SCOTTISH TRENDS

(Press Release - 20th July 2016)

Analysis of latest Quarterly Scottish GDP (2016 Q1) statistics, including detailed look at the Construction sector

Key points

- **Latest data reveals no growth in the Scottish economy in the first quarter (Q1) of 2016, which should come as little of a surprise given the recent falls in Q1 with regards to employment levels, Construction output and Survey results.**
- **Scottish GDP growth over the last 4 quarters is 0.6%, while GDP per capita** (a more accurate reflection of the change in the standard of living) **is 0.4% above the level of a year ago.**
- **Relative to the UK, Scotland has been growing more slowly, with UK growth over the last quarter up 0.5% and over the last 4 quarters up 1.7%.**
- **Output from the Construction sector declined in Q1 by 1.5%, depriving the Scottish economy any boost from what had been its fastest growing sector over the past two years.**
- **Tailwinds very much dominate the landscape and prospects for the growth of the Scottish economy are probably bleaker now than at any time since the finance led crisis in 2008.**
- **Even a return to average growth throughout the rest of 2016 would only result in year-on-year growth of around 1% in 2016. However, with Construction output likely to decline further then a year of no, or even negative, growth is possible, with prospects for 2017 also looking gloomy due to Brexit.**
- **Much of this has been foreseeable for some time, if a little obscured by the Construction data, and in normal circumstances one would have expected the state of the economy to dominate the political discourse but instead politicians have been consumed by two referendums and two elections.**

(Note: As all extra regio (mainly North Sea related) activity is allocated to the UK as a whole, and not on a regional basis, the UK measure shown throughout this analysis excludes it in order to make overall GDP growth more comparable with the Scottish figure. Hence both effectively refer to 'onshore' GDP growth.)

The remainder of this analysis looks at the following:

Overview - latest data (see also Table 1)

Latest quarter (change Q1 2016 on Q4 2015)

- Scottish GDP did not grow in the first quarter, due to slow growth in Services being offset by falls in Manufacturing and Construction.

Latest year (change Q1 2016 on Q1 2015)

- Scottish GDP grew by 0.6% over a year ago, due to Construction growth and (weak) Services growth being offset in part by a fall in Manufacturing.

Since 2009 Q1

- Scottish GDP has grown by 8.3% over the past 7 years. The main sub-sectors of growth have been Construction and Retail and Business services while those performing poorly include public sector services and most other private sector services.

Compared to the UK

- Scotland has been growing more slowly than the UK in terms of GDP, even after adjusting for population.
- The main sectoral differences are the higher growth in Construction in Scotland and the lower growth in Scotland of Services, both public and private.

Main Revisions

- The latest figures include a number of revisions, due to the availability of more data.
- In particular, the Agriculture sector has seen some very large revisions, which have generally improved performance over the past decade. However, this sector has a vey low weight (1%) in terms of the output of the economy as a whole.
- Overall, the revisions have improved the performance in recent years, particularly with respect to Manufacturing, Transport and Other services. However, this has been offset in part to revisions down to Business services.
- Overall, these revisions further highlight the disparity in some sectors between the UK and Scottish performances, with Scottish Business services badly under performing and Construction over performing, in relative terms.
- Some sub sectors have seen very large revisions in particular years. For example, Textiles (+23.5%) and Computer Products (+14%) have been revised up in 2013 and Transport Equipment (-18.7%) revised down in 2010.

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

	% change on Q4 of 2015		% change on Q1 of 2015		% change on Q1 of 2009		
	Scotland	**UK**	**Scotland**	**UK**	**Scotland**	**UK**	**Diff**
GDP*	0.0	0.5	0.6	1.8	8.3	14.7	-6.4
Manufacturing	-2.6	-0.2	-5.4	-1.0	9.6	7.1	2.5
Construction	-1.5	-0.3	4.8	0.3	30.0	17.4	12.6
Services	0.4	0.6	1.3	2.5	6.0	15.7	-9.7
Of which:							
Private sector							
- Wholesale & Retail	2.2	1.7	3.3	5.2	14.6	24.5	-9.9
- Hotels & Restaurants	0.8	0.0	3.8	3.4	-1.0	16.5	-17.5
- Transport & Comm'ns	-1.6	-0.1	-1.8	2.7	4.9	19.3	-14.4
- Financial Services	6.3	1.4	6.7	1.0	-7.2	-11.7	4.5
- Business Services	0.3	0.4	2.8	3.8	15.1	45.3	-30.2
- Other Services	-1.4	0.4	-0.7	2.6	6.4	12.5	-6.1
Public sector							
- Admin & Defence	0.0	-0.4	0.1	-2.9	-11.4	-12.7	1.3
- Education	0.3	0.1	0.6	1.2	1.2	6.4	-5.2
- Health & Social Work	0.2	0.9	0.5	3.5	6.6	22.2	-15.6
GDP* per capita	0.0	0.3	0.4	1.0	5.2	8.9	-3.7

Sources: Scottish Government GDP release (July 2016); ONS UK National Accounts

* As all extra regio (mainly North Sea related) activity is allocated to the UK as a whole, and not on a regional basis, the UK measure shown excludes it in order to make overall GDP growth more comparable with the Scottish figure. Hence both effectively refer to 'onshore' GDP growth.

Colour Code: Orange = negative; Green = over 20%; Blue = UK notably better than Scotland; Grey = Scotland notably better than the UK

Commentary

The decline in Q1 should not come as a surprise. Most of the economic data previously available for Q1 suggested that such a poor out-turn was likely:

- **employment** fell by over 50,000 in the quarter to March 2016 *(ideally we could look to the published (ONS) data for workforce jobs in Scotland, but this shows a rise from December to March, due to an implausible 14% increase in business service jobs)*;
- as discussed below, **Construction** output fell by 7.5% in Q1;
- a number of surveys (e.g. the **Bank of Scotland PMI,** the **RBS (Scottish) Business Monitor** and the **Scottish Chambers of Commerce Quarterly Business Survey)** indicated that various elements of private sector output was stagnant or contracting over Q1.

All of this is on top of the on-going concerns over investment and employment, onshore and offshore, in the North Sea related business.

It will be interesting to see now how the Scottish Government, or its Council of Economic Advisers (which last met in early February) reacts to the latest news. Previous bad news led to the appointment of a new Economic Secretary post in the Cabinet. However, it is unclear what further steps have been taken to try to get to grips with Scotland's on-going underperformance problem or what the new Minister has planned.

Scottish Construction Sector

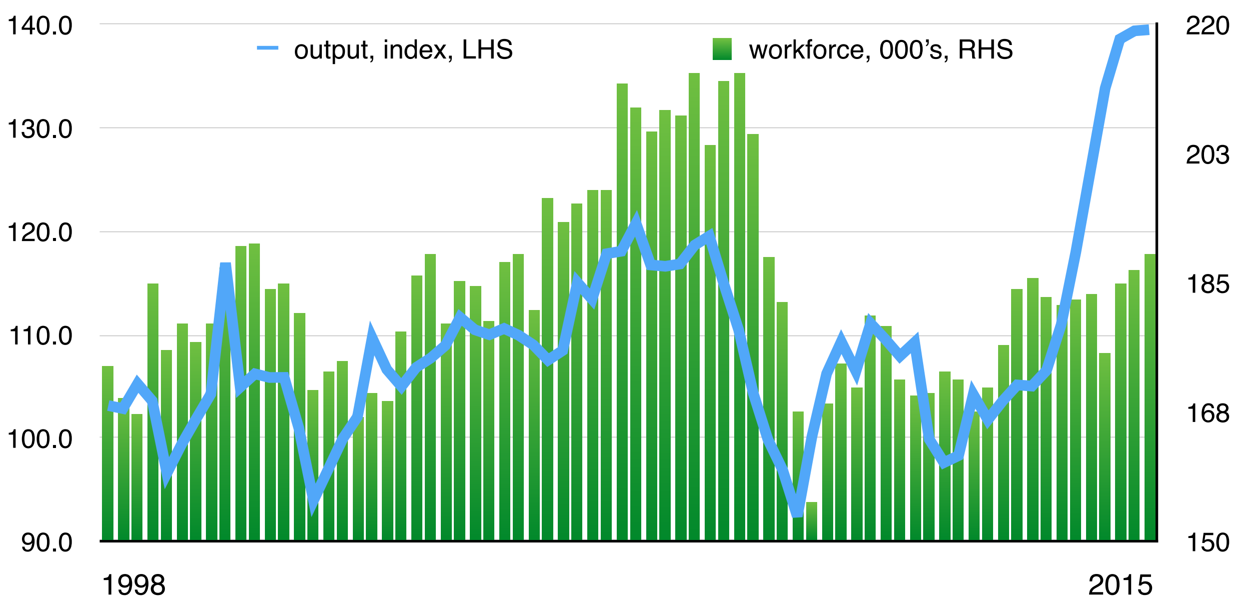
In 2014 and 2015 the Construction sector has been the star performer in the Scottish economy, led by new infrastructure work, but this now seems set to change in 2016. Furthermore, the recent stellar performance seen in some fields of construction has not been seen across all sectors, as the Table and Charts in Annex 1 illustrate.

Some of the key points to note are:

- the dependency on new infrastructure build over the past two years, probably linked to large projects like the Forth Replacement Bridge and the Borders Railway. Some of these projects are now finished or near finishing;
- Construction related output in the past was dominated by new private housing build and new private commercial build, neither of which has recovered to their mid-2000's peaks, even in cash terms;
- (real terms) output and employment largely moved in line post 1998, up to the recent surge in infrastructure, when the very fast and large increase in output has not been matched by any change in the workforce data published (see Chart 1);
- this breakdown in the relationship between output and employment may be due to the heavy reliance of the former on big infrastructure projects which may involve more dependency on non Scottish workforce (which is not picked up in the residence based surveys used);
- if so, this also suggests an exaggeration of Scottish wealth, as the income of these workers will end up largely out with Scotland.

The implications of this analysis is that, instead of buoying up Scottish growth as it has in the past two years, the Construction sector may have a negative impact in the quarters to come, as infrastructure declines to more normal levels. This path seems likely unless private housing new build returns to its previous highs, not something that is currently forecast, especially post the UK's Brexit vote.

Chart 1: Construction output and workforce, 1998 to 2015



Sources: Scottish Government GDP publication; ONS regional labour market xls tables. (Note output data is consistent with 2015Q4 Scottish GDP release.)

Headwinds and tailwinds affecting future prospects

Scotland and the UK are currently facing very high levels of uncertainty with respect to economic and political outcomes. Typically such uncertainty is associated with increased levels of perceived risk and tend to have a negative impact on economic prospects. Table 3 highlights some of the headwinds, as well as potential tailwinds, affecting Scotland in the months and years to come.

Figure 1: Headwinds and Tailwinds affecting the Scottish economy

Headwinds	Tailwinds
UK Brexit	Tourism
Scottish independence	Manufactured exports
North Sea Oil activity	Oil price revival
Construction (see above)	

The most obvious such headwind relates to the impact of the **Brexit** vote. However, a return to uncertainty over Scotland's position within the UK further heightens the overall confusion around Scotland's future. In particular, returning to this issue has implications for the future currency to be used within Scotland and on future tax rates, given the likely adjustment needed towards greater fiscal balance in an independent Scotland. Hence, while the greater risk environment has been inspired by the UK vote on EU membership, an even greater risk scenario for Scotland is being generated in Scotland due to the lack of clarity over what strategy will be pursued in light of this vote, i.e. one within the UK economic union or one within the EU economic union. *(See also post Brexit re-analysis of implications of Scottish independence on economic and fiscal matters at http://scottishtrends.co.uk/wp-content/uploads/2016/06/2nd-referndum.pdf .)*

On the upside, the recent **fall in sterling** (by around 10%) could improve prospects in some sectors, including **Tourism and Manufactured exports**. However, this is by no means certain and the big decline in sterling after 2008 (by around 25%) did not result in a a boost in **Tourism** income for the UK. Manufactured exports from Scotland also appear to have been unaffected post 2008, not showing any rise until 2011. However, this may have been due to the exceptional strength and breadth (i.e. worldwide) of the accompanying recession.

With respect to **North Sea oil**, fortunes are a little more mixed now than a few months ago. While the price remains relatively low, still below $50 a barrel, rather than the above $100 position experienced pre crash, it has been slowly recovering and may do so further, possibly back up to around $65-75 per barrel. However, in sterling terms the recent $ per barrel price rise has been undermined, to some extent, by the fall in sterling post Brexit.

Any such, partial, price recovery may improve the investment prospects of the North Sea in years to come, although it seems unlikely that any such revival is likely to lead to renewed significant flows of tax revenue. Instead it could help maintain employment prospects for this sector and for the geographic areas dependent on it.

In conclusion, potential headwinds dominate the landscape and future prospects for the growth of the Scottish economy are bleaker now than at any time since the finance led crisis in 2008.

Prospects for 2016 and 2017

As a result of the major headwinds facing the economy, prospects for 2016 and 2017 are not good. Growth in 2016 is likely to be around or under 1%. This is due in part to the pattern of growth seen in recent quarters, as shown in Table 2.

Table 2: Quarter by quarter growth in the Scottish economy since 2014 Q1

Time period	Level	Change on previous quarter or year		
Out-turns				
2014 Q1	101.4	0.5		
2014 Q2	102.4	1.0		
2014 Q3	103.1	0.7		
2014 Q4	103.9	0.8		
2014	102.7	2.7		
2015 Q1	104.6	0.7		
2015 Q2	104.7	0.1		
2015 Q3	104.9	0.2		
2015 Q4	105.3	0.4		
2015	104.9	2.2		
2016 Q1	105.3	0.0		
Forecasts*		average	low	high
2016 Q2	*105.7*	*0.4*	0	0.6
2016 Q3	*106.1*	*0.4*	0	0.6
2016 Q4	*106.5*	*0.4*	0	0.6
2016	*105.9*	*1.0*	0.4	1.2

* ‘Average’ equates to the average quarterly growth rate over the past 5 years. High and low growth rates are asymmetrical around the average due to headwinds dominating tailwinds at present.

Table 2 shows that growth through 2014 was very strong, above the recent ‘average’ (0.4%) in each quarter and more than double that rate in two quarters. Much of this high growth was down to the Construction sector, which was growing at 5 to 6% a quarter.

This Construction led growth continued into Q1 of 2015 but the level of ‘overall’ output has grown little since then. The effect of this pattern of growth means that:

- growth in 2015 as a whole, over 2014, was reasonably good, even though most of the growth actually took place throughout 2014 rather than throughout 2015;
- growth in 2016 is likely to be poor as most such growth will need to take place throughout 2016 with little contribution coming from its profile through 2015.

As a result, a return to average growth throughout the rest of 2016 will only result in year-on-year growth of just under 1%. However, if the downturn in Construction continues then a year of even lower growth, or potentially negative growth, is possible. Even if stronger, above average, growth returns for the rest of the year, it is unlikely to result in growth of much above 1%, year-on-year.

The estimates shown in Table 1 for 2016 (which largely exclude any impact from Brexit at this stage) are below even the recently (June) revised down projections by Fraser of Allander, (FoA) of 1.4% in 2016. FoA's forecast for Construction appears to be overly optimistic.

Estimates for 2017 remain highly conjectural in light of Brexit. However, the IMF have revised down its UK forecast for 2017 from 2.2% to 1.3%, although this is still above its estimates for the likes of Germany (1.2%).

Quality and accuracy of Scottish data

The recent publication of extraordinary rates of growth for Irish GDP is a warning to Scotland that more and better data is needed in order to avoid similar problems.

Official (Irish Central Statistics Office, CSO) data published for the Irish economy shows GDP grew by over 33% in 2015 (27% in real terms) and in Q1 of 2015 alone grew by over 20%! Meanwhile the 'real' economy is growing by more like 2-4%, as seen in employment and consumers expenditure data.

These problems emerge despite the CSO following international best practice standards in compiling and calculating the data.

The reasons for the massive discrepancies revolve around the practices of multi-national companies in moving around profits, assets and production, mainly on balance sheets rather than actually changing to production in Ireland.

While Scotland does not (yet) suffer from the same issues or, where it does, on the same scale, there are other relevant statistical issues which make judging the performance of the Scottish economy difficult. For example, the Quarterly National Accounts for Scotland (QNAS), show the Scottish economy, including North Sea activity, to have contracted by 1% in 2015, in cash terms, while in real terms, and excluding North Sea activity, it grew by 1.9%. The figure for GNP (Gross National Product, which includes Scottish owned income from abroad and excludes income derived in Scotland by overseas owners) would be different again.

All such measures are relevant in a country like Scotland where foreign (including RoUK) ownership of key businesses and the scale of output of a large commodity (oil) are both significant. The collection and publication of a wider range of measures for the Scottish economy would lead to a more informed debate as to its performance and prospects.

Summary comments

Scottish growth had looked poor throughout most of 2015 and prior to that had been highly dependent on a booming Construction sector that was never going to last. In normal circumstances one would have expected this to dominate the political discourse but instead Scottish politicians have been consumed by two referendums and two elections.

As a result too little attention has been paid to the underlying weakness of the Scottish economy and what might be done to improve matters. The possibility of Brexit or Scottish independence only heightens worries over the short to medium term growth prospects.

Quotes:

"*No-one who has been following the emerging Scottish economic data relating to Quarter 1 will be surprised at the lack of growth seen in the first quarter of 2016. Now that the huge boost to the Scottish economy from the Construction sector has come to an end, the underlying weakness of the Scottish economy has been exposed.*

Furthermore it is difficult to see where growth will come from over the rest of the year to enable 2016 to be anything other than a low or no growth year. And all of this before the potential negative impacts of Brexit are factored in."

Contact details

John McLaren

Mobile: 07429 508 596
E-mail: john.mclaren@btinternet.com
Website - scottishtrends.co.uk

Annex 1: Portrayal of Construction output by sub sector

Table 2: Scottish Construction sector analysis of data post 1998

Construction sectors	Value in 2016Q1	Post 1998 peak	Post 1998 low	Current position
Output measures, cash terms	*£, mn*			
New Public Housing	**176**	2010-11	2013	Back up to position seen in 2013, but lower in real terms.
New Private Housing	**415**	2005	2013	33% up from 2013 but still 40% down from 2013 peak, even in cash terms
New Infrastructure	**789**	2015	1st H 2012	2016 Q1 is down 25% on 2015 Q2 but still exceptionally high in relative terms
Other New Work				
- public	**365**	2015	2001	2015 output rose above previous (2011) peak
- private industrial	**46**	1998	2009 & 2015	Rapid decline post 2014 revival, with last 2 quarters the lowest recorded, even in cash terms
- private commercial	**560**	2007	2012	Still around 25% below peak
Repair & Maintenance	**1,074**	2010	1999	Returned to 2010 levels, but only in cash terms
Total	**3,425**	2015	2012	Peaked in 2nd H of 2015, fell in last 2 quarters, inc by -7.5% in 2016Q1
Construction sector, National Accounts	**2,636 (Q4, 2015)**	2015	2009 & 2012	Previous peak of 2008 matched by 2014 in cash terms, followed by 18% rise in 2015.
Other measures	*(as stated)*			
GDP, real terms (2013=100)	**130**	2015	2009	Grew by 29% from 2013 to 2015, but fell by 1.5% in Q1 2016.
Workforce, '000's	**188**	2008	2010	2015 only 1% up on 2014 and still over 10% below 2008 peak.

Sources: ONS UK Construction spend; Scottish Government- QNAS - GDP; ONS Regional Labour Market xls tables

Chart 2: Scottish construction output by sub sector