The Scottish economy

Forecasts of the Scottish economy

Summary
We revise down our forecast for GVA growth in 2011 from 1.0% to 0.8%. This is due to three factors: weak domestic demand; low investment activity and slower growth in world trade than was expected earlier this year. Firstly, there is ongoing weakness in consumer confidence, in turn damaged by falling real incomes for households due to rising inflation rates impacting on spending power. Reduced real government spending on current and capital expenditures are due to impact on the Scottish economy particularly from April 2011, and the impact that this has on employment and activity in the public sectors will be critical for the short-term outlook. Business investment spending appears relatively static from previous periods, but will depend on expected demand as well as the availability of finances to undertake investment. To the extent that external finance sources remain challenging, internal financing will require the corporate sector to build up balance sheet strength. External demand remains slow, with lower growth forecasts for the UK economy as a whole (the largest market for Scottish exports) and weaknesses across the Euro area driven by sovereign debt concerns and major questions about the future path of this economic area. The outlook for the Scottish labour market remains poor, with the link between economic activity and employment growth uncertain, at the same time as some evidence of workers exiting the labour market to inactivity.

The Scottish economy

Value added and output

Figures published on the 20th of April 2011 revealed that the Scottish economy declined by 0.4% in the final quarter of 2010. This means that the Scottish economy has seen three quarters of negative growth in the last six quarters. Year on year growth (i.e. the average of the last four quarters on the previous four quarters) was +0.8%. Over the same basis the UK economy grew by 1.4% through 2010. The data reveals that a very strong performance by the construction sector in Scotland throughout the first three quarters of 2010 had stalled in Q4, falling by 2% in Q4. More significantly perhaps for the future strength of the economic recovery was the decline across the production, construction and services sectors in Q4. Service sectors saw growth of -0.1% through 2010, with GVA falling in the “Hotels and catering” (falling by 2.4% in the last four quarters on the preceding four quarters), “Transport, storage and communication” (-2.3%) and “Other services” (-3.9%). The production sectors of the economy grew by 0.5% over the year, during which period the same sectors in the UK as a whole saw growth of 2.0%.The 0.1% decline in the service sectors in Scotland was not matched at the UK level, with

Vol.35 No.1, pp.18-29.

GVA increasing by 1.1%. Scotland's growth performance relative to the UK as a whole would have been significantly worse had it not been for the better performance of the "Construction" sector in Scotland, which grew by 11.2% in Scotland, but only 6.0% in the UK as a whole.

Labour market

The most recent figures for the Scottish labour market at the end of 2010 are discussed in greater detail in the Labour market section of this month's Commentary. Prime among the recent trends in the labour market however was a continuing fall in the unemployment rate from previous quarters, down to 7.7 % of the economically active (16+) population in the quarter to April 2011. The total economically active of working age has fallen significantly (down 22,000 in the last six months), employment increasing by 2 thousand people, and the number of unemployed (but in the labour force) falling by 24,000 in the last two quarters. The movement between labour force and inactivity remains a complex issue, with the path that this takes critical for the forecasted performance of the labour market.

Total weekly hours worked continue to show that underemployment of labour in employment, i.e. through working less hours, remains a feature of the Scottish labour market, particularly for full-time workers. The number of total weekly hours worked to September 2010 was 2.9% lower than the same period one year earlier.

The claimant count level has risen since the start of the year, and remains higher than throughout 2010. The number of people out of work and receiving Jobseekers Allowance was up 4,900 in May 2011 compared to May 2010, rising 1,200 in the last month. As a rate of the number of those receiving benefits plus the number of Workforce Jobs, the claimant count rate stands at 5.2%.

Prices

Inflation measures for the UK suggest that prices are continuing to rise above the target inflation rate of the Bank of England's Monetary Policy Committee. In June 2011, the inflation rate remained at 4.1%, almost 2 percentage points above the MPC's medium term target. High and rising commodity and import prices, plus the impact of increased VAT accounted for the increase seen in the first quarter of the year.

The price of a barrel of oil has increased by almost 70% since July 2010, and stands at just under $120 at time of writing. This is slightly lower than the price during April. Other commodity prices on world markets have surged over the last year, under a combination of rising demand and falling output from shocks to production. Corn futures are trading at 240 euros/m tonne for June delivery, up from under 160 euros/m per tonne a year ago, while the price of soybeans is trading up almost 40% in the past year.

It appears that the increase in VAT from 17.5% to 20% in January 2011 has had a larger impact on CPI measure than the previous increase in VAT from 15% to 17.5% in January 2010. The Bank of England's latest inflation report cautions that it appears that more of the VAT increase was passed onto prices paid by consumers than the earlier increase. Measures of the CPI inflation excluding VAT, energy and commodity prices were below the 2% target as spare capacity in the UK put downward pressure on domestic prices.

There are no official measures of inflation in Scotland. As for evidence of different consumer inflation rates within the UK, recent evidence from the Institute of Fiscal Studies reported differences in the inflation experienced by people on low incomes or in "benefit dependent" households. By their calculations, while no income group saw consistently higher average inflation than any other group in every year of their sample period, "lower income households had higher inflation rates over the last decade than higher-income households".

Wage growth remains relatively flat in Great Britain as a whole, with average weekly earnings growth around 2%, down from pre-recession growth of closer to 4%. The lack of comparable data on Scotland limits the extent to which we can say that wage pressures are different in Scotland than the UK as a whole. As a simple comparison, however, average weekly earnings have risen slower in the private sector than the public sector since the start of 2009, so, with a slightly higher public share of employment in Scotland, it would appear likely that in the Scottish economy as a whole average weekly earnings growth has been stronger than in the UK as a whole (although still weak).

House prices in Scotland have been reported by the Lloyds TSB Scotland House Price Monitor, to have "return[ed] to the prices of four years ago", having fallen by 3.6% in the first three months of 2011. The average value of a house in Scotland is now £153,335. The number of housing transactions rose in March, but remains very low by the standard of pre-recession years. The link between house prices and consumer spending remained unexamined for Scotland, but evidence for the UK (published by the ONS in 2006) suggests that if there was any link between these variables, this may have weakened during the early part of the 2000s.

Surveys of business and consumer confidence

The survey evidence for Scotland is discussed in great detail in the "Review of Scottish Business Surveys" section of this Commentary. Broadly these appear to suggest weak growth at the start of 2011, with rising production from the second half of quarter one. Within manufacturing surveys, increased demand was reported, and some employment growth, however, also reported were rising cost pressures, particularly from commodities and energy goods. The weakness of consumer demand for household-facing operations, coupled with the fiscal spending reductions in this year, and the additional impact of the Supplementary Tax charge on the Oil and Gas sector introduced in the March 2011 Budget, all appear to have a constrained effect on growth in this early part of 2011.

The Bank of Scotland's Purchasing Managers' Index for May 2011 reported continuing inflationary pressures, while output growth was slower and a decline in the level of new business reported. This PMI reported a slowdown in the rate of growth in the private sector, although this was still positive. Workforce growth reported was positive compared to some regions of the UK (Wales, Northern Ireland), but slower than most English regions.

Within manufacturing, Scottish Engineering, the Scottish Chambers Business Survey and the Bank of Scotland PMI all suggested an improvement in activity, with some signs of faster growth in Scotland than in the UK as a whole. The surveys would appear to indicate an anticipated uptick in demand continuing in the second half of 2011, albeit perhaps with declining margins on production.

Surveys of the construction sector reported weak and falling confidence in Q1 2011, with the exception of infrastructure and non-housing repair and maintenance. With squeezing margins due to rising costs, and public capital spending projects likely to see large falls in expenditure through the latter half of 2011, the outlook for the sector remains poor in the short-term.

Retail surveys give some indication of the state of consumer confidence in Scotland. On this basis, the weak trend in sales growth in Q1 and the fact that no firm expects an overall increase in total sales gives severe cause for concern.

Trends in drivers of the economy

Consumption

The macro-indicators for consumption indicate that consumption spending is recovering slightly, or at least is no longer declining on an annual basis. Figures for consumption spending on an annual basis show that spending in Scotland grew slightly more than spending in the UK as a whole in 2010. The savings ratio for Scottish households has fallen from its high in 2009Q2 of 8.8%, although is now below its average figure for the period since 1998. Consumption spending remains weak, and is unlikely to be the source of significant growth over the short term.

The Retail Sales Index for Scotland reported on the 4th of May 2011, that the first quarter of 2011 had seen a decline of 0.3% in real terms. Retail Sales in Great Britain as a whole were flat (+0.0%) over the same period, showing a weaker growth in Scotland.

In June, the Scottish Retail Consortium (SRC) revealed that, after relatively strong sales in April in part driven by weather and holiday periods, sales in May 2011 fell by their largest amount since the survey started in 1999. Like for like sales values were down 3.2%, while total sales were down by 1.1%. Both these declines are greater than in the UK as a whole, where sales values were down 2.1% on a like-for-like basis and total sales were down 0.3%, the SRC reported.

The outlook for private spending remains mixed. The Bank of England's "Inflation Report" from May notes that low interest rates could act as a spur to consumption, however to the extent that households are unwilling to spend their savings in order to protect against future unemployment or increased prices this will not occur, despite the actions of the MPC. It will likely be some more quarters until we know if households are adjusting their levels of desired savings to a higher level than prior to the recession. The feed through from unemployment fears (and possible realisations) and cost anxiety to reduced consumption spending is likely to be a feature of the Scottish and UK economies over the medium term.

Government spending

As we noted in March's Economic Commentary, the Scottish Parliament approved its one year Budget for 2011-12. The total size of the budget for the year is £33,620 million (Total Managed Expenditure), split between Resource Departmental Expenditure Limits (DEL) of £25,400 million, Capital DEL of £2,607 million and Annually Managed Expenditure of £5,612 million. While resource spending has been reduced in real terms, the most significant percentage reductions have fallen upon capital spending in the financial year 2011-12. The implications of this for overall investment spending is discussed in the next section. The challenge for the public sector in continuing to provide levels of service while undergoing significant reductions in income, particularly after a period of relatively strong growth of public resource – as well as capital – spending. A three-year freeze in public sector pay for those earning over £21,000 appears to be the significant way by which employment in the public sector may be protected at a time of reductions in public sector budgets. The most recent data for Scotland on the numbers employed in the public sector are discussed in the *Labour market* section of this commentary.

The UK Government announced its Budget in March 2011. Its policy decisions in this budget were broadly cost neutral over the five year policy window. Of the major changes to public revenues and expenditures announced here – rather than at the Comprehensive Spending Review in October 2010 – were the following.

On the government debit side, the major changes were to:

- Reduce fuel duty by 1 pence per litre from 23 March 2011 (costing 2,100 million per year by 2015-16);
- Reduce corporation tax to 26% from 2011, with a plan to reduce down to 23% by 2014-15 (costing 1,075 million per year by 2015-16);

- Increase personal income tax allowances by £630 in 2012-3 with adjustment to basic rate limit (costing 1,230 per year by 2015-16);
- Tax reform to “Controlled Foreign Company” rules (costing £840 million per year by 2015-16).

These changes were offset by revenue raising decisions including:

- Increasing the supplementary charge on North Sea Oil from 20% to 32%, and restricting decommissioning relief from 2011-12 (raising £1,780 million in 2011-12, rising slightly over each of the four years from this level);
- Indexing direct taxes to CPI from RPI (raising £1,080 million per year by 2015-16);
- Bank levy (raising £630 million in 2011-2, falling to £100 million by 2015-16);
- Changes to raise revenue from tax avoidance, tax evasion and administration, raising a total of £1,335 million by 2015-6, predominantly from raising revenue from “Disguised remuneration”.

Changes to the supplementary tax on activities in the North Sea have prompted significant debate between the industry and governments about the impact that these changes will have on exploration and drilling activity, with knock-on effects on the economies from reduced activity, and also a lower tax take.

Investment

While investment spending appears to have recovered strongly through 2010 (witness the large increases in the construction sector seen throughout the year), this could have been necessary following the complete collapse of investment during the recession – the low base made for significant increases during the normal replacement and maintenance of the capital stock, perhaps, and also the “green-lighting” of new projects delayed from 2008-9.

Where the outlook for demand for goods and services is weak, it is likely that private investment will be sluggish, however this will also be affected by the abilities of firms to raise the appropriate finance for investment projects. March 2011 saw the publication of the latest “SME Access to Finance” survey, which examines the credit availability in the Scottish SME sector, which accounts for 53% of all employment in the Scottish economy. This now gives the fourth in a series of surveys of this crucial part of the Scottish economy.

This survey paints a mixed picture. Demand for new borrowing has fallen compared to previous surveys, in part due to respondents revising down their growth objectives. Further, while credit conditions appear to have eased for those renewing credit facilities, access to new credit remains difficult. Of course, the extent to which firms require external credit will depend upon firms’ positions with regard to internal funds. One potentially critical issue is the availability of credit for firms exporting, where a higher than average rejection rate for new credit could limit the ability of Scottish firms to unlock export markets.

The Scottish Load Fund, setup with £40 million of private capital and a commitment of £55 million from the public sector intends to fill some of the gaps in SME finance availability. It was due to begin making loans of between £250,000 and £5million to established SMEs, with a preference for exporting firms. The Business Growth Fund, comprised of equity investment from five major UK banks, is an alternative model for private financing of investment, with loans of between £2 and £10million available to firms with turnovers between £10 million and £100 million. A of May 2011, the BGF was considering its first investments.

As well as private investment, government as a consumer of investment projects has seen significant retrenchment over the Budget in June 2010 and October 2010’s Comprehensive Spending Review. The bringing forward of Government capital spending in Scotland means that there is a larger decline in public capital spending in 2011-2 than would otherwise be the case, however, capital spending in 2010-11 was protected. The bulk of the “hit” to capital spending in Scotland suggested by the CSR is projected to occur in 2011-2, with significantly smaller declines in future years (indeed a small upturn in capital spending in the final year of the CSR period). This is likely to have a significant impact on Scottish construction and other (non-public) activities. Ambitions by the Scottish Government to bring forward plans to borrow in order to fund capital projects – such as the Forth Road Bridge, could go some way to alleviating this decline in capital spending.

Exports to the rest of the UK

Growth in the rest of the UK remains critical for the export performance of Scottish firms, being responsible for over two-thirds of all Scottish exports in 2009. UK growth has typically been stronger than in Scotland over the last few quarters, with Q1 2011 showing a 0.5% increase. The terrible weather before Christmas meant that some expenditures were delayed into Q1, meaning that the rate of underlying growth in the economy over Q1 was broadly flat. Output in the construction sector which had provided strong growth during 2010 fell sharply in Q1, while manufacturing and services sector growth in Q1 was around 0.5%, excluding the effects of snow.

The Office for Budget Responsibility updated their forecasts for the UK economy in March 2011. Since their November 2010 forecasts, they noted the fall in Q4 2010 GDP, the rise in world oil prices and continued higher than expected inflation. They note that “these data have on average prompted external forecasters to reduce their estimates of economic growth in 2010 and 2011. The average external forecasts for CPI and RPI inflation have risen significantly, again reflecting recent data” (p. 11). They predict that “this recovery will be weaker than the recoveries of the 1980s and 1990s… [reflecting] the effects of the fiscal consolidation, the relatively slow easing of tight credit conditions and ongoing private sector deleveraging" (p. 12). Their forecasted UK growth is again reliant on business investment and net trade, with a slight revision downwards of prospects for domestic demand, given continued squeezing of household budgets.

The OBR's forecasts for UK GDP growth in 2011 has been revised down by 0.4 per cent to 1.7 per cent, while the 2012 forecast has been revised down by 0.1 per cent to 2.5 per cent. This forecast for 2011 is 0.2 above the average of independent forecasts from June 2011, while the OBR's forecast for 2012 is 0.3 above the same average of 2012 forecasts. Within demand components of GDP, the OBR's household spending forecasts for 2011 and 2012 has been revised down by 0.7 per cent to only 0.6 per cent in 2011, while general government consumption and investment has been revised upwards. No changes have been made to the contribution anticipated from net exports.

Upward revisions have been made to the UK ILO unemployment rate which is forecast to reach 8.2% at the end of 2011, and 8.1% at the end of 2012, before falling slightly to 7.6% at the end of 2013.

Exports to the rest of the world

The most frequent survey of Scottish exports to the rest of the world is the Index of Manufactured Exports. The most recent results revealed that Scottish manufactured exports fell by 0.3% in real terms during Q4 2010, and increased by 1.6% in 2010 on 2009 levels (on a four quarters on the previous four quarters basis). Of the annual figure, a positive increase in exports was observed in all sectors, with the exception of Engineering and Allied Industries. This one sector is, however, responsible for over 41% of manufactured exports from Scotland. The strong export performance of the "Food, drink and tobacco" sector – growing by 4.9% in 2010 – shows that the export-led growth prospects for Scotland are perhaps not being equally felt across Scottish manufacturers.

Worldwide, the outlook for growth remains mixed. In the US, non-farm payrolls rose in the most recent month, albeit weakly, while the unemployment rate remained at 9.1%. The US economy grew in the first quarter of 2011 by an annualised rate of 1.8%, while inflation concerns continued as inflation grew to 3.6%, driven by increases in commodity, energy service and food prices. In the Euro area, overall growth on an annual basis appears relatively strong at 2.5% in Q1 2011, but this masks a divergence in the growth outcomes within the area. By the latest figures to Q4 2010, real GDP in Ireland, Greece and Estonia were around 15 percentage points below its Q1 2008 figure, while in Slovenia, Italy, Portugal and Spain output was down by between 5 and 10 percentage points.

Growth in the Euro Area, a key market for many Scottish products, remains uncertain, and there are concerns about a two-speed Euro Area with growth in "core" countries expected to exceed that in the struggling "periphery". Continued worries about sovereign debt and the sustainability of public finances and banking reforms, the lack of the ability to improve the competitiveness indicate severe challenges in these economies, and by implication the Euro project as a whole, over the medium term.

The recent outbreak of E-coli in European vegetables, initially suspected to have begun in Spanish cucumbers, and now most likely to have originated at a German beansprout farm, has – as well as its fatal effect on humans (with 34 deaths and 812 cases at time of writing – significantly undermined confidence of consumers of European vegetables. At one stage Russia imposed a blanket ban on all imports of vegetables from the EU. While agricultural exports from Scotland are low (exports of produced food are less than 2% of all manufacturing exports, while the Global Connections Survey reported that in 2009, "Agricultural, forestry and fishing" products comprised 1.2% of all Scottish exports), it is possible that consumers would avoid products from markets where affected foods have been found – these include Germany, France, Denmark and Sweden. Such disruptions, to the extent that new tastes are developed for the new types of produce and hysteresis results, could lead to permanent step changes in exports. It is also possible that new export markets may not contribute to agricultural sales in the UK, but UK and Scottish consumers could switch demand to UK-grown vegetables.

The GDP growth forecasts for 2011 and 2012 for the top five export markets for Scottish goods and services in 2009 are given in Table 1.

Table 1: GDP growth forecasts for 2011 and 2012 for top five export markets for Scottish products in 2009, % year on year change, plus United Kingdom and Euro area

	Share of Scottish exports ROW 2009	2011		2012	
		IMF, May	OECD, May	IMF, May	OECD, May
USA	15.5%	2.8%	2.6%	2.9%	3.1%
Netherlands	9.6%	1.5%	2.3%	1.5%	1.9%
France	7.5%	1.6%	2.2%	1.8%	2.1%
Germany	6.1%	2.5%	3.4%	2.1%	2.5%
Belgium	4.0%	1.7%	2.4%	1.9%	2.0%
Others					
Asia	9.8%	8.4%[1]	n/a	8.4%[1]	n/a
European Union	n/a	1.8%	2.0%	2.1%	2.0%
United Kingdom	n/a	1.7%	1.4%	2.3%	1.8%

Sources: International Monetary Fund, Regional Economic Outlook: Europe: Strengthening the Recovery, May 2011, International Monetary Fund, World Economic Outlook, April 2011 and OECD Economic Outlook No. 89, May 2011.

Forecast accuracy

Economic forecasts are often criticised for being inaccurate, i.e. the predicted outcome differs from the actual outcome. This is a valid criticism of forecasts, obviously, given that one purpose of economic forecasting is to attempt to predict the future values of specific variables.

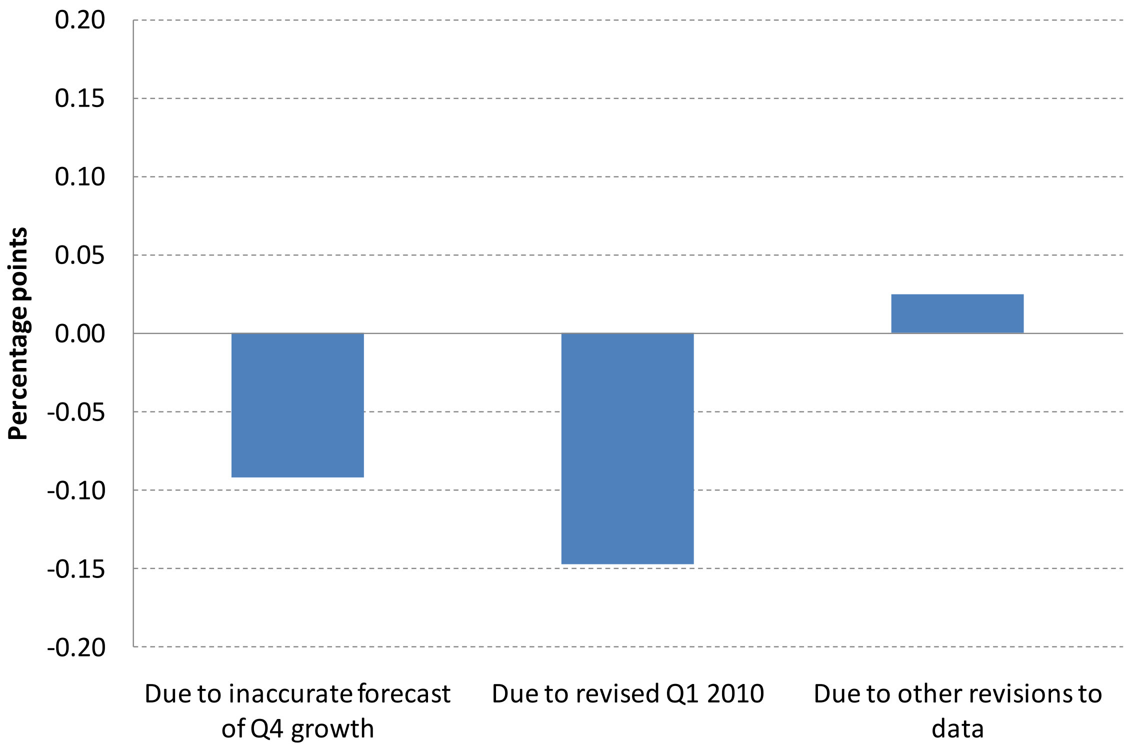
As part of an ongoing process of evaluating our economic forecasts we discuss here the difference between our forecast for 2010 growth published in March 2011, and that which was revealed by the published data in April 2011. Our forecasts was for growth in 2010 of +1.04% (which was published as +1.0) while the outcome figure for growth was +0.84. The absolute difference therefore between our forecast and the outcome was -0.21%.

We can separate out three reasons why the outcome data was different to that which we had forecast. Firstly, while growth in Q1-Q3 was known in March 2011, growth in Q4 was not. Mis-forecasting growth in Q4 would therefore lead to a difference between the annual growth forecast and outcome data for 2010. Secondly, there are revisions made to the GVA series as more information reveals the previous pattern of growth in the Scottish economy. Such revisions are a regular feature of all published economic statistics, and the growth figures for Scotland are no different[1]. Revisions to previous data are therefore another reason why forecast outcomes may not arise in actual outcome data (these can occur as we do not forecast revisions to past growth data, which seems sensible given the good quality of the Scottish GVA series).

We see that the absolute difference between our 2010 forecast and actual 2010 growth outcomes can be explained by a combination of own forecasting error for Q4 2010 and by revisions to past data. The major revision in the data published alongside Q4 2010 data was the revision of growth in Q1 2010 from 0.0% to -0.2%. Other revisions to the GVA series had the effect of slightly increasing the outturn growth for 2010. These are shown in Figure B1 below. Note the scale on the axis refers to percentage points: these are all small differences in absolute terms. One interesting result of this is that we can see that without the revision to Q1 2010, the outcome would have been annual growth 0.15 percentage points higher. Growth would therefore have been rounded to 1.0% - which would have had the impact of making our forecasts appear accurate despite our error in forecasting growth in Q4 2010.

We are continuing to examine our past forecast accuracy and will report on this in more detail in the next commentary.

Figure B1: Importance of forecast inaccuracy and revisions for difference between 2010 forecast and outcome



Notes:

[1] A paper published in December 2010 by the Scottish Government showed that in the five years to Q2 2010 the mean revision between quarterly GVA growth and its value one quarter and one year later was approximately zero, i.e. the first estimate of GVA growth was neither biased greater or lower than the outcome growth rate. The absolute mean revision was 0.1 percentage points after one quarter and 0.2 percentage points after a year.

Forecasts of the Scottish economy

As with the forecasts published in the last seven Commentaries, we give three alternative scenarios for growth, employment and unemployment in the Scottish economy from 2011 to 2013. We give a "Central" case, with "High growth" and "Low growth" as two respectively upper and lower growth alternatives. We intend these to capture the range of outcomes that are possible, given that there are considerable uncertainties surrounding any specific single or point estimates. While we do not give explicit probabilities for each of these outcomes, we see the "Central" scenario as being that which is most likely, while "High growth" and "Low growth" reveal the possible range of outcomes for the Scottish economy.. We will know the outcome for Scottish GVA growth in 2011 with the publication of Q4 2011 figures in April 2012.

The forecasts: Detail

In the three scenarios considered, the following elements are assumed to influence the demand for goods and services produced, and therefore the levels of economic activity, in the Scottish economy:

Households

In the Central scenario we forecast that household spending increases by 0.4% in 2011 and rises by 1.0% and 1.4% in 2012 and 2013 respectively. This is lower than the growth in household spending predicted by the OBR over this period. Three factors bear on this comparison being plausible. Earnings growth is anticipated to recover more strongly in the private sector than in public sector activities, where pay restraint is evident. As fears about job security for some, and slow income growth for public sector workers is revealed, the prospects for household expenditure remains weak. This could affect Scotland particularly badly with typically higher levels of public sector employment than the UK as a whole. Savings rates are anticipated to remain above levels seen prior to 2009 as households rebalance their debt levels and are reluctant to take on borrowing for consumption. High inflation in particular damages those on low and fixed incomes especially badly, with spending power of these households likely to be squeezed over the medium term, allied to the scheduled reductions in welfare spending affecting household incomes towards the end of the forecast period. Household spending is forecast to be closer to the OBR forecasts for the UK, in the High growth scenario, although for the reasons discussed above this is, in our opinion, an unlikely path for household spending in Scotland.

Government

In the Central scenario we anticipate real reductions in government current spending of 2.4% in 2011, -1.0% in 2012 and -1.9% in 2013. It remains the case that where government spending supports economic growth and activity will be through careful targeting of limited funds available to it, with declines in employment in public sectors likely by the end of the forecast period.

Investment

We reported in March's commentary that it appeared that investment spending in Scotland had responded later and fallen less than investment spending in the UK as a whole. This would be consistent with public sector projects being encouraged at a time of private investment projects being delayed, as appears to have occurred through 2009 and the first part of 2010 in the UK. The outlook for private investment appears to be relatively sluggish, with demand signals weak, with the exception of some export sectors. As private investment remains weak, the state of public investment remains poor with significant reductions in capital expenditures front loaded in 2011-2. Overall, we forecast investment spending to fall in real terms by 1.1% in 2011, before rising by 6.6% and 6.4% in 2012 and 2013 respectively.

Exports

In the Central scenario, we forecast a relatively strong ROW export growth by historic standards of almost 5% growth in 2011, increasing slightly in the two years subsequent. We would anticipate stronger performance in those sectors' exports to the rest of the world, rather than serving domestic or even UK markets. Even in ROW exporting sectors, however, continuing worries about the strength of the global, and particularly Euro area, recovery may mitigate some of the earlier hopes for immediate export led-growth. This is particularly given the lack of a significant rebound in exports from the increased competitiveness of the pound making Scottish exports cheaper on the international market. Exports to the rest of the UK grow relatively slower in comparison, broadly tracking UK domestic demand forecasts. For the real growth of UK exports, we anticipate growth of under 2% in each of the next three years, broadly as the UK consumer is likely to be a key part of the demand for Scottish goods and services, and incomes and expenditures are forecast to recover growth very slowly.

Tourism

Tourism spending is forecast to remain slower to recover than household spending as a whole through the forecast period. Discounting appears to remain a key feature of the Scottish tourist market, with occupancy levels remaining solid despite significant price reductions. It is likely that business spending on trips may recover as business growth picks up towards the end of the forecast horizon, however domestic spending on tourism activities – the key part of the market in Scotland – is likely to remain sluggish, with exceptions perhaps in niche sectors of the industry.

Results

All three scenarios forecast Scottish GVA growth for the calendar years 2011 to 2013. As before, we are forecasting year-on-year growth, so will know the accuracy of our forecasts with the publication of Q4 data for each year, typically around the April of the subsequent year. The difference between our forecast for 2010 growth reported in March 2011 and the outturn growth rate for 2010, as revealed by the publication of Q4 2010 data in April 2011, is discussed in the Box above.

The three scenarios – Central, High and Low – are presented in Figure 1, alongside (for comparison only) the forecasts for the UK over the same period by the Office for Budget Responsibility (reported in March 2011). Forecasts for UK growth in 2011 and 2012 from City and non-City forecasters were collated in June 2011 and these are included for comparison. Also included is the independent average of new forecasts for the UK between 2011 and 2013, dating from May 2011. The average of UK growth forecasts for 2011 has been revised down between May 2011 and June 2011 from 1.7% to 1.5%, reflecting the underlying weakness observed during Q1 data for the UK.

Figure 1: GVA growth for Scotland, 2005 to 2010 and forecasts for 2010 to 2013, annual real %

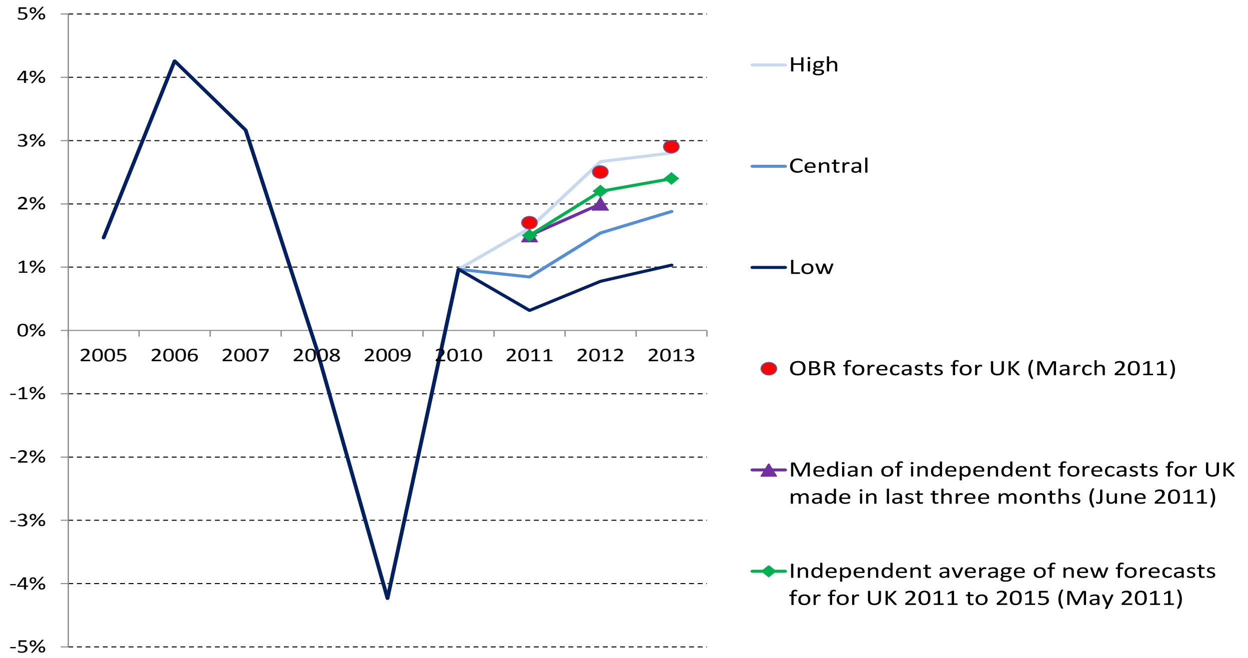


Table 2: Main forecasts of the Scottish economy (Central scenario), 2011 to 2013, % change from four quarters of previous calendar year

	2011	2012	2013
Gross Value Added	0.8%	1.5%	1.9%
Production	2.2%	3.6%	4.3%
Services	0.5%	1.1%	1.3%
Construction	0.5%	0.9%	1.1%

Table 3: Forecasts of GVA growth in three scenarios, 2011 to 2013

	2011	2012	2013
High growth	1.6%	2.7%	2.8%
Central	0.8%	1.5%	1.9%
Low growth	0.3%	0.8%	1.0%

Our Central forecast for growth in 2011 is now 0.8%, down from the 1.0% forecast in March 2011. This revision largely reflects more cautious outlook regarding household finances and expenditure plans in light of continuing uncertainty about employment security, the full impact of the fiscal consolidation and real incomes being reduced by higher than anticipated inflation. Our forecast for 2012 is lowered (by 0.1%) from March's forecast, and is now for growth of 1.5%. Our forecast for 2013 remains unchanged from March's Commentary at 1.9% under the Central scenario. Forecast headline growth in all three scenarios are shown in Table 2.

As before, we present forecasts for growth over the forecast period at broad industry groupings. Figure 2 gives the GVA changes in "production" sectors (classified as categories CDE of SIC 2007), while Figure 3 and Figure 4 give the GVA changes forecast in "construction" (category F) and "services" (categories G-P). These figures have been put on the same vertical axis scale, to ease comparison in the growth forecasts across these broad sectoral groupings.

Figure 2: Forecasts of GVA growth in Production under three scenarios, 2011 to 2013

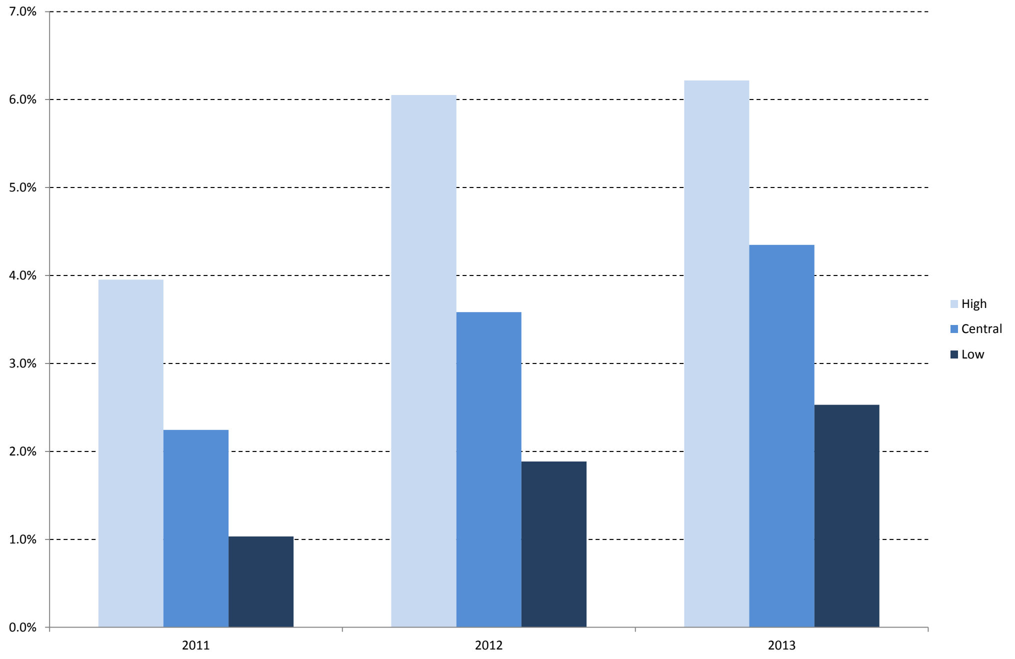


Figure 3: Forecasts of GVA growth in Construction sector under three scenarios, 2011 to 2013

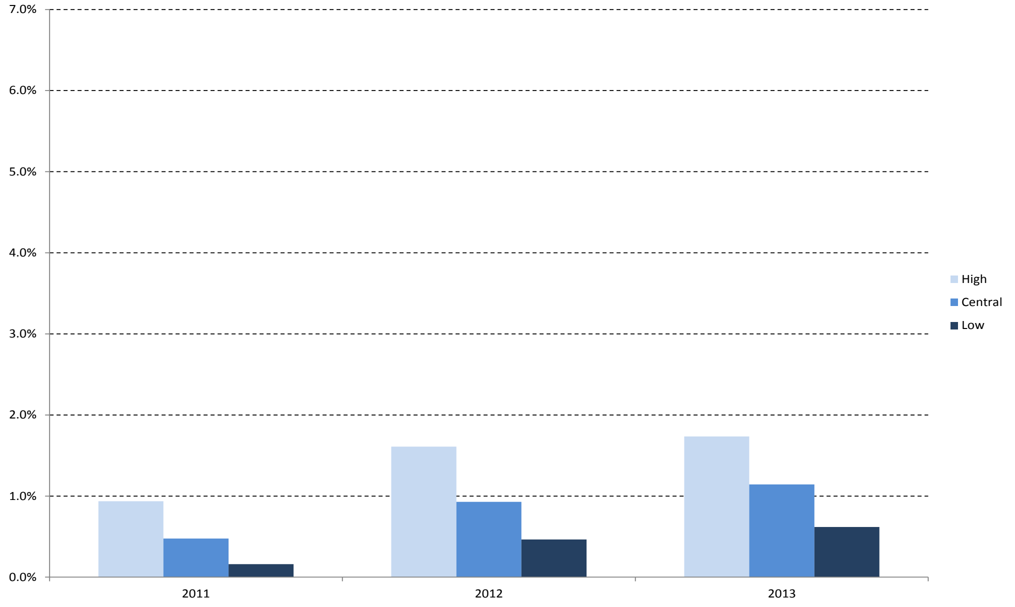
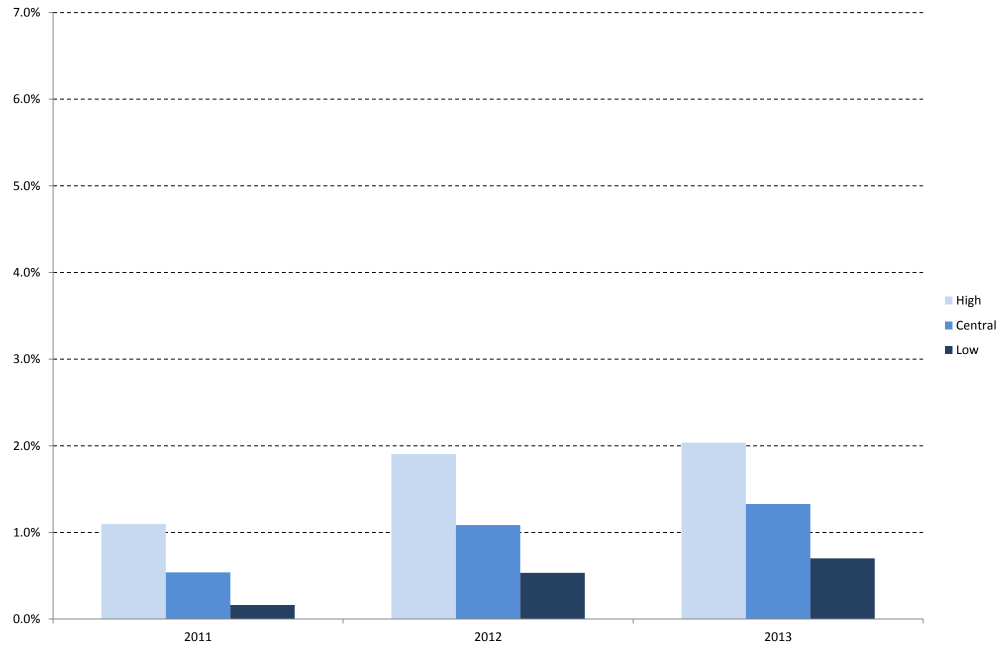


Figure 4: Forecasts of GVA growth in Services sectors under three scenarios, 2011 to 2013



Employment

Our forecasts for employment in Scotland for each of the years from 2011 to 2013 are given in Table 4 below. These forecasts are for (seasonally adjusted) employee jobs at the end of the year reported, rather than full-time equivalent job numbers or other measures of employment (e.g. workforce jobs). As with the GVA, we can assess the accuracy of our employment forecasts by examining the number of employee jobs in the quarter ending December. These are published early in the following year, with some revisions over the first half of the subsequent year as more complete data are available. As of December 2010, the number of employee jobs in Scotland stood at just under 2.3 million, and by the end of Q1 2011 had risen by 30 thousand to 2,325 thousand.

The major difference between employee and workforce jobs are that self-employment is included in workforce, but not employee jobs. Since these figures are job numbers, rather than the numbers in employment, these figures differ slightly from those reported in the labour market section of the Commentary.

Table 4: Forecasts of Scottish employee jobs (000s) and net change in employee jobs in Central scenario, 2011 to 2013

	2011	2012	2013
Total employee jobs (000s), Dec	2,315	2,334	2,373
Net annual change (jobs)	*20,600*	*18,548*	*39,849*
% change from previous year	0.9%	0.8%	1.7%
Agriculture (jobs, 000s)	33	34	36
Annual change	*748*	*981*	*1,493*
Production (jobs, 000s)	230	237	248
Annual change	*6,171*	*7,380*	*11,257*
Services (jobs, 000s)	1,915	1,925	1,950
Annual change	*12,489*	*9,605*	*25,249*
Construction (jobs, 000s)	137	137	139
Annual change	*1,192*	*582*	*1,850*

In our Central scenario, we therefore forecast that the number of jobs in Scotland at the end of 2011 will be 2,315 thousand. This is down slightly on the number of employee jobs in the first quarter of 2011. Within sectors, the largest percentage growth in jobs numbers is forecast for the production sectors, which are forecast to increase employee jobs by the end of 2011 by over six thousand. Services jobs are forecast to continue to expand slightly, and continue to provide the majority of the employee jobs growth over the year. Within production, the largest increases are forecast to be seen in the “Other manufacturing industries” sector, with smaller increases in “Mining and quarrying industries”, “Food and tobacco”, “Metals and metal products”, and “Electricity, gas and water supply”. Within services, total employee numbers are forecast to rise, as described above, however there are declines in employee numbers forecast in “Public administration and defence”, “Education”, and the “Financial services” sector. Some of these declines in employee jobs in 2011 in the “Financial services” sector are recovered during 2012 with employee jobs at the end of 2013 in this sector up slightly compared to the end of 2010.

In all, the number of jobs in 2011 is forecast to grow by just over 20,000 in 2011. In 2012 and 2013 the number of employee jobs is forecast to increase by 18,500 and almost 40,000 respectively. Total jobs at the end of 2013 are forecast to be 2,373 thousand, down 60,000 on employee jobs at the end of 2007, but up by 80,000 from the end of 2010. Table 5 shows the net growth in employee jobs forecast across each of the three scenarios between 2011 and 2013.

Table 5: Forecast net employee jobs growth in three scenarios, 2011 to 2013

	2011	2012	2013
High growth	36,317	41,882	60,675
Central	20,600	18,548	39,849
Low growth	9,621	2,661	21,431

Unemployment

We present our 2011 to 2013 forecasts for unemployment in the Central scenario, as measured by the ILO definition, as well as those receiving unemployment benefits, in Table 6. The preferred measure of unemployment is the ILO definition as given by the Labour Force Survey. This measure is typically preferred as it gives a better picture of the number of employees available for work in the labour market, and so a better measure of the spare labour capacity there is. One issue with increases in the inactivity rates over recent quarters in Scotland is that the unemployment rate has fallen despite weak growth, or even declines, in employment. The numbers unemployed by the ILO measure have typically declined, but there has also been increases in the inactivity rate, reducing the size of the labour force (and so the denominator in the calculation of the unemployment rate). As before, we would highlight the uncertainty around our unemployment estimates as there may be some further changes in the activity rates, and the size of the labour force as a whole as migration occurs, making forecasting more difficult than in more normal times for the labour market.

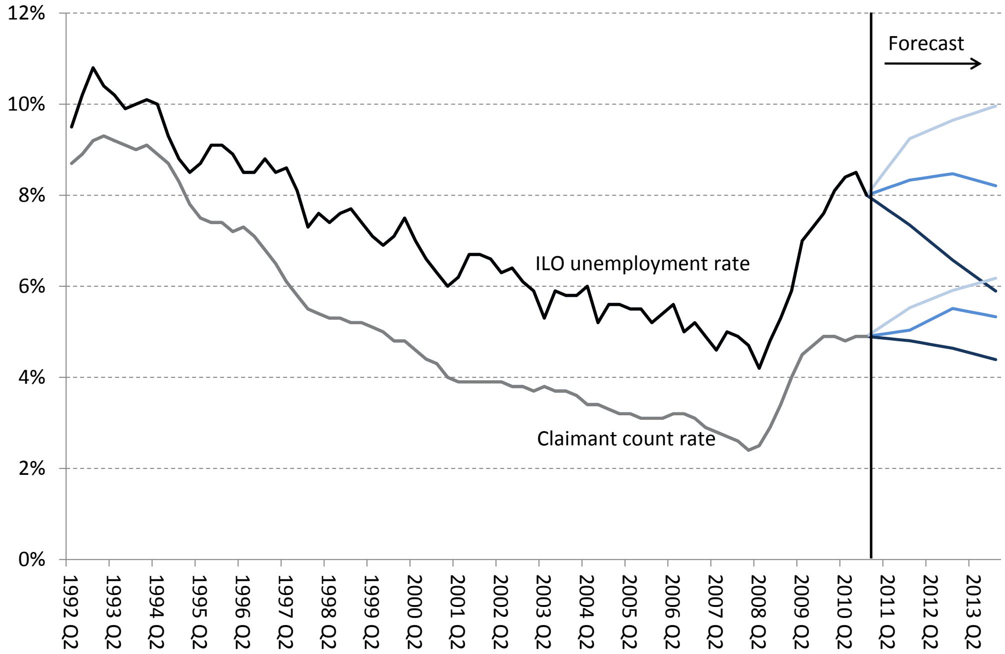
We show the claimant count and ILO unemployment rates over the period 1992 to 2010, followed by our forecasts from 2011 to 2013 in Figure 5.

Table 6: Forecasts of Scottish unemployment in “Central” scenario, 2010 to 2013

	2011	2012	2013
ILO unemployment	216,723	220,350	213,308
Rate[1]	8.3%	8.5%	8.2%
Claimant count	143,037	158,652	155,714
Rate[2]	5.0%	5.5%	5.3%

Notes: [1] = rate calculated as total number of unemployed on ILO definition divided by total economically active 16+ population.
[2] = rate calculated as claimant count divided by sum of claimant count and total workforce jobs. The latest figures for ILO unemployment in the three months to April 2011 are 207,000, at a rate of 7.7%. The latest figures for claimant count rate in May 2011 (on a provisional estimate) is 139,300, and a rate of 5.2%.

Figure 5: Scottish ILO and claimant count unemployment rate, past and forecast under three scenarios



Grant Allan,
17 June 2011

Vol.35 No.1, pp.18-29.