Monthly Economic Brief

Office of the Chief Economic Adviser

January 2022

Scottish Government
Riaghaltas na h-Alba
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Office of the Chief Economic Adviser

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January 2022

Data up to 28 January 2022

Overview

This month's economic brief provides an update on the Scottish economy as it reached an important milestone in its recovery from the pandemic at the same time as the Omicron variant led to a tightening of public health restrictions during December and January, continuing to emphasise that the pandemic is not over.

The latest GDP data for November, prior to the emergence of Omicron, showed that the Scottish economy grew 0.8% over the month with broad based growth across the services, production and manufacturing sectors. Furthermore, Scotland's GDP had recovered to above its February 2020 pre-pandemic level for the first time (+0.6%), and broadly in line with the UK as a whole. However it's important to note that the pace of recovery continues to vary by sector, with the group of consumer facing services industries remaining 5.5% below its pre-pandemic level.

Those industries, particularly in hospitality and leisure, have been most exposed to the restrictions introduced in December to slow its spread, impacting on demand and the capacity at which businesses could operate during this important trading period, and renewing uncertainty for consumers and businesses. Business survey data indicates that the pace of growth slowed in December in Scotland and across the UK as a whole.

At the same time, inflationary pressures have continued to strengthen with inflation rising to 5.4% in December, its highest rate since the 1990s. This is expected to rise further in the first half of 2022, and presents an extremely challenging outlook for household finances. Consumer sentiment in Scotland weakened over the fourth quarter of 2021 (though remained positive overall) with expectations for the economy and household finances moderating from earlier in the year.

Scotland's labour market has continued to perform strongly following the end of the furlough scheme in September. Unemployment fell to 3.6% in September to November, below the rate at which it entered the pandemic. Furthermore, payrolled employee levels continued to rise in December and are now 44,000 (1.9%) higher than they were in September when the furlough scheme ended.

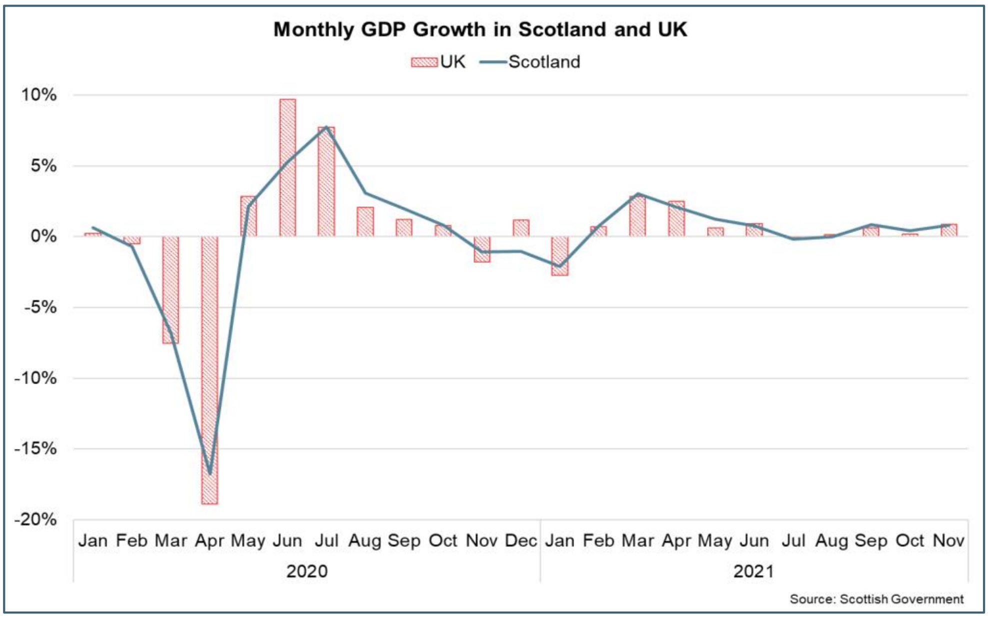
Challenges of shortages in the labour market remain however, with demand for staff continuing to rise in December while staff availability has remained subdued. This, coupled with higher numbers of staff self-isolating, has been a real concern for businesses over December and January.

Looking ahead, although economic activity may disrupt the recovery at the beginning of the year, the easing of restrictions at the end of January should provide renewed optimism for businesses and households. However, supply chain challenges, labour shortages and the further rise in inflationary pressures at a domestic and global level, continue to present significant headwinds for the economic outlook this year.

Output

Scotland's GDP grew 0.8% in November and is back above its February 2020 pre-pandemic level for the first time.

- Scotland's GDP grew 0.8% in November, with the pace of growth picking-up into the start of the fourth quarter following relatively flat growth over July and August.[1]

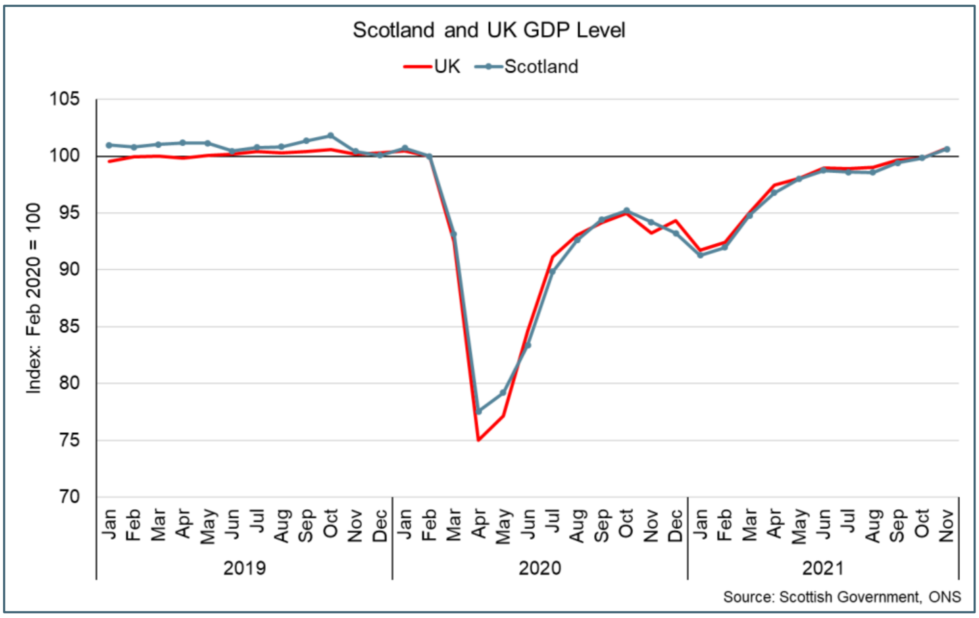


- Growth was broad based across the services (0.5%), production (1.7%) and construction (3.6%) sectors in November. Services sector growth saw a pick-up in professional, scientific and technical services output (3%) while there was growth in parts of hospitality, including accommodation and food services (1.9%) and arts, culture and recreation (4.6%).

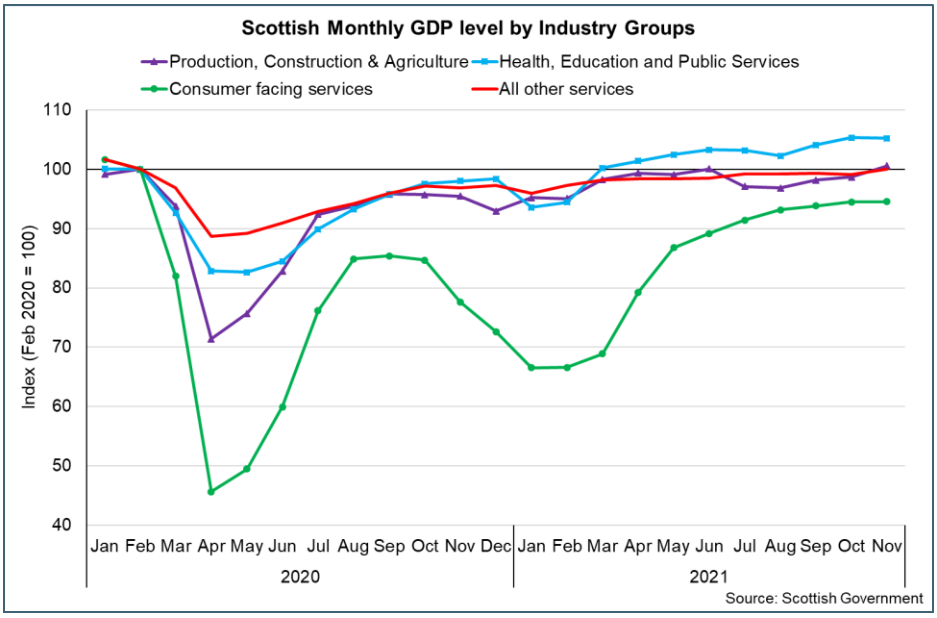
- Production output growth continued to strengthen on recent months (1.7%) supported by a pick-up in manufacturing output (1.7%). Sectors continued to face significant supply chain challenges in November however, while the boost to output growth from restrictions easing earlier in the year continued to fade.

- Scotland's economy reached an important milestone in November in the recovery from the pandemic with Scotland's GDP growing to above its February 2020 pre-pandemic level for the first time (+0.6%), broadly in line with the UK as a whole (+0.7%), having fallen 22.4% below in April 2020. Over the course of the pandemic, the Scottish economy has broadly tracked the UK economy.

[1] https://www.gov.scot/collections/economy-statistics/#gdpmonthlyestimates



- There remain significant differences across sectors in the pace of recovery, which continues to partly reflect the restrictions that have been in place earlier in the year, levels of demand across sectors at this stage of the recovery, and the impact of supply chain disruptions on the pace of activity.
- Within the services sector, output in consumer facing services remains 5.5% below pre-pandemic levels, while output from health, education and public services is 5.2% above, and output from all other services is back to the same level of output as prior to the pandemic.
- Output in the production, construction and agriculture group first returned to pre-pandemic levels in June 2021 before falling back again over the third quarter, driven by volatile output across the manufacturing, construction and electricity and gas supply subsectors. Output in this group is currently 0.6% above its pre-pandemic level.

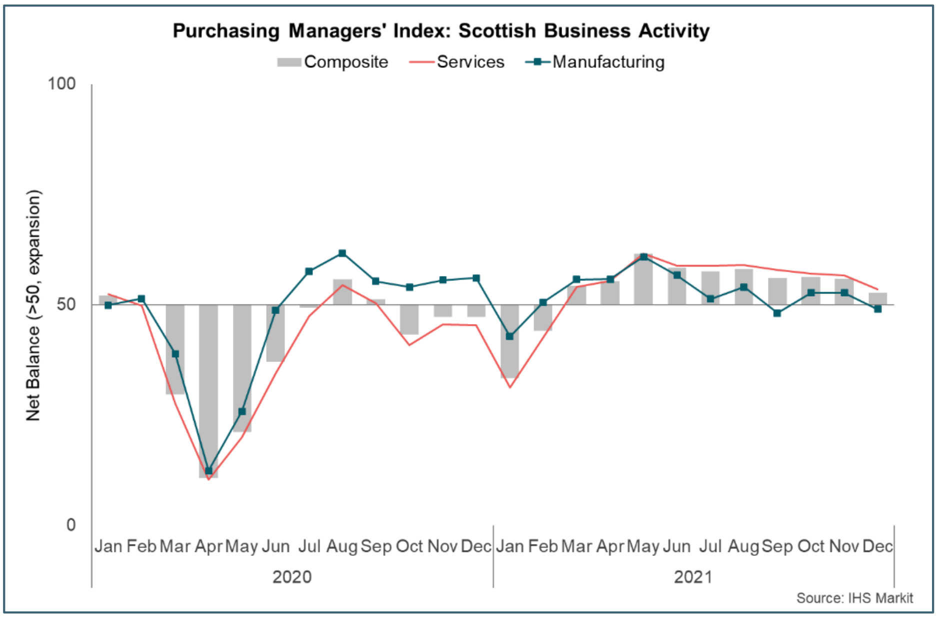


Business Activity

The latest survey data indicate that the pace of growth slowed in December as Omicron started to impact activity.

Business Output

- The Purchasing Managers Index (PMI) business survey signalled further private sector business activity growth in December, however the growth indicator fell to its lowest level in 10 months (52.7) indicating a slowdown in the pace of growth in Scotland, with the wider survey signalling a slowdown across the UK as a whole.[2]
- Growth in inflows of new business/orders particularly slowed over the month, with concerns around Omicron and tightening of restrictions likely a key factor weighing on activity.



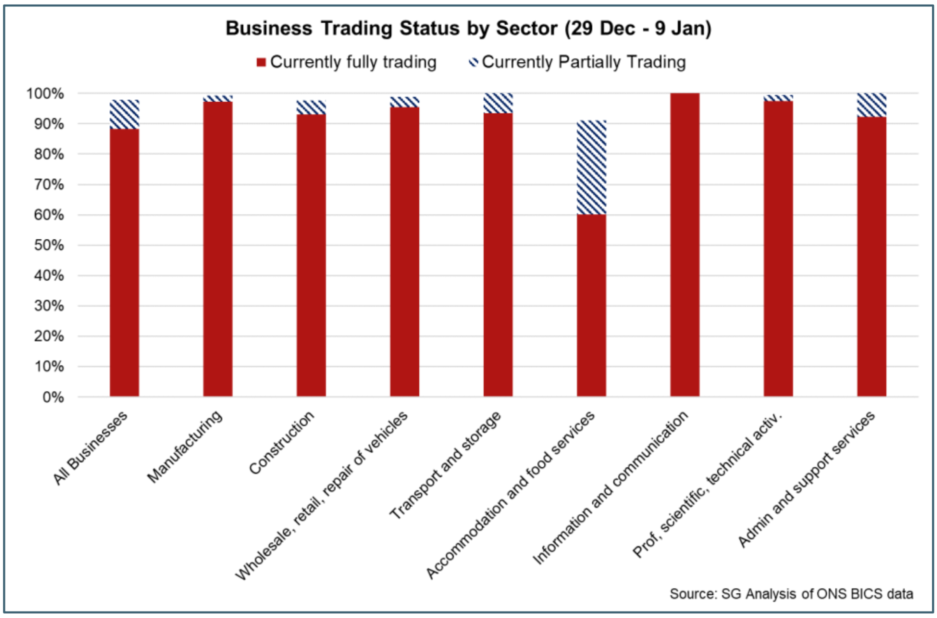
- Looking ahead, business optimism in Scotland eased slightly over the month (67.0), though remained strong overall, with anecdotal evidence in the survey suggesting that businesses are hopeful that pandemic and Brexit related issues will diminish over the coming year.
- In the short term however, the latest flash UK PMI data for January indicates that private sector growth, while remaining positive, may have softened slightly further at the start of 2022, particularly in consumer services most directly impacted by Omicron restrictions, while manufacturing activity picked-up slightly supported by an improvement in materials availability.[3]

[2] IHS Markit, RBS Purchasing Managers Index, January 2022. RBS | Private sector growth moderates further as Omicron concerns strike (rbsbusinesshub.com)
[3] IHS Markit/CIPS, Flash UK Composite PMI 0140ace85cfc4f48a4748080468dc73a (markiteconomics.com)

Trading status

- During the second half of 2021, business survey data indicated that close to all businesses in Scotland were trading in some form following the move beyond level zero restrictions.[4] The emergence of the Omicron variant in November 2021 meant that increased restrictions limiting social interaction, requirements around testing and self-isolation, alongside closure of nightclubs, limits on capacity at indoor hospitality and leisure settings and attendance at large events, were introduced over the course of December.

- The latest business survey data into the start of January indicates that the share of businesses currently trading fell marginally to 98%, however this was mainly driven by a fall in the share of accommodation and food services businesses trading from 99% to 91%. There were further differences in the capacity at which firms reported they were trading with 88% of all businesses reporting as fully trading (10% partially trading). This reflected a slight fall in the proportion of businesses fully trading across almost all sectors, but most notably in accommodation and food services in which 60% of businesses reported as fully trading (down from 84%) and 31% partially trading.



- Several factors will have impacted business activity and trading status at the start of the new year, including the holiday season, as well as the increased restrictions and their impact on demand, capacity and staffing availability.

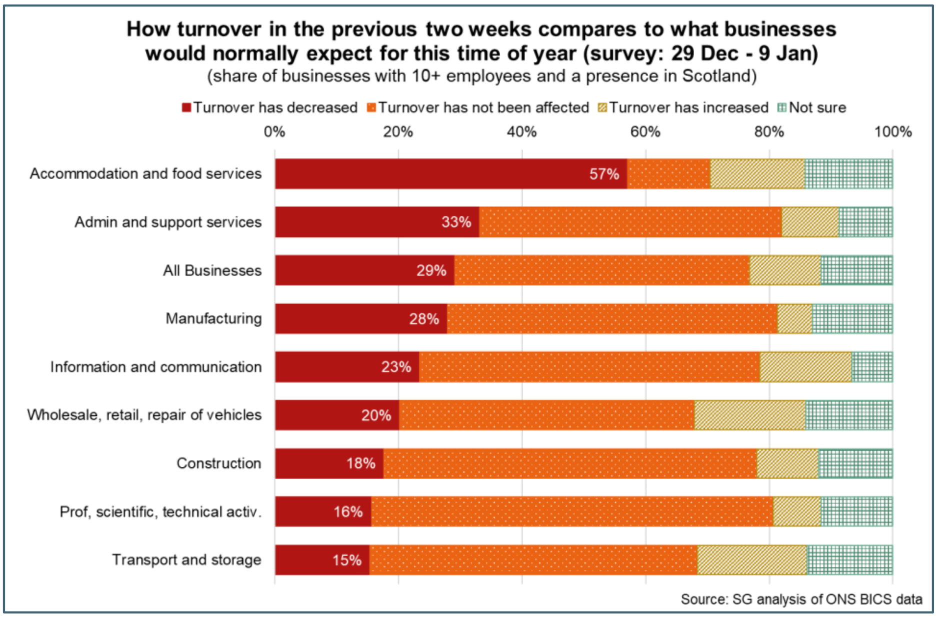
Business turnover and input costs

- The financial context of businesses also continues to vary across sectors. In terms of business turnover in December and into the start of January, 29% of all business reported having lower

[4] BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)

turnover than normal for the time of year, while 48% reported that turnover was not affected and 12% reported that it had increased.[5]

- The share of businesses reporting decreased turnover increased moderately in December (29%, up from 25% in November), however remained broadly stable in the context of recent fluctuations in the time series.
- Lower than normal turnover continued to be most widespread in the accommodation and food services sector, with 57% of businesses in the sector reporting this in December and into the start of January. The share had also risen sharply from 49% in November and 40% during October, indicating that turnover has been impacted during the Omicron wave. However, the shares of businesses reporting lower than normal turnover, remained notably lower than earlier in the pandemic.
- Notable shares of most other sectors continued to report that turnover had not been affected, while accommodation and food services also had amongst the highest share of firms reporting that turnover had increased (15%) alongside the transport and storage sector (18%) and wholesale, retail and repair of vehicles (18%), emphasising the level of variability of demand within sectors.



- On the cost side, supply chain disruption, high input cost inflation and employee shortages have emerged as key challenges and risks for many businesses at this stage of the recovery.
- Input cost pressures (e.g. raw materials and energy) remained elevated in November with latest BICS data indicating that 45% of businesses had seen prices increase more than normal, and most prominently in manufacturing (64%) and construction (64%).[6]

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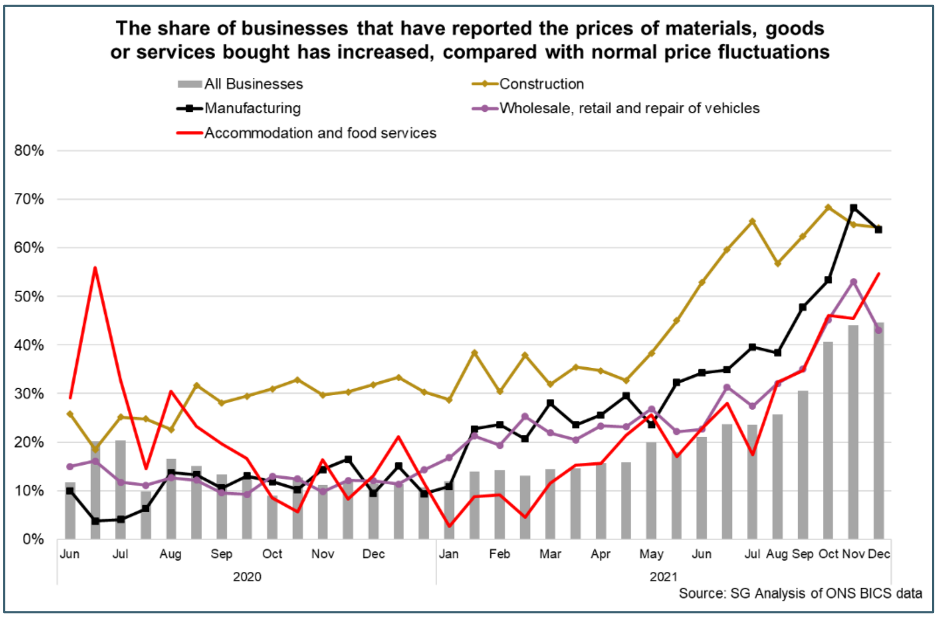
[5] BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)
[6] BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)



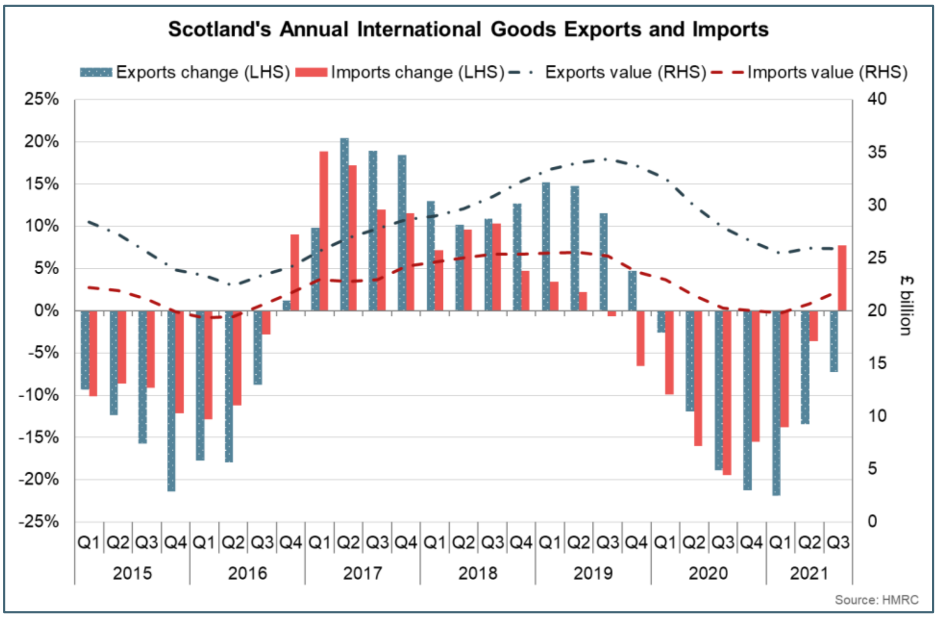
- Scottish PMI data also showed the indicator for input cost inflation remained elevated in December, indicating that prices continued to rise (75.9), albeit at a slightly slower rate than in November. A range of factors including fuel, transport and materials costs continued to be cited by the survey respondents as sources of inflationary pressures. PMI data also indicated that firms continued to partly pass on greater costs through to customers, though similarly at a slower rate than in November.[7]

Trade

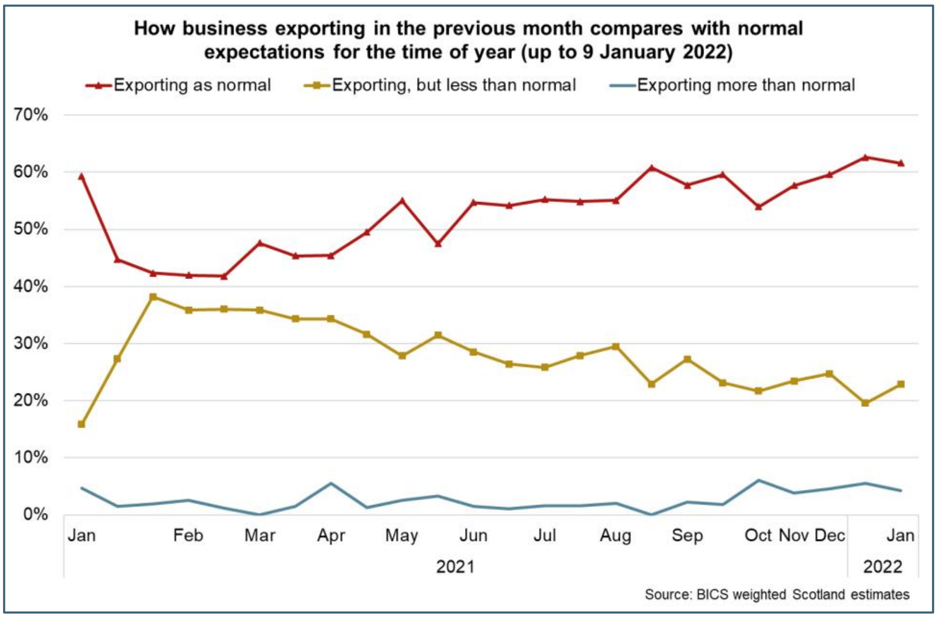
- Latest trade data provides Scotland's international goods trade up to Q3 2021[8] while BICS data provides latest insights on trade challenges for businesses in the final quarter of 2021 and start of 2022.

- Compared to the year ending in Q3 2019, the value of Scotland's annual goods exports for the year ending in Q3 2021 had decreased by 24.8% to £25.9 billion. The biggest driver of the decrease over this period was exports of oil and gas, which decreased by more than half. When excluding oil and gas, the decrease in Scotland's goods exported over the period fell to 5.6%. The value of Scotland's annual goods imports for the year ending in Q3 2021 also decreased over this period by 13.2% to £21.8 billion.

[7] IHS Markit, RBS Purchasing Managers Index, January 2022. [RBS | Private sector growth moderates further as Omicron concerns strike (rbsbusinesshub.com)]
[8] UK regional trade in goods statistics: [UK regional trade in goods statistics: third quarter 2021 - GOV.UK (www.gov.uk)]



- BICS data for the end of December and into the beginning of January indicates some stabilisation in trade indicators in recent months, while they remain improved from earlier in 2021, with 62% of Scottish businesses reporting to be exporting as normal for the time of year (up from 42% at the start of February 2021) while 23% were exporting less than normal (down from 38% at the start of February 2021).[9]



- However, supply chain bottlenecks continue to present significant challenges in December and at the beginning of January with 50% of exporters and 53% of importers reporting facing changes in transportation costs while 17% of exporters and 21% of importers reported a lack of hauliers to transport goods or lack of logistics equipment.[10]

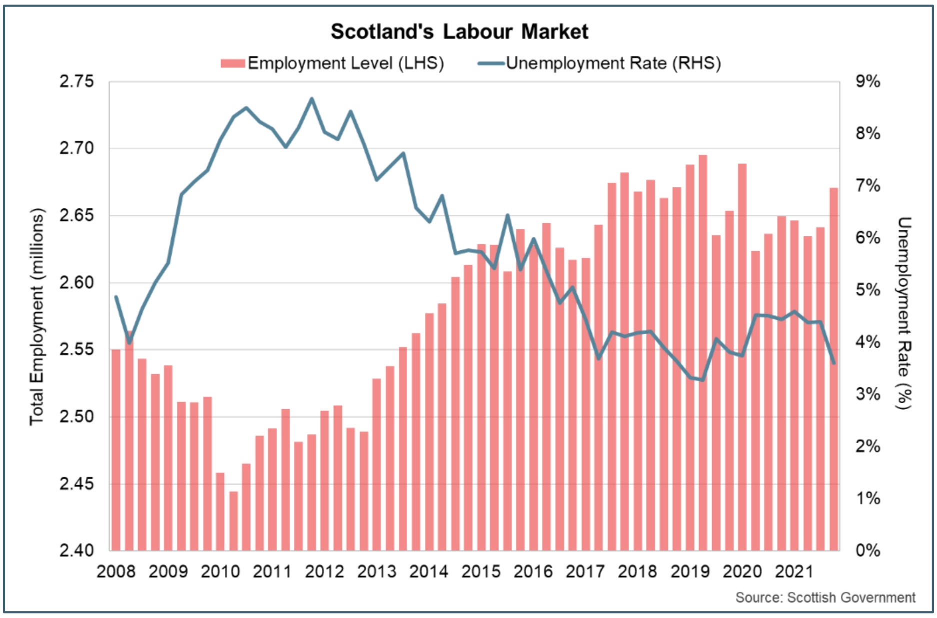
[9] BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)
[10] BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)

Labour Market

The number of payrolled employees continued to rise in December as demand for staff remained strong though staff shortages persist.

Official labour market statistics, payrolled employment and claimant count

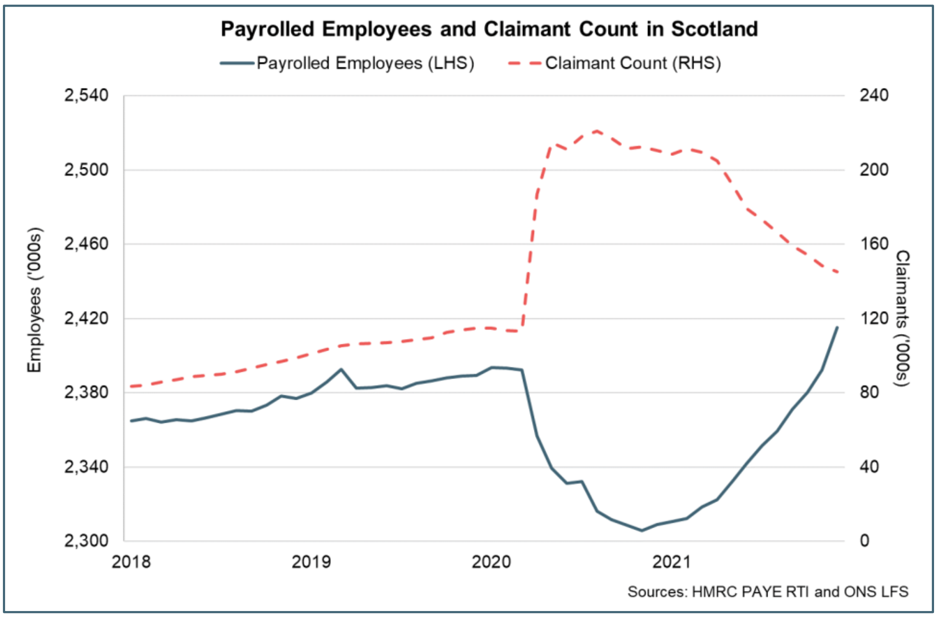
- The latest labour market statistics for September to November 2021 in Scotland, show there were 2.67 million people in employment (rate of 75.1%, up 0.7 percentage points over the year), 100,000 people unemployed (rate of 3.6%, down 0.8 percentage points) and 755,000 people economically inactive (rate of 22.1%, down 0.1 percentage points).[11]
- These indicators continue to compare well against historical trends, and reflect the support provided to the labour market during the pandemic by the furlough scheme which finished in September 2021.



- The unemployment rate (3.6%) fell below its pre-pandemic level of December to February 2020 (3.7%) for the first time. Over the same period, the employment rate remained slightly below (75.1%, down from 75.4%) and the inactivity rate remained slightly above (22.1%, up from 21.6%). There are a range of reasons why people are economically inactive (neither in employment or actively seeking and available for work) with the highest proportions being long-term sick, students, looking after family/home and retired.
- Wider labour market indicators show the labour market continued to strengthen in December. Pay As You Earn (PAYE) Real Time Information estimates indicate the number of payrolled employees in Scotland continued to increase in December, up 23,000 (1%) over the month and 44,000 (1.9%) more than in September at the end of the furlough scheme. Overall in December,

[11] [Labour market monthly briefing: January 2022 - gov.scot (www.gov.scot)]

there were 2.42 million payrolled people in employement, 22,000 more than the pre-pandemic level in February 2020.[12]

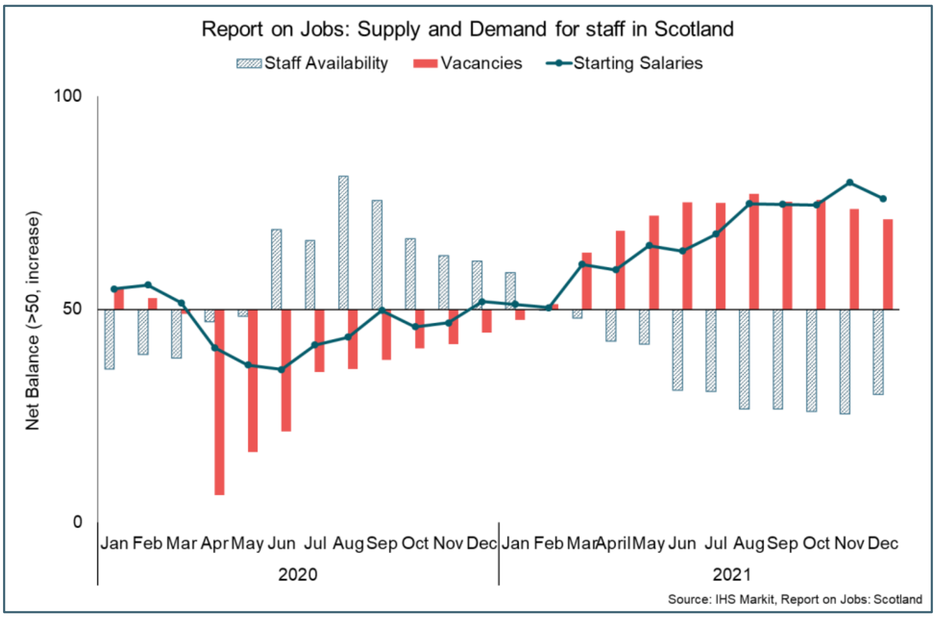


- Alongside the rise in payrolled employees, Scotland's Claimant Count (the number of claimants of Job Seekers Allowance and claimants of Universal Credit claiming principally for the reason of being unemployed) fell 2.1% in December to 145,400; a claimant count rate of 4.6%.
- The claimant count continued its recent downward trend and has fallen 34.2% from its peak in August 2020 and 8.7% since September when the furlough scheme ended. However, the claimant count remains 31,700 (27.9%) higher than its pre-pandemic level in February 2020.[13]

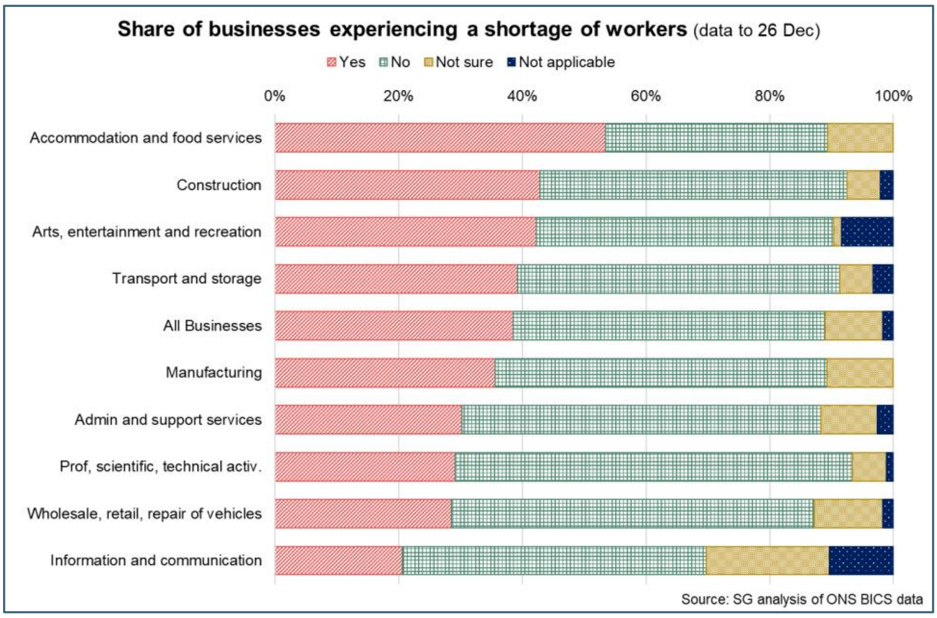
Demand for staff

- The latest Report on Jobs signalled that demand for both permanent and temporary staff remained elevated in December, though the pace of growth continued to ease over the month, while candidate availability (labour supply) continued to fall at similar rates across permanent and temporary candidates.[14] More recent online vacancies data signal that strong demand for staff continued into January. Latest figures for the week to 14 January, show online job vacancies were 21.6% higher than in February 2020.[15]

[12] Earnings and employment from Pay As You Earn Real Time Information, UK - Office for National Statistics (ons.gov.uk)
[13] Labour market monthly briefing: January 2022 - gov.scot (www.gov.scot)
[14] IHS Markit: RBS Report on Jobs for December: 265c1e92f8564af4b95351a37edb7f5b (markiteconomics.com)
[15] Online job advert estimates - Office for National Statistics (ons.gov.uk)

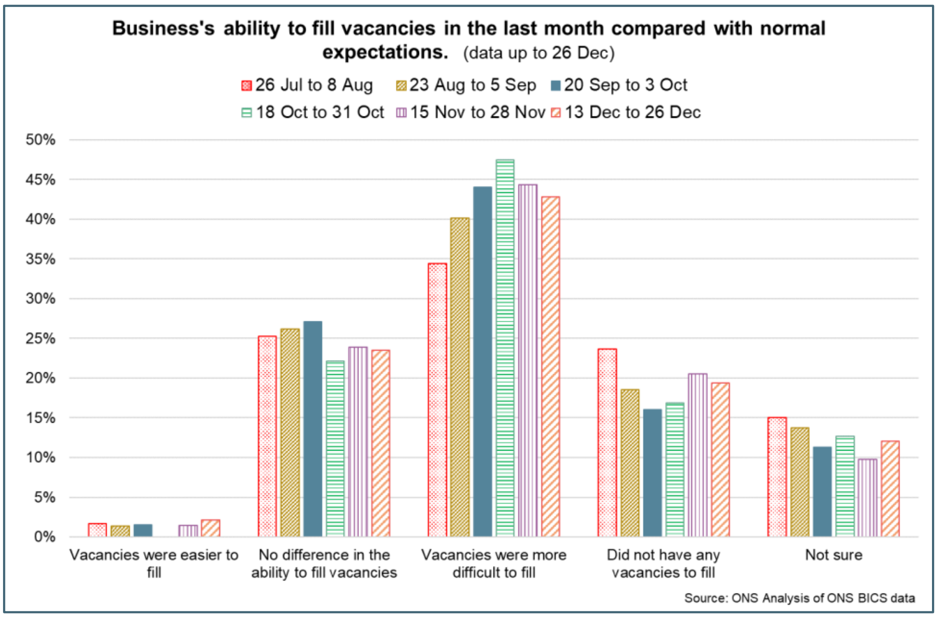


- The combination of low unemployment, the recent rapid strengthening in demand for staff and sharp decline in candidate availability has resulted in further upward pressure on starting salaries, particularly for permanent roles and ongoing labour shortages affecting a range of sectors.
- Latest BICS data indicates that accommodation and food, construction, arts, entertainment and recreation and transport and storage remain the sectors with the highest shares of businesses reporting a shortage of workers.



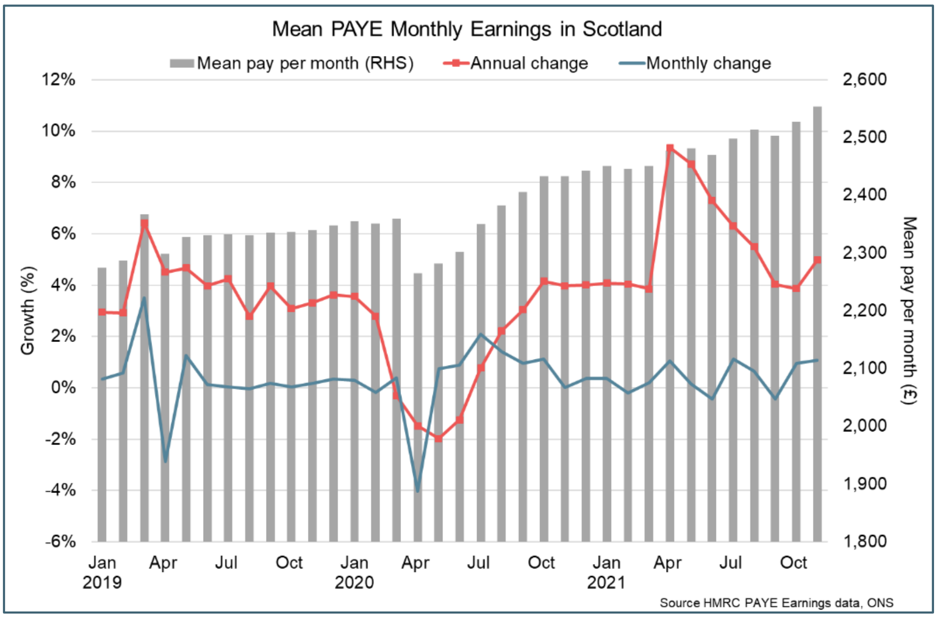
- Furthermore, in December, 43% of businesses found vacancies were more difficult to fill than normal (marginally down from 44% in November), while the number of businesses reporting no difference and that vacancies were easier to fill remained broadly steady at 24% and 2% respectively.[16]

[16] [BICS weighted Scotland estimates: data to wave 47 - gov.scot (www.gov.scot)]()



Earnings

- Mean PAYE monthly pay fell sharply at the start of the pandemic, however strengthened over the course of 2020 and rebounded back above its pre-pandemic level in August 2020.[17,18]
- Following a slight fall in September, latest PAYE RTI data show mean monthly pay grew by 1% in October (3.9% annually) and 1.1% in November (5% annually) to £2,554.
- However, the CPI annual inflation rate was 4.1% in October and 5.1% in November, reflecting that the current rise in inflation is weighing notably on real earnings growth.



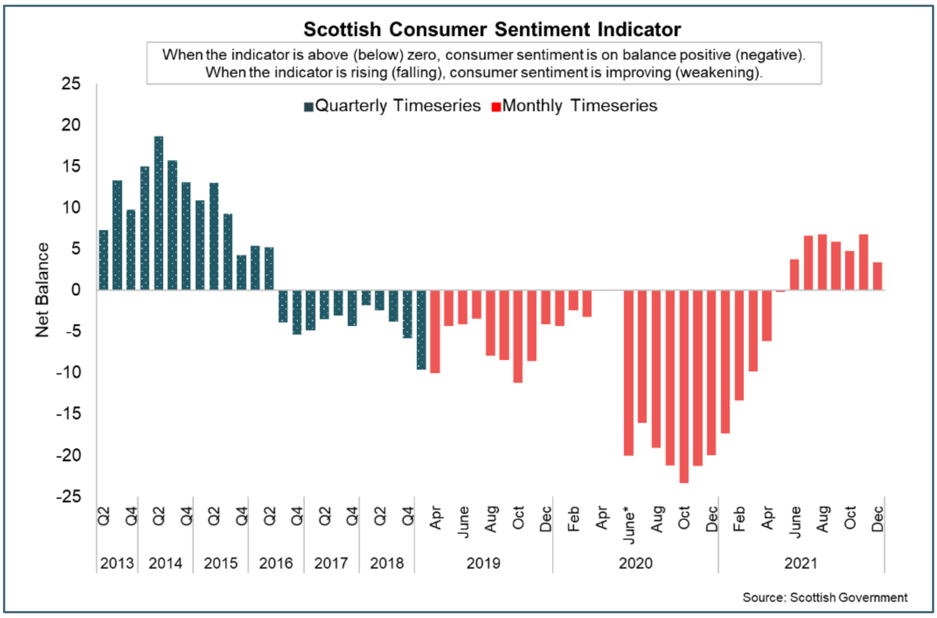
[17] [Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)](https://www.ons.gov.uk)
[18] The rates of earnings growth during the pandemic need to be interpreted with caution as base effects, compositional factors and the furlough scheme have all influenced the data.

Consumption

Consumer sentiment weakened in Q4 2021, particularly in December, however the composite index remains significantly higher than at the start of the year.

Consumer sentiment

- Consumer sentiment indicators continue to be highly sensitive to the rapidly moving developments on the pandemic and the unprecedented economic challenges that have occurred during its initial stages and over the course of the recovery to date.
- In December, consumer sentiment in Scotland weakened over the month, with the Scottish Consumer Sentiment Indicator falling 3.4 points to 3.4, its lowest level since May 2021.[19,20] Consumer sentiment generally softened over the fourth quarter of 2021, however overall remains positive and notably improved from the series low levels of sentiment in the second half of 2020.

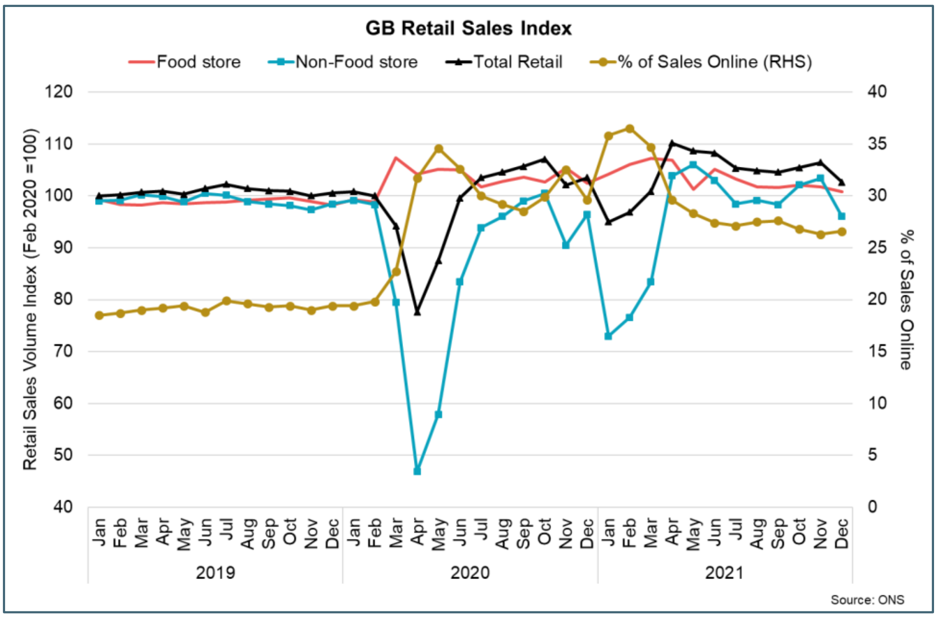


- The fall in sentiment in December was driven by a weakening in current sentiment and expectations about economic performance and household finances. Households continue to expect the Scottish economy and household finances to improve over the coming year, however the indicator net balances fell to their lowest levels since the start of 2021.
- Despite the weakening in sentiment across the other indicators, the household spending indicator was unchanged over the month, however remained in negative territory reflecting that households on balance felt less relaxed about spending money than they did last year.

[19] The latest consumer sentiment survey was undertaken between 24 November and 20 December 2021.
[20] Economy statistics - gov.scot (www.gov.scot)

Retail Sales

- In December 2021, retail sales in Great Britain fell by 3.7% on November as the volume of retail sales further moderated from earlier in the year, however remained 2.6% higher than their pre-pandemic level in February 2020.[21]
- Non-food stores sales fell by 7.1% in December following a pick-up over October and November with retailers noting that the Omicron variant had impacted footfall. Food store sales also fell in December (-1%), however remained 2.0% above their pre-pandemic level.



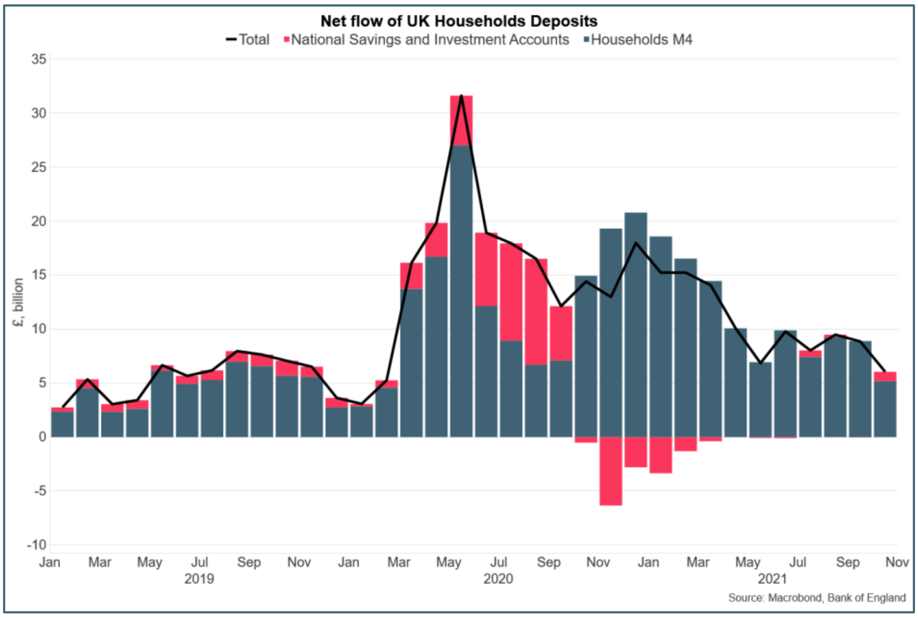
- On a monthly basis, the proportion of retail sales online rose to 26.6% in December (up from 26.3% in November) and remained significantly higher than in February 2020 prior to the pandemic (19.7%).

Household Savings and Consumer Credit

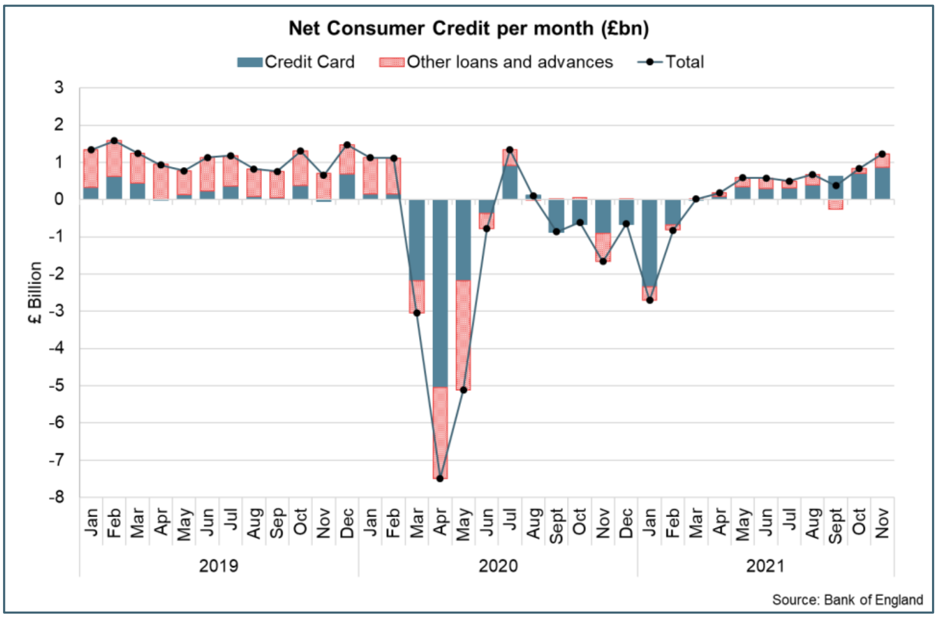
- At an aggregate level, households have increased their levels of savings during the pandemic due to a reduction in expenditure coupled with a rise in disposable income through the retention of earnings. This was particularly evident during periods of lockdown in Q2 2020 and Q1 2021 when consumer facing services were largely closed.
- Bank of England data provides insights at an aggregate level of how savings and consumer credit flows have evolved over the year as restrictions have been removed and economic activity recovery has progressed.
- At an aggregate level, net flows from UK households into deposit-like accounts was £4.5 billion over the month in November 2021.[22] This continued its downward trend from recent months

[21] Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)
[22] Money and Credit - November 2021 | Bank of England

during which the average monthly net flow into banks and building societies and national savings and investment accounts was £11.2 billion in the year to October 2021, and was slightly lower than pre-pandemic flows which averaged £5.5 billion in the year to February 2020.

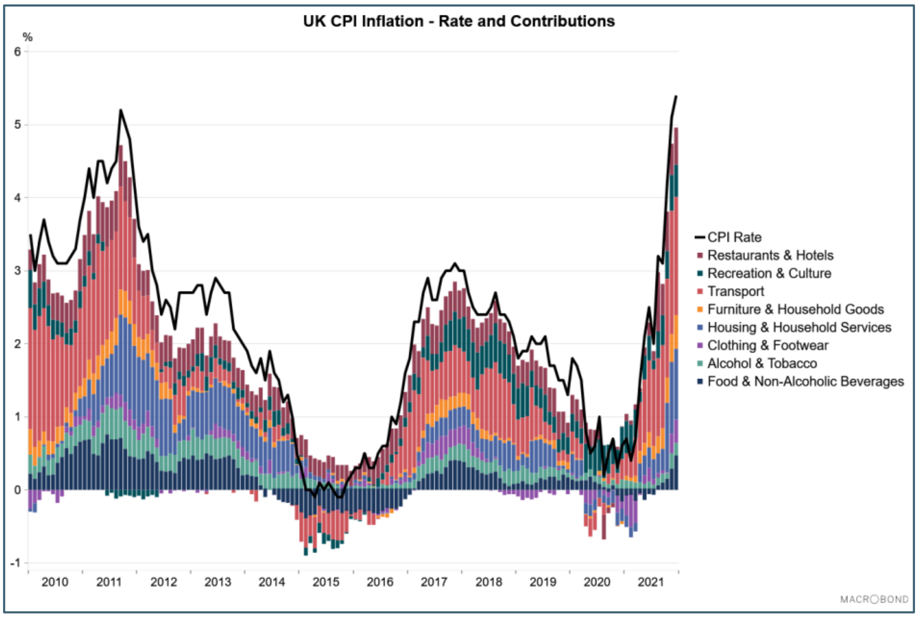


- Alongside this, net consumer credit fell significantly during the pandemic, however started to grow again over the course of 2021. In November, consumers borrowed £1.2 billion in credit on net. Within this, they borrowed £0.9 billion in credit card debt and £0.4 billion of 'other' forms of consumer credit (such as card dealership finance and personal loans). November was the ninth consecutive month of positive net borrowing and the highest since July 2020.



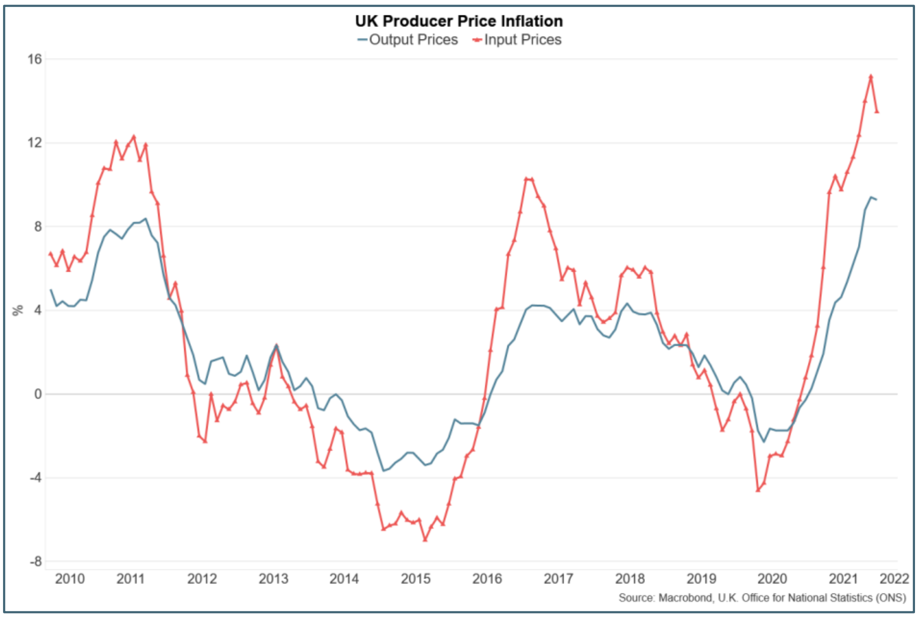
Inflation

- UK CPI inflation was 5.4% in December, up from 5.1% in November, and has risen to its highest rate since the 1990s.[23] Inflation rates also continued to rise in the US (7.1%) and in the Eurozone (5.0%), in part reflecting rising energy prices over the past year.



- UK inflation continued to rise, as forecast, in part reflecting the broad based increase in prices across goods and services, particularly in fuel and energy costs for transport and housing, and in the latest month the cost of food.
- Further price rises are expected, with the Bank of England forecasting inflation to peak at around 6% in the first half of 2022, and cost of living challenges continuing to intensify.
- Similarly, producer price inflation (changes in the prices of goods bought and sold by UK manufacturers, including price indices of materials and fuels purchased and factory gate prices) also remained elevated in December, though had softened slightly from November.
- Input price inflation was 13.5% in December (down from 15.2% in November) while output price inflation was 9.3% (down from 9.4% in November).[24]

[23] Consumer price inflation, UK - Office for National Statistics
[24] Producer price inflation, UK - Office for National Statistics (ons.gov.uk)



- In response to the further rise in underlying inflationary pressures, at their December meeting, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.15 percentage points to 0.25%, with no change to the current programme of Quantitative easing.[25]

- The MPC noted that inflation in advanced economies has risen by more than expected in their November Monetary Policy Report and there are some signs of greater persistence in domestic cost and price pressures. In terms of the potential impact of Omicron, the MPC considered that it presents downside risks to economic activity in the short term, however, the medium term impacts on inflationary pressures remained unclear.

GDP growth outlook

The pace of Scottish GDP growth is forecast to moderate in 2022 as the economy continues to stabilise, while cost of living pressures are expected to intensify.

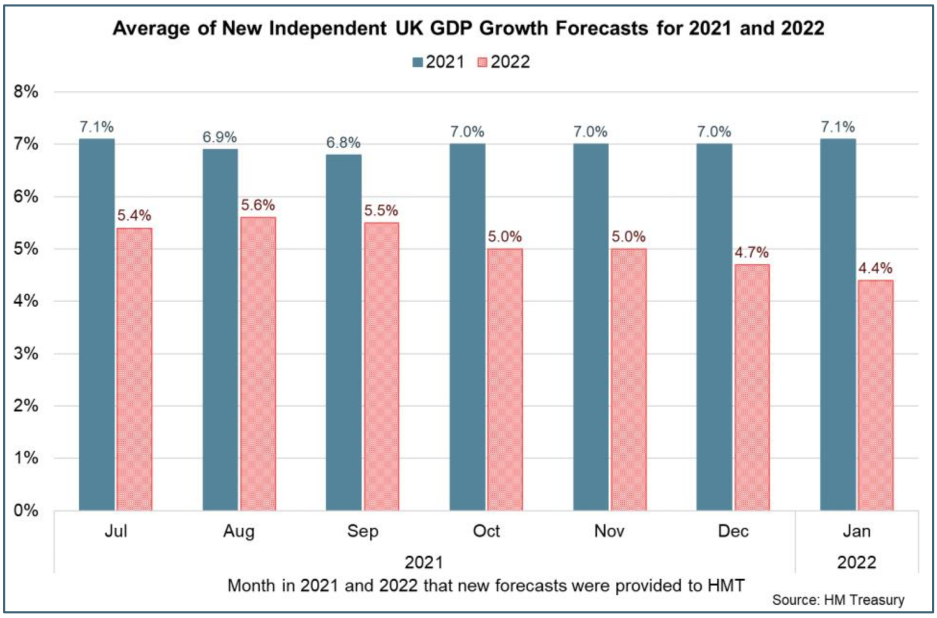
- The most recent Scottish Fiscal Commission (SFC) forecasts from December 2021 expect the Scottish economy to grow 6.7% in 2021 before moderating to 3.8% in 2022 and 1.3% in 2023, while the Fraser of Allander Institute Q4 2021 Economic Commentary forecasts Scottish GDP growth of 6.4% in 2021 and 4.7% in 2022.[26, 27]

- Since the forecasts were undertaken, public health restrictions have changed in Scotland and across the UK during December and January and as such are yet to reflect the full short and medium term impacts of the Omicron wave on the Scottish economic outlook.

- At a UK level, the average of new independent forecasts in January (published monthly by HMT) forecast UK GDP to have grown 7.1% in 2021 and to moderate to 4.4% in 2022. The average

25 Bank Rate increased to 0.25% - December 2021 | Bank of England
26 FAI Economic Commentary, 2021 Q4 | FAI (fraserofallander.org)
27 Scotland's Economic and Fiscal Forecasts – December 2021 | Scottish Fiscal Commission

new forecast for 2022 has progressively weakened in recent months, likely reflecting the persistence of supply chain disruption, inflationary pressures, alongside the emergence of Omicron.[28]



- In January, the IMF also revised down its UK GDP growth forecast for 2022 to 4.7%, from 5% in October, reflecting the impacts of Omicron on economic activity and ongoing supply constraints in the labour and energy markets. Growth is forecast to ease further to 2.3% in 2023.[29]

- This is part of a general downward revision to forecasts for 2022 across countries with the IMF forecasting global growth of 4.4% in 2022, down from 4.9% forecast in October. This reflects the disruption to the global economy from the spread of the Omicron variant and the reintroduction of restrictions, combined with the persistence of supply disruptions and inflationary pressures.

[28] Forecasts for the UK economy: January 2022 - GOV.UK (www.gov.uk)
[29] World Economic Outlook Update, January 2022: Rising Caseloads, A Disrupted Recovery, and Higher Inflation (imf.org)

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