

(Press Release - 4th April 2018)

Analysis of latest Scottish GDP (2017 Q4 and full annual year 2017) statistics

Latest figures confirm 3 to 8 years of low growth in Scottish Economy

Today's official figures for Scottish Gross Domestic Product (GDP) - onshore and in 'real' terms - go up to the Fourth Quarter of 2017 and allow us to look at the outcome for 2017 as a whole.

Key points

- Latest data reveals growth in the **Scottish economy in the Fourth Quarter (Q4) of 2017 of 0.3%**, below the **UK** growth rate of 0.4%;
- For **2017 as a whole, the Scottish economy grew by 0.8%**, well below the UK's 1.8%;
- Revised data shows that there was a very mild **recession in Scotland during 2015** (i.e. 2 consecutive quarters of falling GDP from Q1 to Q3);
- After **adjusting for an unusual pattern in Construction growth** (see main text for further explanation of this), it can be argued that Scottish growth has been very poor, at just under 1% a year, in both absolute and relative (to the UK) terms, for 3 years now;
- The position is little better looked at over the past 8 years, with annual growth averaging 1.1%;
- In comparison the UK has grown by around double this rate, 2% a year, over the past 3 years (or over the past 8 years). The main sources of this relative underperformance were:
 - Manufacturing - in particular post 2014;
 - Transport & Communications - going all the way back to 2003;
 - Retail - since 2012;
 - Hotels & Catering - going as far back as data is published (1998);
 - Business Services - post 2009;
 - Health & Social Work - post 2009.
- The **Business Services sector performance is a particular worry**. Even though this has been the strongest growing sector of the Scottish economy post 2009, its growth rate (2.5% per year on average) is well behind that seen at the UK level (5.6% average per annum);
- In **GDP per capita** (standard of living) terms, Scotland has now experienced no change since the start of 2015, compared to a rise of 3.2% seen for the UK over the same period;
- At 0.6% a year, the specially constructed '**Active Economy**' measure (essentially Manufacturing and (non-financial) Private Sector Services) for Scotland grew at less than a fifth of the rate seen for the UK (3.5%) over the past 3 years.

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

Comparison of growth rates over time and across sectors

While the performance of the Scottish economy has been obviously poor for the last 2 years, if the distortionary impact of recent Construction data is taken into account then it is the last 3 years that have been particularly poor. Large infrastructure projects, that saw a huge surge in Construction activity through 2014 and 2015, are likely to have been associated with leakage out of the economy to non-Scottish companies and workers (see Box 1 for more detail). This has led to Scotland's GDP growth performance being bolstered in 2015 and undermined in 2016. Averaging this impact out leads to a smoother profile but one that is still very poor in terms of year-on-year growth, at marginally under 1% a year on average.

Construction - how much is it really adding to the Scottish economy?

The Construction sector in Scotland grew very quickly through 2014 and 2015 on the back of large (non-housing related) infrastructure projects like the new Forth Road Bridge, the Borders Railway, schools and hospitals. However, surveys showed Construction employment remaining flat over this period.

A possible explanation for such contrasting trends is that many of the, often highly skilled, jobs in these big projects were 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 then the output figures may be being exaggerated, as much of the wage income from the infrastructure projects is ending up outside Scotland. (A similar point may also be relevant with respect to the ownership of these companies and where profits end up.)

This re-enforces the case for a Scottish measure of Gross National Income (GNI), which looks at the economic activity of Scots regardless of where it occurs (i.e. at home or abroad).

Indeed, since the economy bottomed out in 2009, the average GDP growth rate is still close to a poor 1% a year. This 9% growth in Scottish GDP between 2009 and 2017 compares highly unfavourably with other post recession recoveries, for example, in the 8 years following previous recessionary periods:

- post the 1973 to 75 recession, output grew by over 10% , even though this subsequent period incorporated another (79-81) recession;
- post the 1979 to 81 recession, output grew by over 20%;
- post the 1991 slowdown, output grew by almost 17%.

Table 1 highlights the sources of the slowdowns by sector, over both the last 3 and the last 8 years, both in absolute terms and in relative (to the UK economy) terms. It shows that:

- **Manufacturing** is a source of recent weakness, although not when looking at the medium term. (See last quarters Scottish Trends GDP bulletin (<http://scottishtrends.co.uk/wp-content/uploads/2018/01/Scottish-GDP-January-18.pdf>) for a more detailed analysis of recent shifts in Manufacturing output.)
- Even with the 18% jump up in output in 2015, **Construction** has still underperformed the UK over the last 3 years. This is likely to continue as the sector has not yet fully adjusted down from its 2015 peak. In the longer term, since 2009, the Construction sectors relative underperformance is even worse, although both countries have seen strong growth overall.

- **Private Sector services**, in particular **Retail, Hospitality, Communications and Business Services** (in relative terms) have badly underperformed in both the short and medium term.
- **Public Sector services** have also underperformed in the medium term, in particular **Health & Social Work**, although more recently the position has improved.

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

		3 YEARS OF POOR GROWTH FOR SCOTLAND....		OR 8 YEARS?		
	2014 Scottish GDP Weights	% change 2014 to 2017			% change 2009 to 2017		
		Scotland	UK	Difference	Scotland	UK	Difference
GDP (O) (1,2)	100	2.7	6	-3.3	9.0	17.2	-8.2
GDP per capita* (3)		1.2	3.8	-2.6	5.1	10.1	-5.0
- <i>population change</i>		<i>1.5</i>	<i>2.3</i>	<i>-0.8</i>	<i>3.9</i>	<i>6.1</i>	<i>-2.2</i>
Active Economy		2.0	10.9	-8.9	13.4	29.3	-15.9
<i>By main sectors:</i>							
- Production	17	-5.5	4.5	-10.0	9.0	5.0	4.0
- Manufacturing	11	-6.4	3.5	-9.9	11.9	11.1	0.8
- Construction	6	13.2	14.7	-1.5	23.8	30.9	-7.1
- Services	75	3.6	6.8	-3.2	7.4	18.6	-11.2
- Retail & Wholesale	11	4.9	11.9	-7	14.7	27.7	-13.0
- Hotels & Catering	3	4.7	10.7	-6	4.2	21.1	-16.9
- Transport & Comm'ns	8	2.6	12.6	-10.0	7.2	27.4	-20.2
- Business	10	6.6	14.4	-7.8	22.3	54.5	-32.2
- Health & Social Work	9	4.5	4.1	0.4	8.8	21.5	-12.7

Sources: Scottish Government GDP release (April 2018); ONS UK National Accounts.

(1) As 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 UK GDP growth more comparable with the Scottish figure.

(2) The UK GDP figure shows the average across Income, Expenditure and Output measures and is used in the Scottish Government's release, although this means that sectoral changes do not add up to the overall UK change.

(3) GDP per capita is shown including the North Sea, consistent with ONS statistics.

The most pressing question that needs to be answered is - why are Scottish Private Sector services growing so slowly compared to the UK and compared to the past? There is no obvious answer to this and each sector tells a slightly different story. For example:

- **Business Services**: while this has been the fastest growing sector of the Scottish economy, averaging growth of 2.5% a year since 2009, this is still less than half the average annual growth rate seen for the UK over the same period (5.6%);

- **Hotels & Catering:** this has been a longstanding problem area as the sector has recorded almost no growth over nearly 20 years (an average annualised growth rate of 0.1% !), unlike the UK which has seen a growth rate of around the GDP average (2.1%);
- **Transport & Communications:** Scotland suffered a decade of no growth in this sector post 2002 (compared to an increase of 19% for the UK) followed by a one off jump up of 8% in 2013, since when it has returned to slow growth;
- **Health & Social Work:** although a public, rather than a private, service this accounts for almost 10% of the economy. While it is a difficult to measure sector it is surprising that, given similar public funding resources, the UK should have grown by over twice the rate seen in Scotland. There may be issues here with how ‘free personal care’, for example, has affected measurement between the two countries.

(Note that the above findings remain true even once the faster population growth seen at the UK level is taken into account.)

One point to emerge from the above analysis is that while the fall in **North Sea activity** may have played a role in Scotland’s poor performance in the last 2-3 years it does little to explain the longer term slowdown.

Elsewhere, the Scottish **Labour Market** continues to perform at a near historic high, in terms of employment, although earnings growth remains sluggish in real terms. This contradiction, with the GDP performance, remains an unusual feature of the current economic landscape, although it does help explain the poor productivity performance (see <http://scottishtrends.co.uk> for more analysis of this subject).

In terms of **revisions**, the latest data now shows that there was a **very mild recession at the start of 2015** (Q1 to Q3), with a fall of 0.1% in each quarter. Also the Construction data has been revised so that the peak in 2015 is less prominent.

Looking ahead, the bad weather seen in Q1 of 2018 may lead to a poor GDP performance in that quarter.

Quotes:

“Scotland’s GDP growth performance continues to disappoint. While the last 2-3 years have been particularly poor, slow growth has been evident ever since the end of the recession back in 2009. Despite initiatives like the new Scottish Investment Bank, current Scottish Government policies seem unlikely to do much to remedy this. Meanwhile the lack of understanding, or interest in, why this has happened remains of worry.

It bears repeating that if such a poor performance was being observed at the UK level, for a similarly long period of time, then far greater pressure would be being brought to bear on the UK Parliament and the Bank of England to act on, or to explain, the slowdown.”

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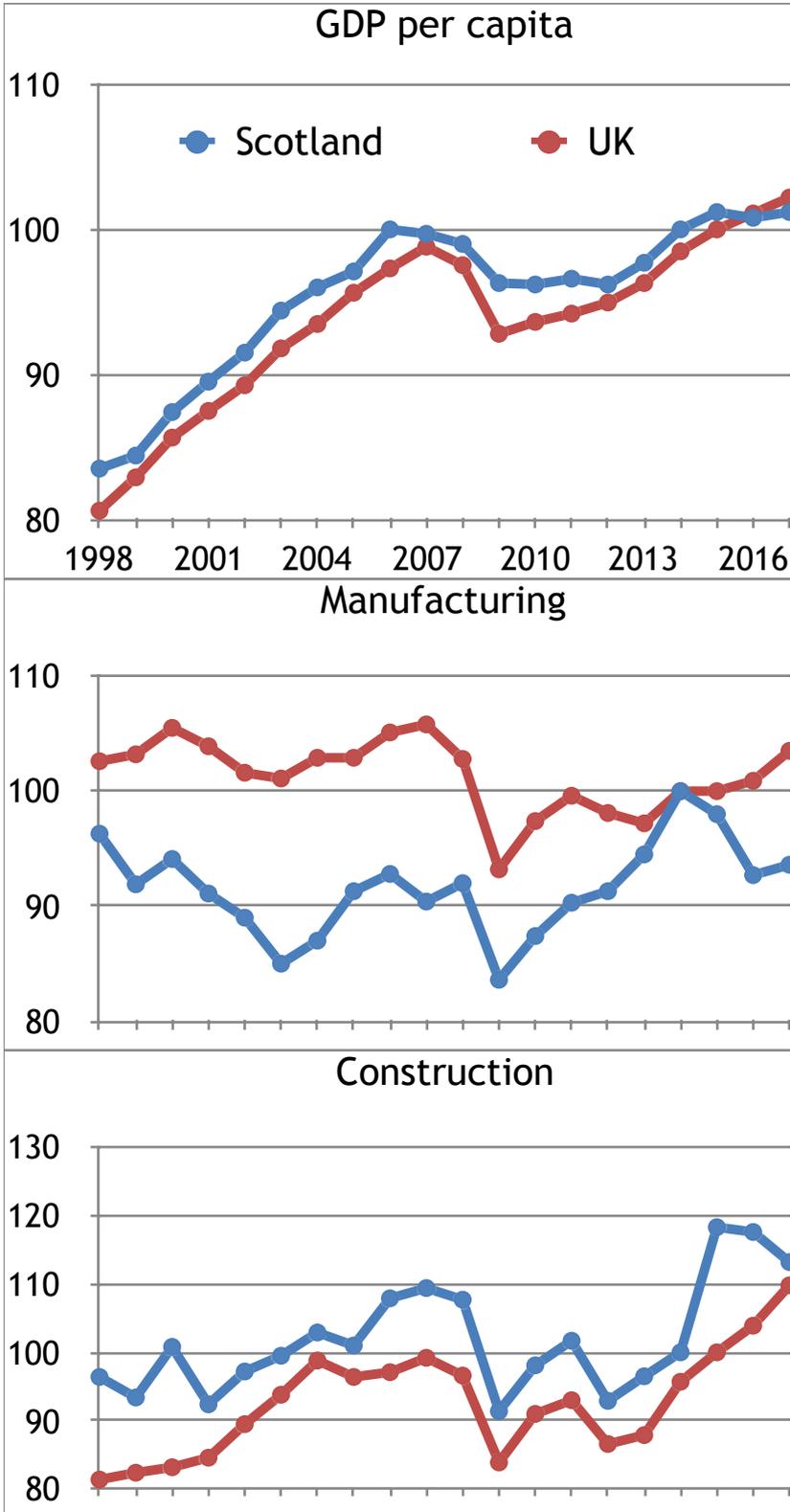
Website - scottishtrends.co.uk

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Annex 1: Longer term sectoral trends

The following charts highlight the paths of various key sectors of the Scottish economy since 1998.

Charts of Scottish and UK growth 1998 to 2017



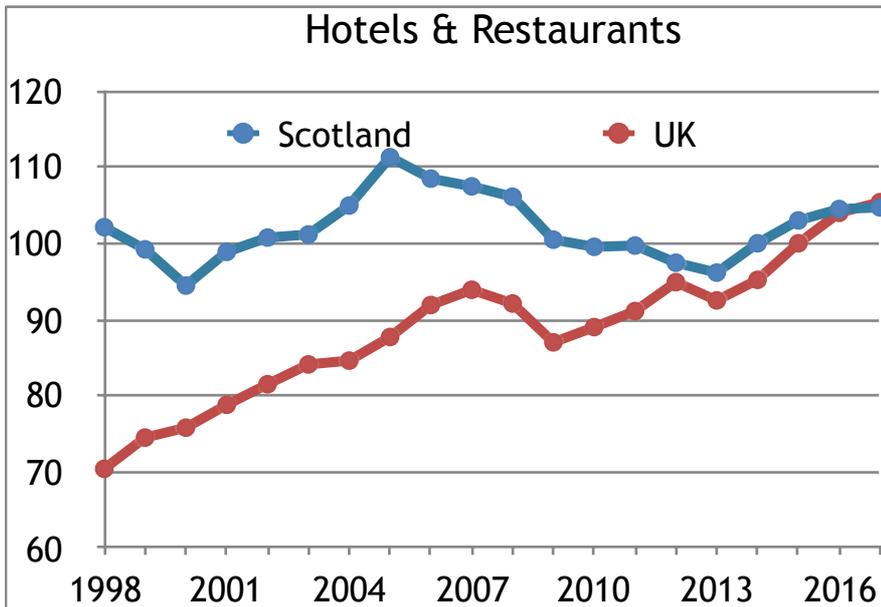
Scottish and UK patterns are not dissimilar until the time of the Great Financial Crisis, after which the UK suffers larger fall but has rebounded more quickly post 2009.

Scottish and UK Manufacturing patterns are not dissimilar overall. However, the post 2014 decline in Scottish Manufacturing feeds into the recent poor relative performance.

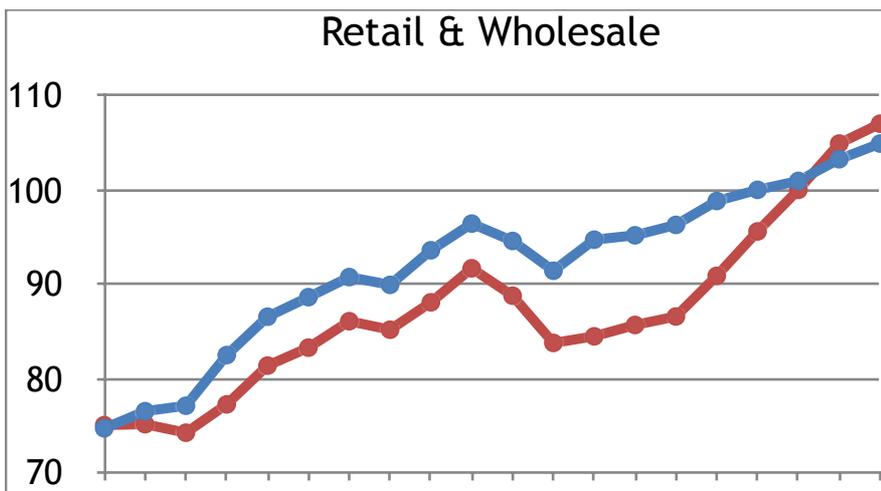
Again, the patterns are not dissimilar once the 2014-2015 Scottish infrastructure blip is removed.

Within the **Service sector**, which accounts for 75% of economic output, there are certain key areas where Scotland has underperformed.

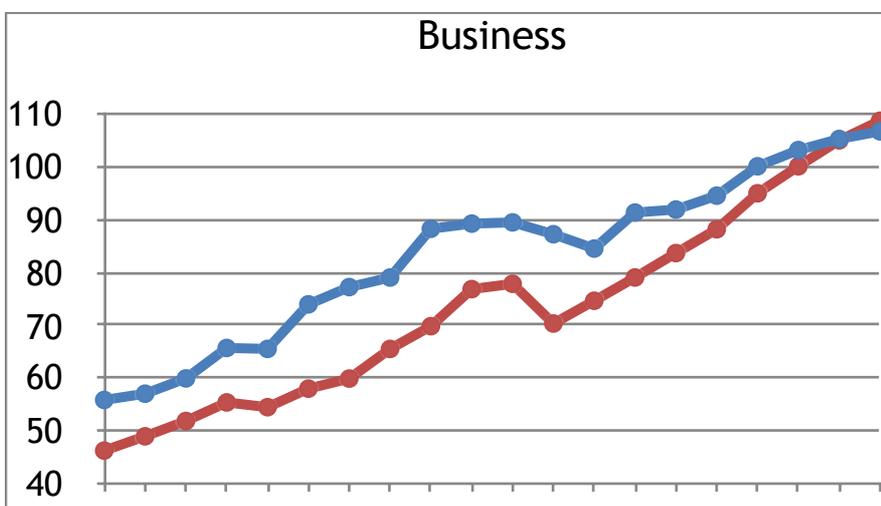
Key service sector charts



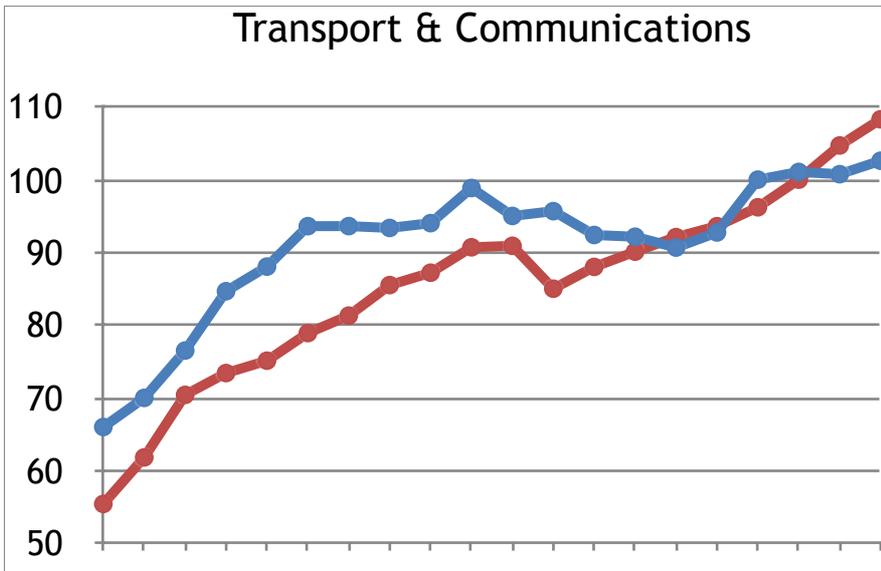
In the **hospitality sector (Hotels & Catering)** Scottish output has barely grown in 20 years, in contrast to the healthy, in line with the GDP average, growth rate seen at the UK level.



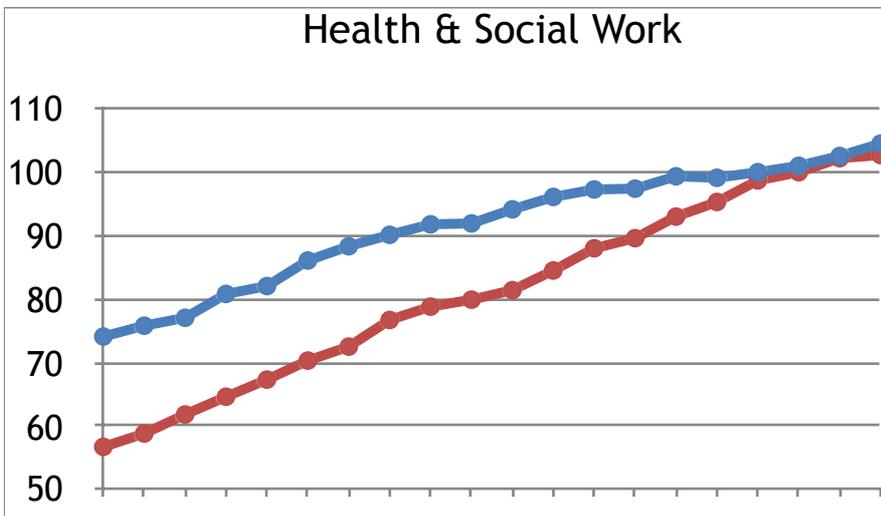
The Scottish **Retail & Wholesale** sector has seen relatively sluggish growth since 2012.



UK **Business Services** have grown consistently faster post 2009 than in Scotland. This is important as it is both a large sector (over 10% of the economy) and tends to be the fastest growing.



Barring 2015, the **Transport & Comm's** sector in Scotland has barely grown since 2003, in contrast to the UK's healthy growth rate since then.



Within public services the biggest contributor to output is **Health & Social Work**. Here Scottish growth has been relatively sluggish since 2009, although it has picked up in the last couple of years.