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A recovery, of sorts - at last!

Clearer signs of a recovery are now emerging within the Scottish economy according to the latest Economic Commentary from the University of Strathclyde's Fraser of Allander Institute, sponsored by PwC.

But the Institute also notes that despite the recent good survey evidence the recovery so far is weaker than would be expected 5 years after a recession, even a recession generated by a banking crisis.

GDP growth is forecast to be 0.9% in 2013, the same as our March forecast, 1.6% in 2014, a lowering of the Institute's forecast in March, rising further to 2.1% in 2015.

Brian Ashcroft, Emeritus Professor of Economics at the University of Strathclyde, said:

> "The evidence of recovery is to be welcomed. Business services are now growing strongly and leading the way. Yet, financial services appear to have suffered a structural decline and manufacturing output and export performance is weak."
>
> The explanation for the welcome, but still anaemic, recovery 5 years since the start of recession is the UK government's fiscal consolidation programme and weak export performance reflecting both supply-side structural problems in the UK and Scottish economies as well as weak global demand."

Despite evidence of recovery, the forecasts reflect continued weakness of domestic demand, in particular government spending and consumer expenditure, and weak anticipated growth in the rest of the UK and Eurozone markets to which Scottish exports are so reliant.

Paul Brewer, senior partner at PwC in Edinburgh, commented:

> "The latest commentary emphasises the importance of investment as a major contributor to economic growth, particularly over the last three quarters.
>
> "The pace of investment in energy assets, such as renewable generation and grid development, has picked up while manufacturing continues to claw its way back to its pre-recession peak. Scottish Government sponsored projects such as the New Forth Bridge Crossing, Edinburgh Trams and the affordable housing programme are also delivering an economic boost during their construction phase.
>
> "Our cities are also increasingly recognising their role as a focal point of investment, helping to drive Scotland's future growth. In Aberdeen, for example, the focus is clearly around developing and sustaining the energy supply chain resulting in public-private sector policies that will help deliver a supply of skilled people, greater connectivity and a modern infrastructure.

> "As we continue along this path of slow, tentative growth one thing is certain: the most successful cities will be those whose strategies focus on innovation, digital connectivity and transport infrastructure, as well as improving factors such as income levels, the quality of jobs, health and housing."

Projected net job creation is 12,150 in 2013, rising to 28,200 in 2014 and 38,700 in 2015.

The unemployment forecast has been revised down somewhat from March, reflecting the weakness of productivity, and higher employment given the growth of output. Unemployment on the ILO measure at the end of 2013 is now projected to be 213,250.

The unemployment position is expected to deteriorate slightly in 2014 compared to 2013 due to relatively weak output and employment growth. Unemployment is now forecast to be 228,000 by the end of 2014 but then falls back to 189,350 by the end of 2015 as growth in the economy strengthens.

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Notes to Editors:

1. The University of Strathclyde's Fraser of Allander Institute (FAI) issues its Economic Commentary with the support of PricewaterhouseCoopers LLP.
2. PricewaterhouseCoopers supports the production of this report but it has had no control of its editorial content, including in particular the economic forecasts. FAI's comments on the future performance of the UK economy have been drawn from consensus forecasts.
3. PwC firms provide industry-focused assurance, tax and advisory services to enhance value for their clients. More than 161,000 people in 154 countries in firms across the PwC network share their thinking, experience and solutions to develop fresh perspectives and practical advice. See pwc.com for more information.

Overview

In their latest Economic Commentary, sponsored by PricewaterhouseCoopers, the University of Strathclyde's Fraser of Allander Institute notes that clearer signs of a recovery are now emerging within the Scottish economy. But the Institute also notes despite the recent good survey evidence the recovery so far is weaker than would be expected 5 years after a recession, even a recession generated by a banking crisis. The reason for this stagnation and anaemic recovery, the Institute argues, is twofold: the UK government's fiscal consolidation programme and a weak export performance reflecting both supply-side structural problems in the UK and Scottish economies as well as weak global demand.

There is evidence of recovery in the business services sector, in particular. By the end of the fourth quarter 2012 GVA in the sector stood 5.1% above its pre-recession peak. It is also evident that while real estate activities, accounting for just under 40% of business services, have recovered to stand at around 2.5% above pre-recession peak output, the remaining 60% element of business services - professional, scientific, administrative & support services, has been growing the fastest with GVA reaching nearly 6% above its pre-recession peak by the end of last year. Financial services are a cause for concern. GVA in the sector has now fallen more than 17% below its pre-recession peak, a loss of around one sixth of total output in the sector. There seems a strong likelihood that some of this lost output may never return. The production sector is buoyant but it would seem largely for one-off technical reasons as affected by energy supply. Scottish manufacturing GVA now stands at -5.5% below the 2008-09 pre-recession peak. The downturn in the fourth quarter in Scottish manufacturing as well as in UK manufacturing takes some of the shine off the good overall Scottish GDP performance in the fourth quarter. This is reflected in the export performance of Scottish manufacturing where exports abroad (ex rUK) fell by 1.4% in the fourth quarter of last year so manufactured exports now stand 13.1% below their pre-recession peak.

In the labour market, conditions continue to improve at a faster rate than GDP, suggesting deterioration in productivity. In the quarter January to March there was a 54,000 surge in employment in Scotland and unemployment fell to 7.3%. But the ratio of employment to population is still -4.3% below its level before the recession. This suggests that the size of labour reserves in Scotland, and the extent of human misery at not having a suitable job, remains large.

Aggregate data show that with weak export and investment data, there is little evidence of a rebalancing of the Scottish economy away from domestic private and public consumption spending to external private and domestic investment spending. Such a rebalancing is seen by many as a pre-requisite for a strong recovery.

Against this background we have maintained our GDP forecast for 2013 at 0.9%, the same as our March forecast. For the two years 2014 and 2015, we have revised down slightly our forecast for 2014 from 1.7% to 1.6%, and have revised up the forecast for 2015 from 1.9% to 2.1%. Projected net job creation is 12,150 in 2013, rising to 28,200 in 2014 and 38,700 in 2015. Unemployment is forecast to be 213,250 at the end of 2013, rising to 228,000 by the end of 2014 but then falling back to 189,350 by the end of 2015.

GDP Performance

- The latest Scottish GDP data for the fourth quarter of last year show that Scottish GDP rose by 0.5% in Scotland in the quarter, while falling by -0.3% in the UK.
- But once declining oil and gas production is removed - offshore activities are not included in Scottish GDP data but they are in the UK data - we find that Scottish and UK growth is largely identical. Moreover, in 2012 GDP ex oil and gas grew at 0.5% in the UK compared to 0.3% in Scotland.
- By the fourth quarter last year GDP was -1.9% below its pre-recession peak in the UK compared to -2.4% for Scotland.
- The Scottish production sector was buoyant in the fourth quarter both absolutely and compared to the UK. Unfortunately, this may reflect one-off technical production considerations in energy supply in Scotland.
- Manufacturing GVA contracted by -0.5% in the fourth quarter in Scotland and by far worse, -1.4%, in the UK. Scottish manufacturing GVA now stands at -5.5% below the 2009-09 pre-recession peak, while the figure for UK manufacturing is -9.5%.
- Weak manufacturing output growth is reflected in the export performance of Scottish manufacturing where exports abroad (ex rUK) fell by 1.4% in the fourth quarter of last year so manufactured exports now stand 13.1% below their pre-recession peak. The manufactured export position continues to be worse than the situation after the collapse of electronics production led to an exporting nadir in 2002.
- Scottish services GVA grew by 0.3% here in the fourth quarter compared to zero - very slightly negative - growth in the UK. By the fourth quarter of this year, Scottish services GVA was still -1.6% below its pre-recession peak compared to a UK position where the sector now stands 0.5% above its pre-recession peak output.
- Yet, despite that there are some bright spots within Scottish services as well as some causes for concern.
- The bright spots are the evidence that business service activities are now recovering strongly. By the end of the fourth quarter 2012 GVA in the sector stood 5.1% above its pre-recession peak. It is also evident that while real estate activities, accounting for just under 40% of business services, have recovered to stand at around 2.5% above pre-recession peak output, the remaining 60% element of business services - professional, scientific, administrative & support services, has been growing the fastest with GVA reaching nearly 6% above its pre-recession peak by the end of last year.
- The cause for concern is the performance of financial services. When we disaggregate the data we find that that a structural decline appears to have been taking place in financial services in Scotland. GVA has now fallen more than 17% below its pre-recession peak, a loss of around one sixth of total output in the sector. There seems a strong likelihood that some of this lost output may never return.

Labour Market

- In the labour market conditions continue to improve at a faster rate than GDP, suggesting a deterioration in productivity.

- In the quarter January to March there was a surge in employment in Scotland. Jobs rose by 54,000 in the first quarter of this year compared to a fall of 43,000 in the UK as a whole.
- Scottish jobs are now -1.3% below their pre-recession peak, whereas in the previous quarter they were more than 3% below the pre-recession peak. This is still worse than the UK, where, despite the loss of jobs in the recent quarter the total is 0.6% above the pre-recession peak.
- Unemployment fell in the quarter January to March by just under 7,000 to below the 200,000 mark to 199,000, or a rate of 7.3%.
- Unemployment is falling but at 7.3% it is still high compared to the 3.9% before the recession and it could begin to rise again.
- Moreover, when employment is compared to the 16 plus population we find that before the surge in jobs in the first quarter of this year this ratio stood at -6.2% below its pre-recession peak, identical to the position at the trough of the recession. After the surge it rose to -4.3% below.

Forecasts

- Our GDP forecast for 2013 is 0.9%, the same as our March forecast.
- For the two years 2014 and 2015, we have revised down slightly our forecast for 2014 from 1.7% to 1.6%, and have revised up the forecast for 2015 from 1.9% to 2.1%.
- The forecasts reflect the continued weakness of domestic demand, in particular government spending and consumer expenditure, and weak anticipated growth in the rest of the UK and Eurozone markets to which Scottish exports are so reliant.
- Some may be surprised that we have not revised up our forecasts for 2013 and 2014 given the evidence of a recent pick up in the economy. We have not done this since our forecasts already contain gradual improvements to the growth rate. And so a recovery - all be it anaemic - is built in.
- We are now forecasting that net jobs will rise by 12,150 in 2013, rising to 28,200 in 2014 and 38,700 in 2015.
- These forecasts are greater than those in our March forecast. This reflects the stronger jobs performance noted in the recent data and reflects the sectoral rebalancing of our growth forecast more in favour of labour intensive services.
- Our unemployment forecasts have been revised down somewhat from March, reflecting the weakness of productivity, and higher employment given the growth of output. Our projection for unemployment on the ILO measure at the end of 2013 is now 213,250. We continue to expect the unemployment position to deteriorate slightly in 2014 compared to 2013 due to relatively weak output and employment growth. Unemployment is now forecast to be 228,000 by the end of 2014 but then falls back to 189,350 by the end of 2015 as growth in the economy strengthens.

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Annex: Forecast Tables

Table 1: Forecast Scottish GVA Growth, 2013-2015

GVA Growth (% per annum)	2013	2014	2015
Central forecast	**0.9**	**1.6**	**2.1**
March forecast	*0.9*	*1.7*	*1.9*
UK mean independent new forecasts (May)	0.8	1.5	2.1
Mean Absolute Error % points	+/- 0.440	+/-1.031	+/- 1.204

Table 2: Forecast Scottish Net Jobs Growth in Three Scenarios, 2013-2015

	2013	2014	2015
Upper	22,600	50,500	64,300
March forecast	*21,400*	*44,950*	*59,100.*
Central	**12,150**	**28,200**	**38,700**
March forecast	*9,400*	*19,150*	*31,800*
Lower	2,450	4,450	16,400
March forecast	*-3,100*	*-5,750*	*5,150.*

Table 3: Forecasts ILO unemployment 2013-2015

	2013	2014	2015
ILO unemployment			
Rate (ILO un/TEA 16+)	**7.9%**	**8.4%**	**7.0%**
March forecast	8.3%	8.6%	7.7%
Numbers	**213,250**	**228,000**	**189,350**