University of Strathclyde Business School

Fraser of Allander Institute

Economic Commentary

Vol 45 No 4

Deloitte.

Foreword

Over the course of this year, we saw an easing of restrictions which helped the Scottish economy grow by 1% during the third quarter of 2021. However, the arrival of the Omicron variant is bringing fresh uncertainty and new restrictions to all of our lives, and is a stark reminder of the unpredictability of this pandemic.

While the effects of the variant itself will take some weeks to fully understand, the implications of its rapid spread in our communities is an immediate concern for businesses. In addition, the restrictions announced this week will only add further complexity to the many operational changes and challenges on the horizon in 2022. In particular, according to Deloitte's latest CFO survey[1], conducted before the emergence of the Omicron variant, operating costs are expected to rise, with CFO's expecting a margin squeeze over the next 12 months. Labour shortages and supply chain disruptions are also expected to persist for at least a year, with no meaningful easing anticipated until late 2022 and 2023.

However, the latest Commentary does point to some progress over the last year. Fears around mass unemployment, particularly since the end of the furlough scheme, have not been realised and, while the Institute is clear that it is very difficult be certain in the current environment, the Commentary also forecasts a return to pre-pandemic levels of growth by May 2022 – albeit this is slightly later than forecast in September due to sluggish growth in the autumn. Additionally, over 83% of the Scottish adult population are double vaccinated and, given recent developments, there is now a herculean effort on 'booster' jabs, with the Scottish Government committing to giving these to all over-18s by the end of the year.

While the Omicron variant casts a shadow on progress to date, the hope is that many businesses already have resilient response strategies in place and that they have learned ways of maintaining activity in the face of high case rates and restrictions.

Of course, there are also other challenges ahead that will require attention, the most significant of which is climate change. The focus on this will accelerate in 2022 as the UK looks to meet COP26 commitments and as well as being high on the corporate agenda, it is also front of mind for the general public. Deloitte's latest State of the State[2] report found 31% of Scottish citizens surveyed would like the UK to be known globally for tackling climate change and protecting the environment – the highest response across the four UK nations.

To meet these expectations, business leaders have a lot to consider including how they plan to report on climate-related risks and opportunities – including the climate disclosures recently mandated across large companies and financial institutions by 2025 - as well as strategies for setting and achieving net-zero targets. The latest CFO survey found that CFOs see the climate transition as fundamentally reshaping the business environment. More than two-thirds expect a significant or wholesale change in their business model and operations over the next 10 years because of the move to net-zero emissions.

1 CFO Survey 2021 Q3.
2 State of the State 2021-22.

Decision making is also likely to be impacted by conversations around financing to fund climate action and steps to ensure climate equity. This will require shifts across industries and systems as well as the policy and regulatory landscape and while Governments will need to enable equitable industry-wide transformations, we as businesses also have a role in identifying how to modify non-sustainable operations[3]. To move forward, leaders will need to acknowledge and address the uncertainties, practical challenges, and questions associated with this significant change[4].

As we continue to focus on a greener, fairer and more sustainable recovery, organisations must also give consideration to the opportunities provided by the inclusive growth objectives of the Scottish Government and the UK Government's 'levelling-up' programme.

Findings such as those from Deloitte's latest State of the State report back this up, as it reveals that 46% of Scots believe skills and employability are the most important factors when trying to get ahead in life. However, it also found Scots feel more strongly than the UK average that wealth and region are also important indicators on getting ahead in society. Given this, there is clearly significant opportunity for business leaders to work collaboratively with local government, education establishments and other parties to deliver tangible results that will support economic growth for all, in all corners of our country.

While much is uncertain, business leaders can still prepare for these changes, as well as other unknowns, by prioritising long-standing challenges in a way that creates opportunities and weaves them into a long-term strategic vision[5].

Ultimately, if we can take one thing from the last two years, it's that yesterday's business doctrines are insufficient for 2022. To prepare, business leaders should take what they have learnt and apply it to a new operating environment. While this will require focus, creativity and some risk-taking, it will be essential as companies face the future.

Steve Williams
Senior Partner for Deloitte in Scotland
December 2021

3 See: Policy Perspective.
4 Ibid.
5 See: Article.

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ECONOMIC COMMENTARY

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Summary

The announcements this week will feel like groundhog day for many, with memories of the restrictions in the run up to and aftermath of last Christmas.

The threat of the new Omicron variant, which is likely to replace Delta as the dominant variant of COVID-19 by the end of this week, has led to fresh restrictions on the retail and hospitality sector. While many of these are not as severe as restrictions earlier in the year, it will worry many businesses operating in these hard hit sectors, particularly through this crucial Christmas period.

Despite the familiar feel of this December, in this edition of the Commentary, we consider how far we have come in the last 12 months. The economy is in a much better place than feared a year ago, underpinned by the delivery of the vaccination programme and the advancements made in understanding and treating the virus.

As as we moved through the first half of 2021, the prospects for growth in the economy continually improved. Despite growth faltering in the Autumn due to rising prices and supply chain constraints, expectations are much better for the outlook in 2022 and beyond, compared to what was feared earlier in the pandemic.

The removal of the furlough scheme, based on the evidence we have seen to date, has not had the negative impact on employment and unemployment that was feared.

However, what is emerging are early signs that Scotland's recovery may be lagging behind the UK as a whole.

In our forecasts in this edition, we are predicting growth of 6.4% in 2021, followed by 4.7% in 2022. The economy is now expected to get back to pre-pandemic levels in May 2022: one month later than predicted in September due to growth in the Autumn underperforming the previous forecast.

This economic context provided the backdrop to the Scottish Budget last week. The first Budget of this new session of parliament, and Kate Forbes' third Budget, saw some big choices made.

In a nutshell, these choices were to prioritise investments in health, social care and social security, and to risk the ire of local government with cuts to its core budget (offset by faster increases in additional resources for new commitments).

A deterioration in the outlook for income tax, driven by a poorer outlook for earnings in Scotland, has constrained the Budget envelope available to the Scottish Government. There was also a big policy surprise, with a faster than expected roll back of the reliefs for retail, hospitality and leisure businesses.

The government's flagship policy – not only for this year but also for the parliament as a whole – is clearly the Scottish Child Payment. This is genuinely a bold and distinctive policy. The doubling of the payment from the originally planned £10 per week to £20 per week means that it will make a substantial contribution to the government's 'mission' to tackle child poverty.

Fraser of Allander Institute
December 2021

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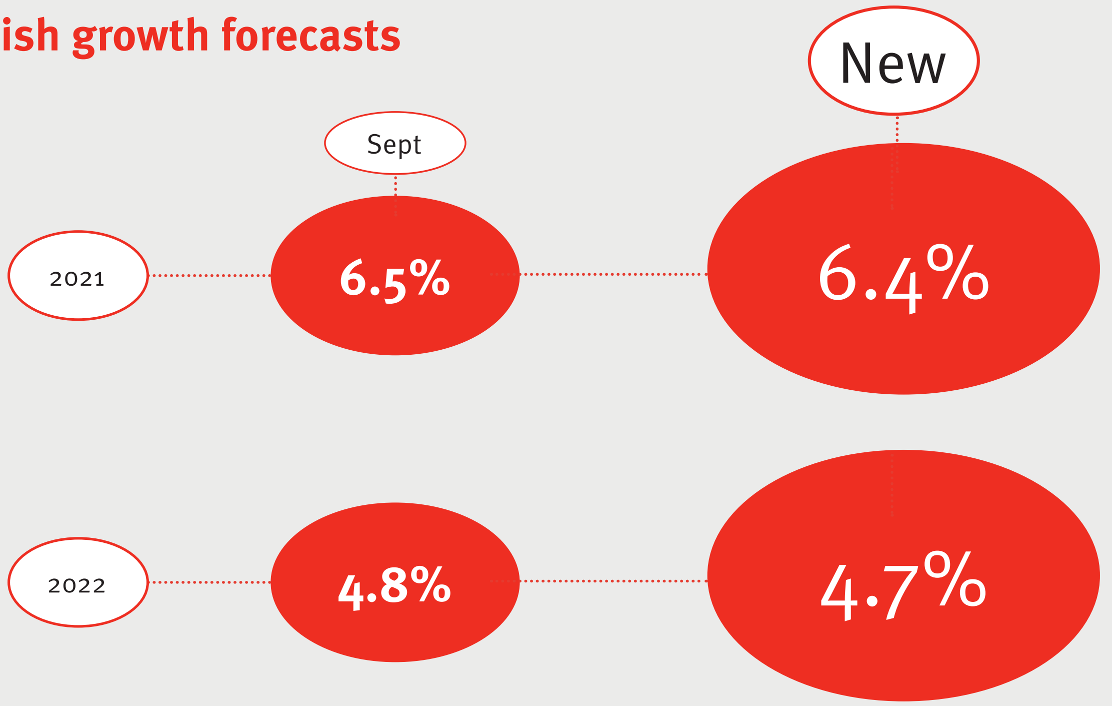
State of the economy

Indicator	% of Feb 2020 levels	Rate	Change on previous month / quarter	Performance	Latest data
GDP					
Total	98.9%		0.4%		September
Production	95.2%		-0.9%		September
Construction	100.0%		1.9%		September
Services	99.6%		0.5%		September
Labour Market					
Employment rate		74.6%	0.5 p.p.		Aug - Oct 2021
Unemployment rate		4.1%	-0.2 p.p.		Aug - Oct 2021

Scottish growth forecasts



	Trough	Return to pre-crisis level	Recovery time
September Commentary	*Apr-20*	*Apr-22*	*2 years*
New	Apr-20	May-22	2 years, 1 month

Outlook and Appraisal

Reflecting on the past year

A few weeks ago, reports of a new variant of COVID-19, Omicron, resulted in countries around the world reintroducing travel bans and tightening COVID-19 restrictions once again.

Weeks on, the Omicron variant is now quickly making its way through communities across the UK.

While the current situation feels like COVID groundhog day, it is important to remember the progress made in the past year.

Last Autumn, the vaccine race was in full swing, with the BioNTech/Pfizer vaccine victorious in being the first COVID-19 vaccine to be approved for use in the UK.

But, by Christmas, COVID-19 cases were increasing at a rapid rate.

A winter lockdown followed in the new year, and, again, businesses shut their doors, and thousands of workers went back on furlough. By early February, the share of businesses trading in Scotland fell to 81% - the lowest rate since early June 2020. See Chart 1.

During the winter lockdown, the spread of a new, highly infectious strain of COVID-19, the Delta variant, further dampened optimism.

But, the winter lockdown was coupled with a successful vaccine rollout, resulting in falling case numbers.

Restrictions began to ease in spring, and by summer, the openness of the economy was almost back to 'normal'.

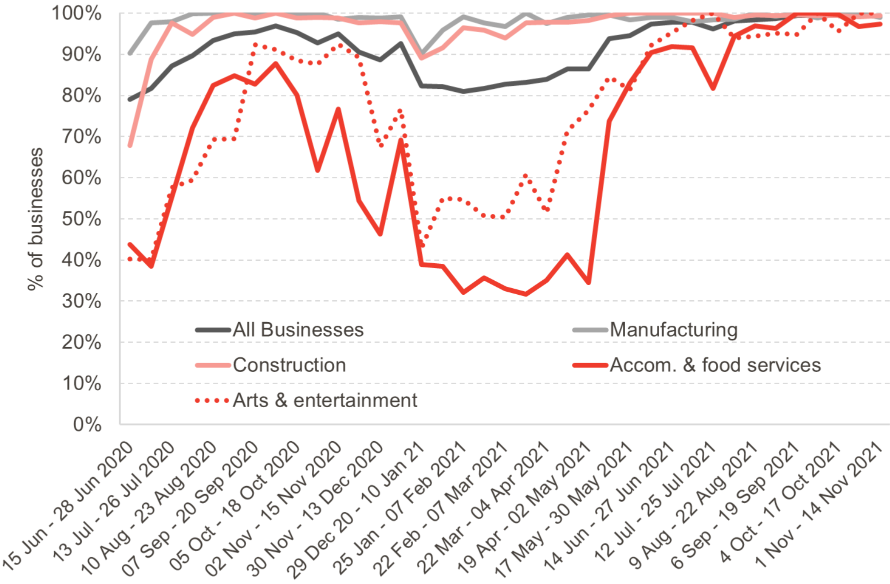
Social distancing in pubs, restaurants, and shops was no longer a legal requirement by August. And, after being closed for over 500 days, nightclubs and music venues opened their doors again. By Mid-August, the share of businesses trading peaked at 99% and has stayed there since.

With the - almost - end of COVID-19 restrictions came an increase in optimism.

Households began spending some of the money they had saved up over the past year and started socialising more regularly, visiting nightclubs, attending concerts and festivals, and holidaying abroad. In Q2 of 2021, household expenditure increased by over 22% compared to the same quarter in 2020.

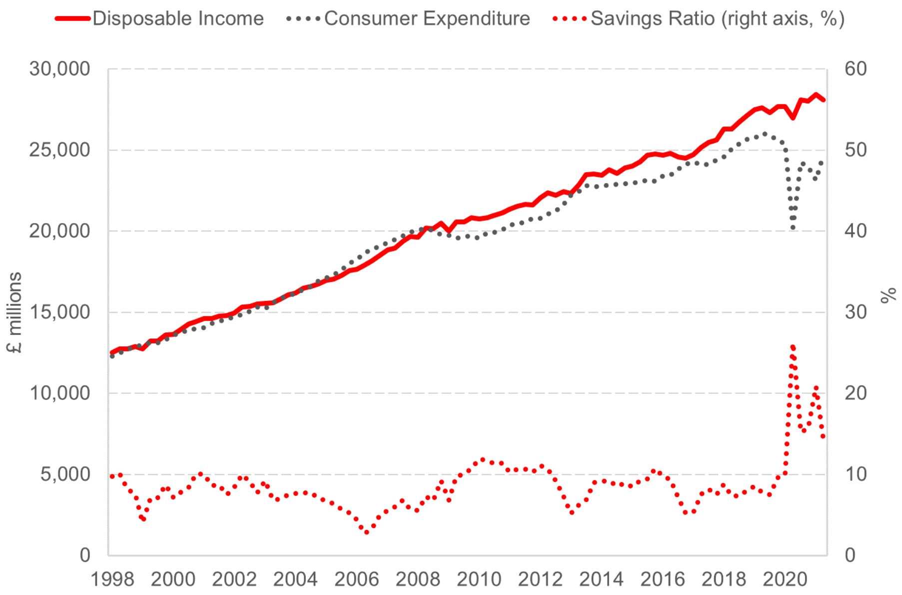
With income increasing by just 5% over the same period, the household savings ratio fell to 14.4%, down almost 12-percentage points (p.p.) from its peak of 26.2% in Q2 2020. See Chart 2.

Chart 1: Share of businesses currently trading, Scotland, 15th June 2020 - 14th November 2021



***Source:** Scottish Government*

Chart 2: Household sector income, expenditure and savings, Scotland, 1998-2021



***Source:** Scottish Government*

This increase in household spending is expected to continue into Q3 as households increasingly feel more relaxed this year towards spending money than they were last year.

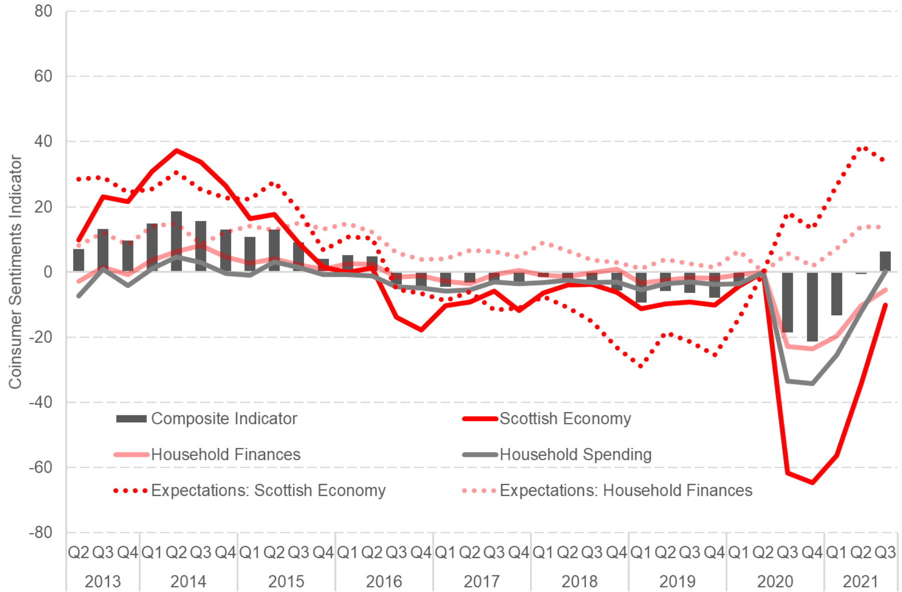
In Q3 of 2021, the Household Spending Indicator[1] rose by 12.3 points to 0.2, the first positive net balance in six years. See Chart 3.

As a whole, consumer confidence has improved significantly over the past year.

1 This indicator shows how 'relaxed' consumers currently feel about spending money relative to 12 months prior.

The consumer sentiment composite indicator reached 6.5 in the latest quarter, up 7.3 compared to Q2 2021, and the first positive result for this indicator since Q2 of 2018.

Chart 3: Consumer sentiment indicators, Scotland, Q1 2013 - Q3 2021



Source: *Scottish Government*

While the current consumer sentiment indicators increased in the latest quarter, expectations of the economy's performance and household finances contracted.

This contraction in consumer sentiment about the future occurred before the Omicron variant was first identified in South Africa last month. However, Q3 of this year saw rising prices, driven by increased demand from households and soaring energy costs. Increasing concerns of inflation were also coupled with sluggish growth across the economy, overall dampening optimism.

In the month of September, the production sector contracted by 0.9%. The sector reached pre-pandemic (February 2020) levels in June however, experienced contractions every month since - production is now 4.8% below February 2020 levels.

While output in the manufacturing industry expanded in the latest month, it declined by 6% between June and August. In the latest monthly data, electricity, gas, and water supply sub-sectors contracted significantly.

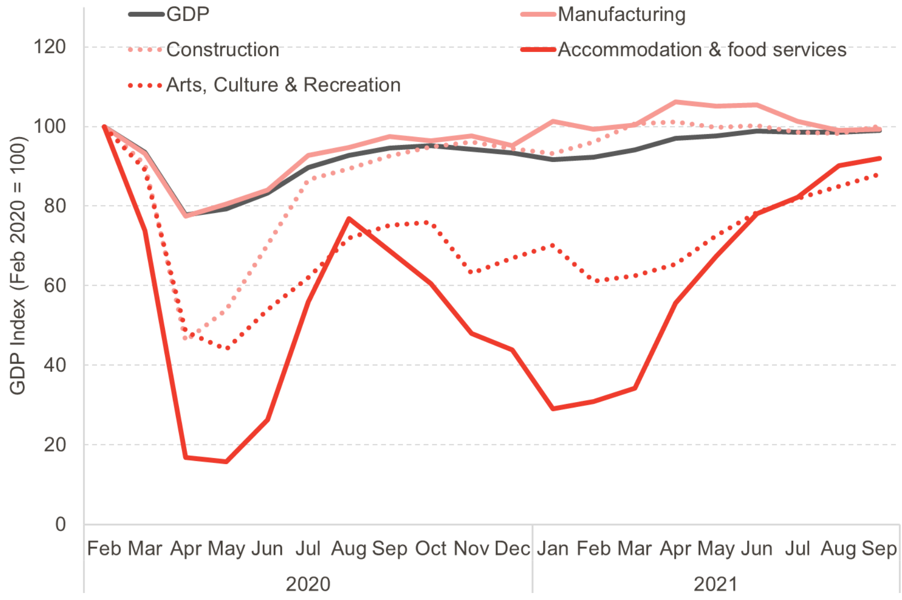
Despite output growing by 1.9% in the construction sector in September, the industry contracted consecutively between July and August, resulting in an estimated decline of 1.5% on the quarter. For the third time this year, the construction sector has returned to pre-pandemic levels.

However, services, which make up the lion's share of GDP, grew by 0.5% in September. The sector is now 0.4% below February 2020 levels.

Overall, Scottish GDP increased by 1.1% in September, compared to 0.6% in the UK. See Chart 4.

As of September, Scotland is 1.1% below pre-pandemic (February 2020) levels, slightly lagging behind the UK's economic recovery (0.6% below pre-pandemic levels).

Chart 4: GDP, Scotland, February 2020 - September 2021



Source: *Scottish Government*

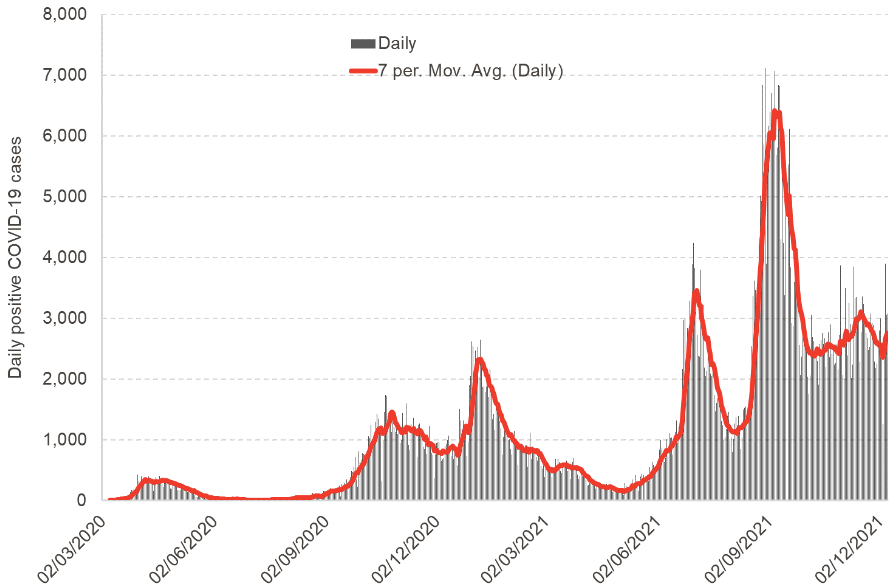
Where are we now?

The number of people testing positive for COVID-19 peaked in late August/early September, following the end of the school summer holidays. See Chart 5.

While case numbers calmed by October, they have remained fairly high since.

The Omicron variant has begun making its way through communities across the UK, and it remains to be seen how effective the COVID-19 vaccines, including boosters, will be in suppressing the impact of this new mutation of the virus.

Chart 5: Number of reported daily new cases and 7-day rolling average, Scotland, 2nd March 2020 - 2nd December 2021



Source: *Scottish Government*

Therefore, the immediate outlook for the economy is highly uncertain.

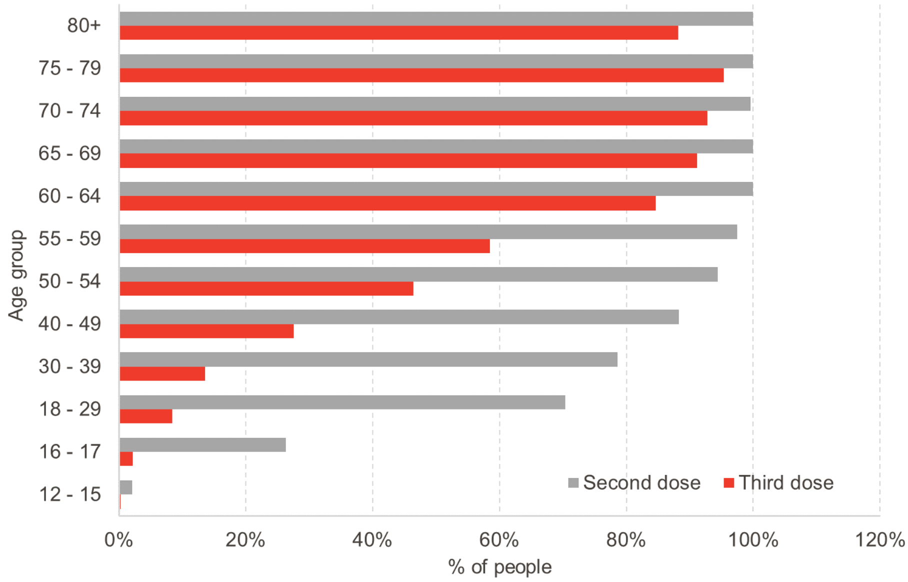
It is, for the most part, unclear how much more contagious and dangerous Omicron is than the Delta variant of COVID-19. However, despite these uncertainties, the economy is in a much stronger position to overcome this latest variant than last winter.

Last Christmas, few had received their first dose of the COVID-19 vaccine. Now[2], 83.0% of the Scottish population (12+ years) have received their second dose, and 42.6% have received their third, 'booster', dose.

Additionally, almost 100% of people aged 60+ have been double jabbed, and the majority have now received their booster too. See Chart 6.

However, attempts to get groups of younger people on board with vaccines remains a challenge. Just 70.4% of 18-29-year-olds have received their second dose.

Chart 6: % of population who have received second and third dose of a COVID-19 vaccine, Scotland, 10th December 2021



Source: *Scottish Government*

Given the events of this week so far, vaccination numbers across the board are expected to rise significantly this month.

On the 12th of December, the UK's coronavirus alert level was raised from level three to four due to rising case numbers and the spread of the Omicron variant.

During a televised speech on the same night, Boris Johnson spoke of the effectiveness of vaccines in curbing COVID-19 cases, urging the public to "Get Boosted Now".

The Prime Minister announced a "national vaccination mission", offering the booster vaccine to every adult (aged 18+) who received their second dose at least three months ago.

This week, Nicola Sturgeon also announced ambitions to offer booster appointments to all over-18s by the end of this year. This was coupled with fresh restrictions for the retail and hospitality sector which may well dent the hopes for growth over the important Christmas period.

2 As of 10th December.

UK Economy

It is hoped that boosters, homeworking and mask-wearing will curb the spread of Omicron over the festive period.

England has therefore seen masks return, making mask-wearing on public transport and certain indoor areas a legal requirement across all of the UK's nations. Once again, workers are encouraged to work from home.

Due to the new Omicron strain, travel restrictions have been put in place for travellers arriving in the UK. Anyone coming into the country will now need a pre-departure COVID-19 test.

Any further restrictions could hinder the UK's economic recovery which is already beginning to slow down.

The latest GDP data for the UK shows that the UK economy grew by just 0.1% in October, driven by growth of 0.4% in the services sector, particularly human health services and GP activities.

Accommodation and food services contracted in the latest month by 5.5% due to a 7.5% decline in food and beverage output within restaurants.

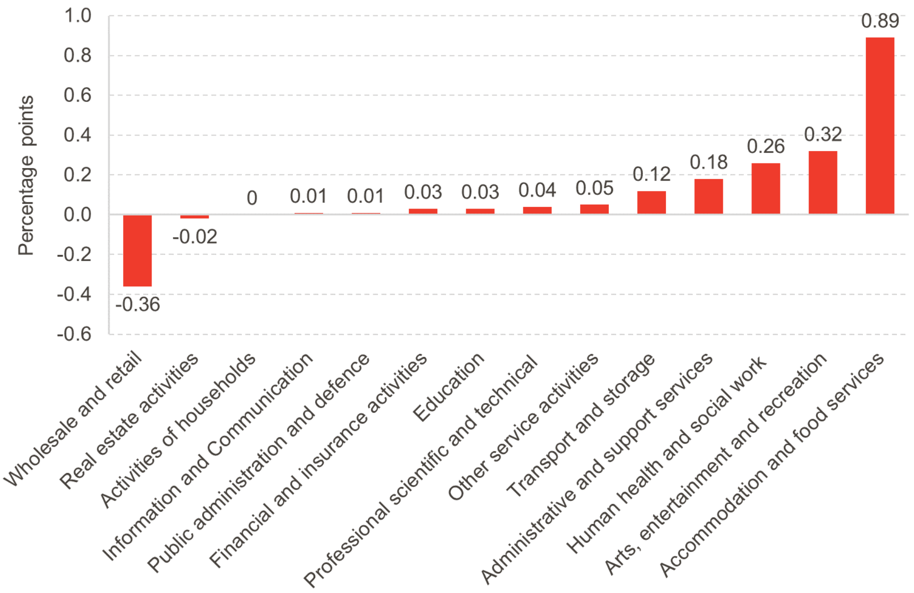
Production and construction contracted by 0.6% and 1.8% respectively, with the fall in construction output being the largest decline since April 2020.

In terms of quarterly growth, the UK economy grew by 1.3% in Q3 of this year, with production increasing by 0.8%.

With clubs and large events like festivals taking place over summer for the first time since the pandemic began, it is unsurprising that growth in the services sector (1.6%) was driven mostly by expansions in hospitality (30%) and arts & recreation sectors (20%). See Chart 7.

During this period, output in the construction sector fell by 1.5%, with all of its industries contracting due to supply chain issues and soaring material prices.

Chart 7: Contributions to services growth, UK, Q3 2021



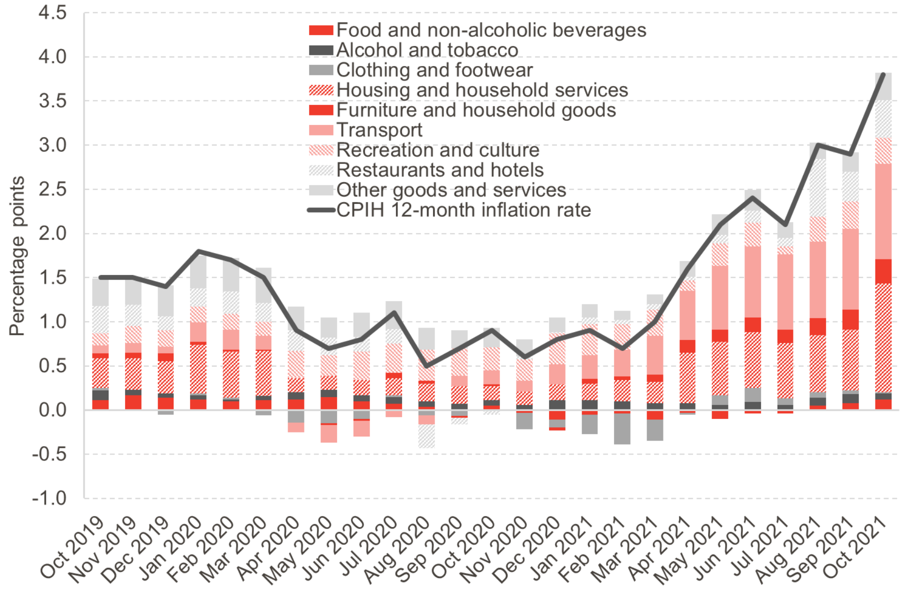
Source: *ONS*

Inflation has been a key feature of the economic recovery from the ongoing pandemic.

The Consumer Prices Index (including housing costs, (CPIH)) increased by 3.8% on the year to October 2021.

The largest contributor to inflated prices was housing and household services (1.23-p.p.), driven by electricity, gas, and other fuel prices. See Chart 8.

Chart 8: Contributions to the CPIH 12-month inflation rate, UK, October 2019 - October 2021



Source: *ONS*

Additionally, transport prices, including the cost of petrol and the price of used cars, have increased significantly over the past year - driven by the reopening of the economy and consequent upwards shifts in demand, and the global car parts shortages experienced this year by car manufacturers.

While inflation and the Omicron variant present immediate economic challenges, it is not all doom and gloom.

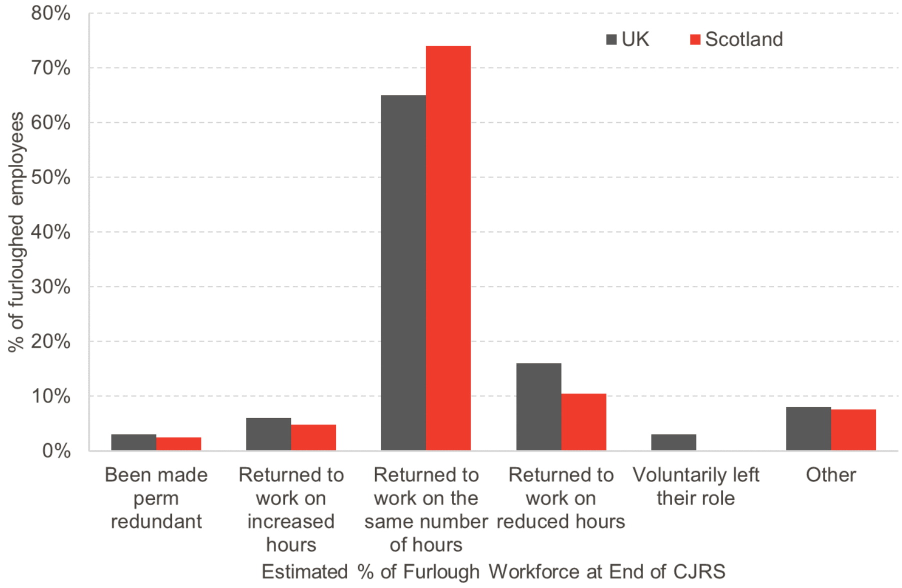
To date, vaccines have successfully suppressed the virus, and the fear that previous lockdowns would result in mass unemployment has not been realised.

So far, it seems as if the furlough scheme supported the labour market exactly how it intended to.

The ONS BICS survey provides some of the best evidence of the impact of the Coronavirus Job Retention Scheme (CJRS) ending on employment.

Of the employees on furlough leave at the end of the CJRS, the majority returned to work on the same number of hours across Scotland and the UK. See Chart 9.

Chart 9: Employee outcomes following end of the CJRS, UK & Scotland, 18th October - 31st October

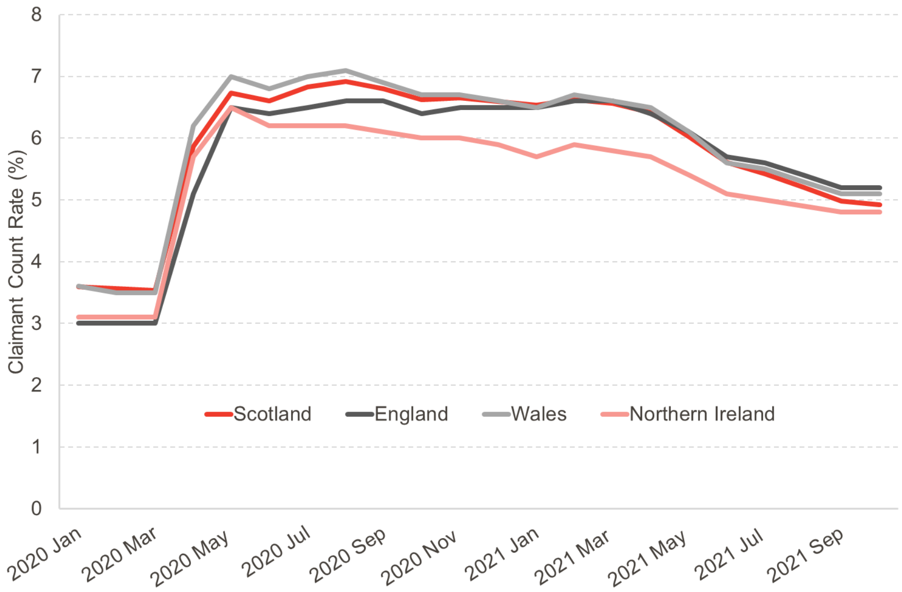


Source: *ONS, Scottish Government*

This chimes with what other key indicators highlight – a lack of much change in unemployment.

The first month of claimant count (those accessing unemployment-related benefits) data covering the period - October 2021 - after the end of the furlough scheme shows that the claimant count rate fell across the UK after CJRS came to an end. See Chart 10.

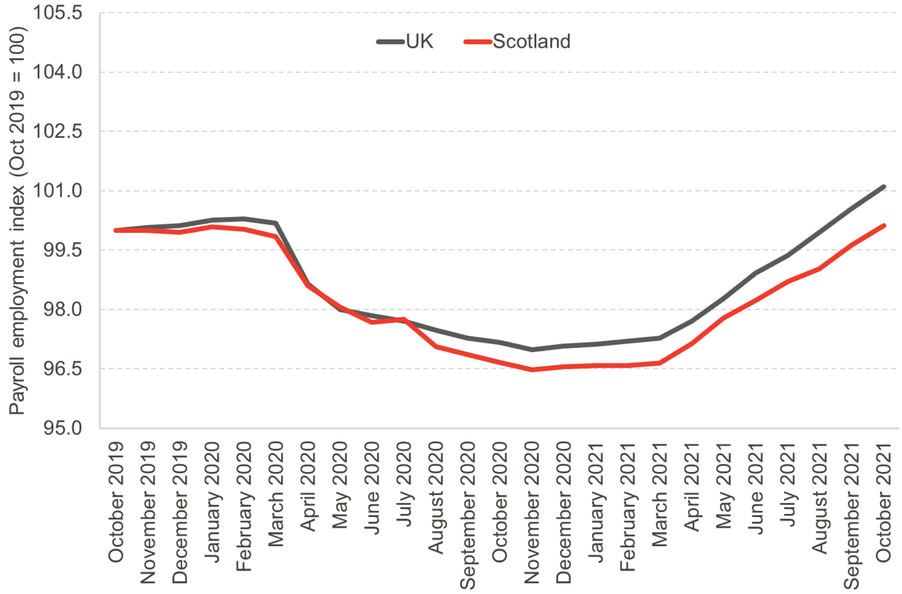
Chart 10: Claimant count rate, Four nations of the UK, January 2020 - September 2021



Source: *ONS*

Additionally, October saw 83,000 more people registered for PAYE than last year, meaning there is now the same number of people registered for PAYE as that in October 2019, almost six months before the pandemic took hold of the UK. See Chart 11.

Chart 11: Payroll employment index, Scotland and UK, February 2020 - September 2021



Source: *ONS*

On the other hand, the number of self-employed people in the UK continues to fall, with self-employment lower by 13,000 in July-September than in April-June.

As of the latest quarter, there are 4,268,000 people self-employed in the UK, down over 700,000 since the first quarter of 2020.

Despite this, the labour market overall is performing better than expected.

The latest ONS data for vacancies shows that there were 1,172,000 vacancies in the UK in August – October 2021, with construction, transport and storage, and the hospitality sector showing a significant increase in labour demand.

While furlough has, from what we can currently tell, done its job well, and vacancies are booming, this does not negate the short-term labour shortages in sectors demanding more labour, and the potential labour shortages brought on by self-isolation.

Given that, vaccinated or not, contacts of someone who has contracted the Omicron variant must self-isolate for ten days, this could add supply-side pressures to businesses this winter.

Looking further ahead, there are concerns around the long-term impact that 'long COVID' could have on the health and productivity of the workforce.

Earlier this month, the ONS reported that 1 in 50 people in the UK are living with long COVID, just under 2% of the UK population.

Longer-term scars of the pandemic make overcoming challenges like the productivity puzzle all the more difficult.

But, the immediate challenge is recovering from the impact of COVID-19, and most forecasters expect the UK economy to reach pre-pandemic levels at the turn of the year.

In the next few years, growth is expected to be driven by consumption, with supply chain issues and rising inflation acting as significant challenges facing the economy.

While the latest forecasts do not account for the potential impact of Omicron, given how recently the variant was identified, or the true effect of furlough ending, they still reflect a slight reduction in expected growth given the sluggish performance of the economy in the second half of the year.

Recent forecasts project GDP growth in 2021 to be between 6-7%, followed by growth of around 5% in 2022. See Table 1.

Afterward, more 'standard' growth rates of around 2% are expected.

Table 1: Forecasts of the UK economy, 2021 - 2023

	2021	2022	2023
BoE	7	5	1.5
OBR	6.5	6.0	2.1
NIESR	6.9	4.7	1.7
IMF	6.8	5.0	1.9
OECD**	6.9	4.7	2.1
Oxford Econ	6.9	5.4	-
ITEM Club	6.9	5.6	-
HM Treasury*	7.0	5.0	-

**Average of latest forecasts, including forecasters not included in this table (November)*

***Published December (not included in HM Treasury report).*

Source: *BoE, OBR, NIESR, IMF, OECD, Oxford Econ, ITEM Club, HM Treasury*

It is important to note that once we reach pre-pandemic levels, the groundwork needed to build a stronger economy must begin.

As we have said before, COVID-19 presents the biggest challenge of this generation for the economy, and it has exacerbated many existing issues our economy has been facing and will continue to face in the decades to come.

COVID-19 has made tackling 'grand challenges', like the productivity puzzle and the climate crisis, discussed in last quarter's commentary, even harder.

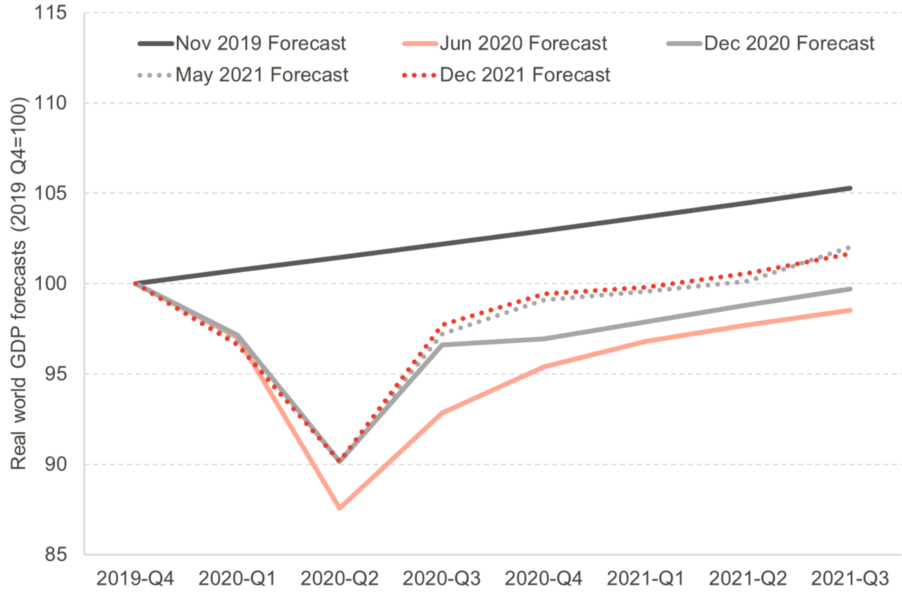
It is important that, if faced with another crisis on this scale, the UK economy is in a stronger position to handle its impact.

Global Economy

Like the UK, the global economy's recovery from COVID-19 has been quicker than previously expected.

Due to the fast-paced rollout of the COVID-19 vaccine across developed economies, and unexpectedly high consumer demand, forecasts of the global economy have improved. See Chart 12.

Chart 12: Forecasts of world GDP, Q4 2019 - Q3 2021



Source: *OECD*

Recent projections suggest that growth in the UK economy will exceed growth in the global economy throughout 2021 and 2022.

However, following this, the consensus is that growth in the global economy will overtake growth in the UK, averaging around 3% in 2023. See Table 2.

Table 2: World GDP growth projections 2021-2023

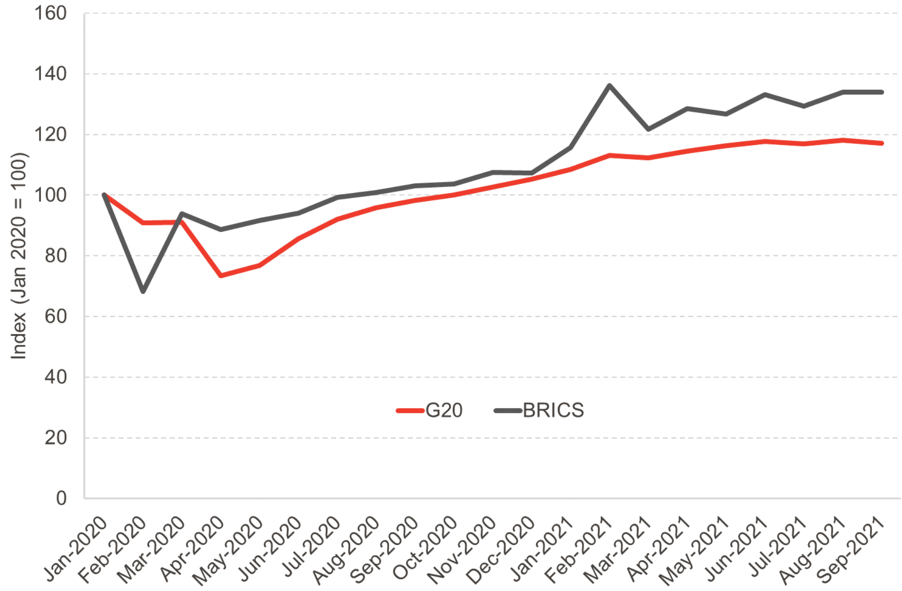
	2021	2022	2023
BoE	5.0	3.75	3.0
EC	5.7	4.5	3.5
NIESR	5.8	4.3	3.7
OBR	5.9	4.9	3.7
OECD	5.6	4.5	3.2
IMF	5.9	4.9	-

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

The bounce back in global trade has supported the ongoing recovery of the global economy.

BRICS countries reached pre-pandemic levels of trade in July 2020, and the G20 reached pre-pandemic levels in August 2020. See Chart 13.

Chart 13: G20 and BRICS Exports in goods, January 2020 – September 2021



Source: *OECD*

However, more recent data from the WTO's Goods Trade Barometer[3] suggests a reduction in the pace of trade expansion, driven by supply chain disruption.

Production in the automobile sector saw a sharp decline in recent months, driven by shortages in the supply of semiconductors.

Trade relating to electrical components and agricultural raw materials also declined, with further reductions in container port activity and overall export demand.

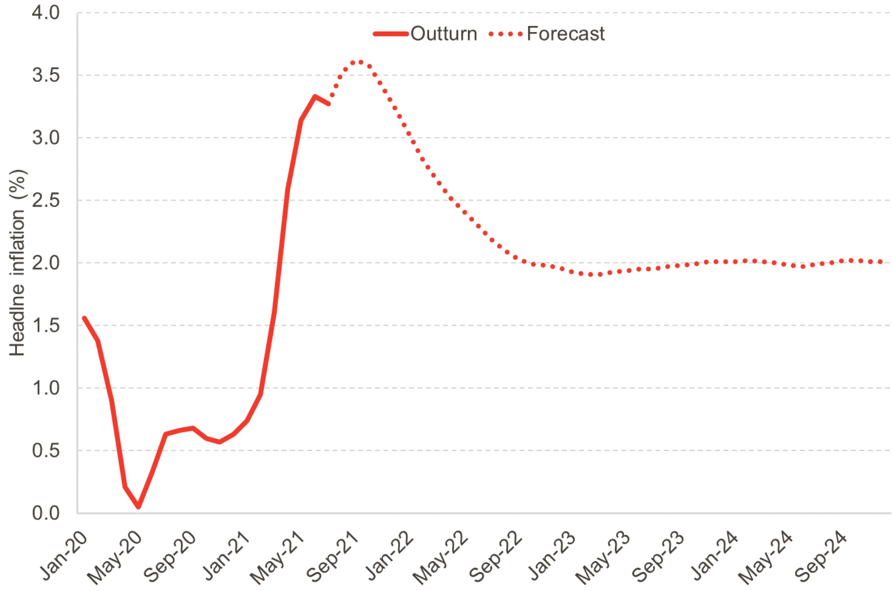
As firms sought alternative forms of transport for their goods - as shipping backlogs continued to cause disruption - air freight trade increased and was the only component of the index that remained above trend.

These supply chain issues, coupled with soaring energy prices and labour shortages, and consequent wage rises, have resulted in rising inflation.

The IMF predicts inflation will peak at 3.6% near the end of 2021, before falling to the worldwide inflation target of 2% in the middle of next year. See Chart 14.

3 See WTO.

Chart 14: Global inflation forecast, January 2020 -December 2024



Source: *IMF*

Whilst inflation remains an immediate challenge for the global economy, recent research from the OECD indicates that high levels of economic scarring in low-income and some emerging market countries could present longer term challenges for the global outlook.

On the other hand, many advanced economies are expected to face challenges related to higher debt levels and depressed underlying growth potentials.

However, the immediate outlook is dominated by COVID-19 cases and the new Omicron variant.

At the start of December, 264 million cases of COVID-19 had been recorded globally, with COVID-19 cases rising sharply in recent months.

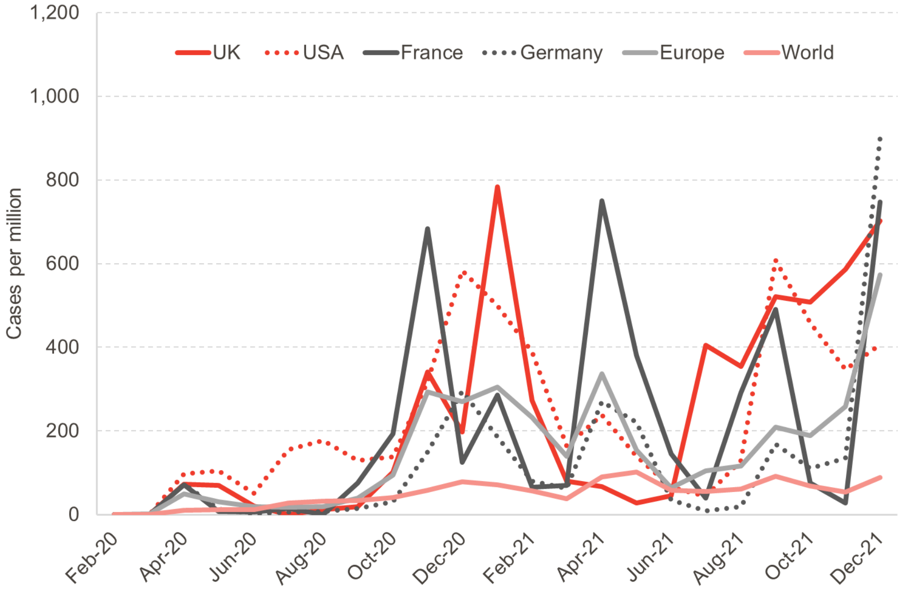
In Europe, this has been acutely felt. See Chart 15.

In an effort to address rising COVID-19 cases, countries have made efforts to rollout vaccinations. In the UK, 171 vaccines per 100 people had been administered at the start of December, bringing the total number of fully vaccinated people in the UK up to 68%.

However, in the global economy, only 43% of the global population has been vaccinated, with many developing countries lagging behind.

With the risk of further COVID-19 variants, concentrations of low vaccination rates in several developing countries could create the risk of new variants, putting global recovery efforts at risk.

Chart 15: COVID-19 cases per million, 1st February 2020 – 1st December 2021



Source: *Our World in Data*

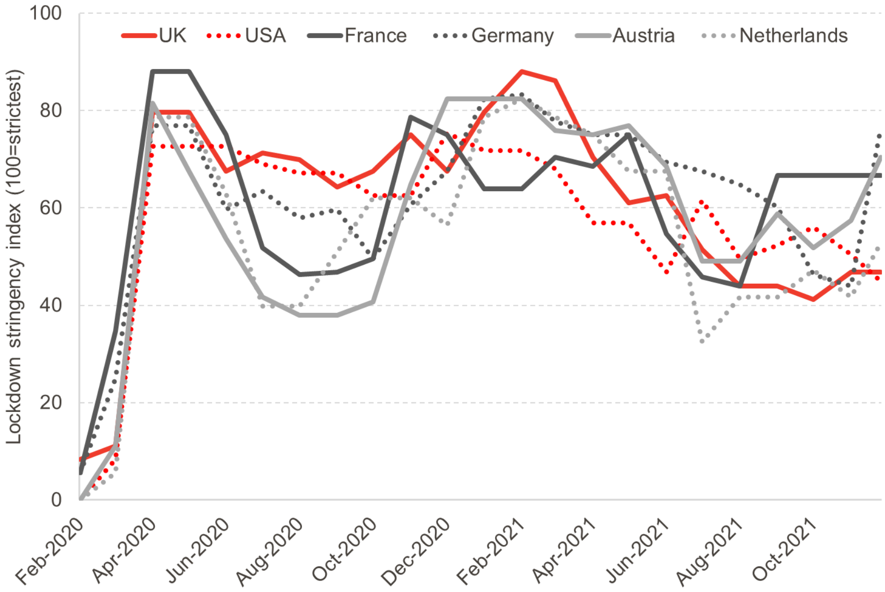
Due to rising cases, and the threat of the new omicron variant, lockdown restrictions have become stricter in several countries. See Chart 16.

The Netherlands has recently announced a new lockdown, and Germany has implemented strict restrictions on those unvaccinated.

The UK is still maintaining a more relaxed approach to lockdown restrictions since the easing in Spring. However, with rapidly rising case numbers, there is a risk that this could change in the coming weeks or months.

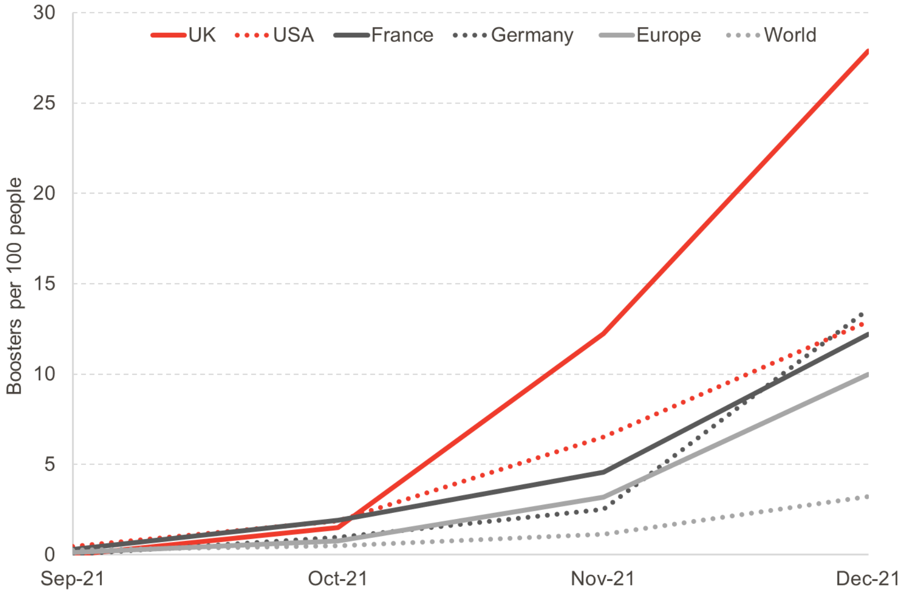
Owing to this, several countries have accelerated their booster rollout. See Chart 17.

Chart 16: Lockdown stringency index, 21st January 2020 – 26th November 2021



Source: *University of Oxford*

Chart 17: COVID-19 booster vaccinations administered per 100 people, 1st September 2021 – 1st December 2021



Source: *Our World in Data*

The UK is one of the leading countries in the rollout of these boosters, administering the 5th most vaccines globally relative to their population.

It remains to be seen how effective vaccines will work against the Omicron strain of COVID-19 however, the past year has undoubtedly shown the power of vaccines in suppressing the spread of the virus.

The Scottish Budget: 2022/23

Kate Forbes billed her first budget of the parliament as a ‘transitionary’ budget of ‘choices’.

In a nutshell, these choices were to prioritise investments in health, social care, and social security and to risk the ire of local government with cuts to its core budget (offset by faster increases in additional resources for new commitments). The biggest surprise was the faster rollback of non-domestic rates reliefs than many had anticipated.

There were certainly some big choices made.

- The health budget will increase by a huge £1.8bn to deal with the pandemic’s legacy on the health service, longer-term demographic change, and other commitments to address specific issues on drugs deaths and mental health.
- The first stage of reforms to social care, following on from the Feeley review, could be seen in additional resources (£170m) for local government to pay a higher wage floor to social care workers, an additional £200m to support health and social care integration, and £124m to begin the expansion of social care access.
- Local authorities will also receive an additional £145m to recruit 4,000 additional teachers and support staff in this parliament.

The government’s flagship policy – not only for this year but also for the parliament as a whole – is clearly the Scottish Child Payment. This is genuinely a bold and distinctive policy. The doubling of the payment from the originally planned £10 per week to £20 per week means that it will make a substantial contribution to the government’s ‘mission’ to tackle child poverty. The policy is likely to reduce child poverty by around 4 percentage points, from the current 24%. The initial cost of £200m in 2022/23 will rise to £360m once fully rolled out.

The budget policies mentioned above, while substantial in terms of funding and bold in terms of vision, were all anticipated (Kate Forbes would dearly loved to have been able to announce the uplift in the Child Payment on budget day, which would have brought her budget speech a welcome spark, and become the key headline – as it was, the First Minister had stolen the glory with the announcement at the previous week’s party conference).

But the budget did contain two surprises – one on tax policy and one on tax forecasts.

The big policy surprise was the decision to roll back non-domestic rates reliefs for retail, hospitality, and leisure businesses more rapidly than many had anticipated. While these businesses have received full relief in 2020/21 and 2021/22, they will receive relief of 50% for the first three months of 2022/23 only.

What made this a surprise was that it is a significantly less generous policy than the one that will exist in England next year, where businesses will receive 50% relief for the whole year. The Scottish Government has in recent years been keen to emphasise the more competitive nature of business rates in Scotland than down south.

But on balance, it feels like a prudent decision. Providing reliefs costs the government vast sums in lost revenues (the full reliefs have cost over £700m this year, whereas the partial reliefs next year will cost a little over £50m). And while there was a good case for providing reliefs at the height of the pandemic and during its aftermath, it is much more difficult to make a case for their continuation. A prolonging of reliefs is unlikely to have economic benefits that would justify the costs.

The other surprise was in relation to income tax forecasts. Since its last forecasts in August, the SFC has wiped £400m off its income tax forecast for 2022/23. It is not immediately clear what specifically caused the abrupt downwards adjustment. But it is clearly not good news for the Scottish budget.

The upshot is that, despite a tax policy that raises Scottish tax revenues by around £500m compared to what would be raised with the UK policy, the Scottish budget (under the latest forecasts for 2022/23) will actually be worse off with income tax devolution than it would have been without. This is because, without income tax devolution, the Scottish budget would receive a share of the faster-growing rUK income tax revenues, but this no longer happens without income tax devolution.

The debate around local government finances had a familiar ring to it. Local government's core settlement is down by around 2% in real terms. But substantial additional resources are transferred to the local government budget to meet commitments on policies in social care and education, amongst other things. Thus, the local government resource settlement is up by over 4 per cent in real terms. The nature of the settlement has understandably antagonised local authorities, but the real friction may be to come later this parliament, as the government establishes a new national care service which local government will perceive as undermining one of its core purposes.

One thing we didn't learn a great deal about was the government's longer-term strategy for economic development. The government made the usual noises about having a competitive business rates system (given the fractionally lower poundage in Scotland and slightly more generous small business reliefs), and it allocated additional resources towards employability services. But the approach to economic development will be informed by the forthcoming report of the government's new 'advisory council for economic transformation', which is, as far as we understand, still planned for publication before Christmas.

Overall, this was a significant budget that, as expected, re-emphasised the government's big spending decisions on health, social care, education, and social security. The spending review, which will be published next year and cover spending in 2023/24 and 2024/25, will spell out the longer-term implications of these priorities.

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.
- Scotland's Budget Report – Annual – The Fraser of Allander Institute's analysis of the Scottish Budget and the choices, risks and opportunities facing the Finance Secretary.
- Our blog – Launched in 2016, and viewed over 200,000 times, our FAI blog is a keenly watched discussion platform on the Scottish economy. The blog publishes short reflections on economic developments as well as the policy debate.

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