

Economic Commentary

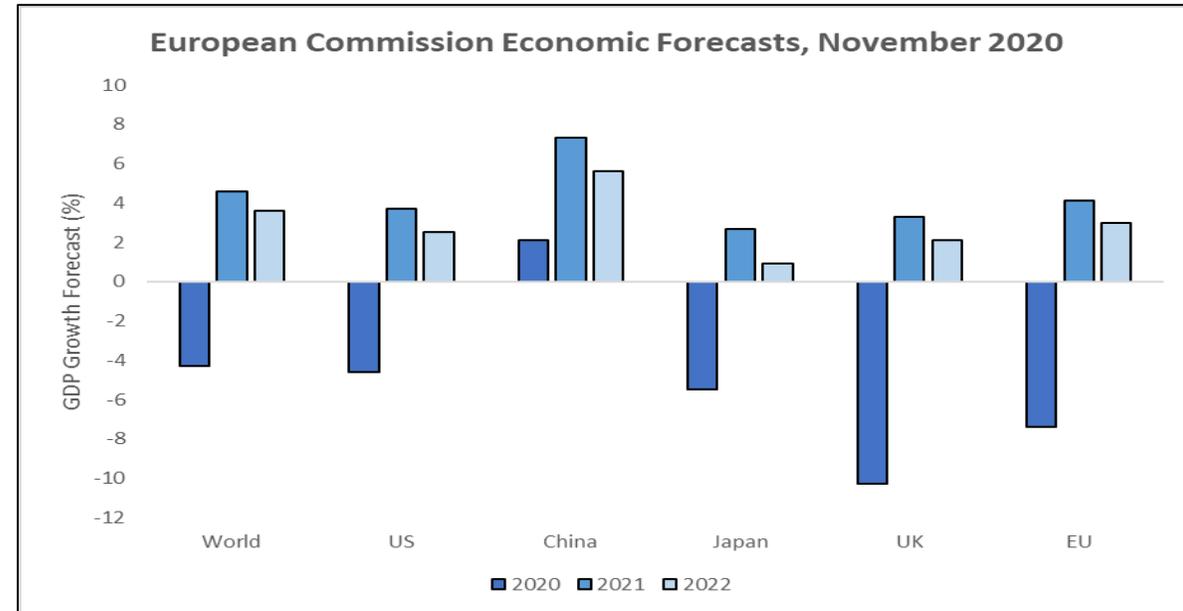
December 2020



Global Trends

- The latest [European Commission Economic Forecast](#) highlights that, although the global economy is **bouncing back** from the unprecedented recession in the first half of 2020, the economic **outlook remains subdued**.
- **Global GDP** is expected to fall in 2020 as the COVID-19 shock, pandemic containment measures and increased uncertainty are set to lower private consumption, investment and foreign trade.
- The economic impact of the COVID-19 crisis, including looming insolvencies, higher unemployment and disintegrating global supply chains are likely to **reduce growth in the near term**.
- **Higher unemployment** and the disruption to **cross-border production chains** are expected to weigh on economic activity.
- Economic growth is forecast to return in 2021 with a **rebound in domestic demand**, helped by supportive macroeconomic policy.
- However, the outlook for GDP growth in 2021 is dampened by the **expected negative impact** of relatively stringent COVID-19 containment measures in the first quarter.
- The UK is expected to have a **larger fall in 2020 and lower growth in 2021** than most main economies.

- Another downside factor is **the impact of the end of the Brexit transition period** and the assumed move to trade between the EU and the UK based on WTO's rules.
- **Growth in 2022** is also expected to be subdued and well below the pre-pandemic growth trend.



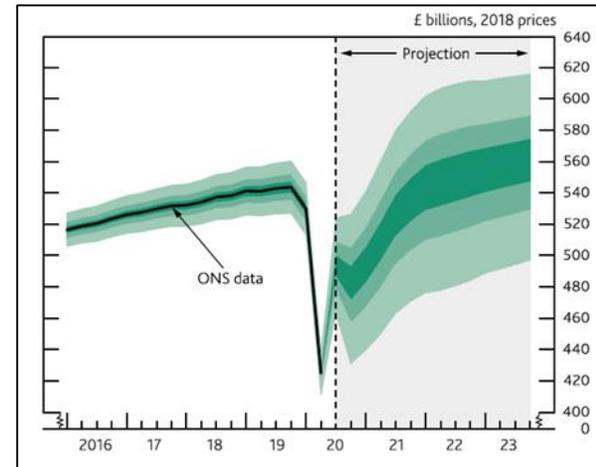
Source: European Commission

Global & UK Trends

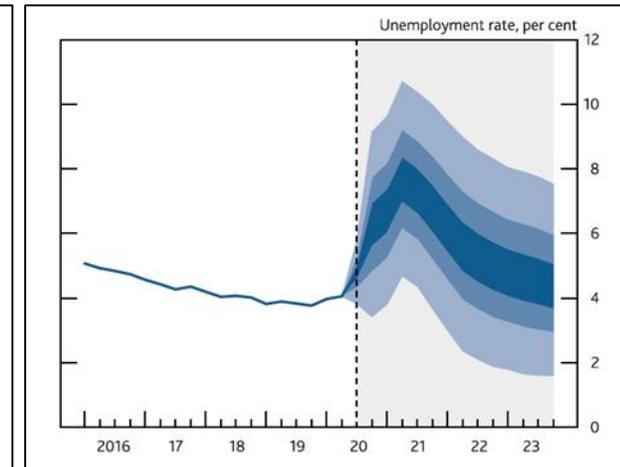
- The Bank of England's latest [Monetary Policy Report](#) noted that the **economic outlook is unusually uncertain** and depends on how the pandemic evolves, the measures taken to protect public health as a result of COVID-19, and, additionally, the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom.
- Global and UK GDP **picked up significantly in Q3** as some social distancing measures were relaxed, although activity remains below levels in 2019 Q4.
- Economic recovery has slowed though, as Covid cases have accelerated and measures intended to slow its spread have been reintroduced. As a result, **global GDP growth is expected to slow in Q4**. The euro-area GDP level is also expected to fall in Q4, and US GDP growth is expected to ease.
- In their central forecast the Bank expects the global economy to **contract by 5.25% in 2020**, before recovering to growth of 5.5% in 2021. In 2022, GDP is forecast to increase by 3.75% and by 2.5% in 2023.
- **UK GDP is projected to fall in Q4** as a result of restrictions and the forecast for 2020 has been revised further down – economic output is now expected to be 11% lower over the year (compared to a fall of 9.5% in the previous forecast).
- The forecast for **2021 has also been revised down** to 7.25% from 9% but the 2022 forecast has been raised from 3.5% to 6.25%.

- **Government job retention schemes have reduced the number of job losses substantially**, but unemployment has still risen, and unemployment is expected to increase further.
- The **UK unemployment rate** is expected to **peak at around 7.75%** in 2021 Q2 before gradually declining.

UK GDP Forecast



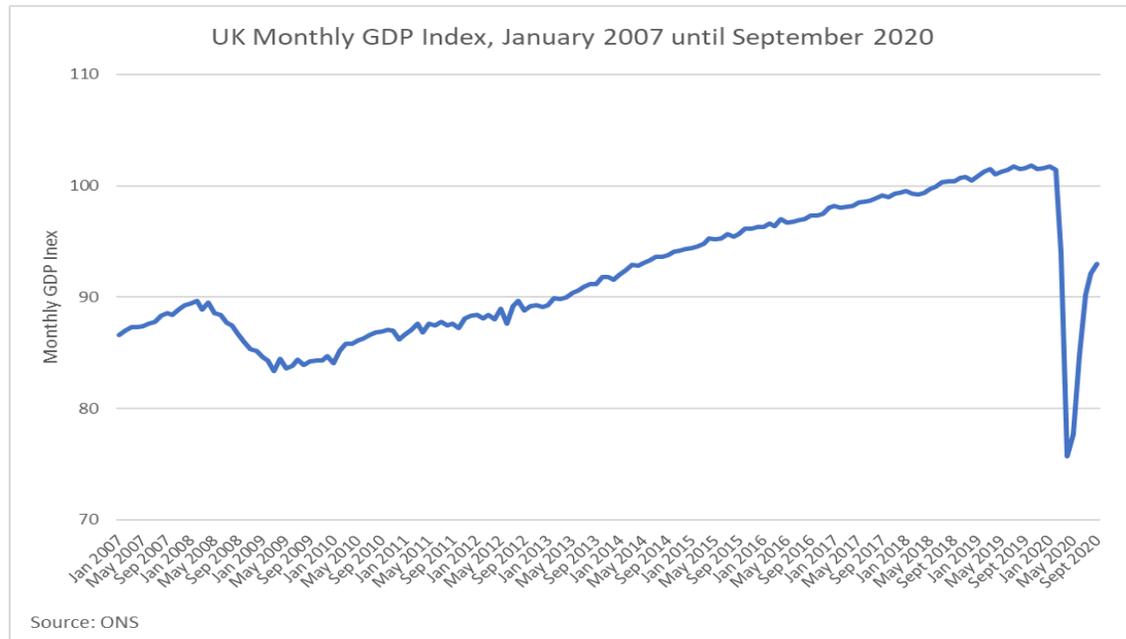
UK Unemployment Rate Forecast



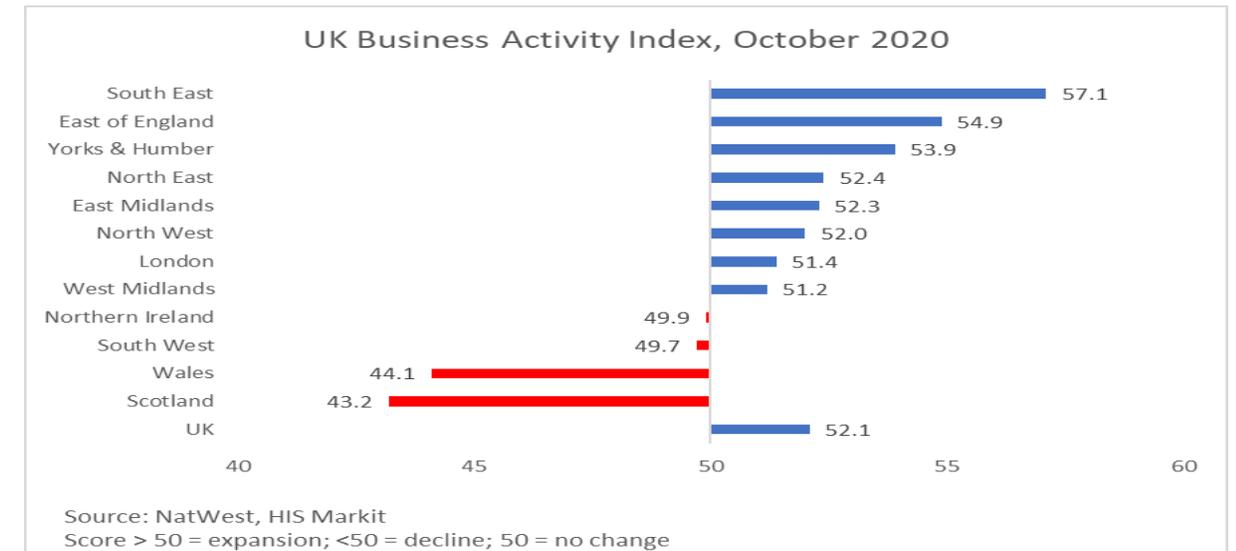
Source: Bank of England

UK Trends

- [UK GDP data](#) for September 2020 showed the economy **grew by 1.1% over the month**, the fifth consecutive monthly increase; however, growth slowed over the month and GDP was still 8.2% lower than in February 2020.
- **Over the third quarter (July to September) GDP grew by a record 15.5%**, following two consecutive quarterly falls, as lockdown measures were eased. This reflects some recovery of activity, but the level of UK GDP is still 9.7% below where it was at the end of 2019 and has not recovered to pre-pandemic levels.

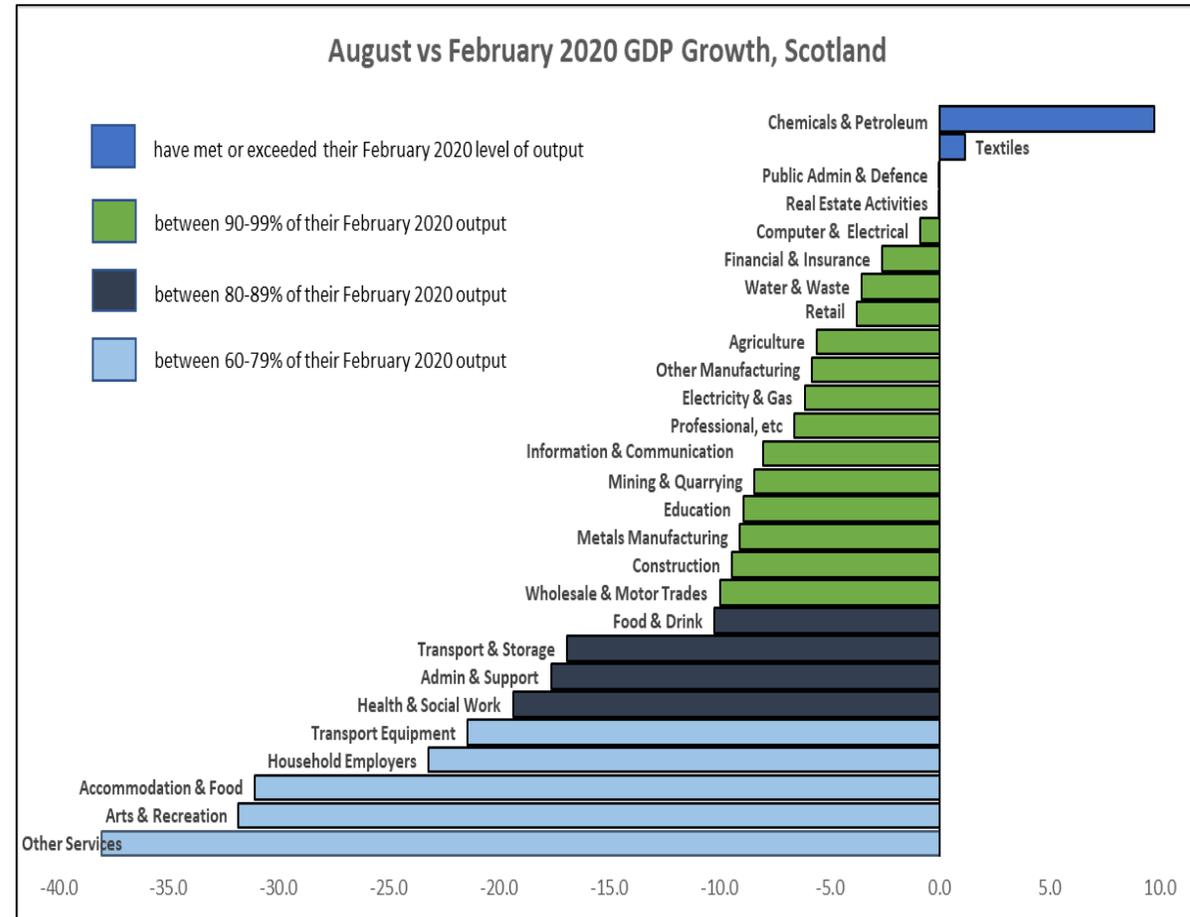


- **UK business surveys highlight slowing recovery in October** compared to the previous month. This trend at first sight seems to have deteriorated further in November with early figures suggestion November economic activity levels back into negative territory.
- The [NatWest Regional Business Activity Index](#) reported a **loss of momentum across the UK economy** in October as coronavirus restrictions were tightened in many areas.
- Eight out of nine regions in England recorded an increase in activity but **most businesses are anticipating a tough end to the year** and declines in activity in November as lockdown restrictions come into effect.
- There was a marked fall in activity in Scotland, although the decline was slower than during the initial lockdown in the spring. **Scotland has been the weakest performing UK nation/regions for several months.**



Scottish Trends

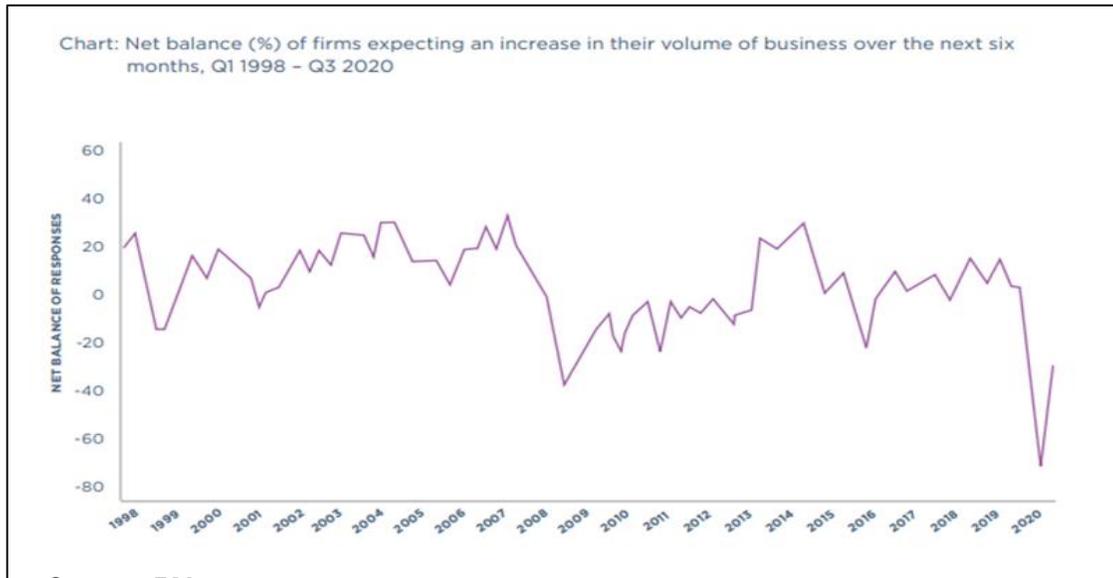
- The [latest GDP data](#) shows that the Scottish economy grew for the fourth consecutive month in August and has **recovered around 60% of the output lost in March and April**.
- However, despite this, Scottish GDP is still 9.4% below February's level and growth of 2.6% in August was slower than July's increase of 6.4%.
- **Growth slowed in both the Services and Construction sectors and there was a slight fall in the level of output in the Production and Agriculture sectors.**
- Output in the Services sector (that accounts for 76% of the economy) increased by 3.3% compared to July **but was still 10.3% below its February level**.
- Output in the Production sector (17% of the economy) fell by 0.3% **and was 5.6% below its level in February**.
- Construction output is estimated to have increased by 3.8% in August **but was 9.4% below its level in February**.
- The scale of the impact on output during the national lockdown, the pace at which demand has recovered and the need for subsequent local restrictions means that **sectoral differences are emerging**.
- **Accommodation and Food Services** output, for example, one of the most badly affected sectors, remains 31% below its February level.



Source: Scottish Government

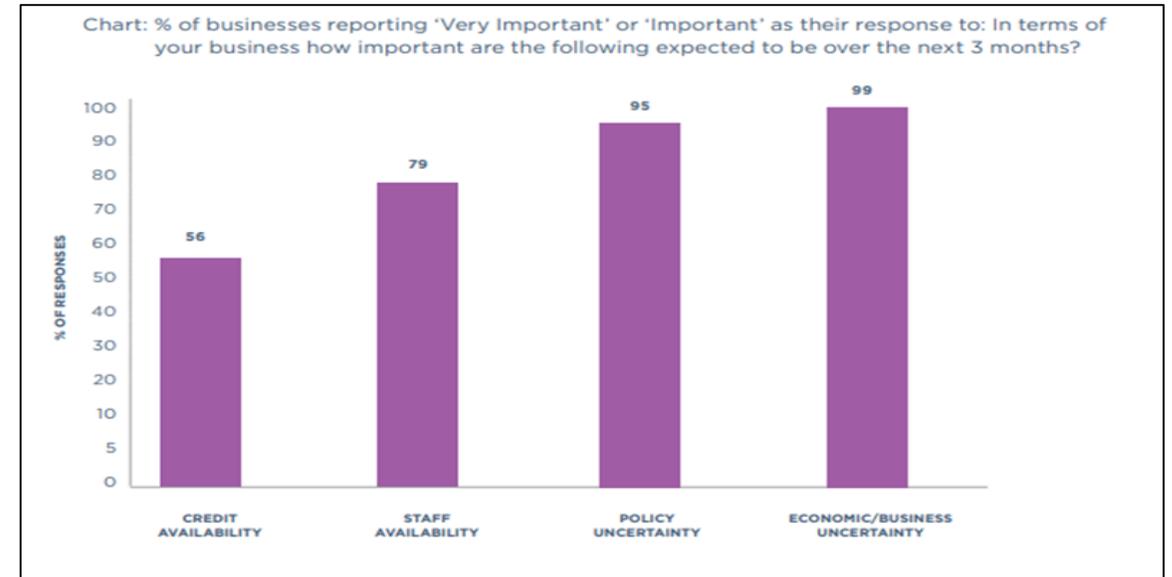
Scottish Trends

- Results from the latest [Fraser of Allander Scottish Business Monitor](#) show that **business activity remains lower than normal**.
- Within a context of tightening restrictions across different parts of the UK, **economic uncertainty remains the biggest concern for businesses** over the coming months.
- Although the number of businesses reporting an increase in activity has improved over the quarter, there were still **more reporting a decrease** than an increase.
- The number of businesses anticipating an increase in volume of output for the next six months was **also down on the previous quarter** - over 40% of businesses expected a drop in activity.



Source: FAI

- Almost all surveyed businesses reported that **economic uncertainty** will be important or very important over the coming three months.
- 95% of businesses also reported **policy uncertainty** as an important or very important factor in the near future.
- Around half were concerned about **credit availability**.
- Most businesses reported **secure or very secure cashflow positions** over the next six months, with just under 40% being insecure or very insecure.



Source: FAI

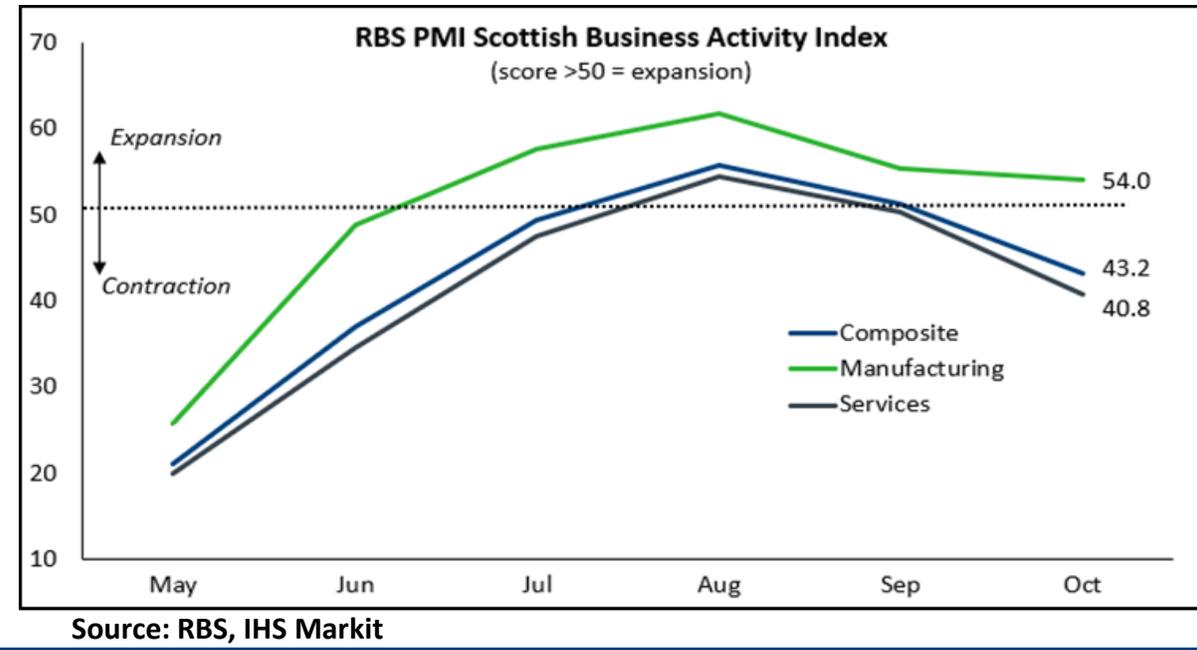
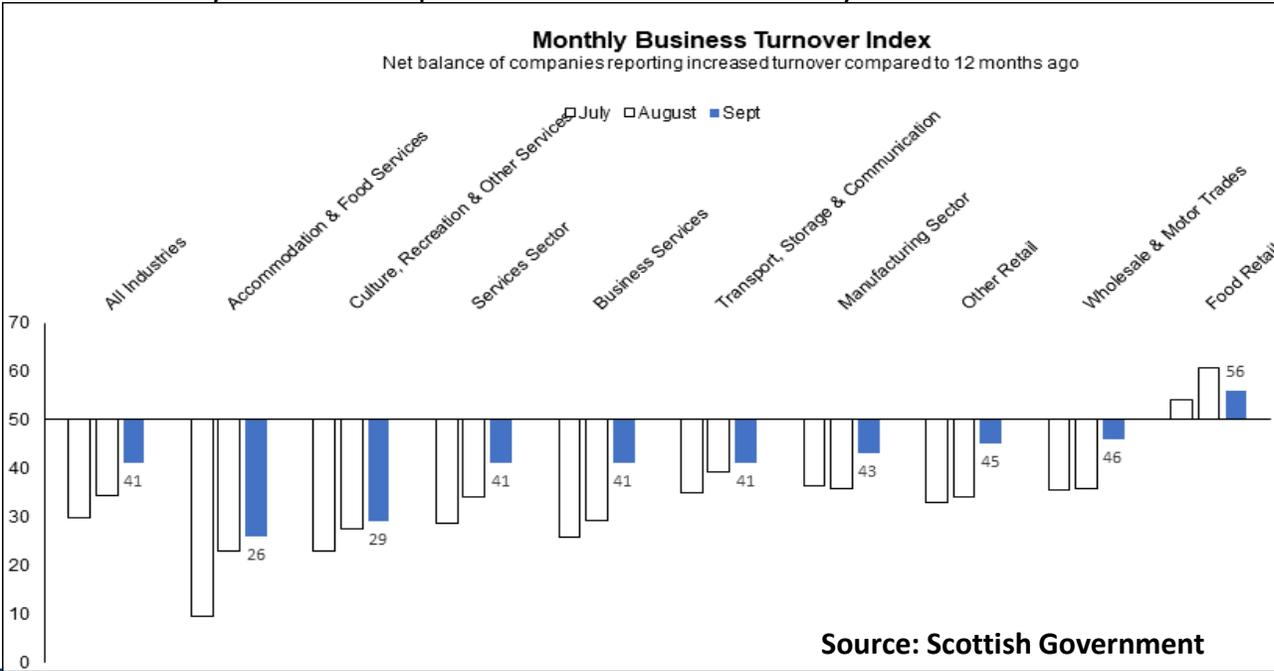
Scottish Trends

The [Scottish Monthly Business Turnover Index](#) is an indicator of business activity. Values below 50 indicate that more businesses are showing decreased turnover than increased. Key points for September are:

- Compared to **one month ago**, the turnover index was 59.7, indicating that more companies reported increasing sales than decreasing sales. Business turnover increased for the fifth month in a row but **remained significantly below pre-pandemic levels**.
- However, **compared to 12 months ago**, the all-industry business turnover index was 41 (up from 34 in August), demonstrating that most companies were still **reporting lower sales than last year**. Turnover was down in all industry sectors except for the food retail industry.

The latest [Royal Bank of Scotland Purchasing Managers' Index \(PMI\)](#) reported a sharp decline in private sector activity in Scotland in October following the introduction of new restrictions to tackle COVID-19, although the **fall in activity was less severe than in the spring**.

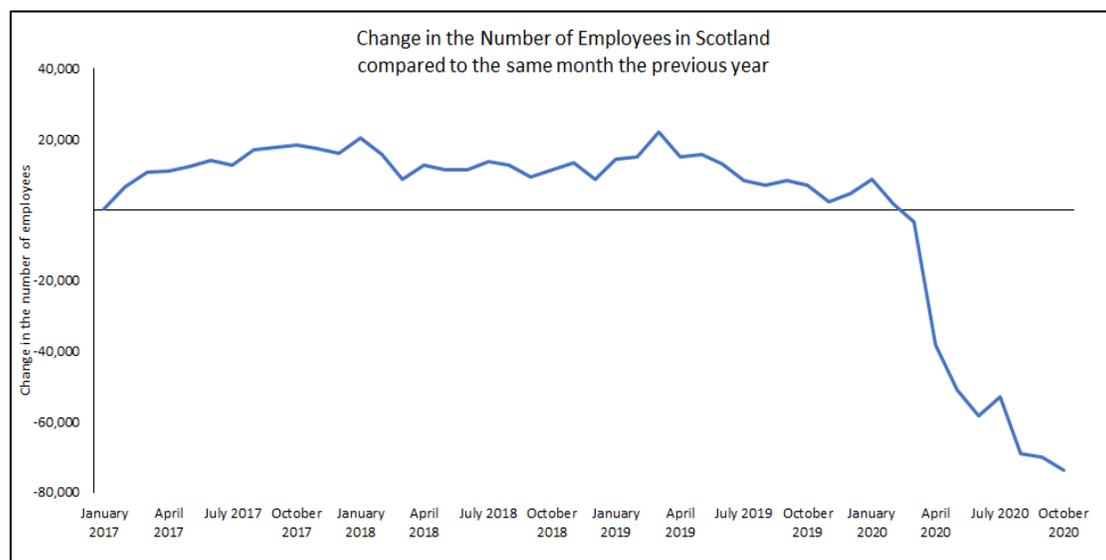
- **Service sector businesses felt the greatest impact**, reporting a rapid fall in activity that offset the decline in manufacturing.
- **Employment levels fell** for the ninth consecutive month and at the fastest pace since July.
- **Business confidence fell to a 5-month low** amid concerns over the length of the pandemic, the speed of economic recovery and uncertainty related to Brexit.



Scottish Trends

Statistics from the [HMRC and ONS](#) highlight how the number of **payrolled employees** in Scotland has fallen since February:

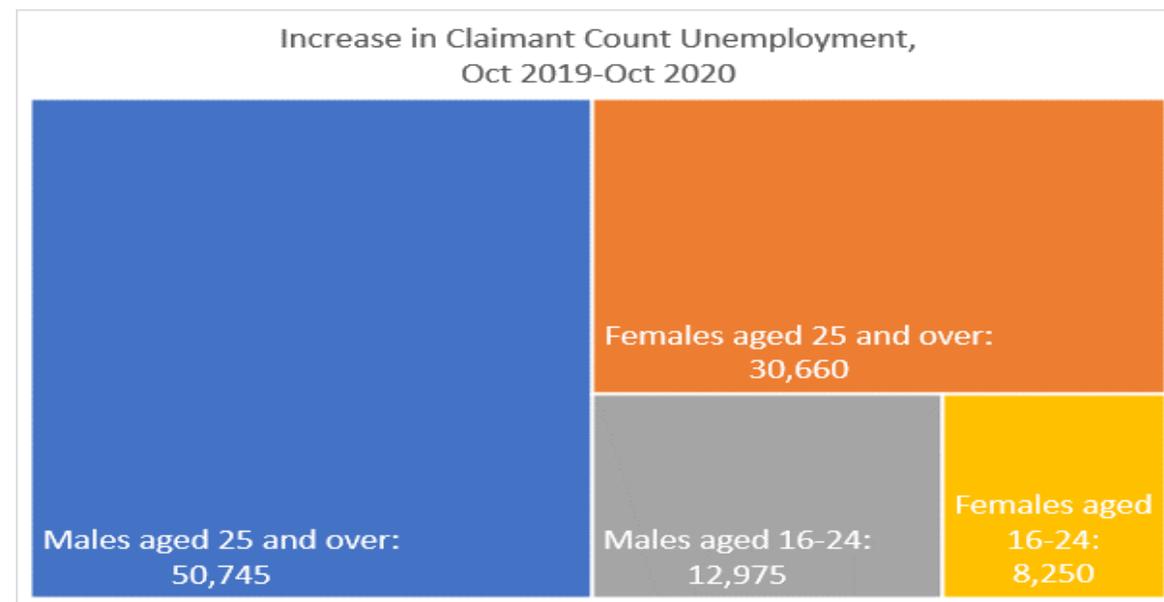
- Compared to the same month last year, the number of employees had **declined by almost 74,000** in October (to 2,322,024) – a fall of 3.1% over the year.
- **Scotland had the second largest percentage fall** across the 12 UK nations and regions. Only London had a bigger proportionate decline (4.6%) while the average across the UK was -2.6%.



Source: ONS

The latest [Labour Market statistics for Scotland](#) show that:

- Scotland's unemployment rate **increased by 0.5 percentage points over the year to September** to 4.5% (4.8% in the UK) but stayed the same over the quarter.
- The **number of unemployed people increased by 16,000 over the year** and fell by 1,000 over the quarter. The unemployment rate for women was 4.2% over the quarter compared to 4.9% for men.
- The unemployment claimant count, which is a measure of people claiming benefits for unemployment-related purposes, **increased by around 102,000 people** in the year to October.



Sources: ONS, Scottish Government

Scottish Trends

The latest ONS [Business Impact of COVID-19 Survey](#) for the period 19th October to 1st November shows:

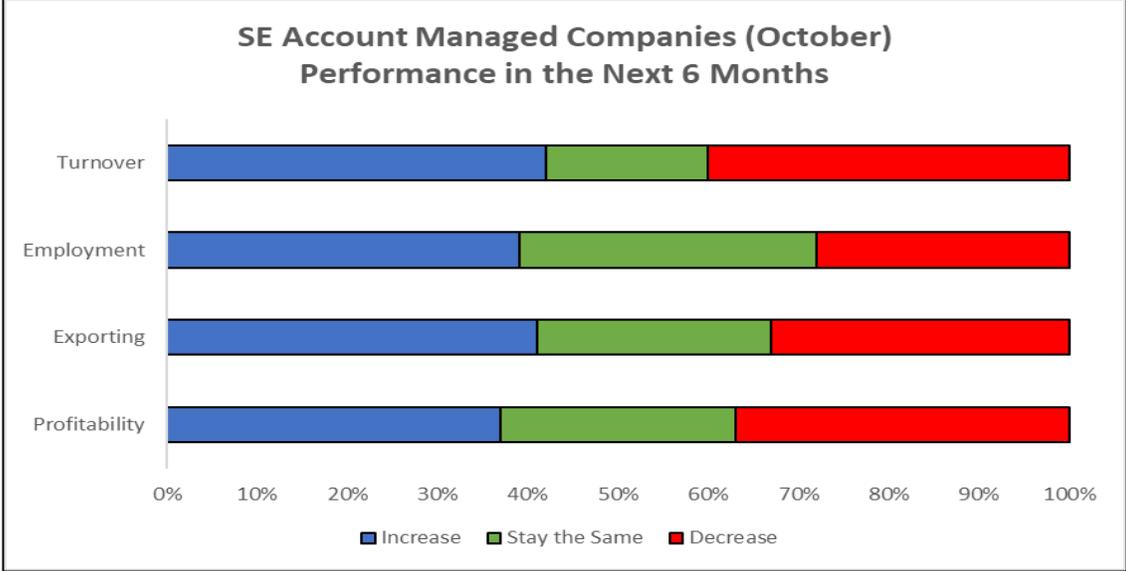
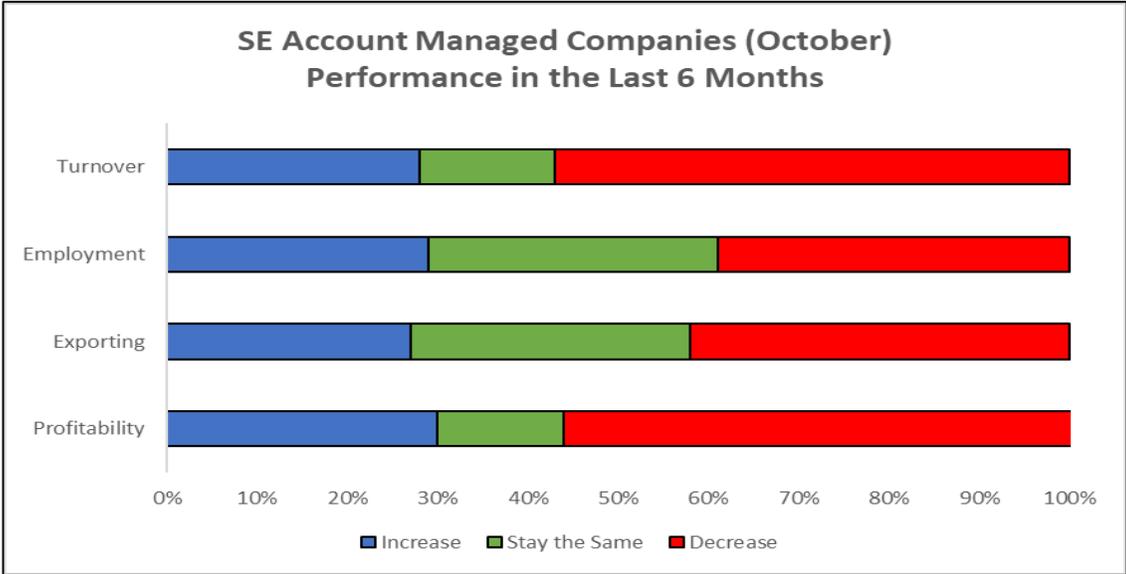
- **96%** of Scottish businesses were **trading** (UK, 92%).
- **56%** of Scottish trading businesses experienced **reduced turnover** over the period (UK, 50%). 14% reported turnover more than halved (UK, 13%).
- **36%** of Scottish exporters trading were **exporting less** than normal (UK, 34%).
- **58%** of Scottish businesses were **using, or intended to use, the Job Retention Scheme** (UK, 54%).
- Scottish businesses were **more likely to have applied for government-funded business grants** than the UK as a whole (21% versus 16%) but slightly less likely to have received Government-backed loans or finance (25% versus 28%).
- **39%** of Scottish businesses believed their **cash reserves could last more than 6 months** (UK, 35%).
- **66%** of Scottish businesses are highly confident that their **businesses will survive the next 3 months** (UK, 58%).

- The Federation of Small Businesses reported that **Scottish business confidence slumped** over the last three months, after a modest recovery earlier this year, in their [Q3 Small Business Index](#).
- The confidence index fell to -26.3 points in Q3 from -10.5 points earlier in the year, probably **due to the prospect of new coronavirus-related restrictions**.
- **24% of small businesses believe that conditions for their business will get much worse** over the next three months and 19% believe they'll get slightly worse. Only 11% believe conditions will get a lot better.
- Many businesses' **cash reserves are already exhausted** and are fearful about the future.
- **Revenue growth has declined**, with 53% businesses surveyed reporting a fall in revenue and 49% expect revenues to fall next quarter.

Scottish Trends

The [Scottish Enterprise Economic Trends Survey](#) provides insight on how Scottish Enterprise **Account Managed Companies** are responding to the current economic environment. Between August and October 2020 (based on 210 businesses):

- **57%** reported a decline in turnover and profitability in the last 6 months.
- **39%** reported a decline in employment and **42%** reported a decline in exporting.
- **41%** expect their turnover to decrease further **over the next 6 months**, while **28%** are expecting to see a decrease in employment.
- Just **12%** think that the **economy will grow** over the next 6 months (an all-time low) as tighter restrictions are placed on activity in Scotland.
- **51%** think Scotland’s economy will **weaken** - the most common reasons are:
 - the impact of COVID-19 (66%)
 - impact of economic and political policies e.g. COVID-19 response (27%)
 - uncertainty around Brexit (27%)
- **36%** are **uncertain** about the prospects of the Scottish economy.



Source: Scottish Enterprise Economic Trends Survey

Recent Scottish Enterprise customer feedback has consistently reflected common themes:

Workplace

- Businesses are exploring their **longer-term approach to home/remote working**. Some are likely to continue predominantly home working; others are looking to have more staff back in offices.

Workforce

- Business that have brought staff back from furlough are implementing changed working environments e.g. different working patterns to comply with **social distancing requirements**; greater use of **flexible working**; and an increased focus on **staff well-being** e.g. issuing staff vouchers for flu vaccinations.
- Businesses that are growing and hiring report an increase in **the availability of high-quality candidates** through layoffs in other firms.
- Businesses from outside Scotland are increasingly advertising for **remote working posts** here, especially for technical roles – this has potential implications for the talent base available to Scottish businesses.
- There has also been an increase in the number of people who want to move to Scotland and **work remotely from here**, attracted by the Scottish scenery and cosmopolitan cities – although this is a relatively small number of people to-date.

Opportunities

- Demand for **contactless solutions is continuing to provide opportunities** e.g. software companies offering new services such as digital menus, menus on big screens and printed menus on antibacterial surfaces.

Brexit

- Brexit is growing in importance for businesses who trade with the EU - many are looking for clear guidance on post-Brexit trading requirements and are concerned that detail remains limited. Many are growing increasingly concerned about the **possibility of a no-deal Brexit**.
- Due to COVID-19 many businesses are **only now looking in detail at Brexit planning**.
- Some businesses that sell products to Europe are considering **setting up subsidiaries** in Europe e.g. Dublin is often mentioned as a potential location.
- Businesses involved in the modification of goods brought in from Europe and then re-sold in Europe will be impacted by new tariffs and **may pass this additional cost onto customers**.
- Some businesses are highlighting the cost of **Brexit related legal fees** that are being incurred to prepare for a new trading environment.
- There is a concern leaving the EU may **diminish Scotland's inward investment offer** in some sectors, as businesses generally prefer to site operations in large trading blocs.

Exports

- **Winning new export sales** is challenging but businesses are adopting online approaches to meet customers. Many are recognising that 'traditional' mechanisms (e.g. trade shows) may have changed permanently are exploring alternative methods and expanding their online presence.

Funding

- Businesses continue to report **funding issues** ranging from an inability to access growth finance from banks to needing to use cash reserves for day-to-day operations.

Supply chain

- Supply Chains are changing as COVID-19 has led to widescale market closures and difficulties accessing parts and materials. Scottish businesses are **reviewing their supply chains** and looking **within the UK** to access products and services instead of importing from overseas.
- Many businesses that **rely heavily on one supplier** have been particularly heavily impacted by supply chain disruptions as finding alternative suppliers at short notice can be difficult.

Sectors

Life Sciences

- Some businesses have **undergone significant expansion** during the crisis – either by **repurposing** current activities (e.g. supporting development of drugs to treat COVID-19 symptoms) or **expanding** current activities (e.g. testing, vaccine development).

Textiles

- The textiles industry has been hugely impacted by the **decline in overseas tourists**, who tend to spend more than local tourists e.g. buying high quality cashmere.

Aerospace

- Businesses involved in the **aerospace manufacturing supply chain** (20% of sector) have seen a huge drop in work as airlines cancel or postpone orders. Job losses and even the closure of some parts of plants have already taken place.
- With the extension of the Job Retention Scheme, it is unclear whether expected redundancies will now materialise – or whether employees will **be placed back on furlough** with the hope of better order books after the scheme ends.
- The outlook for Scottish aerospace continues to hinge almost exclusively on the **return of global travel** – the most optimistic forecast predicts a **return to 2019 levels by 2024**.

Tourism

- Destination hotels are particularly affected by the **collapse in demand across most segments** (international visitors, group travel, events market, corporate market, weddings).
- Some tourism operators have been able to **maintain a level of revenue** despite restrictions - e.g. hotels with kitchens offering takeaway meals.
- For others, such activities have not proven financially viable **and temporary closure** has been the least costly option – recent domestic travel restrictions have made this even more likely.
- Hotels in **rural locations** are generally **faring better** than those in cities as they are more likely to be in areas with lesser restrictions and benefit from guests' interest in wellness e.g. walking in the countryside. The staycation market remains strong but will have been impacted by travel restrictions within Scotland/UK.

Implications

The Scottish economy appears to be stabilising after experiencing an **unprecedented shock from COVID-19**. However, the recovery remains fragile, and will be challenging and gradual. Further future lockdown restrictions will increase recovery time and the benefits from vaccination may not be immediate. The **end of the EU transition period** will see new rules of trade between the UK and the EU and will also potentially have significant implications for the economy as it emerges from COVID-19.

Unemployment is still growing and will likely rise further when the furlough scheme ends. Particular **groups** (e.g. lower skilled, younger workers) remain the most vulnerable to job losses and could face longer periods out of work. Some parts of the **West of Scotland** are among the most affected by rising unemployment.

Business, sectors and places will need to continue to **respond quickly and innovatively** to ongoing challenges and will need a range of support to boost resilience and stimulate recovery – e.g. support to:

- **navigate government advice** to be as prepared as possible for any opportunities that occur as lockdown restrictions change across Scotland, as well helping them prepare for Brexit.
- **access funding support** – both through provision of funding and financial readiness advice.
- **access market intelligence**, especially from overseas - e.g. on the opening of markets, new regulations (especially post-Brexit), new channels to market, and changing customer demands and needs.

- **innovate/invest in R&D** to develop new products/processes; this will include accessing relevant innovation funding, expertise and talent, **especially post-Brexit**.
- **develop new ways of doing business** – including online selling and marketing, investing in the right ICT equipment (including greater automation) and workplace innovation.
- **Retaining, attracting and developing skills** – e.g. supporting staff to work new workplace environments, reskilling workers to effectively use new technology.
- **implement Health & Safety and social distancing requirements** in ways that minimise productivity losses – e.g. support from SMAS practitioners.
- **develop and deepen local supply chains** to build resilience through higher levels of local sourcing. Understanding supply chains also helps identify gaps in Scottish capacity that could be filled by existing/new Scottish businesses or potentially via targeted inward investment.
- **investment in the environmental, low carbon and net zero** aspects of recovery and the opportunities this may bring.
- **build competitive, place-based assets** that will attract investment and create local, high quality jobs.