7 November 2012

Scottish growth and job prospects cloudy but productivity may be the silver lining

As 2013 looms, the traditional Hogmanay pastime of looking to the New Year may be a more pleasant experience as Scotland's lacklustre GDP performance begins to look just a little brighter.

According to the latest PwC sponsored Economic Commentary from the University of Strathclyde's Fraser of Allander Institute, Scotland could even outperform the UK in 2013, with GDP growth of 1.3% as compared with a projected UK average of 1.1%.

However, an even gloomier than expected 2012 means that Scotland could see out the old year with negative GDP growth of -0.1% - well below the 0.4% real growth forecast back in June.

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

> "With GDP falling in the first half of the year, it is likely that Scotland will suffer a fall in GDP in 2012. In a month when the IMF published research indicating that fiscal austerity has had a much greater effect on output than anticipated, we must look forward to further fiscal retrenchment even though both private domestic and foreign demand continues to be weak."

By the end of the second quarter Scottish GVA stood at -4.4% below the pre-recession peak four years ago. In contrast, the figure for UK GVA is -3.8%. This is despite the fact that the depth of the recession was a little greater in the UK, at -6.3%, than in Scotland, -5.8%.

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

> "While the overall picture is one of stagnation, the Scottish Government has been using the levers available to it to stimulate growth. If the focus on infrastructure spending, such as the new Forth Crossing, can strengthen through 2013 and beyond the outlook for construction will be more positive.
>
> "Scotland's latest insolvency data also offers a glimmer of light. This showed the lowest quarterly figure for corporates since Q2 2011, with personal insolvencies also reporting a drop, almost 25% down on Q3 last year which is partly due to an increased consumer focus on repaying debt. While we expect this downward trend to continue into the new year, what happens after that depends on how quickly businesses can address the challenges facing their balance sheets.
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> "With consumer spending remaining weak there are continued pressures on the retail and hospitality sectors in particular, as we have seen recently with Comet. The likelihood is that in the early part of 2013 we could see more restructuring and closures as these firms confront the issues of accessing funding, weak demand, consumer confidence and rising costs."

Olympic bounce unlikely to bolster the job market in Scotland

In the Scottish labour market jobs are now being lost again and unemployment is rising, and with Scotland unlikely to benefit to the same extent as other UK regions from the 'Olympic bounce', job prospects remain under a cloud.

However evidence that labour productivity may have risen in Scotland, or deteriorated much less, while falling sharply in the UK is perhaps a silver lining that may yet bolster growth to a limited extent in the face of continuing UK fiscal consolidation, low Eurozone growth, and a general weakness in global demand for goods and services.

The Commentary shows that since the recession began four years ago labour demand has fallen by much less in the UK than output, suggesting a marked fall in productivity. In Scotland, in contrast, labour demand appears to have fallen by more than output over the period. While this is bad news for unemployment, higher productivity may be good news for future Scottish growth.

Brian Ashcroft, Professor of Economics at the University of Strathclyde concluded:

> **"**We shall see growth return but it will continue to be lacklustre for some time. Scotland may gain some competitive advantage from our apparently better productivity performance than the UK. But without a strong upturn in demand the effect on growth of improved supply-side efficiency is like pushing on a string. "

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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. 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/
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.

Overview

In their latest Economic Commentary, sponsored by PricewaterhouseCoopers, the University of Strathclyde's Fraser of Allander Institute notes that the growth of the Scottish economy continues to be weak. Both the Scottish and UK economies have contracted for the three quarters up to the second quarter. By the end of the second quarter Scottish GVA stood at -4.4% below the pre-recession peak four years ago. In contrast, the figure for UK GVA is -3.8%. This is despite the fact that the depth of the recession was a little greater in the UK, at -6.3%, than in Scotland, -5.8%. The recovery of UK GDP has been somewhat faster than in Scotland, all be it a weak recovery overall.

The performance of the Scottish labour market and unemployment in particular is giving rise to increasing concern, both in itself and in comparison to the UK. Our analysis suggests that over the longer period of recession and partial recovery, the main reasons for a rise in unemployment compared to the UK appear to be the somewhat stronger fall in output and the much greater decline in the demand for labour. It appears that this may be due to an economy-wide improvement - or lesser deterioration - in relative labour productivity.

Data for the third quarter show the UK economy to have expanded by 1%. We consider this to be an 'Olympics bounce' which is unlikely to affect Scotland to the same extent. Positive Scottish retail sales figures for the third quarter need to be set against the reports of several business surveys which depict growth as largely stagnating with household spending depressed and business confidence weak.

Against this background of weakening domestic and foreign demand compared to earlier expectations we have revised down our forecasts. So, we are now forecasting GDP growth of -0.1% in 2012, 1.3% in 2013, and 2.2% in 2014.

GDP Performance

- GDP in constant prices fell by 0.4% in Scotland during the second quarter, the same loss of output as in the UK.
- Manufacturing and electricity & gas supply contracted in the second quarter.
- The contraction in electricity & gas supply is likely to have been temporary for technical industry reasons.
- But the recent performance of manufacturing remains a cause for concern, especially in the light of recent weak export performance, with export volumes around 14 per cent below their 2007 peak and close to the 16.5 per cent fall experienced in the 2007-09 recession.
- The service sector has exhibited a more sustained recovery. But GVA is still nearly 3 per cent below pre-recession peak compared to 0.9 per cent below in the service sector in the UK as a whole.

- Within services there are some encouraging signs of a recovery developing in business and financial services.
- A look at the public sector shows government services GVA contributing to recent growth in the UK but not so in Scotland. The UK performance of government services appears anomalous.
- The construction sector appeared to halt its precipitate decline with growth of 2 per cent in the second quarter. But GVA in the sector still languishes 16 per cent below its pre-recession peak, much the same as UK construction.

Labour Market

- The latest labour market data show jobs in Scotland falling by 1,000, and unemployment rising by 7,000 in the latest quarter to August.
- Over the year, jobs were up by 16,000 but unemployment was higher by 10,000.
- In the UK employment rose, resulting in the 16-64 employment rate rising over the year to 71.3 per cent above Scotland's 71.2 per cent which remained unchanged over the year.
- The contrast in the unemployment performance between Scotland and the UK in the most recent quarter is even more marked. Unemployment in Scotland rose by just over 3 per cent. In the UK, in contrast, unemployment fell by 50,000, a fall of just under 2 per cent.
- We can conclude, that the explanation of the large rise in unemployment in the most recent quarter in Scotland compared to the UK is as follows:
  - output growth was probably weaker here;
  - productivity probably rose faster, or fell by less, here, hence
  - jobs growth was disproportionately weaker here. Moreover,
  - the supply of labour rose disproportionately in Scotland relative to demand so worsening the outcome for unemployment.
- But we can't be definitive about the recent changes.
- The latest jobs and unemployment data published refer to the period June - August. Unfortunately, we don't have GDP data for this period. The latest Scottish GDP data cover the second quarter, that is April - June. There is only an overlap of 1 month.
- We must await the third quarter data to see if there is evidence of an 'Olympic bounce' because, if it exists, it will be picked up in the GDP figures.
- So, the strong jobs growth of 0.72 per cent in UK employment in the quarter, compared to a fall of 0.06 per cent in Scottish jobs, might be largely the result of a strong output differential due to the Olympics.

Forecasts

- Against a background of weakening domestic and foreign demand we have revised down our forecasts compared to June.

- We are now forecasting *GDP* growth of -0.1% in 2012, 1.3% in 2013, and 2.2% in 2014.
- We expect Scottish growth to continue to be a little stronger than UK growth.
- Given our previous forecast errors the lower and upper bounds for forecast growth in 2012 are expected to be -0.4% and 0.2%, for 2013, 0.8% and 1.8%, and for 2014, 1.0% to 3.4%.
- After the predicted fall in output this year in all major sectors, production and manufacturing continue to be the main sectoral drivers of growth in 2013 and 2014.
- For *employment*, net jobs are forecast to contract by -1.1% in 2012, then grow by 0.8% in 2013, and by 1.3% in 2014.
- The number of employee jobs in Scotland is forecast to decline during 2012 by more than 25,000 jobs.
- The vast majority of these job losses are projected to be in the service sector (22,750) and construction (2,550).
- For *unemployment*, on the ILO measure we are projecting the number to reach 225,134 at the end of 2012.
- The unemployment position is expected to deteriorate slightly in 2013 compared to 2012 due to weaker output and employment growth.
- Unemployment is now forecast to be 234,603 by the end of 2013.
- In 2014, unemployment falls to 228,740 as growth and job creation pick up during the year.

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Annex: Forecast Tables

Table 1: Forecast Scottish GVA Growth, 2012-2014

GVA Growth (% per annum)	2012	2013	2014
Central forecast	**-0.1**	**1.3**	**2.2**
June forecast	*0.4*	*1.6*	*2.5*
UK median independent new (October)	-0.3	1.1	1.9
Mean Absolute Error % points	+/- 0.296	+/- 0.492	+/- 1.216

Table 2: Forecast Scottish Net Jobs Growth in Three Scenarios, 2012-2014

		2012	2013	2014
Upper		-19,350	27,100	53,350
	June forecast	*-5,200*	*41,000*	*61,750*
Central		**-25,750**	**16,950**	**29,450**
	June forecast	*-14,950*	*19,950*	*36,050*
Lower		-32,050	5,500	5,850
	June forecast	*-25,350*	*-1,700*	*10,450*

Table 3: ILO unemployment rate and claimant count rate measures of unemployment under each of the three forecast scenarios 2012-2014

	2012	2013	2014
ILO unemployment			
Rate (ILO un/TEA 16+)	**8.5%**	**8.8%**	**8.7%**
Numbers	**225,354**	**234,603**	**228,740**
Claimant count			
Rate (CC/CC+total job)	5.1%	5.3%	5.3%
Numbers	139,720	147,800	148,681