Scottish Economic Outlook

May 2024

The fading impact of a series of adverse shocks to facilitate a slow but steady growth over the next two years.

Economic momentum is set to be propelled by consumer spending, thanks to a recovery in real incomes and relatively low propensity to save, while the outlook for investment is weaker.

Slowing population growth and a decline in North Sea oil activity are among key challenges to the long-term growth outlook.

Unlike the UK, the Scottish economy managed to avoid a technical recession in 2023, registering positive albeit slow rate of growth of 0.1% for the year. As a result, GDP at the end of 2023 was just 1% above its pre-Covid level, broadly matching the UK performance. More recent momentum – based on regional Purchasing Managers' Surveys (PMIs) – suggests a pickup in activity at the start of 2024, with March marking the third consecutive month of private sector expansion. Business confidence remains in line with the UK average, consistent with cautious optimism about the year ahead.

Our forecast paints a picture of a gradual recovery. We expect the Scottish economy to grow at 0.4% this year, similar to the UK but relatively weak by historical standards (see Table 1). Growth is then expected to pick up to 1% in 2025, as the impact of negative shocks dissipates and the economy returns towards a more stable trajectory. We see the risks to the outlook broadly balanced. On the downside, if supply chain issues resurface this year, that could cause a setback to an already fragile manufacturing sector. On the upside, looser financial conditions could see a pickup in business confidence, leading to a stronger recovery in investment.

The labour market has remained robust, with the unemployment rate averaging 4% over 2023, although this was partly due to a somewhat high share of the working-age population outside of the labour market (39.1%) compared to the UK (36.9%). Consistent with a tight labour market, employee pay growth averaged 8.1% last year, above the UK average of 7.3%. The discrepancy in pay could be partly explained by a relatively higher level of vacancies in Scotland as well as the make-up of financial sector activities, which are associated with less volatile bonus payments compared to the City of London.

Table 1: KPMG forecasts for Scotland

	2023	2024	2025
Real GDP	0.1	0.4	1.0
Consumer spending	0.5	0.4	1.5
Investment	2.6	-1.4	0.3

Source: The Scottish Government, KPMG forecasts.
Average % change on previous calendar year. Investment represents Gross Fixed Capital Formation.

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Against this backdrop, we expect consumer spending to grow at 0.4% this year and accelerate to 1.5% in 2025. This outlook rests on three key judgements. First, the expected moderation in inflation supports real households' disposable income and a recovery in purchasing power. Second, the ongoing improvement in consumer confidence seen since the start of 2023 keeps the saving ratio low, as households feel more secure to spend. Finally, low relative housing costs, as Scotland boasts the lowest house price-to-earnings ratio in the UK, and is the only region alongside London where affordability has improved since 2019.

One risk to our consumption forecast relates to the tax changes announced in December 2023, including the introduction of a new 45% income tax band and a rise in the top band by 1p. While this represents a fiscal tightening on top of the already higher rates faced by the Scottish taxpayers, we overall expect it to have a limited impact on aggregate consumption. This is largely because the changes only affect the top 5% of taxpayers – whose spending tends to be less sensitive to changes in income – while the UK-wide cut in the National Insurance should offset some of the overall tax burden.

On the corporate side, business investment has been hurt by higher interest rates, along with earlier global supply chain disruptions that were particularly acute for manufacturing. Expectations for capital expenditure have moderated over the past year, according to the Business Insights and Conditions Survey (BICS), largely due to concerns around future demand. In addition, Scotland registered 1,231 company insolvencies last year, its highest level since 2012, although the liquidation rate at 0.5% remains at nearly half of its 2012 peak. We expect the weaker investment momentum to persist, resulting in a 1.4% fall in 2024, with a modest return to growth next year as near-term uncertainties ease.

The gradual decline of the Scottish oil & gas industry adds further complexity. Declining opportunities for extraction have made investment in the UK Continental Shelf less attractive, which in turn directs less demand towards the onshore economy via the related supply chains. While the hope is that over time the void created by the oil & gas activity could be filled as the economy transitions to renewable resources, in the near term, capital is set to be relocated towards more profitable projects elsewhere as drilling remains at historically low levels.

Other long-term challenges relate to the economy's productive capacity. The latest ONS population projections imply a slowing rate of population growth, with outright falls from the early-2030s. This is compounded by the effects of population ageing, which are expected to lead to a further decline in labour market participation. Since the Covid pandemic, Scotland has been able to match UK's rate of GDP growth despite the fall in labour supply thanks to stronger productivity growth. Scottish productivity is 3.6% below the UK level (and 5% below England's), so there's some limited scope for further catch-up growth. However, if productivity growth remains broadly similar as in the UK, but labour supply continues to slow, that could see growth in the Scottish economy weaker than in the UK as a whole.

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