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Scotland's economy continues to recover – but political uncertainty over Brexit and Indyref2 will act as brake on growth, report finds

Recovery in the Scottish economy is forecast to continue this year but will remain weak with little hope of a sharp increase in growth, according to a new report published today by Scotland's leading independent economic research institute.

The commentary, provided quarterly by the University of Strathclyde's Fraser of Allander Institute, suggests growth in Scotland is forecast to remain fragile over the next few years as the downturn in the North Sea continues to bite and weak levels of consumer confidence put a curb on spending. The report finds:

- *The Institute's new central forecasts are for economic growth of 1.2% in 2017, 1.3% in 2018 and 1.4% in 2019 – broadly unchanged since December's forecasts.*

- *The downturn in the North Sea – alongside lower levels of overall confidence in the economy – suggest that the Scottish economy will continue to lag behind the UK as a whole.*

- *Over the 10 years since the start of the financial crisis, the Scottish economy has grown by an average of just 0.7% each year – less than a third of its long-term trend. It is no surprise therefore, that whilst unemployment rates remain close to record lows, the incomes of most households continue to be squeezed.*

- *Getting the economy moving again must be a key priority for policymakers from all political parties.*

Strathclyde's academics believe unprecedented levels of policy uncertainty will act as their own headwind on growth. Yet, with so little clarity, many businesses appear to be 'looking through the uncertainty' and continue to press ahead with day-to-day activities. Indeed, a number of recent business surveys point to a modest pick-up in activity toward the end of 2016 and into 2017.

The Scottish labour market continues to hold up relatively well the report finds. Employment is close to its record high whilst the current unemployment rate of 4.7% is well below its long-run average. However, with rising inactivity, weak earnings growth and reduced hours worked, the squeeze on households remains challenging.

The prospects of a second independence referendum are likely to dominate debate for the foreseeable future. Whilst the key issues are clear, the arguments this time are likely to be different. For example:

- Firstly, in 2014 there was a clear choice between a stable 'status quo' – albeit with more devolved powers – and independence. With Brexit and Indyref2 the debate will be set against the backdrop of two types of inevitable economic change.
- Secondly, it is undoubtedly the case that the recent performance of North Sea oil and gas poses a challenge to any transition to independence. For example, the sharp fall in oil prices has all but eliminated North Sea tax revenues.
- Thirdly, many of those on the 'yes' side in 2014 argued that there would be a degree of continuity between the then status quo and independence; e.g. plans to keep sterling, joint regulation of banks and for both to be members of the EU. This time, the Scottish Government appear open to more radical ideas on issues such as currency, financial regulation and fiscal policy.

Graeme Roy, Director of the Fraser of Allander Institute, said:
"Growth in the Scottish economy continues to lag behind the rest of the UK, driven in part but not entirely, by the ongoing challenges in the oil and gas sector.

"The immediate outlook for 2017 is marginally more positive than for 2016 with some important business surveys suggesting an increase in new orders and demand. That being said, in the current climate sentiment can change quickly and there remains a high degree of margin for error in all economic forecasts at the current time.

"Irrespective of your views over the long-term benefits of Brexit or independence, the increase in uncertainty caused by the triggering of Article 50 and the prospects of a second independence referendum will act as a headwind to Scottish growth in the near-term.

"Just as it is the responsibility of the UK Government to provide clarity and reassurance where ever possible through the Brexit process, it is incumbent on the Scottish Government to do likewise around independence and to re-double their efforts to support the Scottish economy through these unprecedented times.

"In this regard, what was striking about the recent Scottish political party conference season was just how little the economy featured in the debate. New strategies, actions plans and ambitions around inclusive growth can only help so far. With Scotland taking responsibility for over £11bn of income tax revenues in just a few weeks' time, it is vital that attention turns to practical policy initiatives that will support businesses, secure new investment and create jobs - whatever the constitutional settlement."

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