Scottish Economic Bulletin

Office of the Chief Economic Adviser

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Scottish Government
Riaghaltas na h-Alba

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Cover page Image of peat sampling at Blawhorn Moss © Dougie Barnett NatureScot

Overview

This edition of the Scottish Economic Bulletin reflects on latest indicators from the second quarter of 2026 into the first half of July, in which we saw signs of improvement in some sentiment indicators following the moderation in wholesale energy and fuel prices during this period. However the escalation of tensions in the Middle East again in the second half of July underlines the ongoing risks to energy prices and the outlook for inflation.

The Scottish economy grew 0.6% in the three months to May, strengthening to its highest 3-monthly rate since the first quarter of 2025. The pick-up in growth was broad based across the sector groups and on an annual basis the economy grew 1.2%. However, the monthly PMI business survey for Scotland indicates that demand conditions remained subdued in June with new business orders continuing to fall, though to a slightly lesser extent than in May.

Despite these challenges, there were signs of wider stabilisation in business conditions in June. Producer input price inflation fell from its recent peak of 9.3% in May to 7.3% in June, with business concerns about energy prices and inflation moderating over the month and a falling share of businesses reporting that these factors were causing them to consider raising prices.

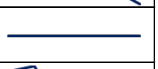
CPI inflation fell to 2.6% in June and consumer sentiment in Scotland improved across May and June to -8.2, though it remains below its level in February prior to the Middle East conflict. However, inflation is expected to increase again in the coming months, with the Bank of England's central projection for it to rise in the third quarter following the 13% increase in the Energy Price Cap in July and to peak at 3.2% in the fourth quarter as higher business costs continue to feed through to consumers.

Business optimism has shown a similar pattern of improvement in recent months, although businesses' main concern remains falling demand, which alongside cost pressures has weighed on recruitment activity over the past year. Scotland's labour market has loosened with the unemployment rate rising to 4.7% in the 3-months to May, its highest rate in 2 years. Vacancies have also fallen from last year albeit latest data indicates staffing levels remained more stable in June.

Looking ahead, the Bank of England's central projection is for UK economic growth to slow this year to around 1.1% (from 1.3% in 2025). However, there remains ongoing uncertainty regarding developments in the Middle East with the recent escalation of military action in July leading to further volatility in oil prices and also gas prices (which are at elevated levels), and raising the risk that inflationary pressures exceed the Bank's central projection. Furthermore, it risks stalling the improvements in business and consumer sentiment we have seen in recent months, which are an important basis of improving underlying demand conditions in the economy.

Data and Forecasts Summary

Outturn Data

Indicator	Latest Data	Next Release	2025	2026						6-month Graph
			Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	
GDP growth (3-month rolling %)	0.6% (May)	26 August	0.0	-0.1	-0.1	0.1	0.2	0.6	n/a	n/a	
Unemployment rate (%)	4.7% (Mar - May)	18 August	3.9	4.1	4.2	4.4	4.4	4.7	n/a	n/a	
Real Earnings growth (YoY %)	2.1% (June)	19 August	1.1	1.7	1.2	1.2	2.5	2.4	2.1	n/a	
Inflation rate (CPI YoY %)	2.6% (June)	19 August	3.4	3.0	3.0	3.3	2.8	2.8	2.6	n/a	
BoE Base Rate (%)	3.75% (July)	17 September	3.75	3.75	3.75	3.75	3.75	3.75	3.75	3.75	
Consumer Sentiment (Index)	-8.2 (June)	26 August	-9.6	-5.9	-4.6	-15.4	-16.7	-13.0	-8.2	n/a	

Forecasts

Indicator	Organsiation	Date of Forecast	2026	2027	2028	2029	2030	Graph
GDP growth (YoY %)	SFC	January 2026	1.3	1.3	1.5	1.5	1.5	
Unemployment rate (%)	SFC	January 2026	4.2	4.2	4.2	4.2	4.1	
Nominal Average Earnings growth (YoY %)	SFC	January 2026	2.9	2.8	2.7	2.8	2.8	
Inflation rate (4Q rate in Q4)	BoE	July 2026	3.2	2.1	1.9	n/a	n/a	

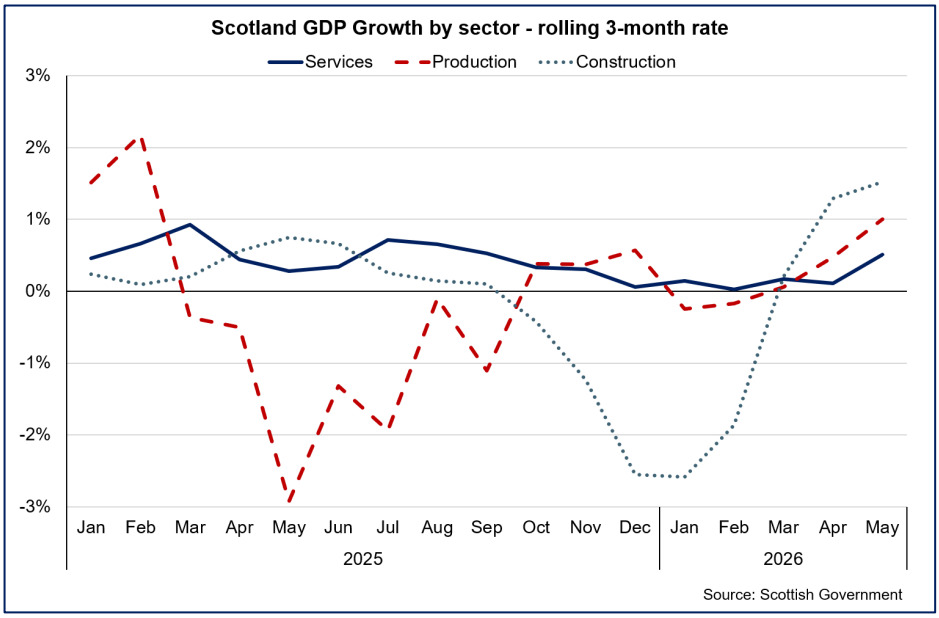
Output

Scottish economic growth strengthened in the 3-months to May to its highest rate since March 2025.

- Scotland's GDP grew 0.6% in the three months to May 2026 (UK: 0.7%), with growth strengthening from 0.2% in the 3-months to April and 0.1% in the 3-months to March. Over the past year, Scotland's GDP has grown by 1.2% (UK: 1.1%).[1,2]

- At a sector level, growth was broad based across the services (0.5%), production (1.0%), and construction (1.5%) sectors.
- Service sector growth strengthened to its highest 3-monthly rate this year. Within the sector, consumer facing services growth strengthened to 1.1% over the 3-months (from 0.4% in the 3-months to April) partly reflecting a pick-up in retail (1.4%) offsetting a further fall in accommodation and food services (-0.3%). Over the past year, services output has grown 1.5%.
- Production sector growth over the 3-months was its strongest since February 2025 and was driven by an increase in growth in electricity and gas supply (4.7%) and water supply and waste management (4.8%). This offset a fall in output from mining and quarrying industries (-2.6%) and flat growth in Manufacturing (0.0%). Over the past year, production output has grown 1.1%.
- The construction sector grew at its highest rate since August 2023 with growth continuing to strengthen from a sharp fall in output through the turn of the year. However, over the past year, construction output has fallen 1.5%.

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



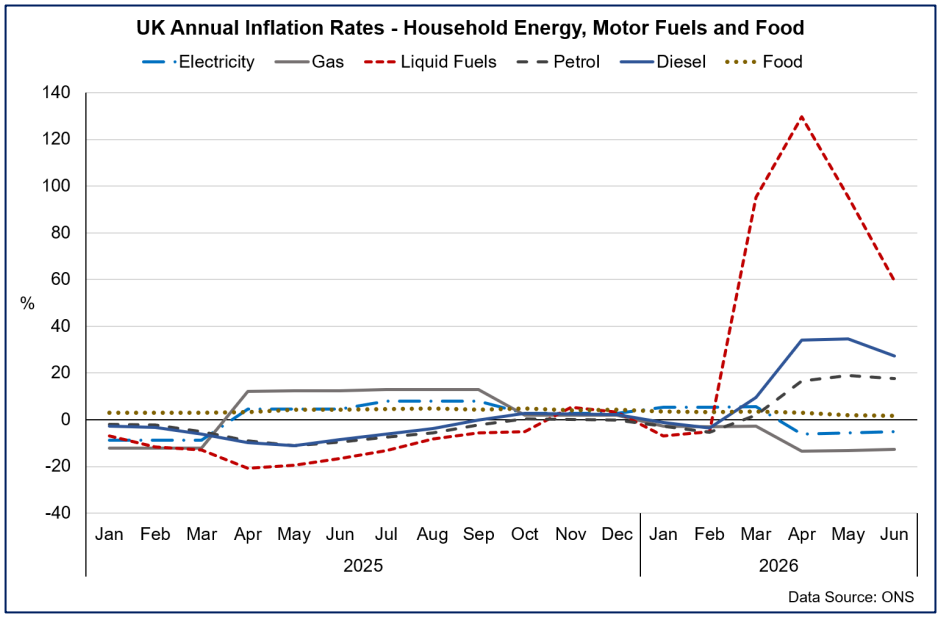
Inflation and Cost of Living

The inflation rate fell in June, however is expected to rise in July reflecting the rise in household energy prices.

Inflation

- UK inflation fell to 2.6% in June, down from 2.8% in May and April and is at its lowest rate since March 2025. Key drivers of the fall in inflation rate over the month were in transport, in which inflation fell from 6.8% to 5.7%, and food and non-alcoholic beverages prices which fell from 2.2% to 1.7%.[3]
- Within transport, motor fuel prices fell in June with petrol and diesel prices falling together (-1.3% and -5.7% respectively) for the first time since February prior to the Middle East conflict. The fall in petrol and diesel prices in June partly reflects that oil prices averaged c. $85 per barrel over the month, down from c. $107 per barrel May, due to the ceasefire in the Middle East.
- That said, annual petrol price inflation remained elevated at 17.7% in June with annual inflation of diesel at 27.4%. Furthermore, road fuel prices have increased again during July, with petrol prices now at their highest since the conflict began.[4]

[3] Consumer price inflation, UK - Office for National Statistics
[4] Weekly road fuel prices - GOV.UK

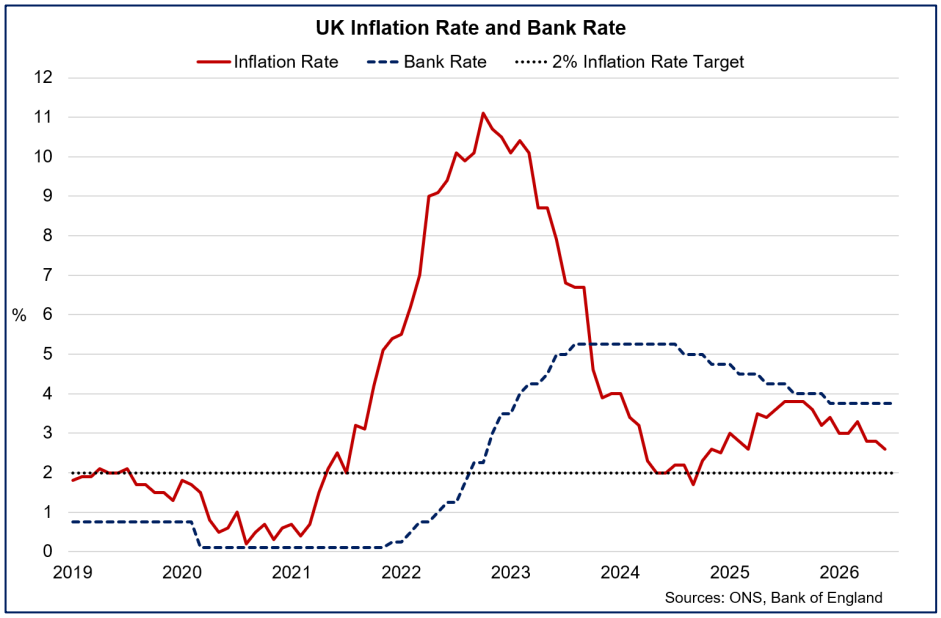


- Prices for household liquid fuels such as heating oil continued to moderate in June, albeit there are indications that heating oil prices have picked up slightly in July. Furthermore, the 13% rise in the household Energy Price Cap (EPC) for the third quarter will also start to be reflected in July's inflation data, reflecting the increase in wholesale energy prices between March and May.[5] The EPC will next change in October and will partly depend on how energy prices evolve in the coming months. The escalation of military action again in July has generated further price volatility, with renewed upward pressure on oil and gas prices.

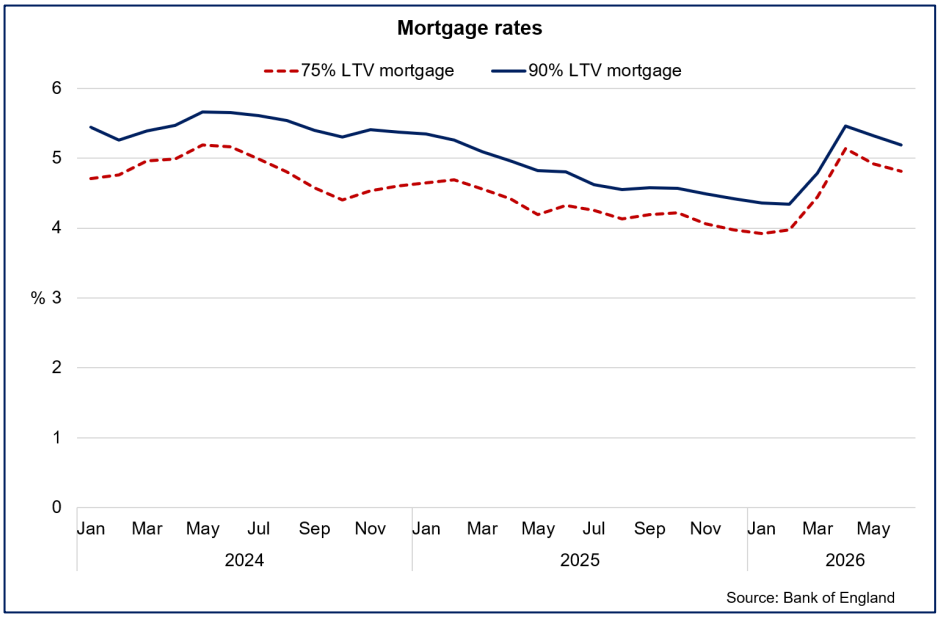
Monetary and Credit Conditions

- Inflation is expected to rise in the second half of 2026 as the rise in energy prices and business costs feed through to consumer prices. The Bank of England project inflation to rise from its current rate of 2.6% to 2.9% in Q3 and peak at 3.2% in Q4.[6]
- The Bank's Monetary Policy Committee (MPC) held the Bank Rate unchanged for a fifth consecutive time in July at 3.75%.[7] The Committee judged that while higher energy prices were expected to increase inflation in the second half of this year, there is little evidence of second round inflation effects so far, and the current interest rate alongside underlying demand conditions are sufficiently offsetting inflationary risks at this point.

[5] Energy price cap will rise by 13% from July | Ofgem
[6] Monetary Policy Report - July 2026 | Bank of England
[7] Interest rates and Bank Rate: our latest decision | Bank of England



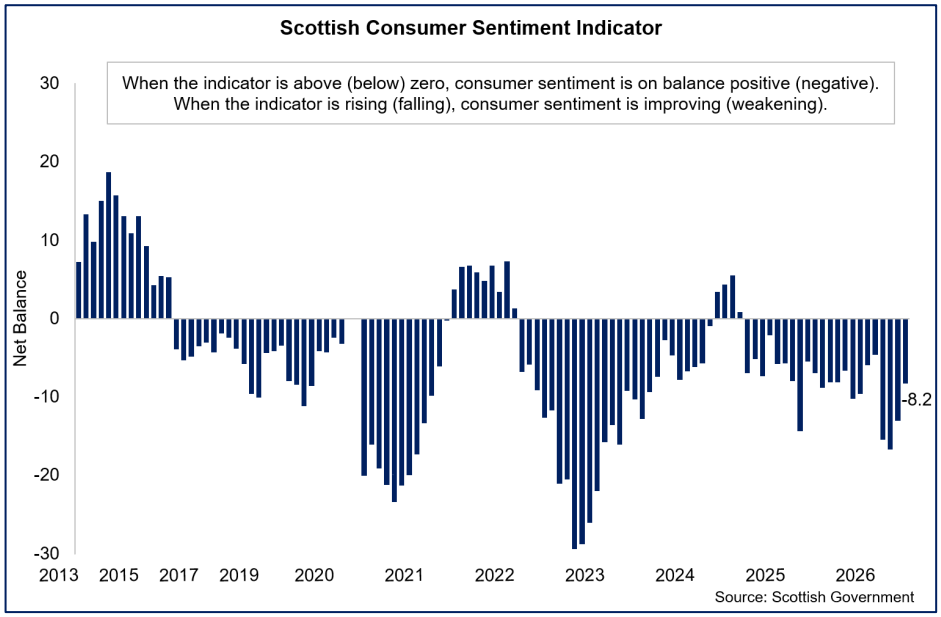
- Increased expectations of higher inflationary pressures and tighter monetary conditions have fed through to higher borrowing costs faced by households since February, and while borrowing costs have fallen back slightly over May and June, they remain higher than their pre-conflict rates.
- For example, interest rates on two-year 75% and 90% loan-to-value (LTV) mortgages eased further in June to 4.81% and 5.19% respectively, down from 4.92% and 5.32% in May. However, rates remain elevated compared with pre-conflict levels in February, when they stood at 3.97% and 4.34%.[8]



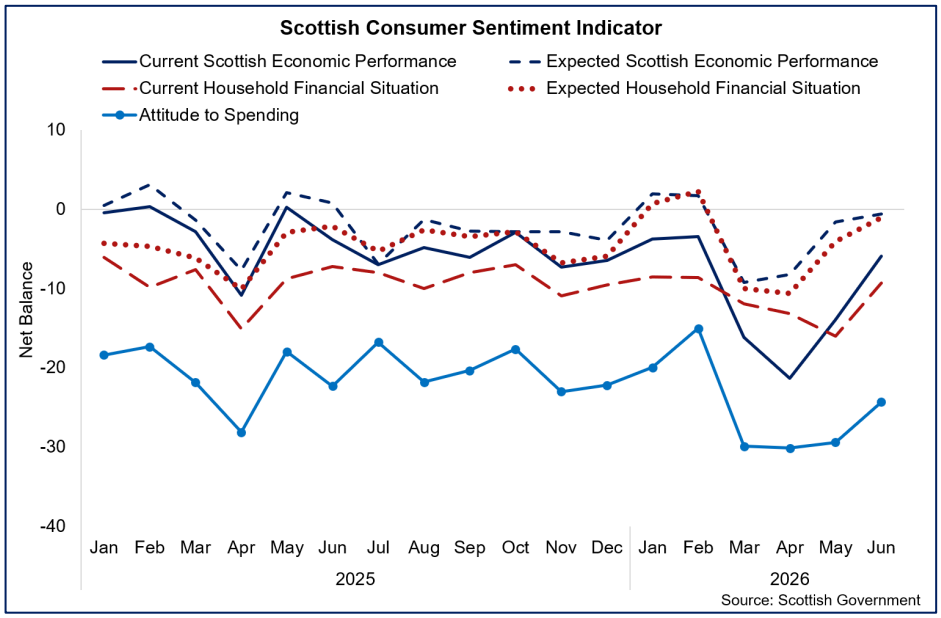
[8] Bank of England Database

Consumer Sentiment

- The Scottish Consumer Sentiment Indicator reflects how people feel the economy is performing, how secure they feel about their household finances and how relaxed they feel about spending money.



- The Scottish Consumer Sentiment Indicator weakened in the second quarter of the year from -8.6 in Q1 2026 to -12.7 in Q2 2026, its lowest quarterly level since Q1 2023 and likely reflecting the start of the conflict in the Middle East at the end of February, the resulting energy price shock and the inflationary pressures this has generated for household finances.
- The monthly data shows that consumer sentiment reached its recent low point in April (-16.7) before strengthening by 3.7 points in May to -13.0 and by 4.8 points in June to -8.2.[9]



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

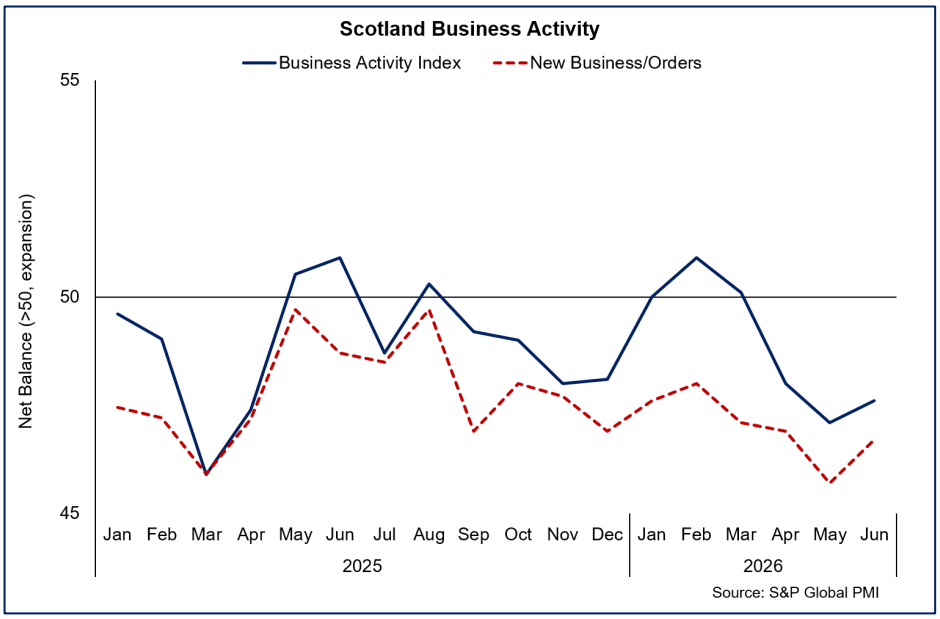
- The strengthening in June was broad based across the current and expectation sub-indicators, however all indicators remain below their pre-conflict levels in February, particularly the household spending indicator (down 9.3 points) and the expected household finances indicator (down 3.3 points) suggesting that households remain most concerned about their household financial security and remain cautious about spending money.

Business Conditions

Business activity fell through the second quarter of the year, however businesses reported a slight improvement in conditions and optimism in June.

Business Activity

- The monthly PMI business survey for Scotland indicates that business activity fell through the second quarter of the year albeit the pace of contraction eased slightly in June (47.6) (a reading below 50 indicates contracting business activity). The survey continues to indicate that falling new business orders and weak demand partly underly the current weakness in activity.
- However there were some indications of improving conditions in June with staffing levels remaining broadly stable over the month, while there was a further slight easing in inflationary pressures from their spike in April. Reflecting this, business optimism for the year ahead also improved slightly in June although remained notably below its level in February prior to the escalation of the conflict in the Middle East.[10]



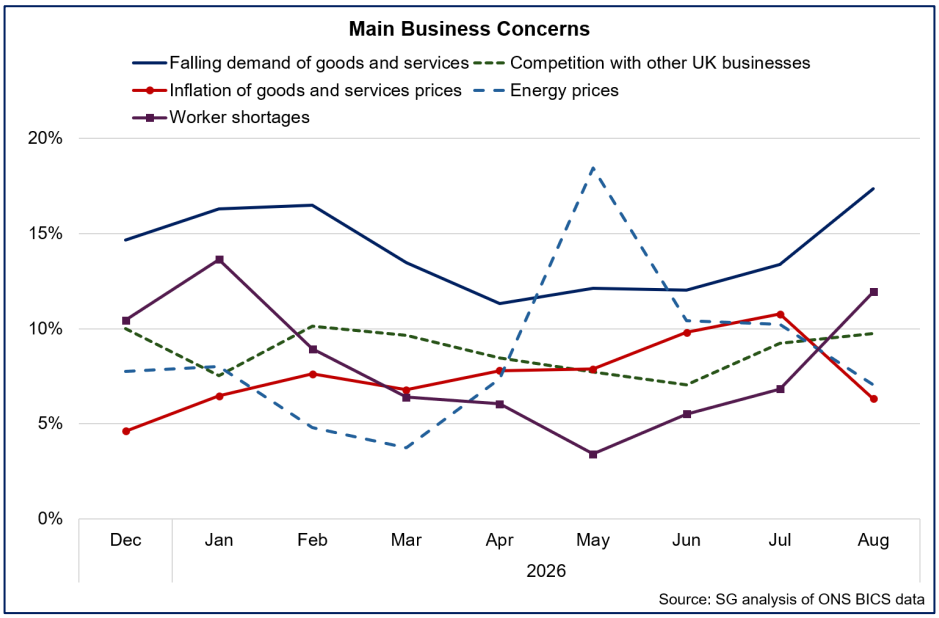
- Latest Business Insights and Conditions Survey (BICS) data for June presents a similarly mixed picture with a slightly higher share of businesses reporting an increase in demand over the

[10] Purchasing Managers' Index Reports | Royal Bank of Scotland , Purchasing Managers' Index Reports | NatWest Business , S&P Global - PMI Press Releases

month than a decrease in demand (14.5% compared to 14%). 50.6% of businesses reported that demand stayed the same. This varies by sector, with businesses most likely to report decreased demand in the accommodation and food services sector (24.3%, compared to 13.6% reporting an increase).[11]

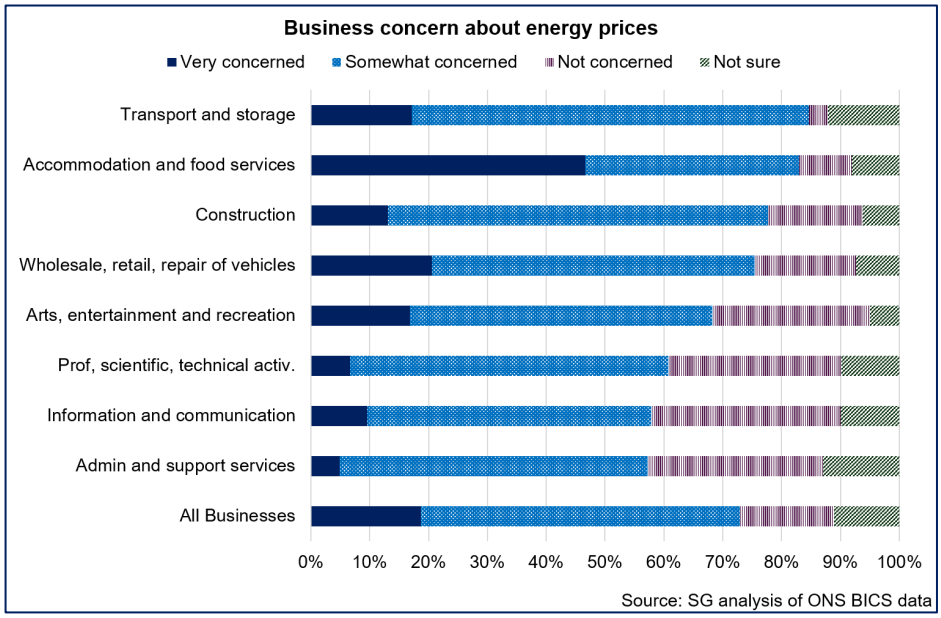
Business Concerns

- The latest BICS data from July shows that falling demand remains the most reported main business concern for the coming month (17.4%) while there has been a further increase in the shares of businesses reporting worker shortages (11.9%) and competition with other UK businesses (9.8%) as main concerns.
- In contrast, there has been a further fall in the share of businesses reporting energy prices (7.1%) and inflation of goods and services (6.3%) as main concerns. Both had increased following the escalation of tensions in the Middle East at the end of February and the sharp rise in energy and fuel prices, however have fallen back to around their pre-conflict levels and potentially reflects the easing in oil and fuel prices in June and into July.



- When asked specifically about how concerned they are about energy prices, latest data for July does indicate that there has been a fall in the share of businesses reporting that they are very concerned (18.6%, down from 27.2% in June). However there has been an increase in the share reporting that they are somewhat concerned (54%, up from 45.7%) and a decrease in the share reporting they are not concerned (15.9%, down from 18%).

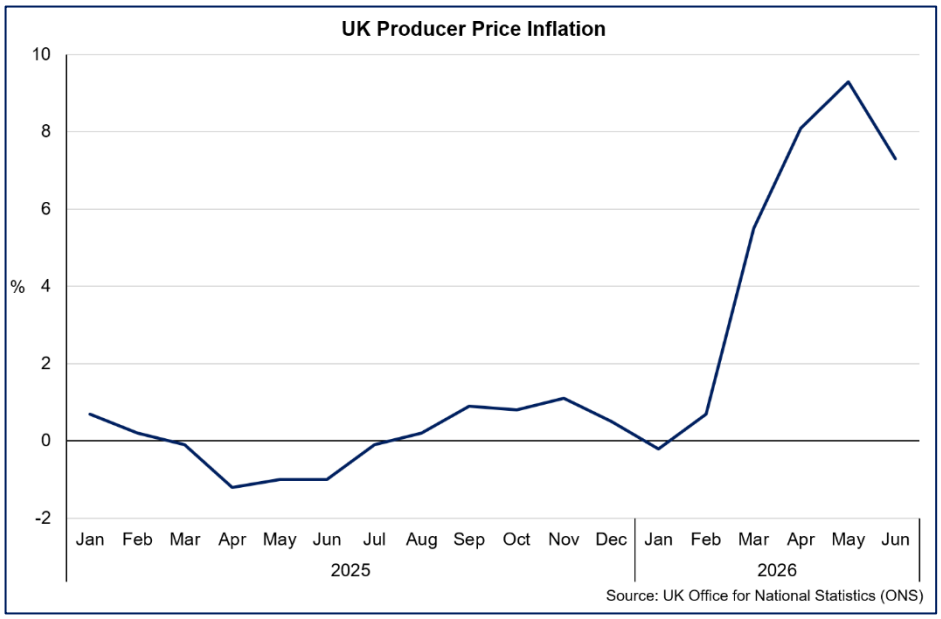
[11] Business and innovation statistics - gov.scot



- The ongoing concern about energy prices is broad based across industries, however remains most notable in the transport and storage sector (84.6%) and accommodation and food services sector (83.0%).

Business Costs

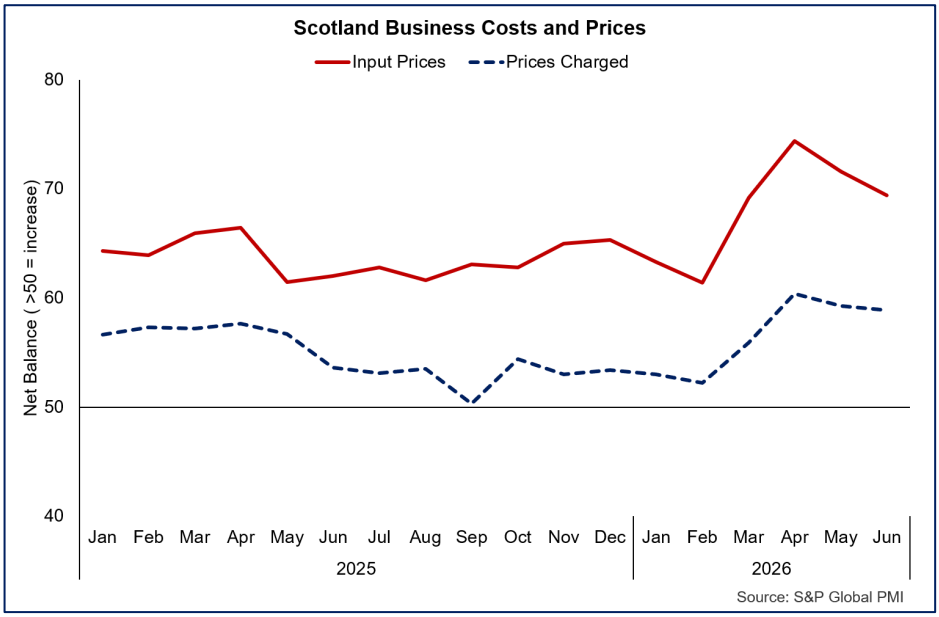
- Business cost pressures have been exacerbated over the second quarter of the year from the sharp increase in energy and fuel prices. However latest data for June indicate the pace of change moderated during the month as the reduction in military action resulted in a fall in wholesale energy costs and fuel prices.



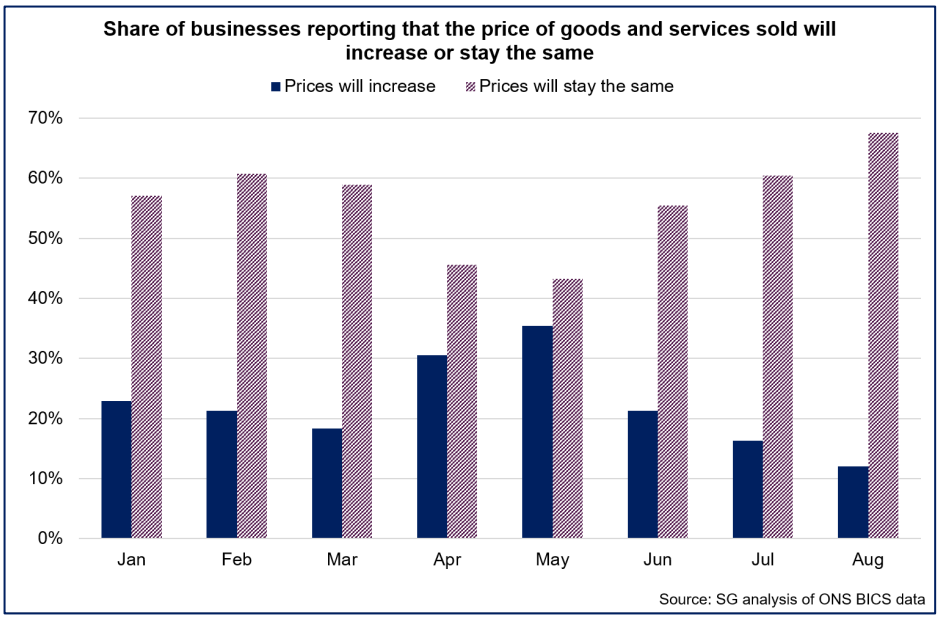
- UK producer input prices rose by 7.3% annually in June, down from 9.3% in May and 8.1% in April. The increase in crude oil prices over the past year (42.3%) remains the main driver of the

annual increase in input costs, however the fall in input price inflation from its recent peak in May partly reflects that crude oil prices fell 20.8% in June.[12]

- The PMI business survey for Scotland also indicated that business input cost inflation eased over May and June, while the feed through to output prices remained more stable.[13]

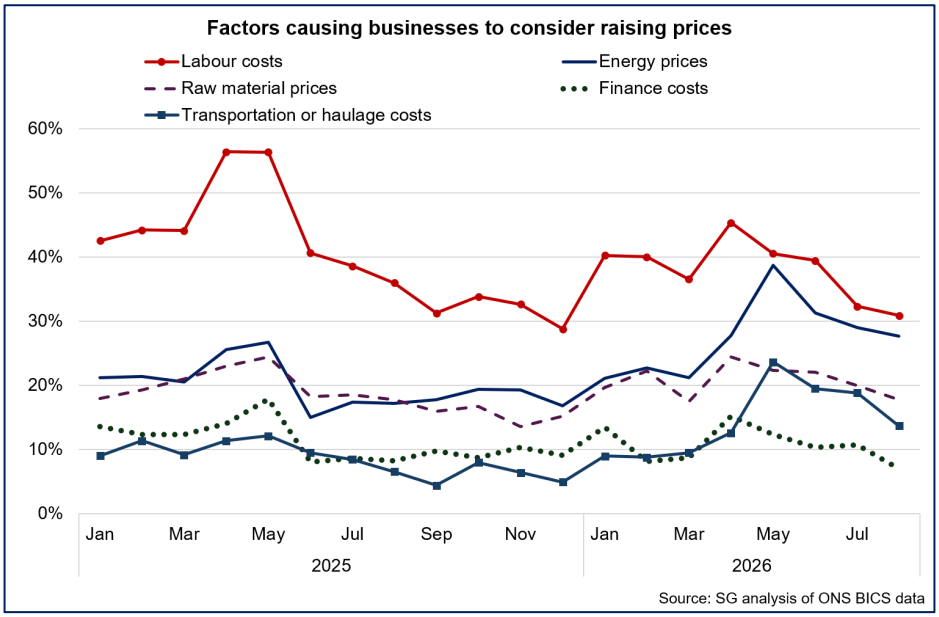


- Furthermore, BICS data from July shows that the share of businesses reporting that they expect to increase prices on goods and services sold, fell for a third consecutive month (12.1%, down from 16.3% in June), while an increased share of businesses expect prices to remain unchanged in August (67.6%, up from 60.5%).



[12] Producer price inflation, UK - Office for National Statistics
[13] Purchasing Managers' Index Reports | Royal Bank of Scotland , Purchasing Managers' Index Reports | NatWest Business , S&P Global - PMI Press Releases

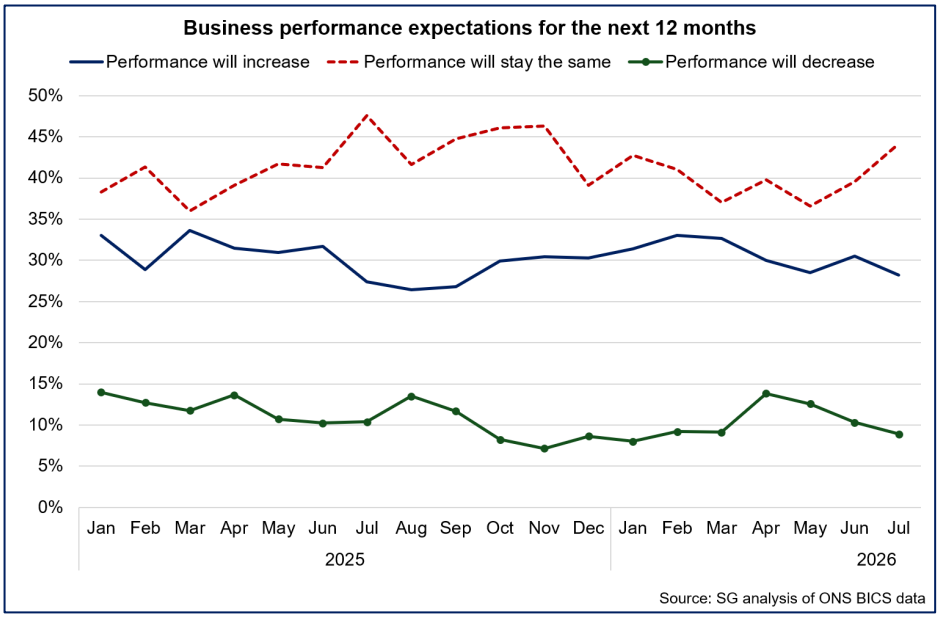
- For businesses expecting to increase prices, labour costs remains the main driver with 30.9% reporting it as a factor, albeit this has fallen from its recent peak in April (45.3%).
- The share of businesses reporting energy prices and transportation or haulage costs as factors for price rises rose sharply following the increase in oil and gas prices since March, however have also eased back as prices have moderated in June and into July.



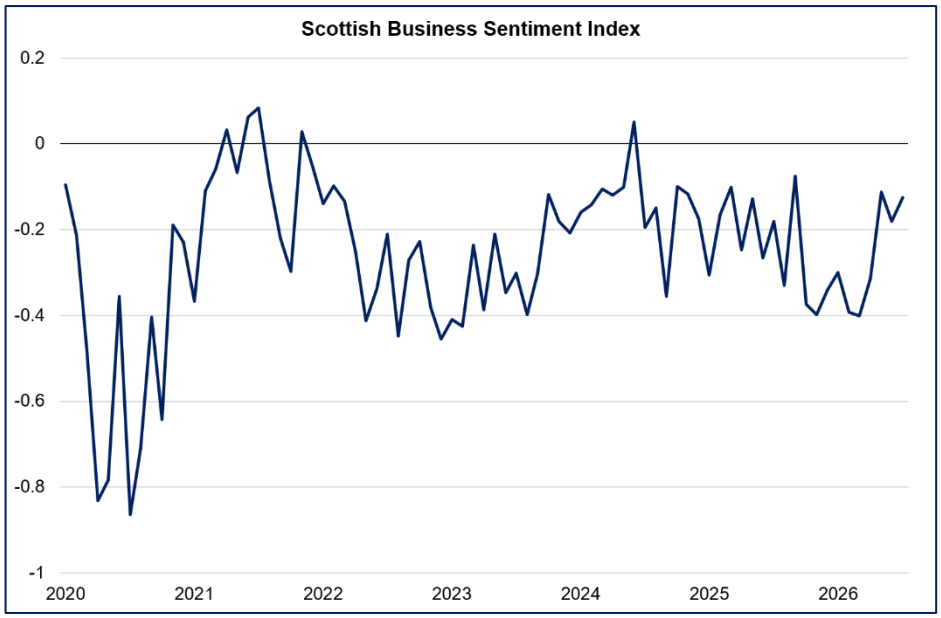
Business Optimism

- The ongoing uncertainty and inflationary risks from the conflict in the Middle East continues to weigh on business optimism. However, there are indications that the period of reduced military action in June and progress in negotiations, had a positive impact on business sentiment.
- The PMI business survey for Scotland reported that business optimism improved slightly for a second consecutive month in June, albeit remains notably below its pre-conflict level while Scottish Business Monitor data collected in June also reported that while business optimism remains subdued, businesses have become less pessimistic about the economic outlook.[14,15]
- Latest BICS data shows that there has been a slight decrease in the share of businesses expecting performance to improve in July (28.2%, down from 30.5%), however there has been an increased share expecting performance to stay the same (44.2%, up from 39.5%) and a further decrease in the share expecting performance to decrease (8.9%, down from 10.3%).

[14] Purchasing Managers' Index Reports | Royal Bank of Scotland , Purchasing Managers' Index Reports | NatWest Business , S&P Global - PMI Press Releases
[15] Scottish Business Monitor Q2 2026 | FAI



- The Scottish Business Sentiment Index (BSI) provides a real-time measure of business confidence in Scotland by analysing sentiment in news articles related to corporate and industrial developments. Latest data indicates that the BSI increased in July to -0.12 having improved moderately in recent months from a fall in the index between the second half of 2025 through to April 2026. The index has risen back above the average for 2025 (-0.24).[16,17]



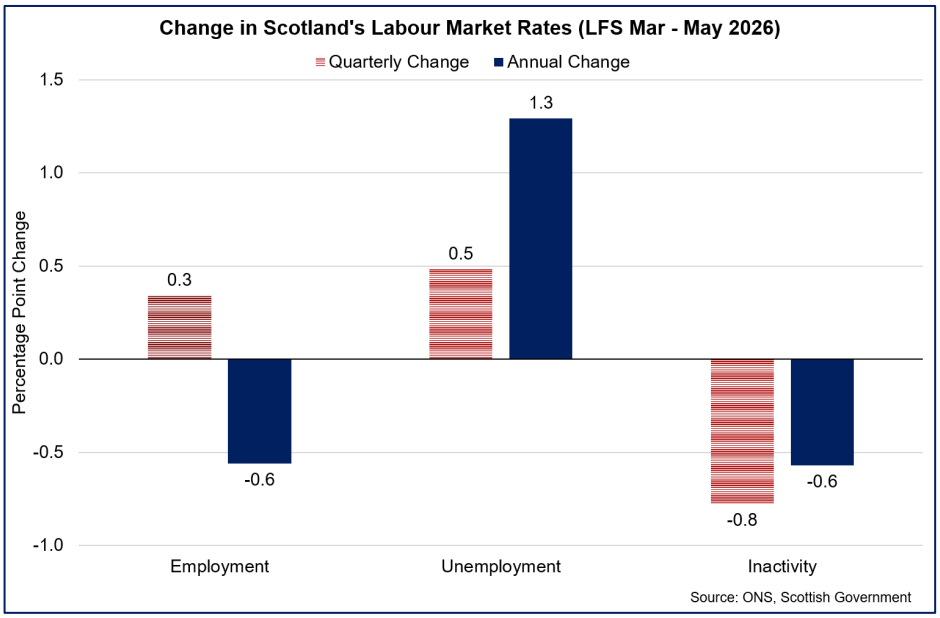
[16] Scottish Business Sentiment Index - gov.scot
[17] The BSI remains in development, and we welcome further comments from users on how best to present the results.

Labour Market

Labour market conditions have loosened over the past year with vacancies falling, however pay growth remains resilient.

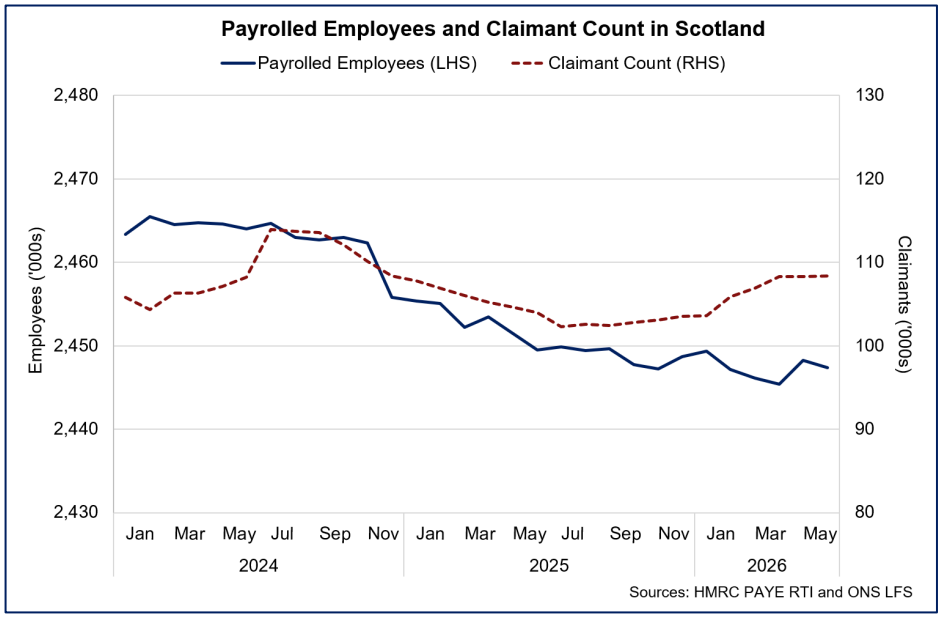
Employment, Unemployment, and Inactivity

- The Labour Force Survey (LFS) shows Scotland's unemployment rate remained relatively low in the 3-months to May at 4.7% (UK: 4.9%), albeit had risen by 0.5 percentage points (p.p) over the quarter and 1.3 p.p over the year, and is at its highest rate in 2 years.
- Alongside this, the employment rate rose 0.3 p.p over the quarter to 74.3%, although is 0.7 p.p lower compared to last year, while the inactivity rate fell 0.8 p.p over the quarter to 21.8% and is 0.6 p.p lower on an annual basis.[18]



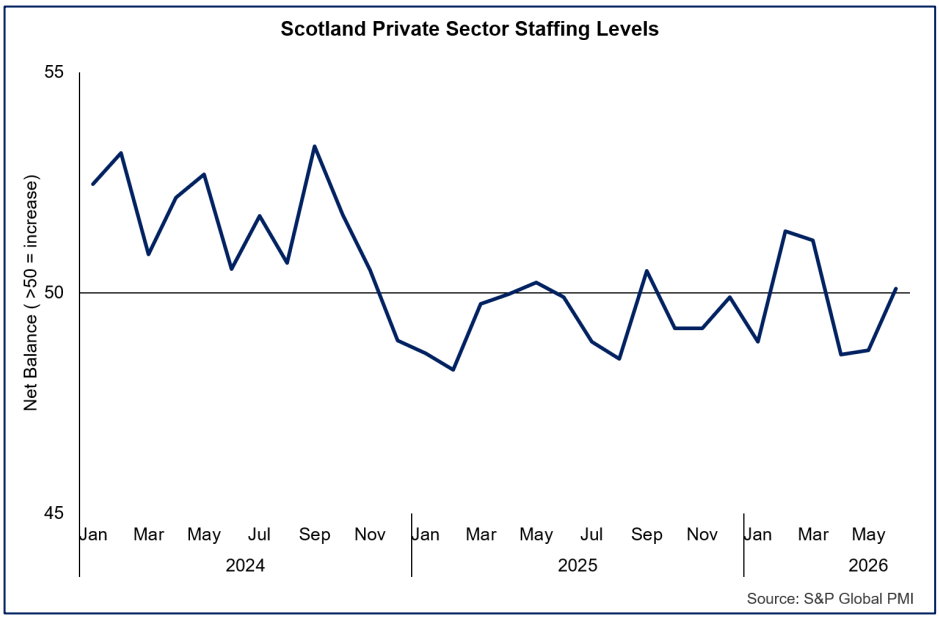
- The fall in employment over the past year is also reflected in Pay as you Earn (PAYE) Real Time Information data which shows that the number of payrolled employees (2.45 million) was broadly unchanged in June (down 800), however has fallen 0.1% (c. 2,100) over the year.[19]
- Furthermore, the increase in unemployment is also reflected in Scotland's Claimant Count unemployment rate (3.7%), which remains low relative to the UK as a whole (4.4%), and was broadly stable in June. However the number of claimants of unemployment related benefits rose 4.3% (4,500) over the year to 108,400, and is at its highest level since November 2024.[20]

[18] Labour market statistics - gov.scot
[19] Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics
[20] Nomis - Official Census and Labour Market Statistics



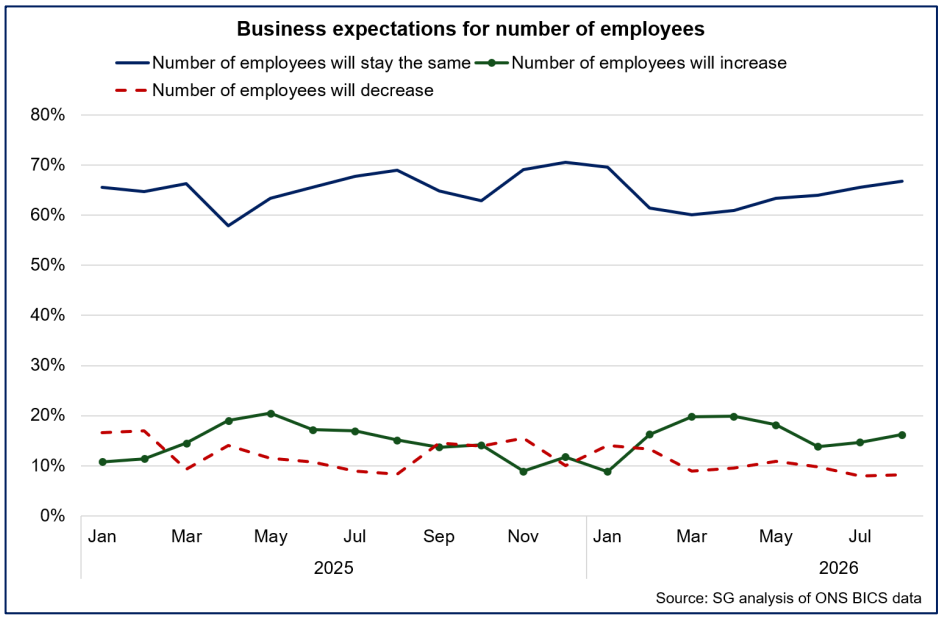
Recruitment Activity

- The increase in unemployment and fall in employment over the past year is also reflected in softer recruitment activity. ONS Textkernel data indicates that recruitment activity compared to last year has fallen with the number of online vacancies in June 13.8% lower than in June last year.[21]
- Similarly, the PMI business survey for Scotland indicates that private sector staffing remained broadly unchanged in June (50.1), however follows a pattern of generally falling staffing levels over the past 18 months (50 = stable employment levels).[22]



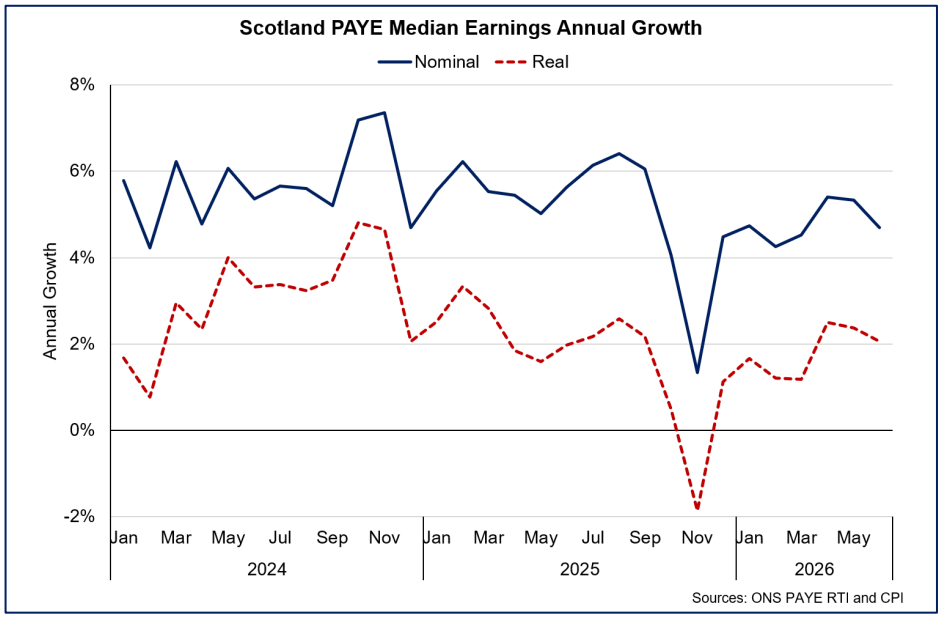
[21] Textkernel new online job adverts - Office for National Statistics
[22] Purchasing Managers' Index Reports | Royal Bank of Scotland , Purchasing Managers' Index Reports | NatWest Business , S&P Global - PMI Press Releases

- Looking ahead, BICS data indicates a higher share of businesses expect employee numbers to increase (16.2%) than to decrease (8.2%). However, most businesses continue to expect employee numbers to remain unchanged (66.8%), with the share increasing since the start of the year and indicating some stabilisation in recruitment against a backdrop of elevated uncertainty in the economic outlook.



Earnings

- In response to the labour market loosening over the past year and lower levels of inflation, the pace of earnings growth had slowed notably towards the end of 2025 and into the new year, however there has been a renewed pick-up in growth in recent months. [23]



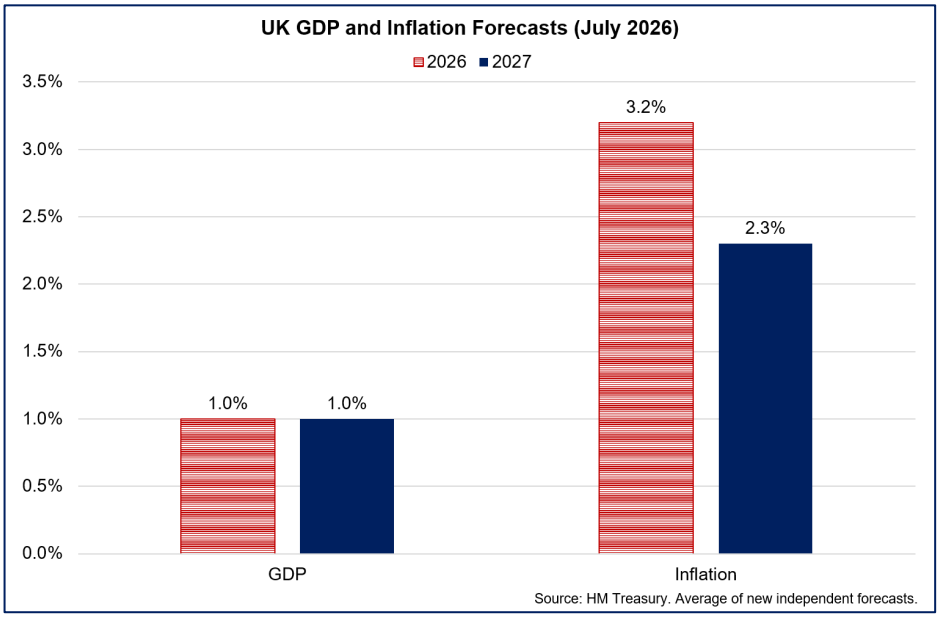
[23] Earnings and employment from Pay as You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)

- Nominal median monthly PAYE pay in Scotland (£2,672) grew by 4.7% on an annual basis in June, down marginally from 5.3% in May. In real terms, adjusting for annual inflation of 2.6%, real earnings grew by 2.1%, above the 1.7% average growth rate of the prior six months.

Economic Outlook

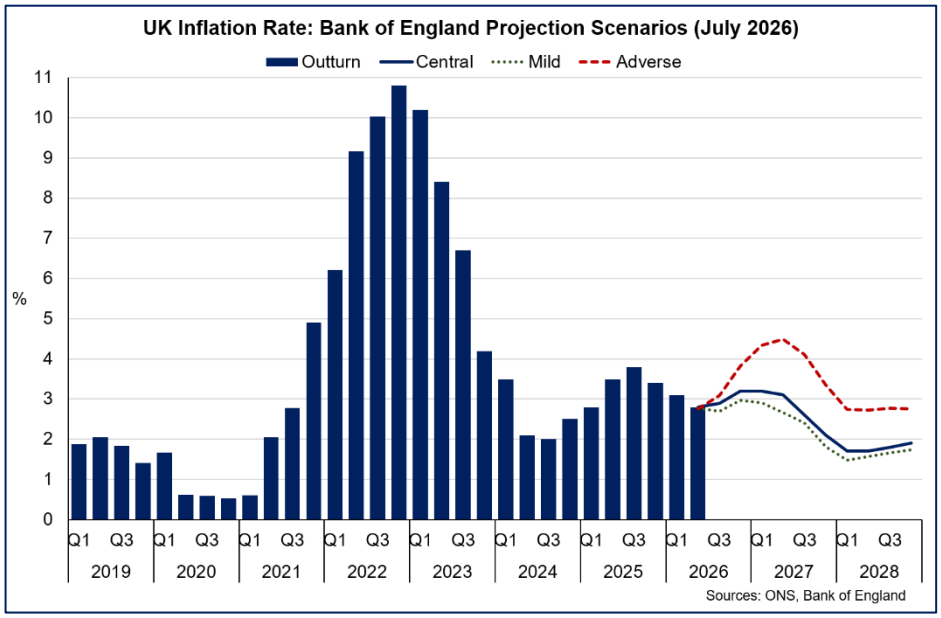
Inflation is projected to rise above 3% in the second half of the year.

- The near term global economic outlook continues to be significantly influenced by the ongoing tensions and uncertainty in the Middle East. The recent escalation of military action over the past month risks further intensifying and extending the upward pressures on oil and gas prices and the feed through to wider inflationary pressures and economic impacts.
- In July, the IMF forecast global economic growth to slow from 3.5% in 2025 to 3% in 2026 before rebounding to 3.4% growth in 2027. Global inflation of 4.7% is projected in 2026 (up from 4.1% in 2025) before easing back to 3.9% in 2027. The normalisation of supply chains through the Strait of Hormuz is key to this, however the latest escalation presents downside risks and highlights the uncertainty in the global outlook at this point.[24]
- At a UK level, the latest HMT average of independent forecasts from the first half of July shows UK GDP growth of 1% in 2026 (down from 1.1% forecast in February prior to the Middle East conflict), and 1.0% in 2027 (down from 1.4% in Feb). This is broadly in line with Bank of England's central projections from July of 1.1% in 2026 and 2027, albeit the Bank projected downside risks to the growth outlook from higher inflationary pressures.[25,26]



[24] World Economic Outlook, April 2026: Global Economy in the Shadow of War
[25] Forecasts for the UK economy - GOV.UK
[26] Monetary Policy Report - July 2026 | Bank of England

- The UK inflation outlook remains subject to a high degree of uncertainty. The HMT average of new independent forecasts from the first half of July show inflation of 3.2% at the end of 2026 (up from an average forecast of 2.2% in February) before easing back to 2.3% at the end of 2027.
- In July, the Bank of England set out three scenarios for the UK inflation outlook – central, mild adverse – which set out different paths for energy prices and the extent to which there are second round inflationary impacts.



- In each scenario, inflation is projected to rise in the second half of 2026. In the central scenario, inflation is projected to peak at 3.2% in Q4 2026, while in the mild scenario it is projected to peak at 3.0%. In the adverse scenario, inflation is projected to rise to 3.8% in Q4 2026 before rising further to peak at 4.5% in Q2 2027.
- In the central and mild scenarios, inflation is projected to return to the 2% target around the end of 2027 while in the adverse scenario, it is projected to remain above target throughout the forecast period.
- At this point, there is little evidence that the rise in energy prices has generated second round impacts, however the transmission of the price rises in recent months is still progressing and the recent escalation of tensions in the Middle East raises the risk of energy prices rising higher and lasting for longer. Furthermore, looking ahead, the Bank of England note that aside from energy prices, other global developments such as the rapid expansion of AI capacity and any disruption to food supplies as a result of extreme weather events, such as El Niño, could add to inflationary pressures.

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