

# The Scottish economy

## Forecasts of the Scottish economy

### **Economic background**

There has been robust signs of a strengthening of the global economy particularly in the US and Asia. Confidence and equity markets have also rallied although output and employment data remains disappointing. The Euro Area has stagnated with recession in Germany, the Netherlands and Italy but France is slightly ahead of its counterparts. The US remains the world's leading economy but perhaps we rely too heavily on the US to turnaround the world economy. Japan has performed better than expected but is not growing at the same pace as its neighbours. There are clear downside risks to the economy, probably the most important being how the growing US deficit is corrected. Trade is expected to improve significantly in 2004.

The UK economy has performed relatively well given the global economic conditions. The forecasts for UK GDP growth have been revised down slightly by most commentators with a corresponding upwards revision to Public Sector Net Borrowing (PSNB). There is little inflationary pressure in the economy, although house prices and indebtedness remain a slight concern, and interest rates are at historically low levels. The labour market is relatively buoyant with employment growth and low unemployment. We are forecasting that the UK will return to trend growth by 2004 and that this will provide a stimulus for Scottish exports.

For 2002 Scottish GDP growth was flat as previously forecast by us. The most important drivers of the economy remain consumption and government spending but if recovery takes hold both net exports and investment should become more important. It was thought that tourism had a relatively poor performance (although strong in some areas) but the latest data for 2002 has demonstrated that visitor numbers were up by 5 per cent in 2002 while spending increased by 8 per cent. This will probably provide the retail and hotel and catering sectors with an added stimulus. Exports performance continues to be disappointing. Despite these difficult economic conditions the labour market has been robust with relatively good employment growth and falling unemployment.

Our forecast is for the Scottish economy to improve in the second half of the year and for recovery to be in place by 2004. The outlook for the world, the UK and the Scottish economy in the short-run is for relatively muted performance.

## The forecast in detail

### GDP

Table 1 presents our forecasts for the Scottish economy. It has been quite problematic to forecast the economy recently for a number of reasons. These include:

- Æ the global economic conditions have been uncertain;
- Æ there have been a number of revisions to the Scottish Executive data;
- Æ survey data has at times been conflicting and marginal and
- Æ the labour market remains buoyant despite relatively weak economic conditions.

This situation is consistent with being close to a turning point in the economy (the Executive data is for the first quarter of 2003). We have probably passed a turning point in the economy but we will need to wait until later for data to confirm this. This situation gives rise to conflicting data and weak signals. The result is that forecasting becomes more difficult. We believe however that our interpretation of events is similar to that of others.

We present our forecasts for GDP and broad sectoral output in Table 1 for the period 2003 to 2005. GDP growth is forecast to be 1.2 per cent in 2003 and 2.0 per cent in 2004. This latter figure is close to trend growth for the economy. We are anticipating stronger economic activity in second half of 2003 and for this increase in activity to continue into 2004. The decline in our forecast is marginal and takes account of several factors: a marginal drop in the service sector, a decline in construction and weaker than expected manufacturing performance.

**Table 1: Main forecasts of the Scottish economy, 2003-2005**

	2003	2004	2005
<b>GDP</b>	<b>1.2%</b>	<b>2.0%</b>	<b>2.2%</b>
Agriculture	-1.3%	-1.0%	0.8%
Manufacturing	-1.9%	0.5%	1.2%
Manufacturing (ex Electronics)	-2.3%	0.2%	1.2%
Construction	-2.4%	2.7%	3.3%
Services	2.3%	2.5%	2.4%

Source: Fraser of Allander Institute, September 2003.

### Output

Agriculture is forecast to decline by 1.8 per cent in 2003 and by a further 1.0 per cent in 2004. This is despite relatively strong growth in 2000, which was lost in 2001. There are no clear signs yet as to what impact on growth the fishing quota losses will have.

Manufacturing growth is forecast to decline by 1.9 per cent in 2003 and to grow by 0.5 per cent in 2004. This is a significant change to our forecast as we previously thought that manufacturing would only see a minor contraction (-1.0 per cent) as recovery took hold but there are clear signs that manufacturing companies are less confident compared to services companies. The immediate prospects also do not look good for manufacturing firms. Smaller firms also report more difficulties compared to large firms. Even the Royal Bank of Scotland PMI index is perilously close to the neutral 50 and clearly all surveys have a degree of error. We are confident that the sector will pick up in 2004 however. Exports will remain important for Scottish manufacturing and it is vital to the economy that markets are re-captured. In the medium-term the best performing sectors include:

- Æ transport equipment (3.3 per cent per annum);
- Æ chemicals (2.7 per cent per annum);
- Æ paper, printing and publishing (2.4 per cent per annum) and
- Æ electronics (2.3 per cent per annum).

Growth in the service sector is forecast to be 2.3 per cent in 2003, and 2.5 per cent in 2004. Both these forecasts are down marginally on the previous quarter. Growth is forecast to be strongest in retail and wholesale and in other services in 2003. Financial services are forecast to be the lead service sector (in terms of growth) in 2004.

Construction is forecast to decline by 2.4% in 2003 following decreases in output in both 2002 and 2001. We are forecasting however that the sector will grow by 2.7 per cent in 2004 and by 3.3 per cent in 2005. Public private partnerships, strong housing demand and planned investment in transport are significant drivers of the construction sector, although some of these projects have implications for the medium and long-term. Some delays in projects have affected the construction industry, which is not slow to cut back in times of economic hardship.

### Employment

Our forecasts of employment are presented in Table 2 with the net employment change figure in brackets. The employment figures are calibrated on the employers quarterly survey series as given in Table B.16 in Labour Market Trends, National Statistics. Within the forecasts there has been an adjustment to electricity, gas and water supply to bring the figures back into line with official projections. This upward revision of this data slightly masks the decrease in our forecasts of employment compared to the previous quarter. For instance the 2003 total employment change is down 11,000 from the previous forecast while the manufacturing job change for the same period is down 3,800. Services are relatively unaffected. Construction is the other sector that contributes to reducing the employment change because it was positive in the previous quarter. Our forecast for 2003 is that employment will be 2,224,900 and

2,268,000 in 2004. This is a net job change of 22,100 and 43,100 respectively. We believe that there were 7,600 jobs lost in 2002 as opposed to our previous forecast of a decline of 6,400. Services employment is forecast to be 1,754,300 (30,600) in 2003 and 1,791,700 (37,400) in 2004. We have revised downwards the number of jobs the service sector may generate in 2003 because of reductions in financial services, weaker GDP growth, and a labour market that is already providing a considerable number of jobs. Manufacturing probably lost 13,200 jobs in 2002 and we are forecasting a further loss of 4,800 jobs this year. We also forecast that 1,800 jobs will be created in 2004 and that in 2005 3,200 jobs may be generated. Our forecast is for manufacturing to support 275,100 jobs in 2003.

Employment in Agriculture is forecast to be 34,900 in 2003 and to remain close to that level over the period of the forecast. Construction is forecast to fall to 120,100 in 2003, and to recover in 2004 to 123,200. Previously we thought the construction sector would expand in 2003 but the signs are that this will probably not take place until early 2004.

Employment continues to be driven by the service sector. Excluding the public sector; retail and distribution, hotels and catering and real estate and business services are the key sectors for employment in the service sector. The largest job gains in both 2003 and 2004 are most likely to be seen in retail and distribution closely followed by other services. In 2004 the public sector is forecast to add 13,600 jobs to employment. The manufacturing sectors that are forecast to have considerable job losses in 2003 include textiles, chemicals and metals and mechanical engineering.

**Table 2: Forecasts of Scottish employment and net employment change, 2003-2005**

	2003	2004	2005
<b>Total Employment (000s)</b>	<b>2,224.9</b>	<b>2,268.0</b>	<b>2,308.1</b>
	<b>(22,100)</b>	<b>(43,100)</b>	<b>(40,100)</b>
<b>Agriculture</b>	<b>34.9</b>	<b>34.5</b>	<b>34.8</b>
	<b>(-300)</b>	<b>(-300)</b>	<b>(300)</b>
<b>Manufacturing</b>	<b>275.1</b>	<b>273.3</b>	<b>276.5</b>
	<b>(-4,800)</b>	<b>(1,800)</b>	<b>(3,200)</b>
<b>Construction</b>	<b>120.1</b>	<b>123.2</b>	<b>127.3</b>
	<b>(-3,200)</b>	<b>(3,100)</b>	<b>(4,100)</b>
<b>Services</b>	<b>1,754.3</b>	<b>1,791.7</b>	<b>1,822.2</b>
	<b>(30,600)</b>	<b>(37,400)</b>	<b>(30,500)</b>

Source: Fraser of Allander Institute, September 2003.

## Unemployment

Table 3 contains our forecasts of unemployment. Both the ILO measure and claimant count measure are given. The preferred measure of unemployment however is ILO unemployment as given by the LFS. The forecast for ILO unemployment is 129,200 (5.0 per cent) in 2003 and 131,400 in 2004 (5.0 per cent). Claimant count is forecast to be 101,300 (3.9 per cent) in 2003, 98,300 (3.8 per cent) in 2004 and 96,300 (3.6 per cent) in 2005. As in previous forecasts there is little change to the unemployment forecast. We believe unemployment will remain at low levels.

**Table 3: Forecasts of Scottish unemployment, 2002-2004**

	2002	2003	2004
<b>ILO Unemployment (levels)</b>	<b>129,200</b>	<b>131,400</b>	<b>128,600</b>
<b>Rate</b>	<b>5.0%</b>	<b>5.0%</b>	<b>4.8%</b>
<b>Claimant Count (levels)</b>	<b>101,300</b>	<b>98,300</b>	<b>96,300</b>
<b>Rate</b>	<b>3.9%</b>	<b>3.8%</b>	<b>3.6%</b>

Source: Fraser of Allander Institute, September 2003.

We continue to believe that our forecasts for the Scottish economy are both robust and consistent. There is also clear evidence that the forecasts are close to the outturn data from official sources. The model outcomes are also consistent with previous forecasts. The outlook for the Scottish economy remains for slow but steady recovery to near trend growth in 2004 and 2005. The expectation is that the labour market will continue to be relatively buoyant and that unemployment will be at historically low levels. Recovery is forecast for the latter half of 2003 and manufacturing is not forecast to recover until 2004. Even during 2004 some sectors will not have recovered. As previously stated when world trade picks up due to increased economic activity then Scottish exports should receive further stimuli resulting in increased manufacturing activity.

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