Monthly Economic Brief

Office of the Chief Economic Adviser

February 2022

Scottish Government
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February 2022

Data up to 28 February 2022

Overview

This month's economic brief provides latest insights on the Scottish economy in the closing months of 2021 and into the start of 2022. Over this period, we have seen a short-term disruption to the economic recovery from the pandemic from the Omicron variant and the necessary tightening of public health restrictions during December and January, although there are encouraging signs that this disruption has been short lived. Overall, looking at 2021 as a whole, GDP grew 7% over the year, only partially recovering from the 10% fall in 2020, in part because of the short term disruption from Omicron at the end of the year.

Scotland's GDP fell 0.4% in December with flat services output and growth in construction offset by a fall in production output. Consumer-facing services' output fell over the month, likely in part reflecting the impacts of Omicron uncertainty and restrictions on the sector, while falls in manufacturing and electricity and gas weighed on output from the production sector.

Despite the fall in output in December, Scotland's GDP remained slightly above its February 2020 pre-pandemic level, though the pace of recovery continues to vary notably by sector.

Looking to the start of the new year, there have been some positive signs of recovery with business survey data showing some strengthening of activity in the services sectors, which were most impacted by Omicron restrictions. January also saw an improvement in consumer sentiment, with households seeing an improved outlook for the economy, as restrictions began to be eased at the end of January, following the successful rollout of booster jabs from December.

Scotland's labour market continued to perform strongly at the end of the year, with unemployment remaining low at 4.1% in October to December. Payrolled employees also continued to increase in January, though only slightly, and remain over 14,000 higher than they were before the pandemic.

Ongoing challenges and headwinds persist, however. Inflationary pressures have continued to strengthen with inflation rising to 5.5% in January. With the forthcoming increase in the energy price cap, inflation is forecast to rise further in April, to around 7%, and is presenting an extremely challenging outlook for household finances, with many households facing falls in their real incomes at a time that both National Insurance and VAT on hospitality are rising.

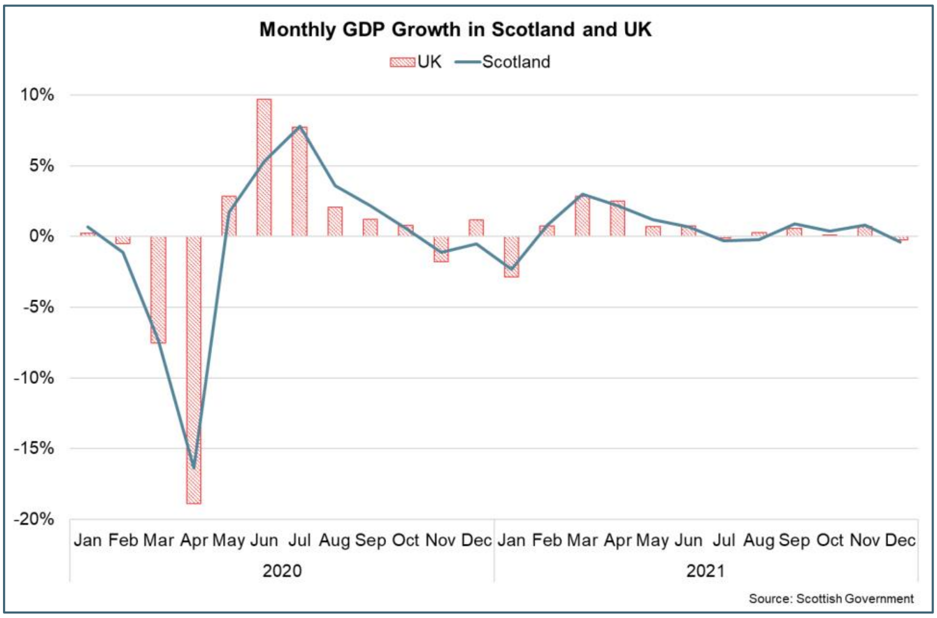
Many firms also continue to report difficulties with recruitment challenges and labour market shortages, although there are some signs of these pressures lessening slightly with the pace of vacancy growth starting to ease. Similarly, whilst supply chain challenges remain, there are signs of some stabilisation in cost pressures in business surveys.

However, looking ahead, the current geopolitical situation means that the global economic outlook is increasingly uncertain, with financial markets likely to be disturbed, growth potentially weaker and with the prospect of higher inflation pressures as energy and other commodity prices rise further.

Output

Scotland's GDP fell 0.4% in December, however remained 0.1% above the pre-pandemic level of February 2020.

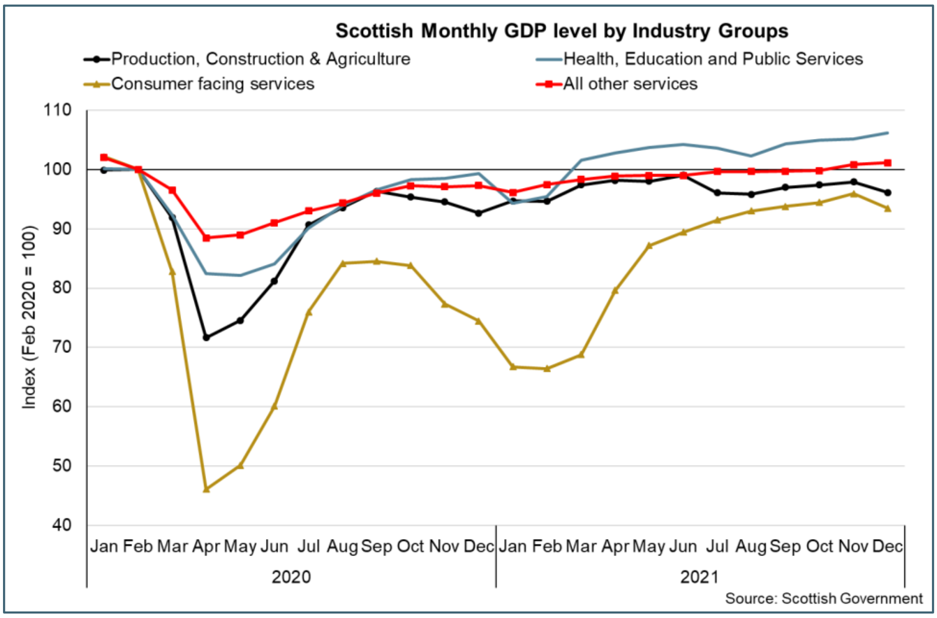
- The emergence of the Omicron variant in November 2021 meant that increased restrictions around social interaction, testing and self-isolation, alongside closure of nightclubs, limits on capacity at indoor hospitality and leisure settings and attendance at large events, were introduced over the course of December.
- Scotland's GDP fell by 0.4% in December (UK: -0.2%), the first monthly fall in GDP since August, after three consecutive monthly increases.[1] As such GDP is estimated to have grown by 1.3% in the final quarter of 2021 (UK: 1.0%) and grown 7% in annual terms in 2021 (UK: 7.5%) following the 10% fall in 2020 (UK: 9.4%).



- At a sector level, output in the services sector was flat in December (0.0% growth), and growth in the construction sector (1.9%) was offset by falls in the production sector (-3.3%).
- Within the services sector, output in consumer-facing services fell by 2.5% in December, including contractions of 3.9% in retail and 3.4% in accommodation and food services, likely reflecting the impacts of Omicron on this broad group. This was offset by growth of 1.8% in the health and social work sector in particular, reflecting higher levels of test and trace and vaccination activity, while output in all other services increased by 0.3%.
- The fall in production output in December (-3.3%), was largely driven by falls in manufacturing output (-3.4%), which fell back in the second half of 2021 following stronger growth earlier in the year, alongside a fall in output in electricity and gas supply (-6.6%).

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

- There remain differences across sectors in the pace of recovery, which continues to partly reflect the restrictions that have been in place, 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 6.5% below pre-pandemic levels, while output from health, education and public services is 6.2% above, and output from all other services is 1.1% above the level in February 2020.

- 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 fell by 1.9% in December and was 3.9% below its pre-pandemic level.

Business Activity

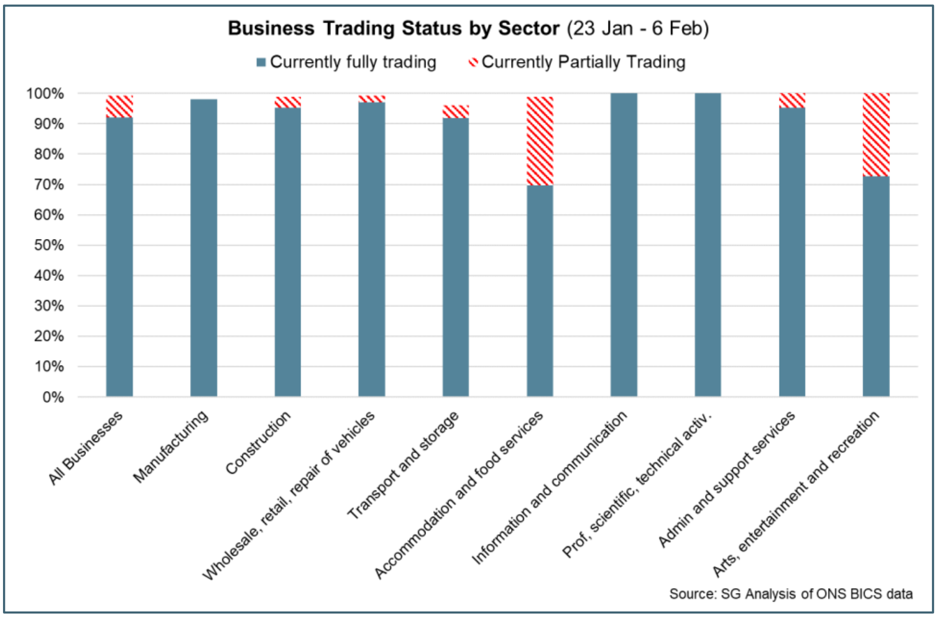
Business surveys indicate that business activity strengthened slightly in January and into February as Omicron restrictions were eased.

Business trading status and activity

- The Omicron restrictions introduced in December were eased over January enabling the resumption of large outdoor events, the removal of physical distancing restrictions in hospitality and leisure settings and the removal of working from home guidance.

- The changes in guidance and restrictions over this period were reflected in the trading status of businesses. At an aggregate level, the change in the proportion of businesses reporting as currently trading was marginal, falling to 98% during December and January before rebounding to 99% going into February.[2] However, it's important to note that of those business trading, 92% reported as fully trading and 7% partially trading.

- As with previous waves of the virus, the fall in the proportion of businesses trading was most evident in consumer facing services. 91% of businesses in the accommodation and food services sector were trading during December before rebounding back to 99% at the end of January. Furthermore, businesses in the consumer facing sectors continued to have the highest proportion of firms only partially trading - 29% in the accommodation and food services and 27% in the arts, entertainment and recreation services sector.

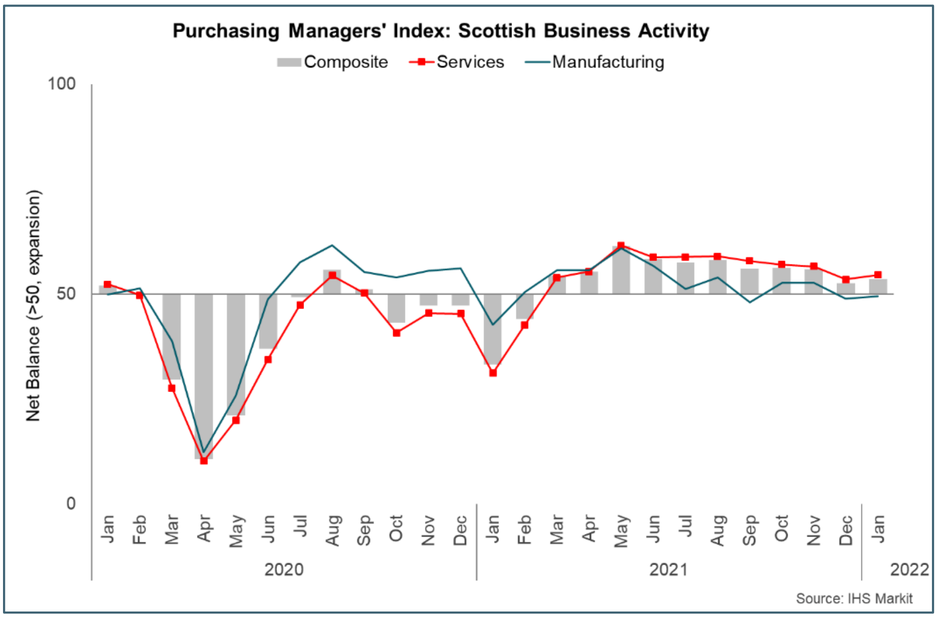


- Several factors have impacted business activity and trading status at the start of the new year, including the holiday season, as well as the increased restrictions and their impact on demand, capacity and staffing availability.

- Overall, the Purchasing Managers Index (PMI) business survey signalled a slight pick-up in growth in January having slowed in December (53.7, up from 52.7).[3]

- The pick-up in activity was supported by further growth in new business, however this was confined to the services sector while new orders fell for a second month in the manufacturing sector. Overall, the pace of growth in new orders was largely unchanged from the slowdown in December reflecting that demand continued to be impacted by current headwinds from Omicron and ongoing supply side issues.

[2] BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)
[3] IHS Markit, RBS Purchasing Managers Index: RBS | Private sector output rises at quicker pace in January (rbsbusinesshub.com)



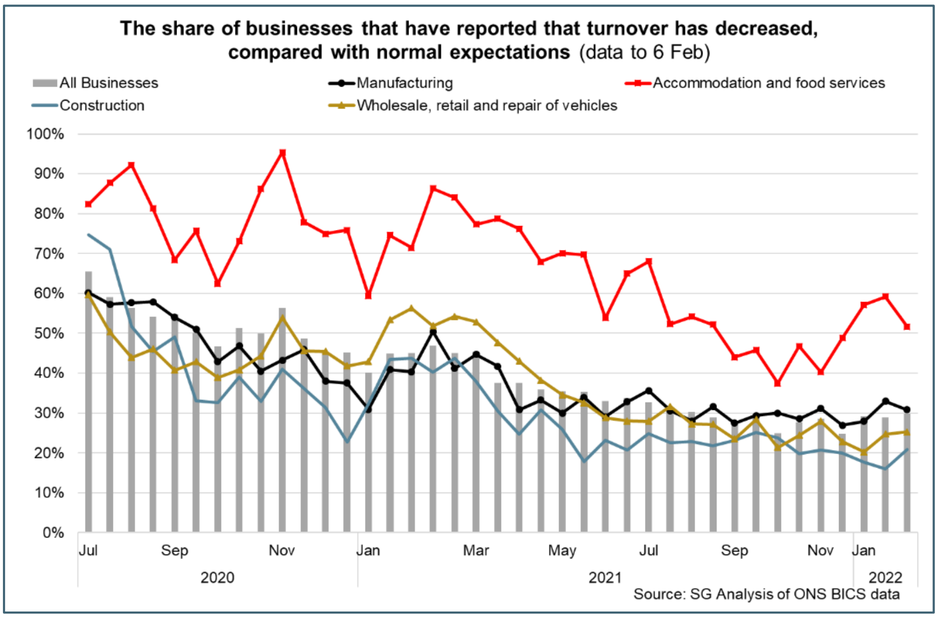
- More recently, flash UK PMI data indicated that private sector growth strengthened further in February, with the composite output indicator rising to an eight month high (60.2, up from 54.2 in January). This was particularly led by increased spend on transport, leisure and entertainment following the easing of restrictions, however manufacturing output was also reported to have improved with respondents suggesting that raw material availability had improved, enabling firms to improve stocks and reduce backlogs of work.[4]

Business turnover and input costs

- The changes in business activity in response to increased uncertainty and the tighter guidance and restrictions over December and January has also been reflected in business turnover indicators.
- At an aggregate level, the proportion of businesses reporting a decrease in turnover remained broadly stable in the second half of 2021, however edged back up to 30% in January and into the start of February (up from around 27% in November). Similarly the proportion of firms reporting that turnover has increased fell to 8% (down from 15% in November/December) while the proportion of firms reporting that turnover has not been affected continued its upward trend to 51%.[5]

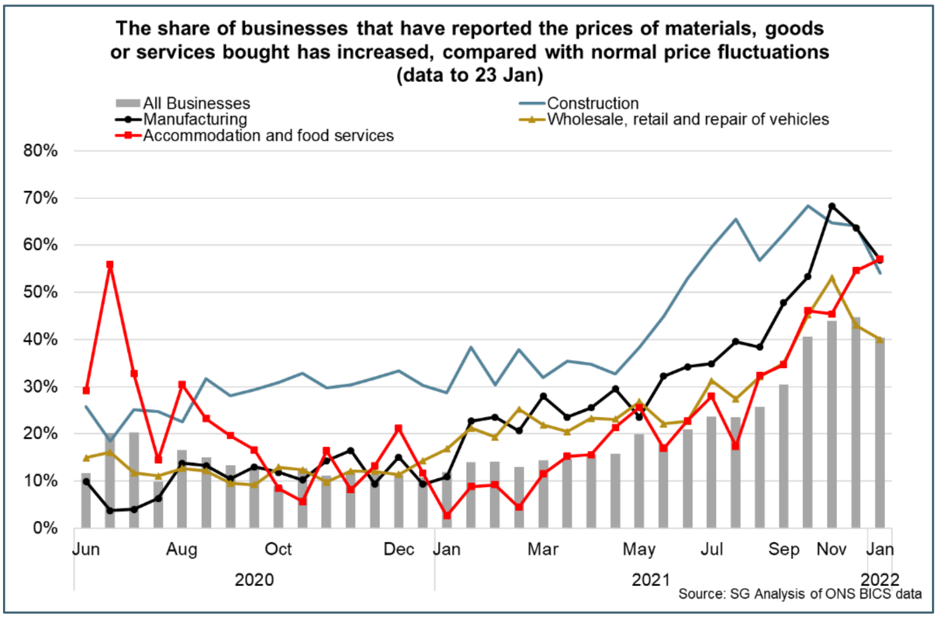
[4] IHS Markit/CIPS, Flash UK Composite PMI: [5b1e74ff34b2406cb5cafedb0522f1a4 (markiteconomics.com)]

[5] [BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)]

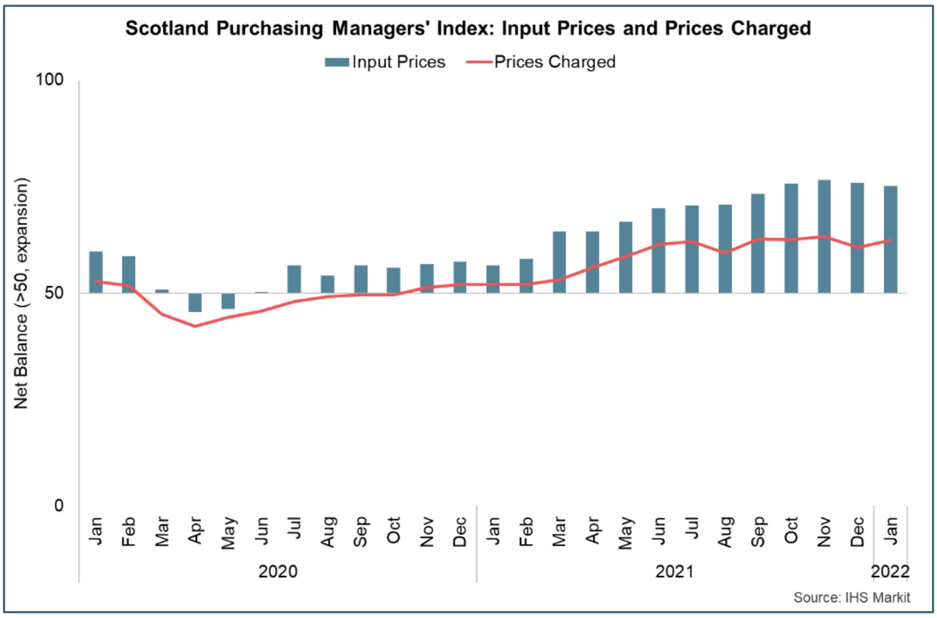


- Lower than normal turnover continued to be most widespread in the accommodation and food services sector. The proportion reporting lower than normal turnover picked up moderately in December and January to 59% (up from around 45% in November), however eased back to 52% going into February and remains notably lower than earlier in the pandemic.
- Notable shares of most other sectors continued to report that turnover had not been affected, while 12% of businesses in transport and storage, wholesale, retail, repair of vehicles and administration and support services reported that turnover had increased, emphasising the level of variability of demand within sectors.
- In addition to the uncertainty generated by Omicron at the start of the year, businesses have continued to face existing headwinds from supply chain disruption and resource availability and energy prices, which have driven up input costs for businesses.
- Input cost pressures remained elevated in January with 40% of businesses reporting that prices increased more than normal, down from around 44% during November and December 2021, however remained most prominent in accommodation and food services (57%), manufacturing (57%) and construction (54%).[6]

[6] BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)



- Scottish PMI data also showed the indicator for input cost inflation remained elevated in January, indicating that prices continued to rise, albeit at its slowest rate since September 2021. A range of factors including higher utility and food bills, material costs and shortages continued to be cited by the survey respondents as sources of inflationary pressures.[7]



- Business Insights and Conditions Survey data show supply chain bottlenecks continued to present significant challenges going into February 2022. 37% of all applicable businesses reported that their business had experienced global supply chain disruption over the previous month, most notably in the manufacturing (56%), construction (40%) and wholesale, retail and repair of vehicles (39%) sectors. Furthermore, 42% of exporters and 44% of importers reported

[7] IHS Markit, RBS Purchasing Managers Index: [RBS | Private sector output rises at quicker pace in January (rbsbusinesshub.com)](rbsbusinesshub.com)

facing changes in transportation costs while 19% of exporters and 18% of importers reported a lack of hauliers to transport goods or lack of logistics equipment.[8]

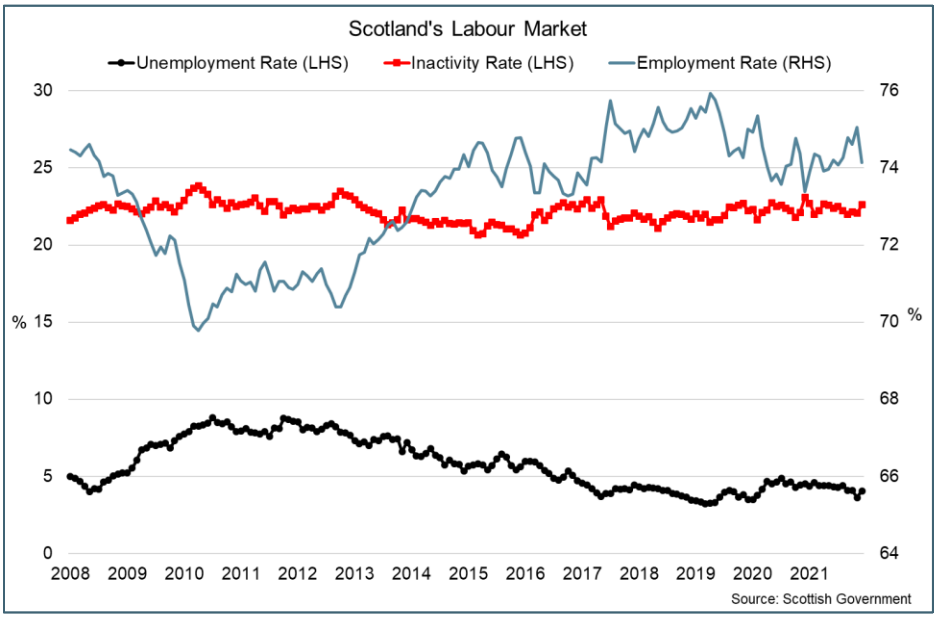
- PMI data indicated that firms continued to partly pass on higher costs through to customers, and at a faster rate than in December.

Labour Market

Unemployment remained low in the final quarter of the year while vacancy rates and staff shortages persist.

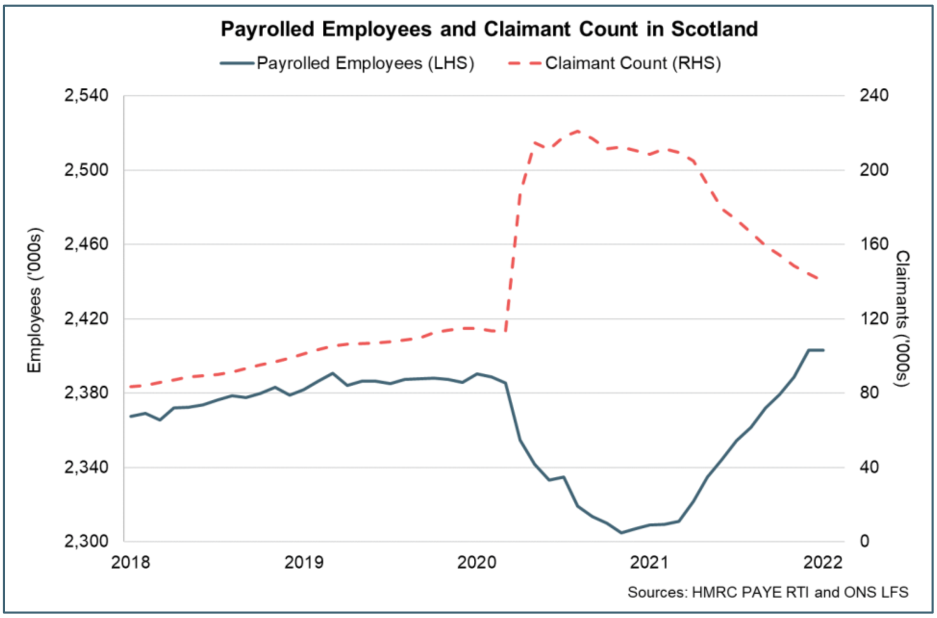
Official labour market statistics, payrolled employment and claimant count

- The latest labour market statistics for October to December 2021 in Scotland show there were 2.65 million people in employment (rate of 74.1%, up 0.8 percentage points over the year), 112,000 people unemployed (rate of 4.1%, down 0.5 percentage points) and 773,000 people economically inactive (rate of 22.6%, down 0.5 percentage points).[9]

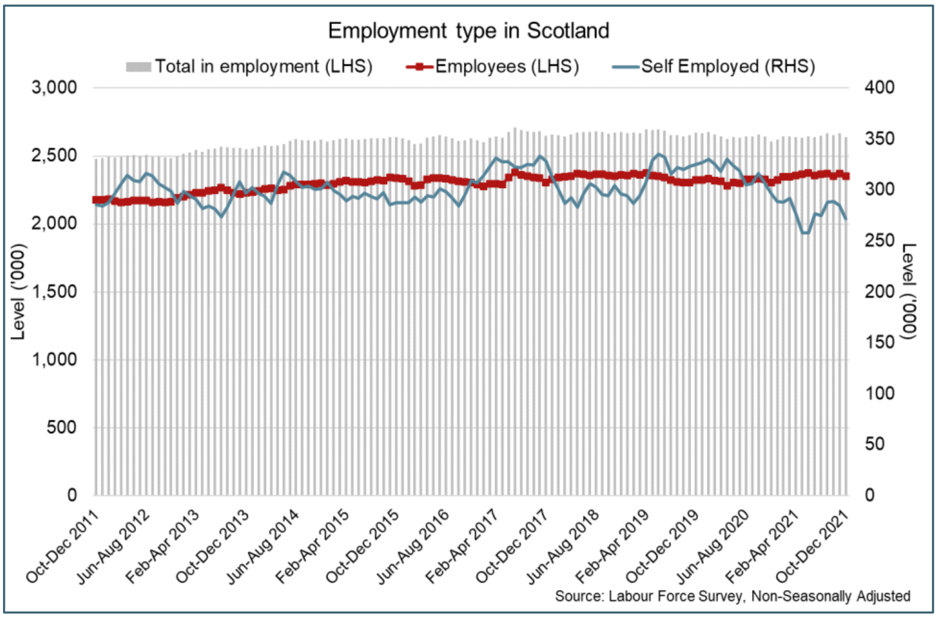


- Wider labour market indicators showed signs of further strengthening in the labour market in January. Pay As You Earn (PAYE) Real Time Information estimates for January 2022 indicate the number of payrolled employees in Scotland remained broadly stable over the month at 2.4 million, however was 30,938 (1.3%) more than in September at the end of the furlough scheme. Furthermore, there were 14,000 more payrolled employees than the pre-pandemic level in February 2020.[10]

[8] BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)
[9] Labour market trends: February 2022 - gov.scot (www.gov.scot)
[10] Earnings and employment from Pay As You Earn Real Time Information, UK - Office for National Statistics (ons.gov.uk)

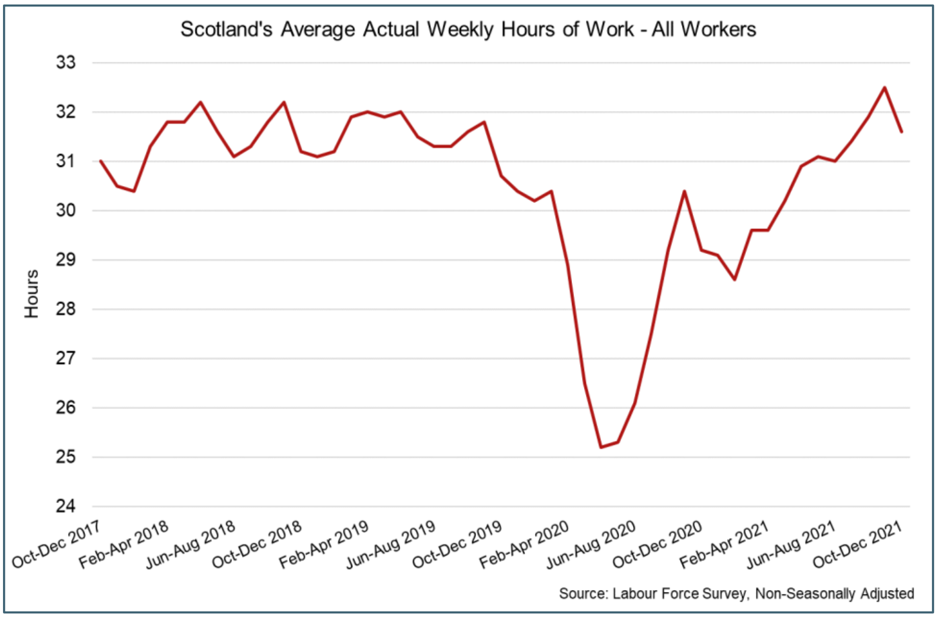


- Scotland's Claimant Count (the number of claimants of Job Seekers Allowance and claimants of Universal Credit claiming principally for the reason of being unemployed) also continued its downward trend in January, down 2.5% over the month to 140,500; a claimant count rate of 4.4%.
- Overall, the claimant count has fallen 36.4% from its peak in August 2020 and 11.7% since September when the furlough scheme ended. However, it remains 26,800 (24.4%) higher than its pre-pandemic level in February 2020.[11]
- Further underlying changes continue to emerge in the labour market as it recovers from the pandemic. While employee numbers have risen above their pre-pandemic level, the overall level of employment remains below, reflecting that the number of self-employed has fallen.[12]



[11] Labour market trends: February 2022 - gov.scot (www.gov.scot)
[12] Scotland data (not seasonally adjusted) OD21 - Office for National Statistics (ons.gov.uk)

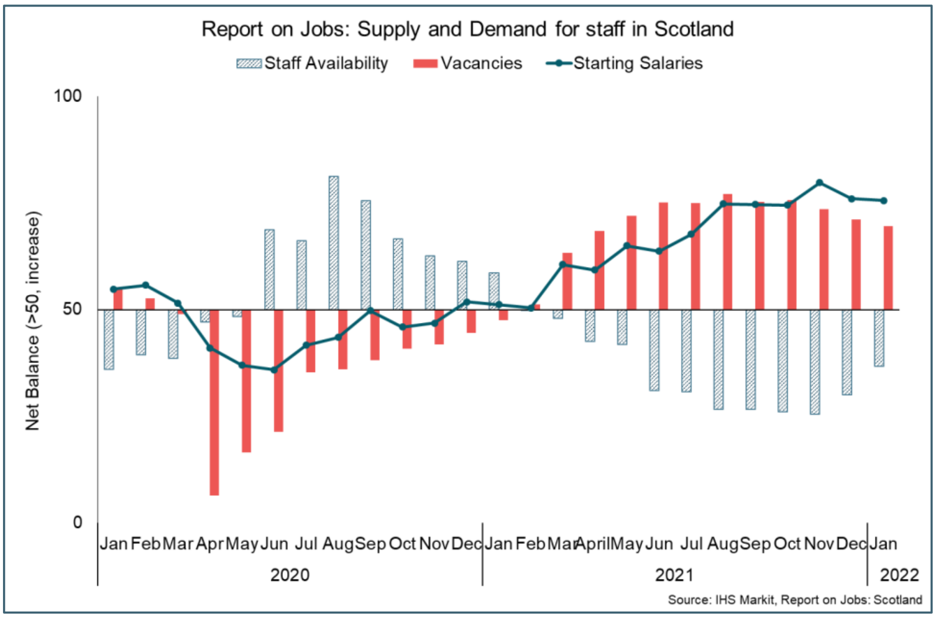
- One of the main impacts of the furlough scheme was that people worked fewer hours, even though they remained in employment. After falling heavily at the start of the pandemic, average actual weekly hours of work have now returned to around pre-pandemic levels. In October to December 2021, average total weekly hours was 31.6, up from 29.2 hours during the same period in 2020 and up from 30.7 hours during the same period prior to the pandemic in 2019.[13]



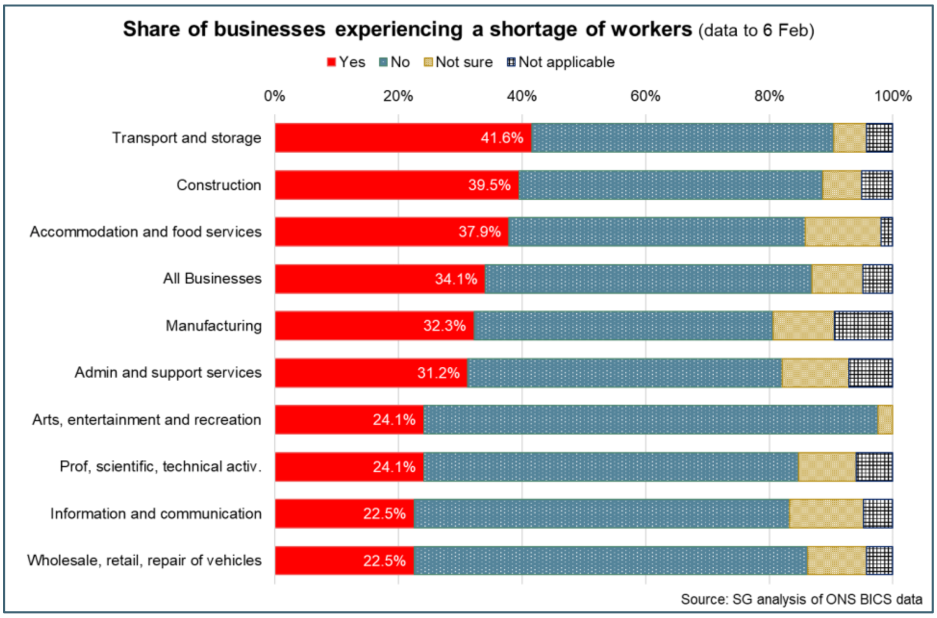
Demand for staff

- Business surveys have also signalled that labour market tightness has persisted into the start of 2022 with strong demand for staff while recruitment challenges continue.
- The latest Report on Jobs signalled that overall demand for staff continued to grow in January (69.6), and remains high compared to historical standards. However, the rate of growth eased over the month, continuing its downward trend from over the second half of 2021, with demand for permanent staff stronger than for temporary staff.[14]
- Supply side challenges in the labour market have also continued with candidate availability (labour supply) continuing to fall for a twelfth month, however the rate of fall was at its weakest rate since May 2021.

[13] [Scotland data (not seasonally adjusted) OD21 - Office for National Statistics (ons.gov.uk)]
[14] IHS Markit: RBS Report on Jobs for January: [9d2e2f8852fb47589fb0c72da6720c9f (markiteconomics.com)]

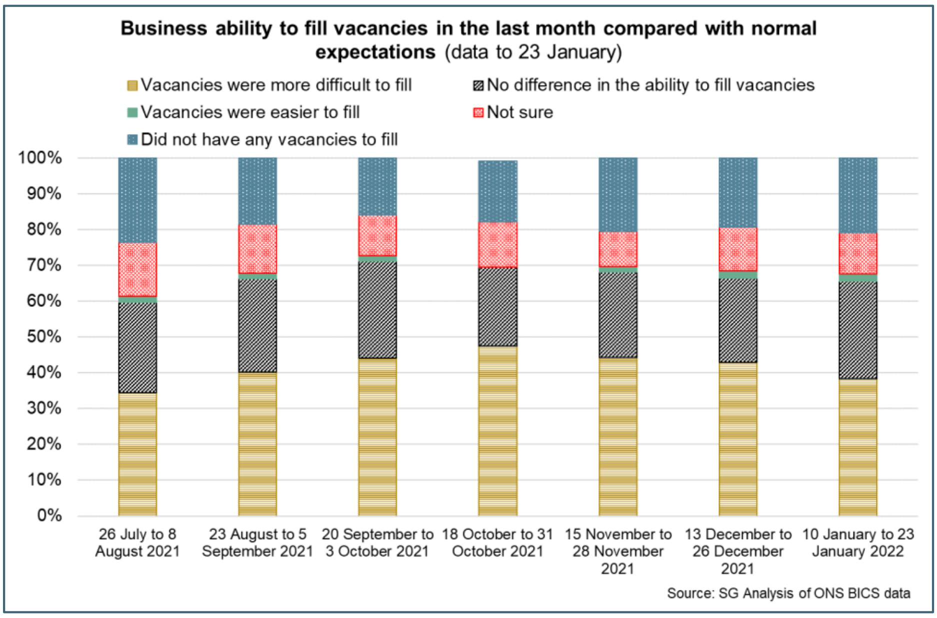


- More recent online vacancies data signal that strong demand for staff continued into February, with online job vacancies 44.2% higher than in February 2020.[15]
- The strength in demand for staff, coupled with low unemployment and falls in candidate availability has meant upward pressure on starting salaries has remained elevated at the start of the year, particularly for permanent roles.
- Labour shortages also continue to affect a range of sectors with 34% off businesses experiencing a shortage of workers into the start of February. This is down from 38% in October, however remains most notable in transport and storage (42%), construction (40%), accommodation and food services (38%) and manufacturing (32%).[16]



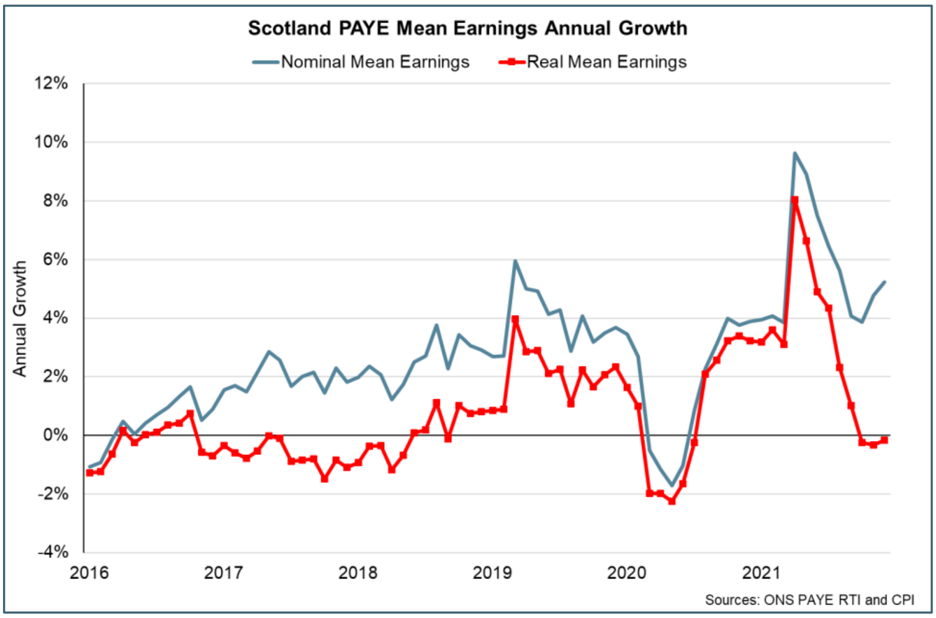
15 Online job advert estimates - Office for National Statistics (ons.gov.uk)
16 BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)

- Reflecting this, 38% of businesses in January, reported their ability to fill vacancies remains more difficult than normal for the time of year, down from 47% in October, while the share of businesses reporting no difference in their ability to fill vacancies increased to 27% (up from with 22% in October).[17]



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.[18,19]



[17] BICS weighted Scotland estimates: data to wave 49 - gov.scot (www.gov.scot)
[18] Earnings and employment from Pay As You Earn Real Time Information, seasonally adjusted - Office for National Statistics (ons.gov.uk)
[19] 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.

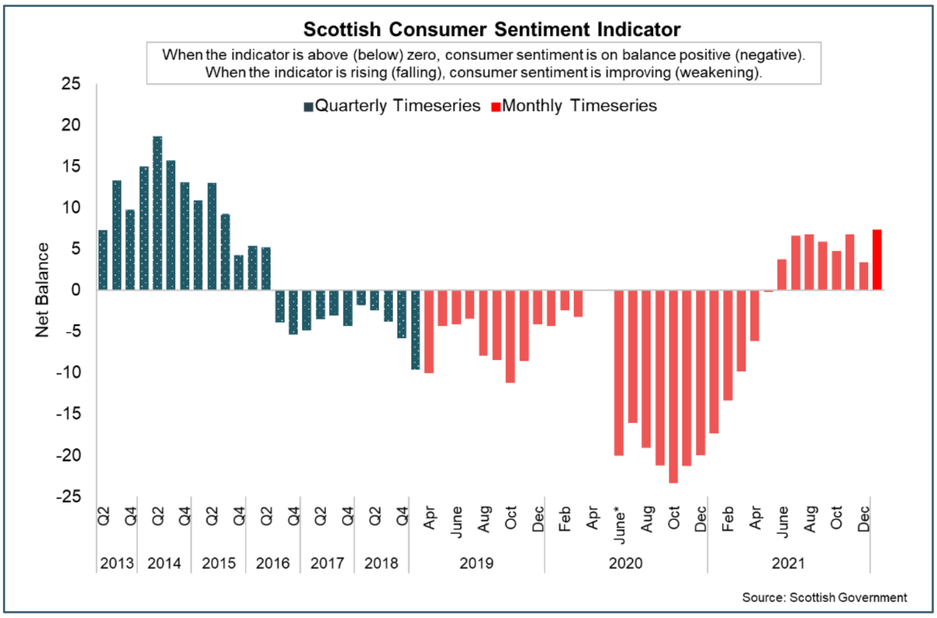
- Latest data show mean monthly pay grew by 0.7% over the month in December (UK: 1.3%), and grew 5.2% annually (UK: 5.6%) to £2,558 (UK: £2,805).
- However, the CPI annual inflation rate was 5.4% in December, and is weighing notably on real earnings growth.

Consumption

Following a weakening of sentiment in December amid the onset of Omicron, consumer sentiment picked up again in January.

Consumer sentiment

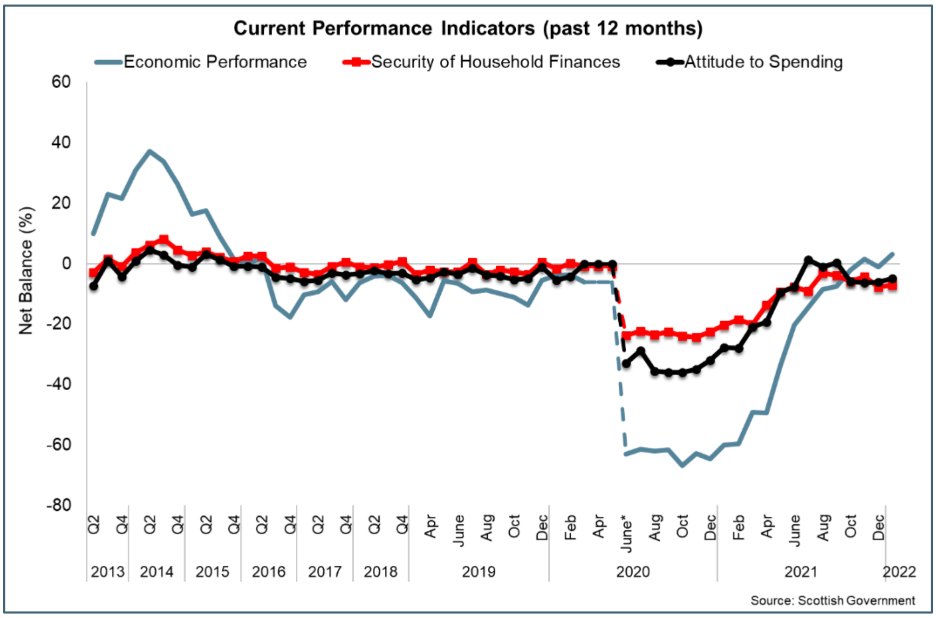
- Consumer sentiment indicators continue to be highly sensitive to the rapidly moving developments on the pandemic and the unprecedented economic challenges that have occurred during its initial stages and over the course of the recovery to date.
- The Scottish Consumer Sentiment Indicator returned to positive territory in the second half of 2021 having significantly improved from the series low levels of sentiment in the second half of 2020.
- Following a slight weakening in sentiment in the final quarter of 2021, consumer sentiment strengthened over the month in January with the composite indicator rising 3.9 points to 7.3, its highest level in the monthly time series.[20,21]



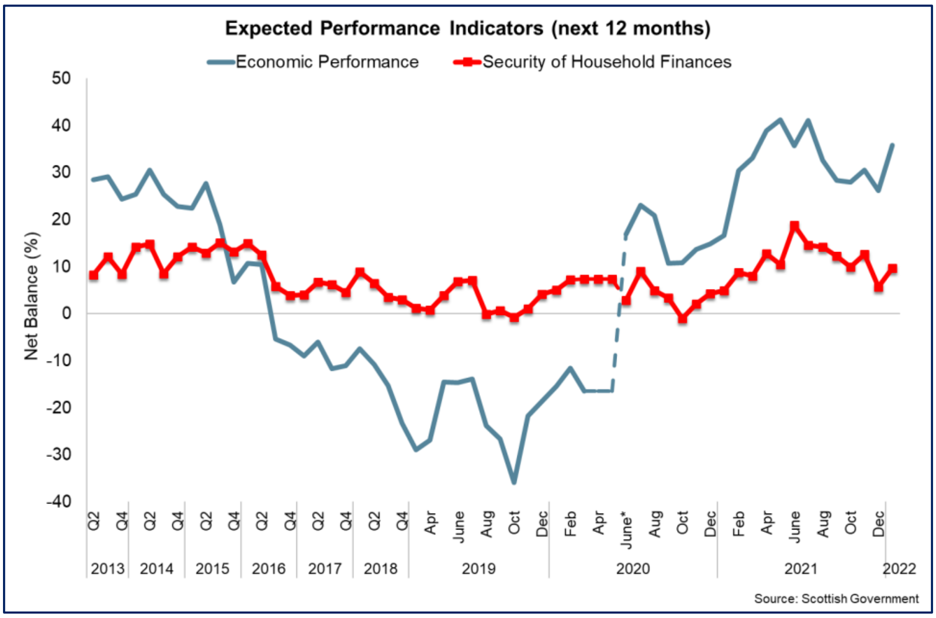
- The rise in sentiment in January was driven by a broad based rise across the current and expectations indicators. In terms of the current indicators, respondents views of current economic performance had the largest rise (4.3) points and was positive overall while

[20] The latest consumer sentiment survey was undertaken between 5 – 30 January 2022.
[21] Economy statistics - gov.scot (www.gov.scot)

respondents views on security of household finances and attitude to spending improved over the month, but remained negative overall.



- Expectation indicators for economic performance and security of household finances notably improved in January by 9.6 and 4.0 points respectively and remained positive overall meaning that households on balance feel more positive about future economic performance and household finances over the coming year.

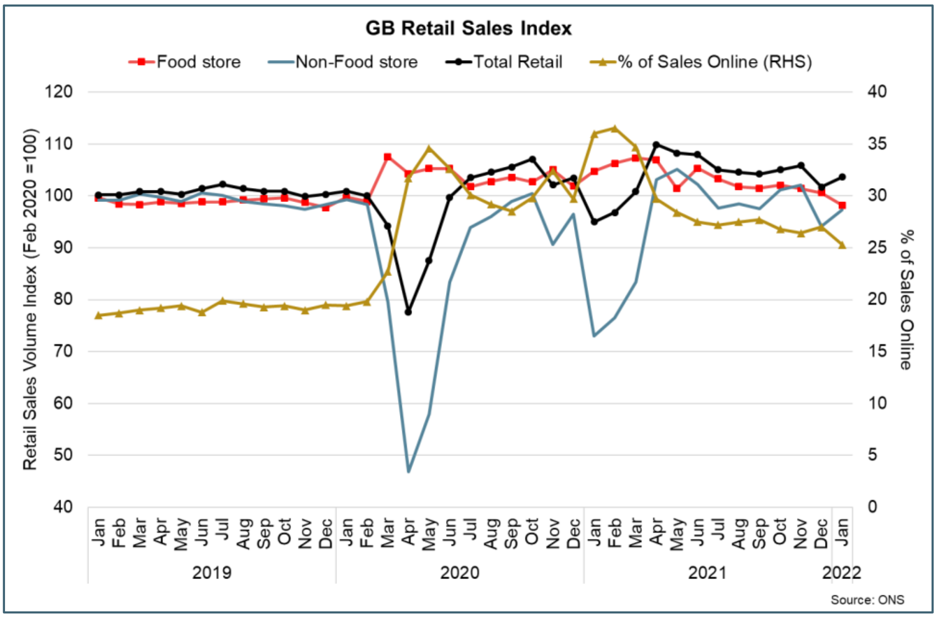


Retail Sales

- In January 2022, retail sales in Great Britain rose by 1.9%, following a fall of 4.0% in December with the overall volume of sales remaining above its pre-pandemic level in February 2020 (3.6%).[22]

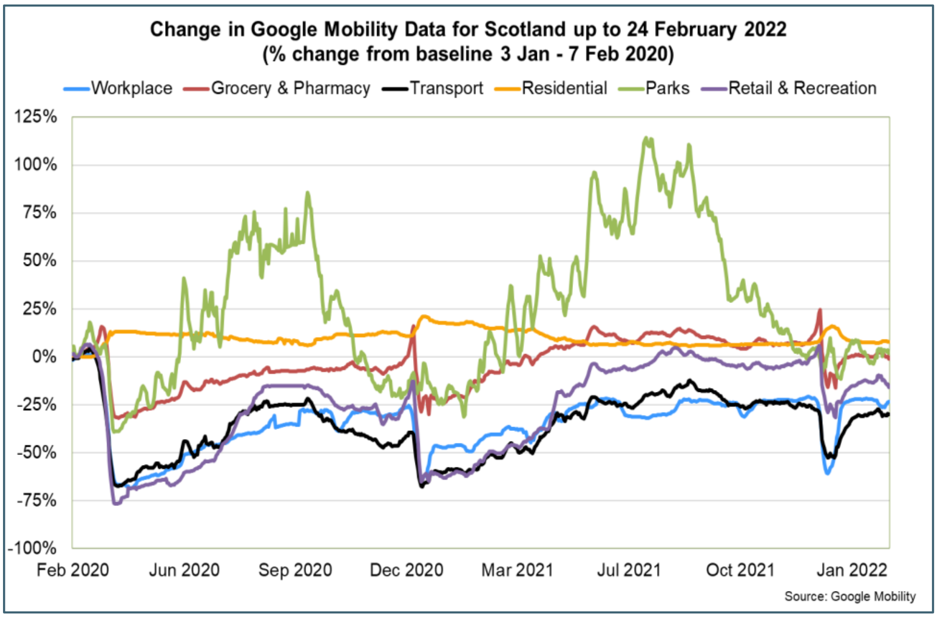
[22] Retail sales, Great Britain - Office for National Statistics (ons.gov.uk)

- Non-food stores sales rose by 3.5% over the month driven by an increase in home improvement sales volumes, while food store sales fell by 2.3%. Both were below pre-pandemic levels (-1.1% and -0.8% respectively) with food store sales volumes falling below pre-pandemic levels for the first time and continuing its downward trend from the second half of 2021 as consumers diverted spending to wider hospitality, food and leisure services.



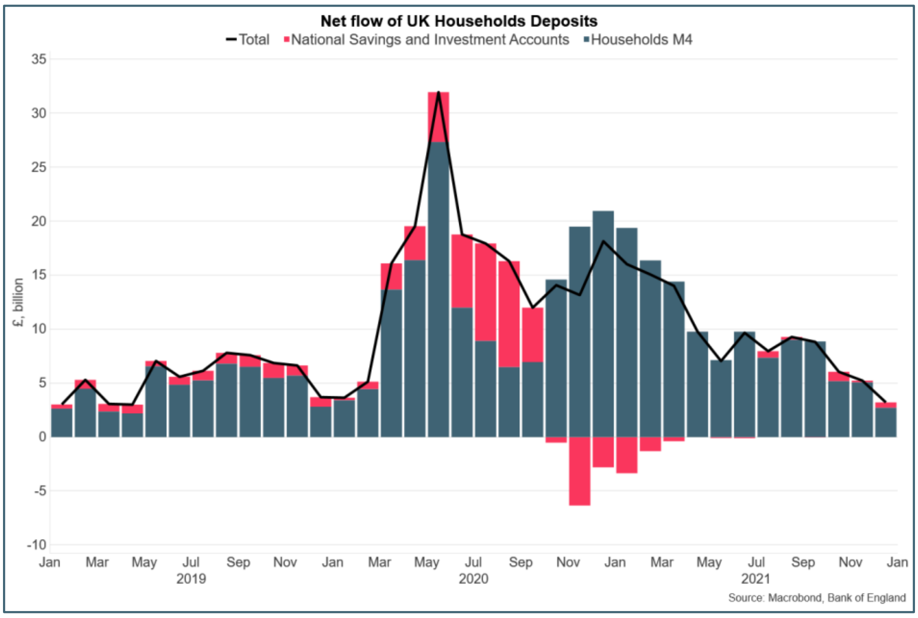
- Online retail sales also fell 4.5% in January and as a proportion of all retail sales, fell to 25.3% (down from 26.6% in December). This was its lowest proportion since March 2020, however remains significantly higher than in February 2020 prior to the pandemic (19.7%).

- Google Mobility data indicates that following a rise in visits to retail and recreation hubs in December, visits fell sharply in January 2022 (30% below pre-pandemic levels) reflecting a combination of the holiday period and Omicron. Movement around retail and recreation hubs have partially picked-up, though remain around 15% below pre-pandemic levels in mid-February.



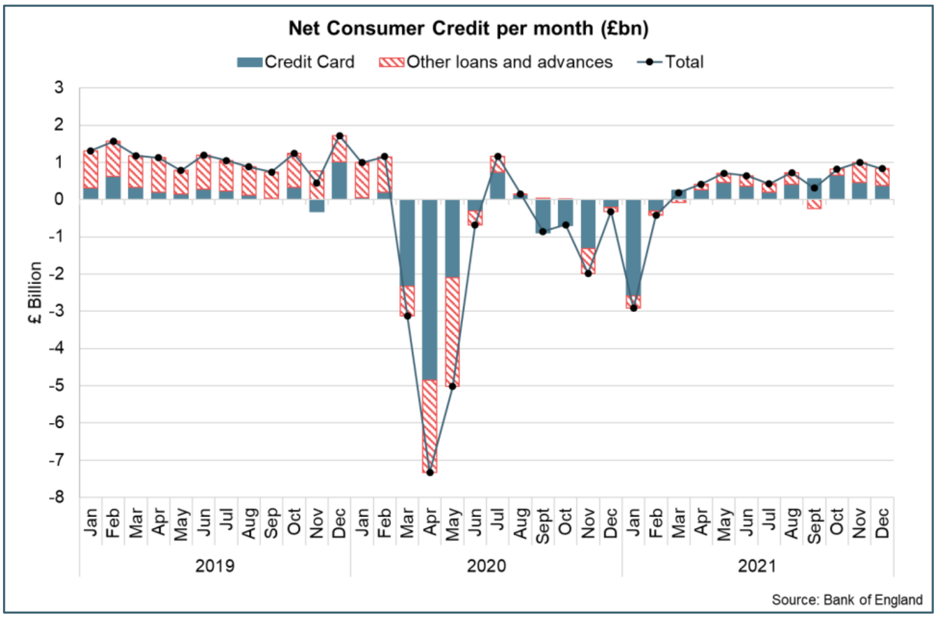
Household Savings and Consumer Credit

- At an aggregate level, households 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.
- In recent months, at an aggregate level, net flows from UK households into deposit-like accounts has returned to a broadly similar position as they were prior to the pandemic. In December 2021, net inflows were £3.2 billion over the month, significantly lower than the monthly average in the year to November 2021 (£10.6 billion) and was lower than pre-pandemic flows which averaged £5.5 billion in the year to February 2020.[23]



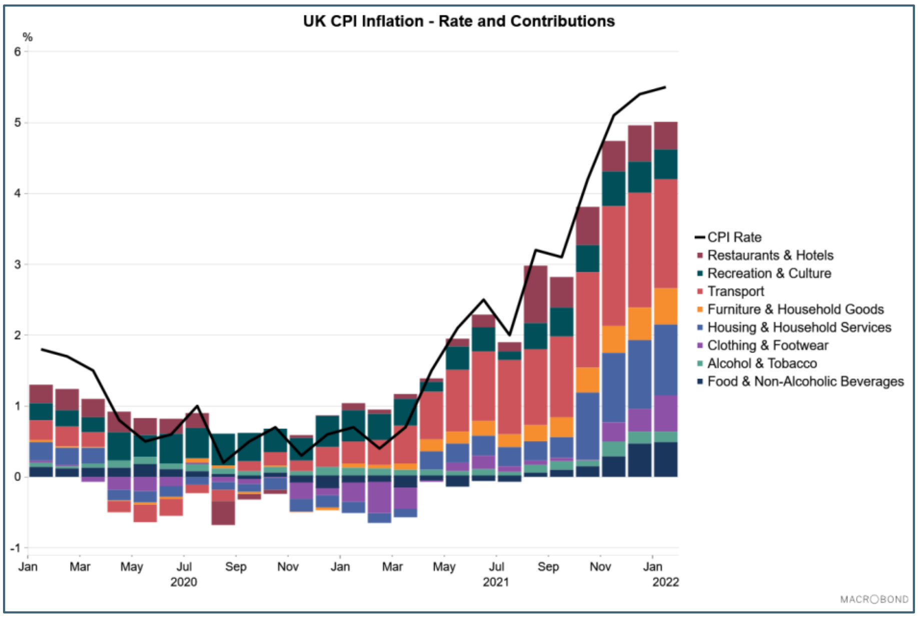
- Alongside this, net consumer credit fell significantly during the pandemic, however started to grow again over the course of 2021. In December, consumers net borrowing was £0.8 billion, reflecting £0.4 billion in credit card debt and £0.4 billion of 'other' forms of consumer credit (such as card dealership finance and personal loans).
- Monthly net borrowing remains lower than in 2019 prior to the pandemic, however the annual growth rate for consumer credit increased to 1.4% in December (up from 0.8% in November).

[23] Money and Credit - December 2021 | Bank of England



Inflation

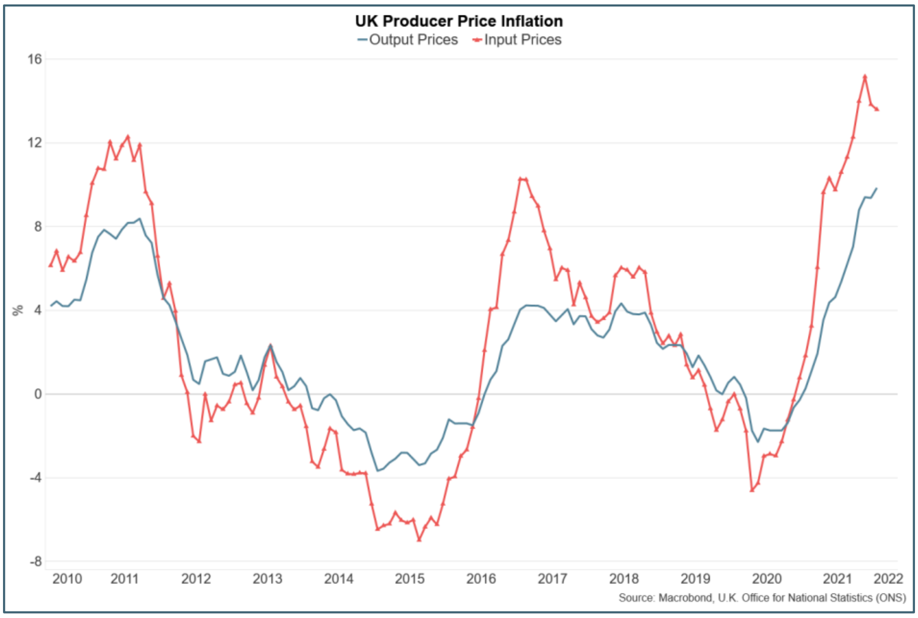
- UK CPI inflation rose to 5.5% in January 2022, up from 5.4% in December and has risen to its highest rate since the 1990s, presenting increased cost of living challenges.[24] Inflation rates have also continued to rise in the US (7.5%) and in the Eurozone (5.1%), in part reflecting rising energy prices over the past year.



- In the UK, the consumer price index has risen over the year across almost all goods and services monitored, most notably in electricity and fuel prices (+23%), transport (+11%), and household goods (+8%), but also in key categories such as clothing (+6.1%) and food (+4.5%).

[24] [Consumer price inflation, UK - Office for National Statistics]

- Further price rises are expected, with the Bank of England forecasting inflation to peak at around 7.25% in the first half of 2022 and to remain high at more than 5% over 2022, intensifying the cost of living challenges.
- Alongside the rise in energy prices, wider drivers of inflation such as the feed through from 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 January. Input price inflation was 13.6% in January (down from 13.8% in December) while output price inflation was 9.9% (up from 9.3% in December).[25]



- In response to the further rise in underlying inflationary pressures, the Bank of England's Monetary Policy Committee (MPC) increased the Bank Rate by 0.25 percentage points to 0.50% in February, having previously raised it by 0.15 percentage points in December 2021.[26]

GDP growth outlook

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 current geopolitical situation means that the global economic outlook is increasingly uncertain.

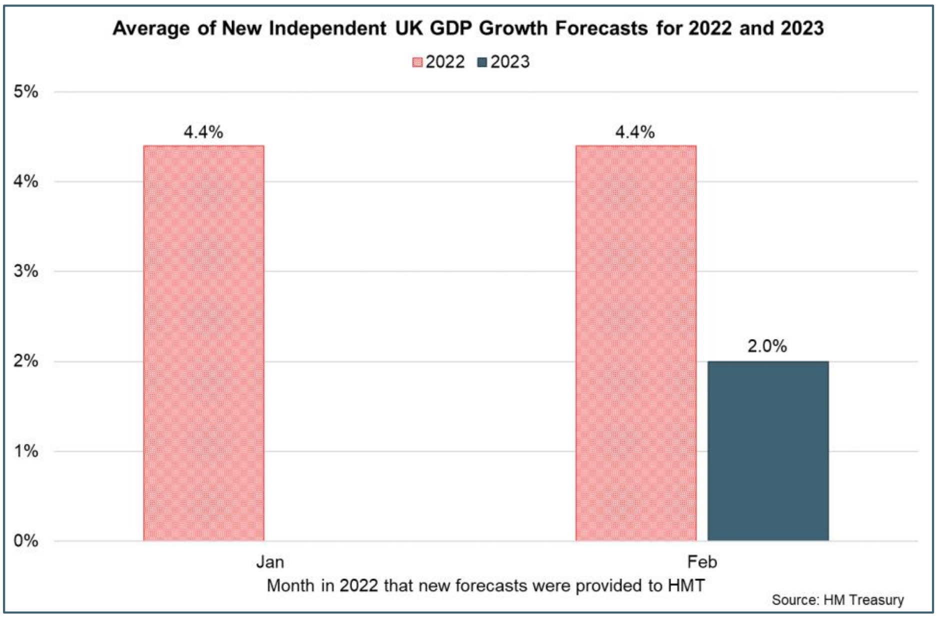
- The latest outturn GDP data initially estimates that the Scottish economy grew 7% in 2021, having fallen 10% in 2020. The most recent Scottish Fiscal Commission (SFC) forecasts from December 2021 (prior to the latest outturn data) expect further growth in 2022 and 2023, though at a more moderate pace of 3.8% and 1.3% respectively as the economy continues to stabilise

[25] Producer price inflation, UK - Office for National Statistics (ons.gov.uk)
[26] Monetary Policy Report - February 2022 | Bank of England

following the pandemic shocks in 2020 and 2021. The Fraser of Allander Institute Q4 2021 Economic Commentary also forecasts the pace of growth to moderate in 2022 to 4.7%.[27, 28]

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

- At a UK level, UK GDP is estimated to have grown 7.5% in 2021 following a 9.4% fall in 2020. The average of new independent forecasts in February (published monthly by HMT) forecast UK GDP growth to moderate to 4.4% in 2022 and 2% in 2023.[29]



- In January 2022, the IMF 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.[30]

- 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 at the start of the year, combined with the persistence of supply disruptions and inflationary pressures.

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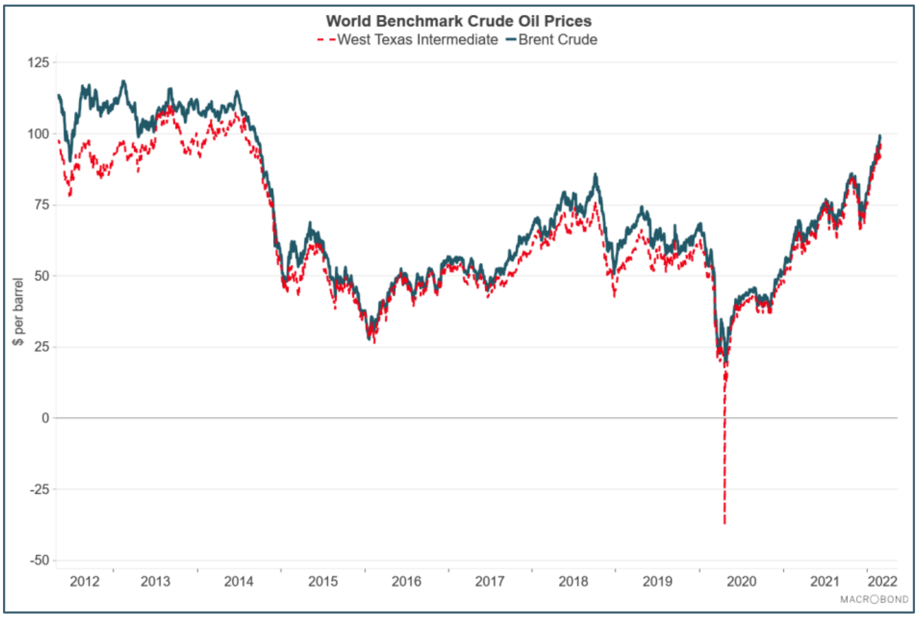
[27] FAI Economic Commentary, 2021 Q4 | FAI (fraserofallander.org)
[28] Scotland's Economic and Fiscal Forecasts – December 2021 | Scottish Fiscal Commission
[29] Forecasts for the UK economy: February 2022 - GOV.UK (www.gov.uk)
[30] World Economic Outlook Update, January 2022: Rising Caseloads, A Disrupted Recovery, and Higher Inflation (imf.org)

- Since then, the current geopolitical situation means that the global economic outlook is increasingly uncertain, with financial markets likely to be disturbed, growth potentially weaker and with the prospect of higher inflation as energy and commodity prices rise further.



- The most immediate global economic effects are likely to be felt through higher inflationary pressures as a result of higher prices for oil, gas and other commodities. On the back of price rises over the past year, oil prices have risen further and are trading above $100 per barrel. However wider global economic implications for supply chains, trade and growth are yet to fully emerge as the situation evolves.

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