Outlook and appraisal

Overview

The recession in the UK economy may be over. The National Institute for Economic and Social Research in London called the end of the recession as occurring in March and is estimating small positive growth in April and May of this year. Due to lack of data the position in Scotland is much less clear. There is a clear danger of a “false dawn”, since it is not unknown for previous UK recessions to have one or two positive quarters of growth before growth turned negative again. Nevertheless, to the extent that the slowdown in economic activity is moderating and may be past its turning point, three reasons are offered for the turn round: re-stocking after considerable stock run-downs, short-time working and temporary plant closures from late 2008; a more price competitive UK economy due to the 20% fall in the value of sterling since the summer of 2007; and the effect of the significant policy stimulus through monetary and fiscal injections.

But to the extent that a recovery may be emerging in the UK it is likely to be slow and protracted. Households are reducing debt and raising savings so that consumer demand remains weak. Companies similarly faced with high debt levels and declining demand are also running down debt and cutting back significantly on investment. Export markets remain fragile with the IMF forecasting an 11% decline in world trade this year. But even as demand growth recovers there is concern that the banking sector has insufficient equity capital to enable credit to be supplied on a sufficient scale to support the recovery.

In the Scottish economy consumption remains weak, proxies for consumer confidence suggest the possibility of improvement as the decline in house prices which has been less in Scotland than in the rest of the UK appears to be moderating. Government spending is expected to remain strong in the current fiscal year but will begin to decline in real terms in 2010-11. Investment is falling in the UK and in the absence of specific Scottish data we assume the UK experience is mirrored in Scotland as in previous recessions. Tourism in Scotland is resilient buoyed perhaps by a weak sterling exchange rate, the events associated with "Homecoming Scotland" and the prospect of good weather. Scottish exports both to the UK and the rest of the world have been badly affected as worldwide demand contracted in the recession. There is some survey evidence on exports to the rest of the UK that the rate of decline is moderating. But the overall export position is difficult and likely to remain so for several months, with the benefit from lower sterling levels only beginning to fully emerge once world trade picks up.

Against this background our central forecast is for a decline in GDP/GVA of -2.9% in 2009. Compared with the Treasury's average of new forecasts for the UK, we are forecasting that the Scottish economy will perform in 2009 more strongly than the UK on our central and high growth forecast but slightly worse than the UK on our low growth forecast. Our forecasts for 2010 and 2011 represent an improvement on our February position reflecting the UK evidence that a trough to the recession may have been reached in the first half of 2009. However, for 2012 we are a little less optimistic than we were in February. This is because while we anticipate a recovery in Scottish GDP growth we do not expect it to be robust. Indeed, in the light of the evidence from earlier recessions we are projecting the recovery to be weaker in Scotland on all three scenarios than the average of independent forecasts for the UK. Nevertheless, Scotland returns to weak positive growth on the central scenario of 0.6% in 2011 led by manufacturing and somewhat stronger growth of 1.4% in 2012 but this is still some way below the 1.9% growth trend.

On jobs, our central scenario predicts losses this year and next amounting to nearly 137,000. Net jobs growth returns in 2011 strengthening in 2012 but net job creation over these two years of just over 28,000 indicates the extent to which we expect the recovery to be slow and protracted.

On unemployment, our central forecast is for a rise in the ILO measure to a peak of 212,600 in 2010 or 6.2% of the workforce and then a gradual fall after that. The Scottish labour market has been outperforming the UK when measured by the employment and unemployment rates. But this masks a significant switch from job losses into labour inactivity, rather than measured unemployment. Scotland's measured and forecast unemployment performance will depend crucially on the extent of this switch in future quarters.

Scotland's economy faces many challenges in successfully recovering from recession and establishing a favourable growth path. Analysis of structural change over the past decade reveals that Scotland became more of a service sector economy as the manufacturing share and electronics production fell. The Scottish economy effectively turned inwards and relied more on financial services, construction, property related and business services, and the public sector as manufactured exports played a smaller part in the demand for Scottish goods and services. Because of this Scotland may have difficulty in adjusting to a situation of higher household savings, lower domestic consumption growth, and severe cutbacks in public spending and/or higher taxation, which will require the economy to become more export and private sector orientated over the medium to long term. The required switch towards exports puts a premium on the competitiveness of manufacturing, since goods still account for the bulk of exports.

A key question here is whether Scottish manufacturing has the size, diversity and capability to take advantage of a recovery. This poses a policy challenge to the Scottish government and its economic development agencies as well as to the private sector in Scotland. New products embodying green technologies, life sciences, digital and creative media, have been mentioned as likely to make a significant contribution to Scotland's export led recovery. But the development of such products may not happen if left to the market alone and, in any event, are unlikely to be sufficient on their own to generate the required growth of the Scottish economy.

The expansion in Scotland's export base necessary to secure the desired increase in growth is unlikely to be achieved without significant successes in attracting inward investment. There are obvious difficulties in the attraction and retention of high quality foreign direct investment. But Scotland won't make the transition from recovery to a higher growth path without it, given that Scotland's domestic business birth rate remains stubbornly low and business R&D is amongst the lowest in the western world. The issue of how we can attract the required high value, inward investment to rapidly boost our export base should be a key topic of public debate in Scotland over the next few years.

Recent GDP performance

The latest official government GDP data for the Scottish economy were published on 22 April of this year and refer to the fourth quarter 2008. Overall Scottish gross value added at real basic prices fell by -1.7% in the quarter but rose by 0.5% over the year. This meant that with two successive quarters of negative growth the Scottish economy was technically in recession in the second half of 2008. The deterioration was slightly worse in Scotland than in the UK (Figure 1) with UK GVA contracting by -1.6% in the quarter, while output over the year rose by 0.7%.

The service sector accounts for around 74% of overall GVA and in the fourth quarter Scottish services contracted by -0.8%, much the same rate of decline as in the UK (Figure 2). Over the year, service sector GVA rose by 1% in Scotland compared to 1.5% growth in the UK. Manufacturing, accounting for 14% of Scottish GVA, contracted significantly in the final three months of last year by -4.6% in Scotland and -4.9% in the UK (Figure 3). This suggests that the incidence of the recession is being born heavily by manufacturing, reflecting the greater export activity in the sector, with Scottish manufacturing output holding up marginally better than in the UK. However, it seems unlikely that demand for Scottish and UK manufacturing products was contracting as rapidly as the GVA figures imply. Other evidence suggests that manufacturers were going through a major process of de-stocking allowing plants to be shut down temporarily and production to be cut back by more than the slowdown in demand. Over the year, to end December 2008 Scottish manufacturing GVA contracted by -0.7% while UK manufacturing suffered a GVA fall of 2.6%. Finally, of the other major sectors, construction, accounting for around 7% of Scottish GVA, contracted significantly in the fourth quarter, with output falling by -4.7% in Scotland and -4.9% in the UK (Figure 4).

Within services, the main sectoral drivers of contraction in the fourth quarter were the important real estate & business services (REBS), and retail & wholesale sectors, which account for 18% and 11% of total Scottish economy GVA, respectively. REBS production fell by an estimated -1.9%, while the output of retail & wholesale fell by -2.1%. The REBS contraction was greater in Scotland than in the UK where the sector contracted by -0.7% in the quarter. Retail & wholesale, in contrast, experienced a somewhat lower reduction in Scotland compared to its UK counterpart where activity fell by -2.4%. Other services (6% of total GVA) contracted by -3.3% during the quarter, a figure identical to that in the sector in the UK. Transport & communication (7% of Scottish GVA) cut back activity by -2% in Scotland in the quarter compared to a 1% fall in the UK. Of the remaining private service sectors, hotels & catering (accounting for 3% of GVA) grew by 0.5% in Scotland, compared to a fall of -0.6% in the UK and Scottish financial services (8% of GVA) grew by 2.2%. UK financial services, in contrast, exhibited neither growth nor decline (Figure 5).

Within manufacturing, the key sectors driving the fall in output in the fourth quarter were chemicals & man-made fibres (1.3% of total Scottish GVA) where activity contracted by -12.3%, food & drink (3% of total Scottish GVA) where the fall was -3.4% and engineering (5% of GVA) which suffered a 2.1% contraction. The figures for UK chemicals, food & drink, and engineering were -5.2%, -1.4% and -5%, respectively, indicating that engineering production is holding up better in Scotland, while the reverse applies for chemicals and food & drink. However, within engineering, the key electronics sector (3% of overall GVA in Scotland) contracted more in Scotland in the quarter by -2.9% compared to -1.9% in the UK. Conversely, transport equipment (1% of GVA) shrank by 2.8% in Scotland while its UK counterpart suffered a -7.3% drop in production. Similarly, paper, printing & publishing (1.4% of GVA) cut back GVA by -3.7% in Scotland compared to a reduction of -5% in the UK.

The course of the recession

Figure 6 charts the recent GVA performance of key Scottish sectors. The general impact of the downturn is clearly evident. Figure 7 offers a clearer picture of the course of the recession in Scotland by charting the percentage decline in GVA from the latest peak to the latest data point 2008q4, or the latest trough. Compared to our previous Commentary where the situation was charted up to the third quarter 2008, the addition of a further quarter has increased the number of sectors affected by the downturn, including now several manufacturing sectors, and led to an accumulation of GVA lost across sectors. One must be careful about making forward looking conclusions on the basis of evidence from one quarter but there is a hint in these data that financial services and hotels & catering may have reached the bottom in the third quarter 2008. Both experienced an upturn in the fourth quarter. However, we know that financial services and banking in particular are undergoing restructuring in Scotland, so it would not be unexpected if further output contraction was reported in the first quarter of this year. The hotels & catering sector might have been experiencing a “Homecoming Scotland” effect going into 2009 but this could easily be contradicted by new data. In contrast, as of the final quarter last year, the recession was continuing relentlessly in construction, mining and quarrying, electronics and real estate and business services, while beginning to embrace food & drink, retail & wholesale, other services and chemicals.

Data on first quarter Scottish GDP are not available until July 22nd. UK GDP fell by -1.9% in the first quarter of this year, with the result that GDP in volume terms has fallen by about 4.2% since the peak in the first quarter of 2008. There have been 4 successive quarters of decline to the first quarter of this year. It is highly probable that Scotland's GDP performance in the first quarter will be broadly similar to that of the UK. Scottish manufactured exports declined sharply in the final quarter of last year, by -9.6% in real terms, which equalled and reflected a sharp decline in merchandise trade volumes in the G7 and across the globe[i]. There appears to have been an easing in the slowdown in merchandise trade values in the first two months of 2009 according to OECD data. Nevertheless, the CBI Scotland survey of manufacturing reported the fastest rate of decline in export orders in the three months to April since January 1983. In addition, domestic orders saw their fastest rate of contraction since April 1999, with expectations at their weakest since July 1980. So, we should expect further large falls in Scottish manufactured and non-manufactured exports in the first quarter of 2009 and this is likely to be reflected in the first quarter GVA data.

The situation in the second quarter is much less clear. Our Review of Scottish Business Surveys below suggests that there is an emerging consistency that the pace of the recession is slowing down, especially after February. But we cannot say with any certainty that the recession has bottomed out in Scotland. However, at the UK level the respected National Institute of Economic and Social Research (NIESR) has called the end of the recession as occurring in March with some small degree of positive growth estimated for April and May. NIESR base their judgement on official UK industrial production data, which show that total production rose by 0.3% in April, with manufacturing[ii] growing by 0.2% in both March and April. The monthly series are volatile and one must be careful not to place too much weight on them but the data are persuasive that a turning point of sorts may have been reached. The lack of comparable data makes it harder to form a similar judgement for Scotland.

There are two further caveats. First, the index of production for the UK only accounts for around 18% of total economy-wide GDP. Secondly, if producing firms had begun to restock after the significant de-stocking evident in the second half of 2008 then production would be running ahead of demand with the possibility that the recovery in production could soon cease.

On the first of these, there is some evidence of 'green shoots' outside the production and manufacturing sectors. For example, the Purchasing Managers Index (PMI) for activity in the service sector went above 50 in May – suggesting a return to growth – in both the UK and Scotland, although after seasonal adjustment the Scottish figure remained below 50. The recent buoyancy in UK house prices may also be a reflection of some recovery of housing demand, which in turn might be expected to support demand generally. But we must not get carried away by these positive signs. The decline in house prices in the UK in the early 1990s was associated with some upward 'blips' against a background of a sustained fall in prices. And as we noted in the November 2008 Commentary, previous severe post war recessions in the UK produced negative growth lasting for 5 to 7 quarters, but not always consecutive quarters.

De-stocking and potential re-stocking also complicates the picture. There is little doubt that manufacturers in the UK ran down stocks considerably during the second half of 2008 and possibly the first of this year as well. It seems unlikely that demand was contracting at an annual rate of around 7% during that period. While shutdowns, short-time working and short-term lay-offs will have protected the cash flow of many firms, stocks cannot be drawn down indefinitely and production would be expected to pick up to restore desired stock levels. Hence, the recent apparent small recovery in production may have preceded any recovery in demand. But that upturn in production will in itself serve to boost demand as the incomes earned in producing additional output are spent. What we need to wait and see is whether current and future indicators of demand reveal that a recovery is underway, or whether the 'green shoots' are soon found to have shallow roots.

We noted in the previous Commentary that it is falling aggregate demand that is driving the contraction of GDP. Moreover, in countries such as the UK and US where there are high levels of household indebtedness the effect of falling asset prices – houses, shares – would be expected to have a significant impact on domestic demand. However, the global nature of the recession meant that countries contributing disproportionately more to world supply would bear the brunt of the global fall in aggregate demand and the associated fall in exports. Conversely as the fall in global demand slows and then begins to pick up the principal exporting countries should benefit. In the UK exports are less important to national income than in Germany, Japan and export 'platforms' such as Taiwan, Ireland and Singapore. This, in part, accounts for the greater fall in output in those economies compared to the UK. But the UK is still an important exporter, underlining the importance of the fall in the value of sterling compared to the Euro and the dollar. Sterling has rallied recently but its value is still around 20% lower than in the summer of 2007. The effect of the decline in sterling, encouraging a switch in domestic and foreign spending in favour of UK produced goods and services, has contributed to a reduction in the extent and depth of the recession here. Moreover, the UK recovery from recession may be quicker than elsewhere if the current sterling rate is maintained, although a competitive price advantage requires growth in world trade and demand for it to be most effective.

A further, and possibly the key, factor serving to mitigate the extent and depth of recession in Scotland and the UK is the stimulus given to UK domestic demand by the enormous monetary and fiscal policy injections. The Bank of England cut interest rates by 4 percentage points, so that by March this year Bank Rate stood at, and has remained at, 0.5%. The Bank through purchases of Government and corporate bonds introduced a significant programme of quantitative easing with the limit raised from £75 billion to £125 billion in May. Purchases of nearly £80 billion have been made by the Bank since March. The aim of these purchases is to increase the money supply and there is now some evidence that the growth rate of broad money is picking up[iii]. In addition, the significant fiscal injections will contribute to government borrowing rising to more than 10% of national income over the next two years representing a substantial boost to domestic demand.

But as the Bank Governor noted in his recent Mansion House speech, while the rapid decline in activity may be coming to an end the path to complete recovery may be slow and protracted. Households and companies will continue for some time to adjust their balance sheets as debt is reduced and saving increased. This will serve to constrain the rise in private spending to levels sufficient to sustain capacity levels of output. It cannot be guaranteed that there will be a smooth adjustment between the necessary increases in domestic and external private spending and the necessary reductions in government borrowing that will have to occur after 2010-11. In addition, recovery of private spending will hampered by the continuing constraints on the supply of bank lending. The low levels of equity capital held by the banks are likely to impair their ability to finance a sustained recovery. Banks themselves are finding it difficult to borrow to support lending with some banks, as the Governor pointed out, viewed as a worse credit risk than some of their customers! Further additions to banks' equity capital are likely to be required to enable credit to be supplied on a sufficient scale to support the recovery and this will take time.[iv]

After the recession

With evidence accumulating that the UK economy may have reached the trough of the recession and while the recovery could be slow and protracted it is reasonable to consider what the economy, and especially the Scottish economy, could look like after the recession. This is valuable in itself but also as a pointer to where policy might have a constructive role to play. The focus should be on Scotland's industrial or sectoral structure, its competitiveness and long-term growth prospects. We can obtain some insights, but no definitive answers, by first examining key trends in the Scottish economy, especially structural trends. Secondly, we then consider the likely impact of the recession on the Scottish economy in terms of its structure and competitiveness. Finally, we look at some of the implications for policy.

Table 1 and Figure 8 indicate the structural changes that occurred within the Scottish economy over the six years between 1998 and 2004. At the broad sectoral level, Table 1 reveals that the share of Scottish value added continued to decline in the production industries of mining and quarrying, electricity, gas and water supply and manufacturing. The share of these 3 sectors fell from 25.4% in 1998 to 17.6% in 2004, a decline of 7.8% points or 31%. Within that aggregate, the important manufacturing sector reduced its share by 6.2% points or 31% moving from 20.3% of total value added to 14.1%. Construction raised its share somewhat, no doubt in part due to the commercial housing and property boom, from 5.8% to 6.5%, while the service sector, constituting the bulk of the economy grew from 67% to 74.3% of Scottish value added. Within that total, both public and private sectors raised their shares of overall value added. The share of private services grew by 4.9% points or 10.4%, while the share of public services grew a little faster by 2.3% points or 11.4%.

Figure 8 provides further detail on the shifts within manufacturing and services. The share of financial services rose by almost 59% from 5.1% to 7.9% while the share of property related and business services rose by 11% from 16.1% to 17.9%. In manufacturing, the main change was the marked contraction in the production of electronics products with its share falling by 41% from 4.9% to 2.8%.

So over the six years to 2004, Scotland became more of a service sector economy, with financial services taking a much greater and public services a slightly greater share of activity both absolutely and compared to the rest of the UK. Construction activity also played a bigger role. As the manufacturing share and electronics production fell, disproportionately affecting Scotland, it is likely that exports played a smaller part in the demand for Scottish goods and services, while domestic demand grew in importance. The Scottish economy effectively turned inwards and relied more on financial services, construction, property related and business services, and the public sector.

The consequences of the recession, through the bursting of the property bubble, banking crisis, credit crunch and expected future contraction in public sector activity as future governments seek to deal with the sharp rise in the burden of government debt, appear to have serious consequences for Scotland's future competitiveness and growth. This should not be exaggerated because financial services in Scotland has so far performed better than expected during the downturn, in part because of the wide range of activities outside banking, including insurance, pensions and fund management. This could change since we must expect some contraction in the scale of banking in Scotland and that should be reflected in the GVA data later this year and next.

Both the Scottish and overall UK economy must adjust to higher household savings and lower domestic consumption growth and become more export and private sector orientated over the medium to long term. A lower level of the sterling exchange rate, which is the outcome of the lost UK financial sector export earnings, will raise export

Table 1: Share of Scottish Value Added – Broad Sectors 1998 and 2004

Sector		**1998**		**2004**	
Agriculture, forestry and fishing		1.8%		1.7%	
Mining and quarrying industries		2.2%		1.1%	
Electricity, gas and water supply		2.9%		2.4%	
Manufacturing		20.3%		14.1%	
Construction		5.8%		6.5%	
Services		67.0%		74.3%	
Of which:	Largely Public		20.1%		22.4%
	Largely Private		46.9%		51.8%

Source: Scottish Government IO tables for 1998 and 2004

competitiveness and help the switch of expenditure away from imports to domestic production. Reduced public expenditure and higher taxes will obviously lead to some shift away from public sector activity.

But Scotland may be less well placed to make the adjustment. The required switch towards exports puts a premium on the competitiveness of manufacturing, since goods still account for the bulk of exports. Scottish manufacturing has lost scale and is relatively smaller than manufacturing in the UK and key international competitors. The key question here is whether Scottish manufacturing in particular has the size, diversity and capability to take advantage of a recovery that will depend more on exporting and less on an allocation of resources to the public sector. But the same question can also be posed of the service sector in Scotland as well as manufacturing. A lower sterling exchange rate favours UK produced goods and services. If Scottish companies fail to take advantage of the opportunities there may be a switch in domestic Scottish expenditure in favour of goods and services produced in the rest of the UK than here in Scotland. Similarly, increased foreign expenditure on UK products may also favour the rest of the UK. The outcome in such circumstances would be a weaker recovery here and relatively lower trend growth.

This poses a policy challenge to the Scottish government and its economic development agencies as well as to the private sector in Scotland. The market and institutional failures and other impediments that disadvantage Scotland's export base need to be better understood and policy developed to deal with them. The public and private effort currently being put in to address the damage to Scotland's reputation in financial services needs to be continued and strengthened. New products embodying green technologies, life sciences, digital and creative media, have been mentioned as likely to make a significant contribution to Scotland's export led recovery. But the development of such products may not happen if left to the market alone and, in any event, they are unlikely to be sufficient on their own to generate the required growth of the Scottish economy.

The expansion in Scotland's export base necessary to secure the desired increase in growth is unlikely to be achieved without significant successes in attracting inward investment. There are obvious difficulties in the attraction and retention of high quality foreign direct investment. But Scotland won't make the transition from recovery to a higher growth path without it, given that Scotland's domestic business birth rate remains stubbornly low and business R&D is amongst the lowest in the western world. The question of how we can attract the required high value, high technology, inward investment to rapidly boost our export base should be a key topic of public debate in Scotland over the next few years.

Forecasts

The recession in the UK economy could be over. The National Institute for Economic and Social Research in London called the end of the recession as occurring in March and is estimating small positive growth in April and May of this year. Due to lack of data the position in Scotland is much less clear. There is a clear danger of a "false dawn", since it is not unknown for previous UK recessions to have one or two positive quarters of growth before growth turned negative again[v]. Nevertheless, to the extent that the slowdown in economic activity is moderating and may be past its turning point, three reasons are offered for the turn round: re-stocking after considerable stock run-downs, short-time working and temporary plant closures from late 2008; a more price competitive UK economy due to the 20% fall in the value of sterling since the summer of 2007; and the effect of the significant policy stimulus through monetary and fiscal injections.

But to the extent that a recovery may be emerging in the UK it is likely to be slow and protracted. Households are reducing debt and raising savings so that consumer demand remains weak. Companies similarly faced with high debt levels and declining demand are also running down debt and cutting back significantly on investment. Export markets remain fragile with the IMF forecasting an 11% decline in world trade this year. But even as demand growth recovers there is concern that the banking sector has insufficient equity capital to enable credit to be supplied on a sufficient scale to support the recovery.

Table 2: Forecast Scottish GVA Growth in Three Scenarios, 2009-2012

GVA Growth (% per annum)	2009	2010	2011	2012
High growth	-1.9	-0.5	1.6	2.1
February forecast	*-1.9*	*-0.4*	*1.1*	*1.7*
Central	**-2.9**	**-0.9**	**0.6**	**1.4**
February forecast	*-2.6*	*-1.2*	*0.5*	*1.53*
Low growth	-3.8	-1.7	-0.2	0.4
February forecast	*-3.1*	*-1.7*	*-0.1*	*0.6*

Table 3: Forecast Scottish Net Jobs Growth in Three Scenarios, 2009-2012

Net job no's	2009	2010	2011	2012
High growth	-62,827	-23,152	33,584	45,174
February forecast	*-73,007*	*-42,400*	*7,923*	*25,089*
Central	**-84,399**	**-51,451**	**11,301**	**26,824**
February forecast	*-94,179*	*51,440*	*3,037*	*14,476*
Low growth	-103,579	-66,894	-3,722	6,847
February forecast	*-108,984*	*-63,064*	*-6,639*	*10,734*

Table 4: Forecast Scottish ILO Unemployment in Three Scenarios, 2009-12

ILO 16+ no's and rate%		2009	2010	2011	2012
High growth	%	4.9	4.8	3.8	3.5
Central	**Nos**	**186,800**	**212,600**	**202,300**	**207,900**
	%	**5.5**	**6.2**	**5.9**	**5.5**
Low growth	%	6.0	7.1	7.2	7.4

In the Scottish economy consumption remains weak, proxies for consumer confidence suggest the possibility of improvement as the decline in house prices which has been less in Scotland than in the rest of the UK appears to be moderating. Government spending is expected to remain strong in the current fiscal year but will begin to decline in real terms in 2010-11. Investment is falling in the UK and in the absence of specific Scottish data we assume the UK experience is mirrored in Scotland as in previous recessions. Tourism in Scotland is resilient buoyed perhaps by a weak sterling exchange rate, the events associated with “Homecoming Scotland” and the prospect of good weather. Scottish exports both to the UK and the rest of the world have been badly affected as worldwide demand contracted in the recession. There is some survey evidence on exports to the rest of the UK that the rate of decline is moderating. But the overall export position is difficult and likely to remain so for several months, with the benefit from lower sterling levels only beginning to fully emerge once world trade picks up.

Against this background of extreme uncertainty we again offer three alternative scenarios for Scotland’s GDP/GVA growth, employment growth and unemployment over the medium term. We produce a “central” forecast, which is the one we hold with most certainty and this is bounded by “high growth” and “low growth” forecasts. The background to the forecasts and the forecasts in detail are discussed below in the section of the Commentary Forecasts of the Scottish Economy.

GVA Forecast

The key forecasts are summarised in Table 2 along with our February forecasts for comparison. We shall primarily focus on our central forecast here. GDP/GVA is forecast to decline by -2.9% this year, which represents a downgrading of our February forecast by -0.3% points. Compared with the Treasury's average of new forecasts for the UK, we are forecasting that the Scottish economy will perform in 2009 more strongly than the UK on our central and high growth forecast but slightly worse than the UK on our low growth forecast. Our forecasts for 2010 and 2011 represent an improvement on our February position reflecting the UK evidence that a trough to the recession may have been reached in the first half of 2009. However, for 2012 we are a little less optimistic than we were in February. This is because while we anticipate a recovery in Scottish GDP growth we do not expect it to be robust. Indeed, in the light of the evidence from earlier recessions we are projecting the recovery to be weaker in Scotland on all three scenarios than the average of independent forecasts for the UK. Nevertheless, Scotland returns to weak positive growth on the central scenario of 0.6% in 2011 led by manufacturing and somewhat stronger growth of 1.4% in 2012 but this is still some way below the 1.9% growth trend.

Employment forecast

The principal forecasts for net jobs growth are presented in Table 3. On our central scenario employment continues to fall through this year and next by nearly 137,000. Net jobs growth will return in 2011 strengthening in 2012 but net job creation over these two years of just over 28,000 indicates the extent to which we expect the recovery to be slow and protracted.

Even in the high growth scenario, the level of jobs in Scotland is still around 7,000 lower than peak employment in 2008, while on the low growth scenario total jobs lost between 2009 and 2012 amount to160,000. In all scenarios, the service sector, which is by far the largest part of the economy, experiences the biggest decline in job numbers in 2009 and 2010, with losses of 51,000 and 27,300 respectively. Financial services are especially affected shedding 14,000 jobs in 2009 and 12,400 jobs in 2010. But large job losses are also forecast in real estate & business services, retail & wholesale, and hotels & catering. Significant numbers of jobs are also lost in 2009 and 2010 in construction and manufacturing, around 21,000 in the former and 33,000 in the latter. By the end of 2012 neither sector will have replaced these job losses, with construction just under 20,000 jobs adrift and manufacturing with 21,000 jobs short.

Unemployment forecast

Table 4 presents our main forecasts for unemployment over the 2009 to 2012 time horizon.

We have revised upwards our forecasts for unemployment compared with the previous Commentary. This is because of our forecast for weaker GVA growth in 2009 and other adjustments. Scottish unemployment on the ILO measure and in our central forecast is predicted to rise to a peak of 212,600 in 2010 or 6.2% of the workforce and then fall gradually after that. The Scottish labour market has been outperforming the UK when measured by the employment and unemployment rates. However, this masks a significant switch, until the most recent quarter, from job losses into increased numbers of ex workers who are not available for work i.e. labour inactivity, rather than measured unemployment (see Overview of Labour Market section). Clearly, Scotland's measured and forecast unemployment performance will depend crucially on the extent of this switch in future quarters.

Brian Ashcroft
22 June 2009

Endnotes:

[i] G7 exports fell by -9.5% in 2008q4.

ii Manufacturing accounts for around 80% of the activity measured by the Index.

[iii] Speech by Mervyn King, Governor of the Bank of England at the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House on Wednesday 17 June 2009.

[iv] Mervyn King speech ibid page 4.

[v] In the jargon this would be a "W – shaped" recession.

Figure 1: Scottish and UK Quarterly GDP Growth, 1998q2 to 2008q4

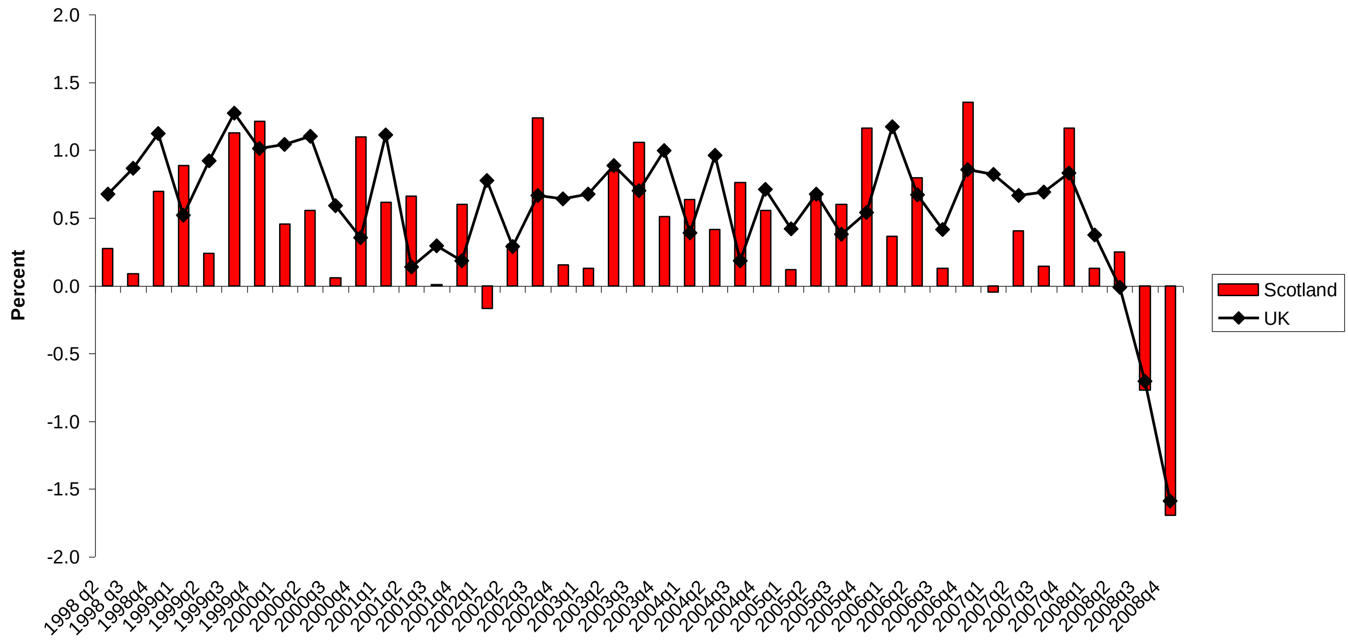

Figure 2: Scottish and UK Services GVA Growth at constant basic prices 1998q2 to 2008q4

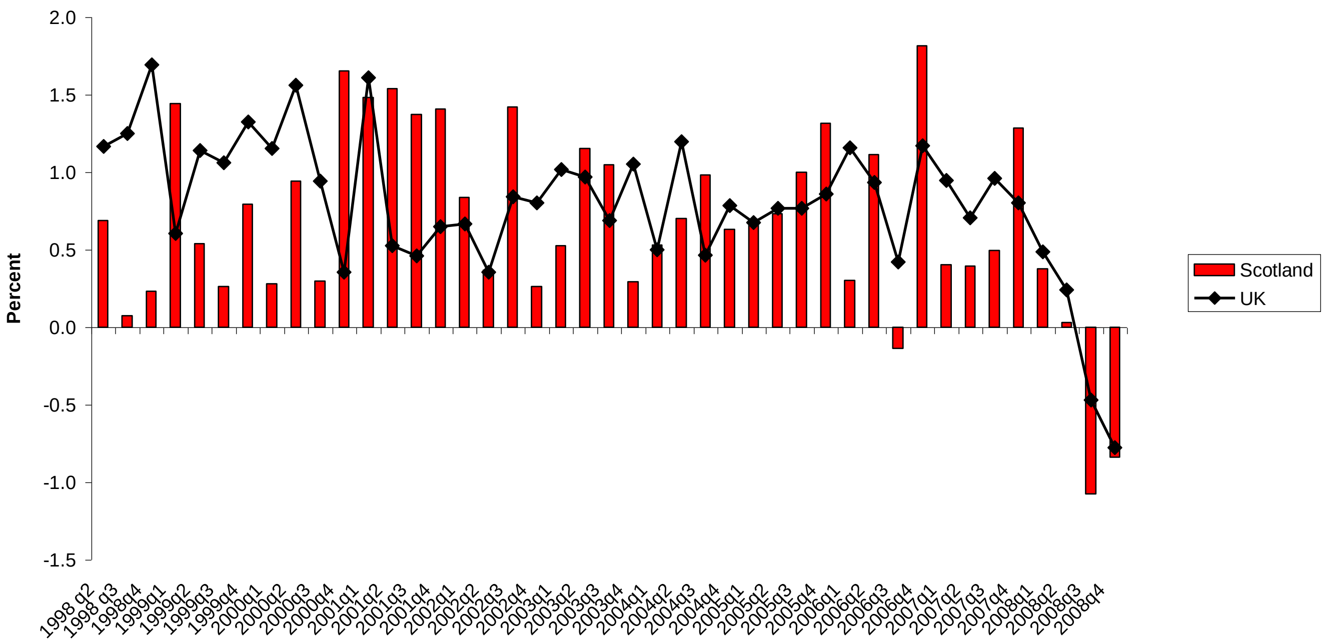

Figure 3: Scottish and UK Manufacturing GVA Growth at constant basic prices 1998q2 to 2008q4

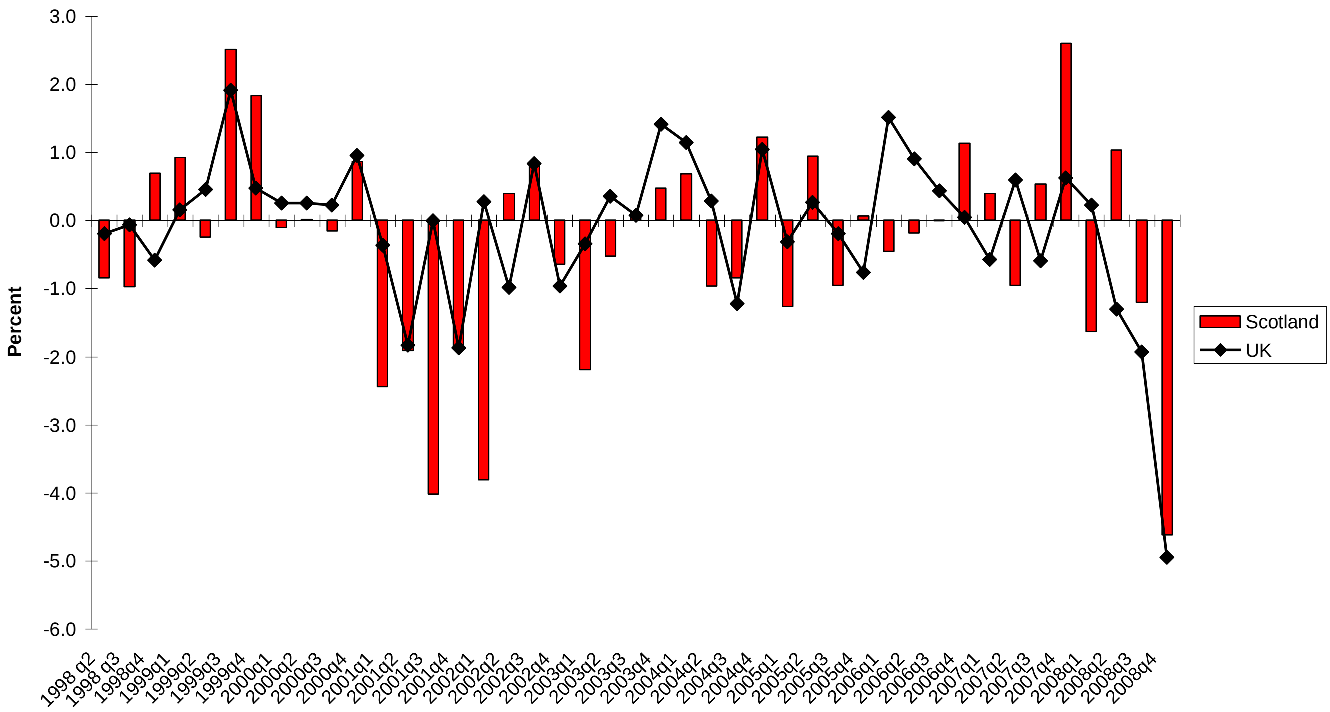

Figure 4: Scottish and UK Construction GVA Volume Growth 1998q2 - 2008q4

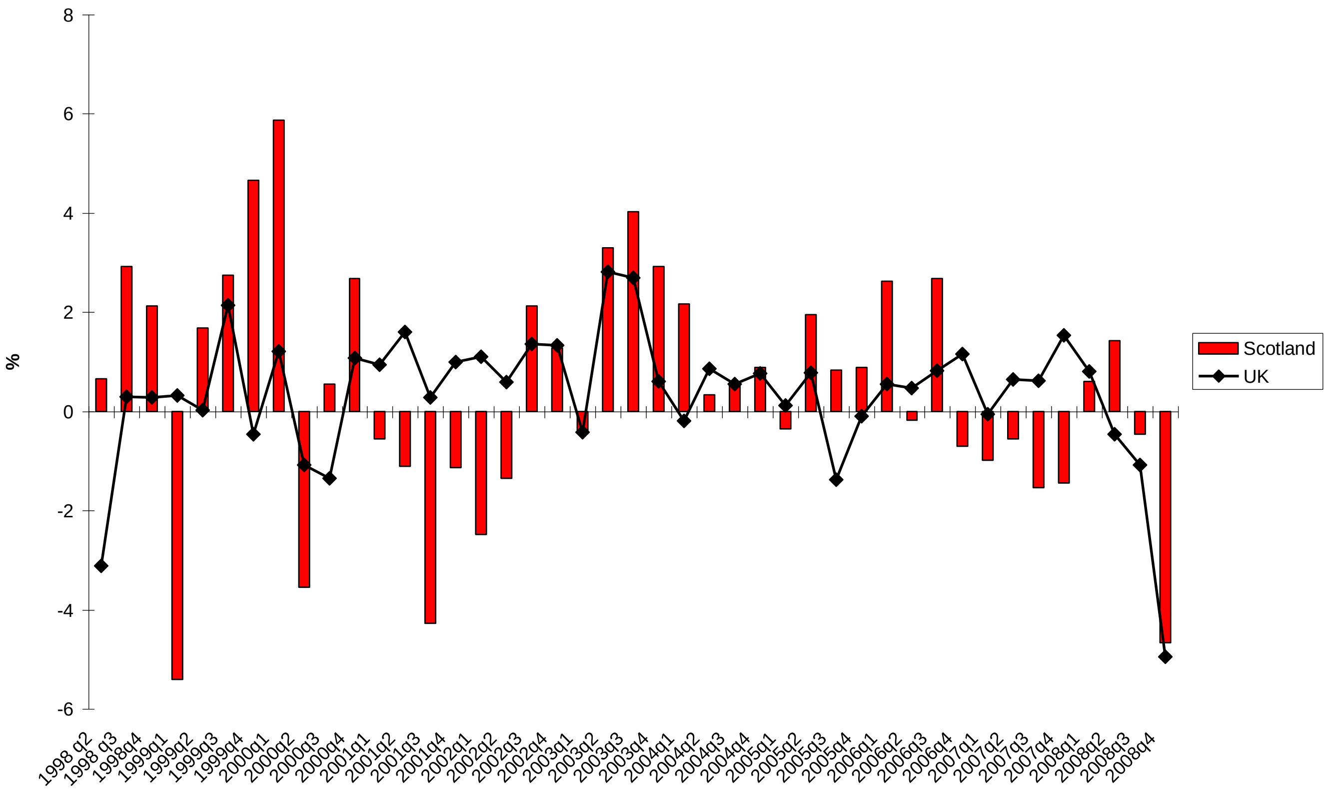

Figure 5: Scottish and UK Financial Services GVA Growth at constant basic prices 1998q2 to 2008q4

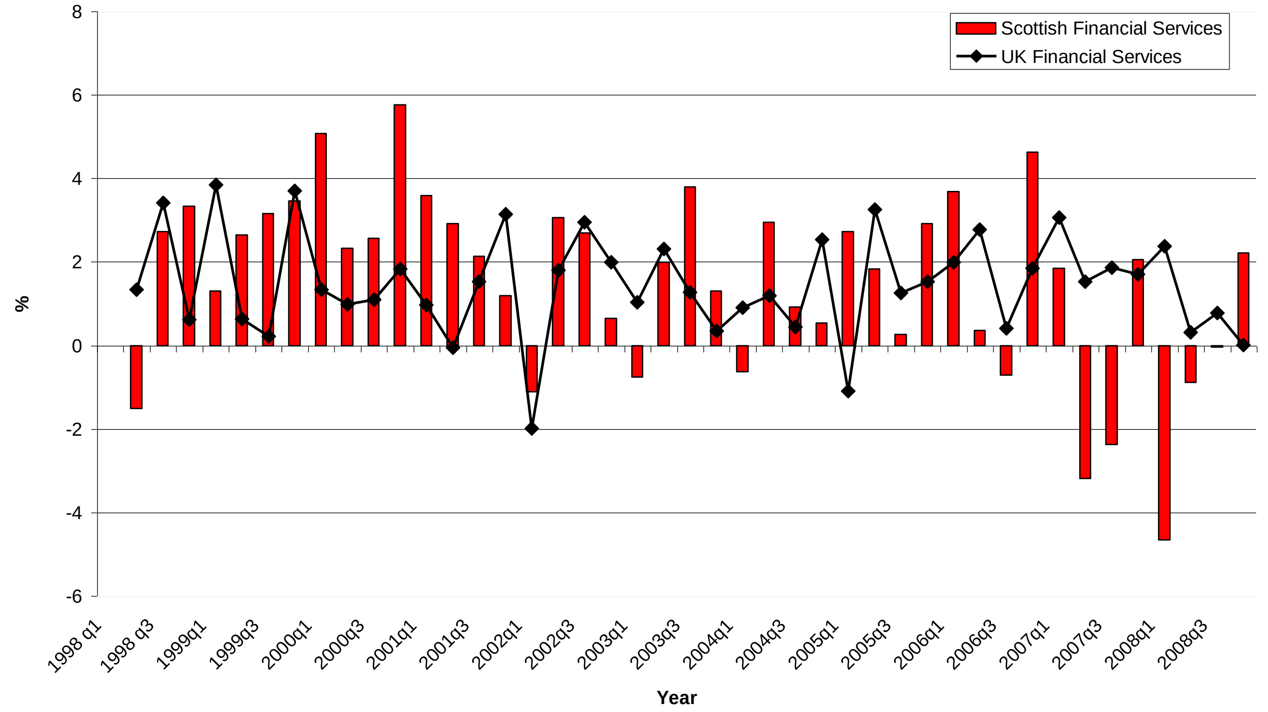

Figure 6: Growth of key sectors in Scotland 1998q2 to 2008q4

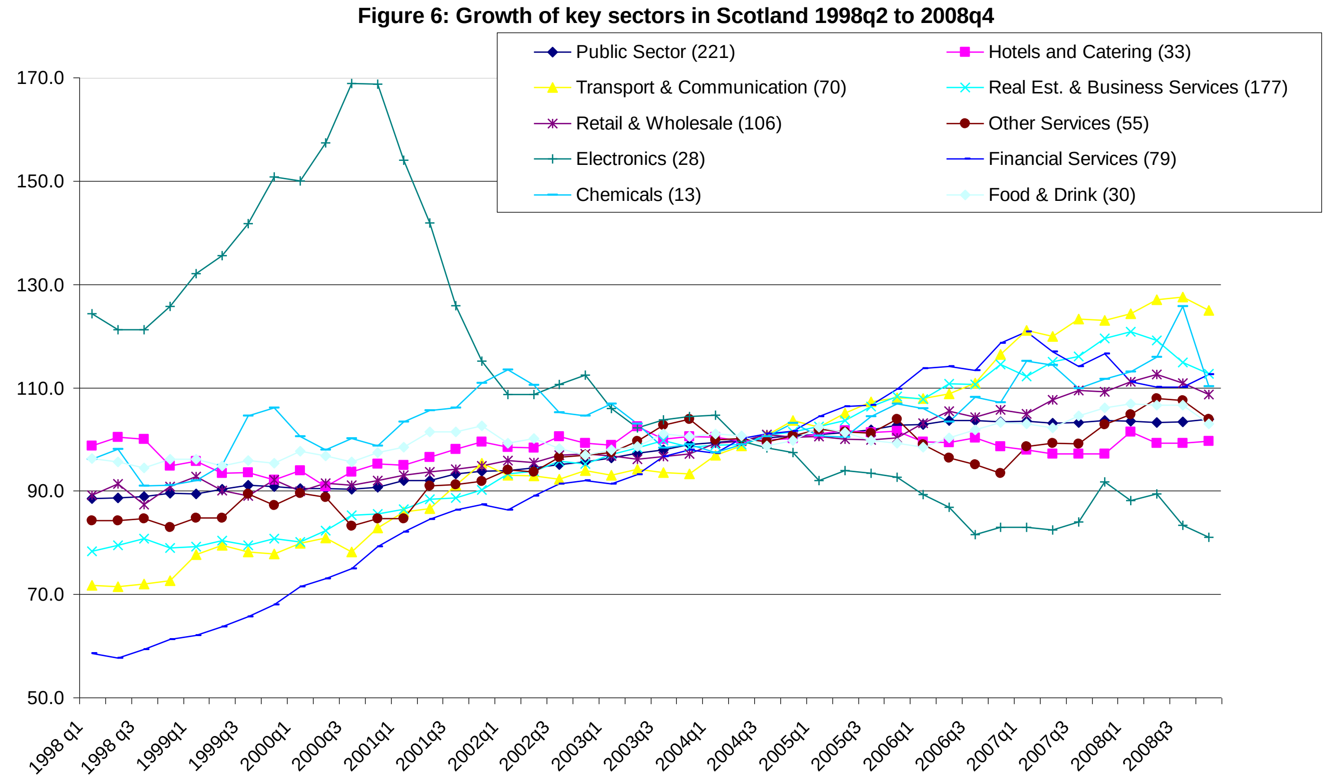

Figure 7: GVA percentage decline to 2008q4, or to trough, from latest peak, by sector

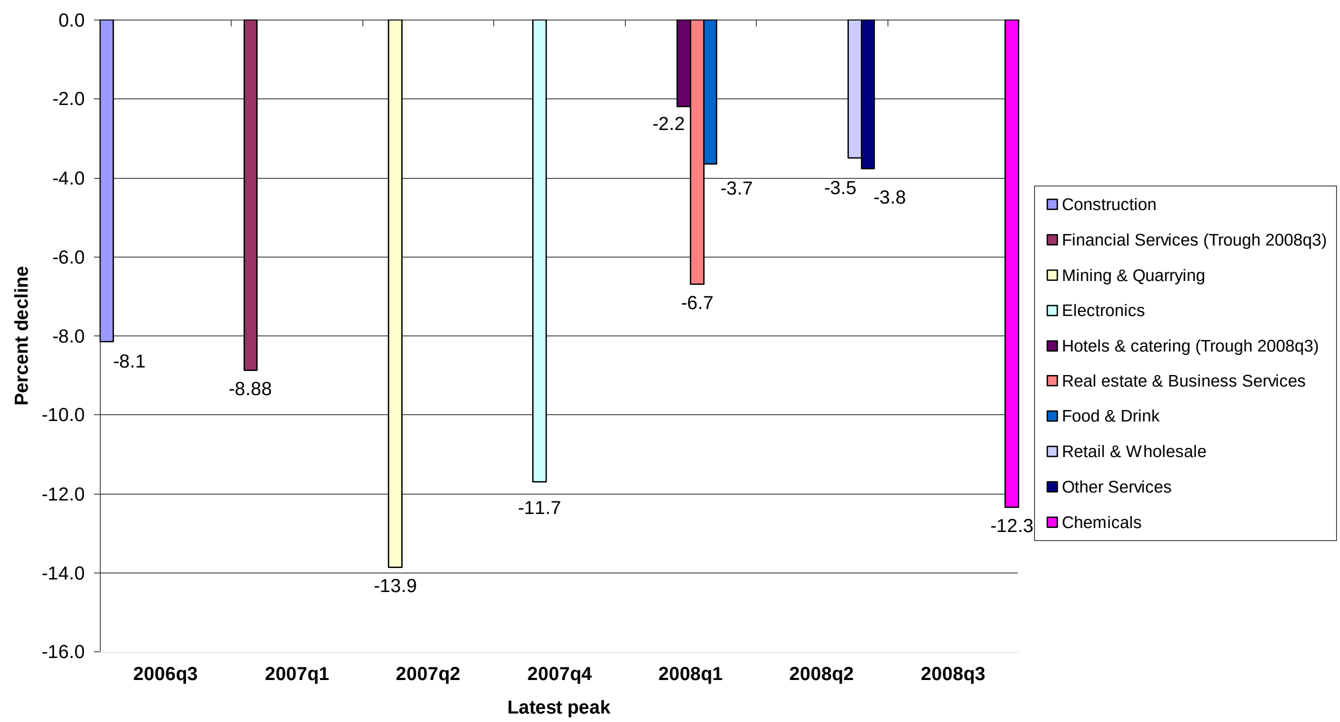

Figure 8: Sector shares of total Scottish value added 1998 and 2004