University of Strathclyde Business School

Fraser of Allander Institute

Economic Commentary

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Foreword

With the turn of the seasons a sense of renewed optimism has been felt across the country. Even though Scotland started the year with high numbers of COVID-19 cases, tighter restrictions, and a nationwide lockdown, the continued rollout of the vaccine programme has meant restrictions have been gradually relaxed and the economy has begun to open back up.

As a result, many in the business community are now turning their attention to the future, what their workforces will look like and where they will be based, and identifying the opportunities that will come with the unlocking of the economy.

It is in this context that this quarter's Commentary discusses a more positive outlook for the economy, and for businesses who have been challenged by the pandemic. While the end of the EU transition period may still pose some further challenges, particularly those whose supply chains have been disrupted, it has also removed some of the ongoing uncertainty.

Along with the vaccine deployment, businesses have been able to refocus on what they do best, with one key area of focus for many being their workforce and the 'future of work'. According to our CFO survey in April, two-thirds of finance leaders expect the bulk of their workforce to return to working from offices by September, but there is still significant uncertainty about how this will look in practice.

While every business is different, it is likely that a generational divide will exist amongst colleagues. Our research of over 1,000 UK consumers in October found that twice as many under-35s want permanent flexible working post-pandemic, compared to over-55's[1]. Arguably young people have borne the brunt of the wider impacts of the pandemic and so it's perhaps not surprising that young people also have significant concerns about their longer-term financial future and career prospects[2].

At Deloitte, the future of work has similarly been a priority area for our firm. The pandemic has demonstrated that people don't have to be physically together to work together, though, for many, the office remains a collective space to meet, connect, and collaborate with both clients and colleagues. We have just announced our plans for a hybrid approach, giving our people the choice and flexibility in when, how, and where they work. While we've encouraged a flexible workplace for many years, this marks a shift in our ways of working with the overriding principle of 'Deloitte Works' being that we trust our people to decide how they can deliver their best work in a way that works for them and for our clients.

The overnight switch from office to home introduced new ways of working for many. More than a year on, the picture is mixed and while some employees have struggled with the transition, the majority have enjoyed a better work life balance[3]. Finding a way to adopt the best practices, while also gaining the benefits provided by a collaborative office environment will be a key priority for those organisations still working from home. Getting this right will help businesses as they refocus on growth and retaining talent into the latter half of 2021 and into 2022.

1 Two thirds of Gen Z and Millennials seek permanent home working as COVID-19 reveals workplace generational divide.
2 The Deloitte Global 2021 Millennial and Gen Z Survey.
3 Two thirds of Gen Z and Millennials seek permanent home working as COVID-19 reveals workplace generational divide.

Looking towards securing the positive recovery predicted by the Commentary, business leaders must also contemplate and demonstrate the positive impact they are having on society. This quarter's Commentary considers the UK Government's flagship policy on Levelling Up, which is concerned with rebalancing opportunities across the country to tackle regional inequalities. While the policy is still emerging, businesses should consider how they can contribute to this agenda. The UK is one of the most unequal countries in the developed world and the pandemic has highlighted and heightened concerns on inequalities. It is a complex set of challenges to address, which, to be successful, will require significant collaboration across central government, local government and the private sector. Inclusive growth should transcend party politics and be something we all contribute to over the next decade as there is no quick fix.

As the Commentary notes, forecasts are still uncertain. However, by taking the opportunity now to think about the response to some of these challenges, businesses can ensure they are in a strong position for growth, able to take advantage of new opportunities and with a workforce that is enthusiastic and upskilled as the world moves to a new form of normality.

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June 2021

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ECONOMIC COMMENTARY

For regular analysis on the Scottish economy and public finances please see
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Summary

The recovery in the Scottish Economy is underway, despite recent delays in the easing of restrictions.

It's important that we don't forget how far we have come: the Scottish economy has seen significant opening up since late April. This is of course down to the incredible progress of the vaccine programme. Incredibly, we are now in the situation where 79% of adults have had at least the first dose of a vaccine against COVID-19: a feat which seemed impossible just 6-7 months ago.

With the progress of second doses being well on track, policymakers are signalling a change in the months to come in the way the manage any future outbreaks to reduce economy wide or local restrictions.

Consumers have demonstrated that, in the aggregate, they are ready and willing to spend. Consumer savings were at a record high at the end of 2020, and there are signs across the economy that this is starting to unwind. While consumer facing business still face some restrictions to capacity as we move towards the end of June, there is no end to the demand for social contact and shared experiences.

In the face of this, some concerns have begun to be raised about rising inflation, following the huge stimulus to household incomes in both the UK and US. So far, central banks have said that they consider this transitory and have not yet signalled a change to expansionary monetary policy.

The latest GDP data for Scotland show the recovery beginning. In March, with some easing of restrictions - particularly in education - in most of Scotland, we saw growth in the economy of 2.1%. This takes us just 0.9% below the previous post-pandemic peak in October. However, the economy still remains 5.4% below the pre-pandemic peak.

Reflecting this positive backdrop, we have revised up our forecasts for the Scottish economy. We expect the economy will grow 5.9% in 2021 and 3.5% in 2022. We are now expecting that the economy will return the pre-pandemic levels in the summer of 2022, 3 months earlier than we were forecasting in March.

The economy faces significant changes when we get properly through to the recovery phase. The shake out in the labour market has still not come to an end, with the Job Retention Scheme remaining in place until the end of September. And whilst the official statistics are still not reflecting this, we know that there are 24,000 fewer employees on payroll than February 2020.

The way many of us work has also changed: certainly, for those who have been able to work from home during the pandemic. As many of us return to the office part of the week, it remains to be seen how persistent many of these changes will be. In this edition of the commentary, we continue the discussion about the future of work, examining the sectoral differences of both prevalence and possible persistence of new ways of working.

We know that the impacts of the pandemic have not been evenly spread. Certain sectors have been much harder hit, and are likely to take much longer to recover than the economy as a whole. This is turn means that particular workers and regions in Scotland have been much harder hit.

We discuss in a special section the "Levelling Up" agenda, and how the impacts of the pandemic are likely to impact on the areas that have been identified for priority support through that UK Government scheme.

There are also risks to recovery which could provide headwinds to growth. The dislocation in global trade was significant due to the pandemic. However, we also know that the UK's exit from the EU Transition period has caused significant issues for manufacturers and others trying to rebuild these supply chains since the start of this year. In this edition, we discuss what the latest data tells us about the impacts of these trade frictions.

So overall, despite our optimism, it is important to remember that forecasts at the moment are still very uncertain: reflected somewhat in the range of forecasts we are seeing from different institutions.

The new Scottish Government has set out a number of priorities for the early days of the new parliamentary session. Unsurprisingly, COVID recovery has been set out as the key priority, with a focus on making the economy both greener and fairer. This aligns with the other key challenges over the next few years: to meet the key statutory targets on carbon reductions and child poverty.

Immediate investments have been set out in order to help the NHS recover and start to address the backlog that has built up during the pandemic; a renewed focus on reducing the attainment gap also features.

The latest announcements of the pausing of planned easing restrictions will lead to calls from some sectors that there should more more extensive business support to get them through to a position where they can properly operate. As well meaning as initiatives like a new Council for Economic Transformation may be, practical policy measures to help these businesses survive through to the winter are likely to be needed.

Fraser of Allander Institute
June 2021

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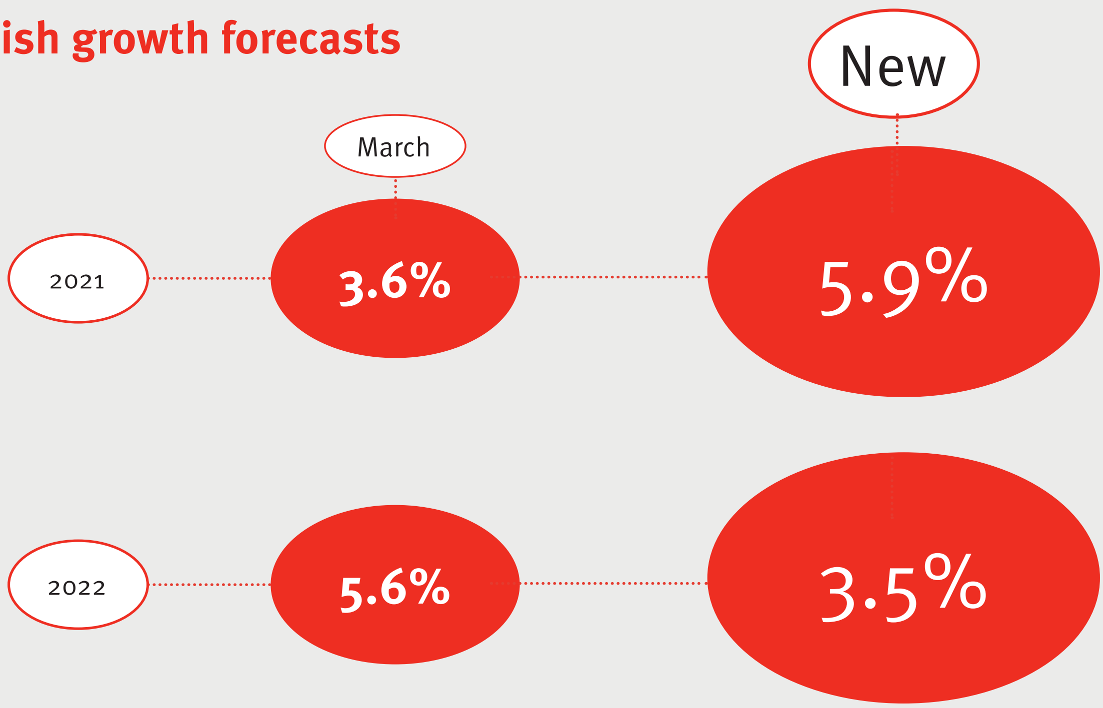
State of the economy

Indicator	% of Feb 2020 levels	Rate	Change on previous month / quarter	Performance	Latest data
GDP					
Total	94.6%		+2.1%	▲	March 2021
Production	96.9%		+3.0%	▲	March 2021
Construction	103.7%		+5.7%	▲	March 2021
Services	93.4%		+1.6%	▲	March 2021
Labour Market					
Employment rate		74.2%	-0.1 p.p.	▼	Feb - April 2021
Unemployment rate		4.2%	+0.1 p.p.	▲	Feb - April 2021

Scottish growth forecasts



	Trough	Return to pre-crisis level	Recovery time
March Commentary	*Apr-20*	*Oct-22*	*2 years, 6 months*
New	Apr-20	July-22	2years, 3 months

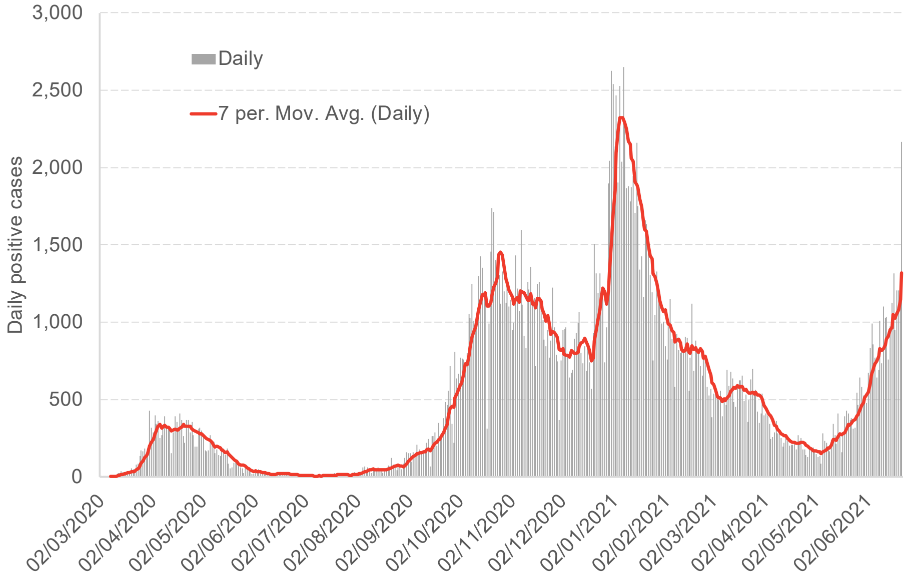
Outlook and Appraisal

Where are we now?

With the majority of Scotland now in Level 1 or 2 of COVID-19 restrictions – and some islands in Level 0 – the level of optimism in the economy has improved since our last commentary in March.

However, the easing of restrictions has been followed, again, by rising Coronavirus case numbers across Scotland and a delay in further restrictions being lifted. Chart 1.

Chart 1: Number of reported daily new positive cases and 7-day rolling average, Scotland, 2nd March 2020 – 22nd June 2021



Source: *Scottish Government*

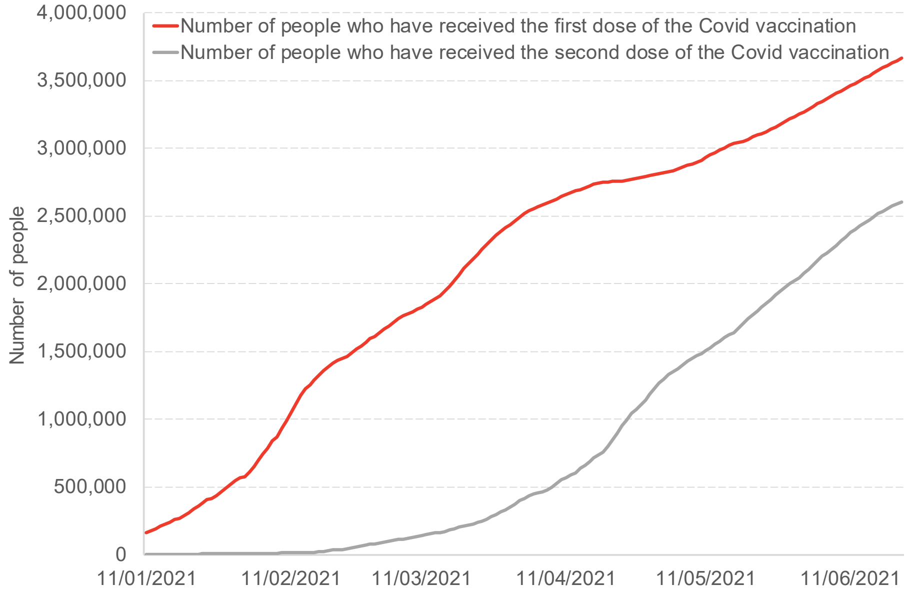
When the country went into a national lockdown in winter the rising Coronavirus case numbers were translating into increased hospital admissions however, this time around the vaccination programme has helped curb the transmission rate of COVID-19 and the hospitalisation rate of those that contract the virus.

However, with the new Delta variant of Coronavirus reported to be more infection than strains like the Kent variant, which drove winter case numbers in the UK, the economy's recovery will be dependent upon continued success of the vaccination programme.

Thankfully, Scotland - and the rest of the UK - has been quick to approve and administer Coronavirus vaccinations.

As of late June, over 2.6 million people in Scotland had received their second dose of the COVID-19 vaccination. Chart 2.

Chart 2: Number of people who have received their first and second dose of the COVID-19 vaccination, Scotland, 11th January 2021 – 22nd June 2021



Source: *Scottish Government*

The success of the vaccination programme so far will give businesses and households some hope that the economy can (hopefully) get on with its recovery from COVID-19, despite of any current, or future, variants of the virus.

So, how is the economic recovery going?

The latest economic output data available for Scotland only extends to March of this year, when the country was still, mostly, under a national lockdown.

Despite this, there are some signs that economic conditions began improving slightly towards the end of Q1.

Scottish GDP grew by 2.1% in March, with output 5.4% below the pre-pandemic levels.

In March, Scottish GDP was 0.9% below its recent high in October, before COVID-19 restrictions were imposed again. Chart 3.

Based on data for March the Scottish economy is slightly ahead of the UK's overall in terms of its recovery.

The UK economy also grew by 2.1% in March however, in March, output was 5.9% below February 2020 levels and 1.0% below the previous recovery high in October 2020.

Whilst the construction sector was a particularly impacted sector during the first lockdown last year, it has proven resilient – thanks to its adaptability - to subsequent local and national lockdowns. The Scottish construction sector is estimated to have grown by 5.7% in March.

The services sector in Scotland, as a whole, grew by 1.6% in March, driven mostly by the education sector due to return of in-person learning in February and March.

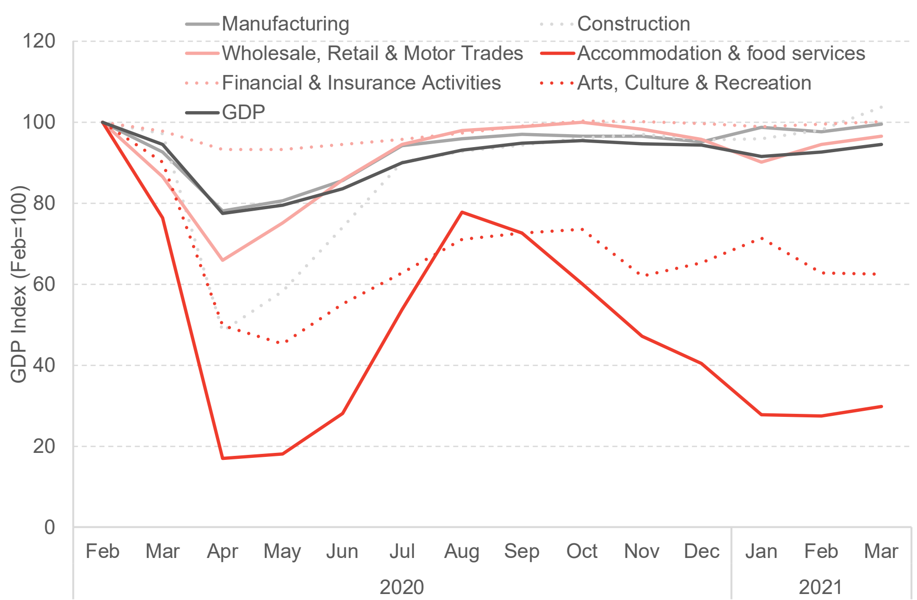
On the other hand, the hit to the accommodation and food services sector during the winter lockdown was not too dissimilar to that of last Spring's. Output in this services industry was estimated to be just 30% of last February's levels in March.

On the whole, the Scottish economy contracted by 1.9% in the first quarter of this year.

However, this contraction is modest when comparing it to the 18.5% hit to GDP felt during the first national lockdown last spring.

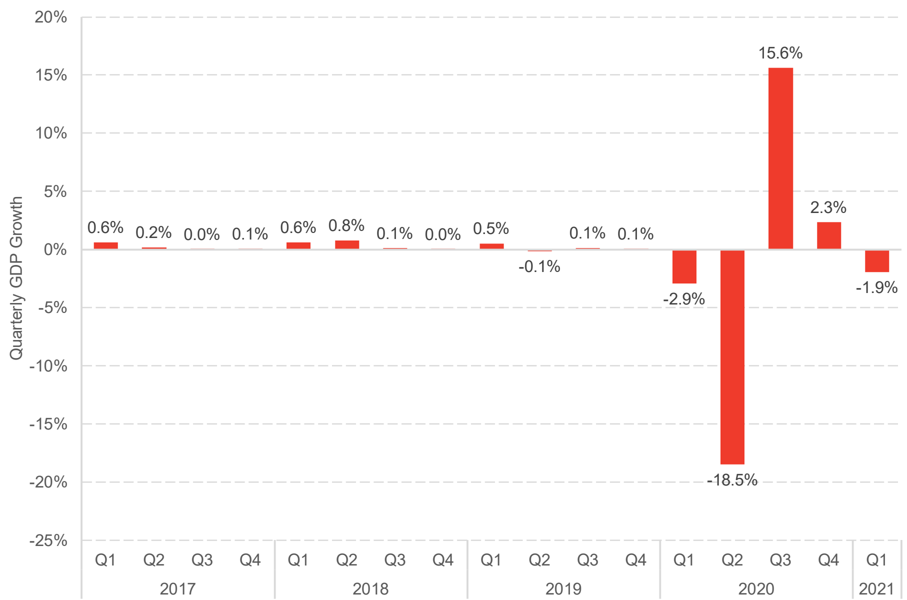
This difference in contraction can mostly be pinned down as being a result of the economy's ability to adapt to COVID-19 restrictions. During the first national lockdown last year, there was an unprecedented mothballing of the economy however, in the recent winter lockdown many businesses were able to operate under COVID restrictions because they had, over the course of a year, implemented COVID-safe ways of working.

Chart 3: GDP Index, Scotland, Feb 2020 – Mar 2021



Source: *Scottish Government*

Chart 4: Quarterly GDP Growth, Scotland, 2017 Q1 - 2021 Q1



Source: *Scottish Government*

In terms of the impact on households, the winter lockdown evidently had an effect on household finances. Crisis grant applications sharply increased at the start of the new year as the economy shut down again. Chart 5.

Crisis grant expenditure reached a new peak in January of this year however, similar to last year, it has since levelled off slightly.

But, not everyone in the economy has had to rely on grants or loans to keep them afloat throughout this pandemic.

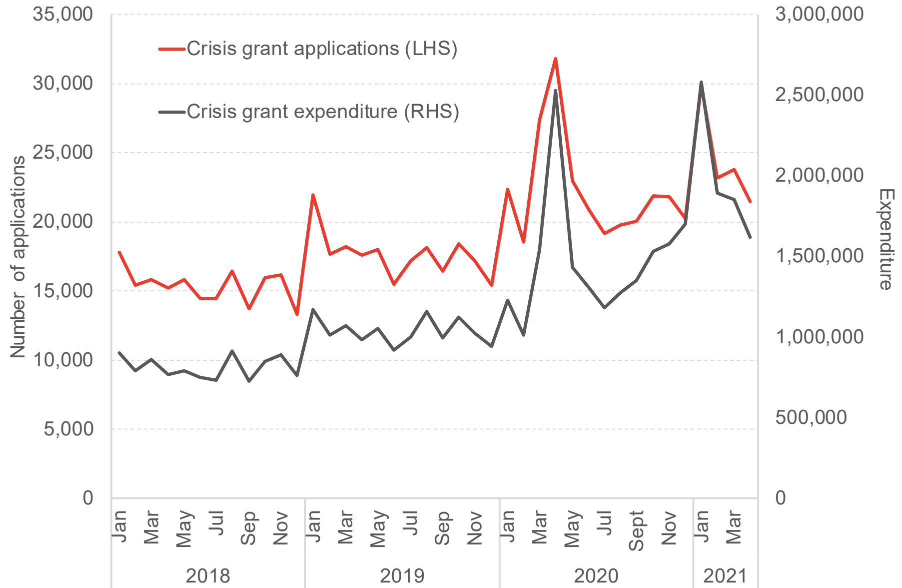
In fact, the household savings rate has increased significantly since the start of the pandemic as households cautiously managed their finances during uncertain times. Chart 6.

At the (first) height of the Coronavirus crisis last spring, the household savings ratio in Scotland almost reached 30% and although it has come down since, it remains just below 20%.

For context, the average household savings ratio from 1998 – 2019 was just 8.1%.

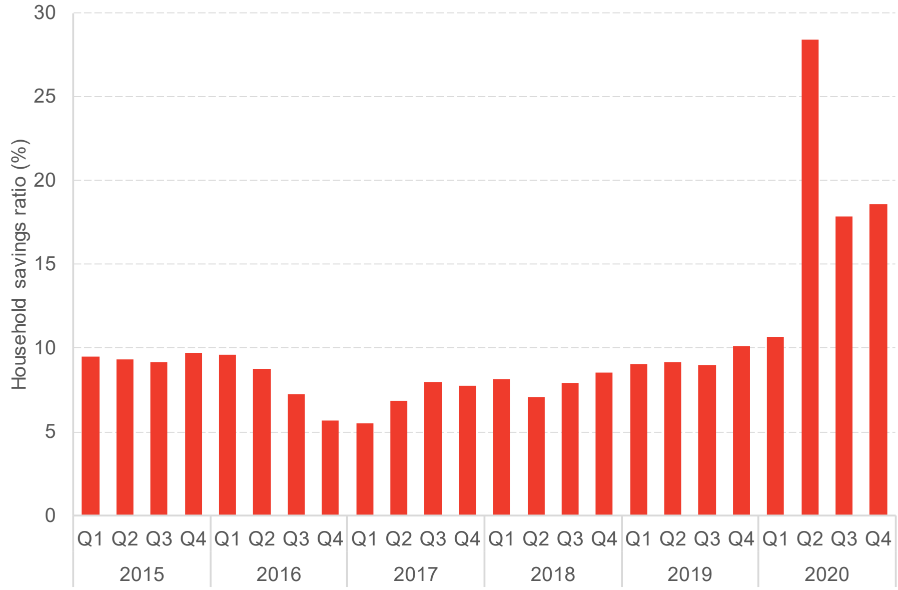
The ratio increased going into Q4 of 2020, likely as a result of panic saving due to the worsening COVID-19 case numbers around that time.

Chart 5: Crisis grant applications and expenditure, Scotland, Jan 2018 – March 2021



Source: *Scottish Government*

Chart 6: Household savings ratio, Scotland, Q1 2015 – Q4 2020



Source: *Scottish Government*

An important indicator for household finances and the outlook of the economy as a whole is the consumer sentiment indicator. Table 1.

Consumer sentiment improved in the first quarter of the year, despite the winter lockdown, across both current and expectation indicators.

The greatest improvements can be seen across current attitudes to spending and expectations of the economy's performance.

Household finances experienced the weakest growth between Q4 2020 and Q1 2021.

Table 1: Consumer Sentiment Indicator, Scotland, Q4 2020 - Q1 2021

Results	**Net balances**		**Change between Q4 2020 and Q1 2021**
	Q1 2021	**Q4 2020**	
Consumer Sentiment composite indicator	-13.5	-21.5	+8.1
Current indicators			
(a) Economy performance	-56.3	-64.7	+8.5
(c) Households' finances	-19.6	-23.6	+4.0
(e) Attitude to spending	-25.5	-34.3	+8.8
Expectation indicators			
(b) Economy performance - next 12 months	26.7	13.2	+13.6
d) Households' finances - next 12 months	7.2	1.8	+5.4

Source: *Scottish Government*

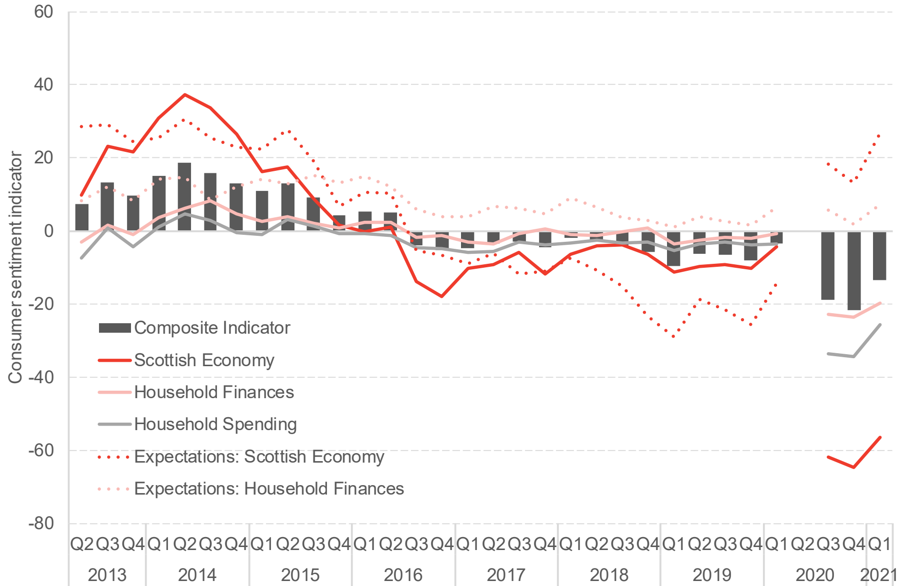
However, although there have been recent improvements, consumer sentiment remains significantly low relative to past trends. Chart 7.

Current sentiment towards the state of the Scottish economy remain at all-time lows however, expectations of the future state of the economy are close to its 8-year high of 30.

However, it must be noted that the bar is set extremely low therefore, it is not surprising that expectations are far higher than current conditions.

Nonetheless, given the easing of restrictions coupled with improvements in the outlook of the economy, it will be interesting to see how much of the increased savings and 'pent-up demand' will translate into actual increased demand and output in the coming months.

Chart 7: Consumer Sentiment indicators, Scotland, 2013 Q2 - Q1 2021



Source: *Scottish Government*

Real time indicators of economic performance

Traditional economic indicators, such as GDP, are often available with a lag. During fast developing crises, such as the COVID-19 pandemic, there is a need to track developments in the economy at a higher frequency.

During the pandemic, the FAI has been tracking several real time indicators which are able to provide a timely picture about the state of the Scottish, and UK, economy.

The real time indicator dashboard shown below summarises recent developments in some key real time indicators. Diagram 1.

Diagram 1: Real time indicator dashboard, Scotland

Indicator	Current level/ Percentage	% change on previous period	Performance	Latest data
Share of businesses currently trading	94.6%	+0.8 p.p.		17 May to 30 May 2021
Share of businesses reporting lower levels of turnover	35.3%	-0.2 p.p.		17 May to 30 May 2021
Share of businesses with no or less than 3 months of cash reserves	24.0%	-4.5 p.p.		17 May to 30 May 2021
Share of businesses with staff on furlough	46.5%	-3.6 p.p.		17 May to 30 May 2021
Share of employees on furlough	9.6%	-1.7 p.p.		17 May to 30 May 2021
Number of Vacancies	43,068	+5%		May 2021

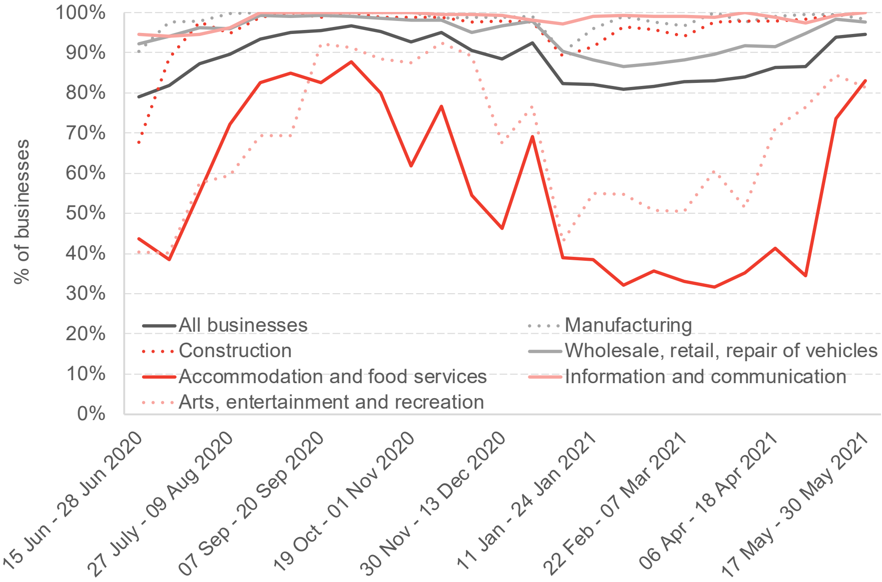
Source: *Scottish Government; Adzuna*

At the time of the BICS survey most local authorities were operating under Level 2 level COVID-19 restrictions. Since then, many parts of Scotland have moved into lower COVID-19 restriction levels.

The latest survey shows that just under 95% of businesses were operating near normal levels of trading in Scotland. A significant improvement on the last survey wave.

This improvement is particularly evident in the accommodation and food services sector, with a 48.5-percentage point (p.p.) increase in the share of businesses trading since mid-April/early May. Chart 8.

Chart 8: Share of businesses currently trading, Scotland, 15th June 2020 – 30th May 2021



Source: *Scottish Government*

As the number of businesses currently trading increases, this has reduced the number of staff currently furloughed in Scotland. There has been a 29-p.p. decrease in the share of those furloughed in the accommodation and food services sector. Chart 9.

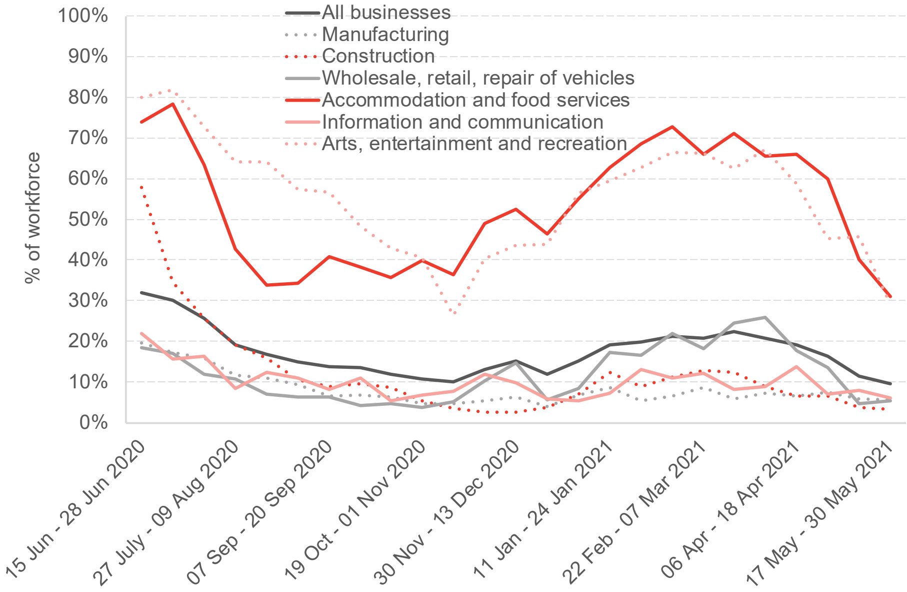
Whilst this reduction in furloughing may seem like good news, the destination of unfurloughed workers is not detailed in the data.

If furloughed workers are being brought back to work on pre-pandemic hours and pay then this reduction is a positive leap forward for this sector's recovery. However, if this reduction is being driven by workers being laid off or being brought back to work on reduced hours/incomes then this change is concerning.

More recent data, covering up to early June, shows that mobility to retail and recreation venues - like pubs, restaurants and bars – increased significantly in late April/early May across Scottish cities. Chart 10.

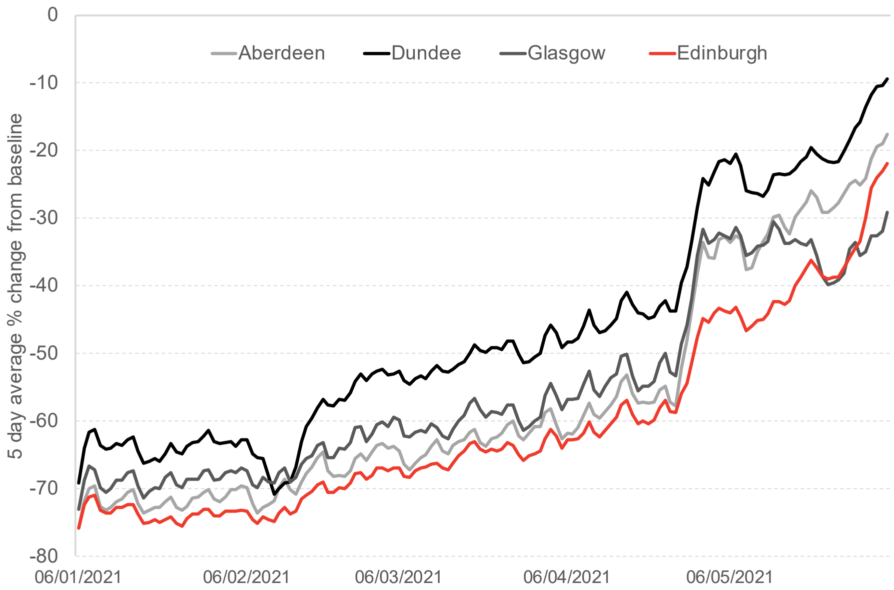
Glasgow experienced a slight decline in mobility in late May – when the city remained in Level 3 whilst the other cities moved into lower restriction levels – however, mobility improved soon after it was moved down to Level 2 COVID-19 restrictions.

Chart 9: Share of workforce furloughed, Scotland, 15th June 2020 – 30th May 2021



***Source:** Scottish Government*

Chart 10: Mobility to retail and recreation venues, selected Scottish cities, 6th January 2021 – 4th June 2021



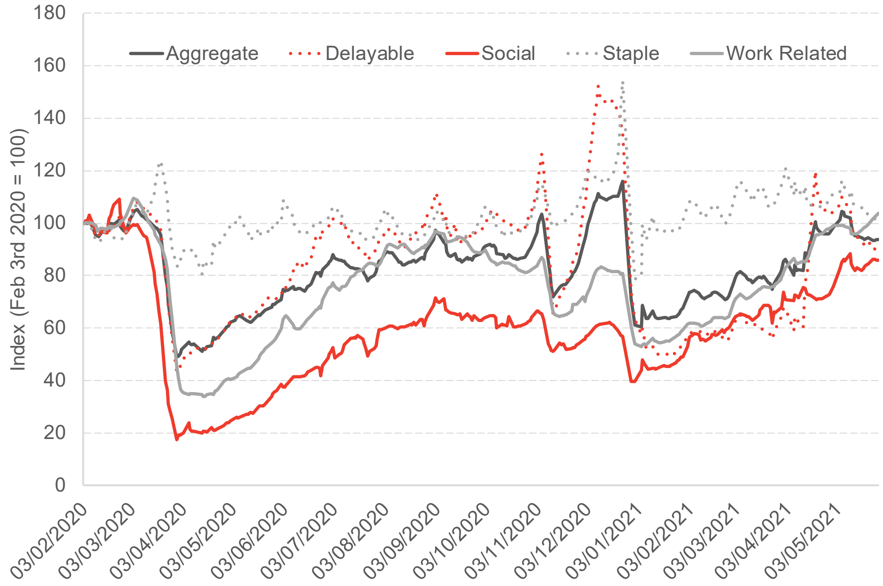
***Source:** Google*

Unsurprisingly, social and work-related spend on debit and credit cards decreased the most during the height of the pandemic last spring. However, both spends have recovered significantly fast over the past few months as the economy began opening back up.

Work-related credit and debit card consumption returned to pre-pandemic levels towards the end of May and is now the most common use of credit and debit cards.

If spending continues to grow at the rate it has been going at in recent months then we could expect aggregate spending to exceed pre-pandemic levels fairly soon which would, in turn, create inflationary pressure on prices.

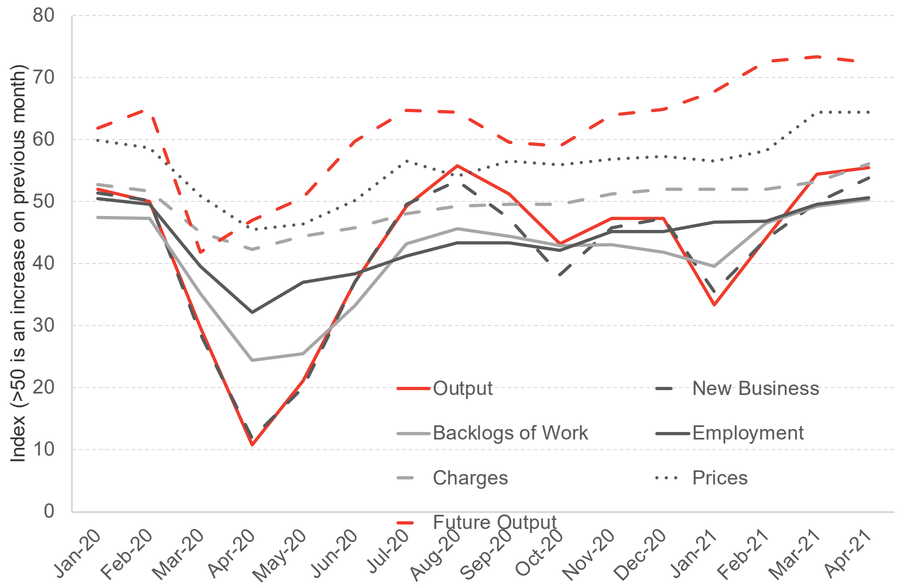
Chart 11: Spending on credit and debit cards by consumption category series, UK, 3rd Feb 2020 – 27th May 2021



Source: *ONS*

But, as the latest PMI index highlights, prices have already been on the rise since last summer and have experienced even greater growth in recent months. Chart 12.

Chart 12: Purchasing Managers Index, Scotland, Jan 2020 – April 2021

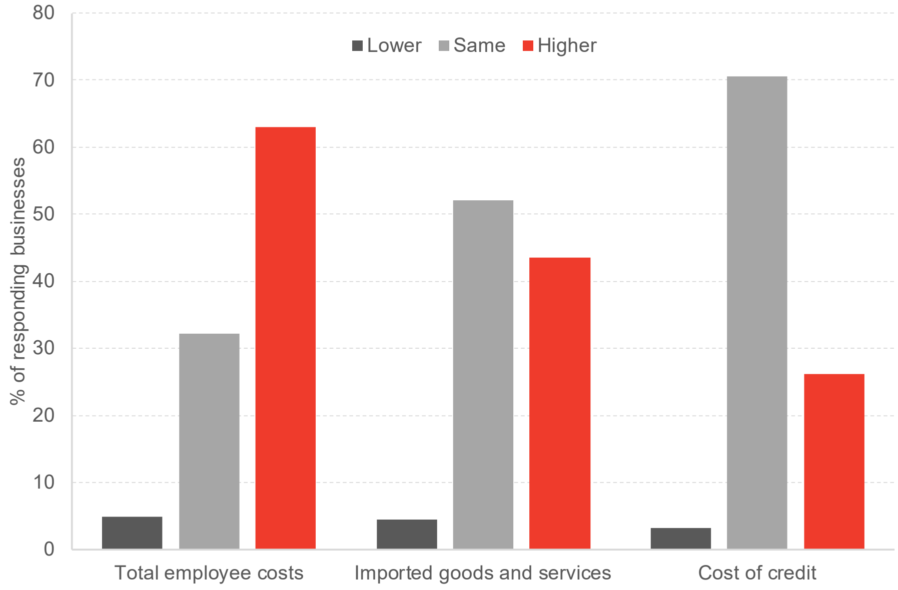


Source: *IHS Markit*

The latest Scottish Business Monitor results indicate that rising prices and costs are expected to continue into the second half of the year. Chart 13.

Over 70% of businesses expect costs to be higher in Q2 2021 – Q3 2021, with the majority of businesses expecting higher costs to come through increased wages.

Chart 13: "Thinking about the key cost drivers for businesses, what is your business' assessment of the following cost pressures over the next 6 months?", Scotland, Q1 2021



Source: *Scottish Business Monitor*

Overall, as the economy continues to open back up we will see increased demand for sectors, like accommodation and food services, that have been particularly impacted by the pandemic and subsequent lockdowns. Early data suggests that mobility and spend for social reasons has already increased significantly.

Household savings are at a record high and only time will tell how much of these savings will be spent in the economy. However, data from the Bank of England suggests that there is an increased willingness among households to spend savings that they have accumulated throughout the pandemic.

All of this, coupled with rising costs for businesses may create inflationary pressure which could dampen the speed at which Scotland's economy recovers from this crisis.

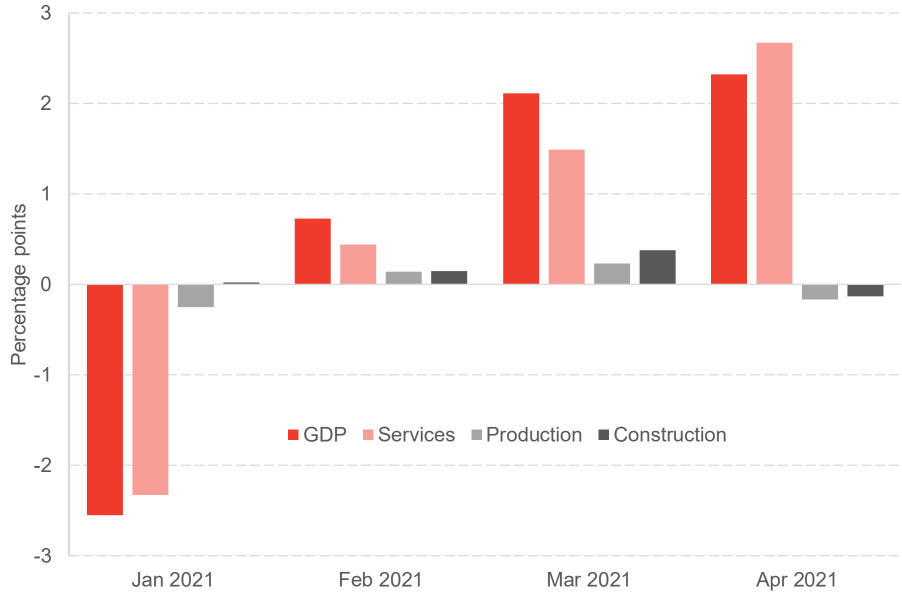
UK economy

As discussed, the UK's economic recovery from COVID-19 has been fairly similar to the Scottish economy.

After a sharp contraction in January of this year, GDP expanded in February-April, driven mostly, due to its share of the economy, by growth in the services sector. Chart 14.

The services sector grew by 3.4% in April whilst Production contracted by 1.3% - driven mostly by the 15% decline in mining and quarrying output caused by planned maintenance to oil fields. The construction sector also contracted - by 2.0% - in April due to a fall in new work projects.

Chart 14: Contributions to monthly GDP growth, UK, January – April 2021



Source: *ONS*

All in all, UK GDP is estimated to have expanded by 2.3% in April 2021, leaving economic output 1.2% above October 2020 levels (previous recovery peak) and 3.7% below pre-pandemic levels seen 14 months prior.

For context, the UK took around five years to return to its pre-recession peak – February 2008 - after the financial crisis.

The UK was around 3.7% below pre-recession peak levels by early Summer 2010, almost 2.5 years later.

However, the trough of both crises was very different.

UK GDP fell to just 93% of February 2008 levels after the financial crisis whereas, at the height of the pandemic, UK GDP fell to just 75% of February 2020 levels.

Therefore, the UK economy is recovering significantly faster than during the 2008/09 Recession recovery however, it remains to be seen how quickly the UK will return to pre-pandemic levels; the speed of which will be heavily dependent upon the vaccination programme's success and future potential lockdowns.

Increased borrowing throughout the pandemic has supported the country's economic recovery so far, by allowing both businesses to stay afloat.

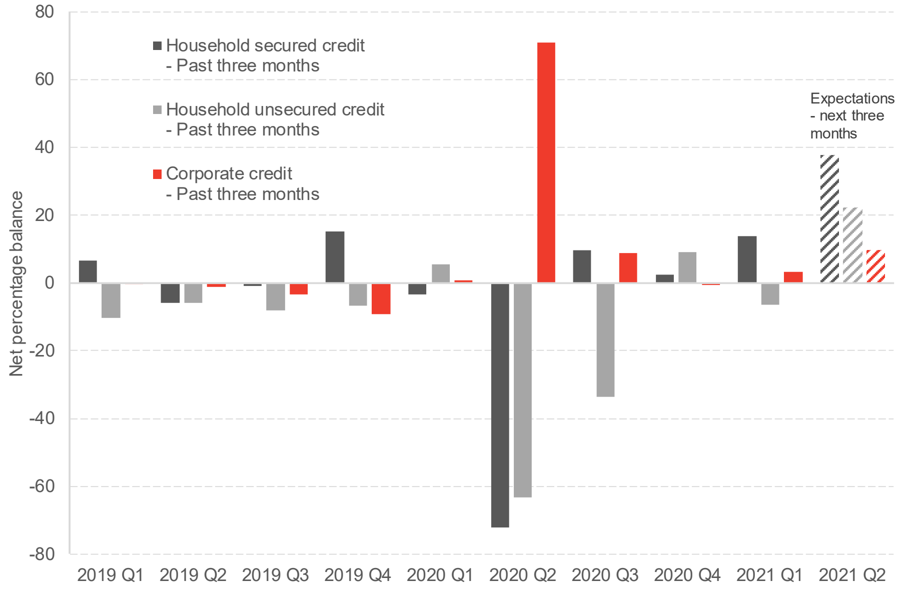
As the economy phases into being fully open again, capacity constraints and social distancing measures will mean that things will not necessarily go back to the way things were; at least for some time anyway.

This means that businesses will continue to rely on credit for a while yet.

The latest Credit Conditions Survey shows that lenders expect credit availability to rise in the second quarter of the year. Chart 15.

Lenders also reported improved availability of secured lending to households in Q1 2021 however, unsecured lending weakened into the first quarter of the year.

Chart 15: Household and corporate credit availability, UK, Q1 2019 – Q2 2021



Source: *Bank of England (Credit Conditions Survey)*

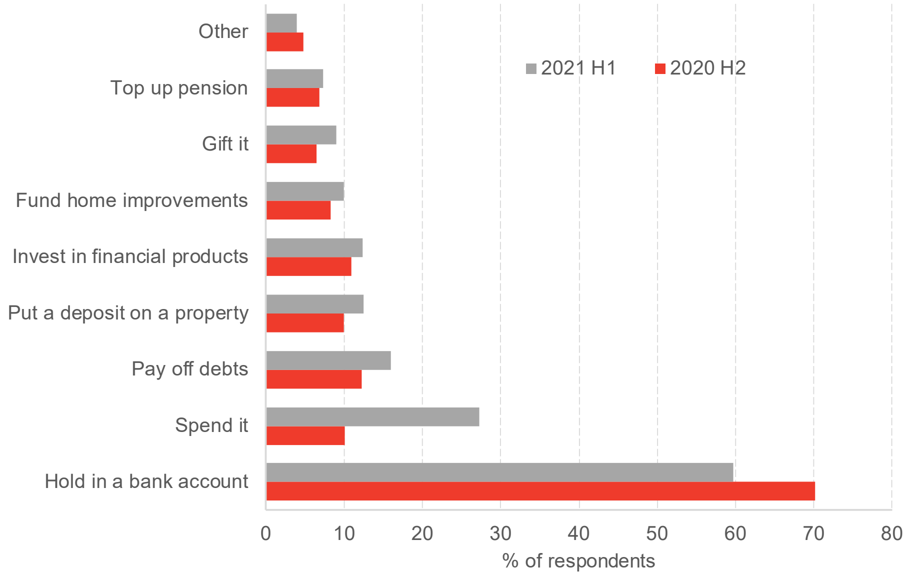
Whilst household debt is now at its highest level since the financial crisis, the rate of household savings has also risen to record highs.

The impact that these increased savings will have on demand and output in the economy will depend on whether households are willing to spend their savings, and when this spending will occur.

The latest Bank of England and NMG Consulting survey indicates that the majority of households with increased savings plan on holding it in their bank accounts; however, this is down by 10-percentage points on last year. Chart 16.

Just under a quarter of savers plan on spending some of their savings, up from 10% last year.

Chart 16: Planned use of funds of households reporting increased savings, UK, 2020 - 2021

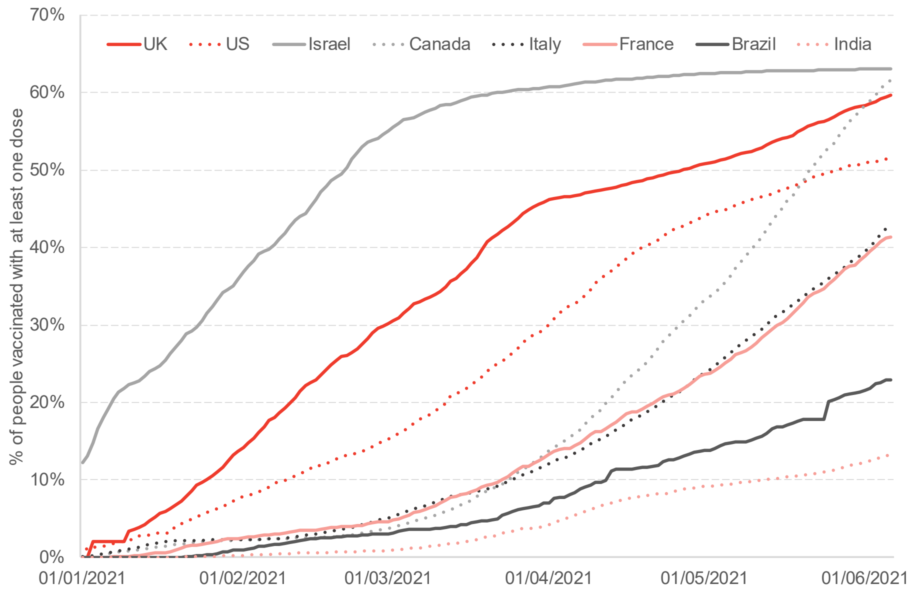


***Source:** Bank of England*

The increase in willingness to spend may indicate that households expect that they will not need their savings as much as they expected last year.

This is not overly surprising given that the economy is reopening, consumer and business confidence is up and in particular, the UK has been performing well on the global stage in its efforts to vaccinate the population from COVID-19. Chart 17.

Chart 17: Share of population that have received at least one dose of the COVID-19 vaccine, UK and selected countries, 1st Jan 2021 – 6th June 2021



***Source:** Our World in Data*

Given recent developments, many forecasters have adjusted their economic growth projections for the UK. Table 2.

In our last commentary in March most forecasters were estimating growth to be around 4-5% in 2021 and around 5-7% in 2022.

Now, forecasts are up for 2021 as forecasters have brought forward growth in 2022 to 2021.

Recent headline forecasts project GDP growth in 2021 to be between 5-8%, followed by growth of over 5% in 2022.

Similar to previous forecasts, these two years of strong growth are expected to be followed by more typical growth rates of around 1-2%.

Table 2: UK GDP growth projections, 2021 - 2023

	2021	2022	2023
BoE	7.25	5.75	1.25
OBR	4.0	7.3	-
NIESR	5.7	4.5	2.6
IMF	5.3	5.1	-
Oxford Econ	8.0	5.9	-
ITEM club	6.8	5.0	-
HM Treasury*	6.8	5.4	2.1

Average of new forecasts

***Source:** BoE, OBR, NIESR, IMF, Oxford Economics, ITEM club, IFS, HM Treasury*

Global economy

Similar to UK GDP projections, global growth forecasts have also been revised up since March.

Last commentary global growth in 2021 was projected to be around 4-5%, now it is estimated to be around 5-6%. Table 3.

Global growth forecasts for 2022 have remained fairly similar, at around 4%.

Table 3: World GDP growth projections, 2021 – 2023

	2021	2022	2023
BoE	5	4.5	2.5
OBR	5.5	4.2	3.8
NIESR	5.5	4.3	-
EC	5.9	4.2	-
IMF	6	4.4	-
OECD	5.8	4.4	-

***Source:** BoE, OBR, NIESR, EC, IMF, OECD*

But, it is not just the successful vaccine rollout seen across the world that is to thank for upwards revisions to growth forecasts.

The rate at which certain industries have bounced back in recent months has been greater than expected.

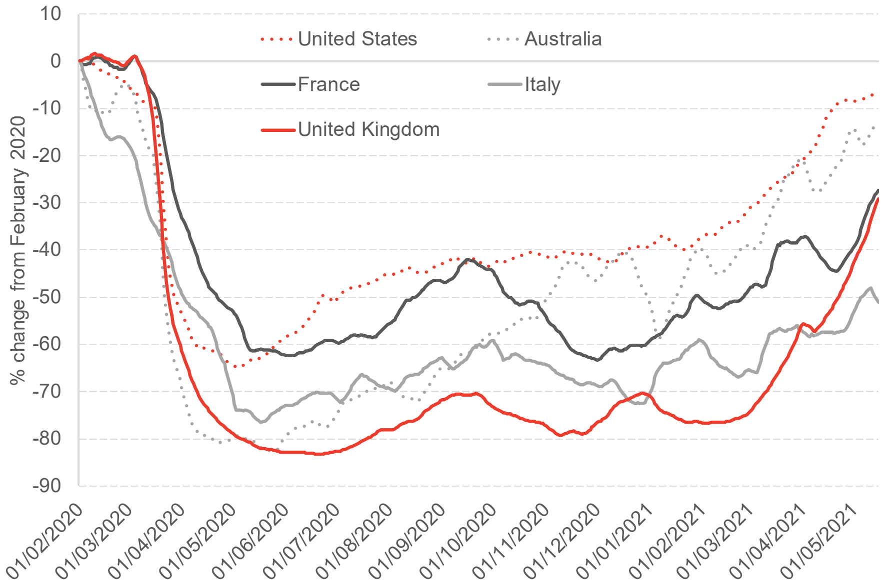
Hospitality and tourism is one of, if not the most, impacted sectors in the economy.

However, as discussed previously, when lockdown restrictions ease, demand for restaurants, bars, pubs, cafés and holiday trips increase significantly.

The increased demand for these services can be seen by looking at trends in job postings in the hospitality and tourism industry. Chart 18.

Since the UK began its phased exit out of lockdown, job postings in this sector sharply rose, indicating that businesses in this sector, both in the UK and globally, expect heightened demand over the coming summer.

Chart 18: Growth in online job postings: hospitality and tourism, UK & selected countries, 1st February 2020 – 15th May 2021



***Source:** OECD*

The increases in mobility and social spending (and other types of spend) have had a direct impact on prices.

This can be seen in the latest oil price data. Chart 19.

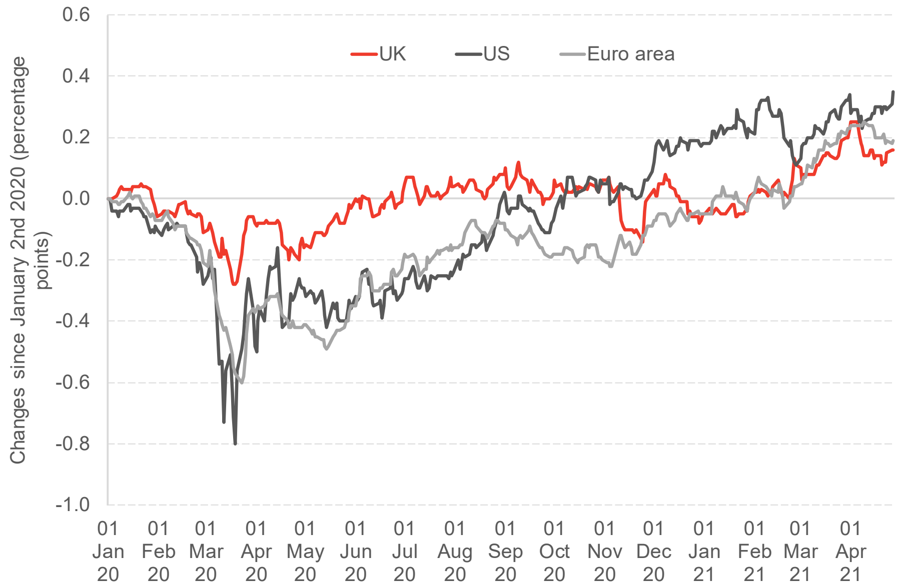
Last April, the price of oil fell to just over $5 per barrel. As of May/June, the price of oil stood at $70 – the highest that it has been in almost 1.5 years.

Long-term implied expectations for inflation have also increased in recent months. Chart 20.

Chart 19: Price of Brent crude oil, US$/BBL, January 2014 – June 2020

Source: *Thomson Reuters Datastream*

Chart 20: Changes in five-year forward inflation compensation, UK, US, Euro Area, 2nd Jan 2020 – 27th April 2021



Source: *Bank of England*

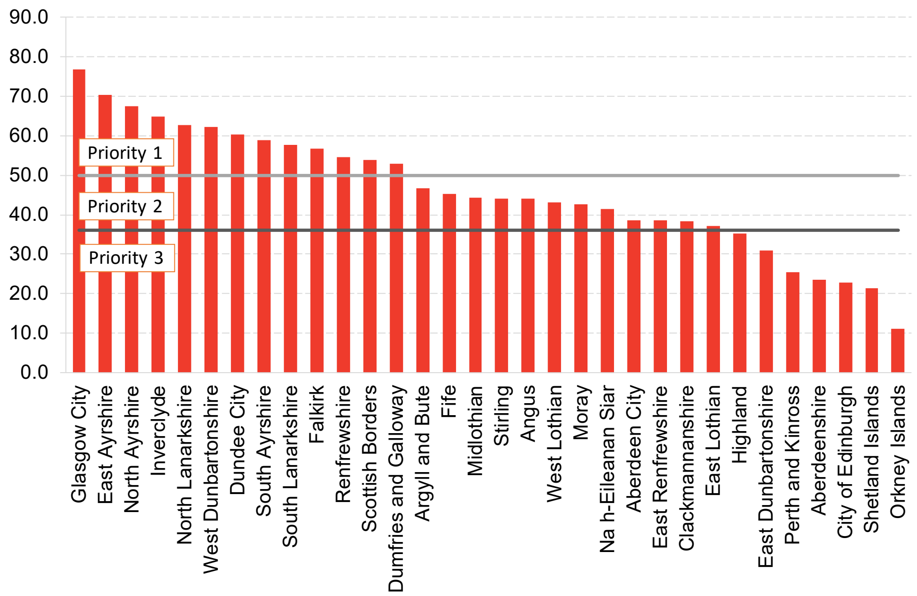
Levelling up

There have been various policy initiatives announced by the UK Government in recent months to try to further their ambition to "Level Up" the country. These recognise that there are huge regional inequalities across the UK, which have only been increasing over the last couple of decades. To a certain extent, the UK Government is also looking to fill a gap left by the absence of EU funding to further similar aims in the past.

Last week, we released new research that focussed on how different areas have been categorised through the Levelling Up prioritisation index. We also discuss the areas flagged for priority funding through the Community Renewal Fund, and compare and contrast the methodology used for both funds.

The categorisation of Scottish Local Authorities through the Levelling Up Fund is shown in the Chart below, with areas that are Priority 1 being the highest priority.

Chart 21: Levelling Up Index Score, Scottish Local Authorities



Source: *FAI*

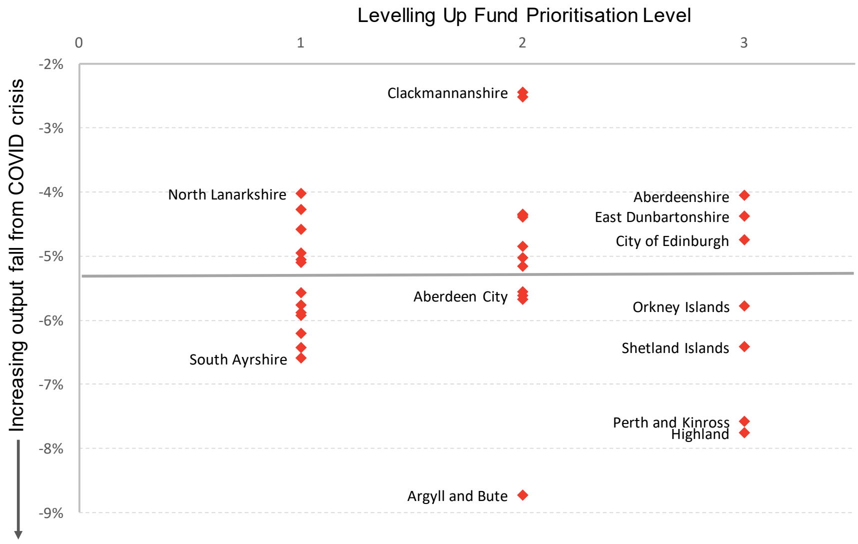
Our main findings were:

- Whilst using a range of indicators to assist with allocation of funding is to be welcomed, this exercise demonstrates the difficulty of using a set of indicators to capture the different types of need in different areas;
- The Levelling Up Fund methodology is not sufficiently transparent – much more must be done in future to ensure that appropriate detail is provided;

- The Levelling Up Fund methodology is not capturing need for transport connectivity in rural areas in Scotland and Wales, due to the inconsistent nature of the indices in different nations;
- Given the level of funding at stake and the need for transparency, it is critical that there is a more open consultation on the allocation of the forthcoming UK Shared Prosperity Fund, including a discussion of current data gaps and limitations to identify the people and areas most in need; and
- Policy makers should pay special attention to areas most impacted by the COVID-19 restrictions, while regional data fails to reflect these disproportionate impacts.

With the last of these points in mind, we modelled the possible local authority level impacts of the economic shock caused between February 2020 and March 2021, and contrasted it with the priority levels identified through the Levelling Up Index.

Chart 22: Levelling Up Index Score, Scottish Local Authorities



Source: *FAI*

We can see from this analysis that the areas with the largest negative impact from the pandemic are Argyll and Bute, Highland, and Perth and Kinross, all of which have not been deemed as the highest priority through the Levelling Up methodology.

Whilst this is of course due to the lag in the data that exists for these areas, it will be interesting to observe how these disproportionate impacts may be considered through the allocation of such funds over the next few years as we recover.

Trade - COVID & Brexit

Introduction

Trade activity fell sharply at the start of the Coronavirus pandemic due to both supply and demand side factors.

Lower consumer and business confidence translated into a fall in demand for goods and services, which contributed to a fall in imports and exports. At the same time, restrictions on international travel led to a lower capacity for the transport of goods, whilst social distancing measures placed restrictions on exports of services delivered in person.

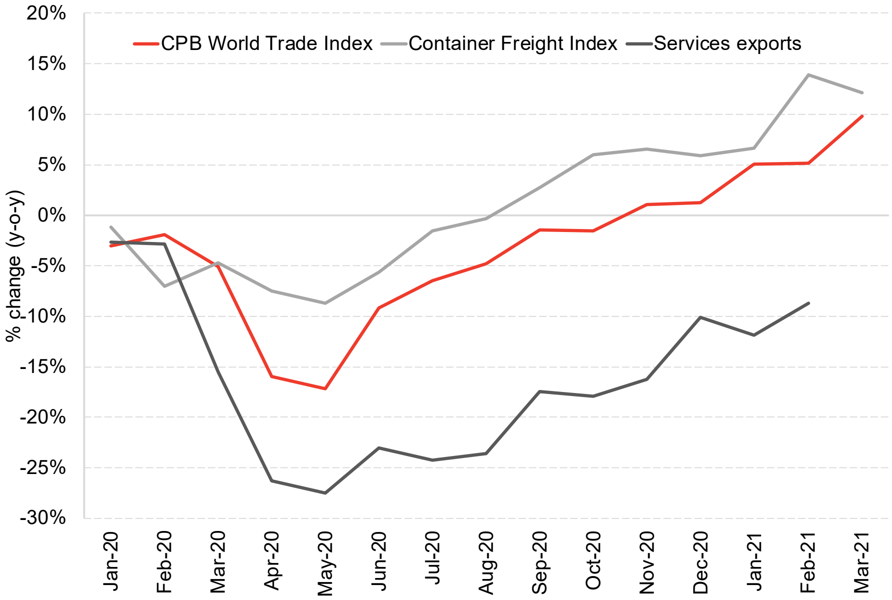
The end of the transition period in January 2021 after the UK's departure from the EU has resulted in further administrative obstacles to trade for businesses, resulting in a sharp month-on-month decline in trade with the EU.

Global trade

In April 2020 global services exports were more acutely impacted than aggregate trade. Services exports fell by more than 25% y-o-y in April and May 2020 and by February 2021 they had still not fully recovered to pre-pandemic levels.

Global container freight transport fell by around 8%, which contributed to a 16% contraction in the CPB World Trade Index. Unlike services, container freight transport and world trade grew above pre-pandemic levels by the end of 2020.

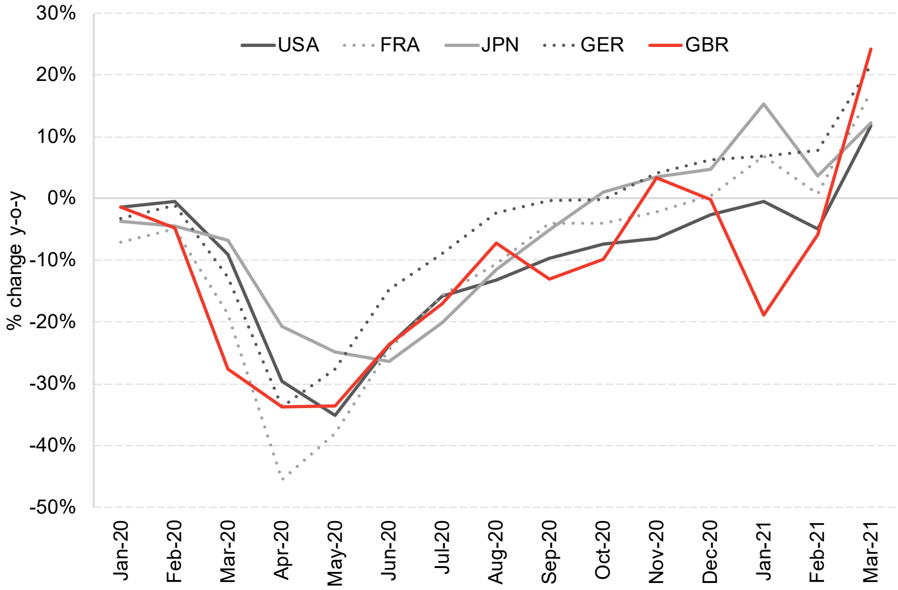
Chart 23: Global trade indicators, January 2020 – March 2021



Source: *CPB Netherlands Bureau for Economic Policy Analysis, WTO, RWI*

The UK had a similar magnitude of a decline in exports compared to other major economies at the start of the pandemic. The subsequent recovery period has been a bit more volatile and the end of the EU transition period resulted in a UK-specific shock to exports.

Chart 24: Exports, major global economies, January 2020 – March 2021



Source: *OECD*

UK trade

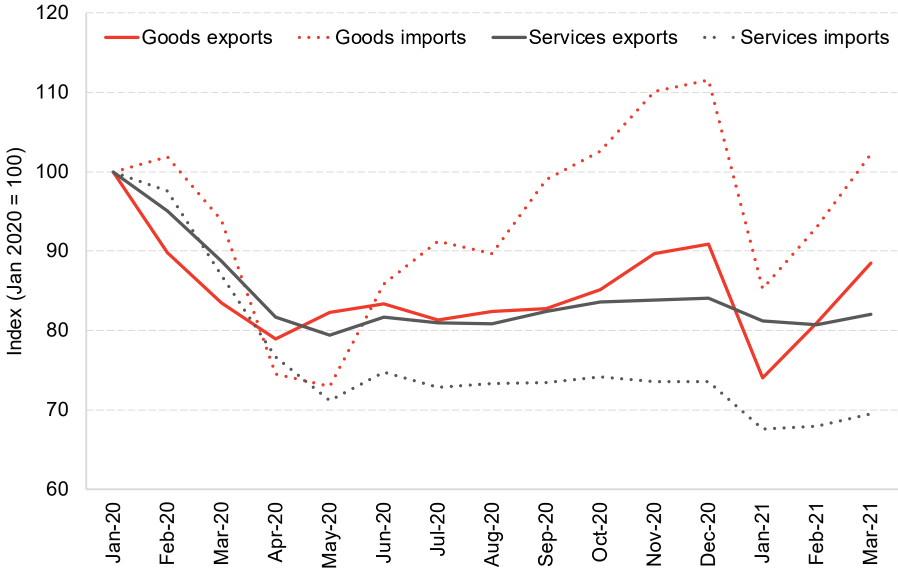
In line with global trends, services exports during the pandemic contracted more than goods exports. Furthermore, imports of both goods and services were more affected at the start of the pandemic than exports.

Goods imports subsequently recovered above pre-pandemic levels by the end of last year but experienced a sharp decline at the end of the Brexit transition period. Trade in services have been considerably less affected by Brexit than trade in goods, but services are suffering from persistent low demand due to Covid-related restrictions.

Chart 25 shows that the contraction in exports in January 2021 was primarily driven by restrictions on trade with the EU and that non-EU exports remained unchanged.

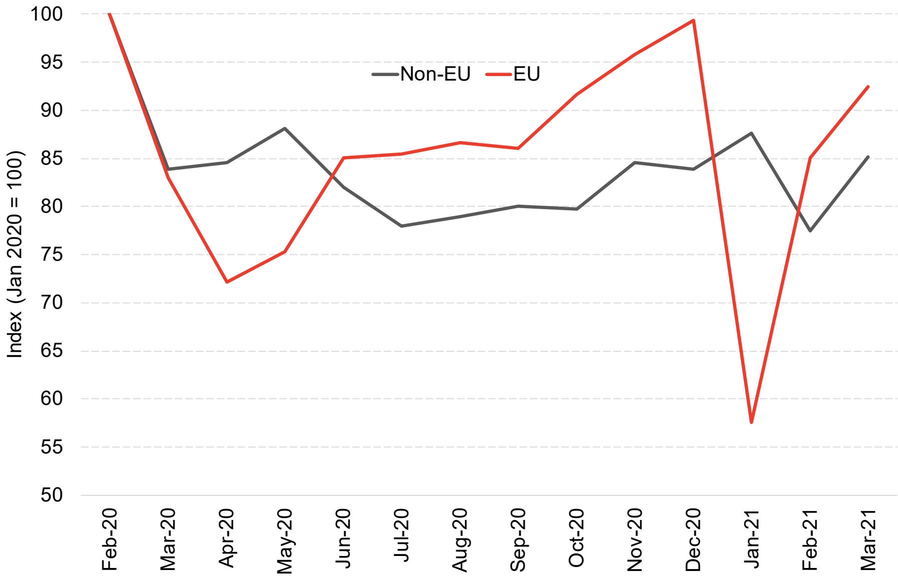
However, it also shows that the decline in EU exports may have been temporary and that once businesses have adapted to the new regulations EU exports have rebounded to levels more in line with long term trends.

Chart 25: Exports and imports of goods and services, UK, February 2020 – March 2021



Source: *UK Trade Statistics*

Chart 26: Exports to EU and Non-EU countries, UK, January 2020 – March 2021



Source: *UK Trade Statistics*

At a more disaggregated level, machinery and transport equipment was the most exported commodity from the UK to the EU. Machinery and transport equipment exports declined from around £4.9bn in January 2020 to around £2.6bn in April 2020.

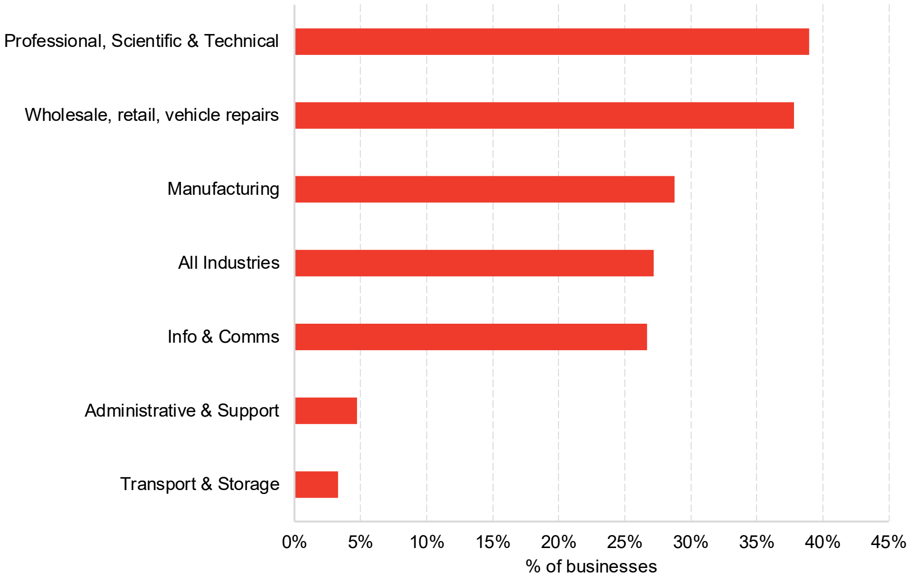
Exports of other commodities were modestly impacted at the start of the pandemic, but the decline was much stronger at the end of the EU transition period, when exports of all commodities fell.

As part of the UK's withdrawal agreement from the EU, Northern Ireland has remained a part of the EU customs union. This has resulted in trade frictions between NI and the rest of the UK.

More than a quarter of all businesses which typically trade with NI experienced decreased volumes of trade between 19th April and 2nd May.

Professional, scientific, and technical activities and retail have been the most affected industries with over a third of all businesses experiencing a decline in trade with NI.

Chart 27: Estimated share of businesses which typically trade with Northern Ireland and have experienced a decreased volume of trade with Northern Ireland, by industry, UK, 19 April – 2 May 2021

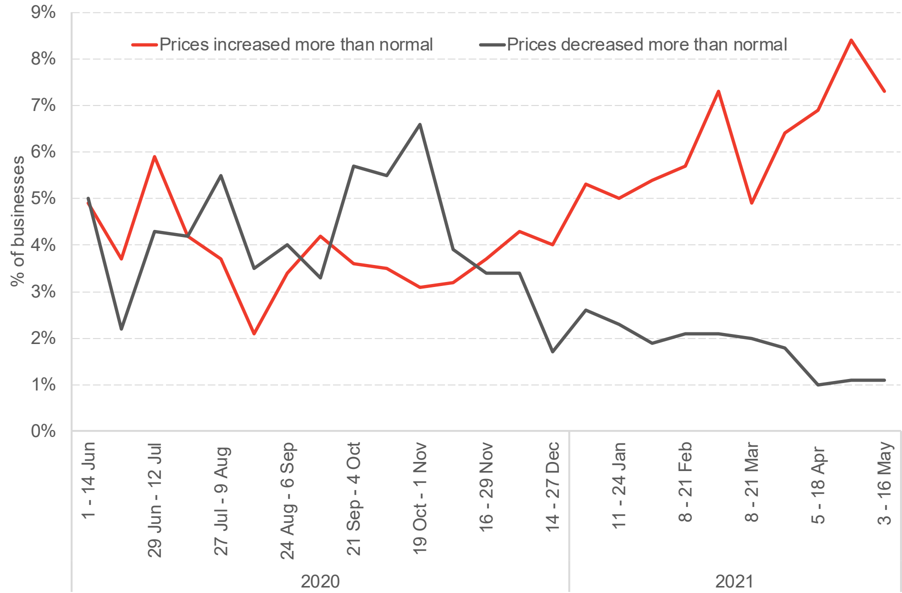


Source: *ONS BICS*

Since the start of 2021 there has been a gradual recovery in the demand for goods and services. At the same time, trade frictions, resulting from the end of the transition period and the pandemic, have put pressure on supply chains which take time to adjust to new circumstances.

Since the demand for goods has started exceeding the supply of goods in some sectors prices have started rising. This has led to upward inflationary pressures in the UK economy.

Chart 28: Share of businesses for which prices sold have increased/decreased more than normal, UK, 1st June 2020 – 16th May 2021



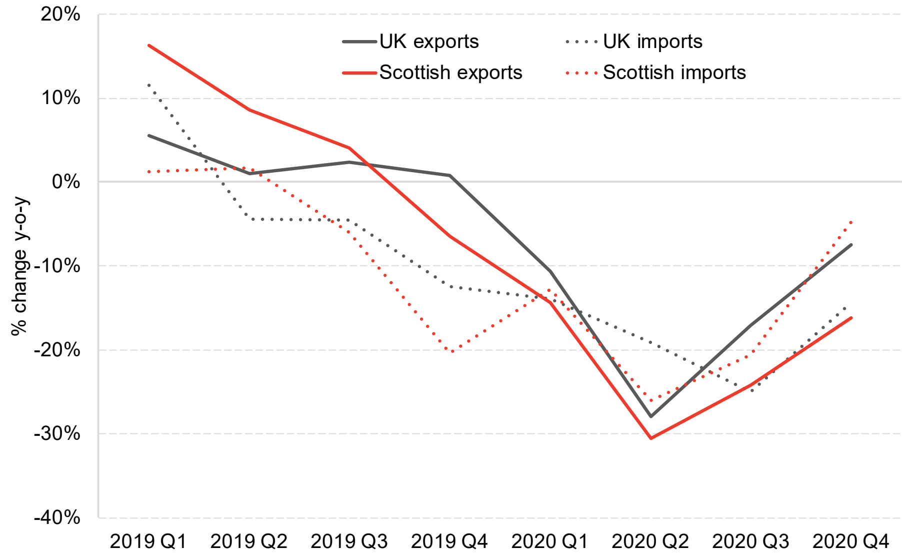
Source: *ONS BICS*

Scottish trade

Scottish trade has been slightly more affected by the pandemic than UK trade.

In Q2 2020 UK exports fell by 28% y-o-y while Scottish exports fell by 31% y-o-y. In the same period, Scottish imports contracted by 26% y-o-y, whereas UK imports fell by only 17% y-o-y.

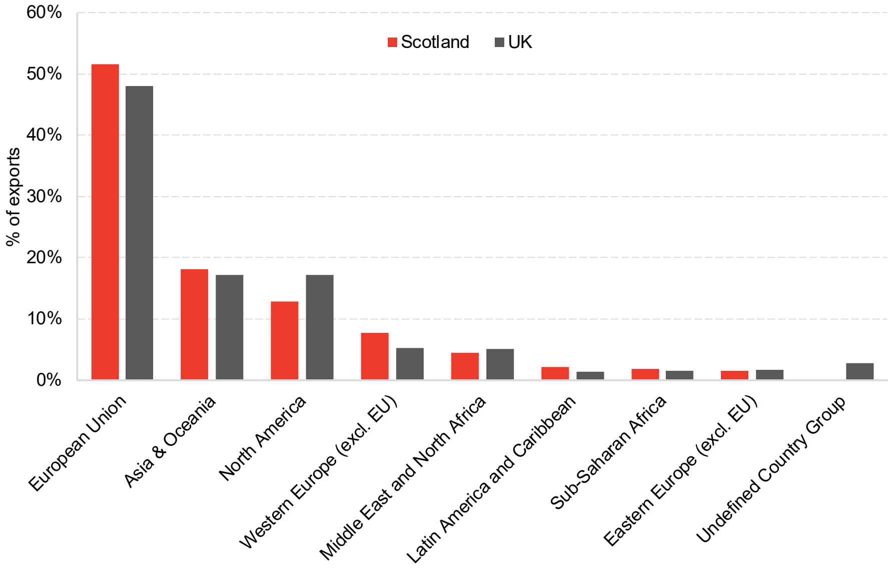
Chart 29: Exports and imports, Scotland and the UK, 2019 Q1 – 2020 Q4



Source: *ONS BICS*

The effect of the end of the EU transition period cannot be seen in the latest available regional trade data yet. However, as shown in Chart 30, Scotland has a slightly higher share of exports going to the EU compared to the share of exports going from the UK to the EU. As a result, Scottish exports are likely to have been more affected than UK exports.

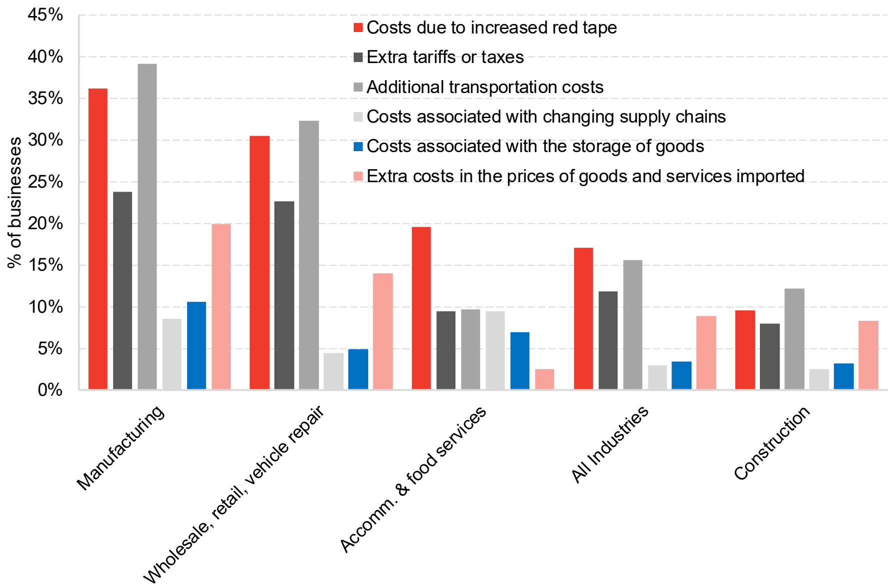
Chart 30: Share of exports by country group, Scotland and the UK, 2020



Source: *UK Trade Statistics*

Data from BICS shows the degree to which different industries of the Scottish economy have been affected by the end of the EU transition period. It shows that manufacturing has been the most impacted industry; where over a third of all businesses have incurred extra red tape costs. Retail and accommodation and food services have been the two other industries which have seen the highest increase in costs due to Brexit.

Chart 31: Estimated share of businesses incurring extra costs due to the end of the EU transition period by industry, Scotland, 19th April 2nd May 2021



Source: *Scottish Government, BICS*

Conclusion

Global trade contracted sharply at the start of the pandemic.

Trade in goods recovered back to pre-pandemic levels by the end of 2020, but trade in services continues to perform below pre-pandemic levels.

Trade in Scotland has been slightly more affected than trade in the UK. The end of the transition period appears to have had an even sharper month-on-month effect on trade with the EU than the pandemic did.

In subsequent months after the end of the transition period, trade activity rebounded quickly from the initial decline seen in January 2021. However, even five months after the end of the transition period, a considerable share of businesses are still incurring extra costs due to trade frictions with the EU and Northern Ireland.

In the long-run, the UK Government's pursuit of new deals could have important sectoral implications. The analysis in this section has shown that trade is being disrupted in the short-run by Brexit and the pandemic. However, the nature of trade and its implications for Scottish businesses will also be influenced by UK Government trade policy – over which the Scottish Government has no formal influence.

Homeworking and the future of work

In the last commentary, we discussed homeworking and how this new way of working had differential effects on each sector of the Scottish economy.

Compared to the end of 2020, where opinions varied, the consensus of most businesses at the beginning of this year were that homeworking is here to stay.

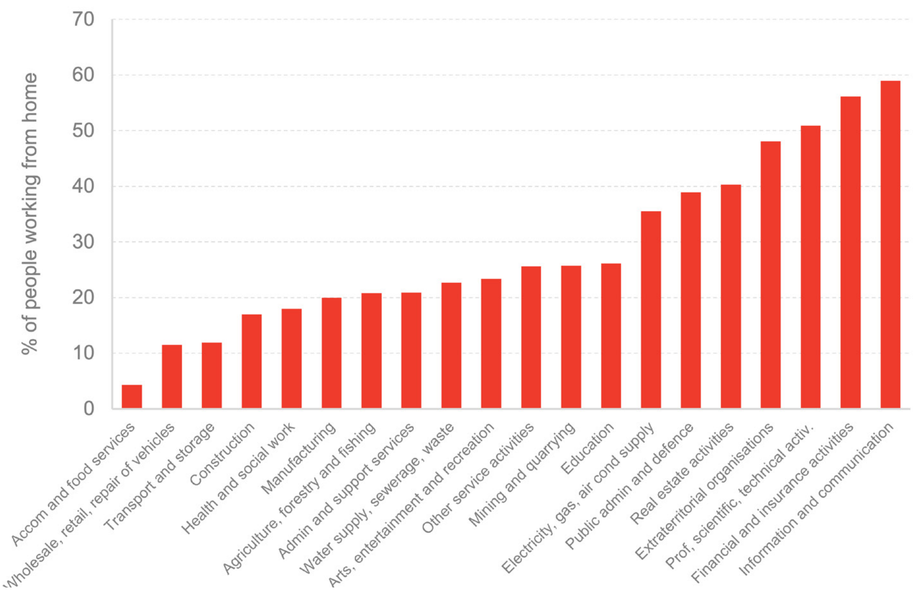
This section provides sectoral analysis on the opinions of businesses towards homeworking, and also gives insight into the factors being considered for those businesses expecting to permanently reduce their office footprint.

Homeworking by sector

The ONS estimate that around one quarter (25.9%) of people had worked at home the week before responding to the Annual Population Survey 2020, which compared to around 12.4% in 2019.

We know that given the in-person nature of many jobs, homeworking has been concentrated in certain sectors: Information and communications, financial and insurance, and professional, scientific, and technical activities were the sectors where homeworking was more prominent, Chart 32.

Chart 32: Percentage of people working from home the week before survey collection, UK, January to December 2020



Source: *ONS*

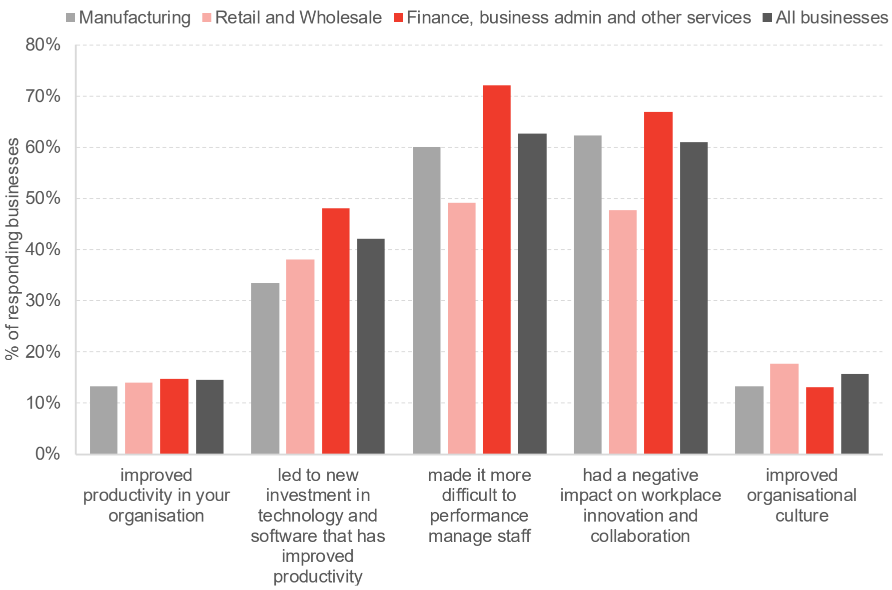
The findings from the APS were similar to that found in the most recent Scottish Business Monitor.

Most businesses across all sectors reported higher levels of staff working from home in Q1 2021 compared to Q1 of 2020, with homeworking more prominent in the finance, business admin and other services sectors.

The majority of businesses continue to report that homeworking has made it harder to manage the performance of staff. This result was prominent in the finance, business admin and other services sector. Chart 33.

However, whilst homeworking has made it difficult to foster workplace collaboration and manage staff, it has also led to new investment in technologies that have helped improve productivity, improved organisational culture and generally improved workplace productivity. The financial sector in particular has benefited from new technologies that have been adopted as a result of homeworking.

Chart 33: To what extent do you agree that staff home working in your organisation has...



Source: *Scottish Business Monitor*

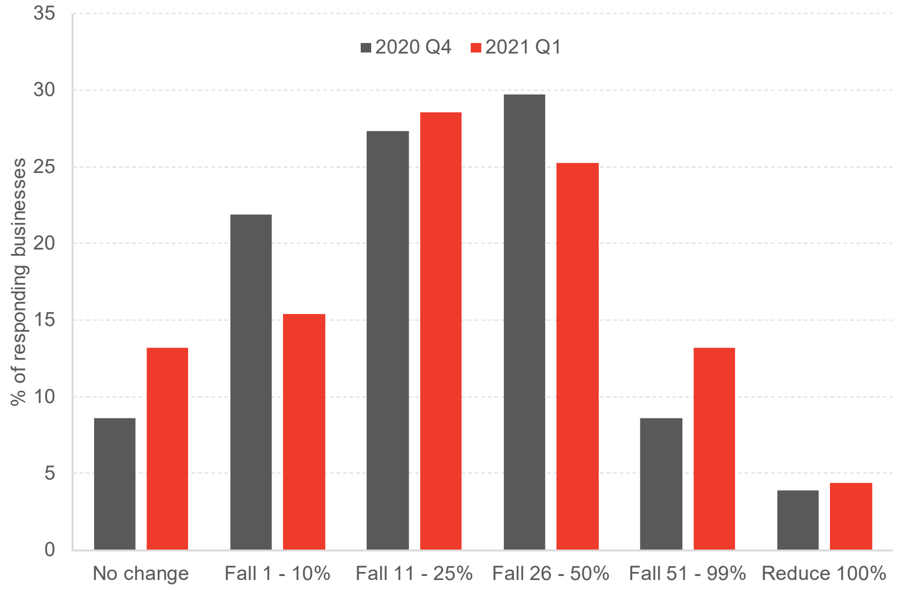
Long term implications of homeworking

What is clear from the latest Business Monitor is that homeworking is here to stay.

The largest share of businesses expect to permanently reduce their office footprint by between 11-25%. This was a reduction on what was reported at the end of 2020, where the average business was expecting to permanently reduce their footfall by between 26-50%. Chart 34.

There has also been a slight increase in the number of businesses expecting to completely reduce their office presence.

Chart 34: How much do you expect home working will permanently reduce your workplace footprint?



Source: *Scottish Business Monitor*

With this new way of working here to stay, much of the focus will now turn to the provisions and investments put in place to ensure that businesses can continue to operate. This will include considerations for the factors that are important for businesses when considering future offices and work spaces.

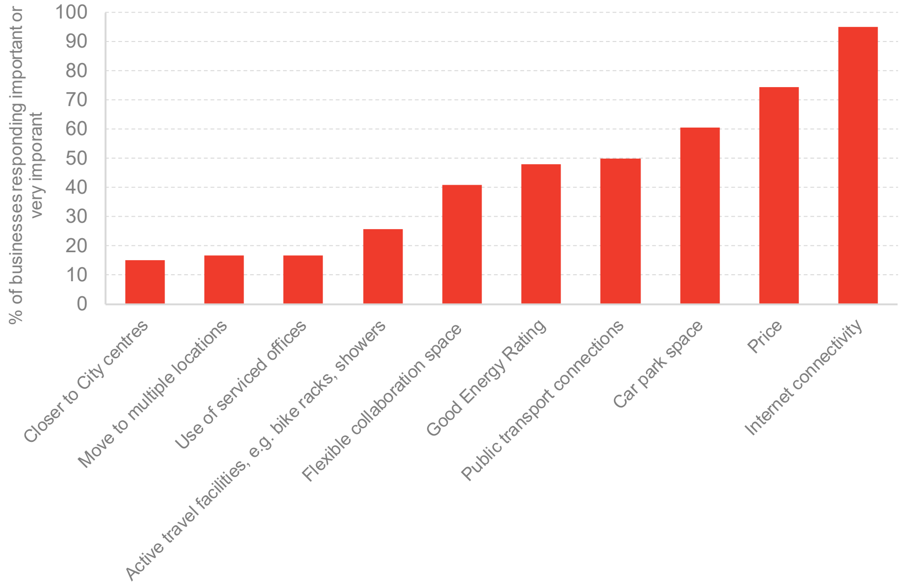
The most popular requirements for businesses over the next 3 years were internet connectivity, location costs and car parking space facilities. Chart35.

It is no surprise that price is an important factor for businesses when considering a shift in workplace. The past year has shown a lot of businesses that expensive office spaces filled to 100% capacity are not always the most optimal way of operating. Therefore, businesses that plan on changing their workspace will be determining the optimal office size for them, based on how many workers require to be in an office environment and the cost of different office spaces.

Additionally, given the reliance on technology during the pandemic, it comes as no surprise that nearly 100% of firms think good internet connectivity is essential for future workspaces.

With some concern surrounding the popularity of city centres post pandemic, the result that only 15% of businesses see proximity to city centres as an important requirement suggests the shift in location we may expect to see in the coming years.

Chart 35: If you are considering changing your workspace requirements over the next 3 years, how important are the following factors?



Source: *Scottish Business Monitor*

The results of the Business Monitor shed light on the impact that homeworking has had during the pandemic, and will continue to have over the coming years. With much of the discussion surrounding hybrid models of work - with only a few days per week in offices and the remainder at home - it appears businesses have significantly adapted to this new way of work.

For certain sectors and businesses, homeworking will be easier and carry more benefits than others.

But, for those planning to reduce their workplace footprint permanently, it will be important to ensure that any difficulties associated with home working, like managing staff, are overcome because, as discussed, there are opportunities, such as new productivity improving technologies or lower running costs, that can drive business productivity and growth in the coming years.

University of Strathclyde Business School

Fraser of Allander Institute
University of Strathclyde

The Fraser of Allander Institute (FAI) at the University of Strathclyde entered Scottish public life in 1975. Since then, it has become established as a leading independent economic research institute working with a wide range of clients on a variety of different topics.

What we do

For 45 years, the Fraser of Allander (FAI) has been monitoring and commentating on the Scottish economy. Our regular publications include:

- FAI Economic Commentary – Quarterly – First published in 1975, our quarterly Economic Commentary provides the authoritative independent assessment of economic conditions in Scotland, along with a wide range of economic and policy issues.
- Scottish Business Monitor – Quarterly – Since 1998, the FAI Scottish Business Monitor has been a key leading indicator of the Scottish economy. This survey of Scottish business sentiment provides vital insights into the Scottish economy well in advance of official statistics.
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