

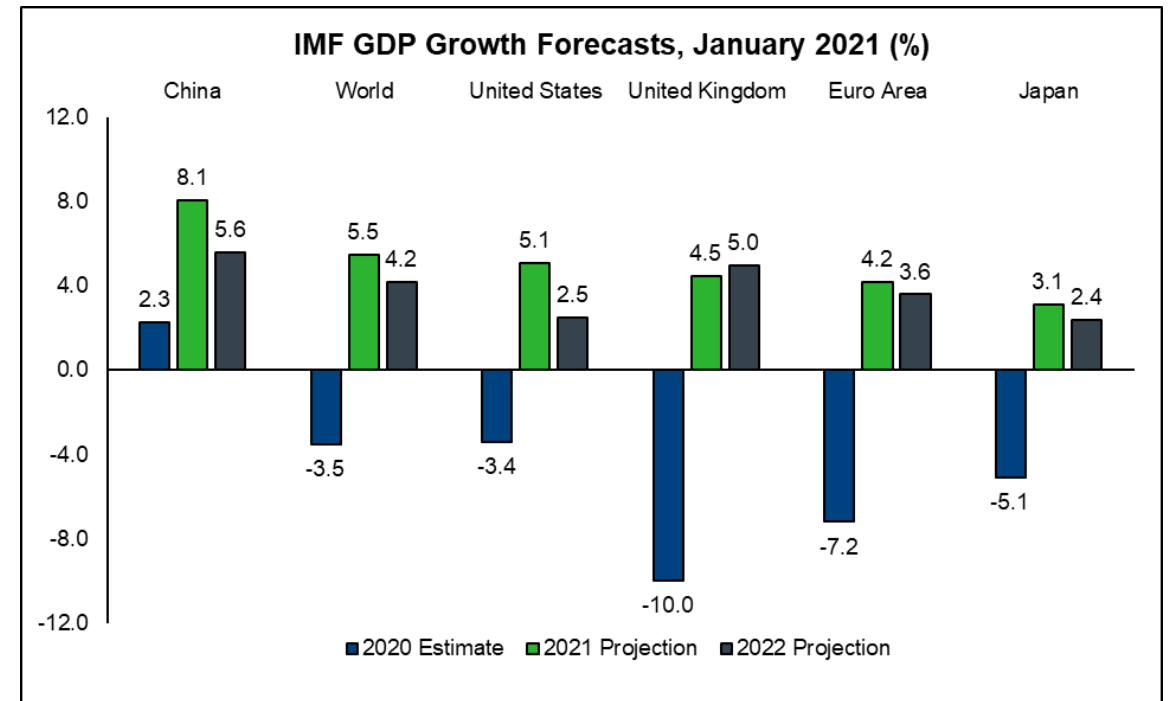
Economic Commentary

February 2021

Global Trends

- The [IMF](#) forecasts the global economy will grow **5.5% in 2021** and **4.2% in 2022**, believing the rollout of COVID-19 vaccines and more government fiscal stimulus will offset the immediate challenge posed by the resurgent virus.
- The projected global recovery follows a **2020 contraction** now estimated at **3.5%**, less than previously forecast after stronger-than-expected momentum in the second half of the year.
- In the first few months of 2021, the IMF expects economic growth to be **subdued** due to renewed restrictions, with **activity rising** in the second quarter as vaccines become more readily available.
- However, the strength of the recovery is likely to **vary significantly across countries** depending on the extent of restrictions and disruptions to activity, and the effectiveness of policy support to limit persistent economic damage.
- Growth is expected to be strongest in **China**, where effective measures to contain COVID-19 and a robust government investment response saw a strong recovery begin in 2020.
- Sizable government fiscal support announced for 2021 is expected to boost activity in both **Japan** and **United States** with both countries regaining pre-pandemic output levels in the second half of 2021.
- However, 2021 forecasts for the **UK** and the **Euro Area** were lowered due to fresh lockdowns - both were among the harder hit advanced economies in 2020 and output is expected to remain below pre-pandemic levels into 2022.

- **Emerging market and developing economies** are generally expected to recover more slowly on expectations of later widespread vaccine availability.
- **Global trade** is forecast to grow 8% in 2021 and 6% in 2022, with services trade expected to recover more slowly than merchandise volumes until Covid-19 transmission declines everywhere.

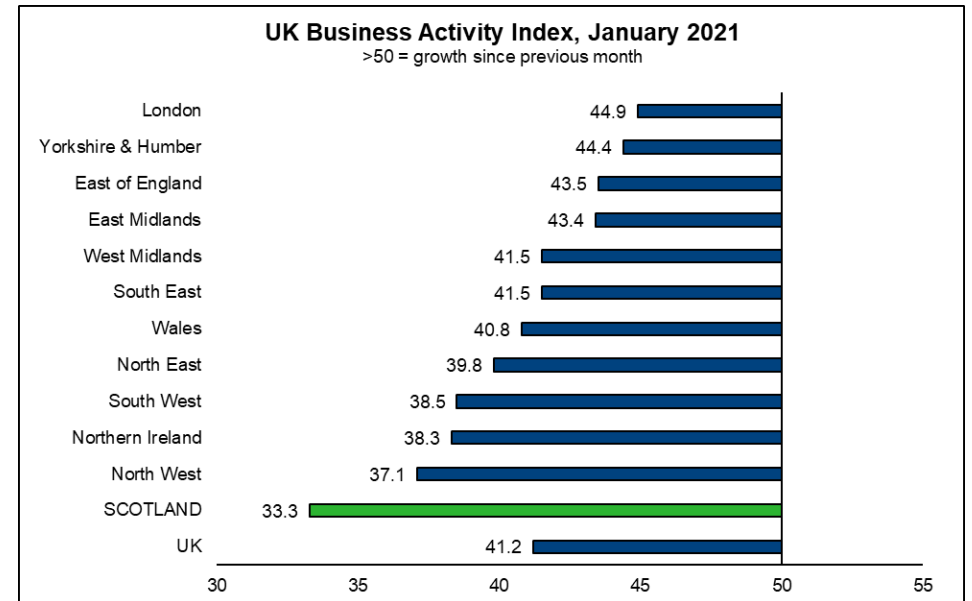


Source: IMF World Economic Outlook, January 2021

UK Trends

- The Bank of England's latest [Monetary Policy Report](#) highlighted again that the **economic outlook is unusually uncertain** and depends on how the pandemic evolves, the measures taken to protect public health, and how households, businesses and financial markets respond to these developments.
- UK GDP growth **slowed to 1.0% in Q4**, following a 16.1% expansion in Q3, as COVID-19 cases rose and restrictions were tightened. GDP contracted **9.9% in 2020**, the largest annual fall on record.
- UK GDP is projected to **fall by around 4% in Q1 2021** as a result of much **stricter restrictions** to help contain the current spread of the virus. Initial business adjustment to the UK's **new trading relationship with the EU** is also expected to temporarily lower activity.
- Economic activity is then projected to **recover strongly over 2021**, reaching pre-pandemic levels in Q1 2022, as the vaccination programme leads to an easing of restrictions and an increase in consumer spending.
- UK GDP is forecast to **grow 5% in 2021 and 7.25% in 2022** before slowing to 1.25% in 2023 as the boost from pent-up demand and fiscal and monetary support fades.
- The **UK unemployment rate** is forecast to **peak at around 7.75%** in the middle of 2021 following the end of the furlough scheme, before gradually declining.

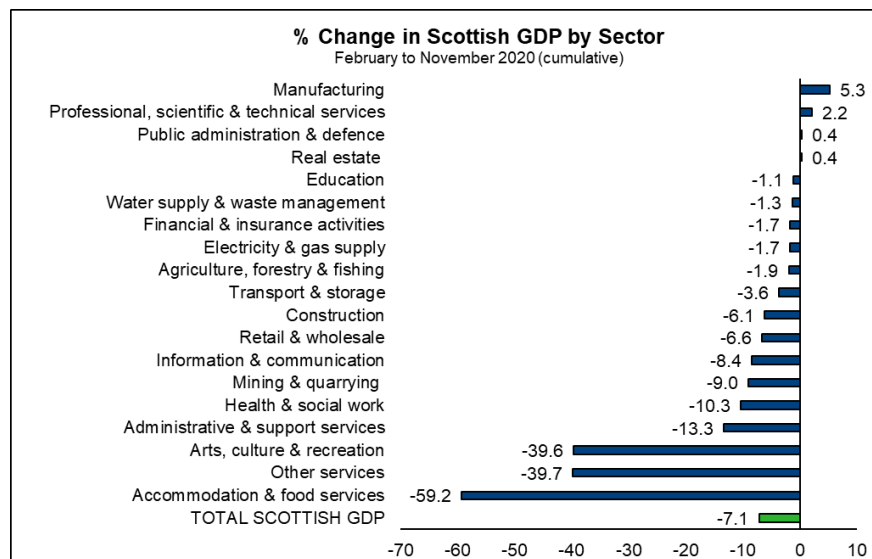
- **UK business surveys suggest a significant setback in the recovery of business activity** following the reintroduction of lockdown measures.
- The [NatWest Regional Business Activity Index](#) reported a **broad-based decrease in business activity** in January, although the decline was less than during the initial lockdown in the spring.
- All regions and nations of the UK recorded their steepest falls in business activity since May, but **most businesses remained optimistic** due to the rollout of COVID-19 vaccines and hopes for the easing of restrictions.
- Scotland experienced the sharpest decline in both activity and new business, **and was the weakest-performing UK nation/region in January.**



Source: NatWest, IHS Markit

Scottish Trends

- The [latest Scottish Government GDP data](#) show that the Scottish economy **contracted by 1.4% in November**, after six months of growth, as restrictions on economic activity were tightened across large parts of the country. Output remains **7.1% below February 2020 level**.
- The scale of the impact on output during the first national lockdown, the pace at which demand has recovered and the uneven impact of subsequent local restrictions means that **sectoral differences remain**.

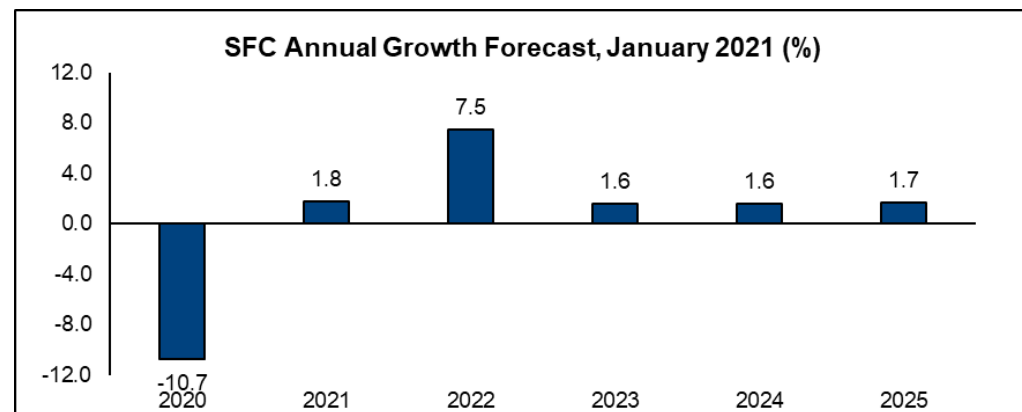


Source: Scottish Government

- Accommodation and Food Services** output, for example, one of the most badly affected sectors, remains 59% below its February level.
- Scottish GDP rose by 16.0% in Q3 after falling 19.8% in Q2, **broadly similar to UK trends**.

The latest [Scottish Fiscal Commission](#) forecast for the Scottish economy projects:

- GDP **declined by 10.7% in 2020**.
- A **fall of 5.2% in the first quarter of 2021**, reflecting the recent tightening of restrictions.
- An **increase in unemployment to 7.6%** in the second quarter of 2021 (from 4.4.% currently) following the end of the furlough scheme.
- Modest GDP growth of **1.8% for 2021 as a whole** as restrictions continue to be in place throughout the year even as the vaccine programme is rolled out.
- More robust growth of **7.5% in 2022** as restrictions are no longer required.
- A degree of 'scarring' to productive capacity that will prevent GDP recovering to pre-pandemic levels until the **start of 2024** and leave **unemployment elevated**.

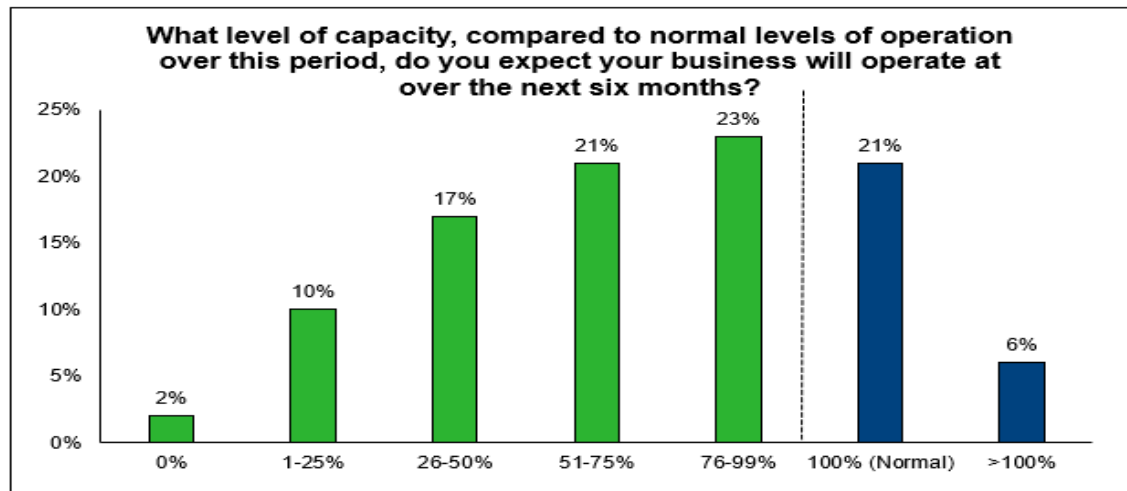


Source: Scottish Fiscal Commission

Scottish Trends

Results from the [Fraser of Allander Scottish Business Monitor](#) for Q4 2020, conducted in January, show that business activity remains **lower than normal despite increased optimism**:

- More businesses **reported a decrease in activity** than an increase for the fourth consecutive quarter.
- The percentage of businesses **reporting an increase in activity** fell from Q3, but businesses were **more optimistic** about their volume of business and levels of employment **in the next six months**.
- However, almost 70% expect Scottish economic growth to be **weak or very weak** in 2021, and 73% expect to **operate at reduced capacity** over the next six months.



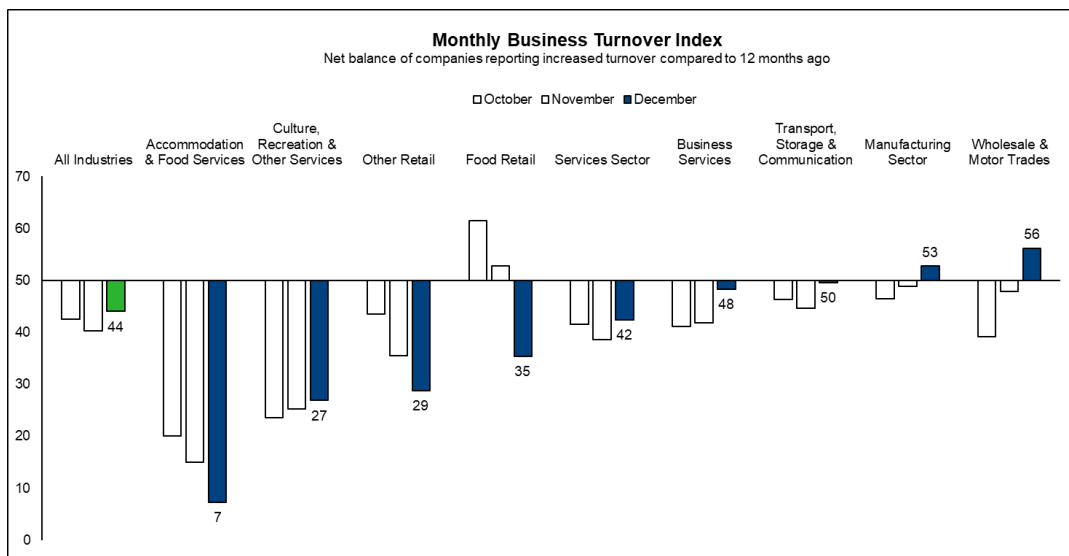
Source: Fraser of Allander Institute, January 2021

- Almost all businesses (98%) reported that **economic uncertainty** will continue to be an important or very important issue affecting them over the next quarter.
- Most businesses (60%) reported having **secure or very secure levels of cashflow** over the next six months.
- Businesses in the **food and accommodation** sectors continue to be the hardest hit, reporting the lowest activity in Q4, and more than 10% reported their **chance of survival** over the next six months as unlikely or very unlikely.
- A much larger proportion of **small businesses** reported falls in volume of business in Q4 than medium or large businesses.
- All businesses reported **reduced employment**.
- Among businesses which trade with the EU, **57% reported negative or very negative impacts** on their trade following the end of the EU transition period, with just 1% reporting positive impacts.
- Compared to Q3, more businesses reported that home working had made **managing staff more difficult** (63%) and had **negatively impacted productivity** (58%).
- There was also an increase in those expecting to **permanently reduce their office footprint** (31%).

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 **December** are:

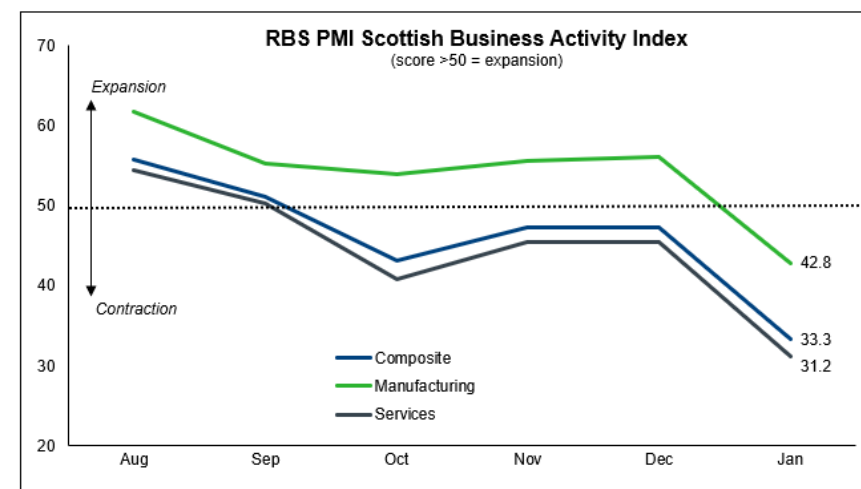
- Compared to **one month ago**, the 'all industries' turnover overall index was 48, indicating that more companies **reported decreasing sales** than increasing sales. This was the first time the index dropped below 50 since April, with the Accommodation & Food Services sector (directly affected by local restrictions) reporting the lowest result.
- Compared to **12 months ago**, the index was 44, demonstrating that most companies were still **reporting lower sales than last year**. Turnover was down in all industry sectors except for Manufacturing and Wholesale & Motor Trades.



Source: Scottish Government

The latest [Royal Bank of Scotland Purchasing Managers' Index](#) (PMI) reported that private sector activity in Scotland fell sharply and into an even steeper downturn in January as new lockdown measures stifled client demand and led some businesses to close temporarily, although the **fall in activity was less severe than during the initial lockdown**.

- **Service sector businesses felt the greatest impact**, reporting a sharper fall in activity than manufacturers.
- **Employment levels fell** again but at the slowest pace since February 2020. Businesses also continued to turn to [temporary rather than permanent staff](#).
- **Business confidence rose to a near 7-year high** on the back of the vaccine rollout and amid hopes of looser restrictions and a solid economic recovery.

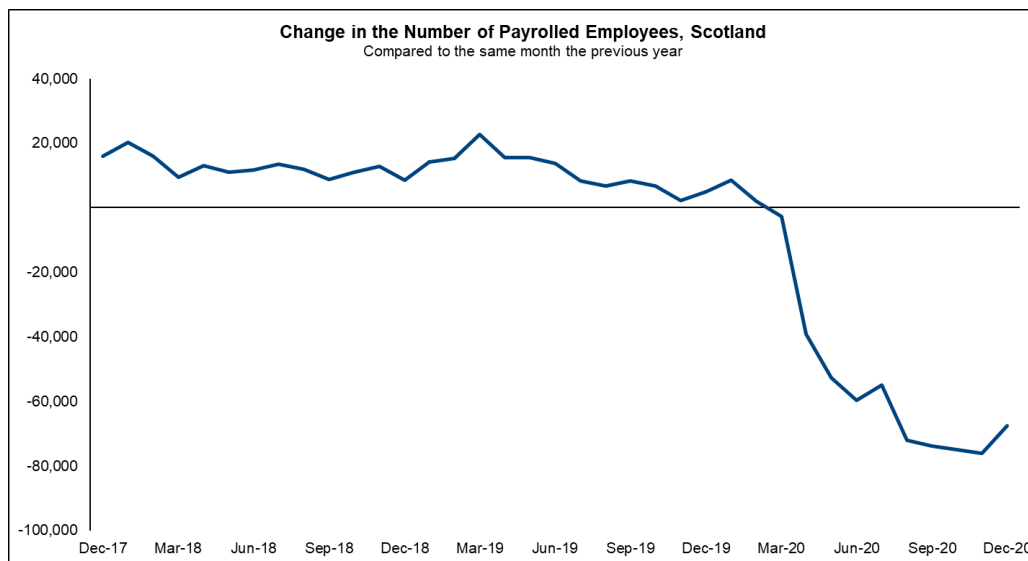


Source: RBS, IHS Markit

Scottish Trends

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

- Almost **70,000 fewer people** were in payrolled employment in December than in February 2020, despite an increase of 9,000 in the month to December.
- Compared to December 2019, the number of payrolled employees has **declined by more than 67,000** - a fall of 2.8% over the year.
- **Scotland recorded the second largest percentage decline over the year** of the 12 UK nations and regions after London - the average drop across the UK was 2.7%.

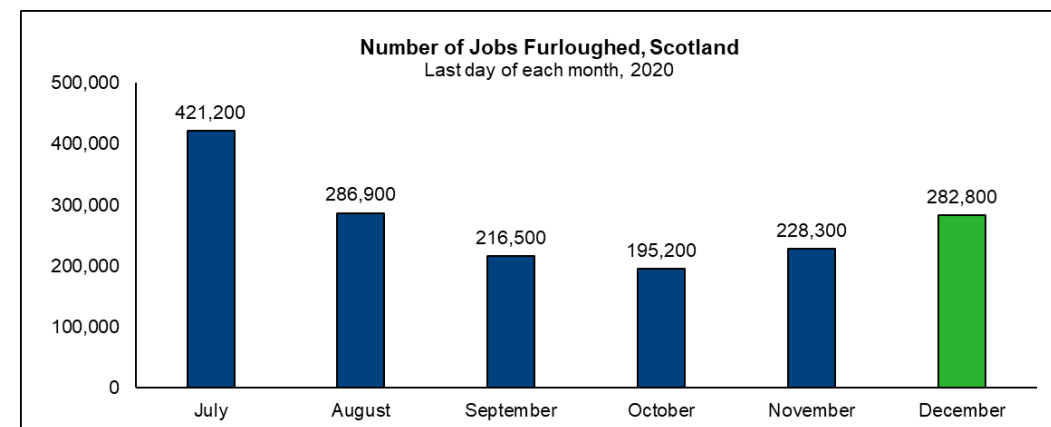


Source: ONS

The latest [labour market statistics](#) for Scotland show that:

- Scotland's unemployment rate **increased by 0.6 percentage points over the year to November** to 4.4% (5.0% in the UK) but fell slightly over the September to November quarter.
- The **number of unemployed people increased by 18,000 over the year** but fell by 1,000 over the quarter. The unemployment rate for women was 3.4% over the quarter compared to 5.4% for men.
- The unemployment claimant count, which is a measure of people claiming benefits for unemployment-related purposes, **increased by 96,400** (almost doubling) in the year to December.
- **Youth unemployment increased by 4,000** over the year to November.

Latest [data](#) for Scotland on the use of the Coronavirus Job Retention Scheme show **282,800 jobs** were furloughed in Scotland on 31st December - a **45% increase** from 31st October when the scheme was originally due to end.

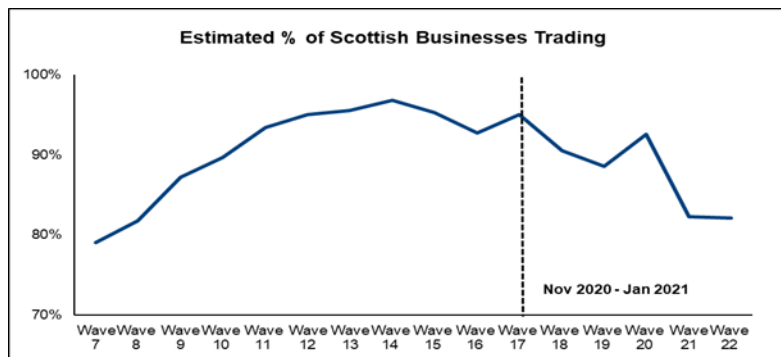


Sources: ONS, Scottish Government, HMRC

Scottish Trends

The latest weighted [Scottish Government estimates](#) of ONS BICS survey data for the period **11th January to 24th January** (with a second national lockdown in place) show:

- **82%** of Scottish businesses were **trading**.



- The **Accommodation & Food Services** and **Arts, Entertainment & Recreation** industries had the lowest shares of businesses trading at 38% and 55%, respectively.
- **28%** of Scottish businesses had **no or less than 3 months of cash reserves**.
- **53%** were **highly confident** their businesses will survive the next 3 months.

Between **28th December 2020** and **24th January 2021**:

- **19%** of the Scottish workforce was on **furlough leave**.
- The **Accommodation & Food Services** and **Arts, Entertainment & Recreation** industries had the highest shares of their workforce on furlough leave at 63% and 60%, respectively.

- **45%** of Scottish trading businesses experienced **reduced turnover**. **11%** reported turnover more than halved.
- **More than half** of trading businesses experienced a **decrease in turnover** in two industries - **Accommodation & Food Services** (75%) and **Wholesale & Retail** (53%).
- **27%** of Scottish exporters trading were **exporting less** than normal.

Results from the [Scottish Chamber of Commerce Quarterly Economic Indicator](#) for Q4 2020 highlight the **ongoing challenges** faced by Scottish businesses as well as the **uneven impact of local restrictions imposed to control the spread of COVID-19**.

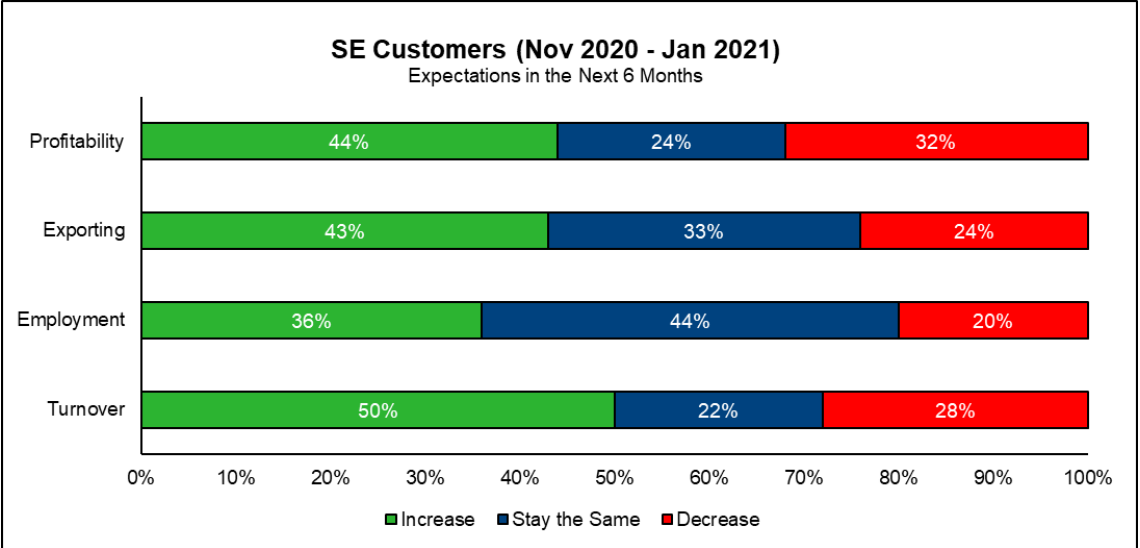
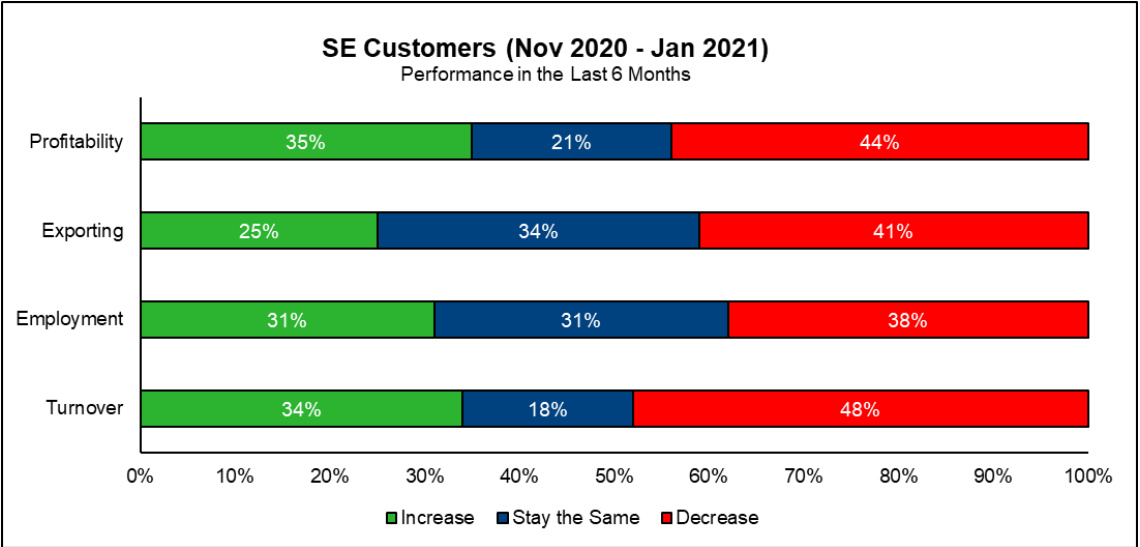
- All sectors reported lower levels of **employment** and reduced **investment intentions**.
- **Manufacturing** and **financial and business services** reported an increase in optimism and improved sales while **retailers** and **tourism** businesses reported sharp falls in sales and further deterioration in cashflow.

The [Federation of Small Businesses](#) reported that **Scottish small business confidence fell to its second lowest level ever** in the final days of 2020 - confidence was lower in Scotland than in the UK as a whole, most likely due to Scotland's proportionally **larger tourism and hospitality sector** and the **local restrictions** faced at the time the survey was conducted.

Scottish Trends

The Scottish Enterprise Economic Trends Survey provides insight on how **Scottish Enterprise Customers** are responding to the current economic environment. Between November 2020 and January 2021 (based on 171 businesses):

- **48%** reported a decline in turnover and **44%** reported a decline in profitability in the previous 6 months.
- **41%** reported a decline in exporting and **38%** reported a decline in employment.
- **50%** expect their turnover to increase **over the next 6 months**, while **36%** expect to see a rebound in employment – this reflects an increase in optimism at the end of 2020 on hopes the rollout of vaccines will bring an end to restrictions.
- However, just **16%** think that the **economy will grow** over the next 6 months and **40%** think Scotland’s economy will **weaken** - the most common reasons are:
 - the impact of COVID-19 (64%)
 - uncertainty over the UK’s future relationship with the EU (29%)
 - uncertainty over Scotland’s future relationship with the rest of the UK (17%)
- **44%** are **uncertain** about the prospects of the Scottish economy.



Source: Scottish Enterprise Economic Trends Survey

Recent Scottish Enterprise customer feedback

Overall Sentiment

- **COVID-19 remains the dominant challenge** - most businesses cite ongoing restrictions at home and abroad as the main reason for their weak performance.
- While confidence in the economy remains low, it is **slowly increasing** due to the rapid **vaccine** rollout which businesses hope will lead to restrictions being eased in the near future.
- Tourism and hospitality businesses are increasingly concerned about **survival** following the extension of COVID-19 restrictions - they have little income and cash reserves are depleted.

Workplace

- Social distancing measures in manufacturing continue to **reduce production capacity** due to fewer staff on the shop floor.
- Many businesses continue to **review their real estate requirements** - hybrid staffing models (part homeworking/part office-based) remain a common option.
- Some businesses are **opting for short term lease extensions** (often 1-3 years) until the extent of current trends become clear. Landlords are likely to accept flexibility in the current economic climate.
- The degree to which businesses continue with **remote working** remains uncertain as a long-term approach: while it offers a number of benefits, concerns are being raised around the productivity of home-based workers and the impact on management time that causes.

- **Serviced/managed offices** are seeing strong demand – these facilities were generally quick to implement safety protocols and adapted business models to **offer flexible options**.
- Since COVID-19 there has been a rise in **cyber security incidents** – e.g. via homeworking system vulnerabilities or businesses moving online rapidly and not taking all the precautions they should.

Workforce

- Businesses continue to **hire staff with IT/social media skills** as business models change, especially the growth in digital activities. Many businesses are also planning digital skills training for existing employees.
- Some businesses are reporting challenges in **retaining staff** due to ‘poaching’ by other businesses in Scotland - e.g. offering higher salaries or more job flexibility.

Logistics/Supply Chains

- Many businesses report **rising costs** - freight container use costs have quadrupled in recent months due to COVID-19 and Brexit.
- Port congestion due to both Brexit and COVID-19 is resulting in **some businesses struggling to fill orders without imported raw materials**.
- Businesses continue to **re-evaluate their supply chains** as a result of both COVID-19 and Brexit.

Brexit/UK's New Trading Relationships with the EU

- Exporters continue to report **increased costs, additional paperwork and delays at ports**; this is leading to longer delivery times and higher prices.
- Some businesses are taking on **staff or consultants with exporting experience** to help navigate and identify opportunities from the UK's new trading relationship with the EU. However, this is adding **additional costs** to business operations.
- Additional costs are **making exporting unviable** for some businesses as their products/services become uncompetitive. Rising costs mean some businesses are **questioning if they should export at all**.
- There have been examples of **lost European sales** as customers have decided to buy from elsewhere in Europe; reasons cited include higher costs post-Brexit and delays in receiving products.
- Some EU wholesalers have advised they are **no longer willing** to take products from Scottish businesses as new customs duties leave them no profit margin.
- Some exporters are actively looking at **establishing European facilities** to serve the EU. For businesses looking to establish European-based **distribution/warehousing centres**, Germany and the Netherlands are popular locations. Setting-up operations in the EU is likely to have an **impact on Scottish operations** as fewer Scottish workers may be needed.
- Due to the reduction in **free movement of people**, some businesses with global contracts have moved staff away from Scotland to Europe to serve customers more easily.
- Trade with **Northern Ireland** has become **much more difficult** e.g. some hauliers are refusing to take goods until customs process issues have eased.
- The **full impact of Brexit may still be to come** as some businesses (with long-dated products) increased exports in advance of the end of the transition period.
- Some service businesses **don't feel the implications of the agreement will be fully clear** until a trade agreement covering services is agreed.
- Despite the challenges, many businesses believe the new trading relationship is having a **relatively small impact overall** on exports. However, **Food & Drink** businesses are far more likely to report challenges.
- For many **multinational businesses** in Scotland, Brexit is not a major issue – their scale and strategic capability has meant resource and planning have been in place for some time, so they have been ready and well prepared for end of the transition period.
- Other businesses highlight the **benefit of certainty after four years of uncertainty**, even if it involves increased costs.
- Some businesses are indicating they may look to export to **additional markets outside Europe** as they become more familiar with export processes and paperwork that will apply in other countries as a result of the UK leaving the EU.
- Businesses are asking for **advice/support** on the most effective processes for EU importing and exporting; assistance in identifying more local suppliers of goods and services; support with export documentation, VAT, Rules of Origin, clarity on import duties and tariffs.

Implications

Renewed lockdown measures are further challenging a Scottish economy still struggling from the **original shock of COVID-19**. Positive news around **vaccines** offers hope but recovery is likely to be gradual and may only gather pace when restrictions are fully eased. The **end of the EU transition period** has also seen some trade disruption and delays in the movement of goods, and may continue to have significant implications for the economy as it emerges from COVID-19.

Unemployment continues to grow 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.

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:

- **access government advice** to be as prepared as possible for any opportunities that occur as lockdown restrictions change across Scotland, and to **adapt to new exporting requirements** post-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, attract and develop skills** – e.g. supporting staff to adapt to changing work patterns, reskilling workers to effectively use new technology.
- **implement Health & Safety and social distancing requirements** in ways that minimise productivity losses and facilitate future growth – e.g. support from SMAS practitioners.
- **develop and deepen local supply chains** to build future 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.
- **invest 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 workers, and ultimately create local, high quality jobs.