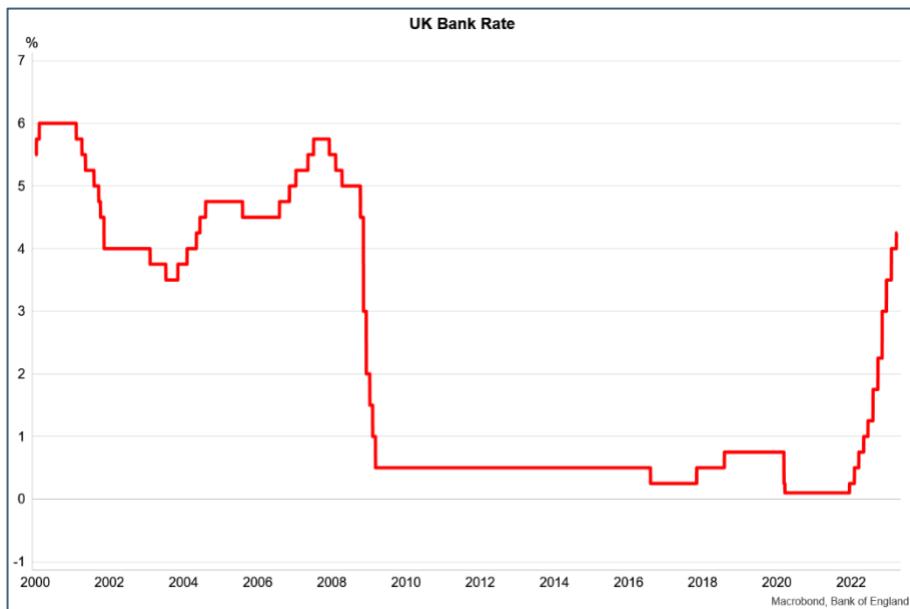
Even if inflation pressures persists, headline inflation is set to fall across 2023, although the decline will not be evenly spread.

The chart below outlines three potential scenarios for inflation, based on simple projections assuming a constant increase in the overall price index each month. In the lower scenario, the CPI index increases by 0.2% each month, an annualised rate of 1%, which sees headline inflation fall to the Bank of England's 2% target by the end of the year. In the upper scenario, the CPI index increases by 0.4% each month, an annualised rate of 5%, which is consistent with the rate in underlying core inflation over the last 3 months. The middle scenario is the mid-point of these two.

As can be seen, regardless of the path of monthly inflation, there are likely to be significant falls in headline inflation in the April and October figures, as previous increases in energy prices become part of the baseline figures. In other months, declines in inflation are likely to be much smaller. As such, it is possible that there may again be some months where there is a surprise increase in inflation, as happened in February, however, despite this overall inflation is likely to be trending down until at least October 2023.



- In March, the Bank of England's Monetary Policy Committee (MPC) raised the Bank Rate by 0.25 percentage points from 4% to 4.25% to further reduce inflationary pressures in the economy. It was the eleventh successive rate rise since December 2021 when the Bank Rate was 0.1% and is at its highest rate since 2008.<sup>4</sup>



- The latest 0.25 p.p. increase is the smallest since June 2022 and reflected the expectation that inflation is likely to be past its peak and will fall sharply in 2023. However, the MPC judged that the latest increase was required because the inflation rate has remained higher than expected and the near-term outlook points to stronger than expected employment and GDP growth.

## Businesses

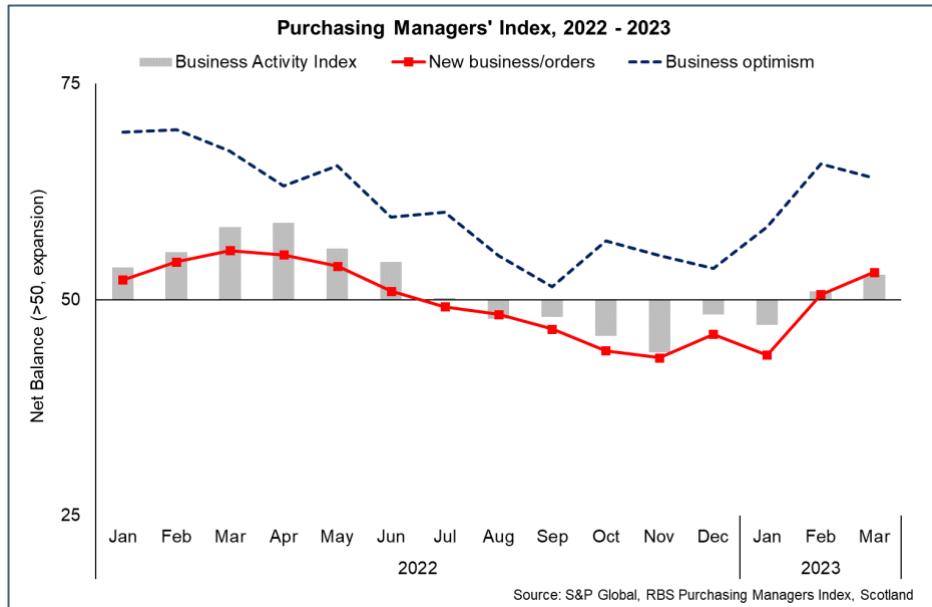
Business activity increased further in March, with optimism improving.

### Business activity

- The Purchasing Managers Index (PMI) business survey indicates that business activity in Scotland's private sector has been improving from the end of 2022 and increased for the second consecutive month in March (52.9) and at its fastest pace since June 2022.<sup>5</sup>

<sup>4</sup> [Bank Rate increased to 4.25% - March 2023 | Bank of England](#)

<sup>5</sup> S&P Global, RBS Purchasing Managers Index: [Purchasing Managers' Index Reports | Royal Bank of Scotland \(rbs.co.uk\); 3f6579c17e2942b5bc85ffb84888a40a \(spglobal.com\)](#)

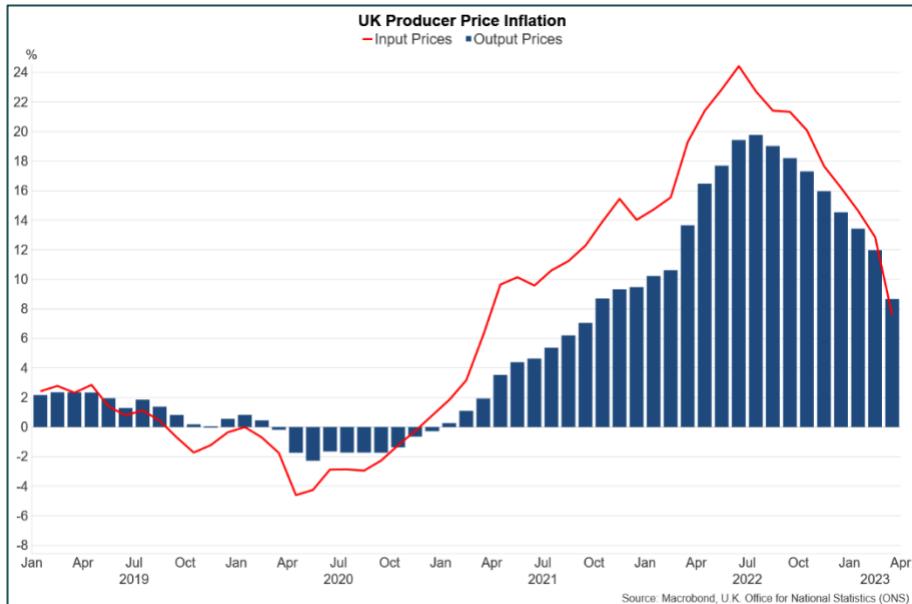


- The increase in business activity reflected a further growth in incoming new business/orders (53.2), with respondents citing stronger demand and a strengthening in the pound against the dollar.
- Further, business optimism has strengthened sharply since the start of the year (64.1) with expectations of increased activity over the coming year. Despite a slight dip from February, concentrated in the services sector, sentiment remained positive and above the historical trend, with respondents' optimism stemming from expectations of new business development and projects in the pipeline.

## Business costs

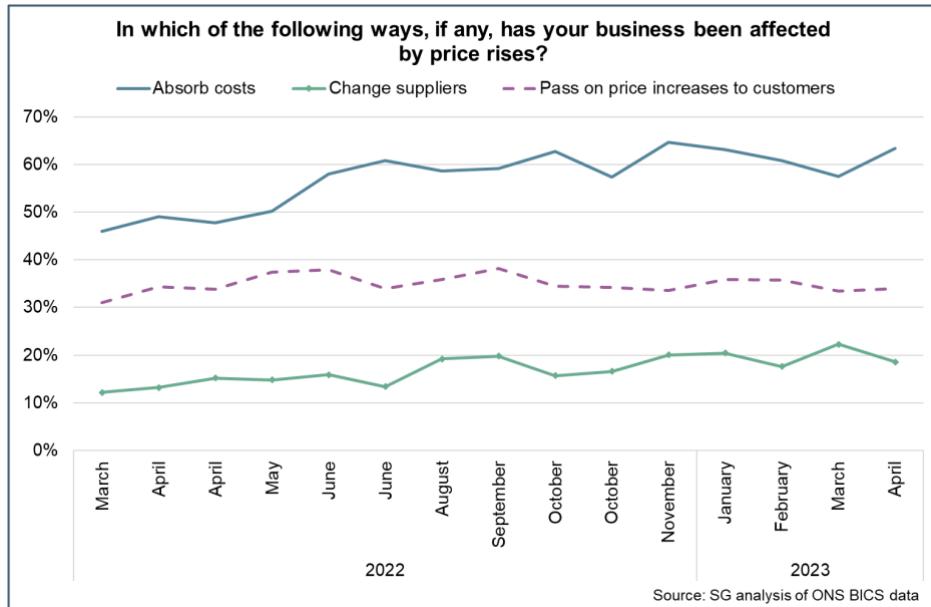
- Higher energy, materials and staffing costs continue to present significant challenges for businesses, however there are further indications that the pace of cost increases is easing.
- Producer price inflation (changes in the prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased and factory gate prices) rose by 7.6% over the year to March, however, slowed for the ninth consecutive month from its recent peak of 24.4% in June last year.<sup>6</sup>

<sup>6</sup> [Producer price inflation, UK Statistical bulletins - Office for National Statistics \(ons.gov.uk\)](https://www.ons.gov.uk)

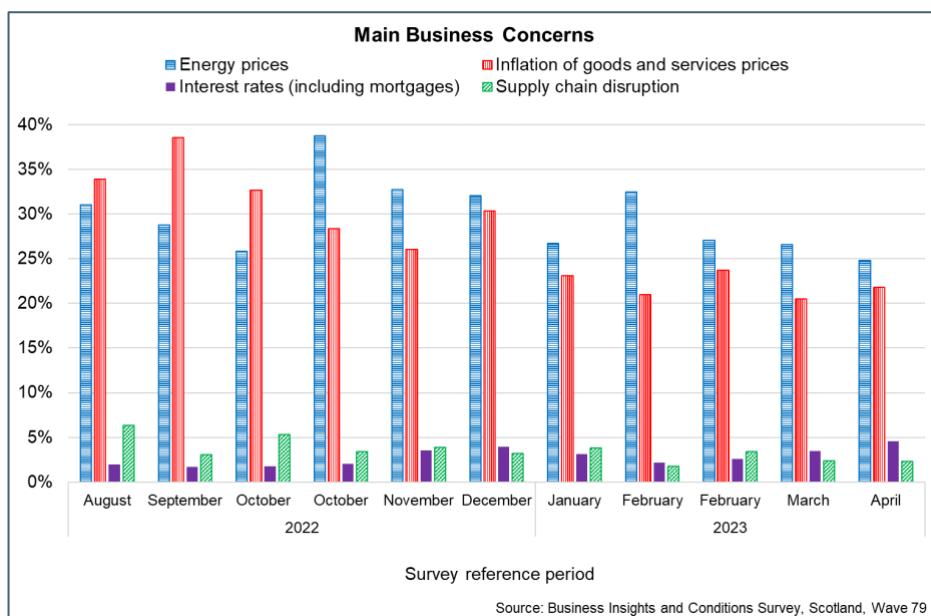


- Similarly output price inflation also continued to ease back to 8.7% in March, down from the recent peak of 19.9% in July. Inputs of crude oil provided the largest downward contribution to the change in input price inflation, with prices falling 24.1% over the year, while petroleum products provided the largest downward contribution to output price inflation (prices fell 10.7% over the year).
- Food materials (home produced and imported) provided upward contributions to input prices and food products provided the largest contribution to output prices, with prices rising 15.5% over the year.
- PMI business survey data for Scotland also indicated that the pace of input price rises across the services and manufacturing sectors continued to moderate in March to the weakest rate in 22 months. Staffing costs, energy prices and food prices continuing to be reported as key drivers of cost rises.
- Business Insights and Conditions Survey (BICS) data provide latest insights into the effects on business of price rises. In April, 63.4% of businesses reported that they had to absorb costs, 34% reported having to pass on price increases to customers and 18.6% had to change suppliers. A much lower percentage of firms reported having to access more financial support (4.8%) and having to reduce staff work hours (6.4%).<sup>7</sup>

<sup>7</sup> [Business and innovation statistics - gov.scot \(www.gov.scot\)](http://www.gov.scot)



- There continues to be notable differences across sectors. For example, 19.4% of accommodation and food sector businesses and 7.7% of arts, entertainment and recreation businesses reported having to reduce staff work hours (compared to 6.4% for all businesses). Furthermore, 46.2% of accommodation and food sector businesses, 45.9% of manufacturing businesses and 45.4% of wholesale, retail and repair of vehicles businesses reported passing prices onto customers (compared to 34% for all businesses).
- This further reflects that cost rises are impacting sectors differently and business responses to price rises will reflect a range of factors such as the nature of the business and customer base within sectors and the options available to improve efficiency and reduce costs.



- Overall, the main concerns for businesses in April continues to be energy prices (24.8%), which has reduced from 38.7% in October last year, but remains elevated, and inflation of good and services prices (21.8%), which is also on a downward trend. Much lower and declining

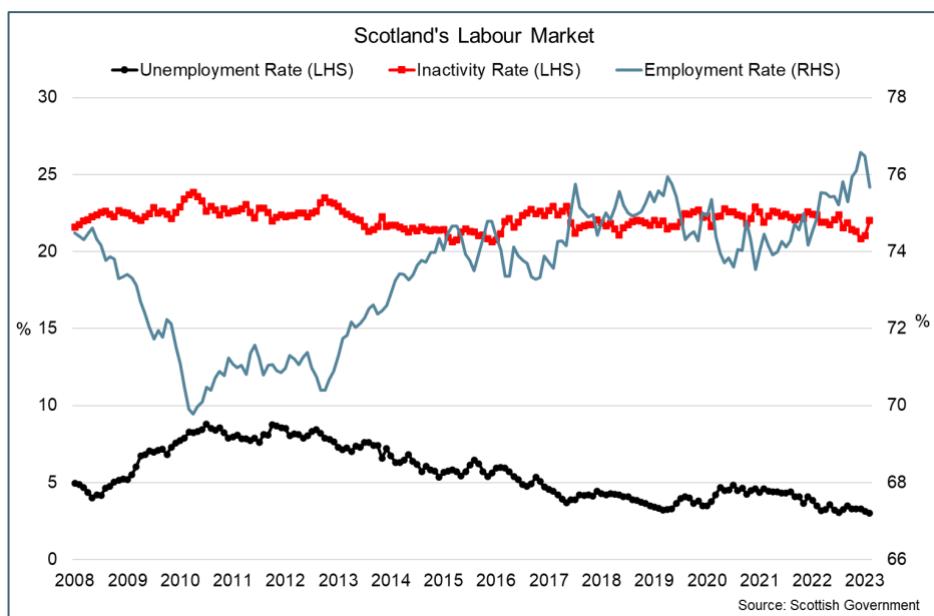
percentages of businesses are concerned about supply chain disruption (2.3%), which reflects wider business survey evidence which indicates that suppliers' delivery times improved notably in March.<sup>8</sup> 4.6% of respondents noted interest rates as the main concern for their business which has been on a slight upward trend over the past year and likely reflects the increase in Bank Rate over this period.

## Labour Market

Unemployment has fallen to a record low amid tight labour market conditions.

### Official labour market statistics

- The latest labour market statistics for December 2022 to February 2023 in Scotland show there were 2.7 million people in employment with the employment rate rising by 0.8 percentage points over the year to 75.7% (UK: 75.8%). 84,000 people were unemployed with the unemployment rate falling 0.5 percentage points to 3.0% (UK: 3.8%), the lowest on record. Scotland's inactivity rate fell 0.4 percentage points over the year to 22% (UK: 21.1%) with 758,000 people economically inactive in Scotland. The primary reason for economic inactivity is long term sickness.<sup>9</sup>



- Latest PAYE data signals a further increase in employment in March with the number of PAYE employees rising by 1,000 over the month and is 1.3% higher than in March last year.<sup>10</sup>

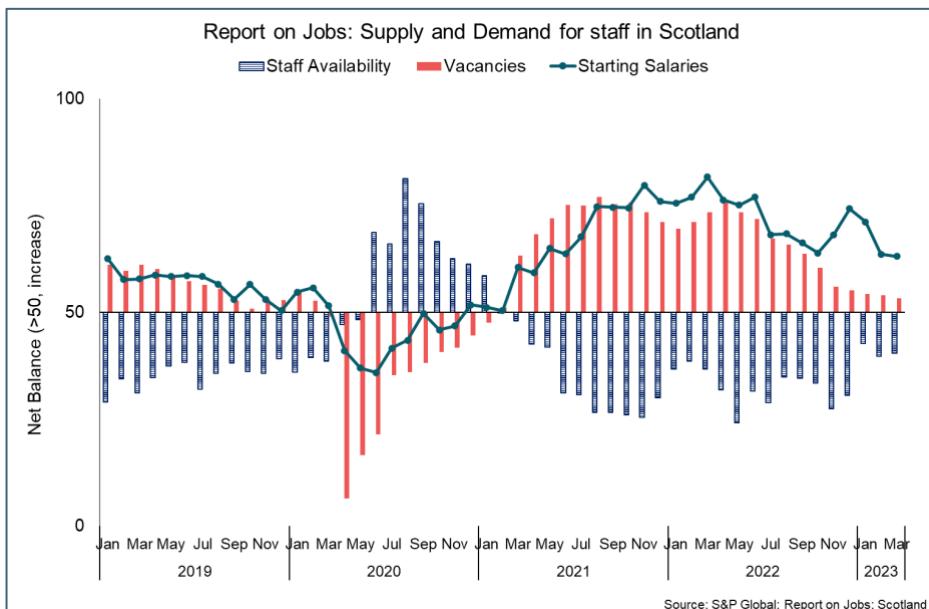
### Demand and supply of staff

<sup>8</sup> S&P Global, CIPS UK Manufacturing PMI: [dffe24b4588d4b478251f2f26feeb5c2 \(spglobal.com\)](https://www.spglobal.com/cips/en/uk/manufacturing-pmi)

<sup>9</sup> [Labour market statistics - gov.scot \(www.gov.scot\)](https://www.gov.scot/labour-market-statistics/)

<sup>10</sup> [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics \(ons.gov.uk\)](https://www.ons.gov.uk/economicsandstatistics/articles/earningsandemploymentfrompayasyouearnrealtimeinformation/seasonallyadjusted/2023-03-27)

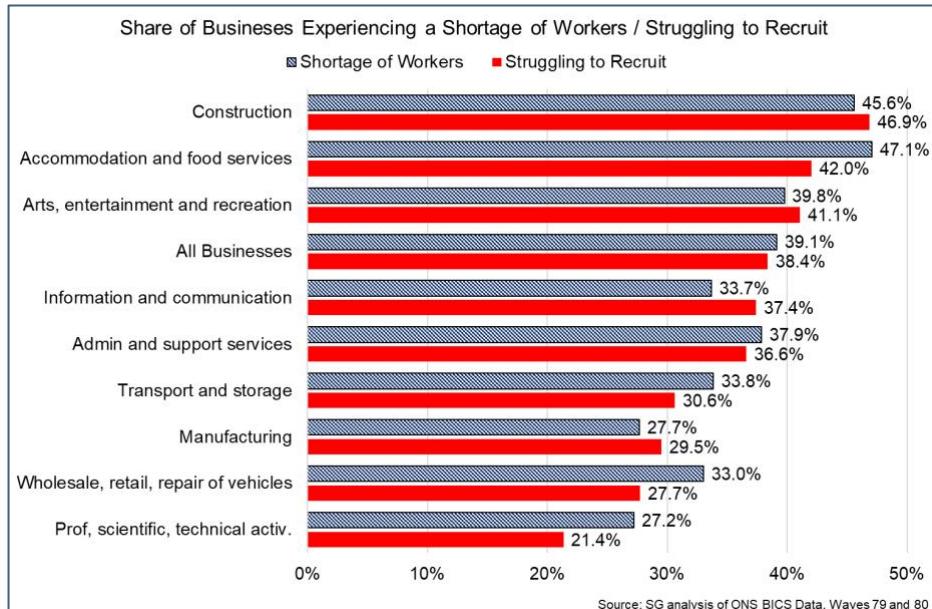
- Business surveys signal that labour market conditions have remained tight in March; however recruitment activity shows further signs that it has moderated compared to the first half of 2022.
- The RBS report on Jobs for March signalled that growth in permanent staff placements (47.6) fell for the fifth time in the past six months, following growth in January.<sup>11</sup> Growth in demand for staff remained positive (53.9) but had slowed to its softest rate in over two years. For businesses seeking to recruit, supply side challenges in the labour market have also continued with candidate availability (labour supply) falling in March (39.9), with uncertainty in the economic outlook for the coming year weigh on both the demand and availability of labour.



- The underlying tightness in the labour market continued to provide upward pressure to starting salaries in March, however the pace of growth continued its downward trend and eased over the month (63.6) to the softest rate seen in 23 months.
- Labour shortages are affecting a range of sectors with BICS data indicating 39.1% of businesses experienced a shortage of workers at the start of April.<sup>12</sup> The overall share has fallen from the start of September when it was 44.5%, however remains highest in accommodation and food services (47.1%) and construction (45.6%).

<sup>11</sup> S&P Global, RBS Report on Jobs: [2a1568f689b14cd392ddb0c380bffa99 \(spglobal.com\)](https://www.spglobal.com); Royal Bank of Scotland Report on Jobs – February 2023 | NatWest Group

<sup>12</sup> [Business and innovation statistics - gov.scot \(www.gov.scot\)](https://www.gov.scot)

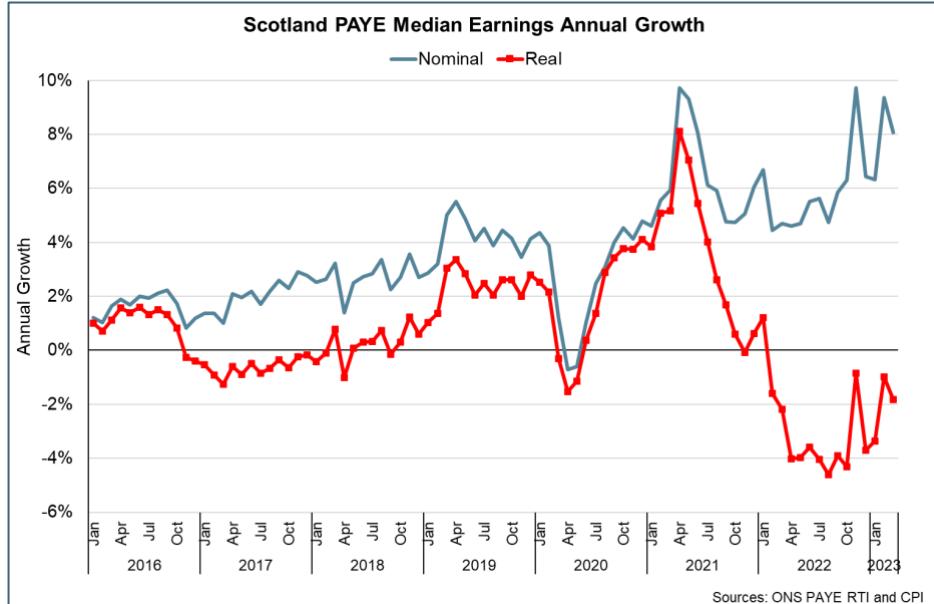


- Furthermore, when asked about recruiting in March, 38.4% of all businesses reported experiencing difficulties recruiting employees. This is highest within construction (46.9%), accommodation and food services (42%) and arts, entertainment and recreation (41.1%).
- Most businesses responded that a low number of applications (62.9%) and a lack of qualified applicants (60.7%) were reasons for why the business experienced difficulties in recruiting employees, while 26.5% reported not being able to afford an attractive pay package to applicants.

## Earnings

- Nominal median monthly PAYE earnings fell 0.9% in March to £2,237. However, the monthly figure can be volatile, and over the past year earnings have grown 8.1%. <sup>13</sup>
- However, adjusting for inflation, which was 10.1% in March, real median earnings fell 1.8% on an annual basis, the fourteenth consecutive month of negative annual growth.

<sup>13</sup> [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics \(ons.gov.uk\)](https://www.ons.gov.uk)



- The annual falls in real earnings are generally softening, however continue to emphasise the cost-of-living challenges that are facing individuals and households.

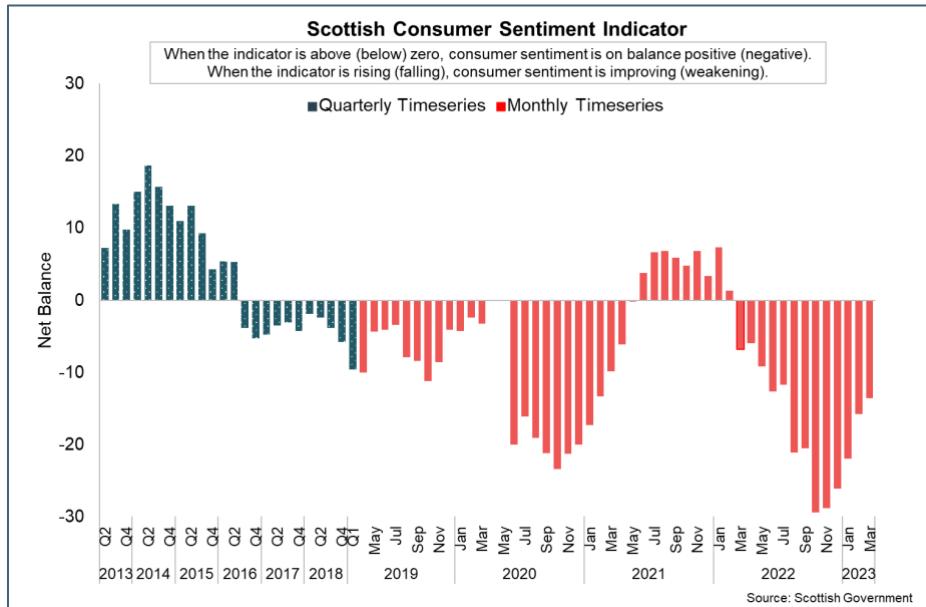
## Consumption

Consumer sentiment has strengthened but remains negative overall.

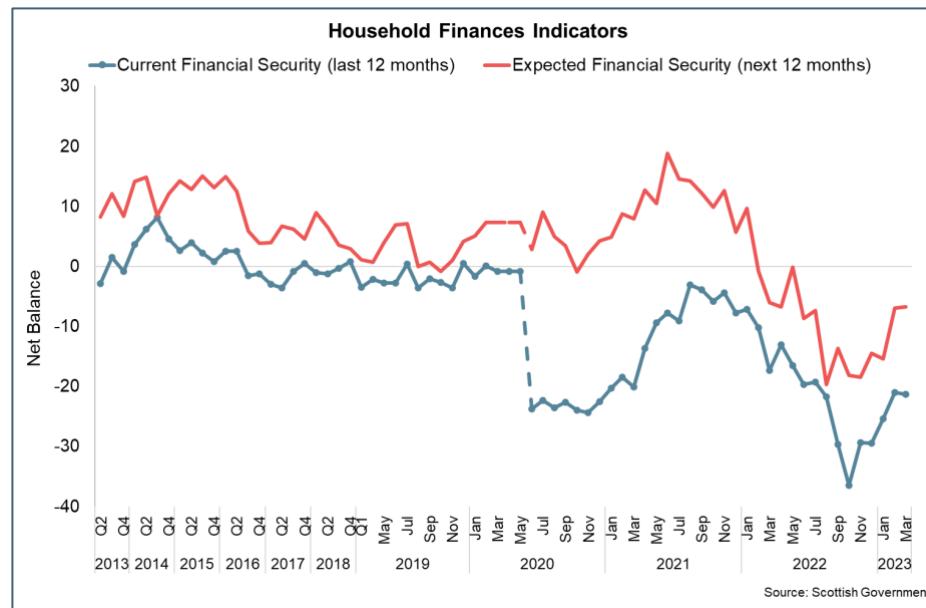
### Consumer sentiment

- Consumer sentiment indicators continue to highlight the pressures that households and consumers face from high inflation and the rapid increase in the cost of living.
- These challenges intensified over 2022 which was reflected in a sharp drop off in the Scottish Consumer Sentiment Indicator, however latest data indicates that consumer sentiment has improved slightly over start of the year, albeit remaining significantly negative overall.<sup>14</sup>
- In March, the Scottish Consumer Sentiment Indicator stood at -13.6; a rise of 2.1 points from February and indicating that sentiment strengthened for a fifth consecutive month, having fallen to its series low of -29.4 in October.

<sup>14</sup> [Economy statistics - gov.scot \(www.gov.scot\)](http://Economy statistics - gov.scot (www.gov.scot))

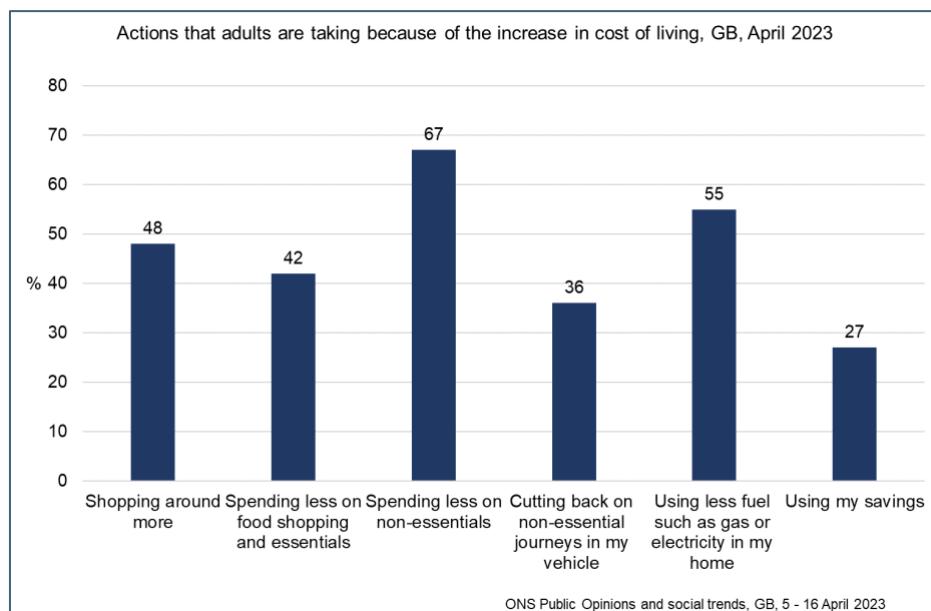


- On the economy, respondents on balance consider current economic circumstances to be worse than last year (-18.7, up from -25 in February) however expect the economy to improve over the coming year relative to the current situation (15.3, up from 12.7 in February); its third consecutive month in positive territory.
- In terms of households' personal finances, respondents on balance continued to report that they are less secure than 12 months ago (-21.3, slightly down from -21 in February). Furthermore, looking ahead, respondents continue to expect their household financial security to weaken over the coming year (-6.7, slightly up from -6.9 in February).



- Overall, households remain notably less optimistic about the outlook for their household financial security than they do for broader performance of the economy and is reflected in ongoing concerns about spending money.

- In March, the consumer sentiment spending indicator increased slightly to -36.5, up from -38.5 in February and its series low of -58.5 in October, indicating that households continue to be uneasy about spending money, but to a slightly lesser degree than towards the end of 2022.
- The general strengthening in consumer sentiment in Scotland is consistent with findings from the GfK Consumer Confidence Index at a UK level which fell to its lowest point in September 2022 before picking up in recent months.<sup>15</sup>
- Furthermore, at a GB level, the ONS Public Opinions and Social Trends survey for April showed that 93% of adults reported an increase in the cost of living compared with a year ago and 70% reported an increase compared to the previous month.<sup>16</sup> The reasons for the increase in the cost of living remain largely unchanged in recent months: (i) price of food shopping (96%); (ii) gas or electric bills (77%); (iii) price of fuel (42%).
- The most common actions reported were spending less on non-essentials (67%) and using less fuel such as gas or electricity in their home (55%), while 48% reported shopping around more and 42% reported spending less on food shopping and essentials.



## Retail Sales

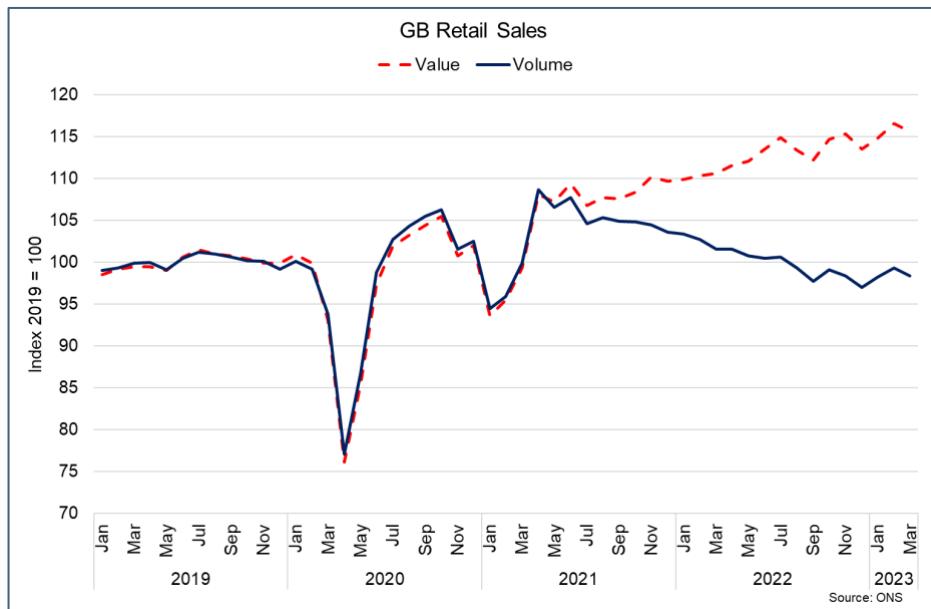
- GB level retail sales volumes fell by 0.9% in March, with a fall across non-food store sales (-1.3%) and food store sales (-0.7%). However, in the three months to March, sales volumes grew 0.6%, the first 3-monthly rise since August 2021.<sup>17</sup>

<sup>15</sup> [Consumer confidence up six points in April to -30 \(gfk.com\)](#)

<sup>16</sup> [Public opinions and social trends, Great Britain - Office for National Statistics](#)

<sup>17</sup> [Retail sales, Great Britain - Office for National Statistics \(ons.gov.uk\)](#)

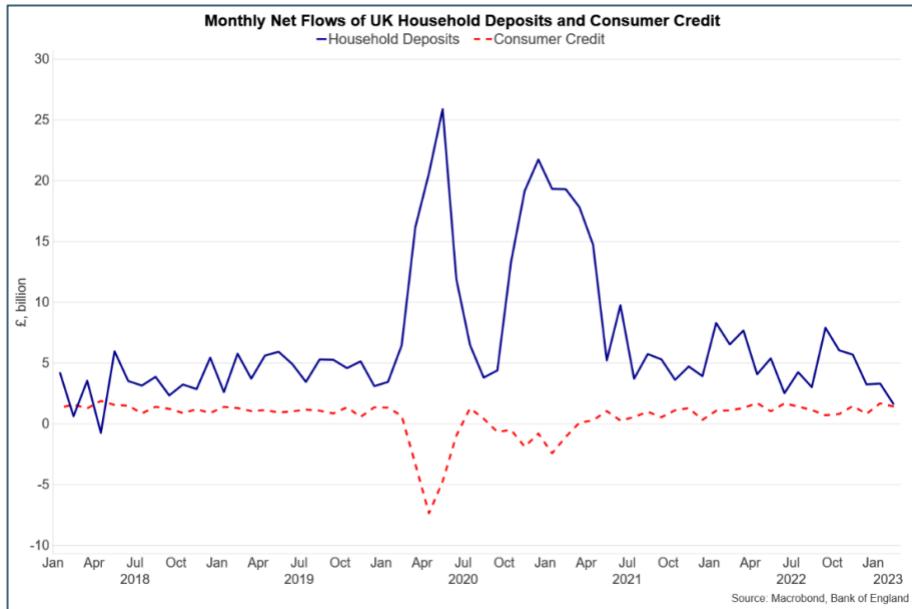
- Retailers indicated that poor weather conditions impacted most recent sales in March, however more broadly, retail sales volumes have fallen 3.1% over the year with retailers indicating that the increased cost of living and food prices if impacting sales volumes.



## Household Savings and Consumer Credit

- The impacts of the rise in cost of living and higher interest rates on households are continuing to develop as disposable income, spending, savings and credit flows have been re-balancing over the past year following notable shifts during the pandemic.
- More recently, at an aggregate level, Bank of England Money and Credit data shows additional net flows from UK households into deposit-like accounts fell to £1.6 billion in February (down from £3.3 billion in January). <sup>18</sup> Alongside this, consumers borrowed an additional £1.4 billion in February, following £1.7 billion of borrowing in January.

<sup>18</sup> [Money and Credit - February 2023 | Bank of England](#)



- Additional savings built up during the pandemic and credit have provided the potential to support consumption as household finances have been squeezed in real terms through higher inflation over the past year. Where savings or borrowing have supported spending to date, we may see consumption more at risk and exposed to lower levels of savings and higher interest rates/borrowing costs in the year ahead.

## Economic outlook

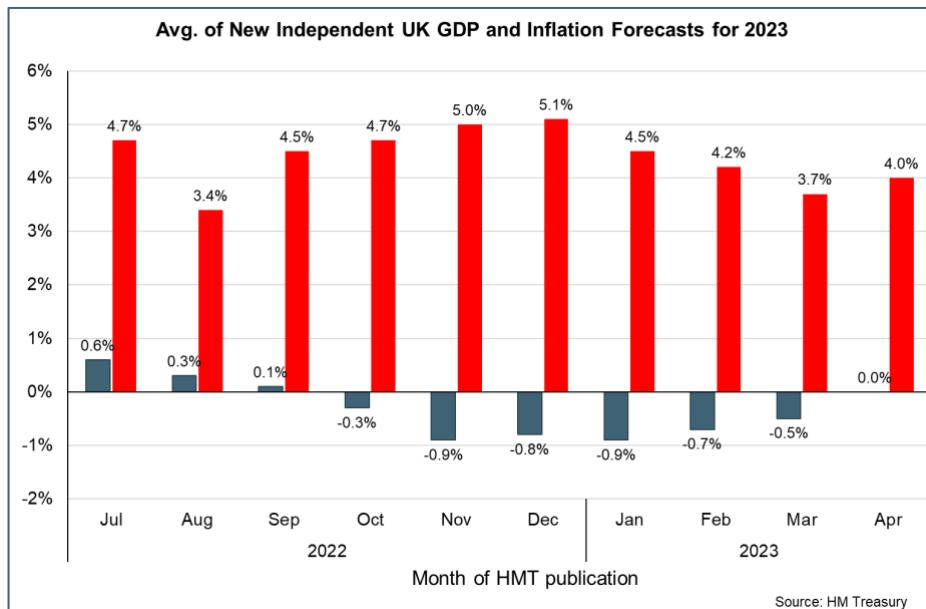
The outlook for 2023 has improved in recent months however remains subdued.

- At a global level, some economic headwinds have eased from last year with notable improvements in global supply chains and falls in global commodity price inflation. However their impacts alongside tighter monetary policy across central banks are expected to weaken growth prospects over the next few years.
- The IMF forecast global growth to weaken from 3.4% in 2022 to 2.8% in 2023 and remain subdued at 3% in 2024. Global inflation is forecast to fall from 8.7% to 7% in 2023, reflecting lower commodity prices while wider underlying inflationary pressures remain more persistent.<sup>19</sup>
- At a UK level, growth forecasts for the year ahead have been revised up from forecasts made in the second half of 2022 with a UK recession no longer expected. In March, the OBR forecast UK GDP to fall 0.2% over the year however not enter a technical recession, while inflation is forecast to fall to 2.9% by the end of the year.<sup>20</sup>

<sup>19</sup> [World Economic Outlook \(imf.org\)](#)

<sup>20</sup> [Home - Office for Budget Responsibility \(obr.uk\)](#)

- More broadly, the average of new independent forecasts published by HMT in April indicates UK GDP growth will be flat in 2023 (0%), which is the highest average forecast since September 2022, while inflation is forecast to fall to 4% by the end of the year.<sup>21</sup>



- At a Scotland level, latest forecasts in March from the Fraser of Allander Institute forecast output to fall 0.7% in 2023 (revised up from -1% in February), before growing 0.9% in 2024 and 1.7% in 2025.<sup>22</sup>
- Overall, economic activity has strengthened at the start of 2023 having remained broadly flat over the second half of 2022, resulting in the outlook for 2023 being revised up from previous estimates. Inflation is forecast to fall sharply this year; however economic growth is expected to remain subdued as households and businesses continue to face challenges from higher prices and higher interest rates.

<sup>21</sup> [Forecasts for the UK economy - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/collections/forecasts-for-the-uk-economy)

<sup>22</sup> [FAI Economic Commentary | FAI \(fraserofallander.org\)](https://fraserofallander.org/research-and-publications/economic-commentary/)



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