

# The Scottish economy

## Forecasts of the Scottish economy

### Economic background

Economic performance in the world economy was better than expected with very strong growth in the US and relatively strong growth in Japan. China remains an important stimulus to manufacturing and growth in the Asian region. The depreciation of the US dollar has boosted US growth considerably. The Euro Area continues to be weak, particularly in terms of domestic demand. On the up side however Germany and Italy are now out of recession. Confidence and forward indicators for the Euro Zone are still improving. It is unlikely that full recovery will take place any earlier than 2005.

UK GDP growth has been revised up to 2.3 per cent for 2003 with growth forecast to be 2.8 per cent in 2004. Real GDP growth was 0.9 per cent in 2003Q4 compared to 0.8 per cent in 2003Q3. While house prices continue to rise and levels of debt are high, there are no other significant inflationary pressures in the economy. CPI growth over the 12 months to January 2004 was 1.4 per cent compared to RPI growth of 2.6 per cent and RPIX growth of 2.4 per cent. The performance of the UK labour market is encouraging with the employment rate at 74.5 per cent for Oct-Dec 2003. ILO unemployment for the same period was 2.9 per cent compared to a claimant count rate of 2.9 per cent in January 2004 (3.0 per cent for the months Oct to Dec 2003). We are forecasting that UK GDP will be 2.8 per cent in 2004 and 2.6 per cent in 2005.

Scottish GDP growth has been revised (see Outlook and Appraisal for more detail) due to the introduction of chain-linking of GDP. Table 1 compares the new (2000 weights) and old (1995 weights) figures over 2000 to 2002 with the old growth rates in parenthesis.

**Table 1 Real GDP growth in the Scottish economy, 2000-2002**

	2000	2001	2002
GDP	2.1% (1.9%)	1.6% (1.2%)	1.6% (0.0%)
Agriculture	0.9% (1.4)	-2.7% (-2.0%)	0.5% (0.9%)
Manufacturing	0.8% (1.0%)	-4.7% (-8.4%)	-7.9% (-11.9%)
Construction	11.9% (7.5%)	-4.5% (-2.6%)	-5.0% (-3.2%)
Services	1.9% (2.1%)	4.4% (5.9%)	4.7% (4.1%)

Source: Scottish Executive, December 2003

We were forecasting that Scottish GDP growth would be 1.3 per cent in 2003 in the last quarter but we have now revised that up to 2.3 per cent in light of this new information. Our forecast for 2004 is 2.1 per cent compared to 2.1 per cent in the previous quarter. Our forecasts change most in the years 2002 and 2003 as these are the years that are further away from 1995 and 2000, the base years, respectively. We will still be anxious to see the next year of GVA data as there are some concerns over the impact of the decline in electronics and its overall impact on manufacturing. This is because there has been significant restructuring in this sector in 2001 and 2002 but at the moment we are using 2000 weights to look at this change in sectoral output and GVA. Four-quarter moving average weights suggest the 'actual' weight of electronics has fallen considerably.

**The forecast in detail**

**GDP**

We present our forecasts for GDP and broad sectoral output in Table 2 for the period 2004 to 2006. Real GDP growth is forecast to be 2.1 per cent in 2004 and 2.7 per cent in 2005. The very strong growth forecast for 2005 is a culmination of relatively strong service sector growth, a significant recovery in manufacturing as both domestic demand increases as well as the Euro Area recovering. Construction is also forecast to significantly add to growth in 2005. We expect growth to return to trend in 2006 and perhaps beyond this to slow marginally as the service sector in particular, may find it difficult to sustain the same trend rate of growth.

**Table 2 Main forecasts of the Scottish economy, 2004-2006**

	2004	2005	2006
GDP	2.1%	2.7%	1.8%
Agriculture	-0.3%	1.0%	2.9%
Manufacturing	1.5%	1.7%	1.4%
Construction	1.2%	3.2%	3.4%
Services	2.4%	3.0%	1.8%

Source: Fraser of Allander Institute, March 2004.

**Output**

Agriculture is forecast to decline by 0.3 per cent in 2004 but to grow by 1 per cent in the following year. This change to our forecast is a direct result of revised information from the Scottish Executive. Mining and quarrying is forecast to grow relatively poorly over 2004-05 and to decrease slightly

in 2006. Electricity, gas and water supply is forecast to have a muted performance over 2004-05 but is forecast to grow by 1 per cent in 2006. Clearly as manufacturing picks up we would expect to see an increase in this sector's output.

Manufacturing growth is forecast to grow by 1.4 per cent in 2004, by 1.7 per cent in 2005 and by 1.4 per cent in 2006. We have been deliberately cautious about the performance of manufacturing. The main reasons for this are that confidence and forward-looking indicators are optimistic but are still not strong enough to indicate a significant upturn in manufacturing. The relative depreciation in the dollar is boosting US growth but the Euro and Sterling have appreciated against the dollar. It is the relative strength of the appreciation here that is important as are relative prices between Europe and the UK. These factors will have a significant impact on exports to Europe. We expect that the Euro Area will pick up and that the slide of the US dollar cannot continue. Our central assumption is that the Fed have signalled that interest rates will rise when US employment data picks up and this is likely to be later this year. The ECB are also likely to raise rates towards the end of the year and thereafter in the US and in the Euro Area there will be a slow tightening of monetary policy that will benefit the UK. Our forecast is that manufacturing recovery will come from food, drink and paper, printing and publishing. It is possible that textiles, other manufacturing, electronics and transport equipment may also add significantly to growth in 2005.

Services are forecast to grow by 1.2 per cent in 2004, by 3.2 per cent in 2005 and by 1.8 per cent in 2006. Retail, hotels and catering, financial services, real estate and business services and other services are all key services with respect to growth over 2004-06.

Construction is forecast to grow by 1.2 per cent in 2004 and by 3.2 per cent in 2004. Our forecast for 2005 remains similar to that in the previous quarter but we have downgraded our expectations for 2004 in light of updated data. There is little to suggest that there is any significant slowdown in private housing demand but public sector projects are taking longer to materialise than previously expected. This could be due to PFI/PPP delays and some related under-spending by the Executive. There has not been a significant rise in private investment and this is unlikely to be seen until 2005.

**Employment**

Our forecasts of employment are presented in Table 3 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.

Employment is forecast to increase to 2,349,300 in 2004 and to 2,402,400 in 2005. This is a net job change of

58,100 and 53,100 respectively. The revisions in the employment forecast are due to the recent upgrade in GDP growth as revealed by the chain-linking exercise and re-calibration with employment data revisions. The service sector is still forecast to provide the majority of employment gains across the forecast horizon. In 2004 it is forecast to provide 79 per cent of all jobs. Manufacturing employment is forecast to increase in 2004 (as in our previous forecast) but by a slightly greater degree with an additional 6,600 jobs as opposed to an increase of 5,000 in our last forecast. We remain cautious about manufacturing and believe that when employment begins to rise again employers will take on many more part-time and flexible workers. Construction employment is forecast to rise by 5,500 in 2004 and by 4,500 in 2005 while agriculture is forecast to add 1,000 jobs in 2004. There are relatively few job gains forecast in mining and quarrying and in electricity, gas and water supply. Within services, retail, hotels and catering, real estate and business services and the public sector remain areas of strong employment growth.

Manufacturing is forecast to shed 12,200 jobs in 2003 but to gain 5,000 jobs in 2004. In 2005 the manufacturing job change is forecast to be 5,300. Employment in Agriculture is forecast to be 35,500 in 2003 and to remain close to that level over the period of the forecast. Construction employment is forecast to be 124,400 (a net job change of 1,200) in 2003. This is a change from our previous forecast, when we forecast a decline in construction employment. The sector is forecast to add 2,400 jobs and 4,500 in 2004 and 2005 respectively.

**Table 3 Forecasts of Scottish employment and net employment change, 2004-2006**

	2004	2005	2006
Total Employment (000s)	2,349.3 (58,100)	2,402.4 (52,300)	2,435.1 (31,800)
Agriculture	33.5 (200)	34.6 (1,000)	36.3 (1,700)
Manufacturing	286.7 (6,600)	294.6 (7,900)	301.5 (6,900)
Construction	127.8 (2,800)	133.3 (5,500)	137.8 (4,500)
Services	1,856.8 (47,500)	1,894.9 (38,100)	1,914.4 (19,600)

Source: Fraser of Allander Institute, March 2004.

## Unemployment

Table 4 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 149,400 (5.4 per cent) in 2004 and 144,600 in 2005 (5.2 per cent). Our error in forecasting unemployment in 2002 was 2.5 per cent (4,100) as the outturn was 164,200 (6.5 per cent) In 2003 the forecast was for 152,400 (5.8 per cent) but the outturn was 147,200 (5.8 per cent) The error here is 5,200 or 3.5 per cent. Claimant count is forecast to be 98,600 (3.7 per cent) in 2004, 98,400 (3.6 per cent) in 2005 and 97,300 (3.6 per cent) in 2006. Our forecast for claimant count in 2002 was 100,400 and the outturn was 102,000 (an error of -1,600 or 1.6 per cent) and in 2003 we forecast claimant count of 98,800 when the outturn was 99,500 (an error of -700 or 0.7 per cent). As previously forecast we firmly believe that unemployment will remain at very low levels and that the decline in claimant count will be steady but marginal. As demonstrated above we also believe that our forecast error is relatively small.

**Table 4 Forecasts of Scottish unemployment, 2004-2006**

	2004	2005	2006
ILO Unemployment (levels)	149,400	144,600	142,400
Rate	5.4%	5.2%	5.0%
Claimant Count (levels)	98,600	98,400	98,000
Rate	3.7%	3.6%	3.5%

Source: Fraser of Allander Institute, March 2004.

The outlook for the Scottish economy is promising as growth returns to trend in 2004 and both domestic and UK demand remain relatively strong. Growth in the US and the Far East will also stimulate exports although the real effective exchange rate will play an important role here. We are forecasting that the strong pick-up in growth in 2005 is due to services, manufacturing and construction having better than expected performances simultaneously as recovery in Europe further stimulates the Scottish economy. We remain optimistic about the labour market and continue to forecast rising employment and a steady decline in unemployment. We also expect an increasing proportion of new jobs in both manufacturing and services to be part-time or flexible in nature.

Kenneth Low  
10 March 2003