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The Scottish economy

Forecasts of the Scottish economy

Economic background

The outlook for the world economy remains promising with the US driving growth. There is also strong growth in the Far East particularly in China. An area of concern is the Euro Area, which remains depressed compared to other major economies. This is largely due to the situation in Germany. Forward indicators for the Euro Zone are improving suggesting that recovery will take place in 2004 but that trend growth will not be achieved until 2005.

The UK economy continues to perform well. GDP data for the UK has been revised up (mainly due to the construction sector) and growth is forecast to be 2.0 per cent in 2003 and 2.6 per cent in 2004. There are some inflationary pressures in the economy. The Bank of England is concerned over household debt and a strong housing market. These were significant factors in their decision to raise the Bank of England interest rate in November to 3.75 per cent. The UK labour market remains buoyant with employment growth and low unemployment. We are forecasting that the UK will return to trend growth by 2004 and certainly by 2005.

The latest Scottish GDP data were encouraging overall. Manufacturing is still experiencing problems but the service sector continues to grow at just below 3 per cent on an annual basis up to the second quarter of 2003. Within services transport and communication, financial services and real estate and business services are the strongest growing sectors. We are forecasting that Scottish GDP growth will be 1.3 per cent in 2003 and 2.1 per cent in 2004. In 2005 we forecast growth of 2.3 per cent.

The forecast in detail

GDP

We present our forecasts for GDP and broad sectoral output in Table 1 for the period 2003 to 2005. GDP growth is forecast to be 1.3 per cent in 2003 and 2.1 per cent in 2004. We expect that through the second half of 2003 and into 2004 economic activity will continue to improve. Manufacturing is the exception where we now believe recovery will take longer. Manufacturing is unlikely to come close to growth of 2.0 per cent until 2005. The main change in our forecast is the dip in manufacturing activity, which is compensated for by increased service sector activity.

Table 1 Main forecasts of the Scottish economy, 2003-2005

	2003	2004	2005
GDP	1.3%	2.1%	2.3%
Agriculture	0.6%	-0.3%	-0.5%
Manufacturing	-5.1%	1.4%	1.9%
Manufacturing (ex Electronics)	-4.9%	1.4%	2.1%
Construction	1.1%	2.0%	3.6%
Services	2.9%	2.5%	2.4%

Source: Fraser of Allander Institute, December 2003.

Output

Agriculture is forecast to grow by 0.6 per cent in 2003 but to decline marginally in the following year. Mining and quarrying is also forecast to decline in 2003 but in the following years to recover. Electricity, gas and water supply is forecast to decline by 0.3 per cent but in 2004 and in 2005 to grow at 0.4 per cent and 2.9 per cent respectively.

We have revised down our forecast for manufacturing growth and now forecast a contraction of 5.1 per cent for 2003. For 2004 and 2005 we forecast manufacturing will grow at 1.4 and 1.9 per cent respectively. As stated in the QEC of the last quarter we believe exports are vital to manufacturing as is business investment. We do not expect the Euro Area to pick up until 2005 and it remains to be seen how the key export sectors (electronics, whisky, paper, food and textiles) perform with a depressed European market. Fortunately both the US and the Far East trade appear to suggest that they will recover before the Euro Area and this may offer some small comfort to manufacturers.

Service sector growth is forecast to be 2.9 per cent in 2003, 2.5 per cent in 2004 and 2.4 per cent in 2005. This is a slight improvement on our previous forecast. The drivers of growth here are banking, communications and other business services.

Construction is forecast to grow by 1.1 per cent in 2003 and by 2.0 per cent in 2004. Output fell in both 2002 and 2001. This is a welcome sign that suggests both government and business believes that the economy is now beginning to grow again although trend growth is unlikely to be seen this year. Physical investment in infrastructure and public sector projects are particularly important at this time. Private housing demand is also significant.

Employment

Our forecasts of employment are presented in Table 2 with the net employment change figure in brackets. The employment figures are calibrated on the employers quarterly survey series as given in Table B.16 in Labour Market Trends, National Statistics.

Our forecast for 2003 is that employment will be 2,226,500 and 2,274,300 in 2004. This is a net job change of 23,700 and 47,900 respectively. This is slightly up on the forecast from the previous quarter as there is more growth forecast in the service sector and less in the manufacturing sector. Employment in the service sector is forecast to be 1,758,300 in 2003, 1,797,800 in 2004 and 1,829,600 in 2005. These figures correspond to net job changes of 34,500, 39,500 and 31,800.

Manufacturing is forecast to shed 12,200 jobs in 2003 but to gain 5,000 jobs in 2004. In 2005 the manufacturing job change is forecast to be 5,300. Employment in Agriculture is forecast to be 35,500 in 2003 and to remain close to that level over the period of the forecast. Construction employment is forecast to be 124,400 (a net job change of 1,200) in 2003. This is a change from our previous forecast, when we forecast a decline in construction employment. The sector is forecast to add at 2,400 jobs and 4,500 in 2004 and 2005 respectively.

Table 2: Forecasts of Scottish employment and net employment change, 2003-2005

	2003	2004	2005
Total Employment (000s)	2,226.5 (23,700)	2,274.3 (47,900)	2,317.9 (42,800)
Agriculture	35.5 (300)	35.4 (-100)	35.3 (-200)
Manufacturing	264.2 (-12,200) (5,300)	269.2 (5,000)	274.4
Construction	124.4 (1,200) (4,500)	126.9 (2,400)	131.4
Services	1,758.3 (34,500) (31,800)	1,797.8 (39,500)	1,829.6

Source: Fraser of Allander Institute, December 2003.

Unemployment

Table 3 contains our forecasts of unemployment. Both the ILO measure and claimant count measure are given. The preferred measure of unemployment however is ILO unemployment as given by the LFS. The forecast for ILO unemployment is 152,400 (5.8 per cent) in 2003 and 148,400 in 2004 (5.5 per cent). Claimant count is forecast to be 98,800 (3.8 per cent) in 2003, 98,300 (3.7 per cent) in 2004 and 97,300 (3.6 per cent) in 2005. We have increased our unemployment forecast marginally to keep in

line with developments in the economy, particularly in manufacturing. We believe unemployment will remain at low levels.

Table 3 Forecasts of Scottish unemployment, 2002-2004

	2002	2003	2004
ILO Unemployment (levels)	168,300	152,400	148,400
Rate	6.4%	5.8%	5.5%
Claimant Count (levels)	100,400	98,800	98,300
Rate	3.9%	3.8%	3.7%

Source: Fraser of Allander Institute, December 2003.

We continue to believe that our forecasts for the Scottish economy are both robust and consistent. There is also clear evidence that the forecasts are close to the outturn data from official sources. The model outcomes are also consistent with previous forecasts. The outlook for the Scottish economy remains for slow but steady recovery to near trend growth in 2004 and 2005. The expectation is that the labour market will continue to be relatively buoyant and that unemployment will be at low levels. Recovery is forecast for the latter half of 2003 and will continue into 2004. Manufacturing is not forecast to recover until 2004 through to 2005.

Kenneth Low
12 December 2003

