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Scottish economy improving, but sustained recovery uncertain

The Scottish economy continues to improve, but sustained recovery is by no means certain, according to the latest *Economic Commentary* from the University of Strathclyde's Fraser of Allander Institute, sponsored by PricewaterhouseCoopers LLP.

Household spending has been the main driver of recent growth and the *Commentary* warns that this provides an unlikely basis for a sustained recovery.

The authors say that a continued improvement in net exports and in physical investment spending is necessary to ensure a durable recovery, particularly with the UK Government's programme of fiscal consolidation set to continue for the foreseeable future.

The *Economic Commentary* forecasts Scottish GDP growth of 1.3% in 2013 – up from the June and March forecast of 0.9%.

The 2014 forecast is also revised up from the 1.6% predicted in June to 1.8%, while estimated growth for 2015, 2.1%, unchanged from the June prediction.

The latest *Economic Commentary* forecasts for 2013 and 2014 reflect better than expected outturn data on the growth of household spending and increasingly optimistic business surveys.

Commenting on the forecasts, Brian Ashcroft, Emeritus Professor of Economics at the Fraser of Allander Institute, University of Strathclyde, said:

> "After 5 successive quarters of GDP growth we are now witnessing a more robust recovery. Jobs are being created, unemployment is falling and many people that had despaired of finding work are now re-entering the labour market.
>
> "However, we are still predicting below trend growth next year reflecting the continued relative weakness of domestic demand, in particular government spending and consumer expenditure, and only slowly rising growth in Eurozone markets but stronger growth in the rest of UK.

According to the *Economic Commentary*, Scotland can expect 21,200 net new jobs in 2013, rising to 27,200 in 2014 and 38,400 in 2015, with the majority of new employment to be in the service sector.

The Fraser of Allander Institute says that the unemployment forecast has been revised down again from its June forecast, reflecting higher employment thanks to increased output

However, the *Economic Commentary* says unemployment may not fall as much as the job creation figures might suggest. Unemployment on the ILO measure at the end of 2013 is now projected to be 204,550 (7.6%).

More.

Scottish economy improving, but sustained recovery uncertain.../2

Unemployment is again expected to deteriorate slightly in 2014 compared to 2013 due to relatively weak output and employment growth. Unemployment is now forecast to be 224,800 (8.4%) by the end of 2014 and then to fall back to 186,450 (7.0%) by the end of 2015 as growth in the economy strengthens.

Brian Ashcroft added:

> "The renewed growth is largely driven by an increase in household spending fuelled by borrowing even when household debt remains high. Unless net exports and investment recover soon we have doubts whether the recovery can be sustained."

According to Paul Brewer, senior partner at PwC, Scotland has performed relatively well as compared to other UK regions, but more needs to be done:

> "Scotland is amongst the best performing UK regions outside London and the South East and that is welcome.
>
> "However, recovery based on consumer spending against a continuing background of weak real incomes is unsustainable.
>
> "There is growing evidence of a return in business confidence and the private sector should take courage and invest while real growth opportunities are emerging.
>
> "The major programme of public sector investment in infrastructure projects is starting to deliver at scale and should continue to stimulate the construction sector and further boost jobs and confidence.
>
> "Collectively, those measures could help drive recovery and sustain growth in the Scottish economy."

Ends.

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Notes for editors:

About the Fraser of Allander Institute

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 the Fraser of Allander Institute Economic Commentary and has had no control of its editorial content, including in particular the Institute's economic forecasts. FAI comments on the future performance of the UK economy are drawn from consensus forecasts.

More.

Notes for editors…/contd.

3. PricewaterhouseCoopers, in association with FAI, produces a Business Review which considers some of the implications of the Economic Commentary trends for Scottish business. The Business Review can be downloaded from: http://www.strath.ac.uk/frasercommentary/businessreviews/

About PwC

4. 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.

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Overview and headline findings follow…/

Overview

In its latest Economic Commentary, sponsored by PricewaterhouseCoopers, the University of Strathclyde's **Fraser of Allander Institute** notes that five years since the start of the Great Recession we are now witnessing a stronger recovery, albeit belatedly compared to any recession in the last 70 to 80 years. The Scottish economy has grown for five successive quarters to the second quarter of this year. The UK has grown for three successive quarters to the third quarter of the year. And the growth rate has been rising as 2013 unfolds. However, there are good reasons to be hesitant about whether the recovery can be sustained.

The industry structure of the recovery differs between the UK and Scotland. The service sector is weaker in Scotland while growth in production and the manufacturing sector within it has been stronger and construction sector growth has been quite similar between the two countries with recovery weak. Financial services appear to have experienced a structural decline since the beginning of the recession in both Scotland and the UK. This decline may be bottoming out but whether the sector will return to 2007 levels of output is a moot point. It is clear that a strong recovery is now taking place in the important business services sector in Scotland and the recovery is stronger than in the UK. The recovery and growth of real estate activities and transport, storage & communications in Scotland is weaker, while that in distribution is stronger.

In the labour market, despite recent strong job creation, Scottish jobs are now 0.8% below their pre-recession peak, which is worse than the UK, where the jobs total is 0.8% above the pre-recession peak. But Scotland's unemployment rate of 7.3% is lower than the UK's 7.7%. Labour productivity in Scotland has improved relative to the UK, which has experienced a sharp drop in productivity. This may principally be due to the different pattern of industrial growth in the recovery in Scotland which has favoured more highly productive, capital intensive sectors.

With a recovery in output and jobs now clearly occurring, the key question is whether it can be sustained over several quarters and even years. The recovery is mainly dependent on growth in household spending. And the main drivers of household spending remain weak: real incomes are falling while asset prices are either flat or falling, or where they are rising, such as in stock and shares, they have only a limited significance for household spending. The Scottish household saving rate remains high and is nearly 4 percentage points higher than in the UK and this suggests that debt continues to be paid down. But the household savings ratio has been falling in Scotland over the past year. Households in Scotland, as in the UK, are borrowing more. But if real incomes continue to fall and asset prices - mainly housing - remain flat, it is difficult to see how such borrowing and spending can be sustained.

Against this background, our GDP forecast for 2013 of 1.3% has been revised upwards from our June and March forecast of 0.9%. For 2014 we have also revised up our forecast from the 1.6% predicted in June to 1.8%, while for 2015, we retain the same 2.1% prediction as in June. The forecasts for 2013 and 2014 are higher than in June because of better than expected outturn data on the growth of household spending and increasingly optimistic surveys during the summer and early autumn. In the labour market, we predict rising employment, rising unemployment next year, and falling unemployment in 2015.

Key Points

GDP Performance

- The latest Scottish GDP data for the second quarter of this year show that Scottish GDP rose by 0.6% in Scotland in the quarter, slightly less than the 0.7% rise in the UK.

- Scottish GDP has recovered by 4.4% since the trough of recession while UK GDP has recovered by 4.3% from its trough, suggesting that the broad track of the recovery has been similar in Scotland and UK.
- However 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 the UK recovery has been stronger.
- By the second quarter last year UK GDP (ex oil & gas) was -2.5% below its pre-recession peak compared to -1.4% for Scotland. But Scottish GDP has recovered by 4.4% since the trough of recession while UK GDP (ex oil & gas) has recovered by 5.3% from its trough.
- In the Scottish production sector output continued to grow strongly. Output rose by 1% in the quarter compared to a rise of 0.8% in the UK. Over the year - four quarters on four quarters - production GVA rose by 1.3% in Scotland compared to a large fall of -2.1% in the UK.
- Manufacturing GVA rose by 1.6% in the second quarter in Scotland after growth of 0.9% in the first quarter and a fall of -0.5% in the final quarter of last year. UK manufacturing, in contrast, has fared worse than the sector in Scotland for the last 5 quarters with output rising by 0.8%. Scottish manufacturing GVA now stands at -4.6% below the 2008-09 pre-recession peak, while the UK figure is -9.8%.
- The Scottish service sector, which accounts for 72% of GDP in Scotland and 77% in the UK, was weaker in Scotland in the second quarter with GVA growing by 0.3% compared to 0.7% in the UK. By the second quarter of this year, Scottish services GVA was -0.8% below its pre-recession peak compared to the UK at -0.2%, just below the UK services GVA pre-recession peak.
- Yet, despite that there continues to be some good news within Scottish services.
- A strong recovery is now taking place in business services in Scotland and the recovery is stronger than in the UK. By the end of the first quarter 2013, GVA stood 6.6% above its pre-recession peak.
- Wholesale/retail distribution and hotels & catering performed much better in Scotland throughout both recession and recovery. Up until recently, spending in the high street may have held up better in Scotland than in the UK,
- The performance of financial services continues to give cause for concern. By the end of the first quarter GVA had fallen by about 13% below the pre-recession peak in both Scotland and UK. However, there was an upturn in the Scottish sector in the first quarter.

Labour Market

- In the quarter June to August, employment continued to rise at a faster rate than in the UK but at a slower rate than in the first quarter. Jobs rose by 37,000, or 1.5%, compared to a rise of 155,000, a rise of 0.5%, in the UK as a whole.
- In addition, unemployment fell by more than 3,000 to 201,000, or a rate of 7.3%. In the UK, unemployment fell more slowly by 18,000 maintaining the UK unemployment rate at 7.7%.
- Scottish jobs are now -0.8% below their pre-recession peak, which is still worse than the UK, where the jobs total is 0.8% above the pre-recession peak.
- Labour productivity in Scotland has improved relative to the UK, which has experienced a sharp drop in productivity. This may principally be due to the different pattern of industrial growth in the recovery in Scotland which has favoured more highly productive, capital intensive sectors.
- The recent improvements in the Scottish jobs market and falling unemployment have started to feed through into the employment population ratio - a better measure than unemployment of labour reserves in the economy. The ratio is still -3% below the pre-recession peak indicating there is still plenty of spare capacity, or unused labour

resources in the Scottish economy. And this statistic takes no account of the large increase in the part-time and self-employed workforce due to a lack of full-time employment.

Forecasts

- The Fraser of Allander Institute's GDP forecast for the Scottish economy in 2013 at 1.3% has been revised upwards from its June and March forecasts of 0.9%. For 2014 it has also revised up the forecast from the 1.6% predicted in June to 1.8%, while for 2015, we retain the same 2.1% prediction as in June.
- The forecasts for 2013 and 2014 are higher than in June because of better than expected outturn data on the growth of household spending and increasingly optimistic surveys during the summer and early autumn.
- But we are still predicting below trend growth next year reflecting the continued relative weakness of domestic demand, in particular government spending and consumer expenditure, and only slowly rising growth in Eurozone markets but stronger growth in the rest of UK to which Scottish exports are so reliant.
- In the labour market, we predict rising employment, rising unemployment next year, and falling unemployment in 2015.
- On the central forecast, we are now forecasting that net jobs will rise by 21,200 in 2013, rising to 27,200 in 2014 and 38,400 in 2015. The majority of jobs created will be in the service sector.
- We are now seeing many workers re-entering the labour market as job prospects improve. This lowers our estimate of 'real' unemployment but may tend to raise measured unemployment as jobs are being created. The upshot is that unemployment may not fall as much as the job creation figures might suggest.
- Our projection for unemployment on the ILO measure at the end of 2013 is now 204,550 (7.6%). 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 224,800 (8.4%) by the end of 2014 and to then fall back to 186,450 (7.0%) by the end of 2015 as growth in the economy strengthens.

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To view the latest edition of the Fraser of Allander Institute Economic Commentary (October 2013, Vol. 37, No. 2) click on: **http://www.strath.ac.uk/frasercommentary/**

Annex: **Fraser of Allander Institute Economic Forecasts (October 2013)**

Table 1: Forecast of GVA Growth, 2013-2015

GVA Growth (% per annum)	**2013**	**2014**	**2015**
Central forecast	**1.3**	**1.8**	**2.1**
June forecast	*0.9*	*1.6*	*2.1*
UK mean independent new forecasts (October)	1.4	2.2	n/a
Mean Absolute Error % points	+/- 0.287	+/- 0.516	+/- 1.204

Source: Fraser of Allander Institute Economic Commentary, October 2013

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

	2013	**2014**	**2015**
Upper	27,900	38,100	68,750
June forecast	*22,600*	*50,500*	*64,300.*
Central	**21,200**	**27,200**	**38,400**
June forecast	*14,150*	*28,200*	*38,700*
Lower	15,750	16,450	11,400
June forecast	*2,450*	*4,450*	*16,400.*

Source: Fraser of Allander Institute Economic Commentary, October 2013

Table 3: Central Forecast of Scottish ILO unemployment 2013-2015

	2013	**2014**	**2015**
ILO unemployment			
Rate (ILO un/TEA 16+)	**7.6%**	**8.3%**	**6.9%**
June forecast	7.9%	8.4%	7.0%
Numbers	**204,550**	**224,800**	**186,450**

Source: Fraser of Allander Institute Economic Commentary, October 2013