Scottish Economic Bulletin

Office of the Chief Economic Adviser

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Scottish Government
Riaghaltas na h-Alba

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Data up to: 9 May 2024
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Overview

The economic outlook continues to improve, with the Scottish economy set to return to growth in 2024 after the economy remained largely flat in 2023, although growth is expected to remain modest. The UK outlook is similar, with the Bank of England's latest forecast showing growth of 0.4% in 2024. Globally, the OECD's assessment is that there are signs that the global outlook has started to brighten, and the OECD forecast global growth of 3.1% in 2024, with European economies in particular growing more slowly this year than the US and other emerging economies.

Scottish GDP grew 0.4% in the three months to February 2024, although it fell in the latest month in the more volatile monthly data. However, it is now very likely that the economy will show growth in first quarter of 2024, confirming that the Scottish economy has avoided a recession. The growth in services (0.7% over the three months to February) is encouraging, particularly consumer facing services growth which remains high at 1.3% over the three months. The stabilisation of the manufacturing sector is also welcome, although the further fall in construction shows that growth is far from being widespread.

Stronger growth in consumer facing services is a sign of improved consumer confidence. Although the Scottish Consumer Sentiment Indicator remains negative and fell slightly in the first quarter to -6.2, it has improved significantly over the past year as the inflation rate has fallen, and households' assessment of the economy's performance continues to improve.

The inflation rate fell to 3.2% in March 2024, its lowest rate since September 2021 and is expected to fall further towards the Bank of England target rate in April, although ongoing pressure from core inflation means that it may again increase slightly over the course of the year. Markets' expectations are for to the Bank Rate to fall during the year. The labour market continues to be robust, with unemployment falling to 4.0% in the latest data, and the number of payrolled employees in Scotland remaining close to its series high. Earnings also continue to grow faster than inflation, with annual earnings growth of 6.3% in March, 3.1 percentage points faster than inflation.

Latest business surveys show that business activity continued to strengthen into March 2024, with activity reaching its highest level in 11 months. While this mainly reflects strength in the services sector, overall business optimism for the year ahead continues to improve, and there are signs that business investment is strengthening.

Looking ahead, economic growth is forecast to strengthen, albeit modestly, across 2024 and 2025, as lower inflation supports real earnings growth. With interest rates also expected to fall this will support a pick-up in consumption. However, the path for inflation, earnings, and interest rates remains uncertain and will be an important determinant of the economic outlook. Risks to the economic outlook are becoming more balanced.

Output

GDP growth continued to grow over the three months to February, although it contracted in the latest month.

- Scotland’s economic output grew 0.4% in the three months to February 2024, although it fell 0.3% over the month of February itself. This follows a 0.5% fall in the final quarter of 2023. The overall pace of growth remains subdued, however February’s data alongside monthly growth of 0.4% in December and 0.6% in January indicates a modest strengthening and suggests a modest growth outlook for the year ahead.[1]

- The 0.4% growth in output over the three months to February was driven by a rise in output in the Services sector (0.7%) which offset further falls of output (0.7%) in both the Production and Construction sectors.
- Within the Production sector, manufacturing growth was flat in the three month period (0.0%), reflecting the current sequence of weak growth in the sector with output falling 1.1% over the year. However, monthly growth picked up sharply in February to 4.1%, its strongest rate of growth since the first half of 2021.
- The services sector as a whole grew 0.7% in the three months to February, reflecting a period of stronger underlying growth compared to during 2023. Growth during this period was strongest in both accommodation and food services (2.5%) and wholesale, retail and motor trades (2.4%). Consumer facing services also grew 1.3%, although in February they fell 0.7%.

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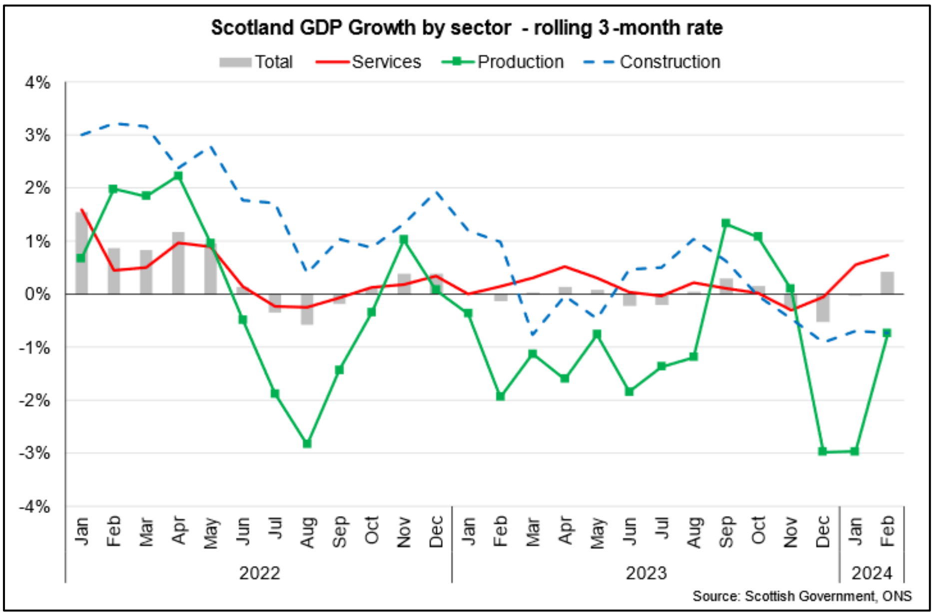
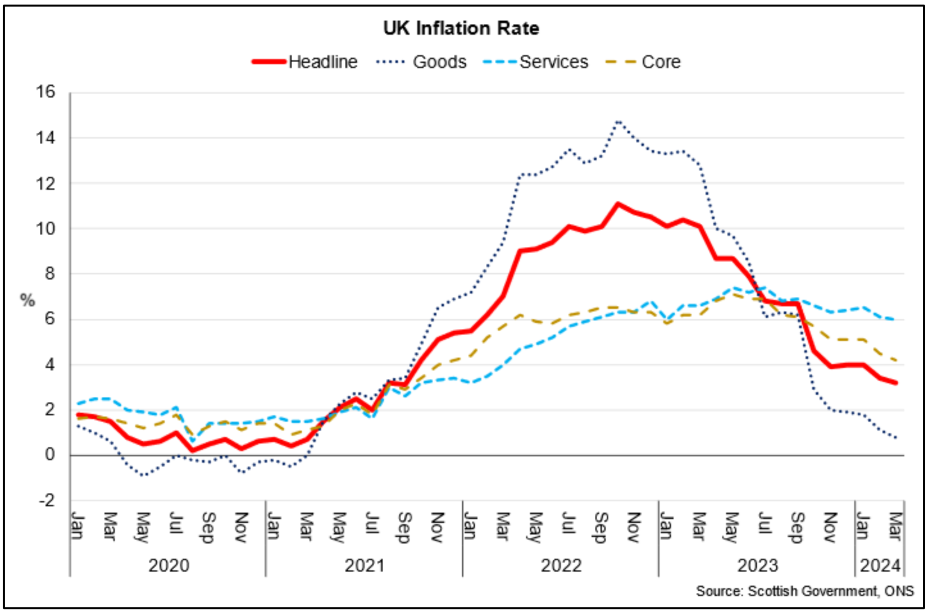
[1] Economy statistics - gov.scot (www.gov.scot) , GDP monthly estimate, UK Statistical bulletins - Office for National Statistics (ons.gov.uk)



Inflation

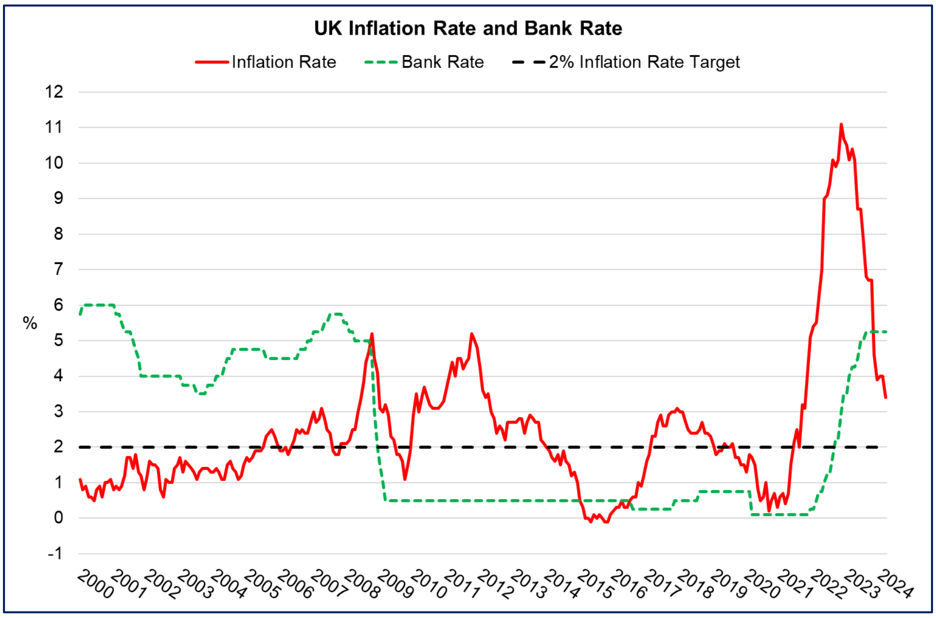
Inflation fell to 3.2% in March, its lowest rate since September 2021.

- The inflation rate fell to 3.2% in March, down from 3.4% in February, and is at its lowest rate since September 2021 as inflationary pressures continue to stabilise.[2]
- The largest downward contributions to the monthly change in the annual inflation rate came from food and non-alcoholic beverages, furniture and household goods, and clothing and footwear. The inflation rate for food fell for its twelfth consecutive month in March to 4% (down from 5% in February), as clothing and footwear inflation also fell from 5% to 4% in the same period. The largest upward contribution came from communication and transport, in which the annual inflation rates rose from 5.6% to 7.5% and -0.1% to 0.1% respectively.



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

- Core inflation, which excludes energy, food, alcohol, and tobacco, fell in March to 4.2% and continues to partly reflect the current persistence of services prices inflation which fell from 6.1% to 6%, while goods prices inflation fell from 1.1% to 0.8%.
- In response to recent inflation and wider economic data, the Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate at 5.25% in May, unchanged since August 2023. The Bank set out that, while key indicators of inflation persistence are easing broadly in line with their expectations, the MPC will continue to monitor underlying tightness of labour market conditions, wage growth and services price inflation when considering future changes to the Bank rate.[3]



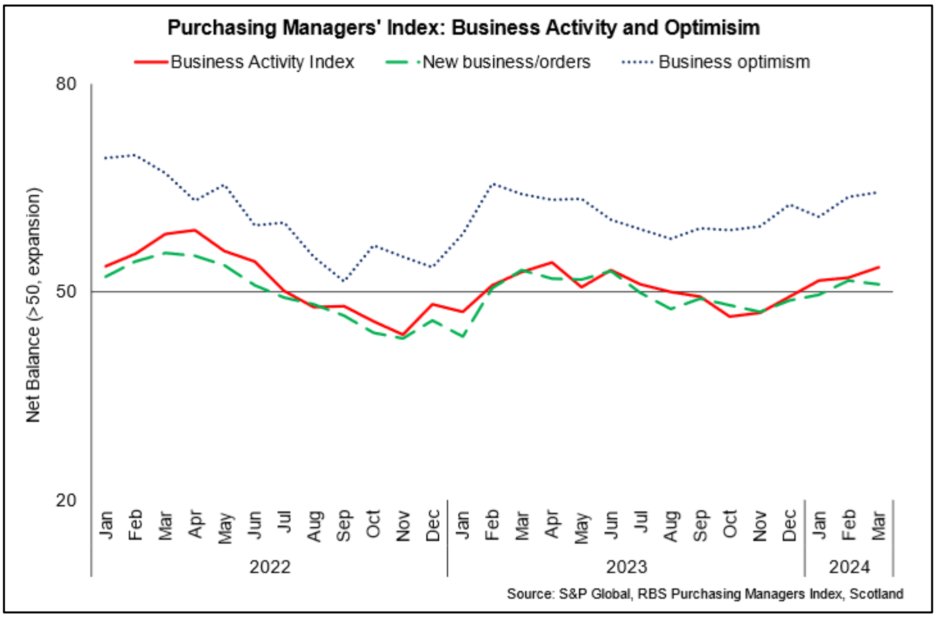
Business Conditions

Business activity has strengthened at the start of the year and business optimism is at its highest for 13 months.

Business Activity

- The Purchasing Managers Index (PMI) business survey indicates that business activity in Scotland's private sector has strengthened at the start of the year and increased for the third consecutive month in March (53.6). This was partly underpinned by an increase in new business for the second consecutive month (51.1), however this was driven by growth in the services sector while manufacturing activity continued to weaken, though to a lesser extent than in recent months.[4]

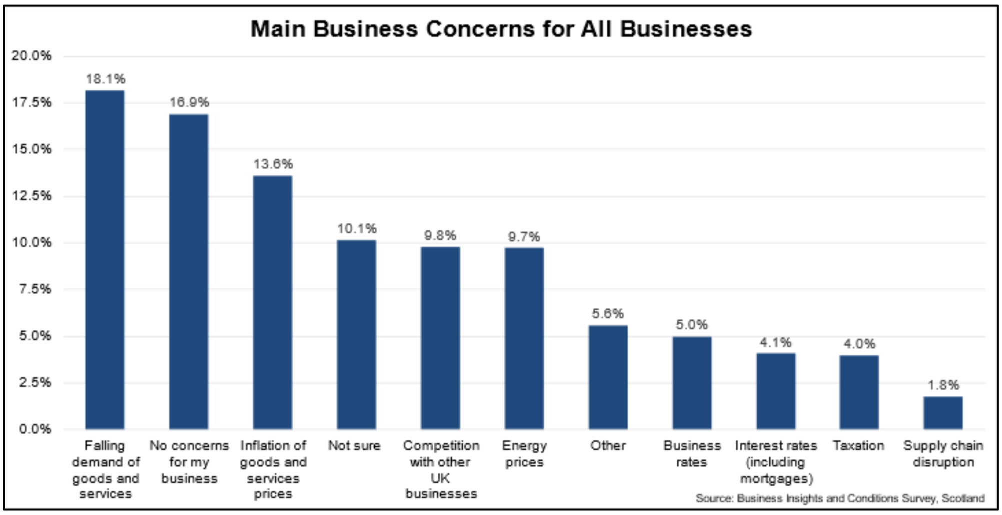
[3] Bank rate maintained at 5.25% - May 2024 | Bank of England
[4] Royal Bank of Scotland PMI report for March 2024 | Royal Bank of Scotland (rbs.co.uk)



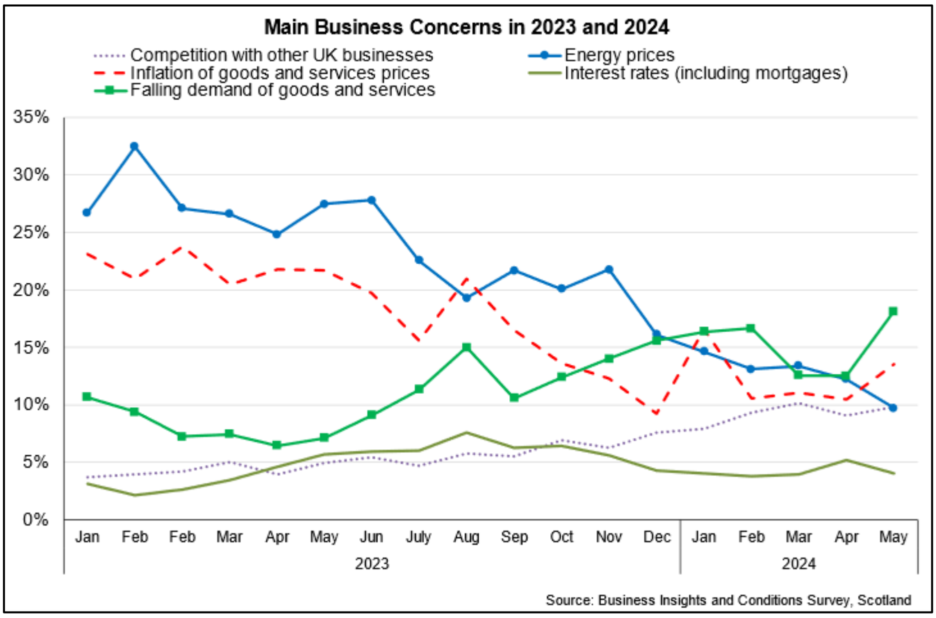
- Reflecting the pick-up in activity, business optimism for the year ahead rose to a 13-month high (64.4), with reports indicating hopes of improved economic conditions underpinning expectations.

Business Concerns

- Reporting of key business concerns have continued to converge through the first quarter of the year as inflationary pressures have eased and increased expectations for improved trading conditions for the year ahead have emerged.



- The Business Insights and Conditions Survey (BICS) for May indicates that businesses' concerns around energy prices (9.7%) and inflation of goods and services (13.6%) have stabilised in recent months following their downward trend over 2023 and have converged with concerns of competition with other UK businesses (9.8%). Concerns around falling demand have increased somewhat in the latest data, rising to become the most common concern among businesses (18.1%), although many businesses have reported having no concerns (16.9%).[5]

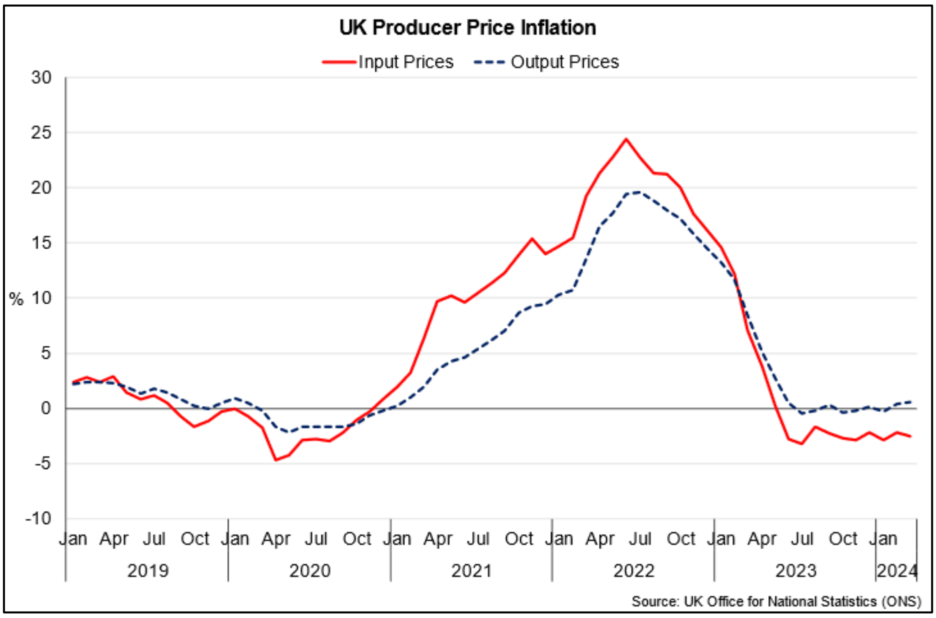


- The rise in the share of businesses reporting falling demand of goods and services in May was broad based across industries, and is consistent with the weakening in the PMI for new business. Concerns regarding interest rates eased over the second half of 2023 likely reflecting increased expectations that interest rates may fall during the coming year and have broadly stabilised at the start of 2024, increasing slightly over the recent month to 4.1%.

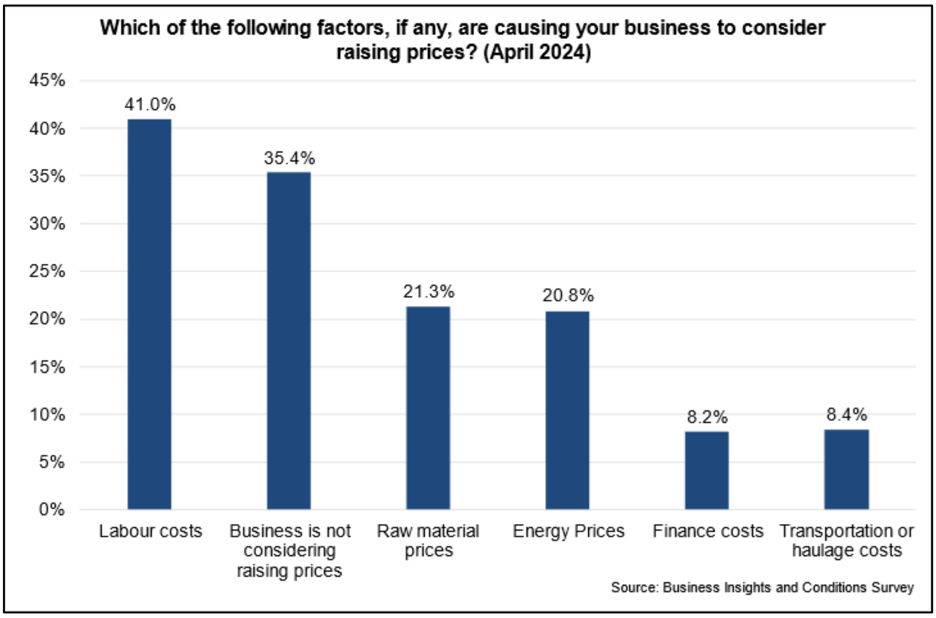
Business Costs

- At a headline level, producer input prices continued to decline in March on an annual basis for a tenth consecutive month, which is feeding through to significantly lower rates of output price inflation. The input price index fell 2.5% on an annual basis in March, while producer output prices rose 0.6%, an increase from the 0.4% recorded last month. [6]

[5] Business and innovation statistics - gov.scot (www.gov.scot)
[6] Producer price inflation, UK Statistical bulletins - Office for National Statistics (ons.gov.uk). Prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased and factory gate prices.



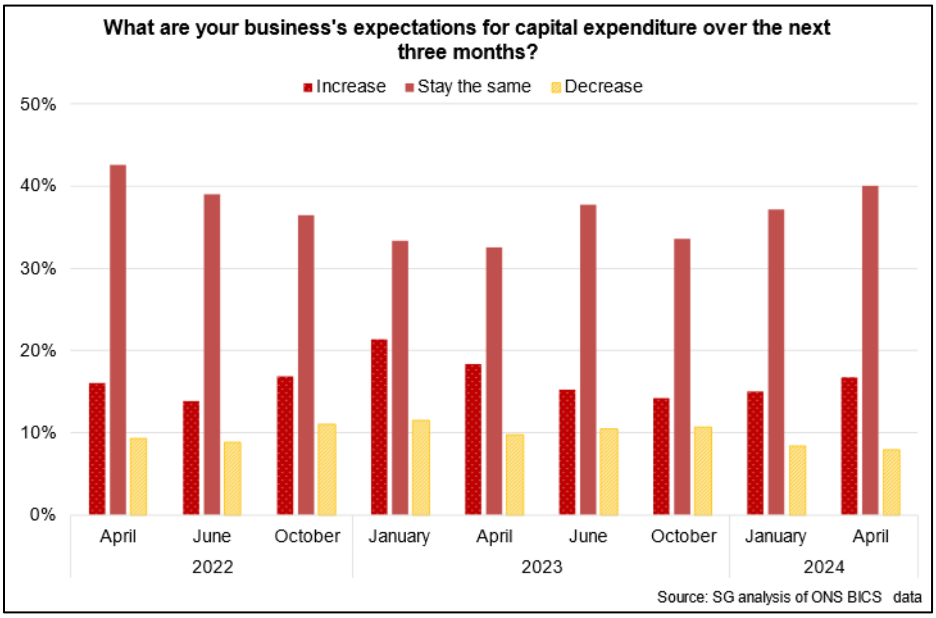
- Overall, input and output price levels have been relatively more stable since June 2023, albeit they are significantly higher than at the start of 2021 (c. +25%) prior to the spike in inflation.
- The largest downward contributions to the annual input inflation rate for producers in March came from inputs of chemicals (-6.9%, up from -7.1%) and other parts and equipment (0.0%, down from 0.1%). Domestic food input prices have also continued to fall on an annual basis (-2.5%), and imported food input price inflation has now also contributed to producer input disinflation in March, with prices falling 1.7% annually. Fuel prices have been the largest upward contributor to producer input prices, with an annual inflation rate of 4.1% in March.
- Looking at a broader range of input costs across the manufacturing and services sectors, PMI business survey data indicates that input prices continued to rise in March, however this indicator is at its lowest level since around the start of 2021.
- In terms of the feed through to output prices, BICS data show that many businesses are not considering raising prices in May (35.4%). However, it also provides insights on which costs remain the most challenging to absorb, with the main factor of considered price rises being labour costs (41%), followed by raw materials prices (21.3%) and energy prices (20.8%).



- At the beginning of April, around 8.4% of businesses reported that transportation or haulage costs are causing business to consider raising prices. This potentially partially reflects the increase in shipping and supply chain costs and delivery times that businesses are facing due to the attacks on commercial shipping in the Red Sea and the rerouting of shipping routes from Asia to Europe round the Cape of Good Hope rather than through the Suez Canal.
- There remains uncertainty over the persistence and impacts of the current supply chain disruption. BICS data show that only 3.4% of businesses in March experienced global supply chain disruption, remaining below the average for the past year (7.5%). Supply-chain disruptions in the Manufacturing sector have also sharply declined from the 11.1% of business reporting concerns in February to 3.7% reporting similar concerns in March.

Business Investment

- The combination of business concerns around demand, cost pressures and higher interest rates continues to weigh on business investment decision making.
- BICS data from March show that capital expenditure expectations have increased slightly over recent months, with 16.8% of respondents expecting their capital expenditure to increase between April and June (up from the 15% reported in February 2024) while a slightly smaller share of businesses expect their capital expenditure to decrease (7.9% down from 8.4%). Of those expecting to authorise capital expenditure, 54.1% report that it will be for replacements, with a growing number of businesses reporting to authorise capital expenditure to increase efficiency (18.7%), expand capacity (15.5%) or to use new technology (12.5%). This suggests businesses remain cautious but increasingly optimistic about future economic conditions.

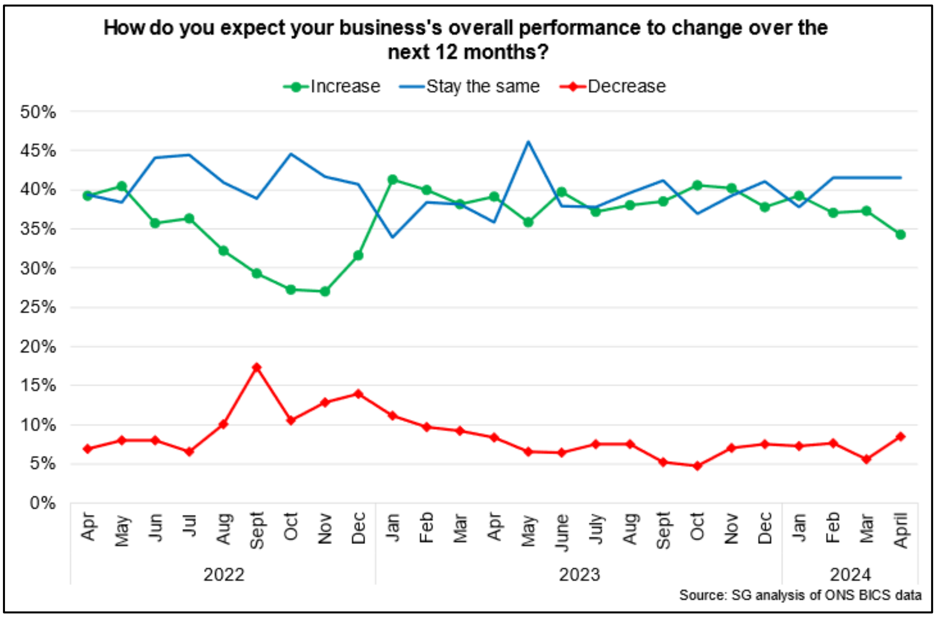


- The Scottish Chambers of Commerce Quarterly Economic Indicator for the first quarter of 2024, however, indicates a level of caution reporting that business investment trends remain largely frozen. Over half of businesses (53%) reported no change to total investment and 52% no change to training investment.[7]

Business Optimism

- Despite the challenging conditions continuing to face businesses, the recent pick-up in business activity and easing of some cost inflation pressures have been reflected in a further improvement in business optimism.
- The PMI business survey data indicates that business optimism for the year ahead rose to a 13-month high in March, continuing its upward trend since the middle of 2023 amid business hopes of improved economic conditions.
- BICS data for April indicates that most businesses expect their overall business performance to stay the same (41.5%) or increase (34.2%) over the coming year. On aggregate, this has remained broadly stable compared to the start of 2023, while the share of businesses expecting their performance to decrease has fallen to 8.5%.

[7] Quarterly Economic Indicator - Scottish Chambers

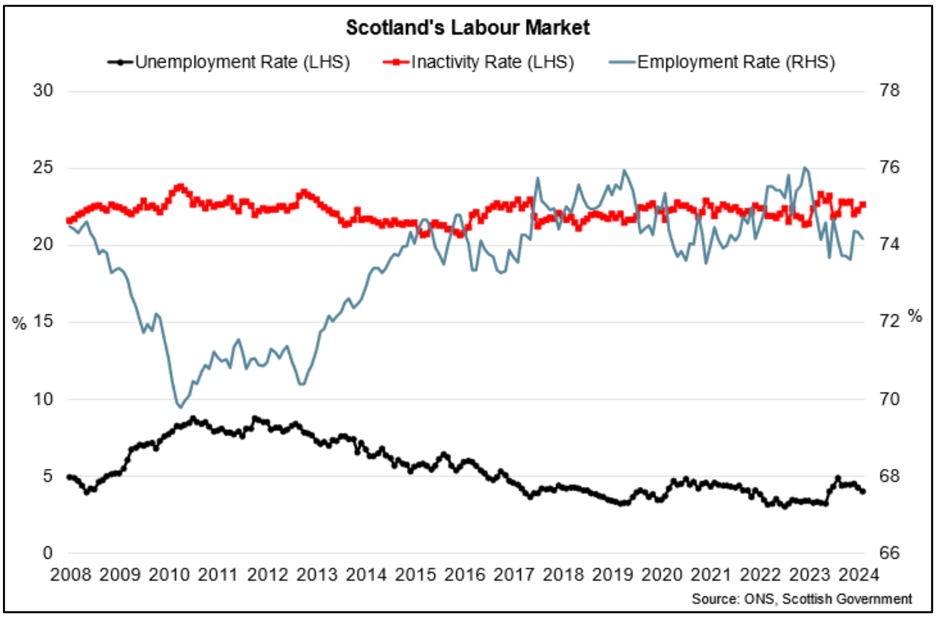


Labour Market

Payrolled employees remain at a near record high in February as recruitment difficulties continue to ease.

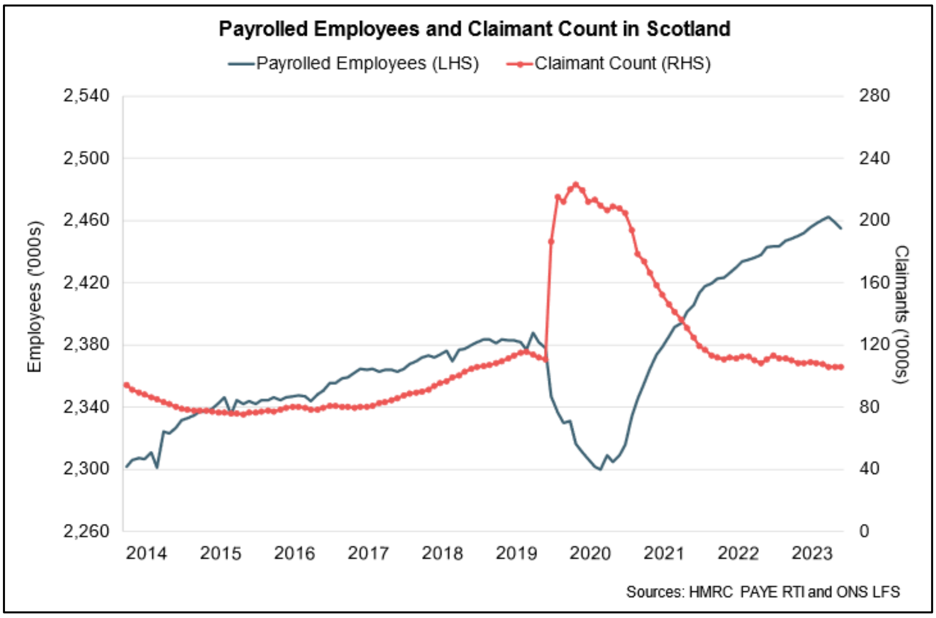
Employment, Unemployment, and Inactivity

- Scotland's labour market has remained resilient at the turn of the year in the face of subdued GDP growth and inflationary pressures. Latest data for December to February show that Scotland's unemployment rate fell 0.4 percentage points over the quarter to 4.0%, while the employment rate rose by 0.5 percentage points to 74.2%, and the inactivity rate fell by 0.2 percentage points to 22.6%.[8]



8 [Labour market statistics - gov.scot (www.gov.scot)](#)

- The labour market has softened slightly over the last year with the employment rate falling 1.7 percentage points while the unemployment has increased 0.8 percentage points, and the inactivity rate has risen 1.1 percentage points. Despite the uncertainties around the ONS's Labour Force Survey data, wider labour market data continues to illustrate underlying resilience. In March, early estimates of the number of payrolled employees in Scotland edged down slightly over the month to 2.45 million, but remains close to its series high. Alongside this, Scotland's claimant count rate remained stable in March at 3.5%, compared to 4% for the UK as a whole, with the number of claimants rising 0.2% over the month to 105,800.[9,10]



Recruitment Activity

- The softening in labour market conditions over the past year has been accompanied by a slight cooling in the extent of labour market tightness in recent months. The RBS Report on Jobs indicated a plateauing fall in permanent staff placements in March (42.6) as business demand for permanent staff fell for a seventh consecutive month (43.5).[11]

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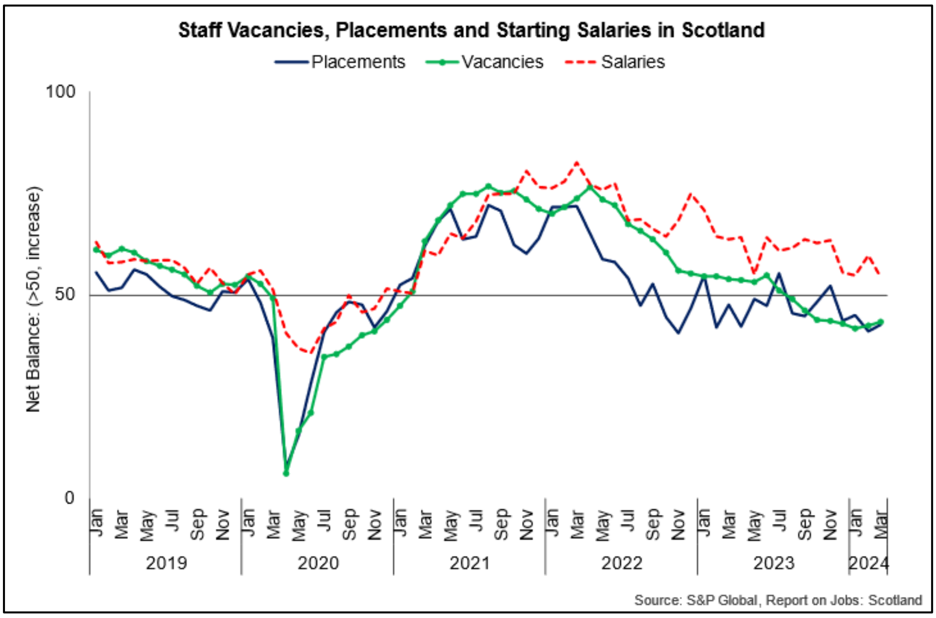
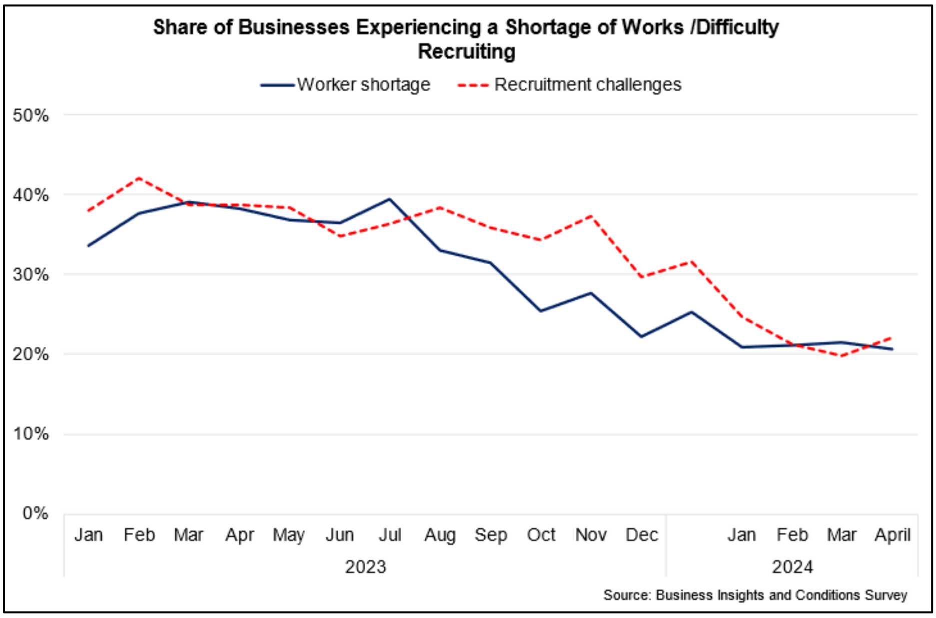
[9] [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)]
[10] [Nomis - Official Census and Labour Market Statistics (nomisweb.co.uk)]
[11] [Royal Bank of Scotland Report on Jobs – February 2024 | NatWest Group]



- The survey also indicates that while there has been a slight easing in labour market tightness over the past year, there have been slightly sharper falls at the start of the year in permanent staff availability (supply) indicating that recruitment conditions remain challenging. Furthermore, the Scottish Chambers of Commerce Quarterly Economic Indicator for Q1 2024 indicated that labour market concerns have increased over the quarter with 47% of businesses reporting recruitment challenges (up from 40% in Q4 2023), with challenges particularly in the construction and manufacturing sectors.
- BICS data provides further insights on labour shortages and recruitment challenges. In March, 20.6% of businesses reported experiencing a shortage of workers, down from the average rate of 34% at the start of 2023, while 22.1% of businesses reported experiencing difficulties recruiting in March, down from 42.1% in January 2023.

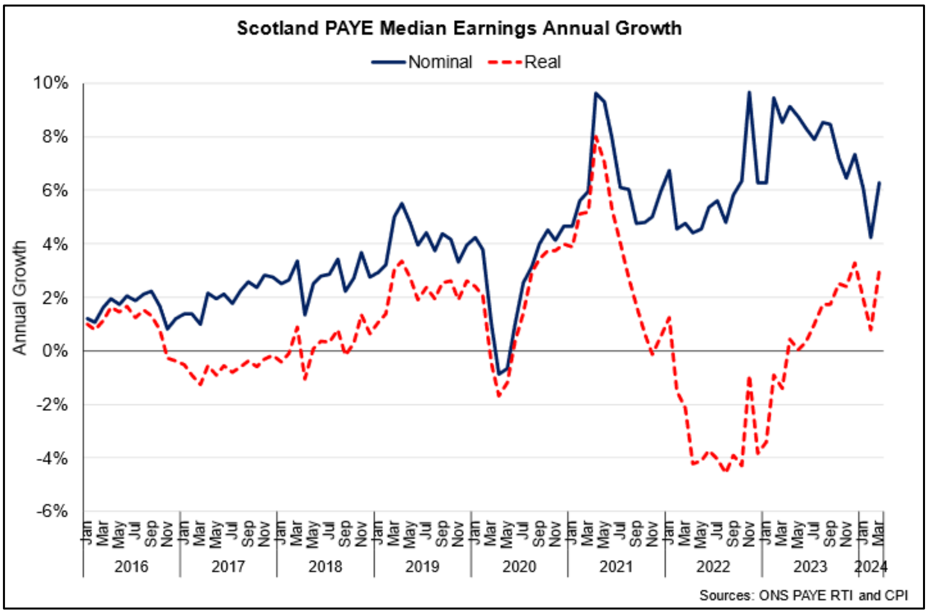


- At a sector level, worker shortages in April were most reported in accommodation and food services (31.6%), admin and support services (30.5%) and construction (30.1%). Most recently at the start of February, 59.5% of businesses reported that worker shortages have led to employees working increased hours, while 40% reported being unable to meet demand and 33% reported having to recruit temporary workers.
- Recruitment difficulties in March were most reported in construction (32.5%) and manufacturing (30.8%). Latest data from January show most businesses responded that a lack of qualified applicants (63.1%) alongside a low number of applications (49.1%) were reasons why they experienced difficulties in recruiting employees, while 20.1% reported not being able to afford an attractive pay package for applicants.

Earnings

- Recruitment challenges, staff shortages and inflationary pressures generated upward pressure on earnings growth over the past 18-months, however the pace of this growth has recently eased.
- The RBS Report on Jobs for March indicated that growth in starting salaries picked-up over the month (54.4), with respondents attributing this to a shortage of candidates with the necessary skills, however the overall pace of growth has significantly slowed compared to the start of 2023 and during 2022.
- More broadly, nominal median monthly PAYE pay in Scotland was £2,389 in March, up 1.3% over the month and up 6.3% over the year. This is above the average annual growth rate over the past eight years (4.2%), having slowed from higher rates of growth of around 9% in 2023 and is the lowest annual rate of growth since August 2020.[12]

[12] Earnings and employment from Pay as You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)



- Adjusting for inflation, which was 3.2% in March, real median earnings grew 3% on an annual basis. This was the eleventh consecutive month of positive annual growth following the period of falling real pay during 2022 and the start of 2023.

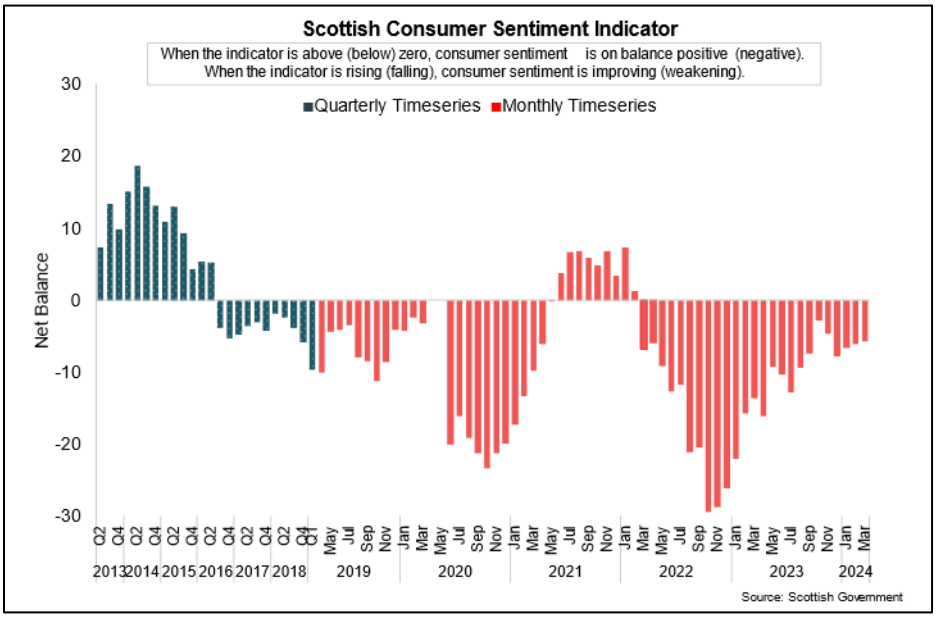
Consumer Activity

Consumer sentiment improved in each of the first three months of 2024, but remains negative overall.

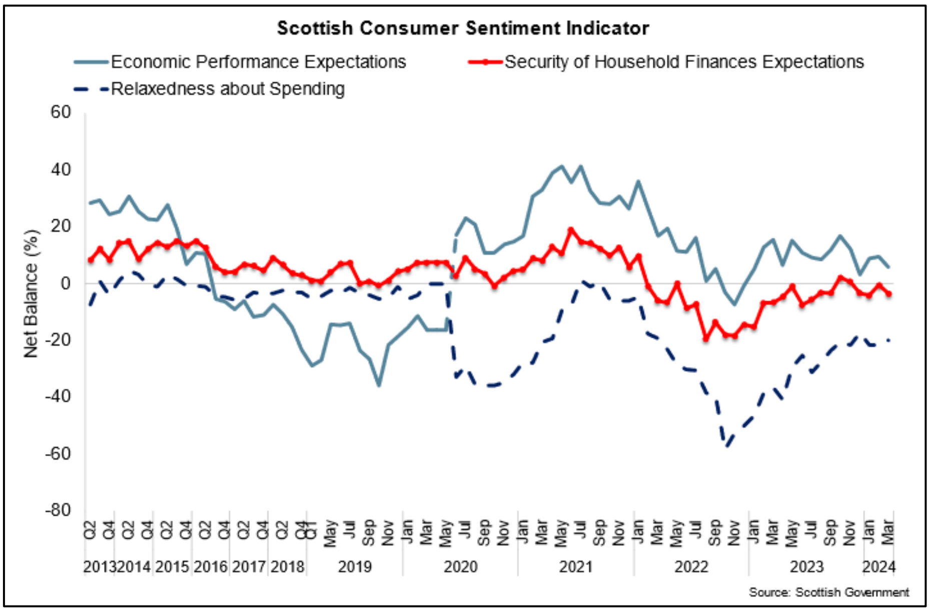
Consumer Sentiment

- The Scottish Consumer Sentiment Indicator reflects how households think the economy is performing, how secure they feel about their household finances and how relaxed they feel about spending money.
- Consumer sentiment fell sharply during 2022 to -29.4 as inflationary pressures increased and the economic outlook weakened. However, sentiment strengthened significantly over 2023 as inflationary pressures reduced and latest data for March show sentiment increased by 0.4 points over the month and by 7.9 points over the year to -5.7.[13]

[13] Economy statistics - gov.scot (www.gov.scot)



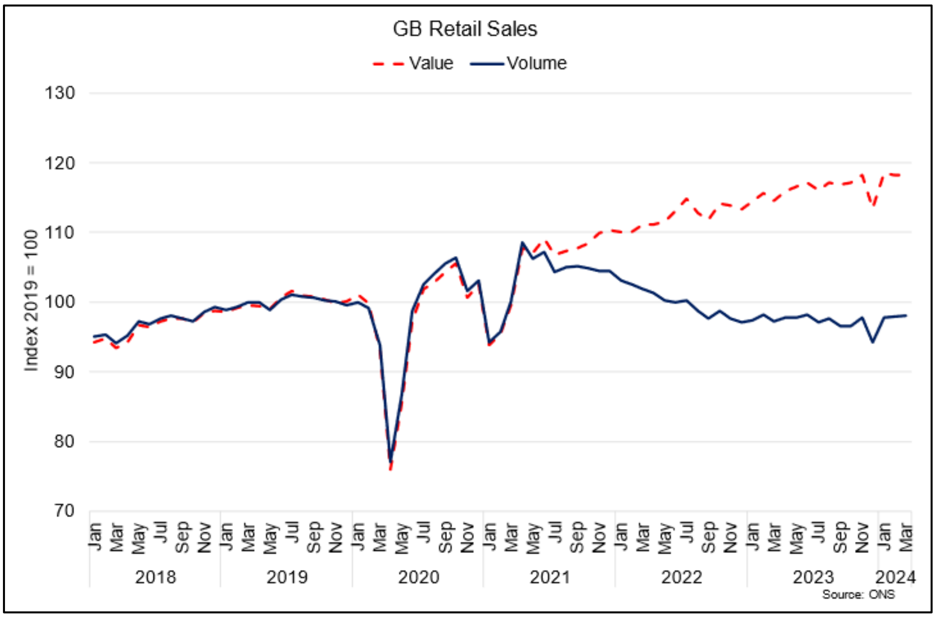
- While four of the five sentiment sub-indicators have strengthened over the past year, households continue to report in March that, on balance, their personal financial secuity is weaker (-10.9) and are more cautious about spending money (-20.1) than at the same time last year. Despite this, households marginally believe that the economy is currently performing better now than in the last twelve months (0.2).
- Looking ahead to the coming year, households expect the economy to improve (5.8), although also continue to expect their personal financial security to weaken (-3.5).



- However, consumer sentiment in the first quarter of 2024 has fallen relative to the fourth quarter of 2023, with the the composite Consumer Sentiment Index falling by 1.1 points to -6.2 points, reflecting weaker consumer confidence since the start of the new year.

Cost of Living and Spending

- The rate of inflation has reduced significantly over the past year, however the sharp rise in cost of living and higher interest rates continues to impact household decisions on spending (essential and non-essential), saving, and borrowing (including financing outstanding borrowing).
- For example, retail sales volumes in Great Britain have remained settled below their 2019 level over the past year, growing 0.8% over the year to March while sales value grew 3.3%; the divergence reflecting the pace of rising prices.[14]



- Similarly the change in prices and interest rates have had a significant impact on the amount UK conumers are paying for their energy costs, mortgages and other loans. In February the average monthly direct debit payment for electricity and gas was £186.48, down 5.1% compared to February 2023 however was up 35% compared to February 2022. This in part reflects that the Energy Price Cap has fallen over the past year, however remains significantly higher compared to two years ago.[15]

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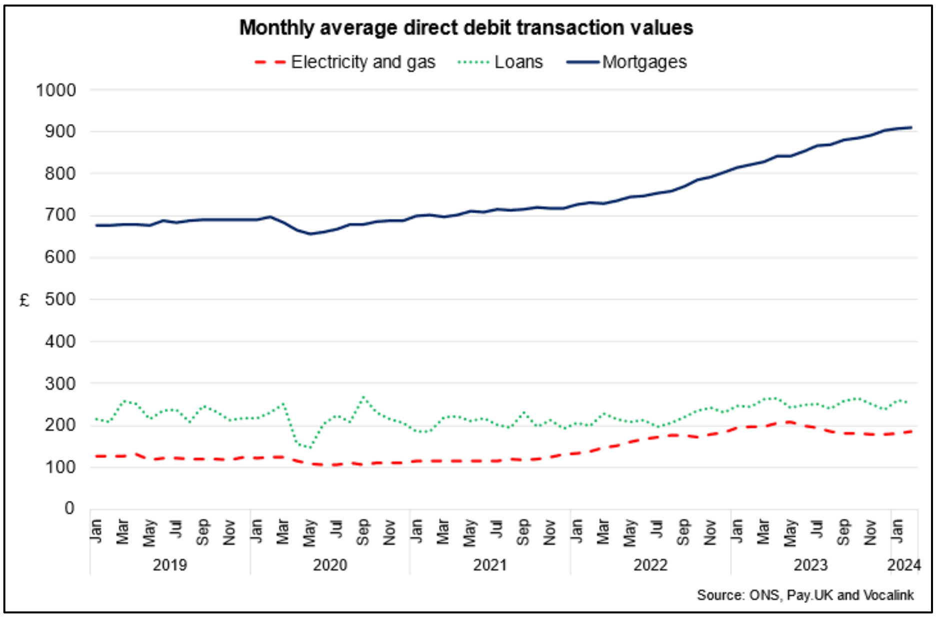
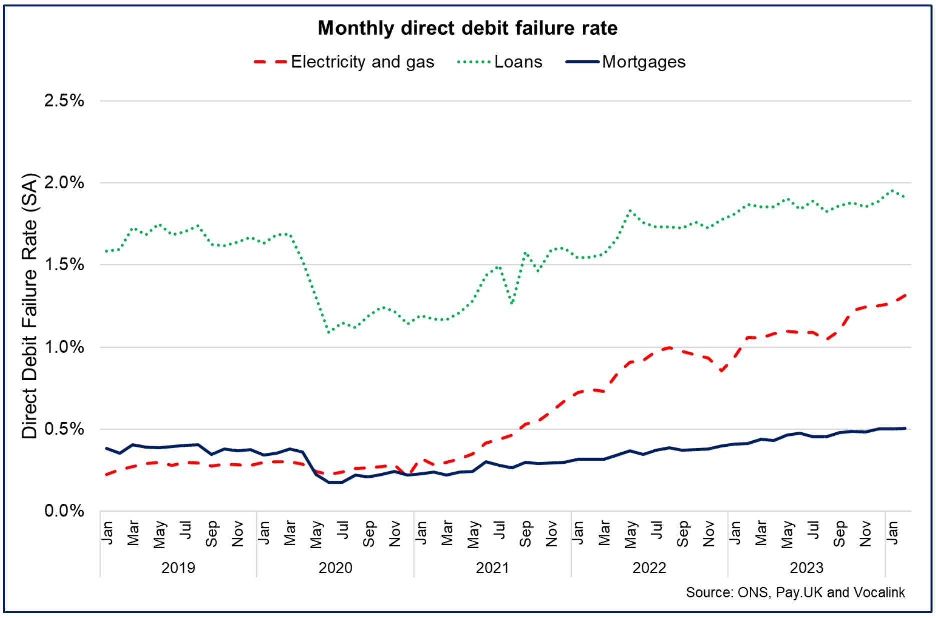
[14] [Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)]
[15] [Monthly Direct Debit failure rate and average transaction amount - Office for National Statistics (ons.gov.uk)]

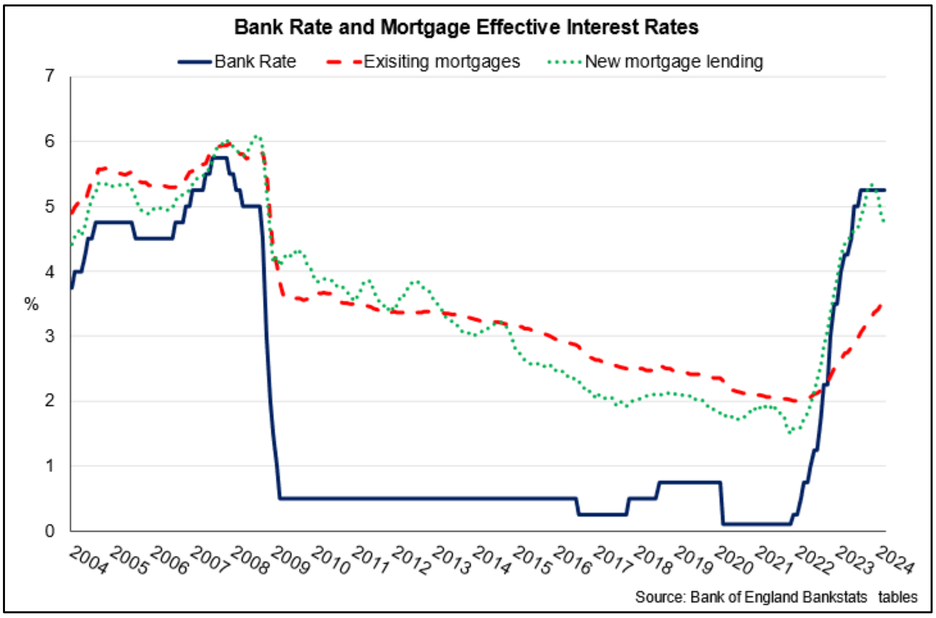


- However, the average monthly direct debit payment for mortgages was £910.76 in February (up 10.8% over the year and 24.5% since the start of 2022) and £253.51 for loans (up 4.3% over the year and 26.7% since 2022). This in part reflects that higher interest rates are continuing to progressively feed through to higher borrowing costs.
- The sharp increase in prices has been accompanied by an increase in the direct debit failure rate (the percentage of transactions that fail due to insufficient funds), reflecting the challenges facing some household budgets. For electricity and gas payments, the payment failure rate has risen to 1.31% (up from 1.06% in February 2023), while for mortgages it has risen to 0.51% (up from 0.41% in February 2023).



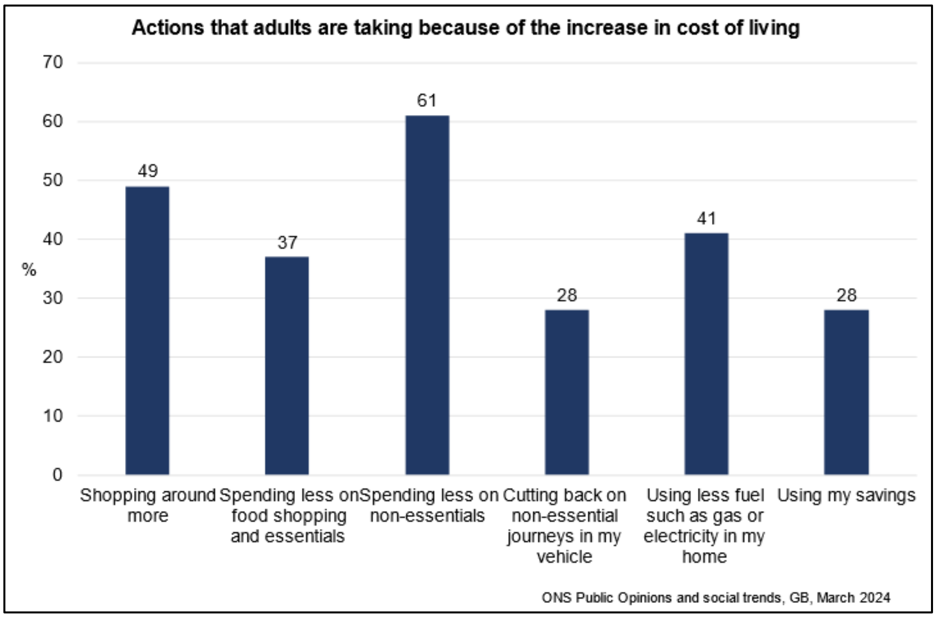
- More broadly in April, the ONS Public Opinions and Social Trends survey showed that 34% of respondents were finding it very or somewhat difficult affording energy bill payments while 40% of respondents said the same for mortgage and rent payments. For energy bills, this was lower than at the same point in 2023 (47%), however this is up slightly for mortgage and rent payments (35%).[16]

- The more gradual and persistent impacts of higher interest rates on mortgage payment challenges compared to energy payments reflects the sharp rise in the Bank Rate between the end of 2021 and middle of 2023 and the time it takes for the full impact of the increases to be felt at an aggregate level due to the high share of mortgages that are on a fixed rate.
- Reflecting this, the 'effective' interest rate – the actual interest paid – on newly drawn mortgages remains elevated but fell for a fourth consecutive month in March to 4.73%, in part reflecting increased market expectations that interest rates may reduce in 2024. Rates on the outstanding stock of mortgages however continued to rise to 3.5%.[17]



- In response to the change in cost pressures facing households, ONS Public Opinions and Social Trends survey data from March show that the most common actions people are taking in response to the increased cost of living were spending less on non-essentials (61%) and shopping around more (49%). Furthermore, 41% reported using less fuel such as gas or electricity in their home and 37% reported spending less on food shopping and essentials.

[16] Public opinions and social trends, Great Britain - Office for National Statistics
[17] Effective interest rates - A visual summary of our data | Bank of England



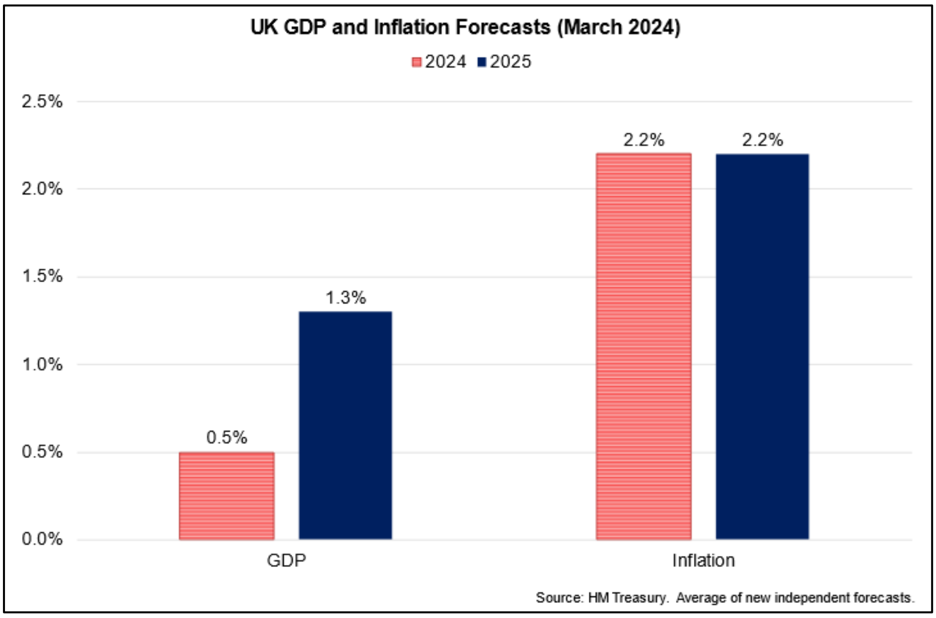
Economic Outlook

Economic conditions are forecast to improve with stronger growth and lower inflation.

- The outlook for economic growth in 2024 remains relatively subdued however is expected to strengthen while inflationary pressures are forecast to moderate further. At the global level, the IMF's World Economic Outlook published in April forecasts global growth to be steady at 3.2% in both 2024 and 2025, with growth in advanced economies averaging at 1.7% in 2024 and 1.8% in 2025.[18] Similarly, the OECD Economic Outlook for May forecasts the global economy to grow by 3.1% in 2024 and 3.2% in 2025, with the UK growing at 0.4% in 2024 and 1.1% in 2025. However, the UK 2025 figure is the lowest growth forecast among G7 economies with the OECD forecasting advanced economies will grow on average 1.7% in 2024 and 1.8% in 2025.[19]
- In December, the Scottish Fiscal Commission forecast Scotland's economic growth to strengthen from 0.1% in 2023 to 0.7% in 2024, rising to 1.1% in 2025. [20] In March, the Fraser of Allander Institute forecast a similar pattern of strengthening growth of 0.6% in 2024, rising to 1.1% in 2025. [21] Most recently, KPMG forecast in their Scottish economic outlook in May growth of 0.4% in 2024 and 1% in 2025.[22] At a UK level, in March, the Office for Budget Responsibility forecast UK growth to strengthen to 0.8% in 2024 rising to 1.9% in 2025.[23]
- The HMT April average of new independent UK forecasts further illustrates the expectation of stronger growth and falling inflation with UK GDP growth forecast on average to rise to 0.5% in

[18] World Economic Outlook, April 2024: Steady but Slow: Resilience amid Divergence (imf.org)
[19] OECD Economic Outlook
[20] Scotland's Economic and Fiscal Forecasts – December 2023 – Scottish Fiscal Commission
[21] FAI Economic Commentary | FAI (fraserofallander.org)
[22] Scottish Economic Outlook - KPMG UK
[23] EFOs - Office for Budget Responsibility (obr.uk)

2024 and 1.3% in 2025, while inflation is forecast to fall on average to 2.2% in Q4 2024 and remain at 2.2% at the end of 2025.[24]



- In May, the Bank of England projected inflation to fall to 2.1% in April 2024 before rising slightly back above target during the second half of the year.[25] This reflects increased energy price inflation, which the bank forecasts will become less negative during the second half of the year. Inflation is then forecast to fall to around 1.9% in two years' time, assuming interest rates follow market expectations.
- The Bank of England maintained the Bank Rate at 5.25% in May, however the projected fall in inflation this year has raised expectations that the Bank Rate will be reduced during the year, and that the pace at which these cuts may be implemented could be faster than in the US. This, alongside supportive fiscal policy and the falling energy prices, underpin the stronger growth outlook for the year ahead. Downside risks to the economic outlook remain, notably from developments in the Middle East, including disruption to shipping through the Red Sea and potential further oil market volatility.

[24] Forecasts for the UK economy - GOV.UK (www.gov.uk)
[25] Bank rate maintained at 5.25% - May 2024 | Bank of England

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