University of Strathclyde Business School

Fraser of Allander Institute

Economic Commentary

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Foreword

The outbreak of COVID-19 has brought significant operational disruption and uncertainty for businesses across all industry sectors, as various levels of restrictions have severely impacted balance sheets over the last 10 months. While the roll-out of a vaccine is welcome news, the effect of the pandemic will likely continue to be felt by business and society for many years to come.

This quarter's Commentary highlights that the ongoing economic crisis remains severe, and while Government intervention has mitigated some of the human cost of the economic downturn for now, there are continuing challenges on the horizon. With the end of the furlough scheme, unemployment is forecast to rise to 7.5% - almost double what we've been used to in recent times - while inflation levels and wage growth will remain low.

Young people are a group that has been disproportionally impacted by the COVID-19 crisis. From the teenagers facing education loss and exam disruption to those starting out in their careers. Earlier this year, Deloitte's Global Millennial Survey explored the views of millennials and Gen Zs and found that almost 30% of Gen Zs and a quarter of younger millennials had either lost their jobs, or been placed on temporary, unpaid leave due to the pandemic.

This is something recognised by Scotland's public. Our latest State of the State report ranked opportunities for young people in Scotland as the country's greatest concern as we come out of the pandemic, with 68% of those surveyed citing this point, in comparison to a UK average of 58%.

While the Scottish Government has already acknowledged this and introduced measures such as the jobs guarantee scheme and the transition training fund, the private sector has a crucial role too. As businesses look to rebuild following the pandemic, they have the opportunity to innovate and transform and create much needed skills, jobs and employment opportunities.

Climate change has also been brought into sharp focus by the pandemic and Scotland's support for a green recovery is another key takeaway from this year's State of the State. More than half of Scotland's public (53%) believe that tackling climate change in the economic recovery from coronavirus will create jobs and boost the economy, compared to 45% UK national average. In Scotland this should perhaps not come as a surprise, we do have a unique opportunity to develop world-class technology and skills in the renewable and clean energy sectors.

As the public mood indicates that economic recovery should not come at the expense of environmental targets, businesses are likely to take the lead from public bodies and governments who are increasingly conscious of climate-related investment. Additionally, a mental shift in how businesses perceive decarbonising the economy could follow. Often viewed as a costly endeavour, with minimal returns, the pandemic has instead increased investor interest in green assets, which could drive new opportunities further down the line, leading to innovative new business models. The impact of this has already been seen in the shift to renewable energy, the electrification of transport, changes to agricultural practices, and the transition to low-emission and higher-efficiency industrial processes.

By using these technologies and keeping momentum going, it is likely businesses will be able to identify increased efficiencies, more targeted intervention, and innovations. This will deliver both environmental and economic benefits which will be critical as the world looks to rebuild after the pandemic.

Thinking ahead to the next twelve months, while much is unknown, it can be argued that 2021 should aim for a recovery that prioritises and pursues the potential of green growth, which has the scope to deliver jobs and opportunities long-term, for young people and beyond.

This progress may be accelerated with the successful deployment of a vaccine, which could support strong rebound activity in 2021. However, businesses are far from out of the woods, and leaders should continue to build on their operational resilience to ensure they are in a strong position for what will likely be an uncertain start to the year.

Steve Williams
Senior Partner for Scotland
Deloitte

December 2020

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Summary

There is finally a light on the horizon, and many of us can now imagine a world without the restrictions we are operating under. While many parts of the world have re-entered lockdown – or have partially locked down – there is tentative hope for the year to come.

As we speak, initial rollouts are beginning of vaccines that will aim to ensure that 2021 will be a better economic year for Scotland than 2020.

Despite this welcome news, it will take some time for the country to get to a point where significant restrictions can be eased. This will continue to have a particular heavy toll on key sectors in our economy, such as tourism and hospitality. Moreover, the roll out of a sustained vaccination programme across the world will take many months, meaning that the global outlook – crucial for Scotland's exports and investment prospects – remains hugely challenging.

As a result, the ongoing economic crisis remains severe: there is still a hard recovery to come. With unemployment soon to rise, and a renewed squeeze on wages across the public and private sector, it will feel like Scotland is in a recession for some time yet.

We have seen in recent weeks the decline of major employers whose demise has been caused or exacerbated by the COVID crisis. Whilst we saw some recovery over the Summer months as restrictions were eased, activity is still well below pre pandemic levels: and is likely to have taken a further hit a restrictions were reintroduced in October and November.

May families will welcome the chance for a brief reprieve this Christmas as restrictions are eased around the big day. But it may well require further restrictions in January to get the virus back under control. We should not forget of course the end of the EU Exit Transition period in January 2021, which may lead to disruption for many firms who have weathered the COVID crisis.

In our commentary today, we have set out three possible scenarios for growth: a central scenario, and then ones that are more optimistic or pessimistic. It is worth saying that due to the optimistic vaccine news that these scenarios are all more positive than in our September Commentary. However, our central scenario sets out that it is likely to be the middle of 2022 before growth gets back to pre-pandemic levels, with unemployment remaining well above pre-COVID rates for longer-still.

A key feature of this crisis has been the unprecedented levels of Government support that have been put in place to help businesses and individuals get through. A key measure has been the UK Government's furlough scheme, which has now been extended to the end of March 2021.

Despite this, though, there is likely to be a serious toll on individuals, with unemployment forecast to rise to 7.5% by the second quarter of next year as this scheme is rolled back. This is pretty much double the rates we have been used to in recent times.

Business support schemes and other measures have seen an additional £8.2 billion flow to the Scottish Government to spend on supporting the economy through the pandemic. This is an eye

watering amount when we compare it to the roughly £30 billion Scottish Budget.

The monies available during the coming financial year are predicted to be substantially less than this year. In the Spending Review on 25th November, Rishi Sunak set out that there would be around £1.3 billion of COVID-related support available to the Scottish Government during 2021-22.

In these challenging and uncertain times, the Scottish Government will set out their budget for 2021-22 on 28th January. Despite the overall increase in their budget of £2.4 billion, it is likely that Kate Forbes will have some difficult decisions to make. Accompanying this commentary, we present Scotland's Budget Report 2020, which discusses some of these issues.

The pandemic has shone a spotlight of some of the existing inequalities that exist within our society, which are likely to have only been exacerbated in recent months. In previous budgets, it is fair to say that the impacts on different groups may not have been considered as fully as it should be, but it is even more important now: whether that is different groups of the population, or different areas of the country, or different parts of our economy.

So, budgets will need to be flexible in the amount and type of support that they provide.

The Scottish Government has limited scope to adapt its fiscal plans. There is a case for saying that current arrangements are not problematic – the Scottish Government has a good idea about what its likely minimum funding envelope is, and can have confidence that additional funding will flow its way given that the UK Government is very open to the idea of allocating further funding if the recovery turns out to be more protracted.

But the dependence of the Scottish budget on policy choices taken in England will continue to be a source of tension, particularly when the economic and health impacts of the pandemic remain high. There is a strong case for discussing some combination of: greater inter-governmental coordination and communication around budgeting; further commitments to funding certainty by the UK Government; and additional fiscal flexibilities for the Scottish budget.

In terms of specific policy decisions, the government faces a wider range of challenging decisions than it does in a normal year. In relation to Covid, it must decide which elements of Covid support it can unwind most quickly, and which it must continue to fund in some way in the early part of 2021/22. Health is likely to absorb much of the Covid funding in 2021, leaving difficult decisions about how to balance remaining support between different sorts of businesses, household and organisations.

Tax choices are also constrained, and there is a difficult balance to be struck between revenue raising, distributional impact and political acceptability.

As we have touched on above, the backdrop to the Scottish budget will be significant uncertainty around the economic and health outlook; ongoing intergovernmental tensions on a variety of matters including funding flexibility and certainty, potentially exacerbated following a no-deal exit from the EU transition agreement; and the Scottish elections in May. The inevitable politicking around all this will hopefully not detract from a focus on the core issues the budget must address.

Fraser of Allander Institute
December 2020

Outlook and Appraisal

Introduction

In this section of the commentary, we summarise some of the latest indicators covering the global, UK and Scottish economies.

There is a mountain of information that we could cover, so we do not try to replicate it all here. Our website – www.fraserofallander.org – provides a regular update and analysis of developments.

Instead we trace some of the key charts and commentary on economic activity, jobs, household incomes, and the latest thinking on the recovery. The outlook for the next few months and years looks incredibly uncertain.

Once again, given such uncertainties, we have avoided providing a specific point estimate or a central forecast for the next few years. Instead, we highlight different scenarios.

What do they tell us?

The optimistic scenario sees the economy recovering relatively quickly over the next year with a full recovery across the economy as a whole by February 2022. With recent positive announcements of vaccine trial effectiveness, and the Pfizer & BioNTech vaccine recently administered in the UK, there is a greater likelihood of an optimistic scenario than in our last commentary.

However, there is likely going to be challenges distributing the COVID-19 vaccine – whether that be regarding the production of the vaccine, the cost or the temperature needed to keep the vaccine cool – therefore, the economy may not bounce back to normality immediately. Instead, the rollout of vaccines might take some time and so will the reopening of the economy.

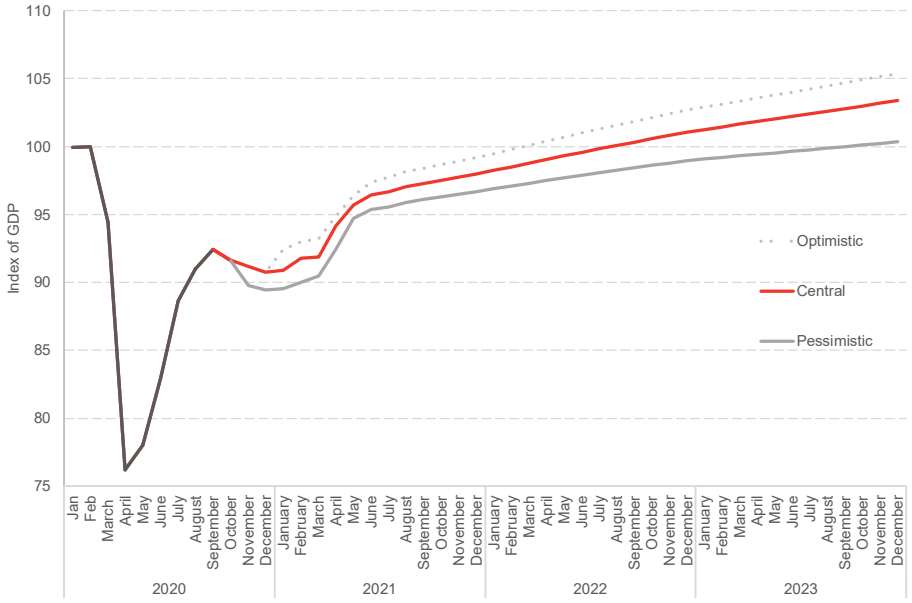
We discussed in our last commentary that there are likely going to be scarring effects from the current recession – unemployment is expected to rise in 2021 and some businesses may not open back up. The central scenario reflects these challenges. In this scenario the economy as a whole does not recover until the end of Summer 2022, under two years from now.

Currently the economic outlook remains extremely uncertain. The Scottish economy is in a tiered restriction system with large parts of the country, particularly the west of Scotland, in the highest tier. So, although there is room for optimism there is still a tough winter ahead and challenges for health services and the economy.

When furlough ends in March it remains to be seen how employment will fare – the furlough scheme has kept unemployment artificially low throughout this pandemic and there is a real risk of a spike in unemployment.

The pessimistic scenario involves an economic recovery that is sluggish due to firm closures, rising unemployment and a slow rollout of the vaccine. Under this scenario the Scottish economy is expected to reach pre-pandemic levels in under 3 years from now.

Chart 1: Scottish Economic Growth scenarios: 2020 to 2025 based upon return to 'pre-crisis level'



Source: *Fraser of Allander Institute*

Table 1: Scottish Economic Growth scenarios: 2020 to 2025 based upon return to 'pre-crisis level'

	Trough	Return to pre-crisis level	Recovery time	2020 annual growth	2021 annual growth
Optimistic	Apr-20	Feb-22	1 year, 10 months	-11.3%	7.5%
Central	Apr-20	Aug-22	2 years, 3 months	-11.3%	6.3%
Pessimistic	Apr-20	Sep-23	3 years, 3 months	-11.5%	5.4%

Source: *Fraser of Allander Institute*

Where are we now?

After a strict spring lockdown life began to return to some normality over the summer as pubs, restaurants, cafés and high street shops opened their doors again.

However, with the number of positive COVID-19 cases rising across the country – albeit there has been a significant increase in testing carried out – restrictions on travel, business operations and socialising slowly returned.

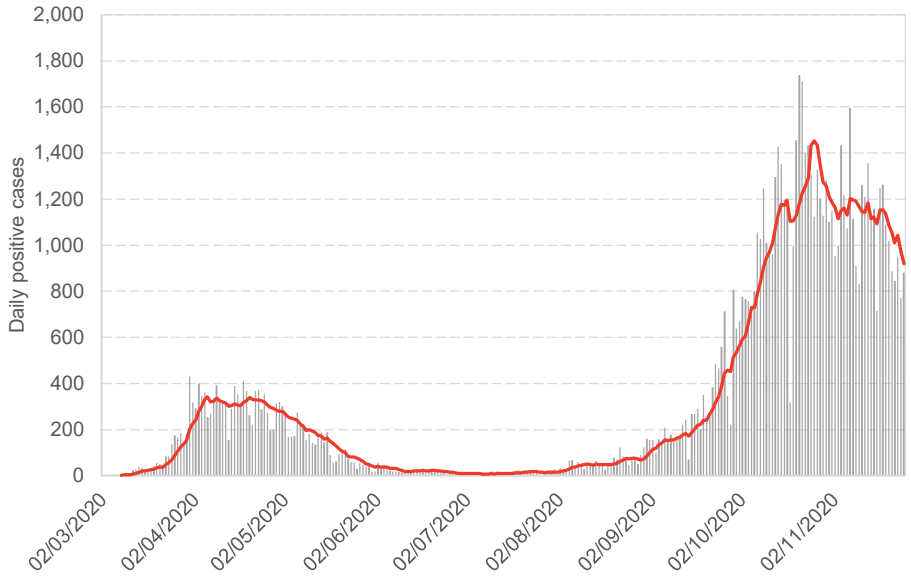
Initially the government set curfews on pubs and restaurants in September however, with daily cases rising substantially every day, Scotland brought in a new local lockdown model of tiered restrictions.

On 2nd November Scotland moved into a five-tiered COVID-19 restriction system with 11 local authorities being moved into the highest tier – level four – on the 20th November for a minimum of three weeks.

This meant that non-essential retail, restaurants and cafés had to close until the 11th December. The toughest restrictions were effective across most of the West of Scotland and in two Scottish cities, Glasgow and Stirling.

Since then, there has been a downwards trend in COVID-19 cases across Scotland. Chart 2.

Chart 2: Number of reported daily new positive cases and 7-day rolling average, Scotland, 2nd March 2020 – 25th November 2020



Source: *Scottish Government*

Unfortunately, headline economic statistics take some time to be estimated and published and so the effects of Scotland's tiered system on economic activity is not yet known.

The latest indicator of economic activity shows that the economy as a whole in September grew by 2% however, the economy remains around 8% below its February level. After experiencing strong growth of over 50% in August, economic activity in the accommodation and food services industry declined by around 7% in September. Chart 3.

It is worth noting, as we did in our previous commentary, that large growth rates on a month-by-month period are not unusual in times of economic crisis. As the economy is recovering a very low base, monthly and quarterly growth is typically far above that of normal times.

Education and construction are two sectors which experienced significant shut downs during the spring lockdown but have since adapted to COVID-19 restrictions – with social distancing measures in place and use of PPE and face coverings - and are operating almost at the levels seen in February.

With large parts of the economy shut down, many people have been furloughed or laid off.

The latest household finance indicator highlights how secure households feel their current financial situation is, compared to 12 months prior, and how secure they expect their finances to be in 12 months time. Chart 4.

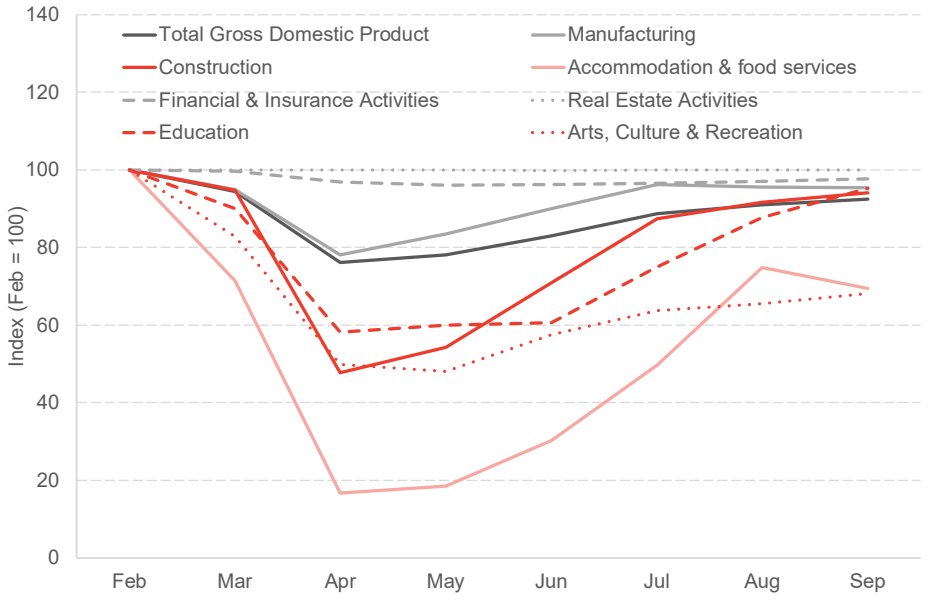
The net balance of current financial conditions was -23 in the latest quarter, a fall of around 22 percentage points since the first quarter of the year. A negative net balance means that the majority of households surveyed deemed their current finances to be worse than the previous year.

Despite this, there is some optimism.

The outlook for next year shows a more positive sentiment. The net balance of households reporting that they expect their financial position to be stronger next year than now was +6 in the latest quarter – down slightly from Q1 2020 however, still positive.

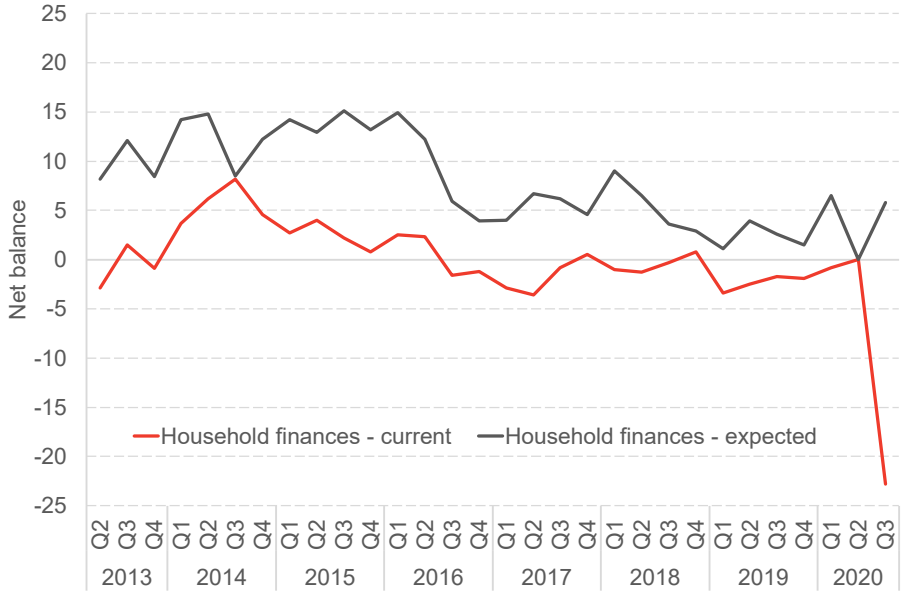
Some word of caution is needed however. We are in unprecedented times so although expectations for next year are positive, the baseline is 2020. i.e. the bar is set very low.

Chart 3: GDP Index by sector, Scotland, February – September 2020



Source: *Scottish Government*

Chart 4: Consumer Sentiment Indicator, household finances, Scotland, Q2 2013 – Q3 2020



Source: *Scottish Government*

Real time indicators of Scotland's economic performance

As discussed, traditional economic indicators such as GDP or the unemployment rate are often available with a lag. During fast developing crises, such as the COVID-19 pandemic, there is a need to track developments in the economy at a higher frequency.

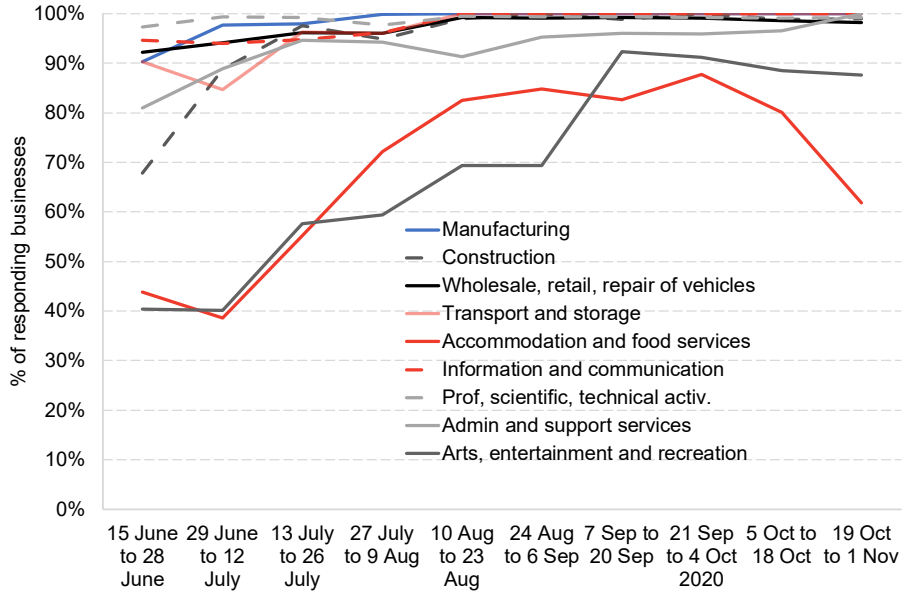
Over the past few months, the FAI has been tracking several real time indicators which are able to provide a timely picture about the state of the Scottish economy.

The latest indicators point towards a recovery in economic activity over summer months which has been hindered by the re-imposition of lockdown restrictions in the autumn. Some sectors have enjoyed a revival in activity, but certain sectors such as accommodation & food services, remain disproportionately affected by the crisis.

The share of businesses trading has returned to near-normal levels in most sectors, with admin and support services seeing a slight increase in the autumn months. However, the share of accommodation and food services businesses trading continues to fall, with just over 60% of businesses in this sector currently trading.

Given that 11 local authorities were under level 4 restrictions from 20th November, the immediate outlook for this sector has worsened.

Chart 5: Estimated share of businesses that are currently trading, broken down by industry, Scotland, 15th June – 1st November 2020

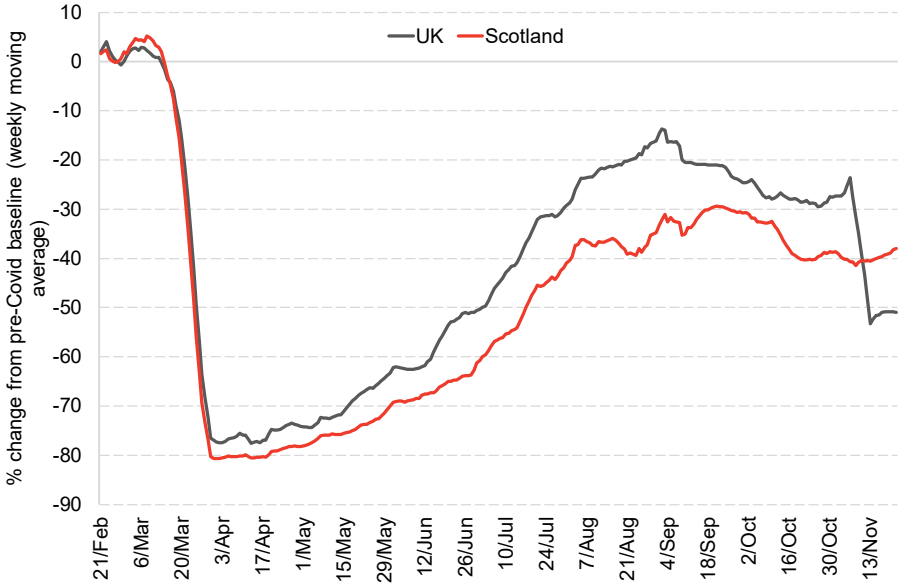


Source: *Scottish Government*

Mobility to retail and recreational venues has fallen slightly more in Scotland compared to the UK and was slower to recover after the first lockdown.

Mobility in Scotland started falling slightly after the imposition of new restrictions at the start of October. However, mobility in the UK fell sharply with the second nationwide lockdown in England. In the second half of November Scottish retail mobility was higher than in the rest of the UK for the first time since the beginning of the pandemic.

Chart 6: Mobility to retail and recreational venues, Scotland and the UK, 21st February – 22nd November 2020

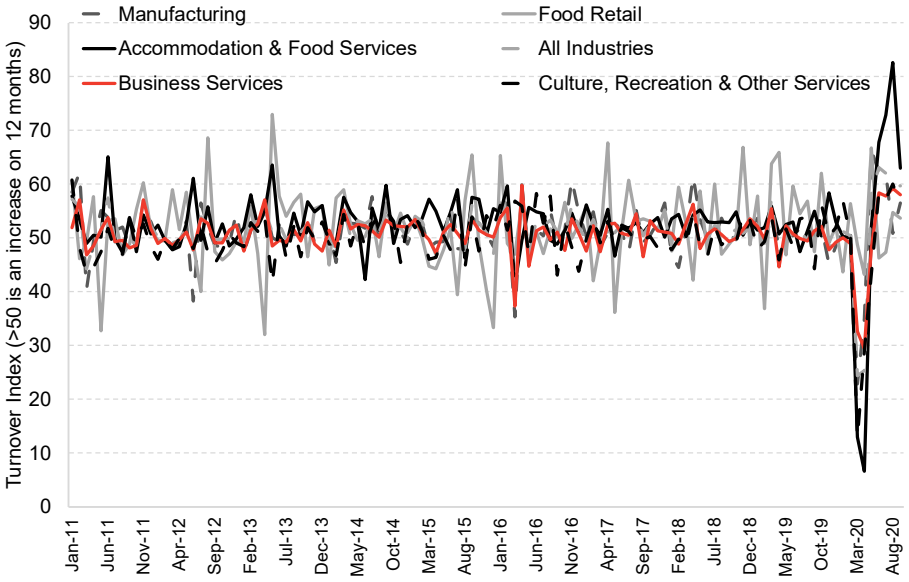


Note: The series for Scotland is an average for Edinburgh, Glasgow, Aberdeen, and Dundee.

Source: *Google Covid Mobility Trends*

Most sectors are reporting an increase in turnover compared to the same time last year. The second shutdown of businesses in the accommodation and food services came at a time when the sector was just starting to see growth in turnover for the first time in many months.

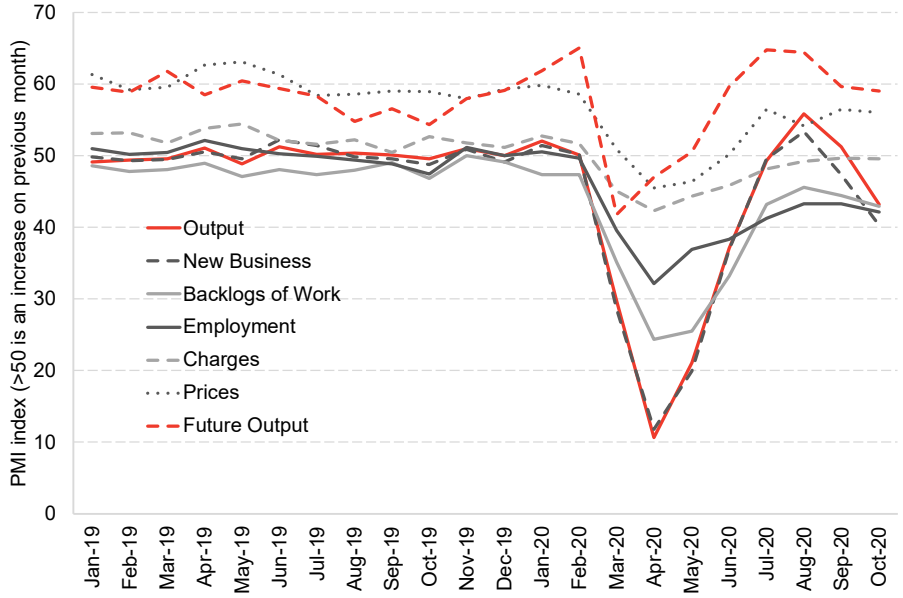
Chart 7: Business turnover index by sector, Scotland, January 2011 – September 2020



Source: *Scottish Government*

Chart 8 shows that new business, output, and expectations of future output grew during the summer months but started declining again in September and October. Indicators of new employment and backlogs of work have not grown in Scotland since the start of the pandemic.

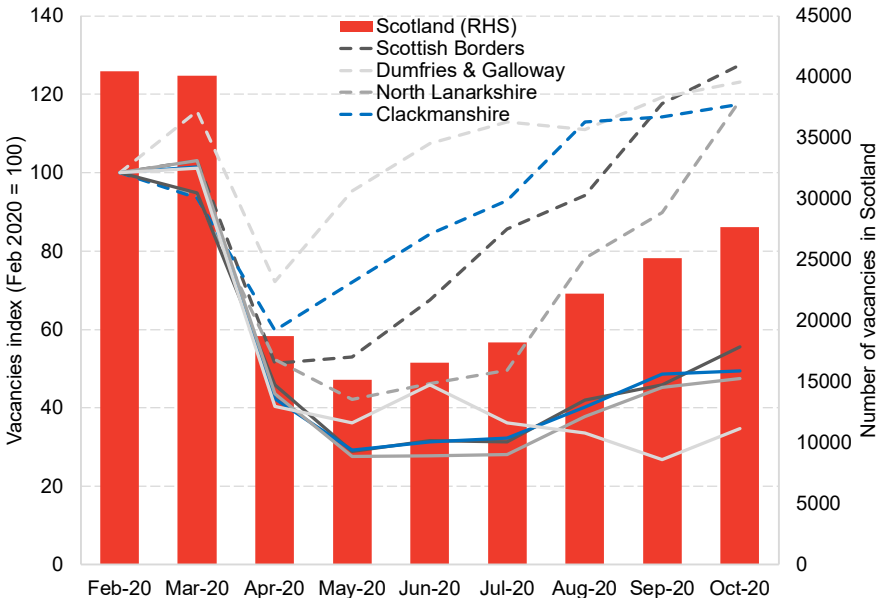
Chart 8: Composite PMI index, Scotland, January 2019 – October 2020



Source: *IHS Markit*

The number of advertised vacancies in Scotland rose to over 27,000 in October. However, the pace of recovery differs across local authorities. The Scottish Borders, Dumfries & Galloway, Clackmannanshire, and North Lanarkshire have all recovered to pre-COVID levels but Aberdeen City, Aberdeenshire, Midlothian, and Glasgow are only at around half of the levels of vacancies reported before the crisis.

Chart 9: Number of vacancies across Scotland, 'best' and 'worst' performing local authorities, February 2020 to October 2020



Source: *Adzuna Labour Market Stats*

Despite rising vacancies across Scotland, it remains to be seen how employment will fare once the government's furlough scheme ends in March 2021.

Labour market

The Scottish and UK labour markets remain somewhat frozen in time, with employment and self-employment support schemes continuing to hold-off the inevitable shakeout in the labour market.

This is reflected in headline labour market indicators (Table 2) having changed little relative to the same period last year, despite the scale of the economic shock represented by the pandemic.

Table 2: Headline labour market indicators

	% Rate (Jun - Sep 2020)	Change on a year before
Scotland		
Employment	74.0	-0.4
Unemployment	4.5	0.5
Economically inactive	22.4	0.0
United Kingdom		
Employment	75.3	-0.8
Unemployment	4.8	0.9
Economically inactive	20.9	0.1

Source: *ONS; LFS*

The unemployment rate in Scotland sits at 4.5% Scotland, compared to a UK rate of 4.8% On employment, the 16-64 rate currently sits at 74%, down slightly (-0.4%-points) on a year ago. The UK employment rate is higher, at 75.3%, but has declined by more since this time last year.

Again though, the scale of these falls is modest relative to the scale of the shock to the economy. The OBR predict that unemployment in the UK will reach 2.6 million in the UK. In Scotland this would be equivalent to over 200,000 people.

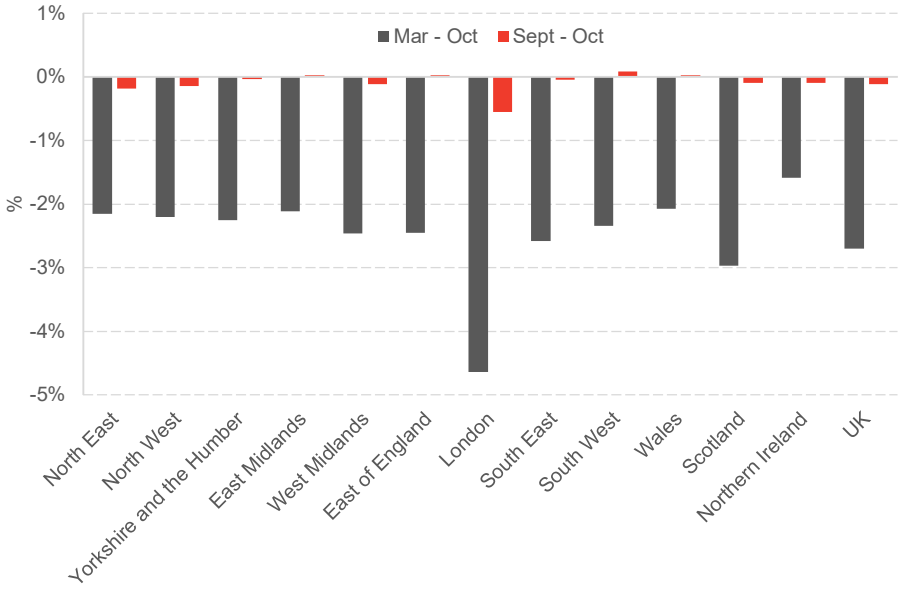
Already we are beginning to see increased stress popping up in wider labour market indicators. When we look at the number of employees registered for PAYE tax, a new and innovative data source, it suggests that the number of employees in Scotland registered for PAYE fell slightly again in October, and is down nearly 3% since March 2020. Chart 10.

We have also seen more movement with the claimant count, which in Scotland currently sits at 7.7%, up from 4% at the same time last year. Chart 11.

This translates to over 100,000 more people in Scotland claiming unemployment related benefits since last year.

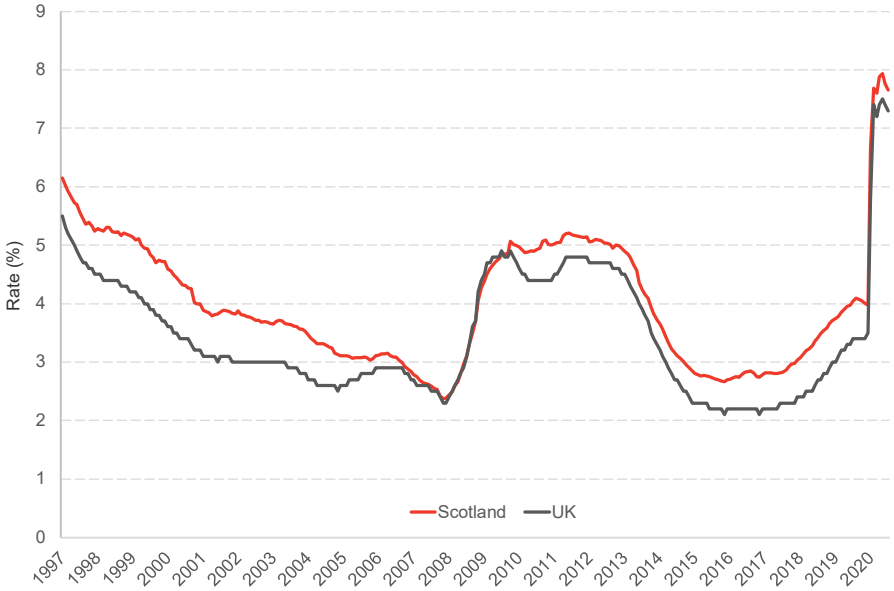
We have a wider set of labour market indicators available for the UK as a whole, and these tell us a bit more about what is happening in the labour market.

Chart 10: Payrolled employees from PAYE RTI



Source: *HMRC*

Chart 11: Claimant count rate

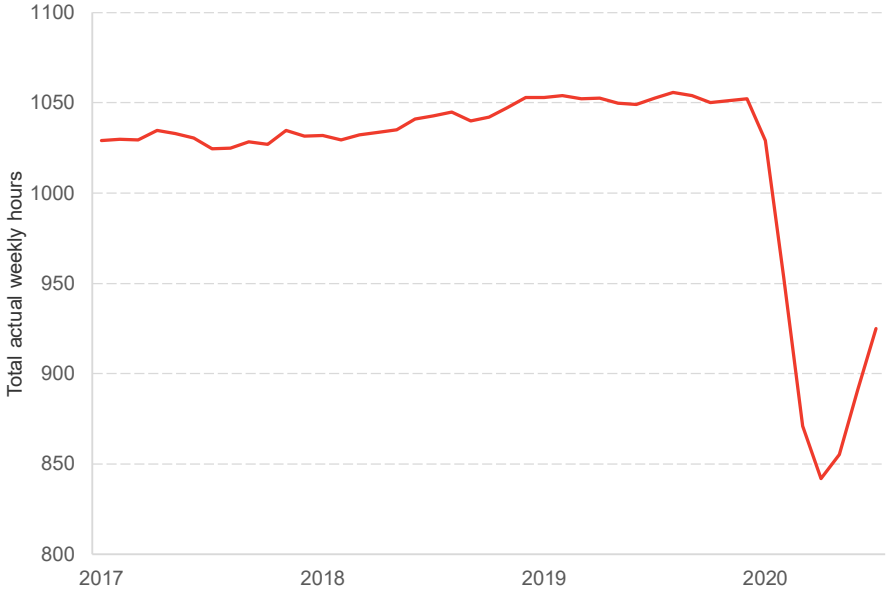


Source: *ONS; DWP*

One key messages from the UK data is that hour worked grew in the 3 months to September at a record rate of 9.9%, although hours worked remains significantly below its level earlier in the year. Chart 12.

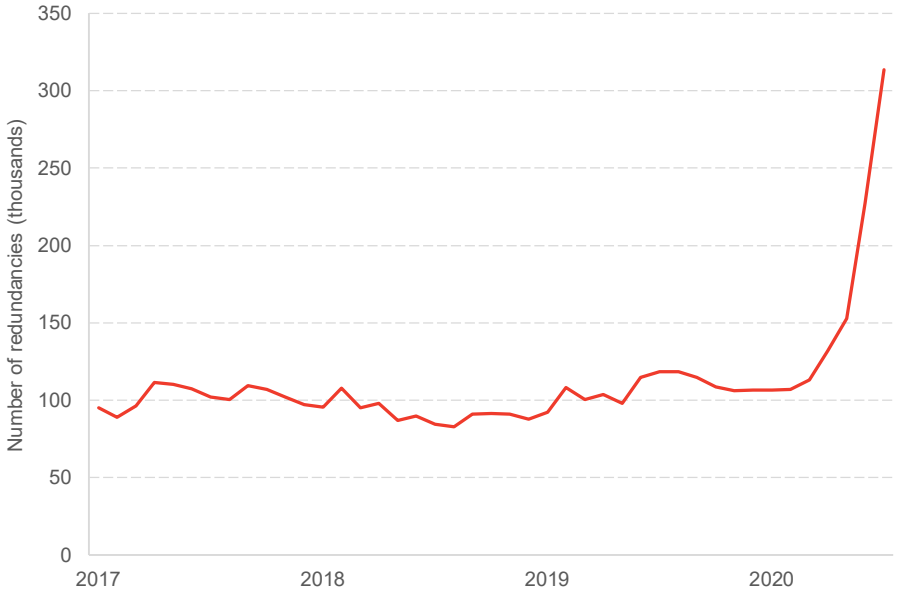
While the number of people being made redundant is rising sharply, the number of vacancies appears to be growing much more slowly. Chart 14.

Chart 12: Total actual weekly hours worked, UK



Source: *ONS; LFS*

Chart 13: Number of redundancies, UK



Source: *ONS; LFS*

A key metric in understanding peoples experience in the labour market is of course what is happening to wages. We do not yet have data for Scotland on the impact that the pandemic has had on earnings, but we do have more information for the UK as a whole.

The latest data confirm that average wage growth did grow faster than inflation (by 0.5%) but as always with significant changes underway in the labour market, we should be cautious about measures of average pay growth. The recent Bank of England Monetary Policy Report (p26) suggested that median pay growth was zero in September.

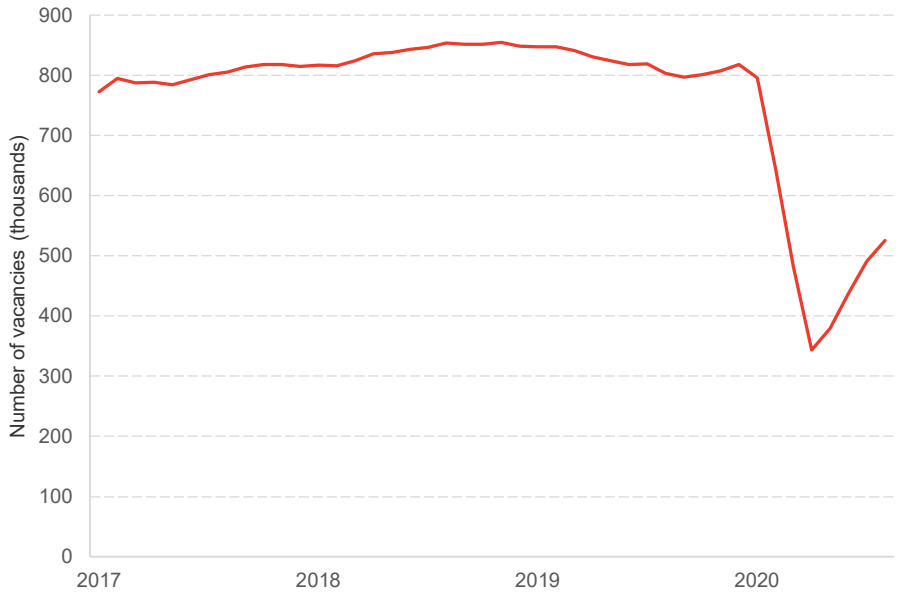
None of the indicators that are available should not be misconstrued as a sign that the labour market is relatively unscathed by the pandemic.

Remember that over 240,000 jobs were still furloughed in Scotland at the end of August. This is slightly more jobs than there were people claiming unemployment related benefits in August (223,000).

If all or a significant number of those people still on furlough in August, when restrictions were relatively relaxed, were to find themselves out of work the effect on headline unemployment would be huge.

With the reintroduction of the full furlough support scheme through to March 2021, with workers eligible for 80% of their salary for hours not worked, this will push the point at which we will see the anticipated shakeout in the labour market down the road.

Chart 14: Number of UK vacancies



Source: *ONS; LFS*

UK economy

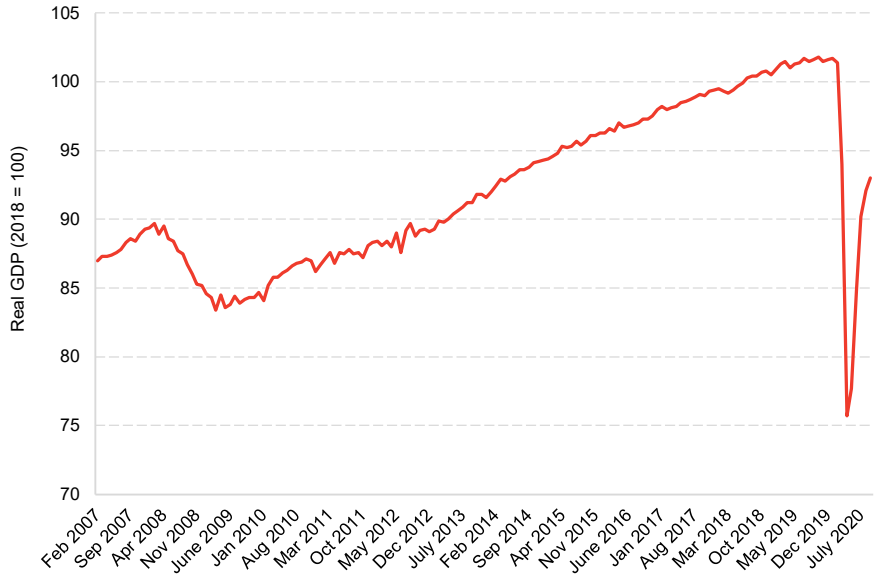
While the true impact of the pandemic on the labour market remains to be seen, looking at how the economy as a whole is currently performing helps indicate what the outlook is like.

The UK economy shrunk by a quarter between February and April of this year. After some recovery over the summer months, growth has slowed slightly – the UK economy grew by 1% in the month to September. Chart 15.

Just like the Scottish economy, the UK economy remains around 8% below its pre-crisis level.

England entered a national lockdown, similar to that of March, with the exception of keeping education open, from 5th November until 2nd December. GDP in the final quarter of the year will reflect these restrictions – and the restrictions across Scotland, Wales and Northern Ireland.

Chart 15: GDP index (Jan 2007 = 100), UK, Jan 2007 – Sept 2020

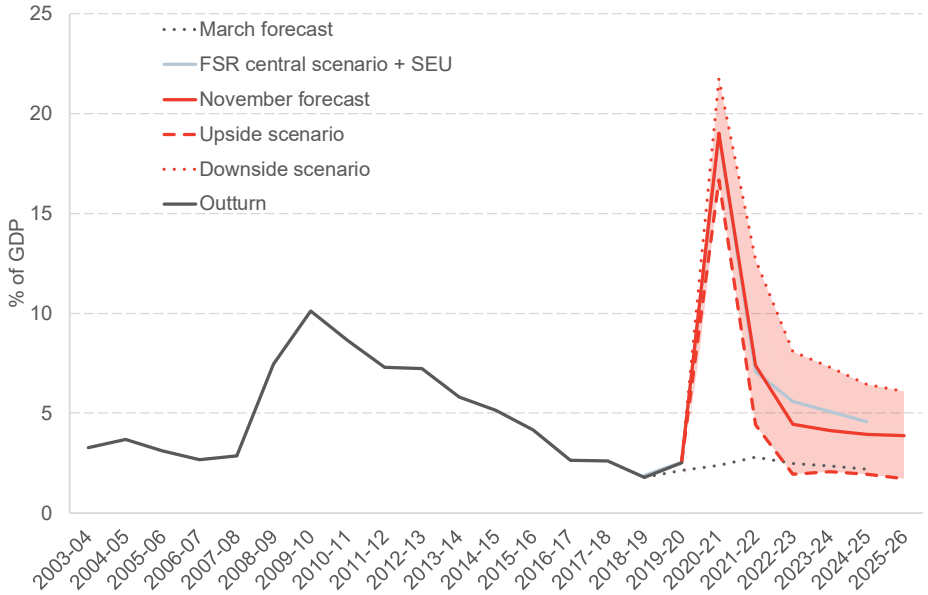


Source: *ONS*

With further restrictions, the outlook for debt has worsened. The UK's deficit has not been as large (in terms of share of GDP) since wartime – the OBR's central forecast has the deficit-to-GDP ratio at 19% (£395bn). The OBR described this level of borrowing as a 'peacetime peak'. Chart 16.

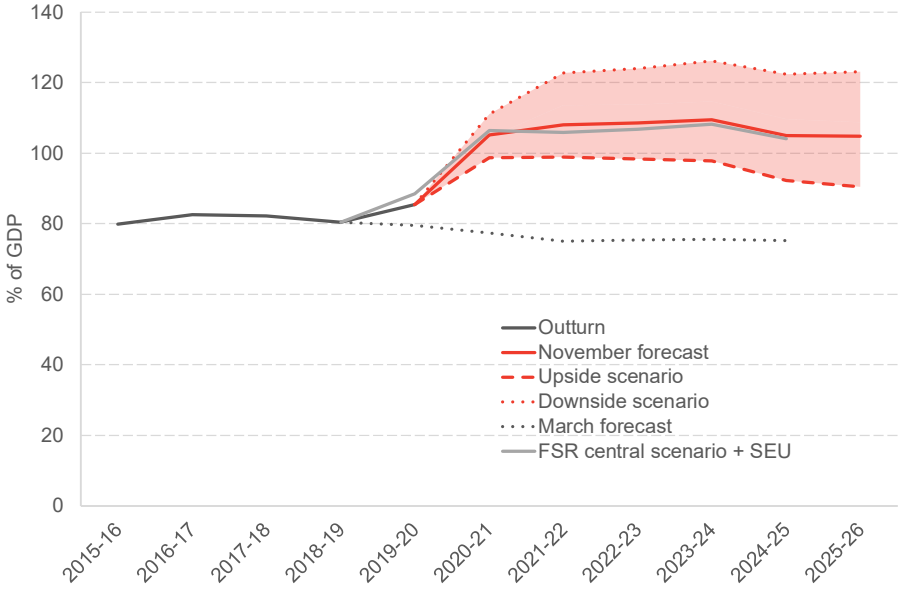
Additionally, PSND is expected to increase by around £475bn in 2020/21 – in excess of 100% of GDP. Debt-to-GDP reached 100% this year for the first time since 1963. Chart 17.

Chart 16: Public sector net borrowing (PSNB), 2003/04 – 2025/26



Source: *OBR*

Chart 17: Public sector net debt (PSND), 2015/16 – 2025/26



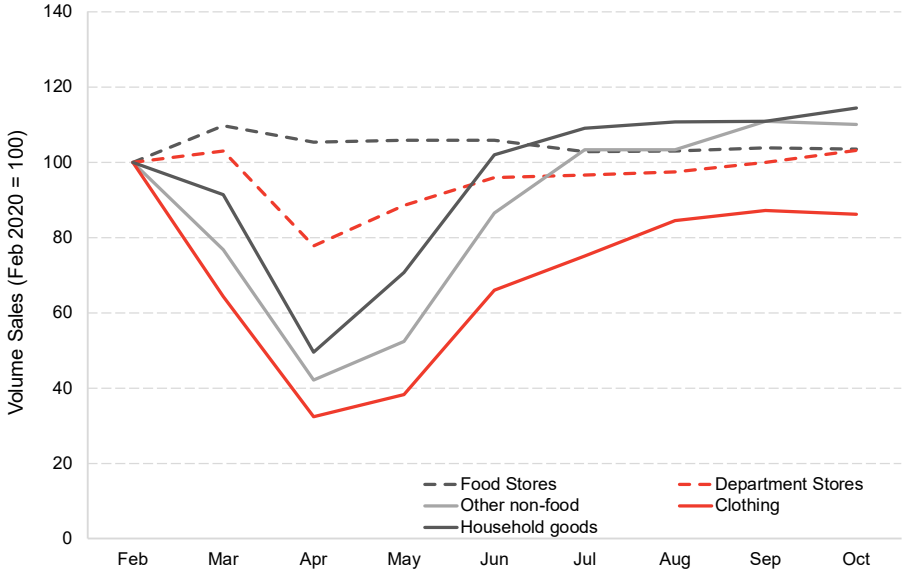
Source: *OBR*

Despite the recent slowdown in economic growth, some sectors of the economy have been recovering well.

Some more recent data on retail sales highlights that household goods continue to be the most in demand retail goods. Chart 18.

But, it's not just household goods that have seen a spike in demand. Houses have too.

Chart 18: Retail sales, Great Britain, February 2020 – October 2020



Source: *ONS*

After taking an initial hit during the peak of lockdown in spring, the UK property market has recovered quickly with housing transactions already back to pre-crisis levels. Chart 19.

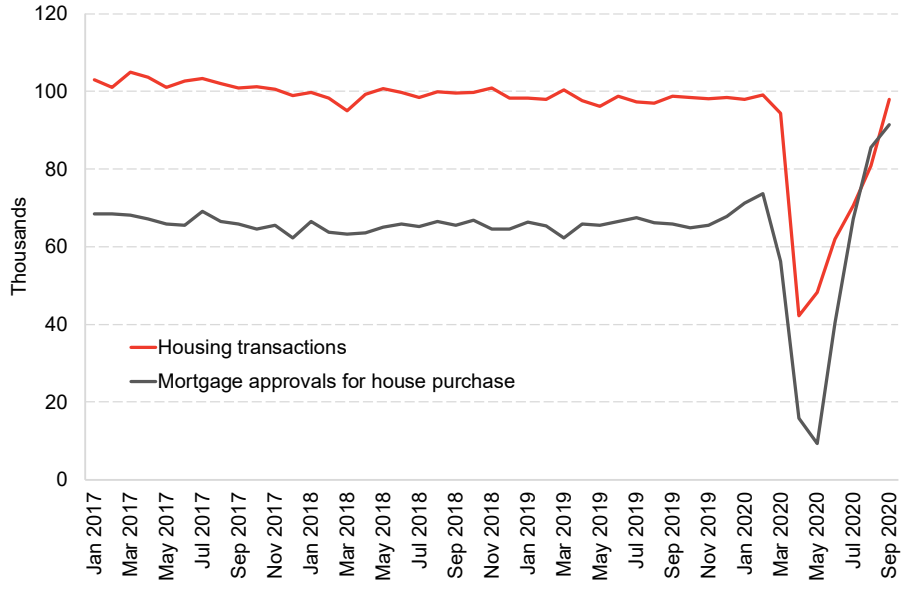
In September, over 90,000 mortgage approvals were carried out – the highest number of monthly approvals since 2007.

This pent-up demand is reflected in UK house prices. Chart 20.

Furlough and the stamp duty holiday have played a significant role in supporting the property market throughout this crisis but with no mention of an extension to the stamp duty holiday in the Chancellor's spending review in November, this holiday will stop at the end of March, alongside furlough.

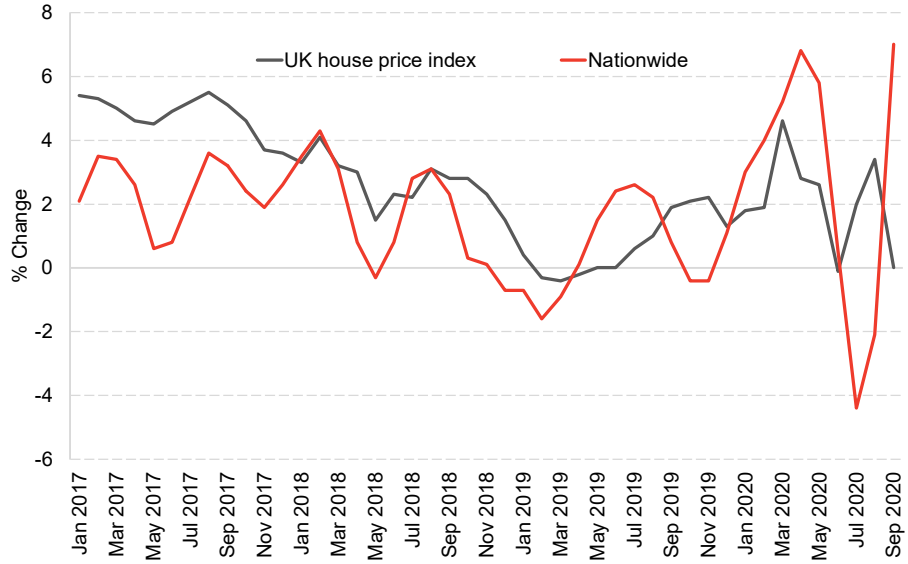
The full effect of the current economic crisis on the housing market therefore remains to be seen.

Chart 19: Housing transactions and mortgage approvals, UK, Jan 2017 – Sep 2020



Source: *BoE; HMRC*

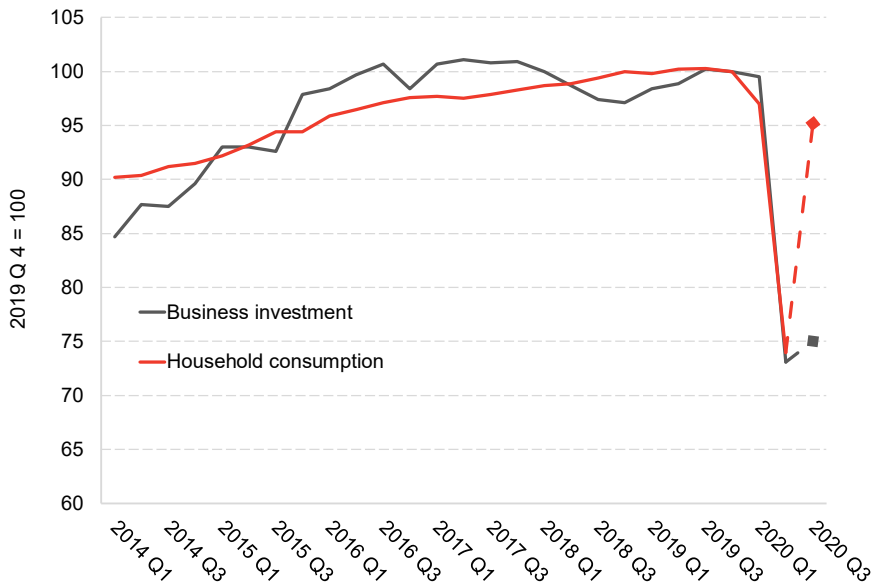
Chart 20: House price inflation, UK, Jan 2017 – Sep 2020



Source: *BoE; IHS Markit; HM Land Registry; Nationwide*

In terms of investment, the Bank of England projects that household consumption will bounce back quicker in Q3 2020 with businesses holding off investment until there is a bit more certainty in the economy – businesses are judging the returns to their investments not only during a pandemic but at a time where the UK is about to leave the largest trading bloc in the world. Chart 21.

Chart 21: Business investment & household consumption, 2014 Q1 – 2020 Q3



Notes: Q3 includes BoE projections ***Source:*** *BoE; ONS*

Most forecasters predict that the UK economy will shrink by around 9-11% in 2020. Table 3.

However, with any forecasts in times of such uncertainty it is possible that the hit the economy could be far less or far greater than the headline forecasts.

There remains considerable uncertainty surrounding the UK's future trading relationship with the EU and despite the encouraging progress of COVID-19 vaccines, only the Pfizer and BioNTech vaccine has been approved for use in the UK so far.

Table 3: UK GDP growth projections, 2020 - 2022

	2020	2021	2022
BoE	-9.5%	9.0%	3.5%
OBR	-11.3%	5.5%	6.6%
NIESR	-10.5%	5.9%	3.7%
EC	-10.3%	3.3%	2.1%
IMF	-9.8%	5.9%	3.2%
Oxford Econ	-9.9%	9.1%	3.3%
ITEM club	-11.5%	6.5%	2.5%
IFS	-9.4%	4.6%	3.6%
HM Treasury	-10.8%	6.8%	3.3%

Source: *BoE, OBR, NIESR, EC, IMF, Oxford Economics, ITEM club, IFS, HM Treasury*

Global economy

Forecasts for the global economy are slightly less severe than for the UK. Table 4.

Headline forecasts predict the world economy to shrink by around 4-5% in 2020 however, recovering by roughly the same amount the following year.

Table 4: World GDP growth projections, 2020 – 2022

	2020	2021	2022
BoE	-5.0%	7.5%	5.0%
OBR	-4.4%	5.2%	4.2%
NIESR	-4.5%	4.9%	3.7%
EC	-4.3%	4.6%	3.6%
IMF	-4.4%	5.2%	4.2%
OECD	-4.5%	5.0%	n.a.

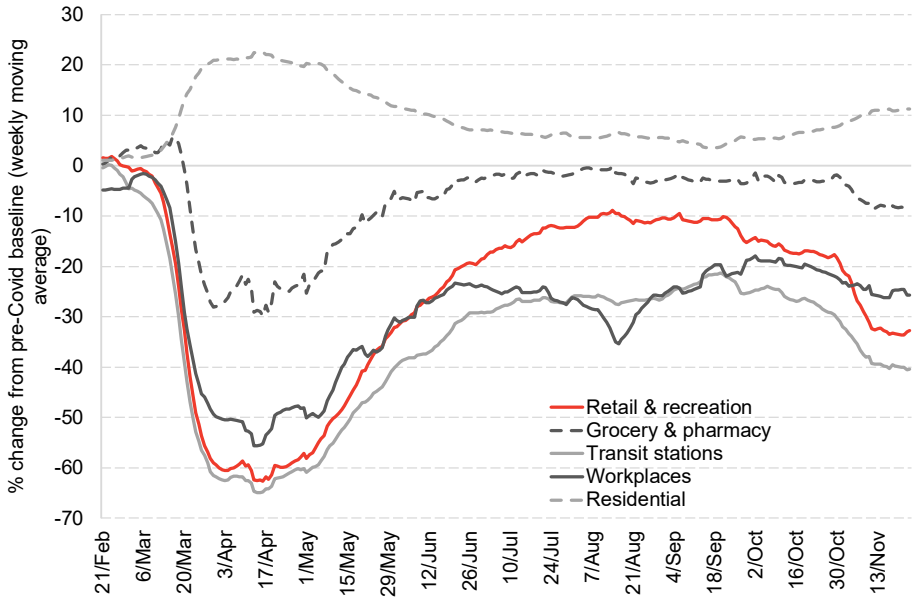
Source: *BoE, OBR, NIESR, EC, IMF, OECD*

But, the outlook remains uncertain.

As many parts of the world began opening up their economies during the summer months, mobility to places like shops and workplaces increased. However, in recent months many parts of the world have had to bring back some COVID-19 restrictions.

The latest data on the G7 economies highlights that mobility began to decline again around the end of September / start of October. The decline in mobility across the UK, France and Italy drove a significant amount of the decline seen in Chart 22.

Chart 22: Mobility tracker for G7 economies, 21st Feb – 24th Nov

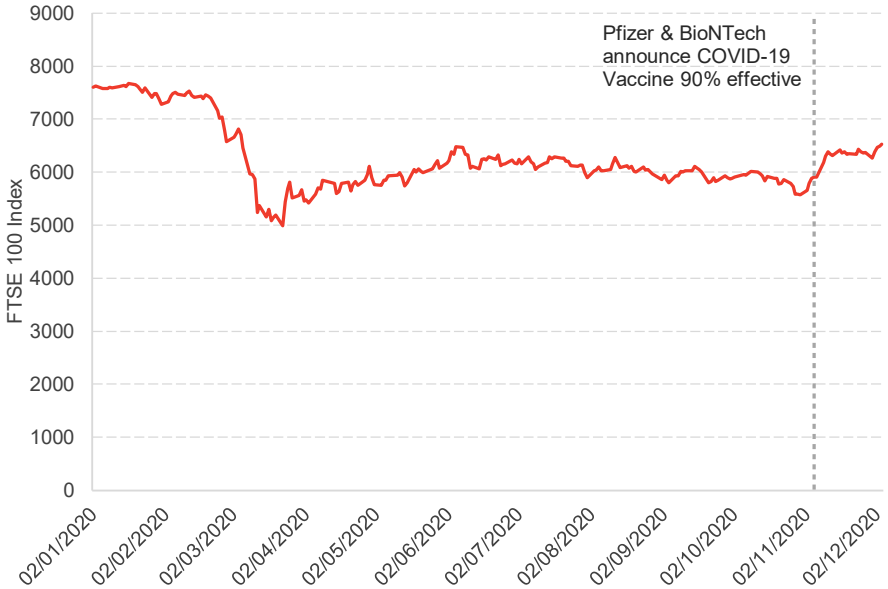


Source: *Google Mobility*

Despite COVID-19 restrictions tightening in recent months, positive news of a COVID-19 vaccine has boosted optimism across the world. On the 9th November, Pfizer & BioNTech announced that their COVID-19 vaccine, now UK approved, was 90% effective in trials, sparking some hope that normality would return soon for the world. The global financial market responded positively. The FTSE 100 jumped almost 5% in a day. Chart 23.

As November progressed, further positive news from other vaccines stimulated some optimism worldwide that the end of the pandemic is near.

Chart 23: FTSE 100 Index, 2nd Jan 2020 – 4th December 2020



Source: *Yahoo Finance*

Homeworking – the future of work?

With the pandemic forcing many people to work from home for the first time, much has been said about how home working could influence the future of work and, with it, the future of city centres.

Some claim that it presents an opportunity to work flexibly, to save on commuting times and to boost the UK's productivity which has been particularly sluggish since the financial crisis of 2007-08.

For others, it could lead to a loss of the innovation that results from informal discussions and presents difficulties in effectively managing staff.

"Whether it is creative sparks being dampened, existing social capital being depleted or new social capital being lost, these are real costs and costs which would be expected to grow, silently but steadily, over time. They weigh on the other side of the ledger when it comes to assessing the case for home-working. They cast doubt on whether it will lead to the promised land of improved productivity and greater happiness."

Andy Haldane
Chief Economist, Bank of England

But which jobs are likely to be most or least affected by home working? And what are businesses saying about their experience so far?

Homeworking by occupation

Of course, not all jobs can be performed at home.

One potential concern around increased levels of homeworking in the future is a potential divide between the jobs which are more easily done at home – typically professional occupations and management roles – and those which cannot, such as cleaners, waiting staff, machine operatives and the roles of many of the key workers during the pandemic.

Typically, the jobs that can be more easily done at home are also better paid. Chart 24 compares the median wages of 365 occupation groups in the UK to their scored ability to work from home.

This indicator was built by the ONS, considering five factors that are associated with being less able to work at home - e.g. the more a job has to be carried out in a specific location, the higher the score. So, for each occupation, the higher the score, the less likely it is that is can be carried out from home. The occupations with an above average ability to work from home (so a lower score) are shown in grey while those with a below average ability to work from home (so a higher score) are in red.

Chart 24: Ability to homework score and median wage by occupation classification, UK

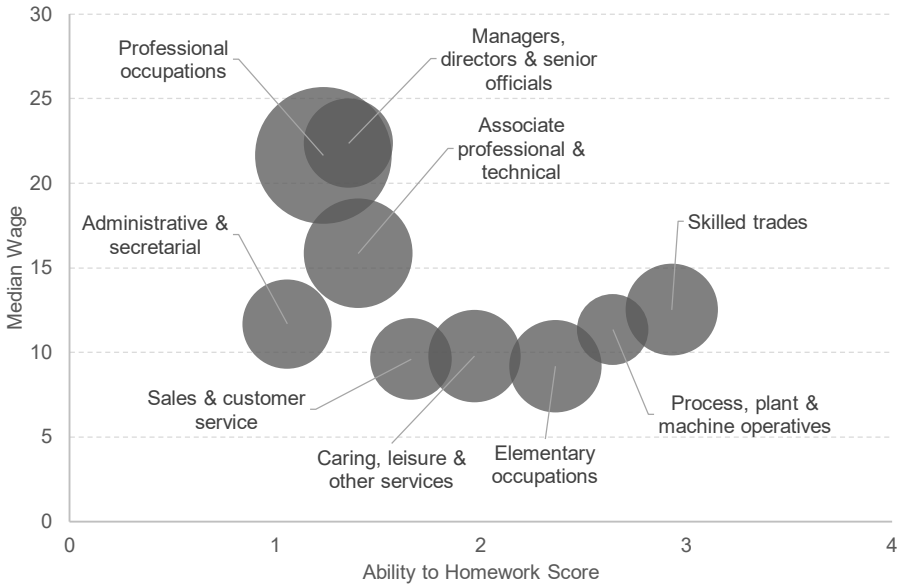
Source: *ONS; FAI*

Looking within Scotland, a large amount of employment is supported in lower paid occupations that are less likely to work from home.

Chart 25 shows groups of occupations by their median wage and ability to homework score, with the size of the bubble representing the occupation group's employment in Scotland.

Three of the four categories here – representing around 46% of Scottish employment – have much higher median wages and more chance of working from home.

Chart 25: Occupation ability to homework Score and median wage, size of bubble represents employment in Scotland



Source: *ONS; FAI*

This provides some insight into the differential impact on jobs during the pandemic. Those with lower wages are less able to work from home and likely will have been affected to a greater degree than those in higher paid occupations.

But what about the business experience of working from home?

Home working – views from business

We surveyed over 500 businesses in October to understand their views on the impact of home working.

Around 3 in 4 of the businesses had seen homeworking increase – this is perhaps the least surprising figure.

What was more interesting was that only 10% believed that it had improved productivity in their organisation. The majority also thought it had made performance management of staff more difficult and that it had a negative impact on workplace innovation and collaboration.

To what degree this effect is due to homeworking being suddenly thrust upon these companies it is hard to say. It may be that this picture improves as businesses are able to set up processes for home working.

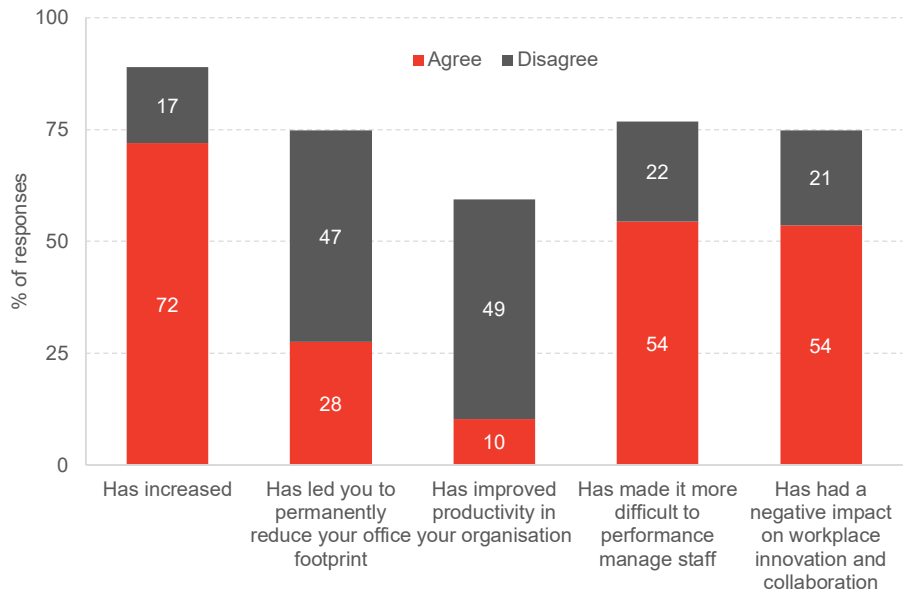
Other evidence also suggests that saving on the commute results in more hours of work being undertaken. This may go some way to mitigating falls in productivity.

Despite the negative views around productivity, management and innovation, more than one in four businesses says that home working has led them to permanently reduce their office footprint.

More work needs to be done to understand whether this is due to cost savings, due to requests from staff for more flexible working in the future or for other reasons.

What is clear right now is that there is a desire to try new ways of working. Whether these changes are for better or for worse, it is difficult to say. The choice to be able to work flexibly – whether from a workplace or from home – is commonly spoken of as vital to the future of work. But this is a choice that seems primarily available to the most privileged in society.

Chart 26: "Do you agree or disagree that homeworking in your business..."



Source: *FAI*

Brexit & Covid: how will these factors interact?

2020 has been a year of change for the Scottish economy.

First and foremost, the pandemic has had a significant and wide-ranging impact on businesses.

Few firms have been fortunate enough to escape the economic repercussions.

The second change, coming up swiftly, is the new trading agreements between the UK and the EU, as well as countries further afield.

While this brings opportunities in new export markets, it also brings challenges to Scottish firms that export to the EU, rely on EU supply chains or, perhaps unknowingly, have EU firms several layers removed in their supply chains.

These challenges will likely be exacerbated by the pandemic. No matter the trading arrangement, many firms we have spoken to feel they currently have limited headspace to fully prepare for new trading relationships.

A feature of the pandemic has been the divergence in the experience of different sectors, the so-called "k shaped recovery". Several sectors – hotels, bars and restaurants, through to gyms, libraries and museums – have borne some of the most severe reductions in levels of operation.

But a characteristic of many of these sectors is that they are not particularly focused on exporting. While many of the sectors that have had an "easier" time during the pandemic are much more export focused.

Looking at the downside risk of a disruption to trading relationships only – could we be seeing a second "k" emerge?

Is it therefore the case that many of the most affected sectors in the pandemic could be the least at risk from trade disruption? And, that some of the least affected sectors in the pandemic could also be the most at risk?

We've taken some clues from the latest monthly GDP data and our model of sectoral exposure to EU exports.

The (unequal) impact of the pandemic

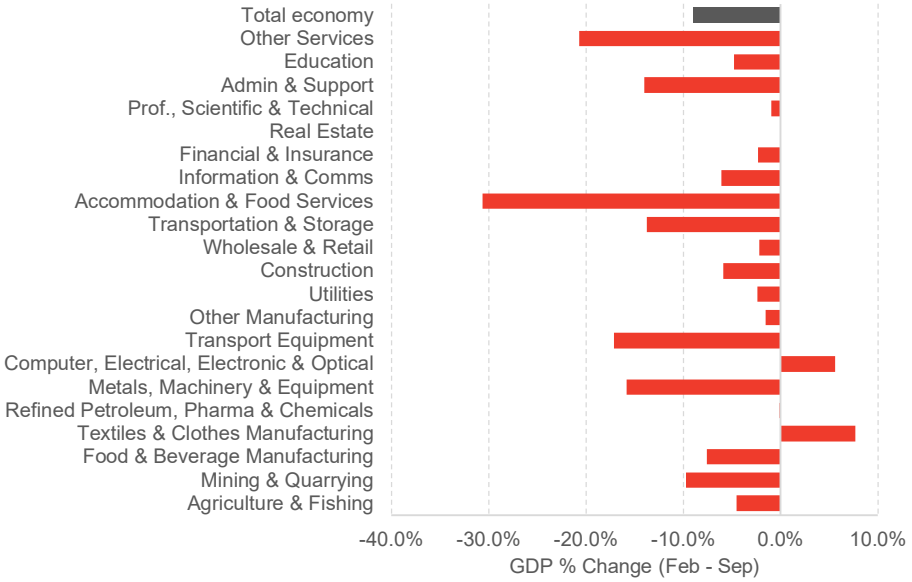
Undoubtedly the Scottish economy has been hugely affected by the pandemic.

The Scottish economy shrank 5% between February and March. This followed with an additional fall of almost 20% in April. And output in the accommodation & food services sector in April was less than 17% of the size it was starting 2020.

Looking up until the latest available month of GDP – September – the economy is 7.6% smaller than it was in February.

Many sectors closely mirror this recovery in the whole economy. However, there are a number of notable exceptions (Chart 27).

Chart 27: Change in Scottish GDP by sector, February - September 2020



Source: *Fraser of Allander Institute, Scottish Government*

Two sectors have seen growth – computer, electrical, electronic & optical and textiles & clothes manufacturing. The latter only because it had already experienced a large contraction in February.

Meanwhile, five sectors are still significantly below their levels in February. Some of these sectors are perhaps unsurprising given their reliance on face-to-face interaction or commuting flows.

Table 5: Top 5 most and least affected sectors, % change in GDP, Feb – Sep 2020

Sector	% GDP change	Sector	% GDP change
Accommodation & Food Services	-30.6%	Textiles & Clothes Manufacturing	7.6%
Other Services	-20.7%	Computer, Electrical, Electronic & Optical	5.6%
Transport Equipment	-17.1%	Real Estate	0%
Transportation & Storage	-13.7%	Refined Petroleum, Pharma & Chemicals	-0.1%
Metals, machinery & equipment	-15.8%	Prof. Scientific & Technical	-0.9%

Source: *FAI*

With the further restrictions put in place over the last months, these figures will have changed. This is likely to exacerbate several of these differences further.

Unlike the start of the pandemic, many firms in sectors such as manufacturing are now able to operate while firms in sectors such as accommodation & food services have large restrictions across most of Scotland.

And changes lie ahead for the Scottish economy with the transition period set to end on the 31st of December. How will this affect firms and sectors?

Normally, the first step to understand the future impact would be to understand how sectors trade with the EU now. But with the immense amount of volatility in the data currently, we have looked back to pre-COVID times.

Relative risks to EU export disruption

To understand the risks to disruption of Scottish exports destined for the EU, we created a model of the Scottish economy. This model estimates the amount of economic activity in Scotland that is supported by exports to the EU.

Of course, after the transition period ends this activity will not all disappear. However, any disruption to EU export arrangements will affect the level of activity, with the effects compounding over time, and will affect sectors which more heavily rely on exporting to the EU.

Our estimates are based on the long-standing methodology of input-output modelling and include the spill-over effects of export supported activity.

For instance, on its own, the construction sector exports very little and so the risk of export disruption is small. However, heavily exporting sectors purchase goods and services from across Scotland to support their exporting. And the supply chains of the heavily exporting sectors also purchase goods and services to enable them to provide this supply. Some of these purchases will be from construction. And through this spill-over effect, a proportion of activity within construction will be supported by the demand from exports.

Throughout the supply chain, activity is supported by these exports. Employment is needed to generate this activity and the employees earn wages. These wages are spent on goods and services around the country. Therefore, export activity can support employment in many sectors which, in turn, supports wage spending in the economy – a further economic boost.

Our model of the Scottish economy captures these complex spill-over effects and, in doing so, allows us to better understand the complex economic relationships that are supported by exports.

The sectors with the most and least activity supported by exports to the EU are shown in Table 6.

Table 6: Top 5 sectors most and least supported by exports to the EU

Sector	% GVA Supported by EU Exports	Sector	% GVA Supported by EU Exports
Refined Petroleum, Pharma & Chemicals	34.4%	Other Services	2.9%
Computer, Electrical, Electronic & Optical	33.2%	Construction	3.9%
Textiles & Clothes Manufacturing	22.3%	Accommodation & Food Services	6.1%
Food & Beverage Manufacturing	21.7%	Mining & Quarrying*	6.4%
Metals, Machinery & Equipment	21.2%	Education	6.7%

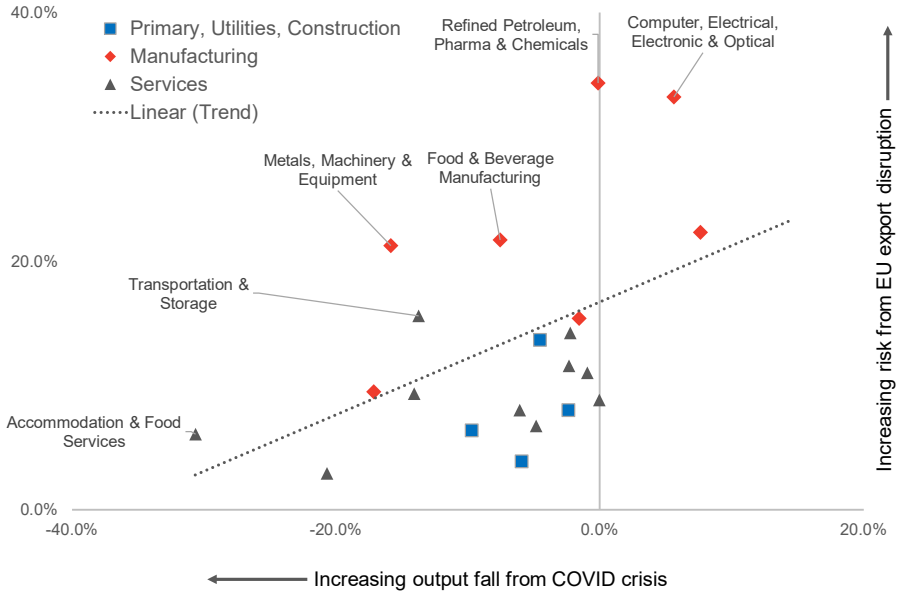
** Estimates exclude offshore activity.*

Source: *Fraser of Allander Institute*

Notably, we can see that some of the sectors most affected in the pandemic have some of the least activity supported by exports to the EU.

Chart 28 visualises the activity supported by EU exports against the change in GDP since February. With a couple of exceptions – Food & Beverage Manufacturing and Metals, Machinery & Equipment – there is a relatively strong case for this relationship.

Chart 28: % GVA supported by EU exports (Y-axis) against % change in GDP between Feb-Sep 2020 (X-axis).



Source: *Fraser of Allander Institute*

Not included in the above diagram is the activity supported by tourism from the EU. This has been excluded as the extent to which Brexit could impact on tourism in the long term is uncertain, and this represents a different type of economic activity to what most people think of as exporting.

By far the largest recipient of tourist expenditure is accommodation and food services. Including this in the estimates raises its exposure to EU exports by 5% and does little to change the overall picture.

The impact of the pandemic and export disruption on Scottish Local Authorities

We have seen over the last few months that the economic burden of the pandemic has not been shared equally across all parts of the country.

Based on where different types of economic activity occur, we can regionalise our results to understand the impacts on the 32 Local Authorities in Scotland.

We find that no local authority has been immune to the economic effects of the pandemic, but some have been particularly exposed.

And, due to the sectoral makeup of the local authorities, it is likely that trade disruption with the EU poses more risk to some areas.

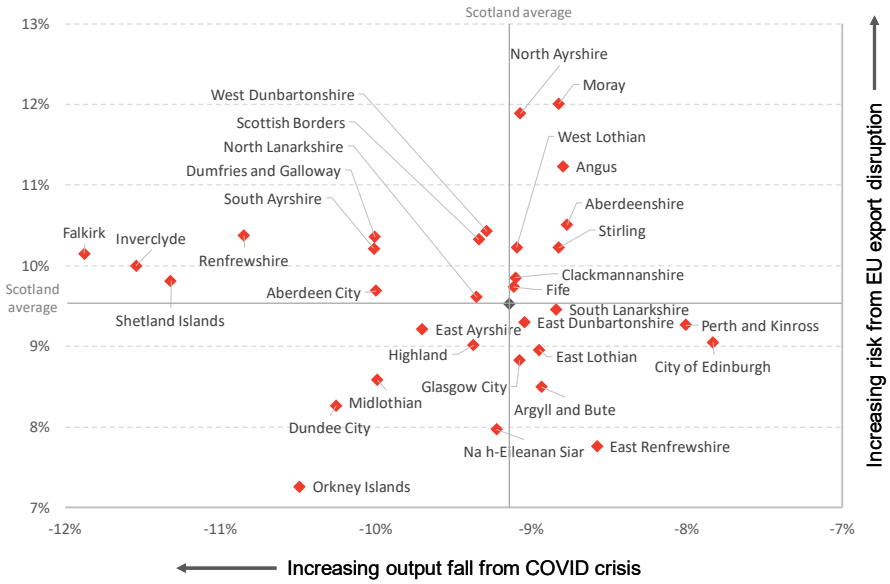
Chart 29 shows on the horizontal axis the estimated fall in output for the 32 council areas between February and September. On the vertical axis, it shows the relative reliance of the area's economy on exports to the EU.

Local authorities in the top left quadrant are estimated to have been hit harder economically by the pandemic compared to Scotland as a whole, while also having more of their economy supported by EU exports than the Scottish average.

If trade disruption does occur after the transition period ends, then these areas face a larger than average shock on both fronts.

The output supported by EU exports estimates only includes onshore activity, and so areas such as Aberdeen may be more exposed to trade disruption than shown.

Chart 29: % GVA supported by EU exports (Y-axis) against % change in GDP between Feb-Sep 2020 (X-axis), by local authority



Source: *Fraser of Allander Institute*

Meanwhile, the areas in the bottom right quadrant have been least economically affected by the pandemic and are less reliant on exporting to the EU – both Glasgow and Edinburgh fall into this category.

Moray, North Ayrshire and Angus are the most reliant on EU exports. A large proportion of the local economy in these areas is manufacturing. Manufacturing sectors in Scotland account for a large amount of exports which explains the level of reliance on EU exports of these areas.

On the reverse is Orkney Islands, Na H-Eileanan Siar and East Renfrewshire which are less at risk to trade disruption due to smaller than average manufacturing sectors and a larger public sector.

And notably, cities such as Dundee, Glasgow and Edinburgh are less reliant on exports to the EU than the Scottish average.

University of Strathclyde Business School

Fraser of Allander Institute

University of Strathclyde

The Fraser of Allander Institute (FAI) at the University of Strathclyde entered Scottish public life in 1975. Since then, it has become established as a leading independent economic research institute working with a wide range of clients on a variety of different topics.

What we do

For 45 years, the Fraser of Allander (FAI) has been monitoring and commentating on the Scottish economy. Our regular publications include:

- FAI Economic Commentary – Quarterly – First published in 1975, our quarterly Economic Commentary provides the authoritative independent assessment of economic conditions in Scotland, along with a wide range of economic and policy issues.
- Scottish Business Monitor – Quarterly – Since 1998, the FAI Scottish Business Monitor has been a key leading indicator of the Scottish economy. This survey of Scottish business sentiment provides vital insights into the Scottish economy well in advance of official statistics.
- Scotland's Budget Report – Annual – The Fraser of Allander Institute's analysis of the Scottish Budget and the choices, risks and opportunities facing the Finance Secretary.
- Our blog – Launched in 2016, and viewed over 200,000 times, our FAI blog is a keenly watched discussion platform on the Scottish economy. The blog publishes short reflections on economic developments as well as the policy debate.

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