

# The Scottish economy

## Forecasts of the Scottish economy

### **Economic background**

The world economy has shown some signs of slight weakening in the first quarter of this year. There is also however some good news in that the uncertainty that was caused by the conflict in Iraq has largely been resolved. This was due to rapid progress in a land war without any major problems. Oil prices have fallen although not as sharply as expected but this has eased concerns about inflationary pressures. Equity markets have increased and confidence has been strengthened. Currencies have also realigned and this will probably narrow the current imbalances in the global economy in due course. The US continues to lead the world recovery and Japan has performed better than expected. On the downside however the Euro Area still appears to be relatively weak. The main issue facing the global economy at the moment is deflation with Alan Greenspan expressing concern over this issue while Wim Duisburg has dismissed deflation as a problem for the world economy.

The UK economy also weakened slightly with GDP forecast to be 1.9 per cent in 2003 and 2.4 per cent in 2004. The economy however is still doing quite well and employment is rising and unemployment is falling. The main issues for concern are the widening current account deficit and the optimistic forecasts by the Treasury with regard to Public Sector Net Borrowing (PSNB) – most commentators believe this will grow to around 3 per cent of GDP as the belief is that the Treasury have assumed tax revenues that are too strong. Inflation is close to the target and the Bank of England have held rates at 3.75 per cent giving them room to manoeuvre if the economy does not recover by the end of 2003.

In Scotland economic growth for 2002 was flat, very close to our forecast in the last QEC. Consumption and government spending are still important drivers of domestic demand. Retail sales in Scotland are outperforming those in England, especially over Easter. Tourism activity is mixed with some areas having a very poor performance and others doing relatively well. Exports to the both the UK and the Rest of the world continue to be very disappointing. This has been a vital factor for Scotland's poor economic performance over 2002. Despite this the economy has steadily rising employment are unemployment is declining.

The outlook for the world, the UK and the Scottish economy over the next 12 months is promising but it is not that encouraging over the short-run. Confidence indicators are demonstrating that short-run prospects are relatively poor but that performance is expected to improve in latter half of 2003 and certainly by 2004.

## The forecast in detail

### GDP

Table 1 presents our forecasts for the Scottish economy. There have been several revisions to the Scottish Executive index for GDP in the last quarter. We present our forecasts for GDP and broad sectoral output in Table 1 for the period 2002 to 2004. Our forecast for GDP growth for 2002 was very close to the actual outturn but we are still awaiting any revisions to the data before making any significant adjustments. We have had some minor changes within manufacturing and two changes within services. We are forecasting that the Scottish economy will grow by 0.2 per cent in 2002 and grow by 1.3 per cent in 2003. We expect more economic activity in the latter half of 2003 than during the first half. This upward revision of this forecast has been due to increases in service sector activity. Retail, hotels and catering, transport and communication have all performed better than expected. Growth is forecast to be 2.2 per cent in 2004 and close to this in 2005.

**Table 1: Main forecasts of the Scottish economy, 2002-2004**

	2002	2003	2004
<b>GDP</b>	<b>0.2%</b>	<b>1.3%</b>	<b>2.2%</b>
Agriculture	0.0%	-1.9%	-0.3%
Manufacturing	-11.8%	-1.1%	0.5%
Manufacturing (ex Electronics)	-6.5%	-1.5%	0.3%
Construction	-3.1%	1.2%	3.2%
Services	3.8%	2.4%	2.6%

Source: Fraser of Allander Institute, June 2003.

### Output

Agriculture is forecast to have relatively flat growth in 2002 and to decline by 1.9 per cent in 2003. The outlook for this sector is slightly gloomy because of the problems of fishing. The "agricultural sector" has itself recovered from FMD etc. quite well and in 2002 Total Income from Farming rose by 13 per cent (£43 million). Most of this was due to rapid compensation schemes and from the subsidies for sheep and cattle. Prices continue to fall, particularly cereal prices.

Manufacturing remains relatively weak but there are clear signs that some sectors will recover towards the end of this year or into 2004. Over 2004-06 the best performing sectors within manufacturing in terms of output are;

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

Manufacturing is forecast to recover in 2004, unchanged from our last forecast. The strength of the recovery is likely to be modest. All sectors except one is forecast to have positive growth by 2005.

Services continue to drive Scottish growth. We forecast that Scottish services grew by 3.8 per cent in 2002 and by 2.4 per cent in 2003. Growth is forecast to be 2.6 per cent in 2004. For 2003 the strongest performances for services are forecast to be retail and wholesale, financial services and other services. In 2003 the weakest performing sectors include hotels and catering and transport and communication.

Construction is forecast to decline by 3.1% in 2002 but to grow at 1.2 per cent in 2003. For 2004 output growth is forecast to be 3.2 per cent. Public private partnerships, strong housing demand and planned investment in transport are significant drivers of the construction sector.

### Employment

We present our forecasts of employment 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. We are forecasting that the number of jobs in the Scottish economy will be 2,229,400 in 2003 and 2,274,100 in 2004. This represents a net job change of 33,500 and 44,700 respectively. In services we forecast that 33,700 jobs will be created in 2003 and 36,500 in 2004. Given the relatively weak performance of the economy it would appear that only 7,700 service sector jobs were created in 2002. 13,600 jobs were lost in manufacturing in 2002 resulting in a net job loss of 6,400 in the Scottish economy for 2002. The forecast for manufacturing employment is 275,000 for 2003 and 277,200 for 2004. Agriculture is forecast to lose 600 jobs over the period, which is similar to the job gain from 2002. In construction growth is forecast to create 10,100 jobs in the period 2003-04. Depending on the actual output of the sector this may have to change.

The drivers of employment are clearly the services sectors. The public sector is particularly important. Other services and retail are also major contributors to net job creation. In manufacturing; chemicals, textiles, paper, printing and publishing, other manufacturing and transport equipment are the main sectors that drive manufacturing job creation.

**Table 2: Forecasts of Scottish employment and net employment change, 2002-2004**

	2002	2003	2004
Total Employment (000s)	2,196.0 (-6,400) (44,700)	2,229.4 (33,500)	2,274.1
Agriculture	35.2 (700)	34.7 (-500)	34.5 (-100)
Manufacturing	275.9 (-13,600)	275.0 (-1,000)	277.2 (2,200)
Construction	123.3 (-1,700)	124.6 (3,300)	128.5 (6,800)
Services	1723.8 (7,700)	1757.5 (33,700)	1794.0 (36,500)

Source: Fraser of Allander Institute, June 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 165,000 (6.4 per cent) in 2002 and 162,400 in 2003 (6.2 per cent). Claimant count is forecast to be 104,500 (4.0 per cent) in 2002, 96,400 (3.7 per

cent) in 2003 and 95,000 (3.7 per cent) in 2004. There is little change to the forecasts of unemployment and unemployment continues to exist at historically low levels. The labour market has performed relatively well during the downturn and we expect this to continue.

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

	2002	2003	2004
ILO Unemployment (levels)	165,000	162,400	156,400
Rate	6.4%	6.2%	5.9%
Claimant Count (levels)	104,500	96,400	95,000
Rate	4.0%	3.7%	3.7%

Source: Fraser of Allander Institute, June 2003.

The forecasts for the Scottish economy are robust and in most cases close to the outturn data from official sources. The model outcomes are consistent with previous forecasts. The outlook for the Scottish economy is for slow but steady recovery to near trend growth in 2004 and 2005. The labour market is forecast to perform well and unemployment is forecast to remain at relatively low levels. Recovery is not expected until the latter half of 2003 and manufacturing is not forecast to recover until 2004. As world trade picks up due to increased economic activity then Scottish exports should receive a further boost. This should increase manufacturing activity further.

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