SCOTTISH TRENDS

(Press Release)

Analysis of latest Scottish Gross Domestic Product (2015 Q3) statistics

Key points

- **Recent Scottish GDP growth remains much slower than for the UK. Despite the stellar performance in Construction over the past 2 years, overall growth in the Scottish economy (4%) has been less than half that seen for the UK (8.8%) since the previous peak of 2007**.
- **Within the Scottish total, Construction sector growth remains very fast over the past year, which can be largely explained by exceptional infrastructure projects (see page 2).**
- **Relatively slow Private Sector services growth continues to hold back growth, particularly with respect to Transport & Communications (see page 3).**
- **Omissions in basic data hamper our understanding of the economy, both in terms of the recent boom in Constructions real impact on Scottish prosperity (see page 2) and with respect to the role of Oil & Gas related industries (see page 4).**

Overview - latest data

Latest quarter (change Q3 2015 on Q2 2015)

- For the second quarter in a row Scottish GDP grew by only 0.1%. The UK grew by 0.5% over the same period (for definitions see Note 1 after Table 1). Any positives (Construction and Hotels & Catering) were offset by falls in Manufacturing and widespread lacklustre performance across most Service sectors.

Year on year (change 2015 Q3 on 2014 Q3)

- Over the past year, Scotland grew by 1.7%. In comparison, the UK grew by 1.9%.

Since previous peak (2007)

- Scottish GDP is only 4% higher than it was in the previous peak year of output (2007). The UK has improved by almost 9% since the same peak year. Whilst this can be put down in part to slower growth in population in Scotland (i.e. the differential in terms of GDP per head would be smaller), nevertheless Table 1 shows that there are some areas of Private Sector services which have contributed to UK growth but which are still in the doldrums in Scotland, notably Accommodation & Food services and Transport & Communications.

Other points of interest

- Outside of the major sectors: Water Supply & Waste Management in Scotland has grown by over 8% in the past year.

- Both the Commonwealth Games and the Ryder Cup took place in the third quarter of 2014, which might have provided some temporary boost, and so lowered the likely annual growth rate seen in Q3 of 2015. In fact, Accommodation & Food Services rose by a robust 2% and Transport & Communications rose by 0.6%, so there may not have been any such effect.

- In areas which might be thought to be affected by reduced activity due to the falling price of oil, (onshore related) Mining & Quarrying actually grew by 1.3% in Q3 over Q2, although Refined Petroleum, Chemicals & Pharmaceuticals fell by 3.7%.

Table 1: Economic growth comparison: Scotland and the UK, % change

	% change on previous quarter		**% change on previous year**		**% change since 2008**	
	Scotland	UK	Scotland	UK	Scotland	UK
GDP*	0.1	0.5	1.7	1.9	4.0	8.8
Manufacturing	-1.3	-0.4	-2.3	-0.9	-3.1	-6.2
Construction	0.9	-1.9	17.3	1.0	18.3	-3.0
Services	0.3	0.6	0.7	2.4	3.9	12.8
Selected services sub-sectors:						
- Accommodation & Food services	2.3	0.7	2.0	4.4	-0.6	8.5
- Transport, Dist'b'n & Comm'n's	-0.1	1.0	0.6	4.1	-10.1	12.3
- Public Services	-0.1	0.2	-0.3	0.1	1.8	8.9

Sources: Scottish Government GDP release (January 2016).

*The UK measure excludes extra regio (mainly North Sea) activity, see Note 1 below.

Note 1: As the Scottish GDP measure excludes any offshore North Sea activity, throughout this Note the UK comparator measure is shown excluding extra regio (mainly North Sea) activity, in order for the two measures of GDP growth to be more comparable. It is also worth noting that if a geographic share of North Sea Output were included in the Scottish figures then, for most years, growth would look very different to the growth seen on the mainland only.

Overview - Key Issues

Construction continues to excel - but how much is it really adding to Scottish prosperity?

The Construction sector in Scotland continues to boom on the back of large (non-housing related) infrastructure projects like the new Forth Road Bridge, the Borders Railway, schools and hospitals.

While some doubts remain about the scale of this increase the Scottish Government's State of the Economy Report outlines why it may indeed be true. However, this still leaves us with some troubling issues over the sectors ultimate contribution to the Scottish economy. For example, Construction employment in Scotland has remained flat while output has risen by a third since the start of 2013.

A possible explanation for such contrasting trends is that many of the, often highly skilled, jobs in these big projects are being filled by workers who live out-with Scotland and so who may be missed on the employment surveys (which are based on place of residence). If this is true, or if many of the companies involved in the projects are also non Scottish, then the GDP figures are being exaggerated as much of the profits and wage income from the infrastructure projects is ending up outside Scotland.

This re-enforces the case for a Scottish measure of Gross National Product (GNP) - which looks at the economic activity of Scots regardless of where it occurs (i.e. at home or abroad), rather than GDP, which measures economic activity within Scotland, regardless of ownership and of where any wages or profits may end up. As with other important, but largely non-Scottish owned, sectors (e.g. the Alcohol, Energy and Oil & Gas sectors) GDP may not accurately reflect the Construction sectors importance to Scottish prosperity.

Growth in Services continues to disappoint

Despite the Construction sectors fast growth, overall Scottish growth remains slower than for the UK as a whole, so there must be significant areas of underperformance. This turns out to be Services and in particular some Private Sector services (PSS).

Within PSS the worst performance relates to 'Transport, Storage & Communications' (TSC), where output is down 10% since 2007, whereas at the UK level it has risen by over 12%. Over the past year this pattern has been maintained, with output up by only 0.6% in Scotland, while for the UK as a whole it rose by 4.1%.

'Distribution, Hotels and Catering' (DHC) has also seen a relative under performance over the past year, although to a lesser degree than TSC. In the longer term, within this sector, the underperformance has been associated with Accommodation & Food services (i.e. Hotels & Restaurants), with output still below its 2007 level, compared with a rise (+8.5%) at the UK level. It remains a mystery why the principal tourism and social entertainment related sector performs so badly in Scotland when, on the face of it, they would appear to be expanding in a similar manner as elsewhere in the UK.

Meanwhile the largest PSS sector, 'Business Services & Finance' (BSF) has seen underwhelming growth of just over 1% in the past year while the UK business sector has recorded much healthier growth of 2.5%. However, this underperformance is less worrying as it stems in the main from the 'Real Estate' sub-sector. This does not cover simply Estate Agents but rather is dominated by the imputed value of renting a house, even if it is an owned property, and where the UK has done better due to more rapidly rising house prices. While such a change has long term wealth implications it is of less concern in terms of short term economic growth.

How much of the slowdown in PSS in the past year can be put down to the shedding of jobs in oil related business is unclear, but in any case there has been a longer term trend of underperformance since 2007, especially for DHC and TSC.

The long term poorer performance of Public Services in Scotland, compared to the UK, continues to be a worry although both are now growing at a very slow pace or not at all.

Scotland and China - some unexpected similarities when trying to understand the data!

While the Scottish and Chinese economies may not share many common traits, at present there are two that stand out. First, the importance of infrastructure investment in maintaining growth. Second, the difficulty in understanding the underlying health of the economy. On the second point the key issue for Scotland is not that the figures lack credibility, rather it is that they do not show us the full picture in terms of what is happening to the Scottish economy.

Progress towards a solution to the Scottish problem (I'll leave the Chinese one to others) is two fold.

First, more resources need to be put in to expanding Scottish statistics, in particular to producing figures for Scotland's Balance of Payments and a measure of its Gross National Product, to be viewed alongside GDP.

Second, the Scottish Government should be more forthcoming in its publications when discussing its own understanding of what is driving the shifts in the Scottish economy. For example, in conversation with government statisticians, a reasonable picture can emerge of why Scottish Construction has grown so quickly, in comparison to the UK and to the employment situation.

However, in the past this information has not been made available in the main GDP publication or anywhere else on a regular basis. This can lead to undue criticism of the robustness of the data, whereas in reality more thought than is immediately evident has been put in to verifying the accuracy of the data. So, it is encouraging to see that a new section has been added to the quarterly GDP publication which goes into more detail on the methodology, in this case with regards to the Construction sector. Even more would be welcome, either here or elsewhere, looking to reconcile the evidence from a wider range of sources e.g. including employment and wider survey trends.

In the meantime, deciding on good and appropriate economic policy for Scotland is hampered by the lack of crucial data and of analysis of the on-going under performance of some sectors by the Scottish Government.

Quotes:

John McLaren: "*Scotland's economy continues to improve but at a very slow pace and slower than for the UK as a whole. This overall position also hides widely contrasting fortunes across industry sectors.*

We now understand better the main causes behind the exceptionally high growth seen in the Construction sector over the past two years but are much less informed over what is slowing growth in Private Sector services, particularly with respect to the 'Transport & Communications' sector.

During 2016 the Construction sectors contribution to growth can be expected to decline, as large infrastructure projects wind down. If this activity is not replaced by higher output elsewhere then the overall growth rate of the economy could fall to closer to 1% a year than the 2% average we've experienced over the last couple of years. With further public sector cuts to come, this means that Manufacturing or Private Sector services will need to considerably improve on their post recession *performance in order to fill the gap. However, these are also the areas that may suffer from the potential impact of further oil industry slowdown effects.*

None of this is good news and may require the Scottish and UK governments to respond with new or revised fiscal and economic policies. However, at present our limited understanding of the causes of the slowdown, and, in some cases, reliability over the data itself, means that is difficult to prescribe specific policies to help address this low growth issue."

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