State of the Economy Office of the Chief Economic Adviser

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State of the Economy

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State of the Economy

This report outlines recent developments in the global, UK and Scottish economies. Updates are provided on a periodic basis and the data in this edition are correct up to and including 3 November 2017.

To view the report online please visit: https://beta.gov.scot/economy/

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Scottish Government

Overview

Scotland's economic performance has, on balance, strengthened in the first half of 2017. This follows a challenging 2016 which saw a combination of headwinds impact on growth.

Over the first six months of 2017, GDP growth was broadly in line with the UK as a whole with broad based growth across the Services sector the main driver of growth over the period. The Production sector has grown for the first time since the start of 2015, supported in part by the low value of Sterling supporting exports and the pick-up in economic sentiment and outlook in the oil and gas sector, as evidenced by industry surveys.

Scotland's labour market continues to perform strongly. The number of people in employment is close to its record high, whilst the unemployment rate is near its lowest rate since current records began in 1992. The continued growth in employment in Scotland has been driven by two trends. Firstly, there has been a rise in full-time employment by 55,000 over the past year, whilst part-time employment has fallen by 15,000. Secondly, self-employment has grown by 23,000 over a broad range of occupations, including construction, finance, distribution, hotels and restaurants.

The acceleration in inflation resulting largely from the depreciation of Sterling following the EU referendum has squeezed households' spending power, with growth in earnings in 2017 not keeping pace with prices. The MPCs decision to increase the Base Interest Rate to 0.5% in November represents the first rate rise for a decade. While the Base Rate remains exceptionally low and effectively returns to its pre-EU referendum rate where it remained unchanged for seven years, this potentially marks the start of a gradual process of returning interest rates closer to their pre-financial crises levels.

The response of consumers to these changes in the economic outlook will be key to determining Scotland's future economic prospects. This edition of the State of the Economy therefore provides new analysis of consumer lending in Scotland. It also provides further information on a new statistical release now being published by the Scottish Government tracking consumer sentiment in Scotland. Both of these indicators will be important in assessing Scottish households exposure to a rise in interest rates, and the wider impact that it has on consumer confidence.

The outlook for the Scottish economy is similar to that presented in June with independent forecasts indicating growth of around 1% in 2017 and 2018. Brexit remains the key risk to Scotland's economy, particularly to business and consumer sentiment. The Scottish Government's Draft Budget on 14 December will be accompanied by the first forecasts prepared by the Scottish Fiscal Commission, providing their official assessment of the outlook for key macroeconomic and fiscal indicators for Scotland.

Global Summary

Global economy builds momentum in 2017.

- The global economy gathered momentum in the first half of 2017 with an uptick in demand growth in advanced economies and stronger performance across large emerging market economies.
- Robust global PMI and consumer confidence data signal that growth is likely to continue into the second half of 2017.
- The stronger outlook for advanced economies is tempered by continued weak productivity growth while an up-tick in activity in China and emerging Europe is driving growth in emerging market and developing economies.
- As a result of these factors, the IMF raised their forecast for global growth to 3.6% in 2017 and 3.7% in 2018.

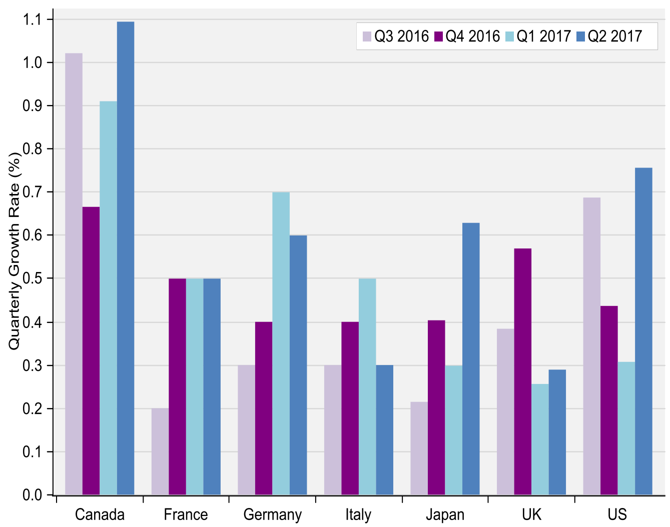
US growth recovers pace following a slow start to 2017.

- Following a slowing of growth to 0.3% in Q1 2017, US GDP growth regained pace in Q2 and Q3 growing 0.8% and 0.7% respectively.
- Despite a fall in employment in September due to hurricane disruption, the US labour market has continued to tighten in 2017 with falling unemployment and rising hourly earnings.
- US inflation remains around the FEDs 2% target, rising to 2.2% in September driven by a rise in fuel prices.
- US GDP growth is forecast to accelerate to 2.2% in 2017 and 2.3% in 2018.

Euro Area economy continues to strengthen in 2017.

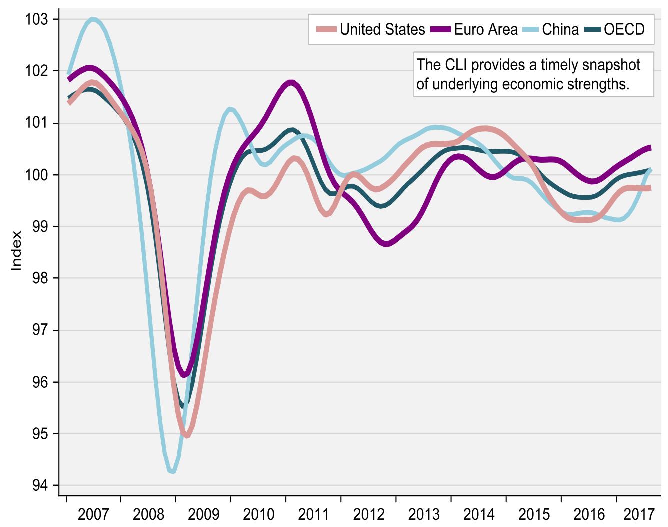
- Euro Area GDP growth strengthened in the second half of 2016 and remained buoyant in 2017, growing 0.7% in Q2 and 0.6% in Q3.
- The unemployment rate fell to 8.9% in September - its lowest rate since the start of 2009.
- Euro Area inflation increased to 1.5% in Q3 2017 with euro appreciation moderating the inflationary pressures resulting from stronger domestic activity. Initial estimate for October signals that inflation has eased back to 1.4%.
- Euro Area GDP growth is forecast to accelerate to 2.1% in 2017, before moderating to 1.9% in 2018.

G7 GDP Quarterly Growth Rates



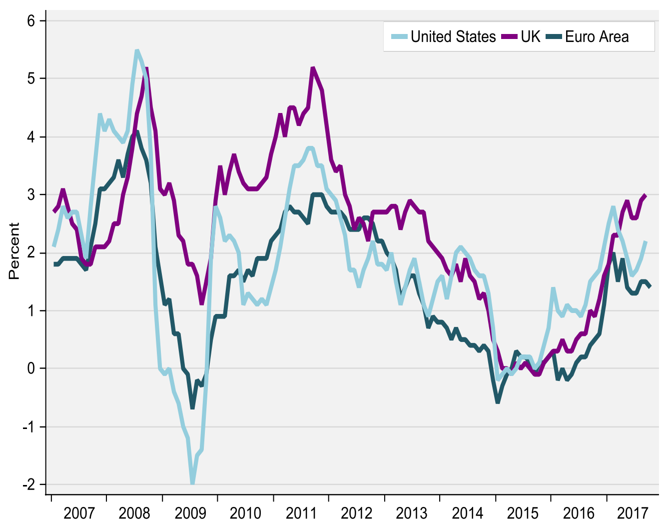
Source: Macrobond

Composite Leading Indicators



Source: Macrobond

Headline Annual CPI Inflation



Source: Macrobond

GDP Growth (%)	Outturn	Projections		Revisions from July 2017 Forecast	
IMF WEO (Oct 2017)	2016	2017	2018	2017	2018
World Output	**3.2**	**3.6**	**3.7**	**0.1**	**0.1**
Advanced Economies	**1.7**	**2.2**	**2.0**	**0.2**	**0.1**
United States	1.5	2.2	2.3	0.1	0.2
Euro Area	1.8	2.1	1.9	0.2	0.2
United Kingdom	1.8	1.7	1.5	0.0	0.0
Japan	1.0	1.5	0.7	0.2	0.1
Emerging Market & Developing Economies	**4.3**	**4.6**	**4.9**	**0.0**	**0.1**
China	6.7	6.8	6.5	0.1	0.1
India	7.1	6.7	7.4	-0.5	-0.3
Brazil	-3.6	0.7	1.5	0.4	0.2
Russia	-0.2	1.8	1.6	0.4	0.2
South Africa	0.3	0.7	1.1	-0.3	-0.1

United Kingdom Summary

GDP growth eased in 2017.

- UK GDP grew 0.3% in the first two quarters of 2017 with the provisional estimate for Q3 picking up to 0.4%.
- Annual growth has been on a downward trend since mid-2014 though has levelled in 2017.
- The Service sector grew 0.1% in Q2, driven by a pick-up in output from Distribution, Hotels and Restaurants.
- This offset contractions of 0.2% in the Production sector and 0.6% in the Construction sector.
- The estimate for Q3 signals growth in Services and Manufacturing offsetting a fall in Construction output.

Labour market has continued to tighten in 2017.

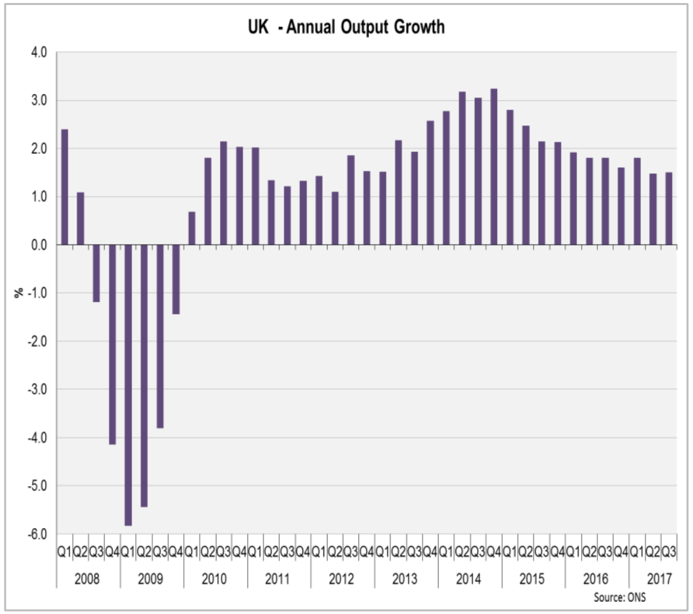
- The UK labour market has continued to perform strongly in 2017. The unemployment rate fell to 4.3% in June-August and inactivity level fell by 13,000 over the year.
- Employment also continued to rise over the past year, increasing by 317,000 to an employment rate of 75.1%.
- Nominal earnings growth has been weak at 2.2% while real wages fell 0.5% over the year to June – August 2017.

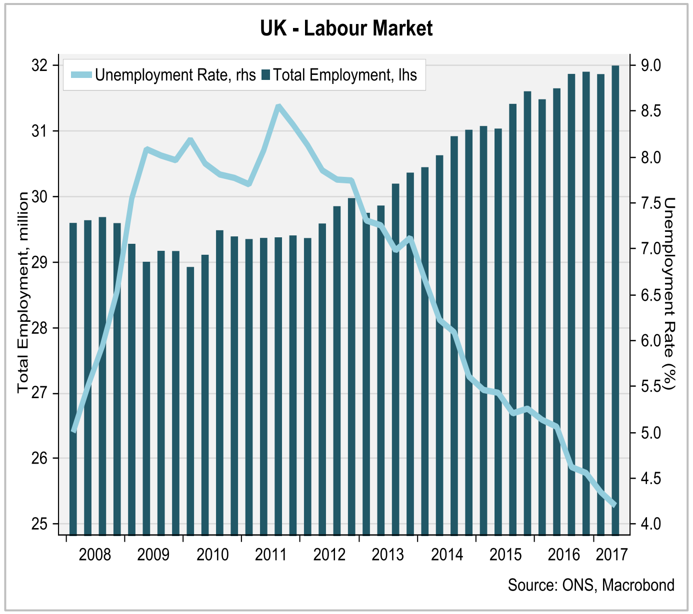
Inflation forecast to exceed 3% in 2017.

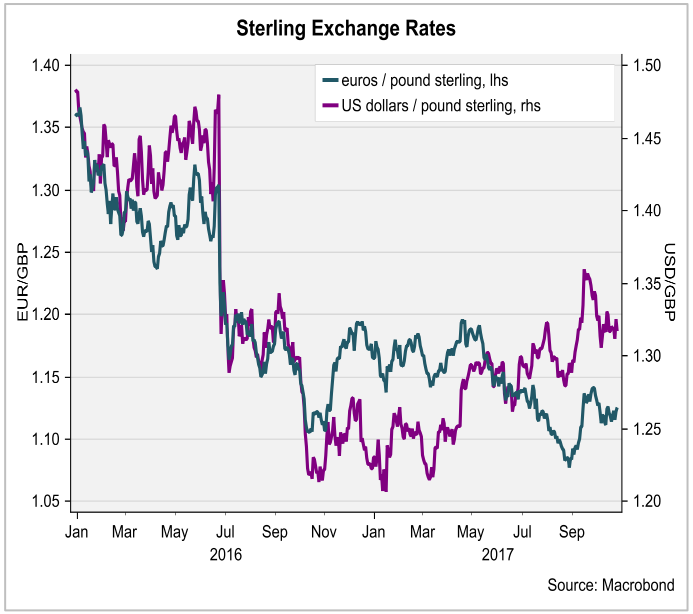
- Consumer Prices Inflation (CPI) rose to 3.0% in September, matching its highest rate since April 2012.
- The lower value of Sterling has pushed up consumer prices while oil prices have also risen 2017.
- The MPC raised the Base Rate to 0.5% in November, forecasting inflation to rise above 3.0% in late 2017.

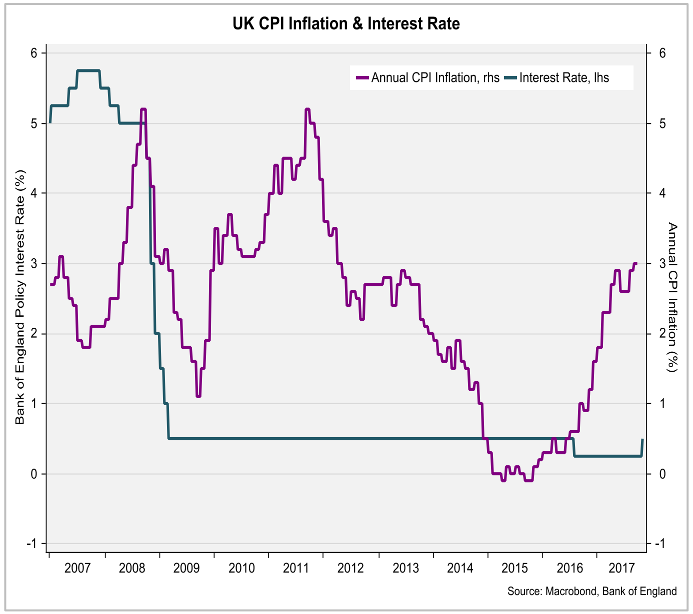
Weaker growth in first half of 2017 weighs on outlook.

- UK economic growth is forecast to slow in 2017 with many forecasters expecting further weakening in 2018.
- Key factors weighing on the growth forecast include higher inflation weighing on consumption and Brexit uncertainty weighing on investment.
- The HMT Average of Independent Forecasts for UK growth in 2017 is 1.6% falling to 1.4% in 2018.









Scotland Summary

GDP continues to grow.

- GDP grew 0.1% in Q2 2017 (0.5% annually), following growth of 0.6% in Q1 2017.
- The Service sector drove growth in Q2, expanding 0.7% with growth broad-based across the sector.
- The Production sector returned to growth in Q1, however contracted 0.7% in Q2 largely due to a fall in manufacturing output.
- Construction sector output fell 3.5% in Q2 2017 as the sector continues to adjust back towards its long-run trend.

The labour market has continued to perform strongly.

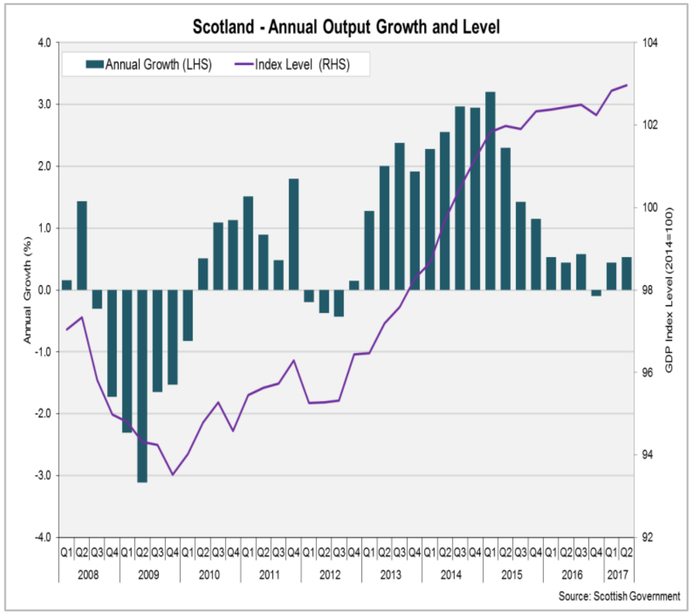
- Scotland's unemployment rate fell to 4.1% over the year to June-August 2017, below the UK average (4.3%).
- The employment level in Scotland rose to 2.66 million people, remaining close to record high levels.
- Following an up-tick in 2016, Scotland's inactivity level and rate have fallen over the past year by 29,000 to 21.5%.
- Gross median full-time weekly earnings increased by 2.4% in 2017 to £547.3 however fell 0.3% in real terms.

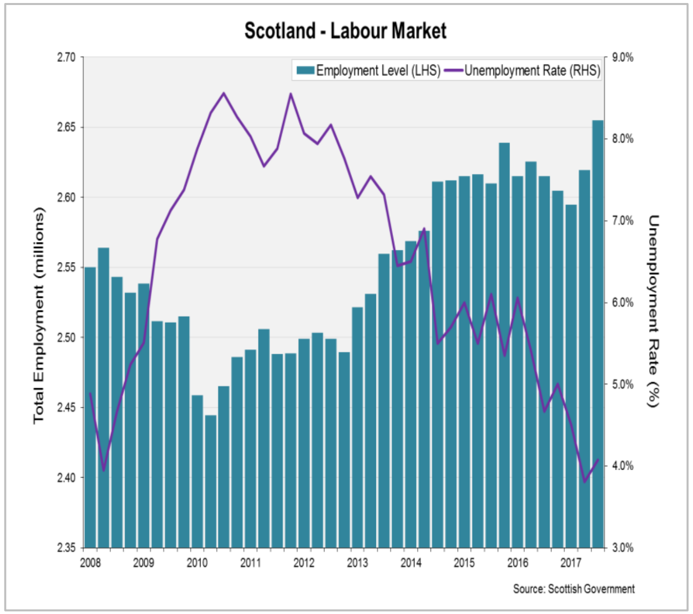
Productivity growth was flat at the start of 2017.

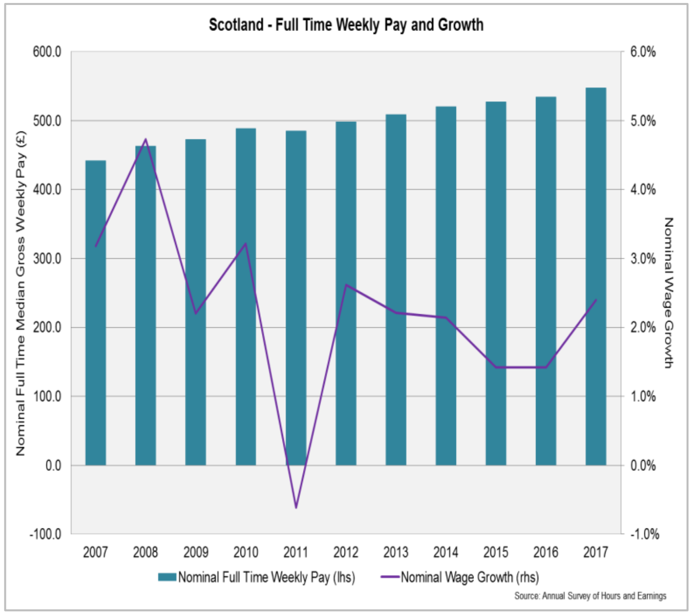
- Trend growth in productivity (output per hour worked) was flat (0.0%) in Q1 2017 and fell by 1.5% over the year.
- The fall in productivity reflects that growth in average hours worked (2.0%), outpaced GVA growth (0.4%).

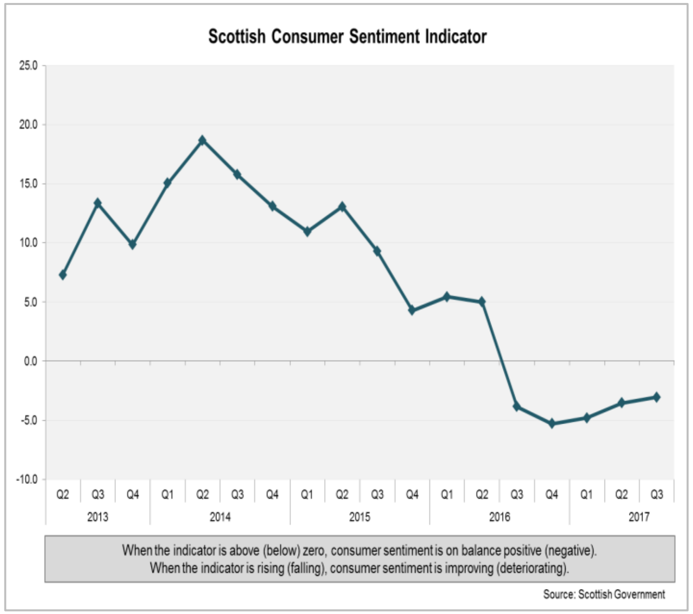
GDP growth forecast remains around 1% for 2017-18.

- The short term outlook for the remainder of 2017 signals steady growth.
- Business optimism and investment intentions are positive but have moderated over the year.
- Scottish consumer sentiment remains weak but has strengthened steadily in 2017, though inflationary pressures on household finances continue.
- Independent GDP growth forecasts for 2017 range between 0.9% and 1.2% and for 2018 between 0.7% and 1.4%.









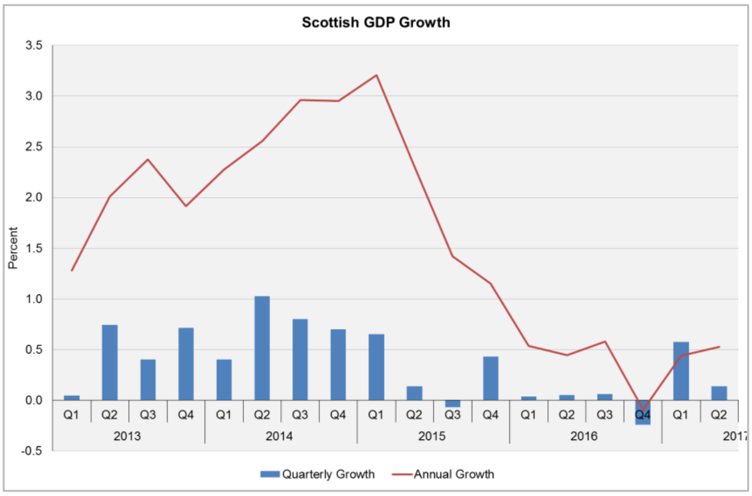
Scottish Economy Update

Gross Domestic Product

Scottish GDP growth has strengthened slightly in the first half of 2017, following subdued expansion in 2016.

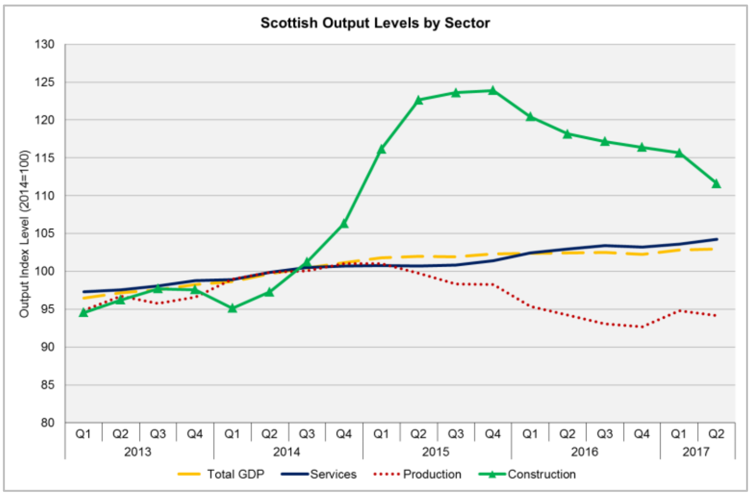
Over the first six months of the year, the Scottish economy grew 0.7% with growth of 0.6% in the first quarter moderating to 0.1% in the second quarter.

Growth in the second quarter of 2017 and over the past year as a whole was driven by the Services sector, offsetting contractions in both the Production sector and the Construction sector.



Services sector growth was broad-based in Q2 2017, growing 0.7% over the quarter and 1.3% annually. Over the past year, growth was particularly driven by the Transport, Storage and Communication sector and Business Services and Finance, and over the past quarter, this was supported by a return to growth in household facing sectors such as Retail, Accommodation and Food Services. However, the contraction in those sectors over the past year signals that inflationary pressures are weighing on domestic demand. However, in some parts of the country this will have been offset in part by stronger tourism demand boosted by the depreciation of Sterling. Over the past year, expenditure by overseas visitors to Scotland has increased by 19%.

The contraction in the Production sector over the quarter comes on the back of a rapid pick-up in growth in Q1 2017. Taken together, the sector has grown over the first half of 2017 driven by growth in output from Mining and Quarrying Industries and Manufacturing halting the longer term contraction since 2015.

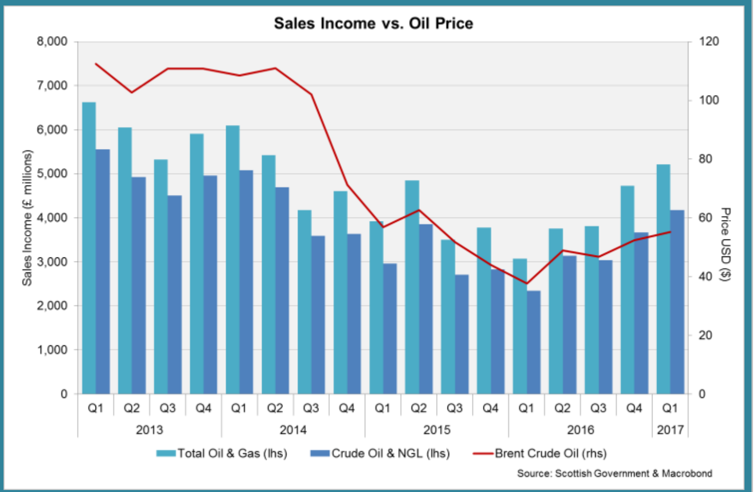


Manufacturing growth in the first half of 2017 has been driven in part by an expansion in industries linked to the oil and gas supply chain, chiming with signals that confidence is gradually returning to the sector.

The Construction sector contracted for its sixth consecutive quarter in Q2 2017 as it gradually adjusts back towards more normal levels of output following exceptionally fast growth in 2014-15. Despite these successive contractions in Scotland, output in the sector is still 17% higher than at the start of 2014 while it is 16% higher at a UK level.

Update on Scotland's Oil & Gas Sector

The June 2017 edition of the State of the Economy set out the negative impact that the fall in oil price in mid-2014 had on economic activity in Scotland's oil and gas sector and its supply chain – accounting for around two-thirds of the slowdown in Scottish GDP growth between 2014 and 2016.



More recent data[1] has presented some positive signals for the industry. Total oil and gas production volumes in Scotland increased by 2.9% in the financial year 2016/17, with quarterly sales revenues approaching pre-2014 levels. Alongside this, the first half of 2017 has presented a more positive picture for the industry supply chain, with sectors linked to the oil and gas supply chain growing by 1.3% over the first six months of the year.

On the costs side, due to efficiency improvements, the average Unit Operating Cost of producing a barrel of oil in the UKCS has halved from $30 to $15 and is expected to fall further during 2017.[2] This cost saving has outpaced the global average and has contributed to positive revenue growth in 2016/17. Brent crude prices have also risen in recent weeks, and now stand at around $60 a barrel, the highest level since spring 2015.

These changes were reflected in the Bank of Scotland Oil and Gas report[3] which reported that firms are planning for growth with a majority of firms no longer planning to control costs by job cuts and are more optimistic about recruiting over the coming year. Alongside this, the Oil and Gas UK report demonstrates that whilst market conditions remain difficult, the UK North Sea is reinventing itself by differentiating its offering through efficiency gains, fiscal competitiveness and a world class supply chain.

Looking ahead, the conditions for growth in the Oil and Gas sector and its supply chain are more favourable now than they have been in recent times. Rising global demand and capital investment should enable oil and gas businesses to maximise efficiency and comparative gains available to them. However, significant challenges remain and Brexit is a key issue for the sector. For example, Oil and Gas UK estimate that reverting to World Trade Organisation rules would more than double the cost of trade at 2016 levels to £1.2 billion per annum in direct tariff payments.

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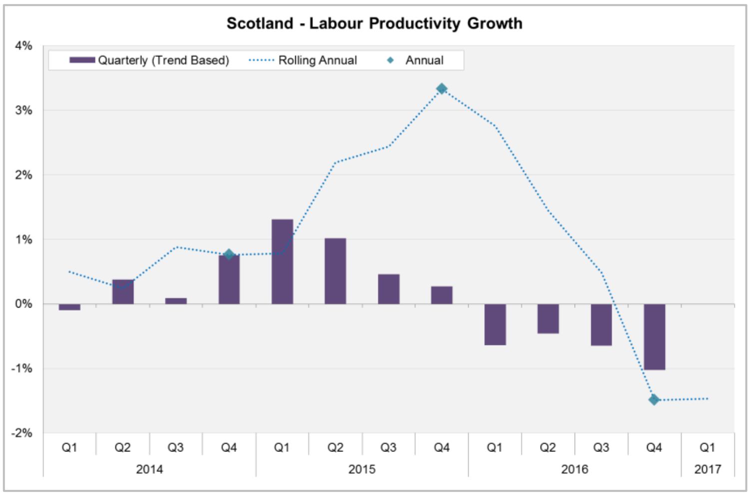
[1] Scottish Government, Oil and Gas Statistics 2016
[2] Oil and Gas UK Report, September 2017
[3] Bank of Scotland Oil and Gas Report, June 2017

Labour Productivity

Labour productivity measures the level of output produced per hour worked and is an important indicator of economic performance.



Latest data for Q1 2017 show that labour productivity growth was flat over the quarter and fell 1.5% over the year. The fall in productivity over the year reflects that the number of hours worked in the Scottish economy has grown more quickly than GDP.

Over the longer term, labour productivity has grown strongly in Scotland. Since 2007, labour productivity in Scotland has grown by 7.6% whereas UK productivity has grown by 0.9% over the same period. As a result, the historical gap in productivity between Scotland and the UK has significantly reduced, with Scotland's productivity now broadly matching the UK as a whole.

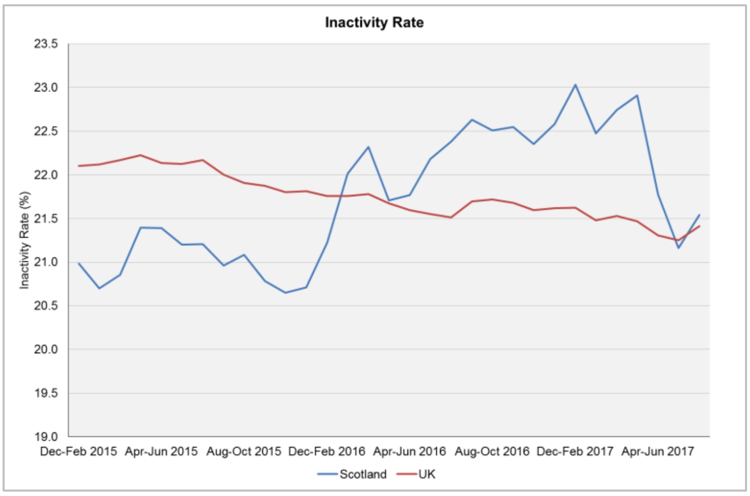
Labour Market

In contrast to the relatively subdued output performance of the economy over 2016-17, Scotland's labour market has strengthened further in 2017.

Latest data for June to August 2017 show that the number of people in employment rose by 40,000 over the past year to 2.66 million, close to a record high. This rise in employment was predominantly driven by women (men up 14,000 and women up 26,000).

Mirroring this strong performance, Scotland's unemployment rate has been on a downward trend in 2017, falling to 4.1%. Both the employment and unemployment rates remain close to their record levels and are outperforming the UK averages.

The current strength of the headline labour market indicators in Scotland is also underlined by the fact that more people are moving into full-time jobs, with full-time employment up 55,000 over the past year, while part-time employment decreased by 15,000. The number of those in self-employment increased by 23,000 over the year.

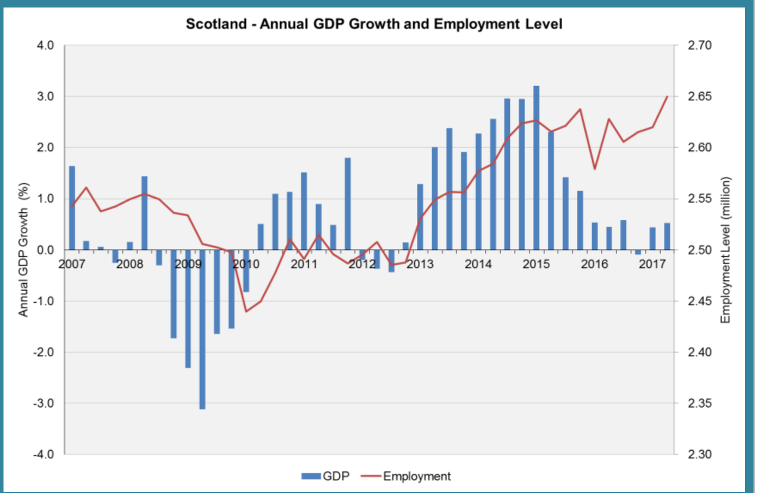


Economic inactivity (those not working and not seeking or available for work) in Scotland also fell in 2017, almost entirely reversing the spike experienced during 2016, and meaning that the inactivity rate in Scotland is now in line with the UK average.

The table below summarises the latest labour market data for Scotland.

HEADLINE LABOUR MARKET STATISTICS							
RATES	**Latest Data**	**Quarterly Change (% p.t.)**	**Annual Change (% p.t.)**	**LEVELS**	**Latest Data**	**Quarterly Change**	**Annual Change**
Scotland				**Scotland**			
Employment*	75.3%	1.2	1.4	Total Employment^	2,655,000	35,000	40,000
ILO Unemployment**	4.1%	0.3	-0.6	ILO Unemployment^	113,000	9,000	-15,000
Economic Inactivity*	21.5%	-1.4	-0.8	Economic Inactivity^^	735,000	-47,000	-29,000
UK				**UK**			
Employment*	75.1%	0.2	0.7	Total Employment^	32,105,000	94,000	317,000
ILO Unemployment**	4.3%	-0.2	-0.7	ILO Unemployment^	1,443,000	-52,000	-215,000
Economic Inactivity*	21.4%	-0.1	-0.1	Economic Inactivity^^	8,812,000	-17,000	-13,000
*Denominator = Working age population (16-64) **Denominator = Total economically active				^All persons ages 16+ ^^All persons aged 16-64			
Source: Labour Force Survey (June - August 2017)							

The relationship between GDP and labour market performances



Several economic commentators have observed the recent disconnect that has emerged between GDP growth and employment which has seen headline employment strengthening during 2016-17 while GDP growth has remained weak.

Between Q1 2016 and Q2 2017, Scottish GDP has grown 0.6% while employment has grown by 3% and average weekly hours per job has increased 1.5%. Furthermore, the proportion of workers who were underemployed in Scotland decreased by 0.8 percentage points over the year to 8.4% .

This disconnect between GDP and employment growth may be due to the types of job growth observed over the past 18 months. The growth in employment since the start of 2016, has been particularly driven by an increase in self-employment which has grown by 11.5% over the same period. Self-employed accounts for 12.3% of employment in Scotland and is made up of a diverse range of jobs and subsequent earnings. While there has been growth in self-employment in high productivity sectors, the growth in low productivity self-employment may be weighing on productivity growth.[4]

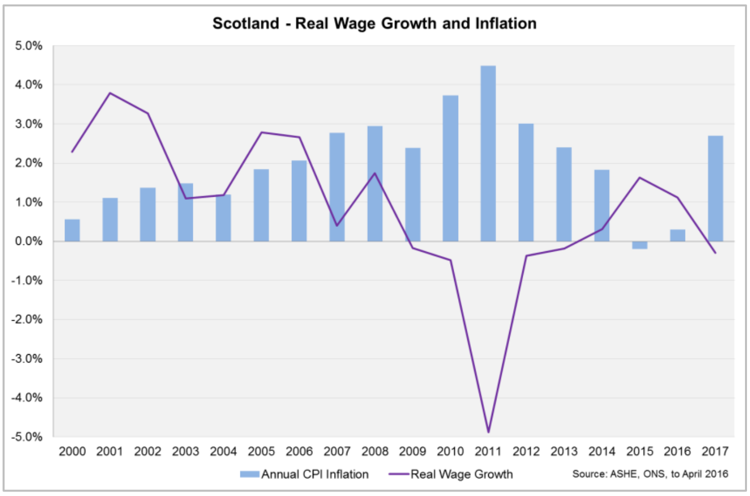
A further possible explanation for the disconnect may lie in which sectors output growth has slowed and employment risen. Since the start of 2016, the slowdown in GDP growth

[4] https://www.strath.ac.uk/business/economics/fraserofallanderinstitute/economic_commentary/backissues/june2017/

has been concentrated in capital intensive parts of manufacturing and construction sectors. As such, the slowdown in growth in these sectors is likely to have had a proportionally higher impact on capital than labour, thus leading to a slowdown in output that may not have been reflected in the labour market.

Earnings

The tightening in the labour market in 2017 was accompanied by a modest rise in nominal earnings with gross median full-time weekly earnings growing by 2.4% in nominal terms to £547. Scotland's median earnings are the third highest of the UK countries and regions behind London (£692) and the South East (£575).



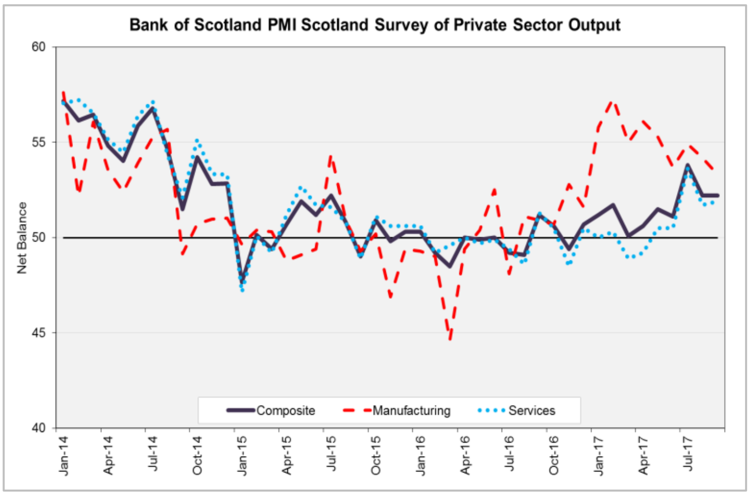
However despite the rise in nominal wages over the year, this has been outpaced by the pick-up in CPI inflation following the EU referendum and has resulted in real wages falling 0.3% in Scotland and 0.5% across the UK as a whole. Real wages have also fallen over the longer term, falling in Scotland by 0.2% since 2007 and 3.1% across the UK.

Short Run Outlook for Q3 2017

Business Sentiment

Scottish buinsess surveys have signalled a positive, but slightly softer outlook for the Scottish economy in the third quarter of 2017.

The monthly Bank of Scotland Purchasing Managers' Index has signalled further expansion of private sector output in Q3 with the pace of growth in the manufactring sector moderating and a slight acceleration in the Services sector compared to the previous quarter. This was broadly consistent with the RBS Business Monitor which reported positive expectations for new business volumes in the finance & business services and tourism sectors while the Scotttish Chambers of Commerce Quarterly Economic Indicator signalled a particularly challenging quarter for the Retail and Wholesale sector.



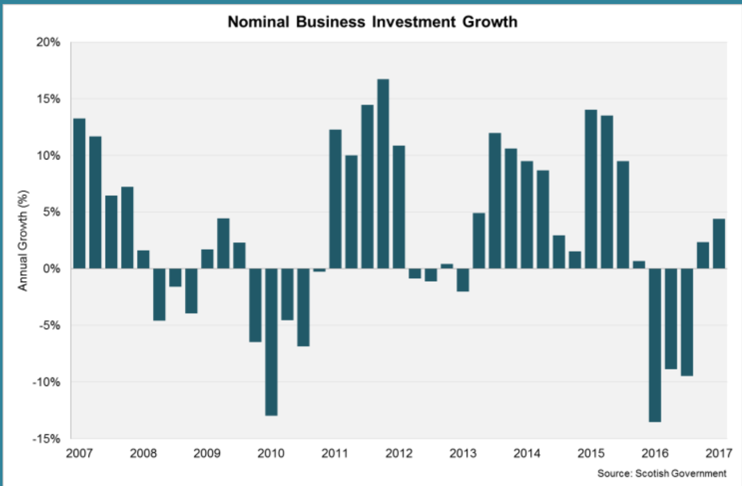
For the manufacturing sector, the Scottish Engineering Quarterly Review signalled growth in output volumes from the Engineering and Manufacturing sectors in Q3, but at a softer pace than in Q2, while the CBI Industrial Trends Survey signalled a slight contraction in output over the quarter.

The surveys also indicate a generally positive outlook for staffing levels across both the Manufacturing and Services sectors over the quarter with firms indicating they are hiring to meet higher output demand.

The lower value of Sterling is a consistent feature across the business surveys for Q3 with businesses continuing to report upbeat demand for export orders whilst input cost inflation for raw materials remains sharp. The evidence suggests that businesses are continuing to pass on these higher costs, at least in part, to consumers.

Scottish Business Investment

Business investment plays two important roles. Firstly, it provides an immediate boost to economic activity when the investment is undertaken. Secondly, it is a key determinant of future productivity and output growth across all sectors of the economy.



Since 2007, growth in business investment has broadly followed wider economic trends, but has seen larger year on year changes. Following the financial crisis and subsequent economic downturn, business investment growth accelerated rapidly. More recently business investment fell in 2016 reflecting a period of weaker activity in the Oil and Gas sector and slowing growth in the Construction sector. The modest pick-up in business investment at the start of 2017 is consistent with the up-tick in output growth across the economy.

Over the past year Scottish business surveys have signalled a mixed picture of current and expected business investment activity in Scotland. Surveys of the Production sector have signalled investment patterns with more emphasis on training investment and less on investment involving plants and machinery, while there have been signals of positive investment intentions in the Service sector, keeping broadly consistent with recent output data. Small businesses in general continue to have a broadly positive outlook on investment, likely reflecting that future trading conditions are less likely to be a major issue for small businesses operating in domestic markets.

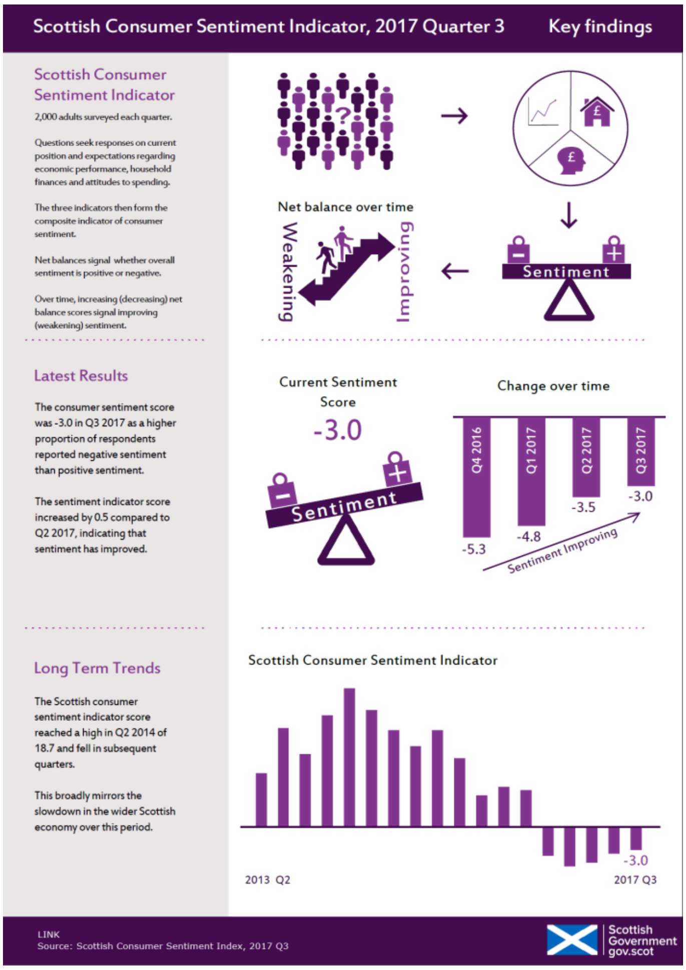
Looking ahead, Brexit uncertainty will play a key role in the scale and nature of firms' business investment decisions in Scotland. For example, companies may choose to delay investment decisions until the UK's future trading relationship with the EU is known. Moreover, if the resulting deal between the UK and EU results in a significant reduction in access, this may reduce the potential returns on investments in the UK, and in turn the amount which companies are willing to invest.

Consumer Sentiment

The Scottish Consumer Sentiment Indicator is based on a quarterly survey of households sentiment regarding the current position and their expectations of Scottish economic performance, household finances and attitudes to spending money. On 18 October, the Indicator was published for the first time as a quarterly Official Statistics publication. The publication, accompanying infographic and underlying data are all available on the gov.scot website.[5]

In Q3 2017, the Scottish Consumer Sentiment Indicator increased by 0.5 points to -3.0. The negative balance reflects that more respondents reported a decline in economic sentiment than an improvement during the quarter. However, the increase in net balance compared to the previous quarter indicates an improvement in sentiment over the quarter.

Consumer sentiment regarding the expected performance of the economy and security of household finances over the coming year weakened compared to the previous quarter. This signals that households confidence about the economic and personal financial outlook has declined and is likely to reflect in part the ongoing heightened economic and political uncertainty that continues to surround the Brexit process.



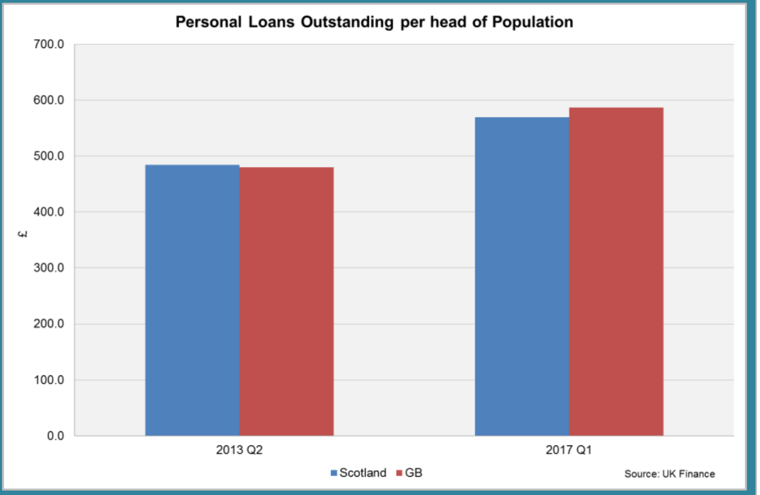
The recent business survey evidence for the Retail and Wholesale sector and latest negative consumer sentiment data for Scotland is reflected in the Scottish Retail Sales Index which showed that during Q3 2017, growth in the volume of retail sales was flat over the quarter (grew 0.6% over the year) while the value of retail sales in Scotland increased by 0.4% (3.3% over the year).

The slowdown in growth reflects the fact that sales in the previous quarter grew very fast, and it was unlikely that this would be sustained. However, it also consistent with an overall slowing in retail sales growth across GB as a whole, reflecting a period in which rising inflation following the EU referendum has placed greater pressure on household finances.

[5] http://www.gov.scot/Topics/Statistics/Browse/Economy/SCSI

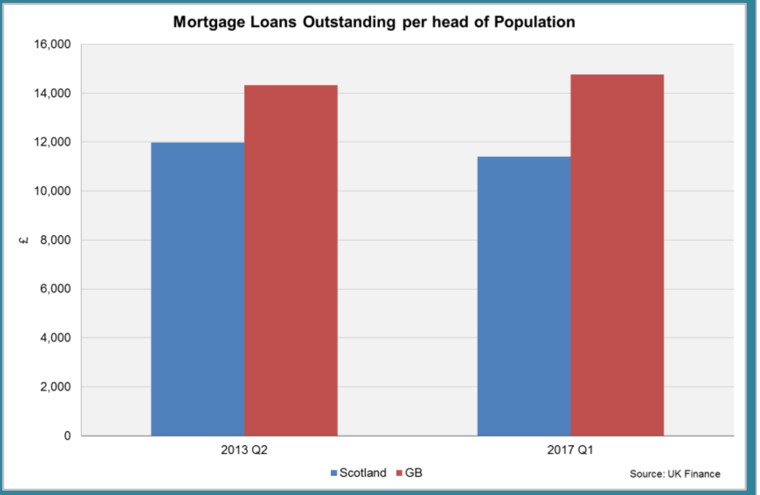
Household Borrowing

Recent increases in inflation, coupled with weak wage growth, have placed greater pressure on household finances. This can impact on consumers borrowing behaviour and their ability to finance outstanding debt. There are many different types of household borrowing and this box focusses on two specific areas – mortgages and personal loans.



Based on data collected by UK Finance, a financial services industry body, in Q1 2017, the value of personal loans outstanding in Scotland was £3.1 billion[6]. This equates to £570 per person compared to £587 in GB as a whole. In recent years, there has been a notable rise in the value of personal loans outstanding per head across GB. In Scotland, they have increased by 18%, compared to 22% across GB as a whole.

Mortgage loans naturally account for a significantly larger proportion of household debt. In Q1 2017, the value of mortgage loans outstanding in Scotland was £61.5 billion, accounting for £11,401 per person compared to £14,766 in GB as a whole. Since Q2 2013, the value of mortgage loans per head outstanding in Scotland have fallen by 4.9%, compared to a rise of 3.2% across GB as a whole. This difference is likely to reflect variations in average house price across GB, and in particular the rapid rise in house prices in London over recent years pushing up the GB total.



Taken together, outstanding personal loans and mortgages in Scotland have fallen by 2.8% since 2013 and risen by 6.9% across GB as a whole. However, levels of these debts will not be evenly distributed across households, and some will have seen the value of these outstanding debts, in both absolute terms and relative to their earnings, rise significantly.

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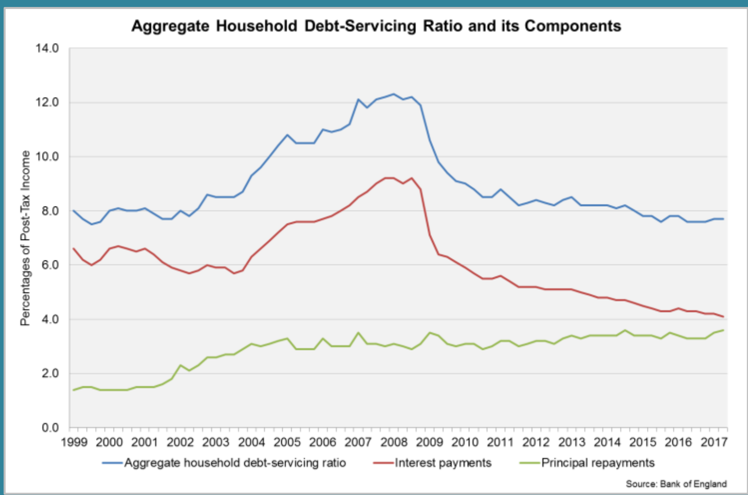
[6] UK Finance is a financial services trade association representing nearly 300 financial services forms in the UK. They publish statistics on the geographic distribution of mortgage lending, personal loans and SME lending by certain UK lenders. Collectively they make up about 73 percent of UK mortgage lending and 60 percent of both personal loans and SME loans by banks and building societies.

The fall in the value of outstanding mortgage loans in Scotland indicates that households have been repaying mortgage debt more quickly than taking on new mortgage debt. This is due to fewer loans being taken out in recent years compared to the housing boom period before the credit crunch (although in recent years the number of new mortgages has been increasing again) and reflects that low mortgage interest rates have allowed households to more rapidly repay their outstanding balance.

The rise in the value of personal loans outstanding in Scotland, indicate that consumers are increasing personal debt levels to fund consumption. This may be to offset the impacts of weak wage growth and, more recently, higher inflation. Alternatively, it may be because households feel more comfortable taking on higher levels of personal loans because of low costs of borrowing and that their mortgage debt has been reducing.



Looking ahead, the recent rise in the Bank Rate to 0.5% and any further increases in interest rates have the potential to impact on household finances through both outstanding personal loans and mortgage loans. However, as 61% of UK outstanding mortgage loans are on a fixed rate, as are 89% of new mortgage loans, the majority of mortgage holders will not see an increase in their borrowing costs until they come to refinance their loans. Moreover, analysis by the Bank of England has demonstrated that households total debt servicing costs relative to income – i.e. the cost of meeting interest payments and repaying the principle – have fallen steadily over recent years on the back of low interest rates.

Scottish Economic Outlook

Independent forecasts for the Scottish economy suggest that GDP will grow around 1% in 2017 and 2018, below Scotland's long run trend rate of 2%.

This forecast has been broadly unchanged since the start of the year as outturn data for output has been relatively weak, despite the pick-up in the pace of GDP growth relative to 2016 over the first half of 2017. Productivity growth has also remained relatively weak, reflecting the contrasting strong performance in the headline labour market indicators alongside the weak pace of output growth.

Looking ahead, opportunities for growth alongside challenges to the economic outlook, continue to be heavily influenced by the Brexit process. Business surveys signal that the economy will grow modestly in Q3. Following the fall in the oil price in 2014 and the subsequent challenging years in the oil and gas industry in Scotland, signals are starting to emerge that confidence is building in the industry. The positive contribution to growth of sectors linked to the industry in the first half of 2017 reinforce that.

The fall in consumer sentiment regarding the outlook for the coming year signals that uncertainty about the political and economic outlook resulting from the Brexit process is weighing on households economic and financial decisions. It also chimes with the rise in inflation over the past year as a result of the fall in Sterling and negative real wage growth creating a squeeze on household finances.

The reduced slack across the UK economy alongside above target inflation resulted in the Bank of England raising the Bank Rate by 0.25 percentage points to 0.5%; effectively reversing part of the monetary stimulus package implemented after the EU referendum. The signals are that any further rises would be slow and gradual to reduce the risk of unduly dampening demand during a period of on-going heightened uncertainty. In that regard, Brexit remains the key risk to Scotland's economy which continues to present a significant risk to business and consumer sentiment in Scotland with investment sensitive to changing market signals.

The range of independent forecasts for Scotland suggest growth of between 0.9% and 1.2% in 2017 and between 0.7% and 1.4% for 2018. The Scottish Fiscal Commission, which produces independent forecasts of key Scottish macro and fiscal indicators to inform the Scottish budget process, will publish its first forecasts of Scottish GDP alongside the Scottish Draft Budget on the 14 December.

Annual Output Growth Forecast (%)[7]	2016 (outturn)	2017	2018
Fraser of Allander Institute (Sep 2017)	0.4	1.2	1.4
PWC (Jul 2017)	0.4	1.2	1.1
EY ITEM Club (June 2017)	0.4	0.9	0.7

[7] The forecasts for the Scottish economy presented in this report are widely available in the public domain. The choice reflects published forecasters which are known to us and are subject to review. No significance should be attached to the inclusion or exclusion of any particular forecasting organisation. The Scottish Government accepts no responsibility for the accuracy of material published in this comparison.
Fraser of Allander Institute:
http://www.strath.ac.uk/business/economics/fraserofallanderinstitute/economic_commentary/latestcommentary/ ,
EY Scottish ITEM Club:
http://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy/ey-scottish-item-club-summer-update-2017
PWC:http://www.pwc.co.uk/services/economics-policy/insights/uk-economic-outlook.html.