EY ITEM Club Scottish Summer Forecast

August 2024

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About EY ITEM Club Scottish Forecast

EY ITEM Club Scottish Forecast

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The report is based on data and information available before August 2024. The quarterly EY ITEM Club Scottish report is part of the EY Economics programme which provides knowledge, analysis and insight to help businesses understand the economic environments in which they operate, both in the UK and globally.

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Foreword

Ally Scott

EY Scotland Managing Partner and Corporate Finance Partner

Ernst & Young LLP

LinkedIn

Sue Dawe

EY Scotland Head of Financial Services

Ernst & Young LLP

LinkedIn

The change in UK political leadership teamed with a vocal, UK-wide, pro-business vision of growth may currently be acting as a balustrade but our latest forecast suggests Scotland's economy is on more stable footing than in previous years. While an upwards revision is to be welcomed, the level of growth and productivity remains arguably anaemic and collectively we should push for a more ambitious position.

As we've seen with previous forecasts, growth is predicted to come from consumer-facing sectors, especially accommodation & food, largely driven by tourism. This continued reliance on tourism, and Scotland as a destination, makes increased and sustained investment in infrastructure and city centres all the more vital.

With consumer-facing sectors forecast to drive recovery, the implication is that it doesn't take much of a headwind for that growth to recede. Depending on this source of recovery can be fragile, especially on the back of public finance messages from the Chancellor and how fiscal policy may impact consumer confidence and spending. All this points to an expedited industrial strategy being even more necessary to safeguard stable, wide-ranging, and sustained economic growth.

The Scottish labour market continues to mirror problems at a UK level, however, Scotland's over-reliance on certain sectors means those trends can be felt more acutely. For example, the structural concentration of manufacturing jobs in Scotland relative to other parts of the UK mean the effects on the local employment market may have higher impact.

Some concerning trends in apprenticeships and the young labour market are emerging with potential short and long-term impact. The apprenticeship model is well-known to be crucial to the manufacturing skills pipeline but is also gaining popularity in business sectors. The Scottish Financial Services sector growth strategy specifically mentions the role apprenticeships could play in supporting social mobility in the sector while providing a pipeline of talent needed for us to compete on an international stage.

Financial Services is crucial to a balanced economic growth trajectory in Scotland, not just as a growth sector in its own right but to enable all growth sectors to reach economic potential. We need to incentivise all levels of a skilled workforce to see Scotland as a place to build a successful career, rewarding life and contribute to a thriving, just, local economy.

Highlights

- Scotland's economic recovery is gaining momentum. The latest quarterly data indicates that the Scottish economy grew in the first quarter of 2024, and the most recent estimate indicates that GDP output is at its highest level since before the COVID-19 outbreak. In May, CPI inflation dropped below 2% for the first time in three years, and the recent cut from 5.25% to 5.00% was voted through narrowly by the committee, reflecting sentiment in market polling among economists.
- The new Labour government came into power on 4 July, and the party is focused on raising economic growth. To that end, it has announced plans to build more housing, a new partnership with business and a national wealth fund, but the impact of these plans in Scotland is unclear.
- The growth in output in Scotland was strongest in the consumer-facing sectors, such as retail & wholesale and accommodation & food. Accommodation & food has recovered more robustly than other sectors since the COVID-19 outbreak as the sector reopened and restrictions eased. The overall services sector is set to drive the recovery of Scotland's economy, whilst the production sector will be a drag.
- The labour market is continuing to cool amid labour supply issues. Scotland's unemployment rate rose in Mar-May, and ONS data for online job adverts index in Scotland fell below the pre-COVID-19 level in April. However, the job advert index for Scotland is still higher than the UK average, indicating that there is a mismatch between labour supply and demand. Relatively high levels of inactivity are also at play and help to explain the labour supply issues. PAYE payroll data shows that the rate of wage increases has continued to ease in recent months, but the rate of wage growth in Scotland remains above the UK average.
- Persistent inflation has dragged down household and business confidence. Households are generally downbeat about their finances, but sticky inflation has affected this view. Business confidence remains positive amid signs it may have stagnated; the Scottish BICS in June found that 34.4% of businesses thought their business performance would increase over the next 12 months, but this is down from 37.3% in March. The largest concern for businesses was falling demand of goods and services.
- The outlook for the Scottish economy is positive; we now forecast GVA to grow by 0.9% this year, up from 0.4% forecast three months ago, though below the UK average of 1.1%. With wage growth cooling and inflation normalising, GVA growth is expected to strengthen to 1.7% in 2025, with growth of 1.6% in 2026 and 2027. This is compared to UK growth of 2% in both 2025 and 2026, and 1.9% in 2027. Unemployment is also forecast to decline, and consumer-facing sectors will grow as consumer spending increases.
- Scottish productivity dipped in 2023 and remains below the UK average. Scotland has relatively high levels of human capital which has helped drive productivity growth. But there is evidence that capital investment growth has been somewhat weaker. AI could help boost Scottish productivity, but current adoption patterns suggest it will help automate tasks rather than drive innovation.

Latest developments

Scotland's economic growth is gaining momentum

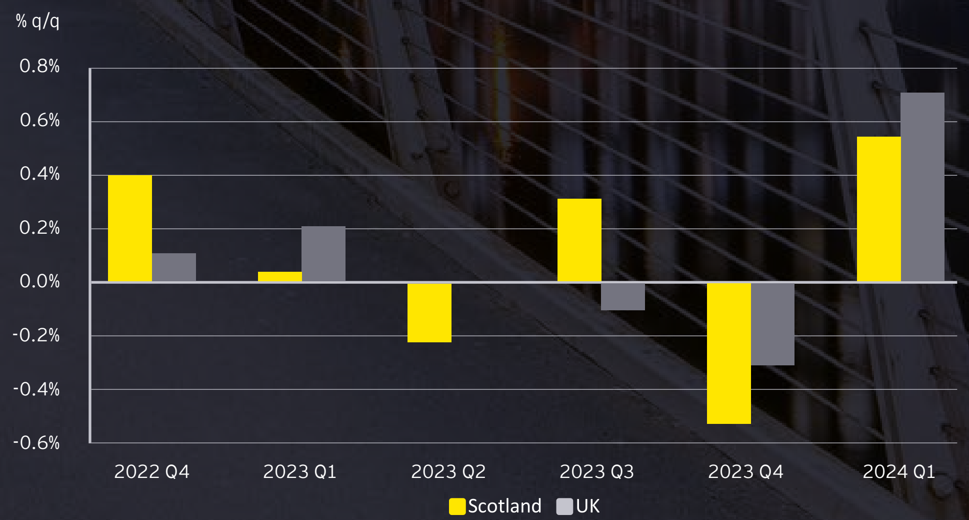
The latest quarterly GDP data shows that the Scottish economy grew at the start of this year, with output expanding by 0.5% in Q1, below the UK-wide average over the same period. Sectoral data confirms that the growth was also broad-brushed as most sectors expanded, but consumer-facing sectors enjoyed the strongest growth in the first quarter of the year. Monthly data adds a further degree of optimism that Scottish economic growth is now on sounder footing after the disappointing end to 2023 and the stop-start pattern of growth that has plagued the last two years. Indeed, the most recent estimate of GDP shows that output from the Scottish economy is at its highest level since the start of the COVID-19 pandemic. In May 2024, the Scottish economy was 3.0% larger than the average for 2019 as output increased by 0.3%, following growth of 0.2% in April.

The UK economy performed slightly stronger than Scotland in the first quarter of the year. The most recent monthly UK GDP figures show output was flat in April, but May estimates for the UK display a return to growth in the month at 0.4% compared to April, and we estimate that UK GDP rose by 0.6% in Q2.

Meanwhile in May, CPI inflation dropped back to the 2% target for the first time in nearly three years. This landmark was reached slightly later than anticipated, with inflation being lower in April. This partly reflected large increases for goods and services where prices are linked to past inflation rates, such as phone contracts and regulated prices. The stickiness of services inflation also reflected firms passing on the impact of higher wage costs. Stubbornly high services inflation was the primary reason the MPC held rates for so long – with the first cut recently bringing rates from 5.25% to 5.00% – with a 5-4 split in the MPC, reflecting market polling and economic consensus.

Another major development was the result of the UK general election on 4 July, with the Labour Party winning 412 seats, giving them a sizeable majority of 174 in Westminster. They made large gains in Scotland winning 37 seats –an increase of 36. The new government, as well as promising economic stability, is keen to demonstrate that it is serious about raising UK economic growth. To that end, it has rapidly announced plans to build more homes and to reform the planning system. However, planning is already a fully devolved function of the Scottish Government, so it is not clear what will change in Scotland and more importantly, how quickly change will come about. Directly targeted at Scotland, the new UK government has pledged to make the country a "green energy superpower", and at the heart of this plan is the creation of Great British Energy, a publicly owned clean power company headquartered in Scotland. Labour's manifesto claims the plans could create 69,000 new jobs in Scotland.

GDP growth, Scotland and UK, Q4 2022-Q1 2024



Source: Scottish Government/ONS

Consumer spending driving growth in retail and hospitality, but manufacturing still struggling

Scotland's output growth in Q1 2024 was strongest in consumer-facing sectors — including retail & wholesale and accommodation & food — as inflationary pressures continued to recede, and rising wages strengthened household budgets. Retail & wholesale grew by 1.4% compared to Q4 2023, but output from the sector remains low by historical norms and is 7.2% smaller than the 2019 average. Monthly data suggests a return to growth in May, following a contraction in April, likely due to the early Easter holiday. The accommodation & food sector was also heavily affected by the COVID-19 pandemic but has recovered more strongly than retail; at the end of Q1 2024 it was over 3% larger than in 2019, growing by 1.6% at the start of the year. Here, again, the monthly data suggests that May output increased as consumer spending continues to recover. The arts, entertainment & recreation, the other main consumer-facing sector, also remains below its pre-pandemic size, though it has grown consistently in recent quarters.

Another service sector that remains short of its pre-COVID-19 output level in Scotland is transport & storage. This is in part due to the relatively weak performance of the wider economy, but also the relatively slow recovery of international travel. The latter is now thriving, with passenger numbers at Scotland's main airports growing by over 7% between April 2023 and April 2024, above the 6% growth reported across all UK airports. Airport passenger numbers in April 2024 were just 3.6% down compared to April 2019. The rise in travel and the pick-up in the wider economy fed output growth of 2.4% in the transport & storage sector in Q1 2024.

Encouragingly, growth is apparent across other service sectors that are less tied to consumer spending, and at the end of 2023 it was these sectors that started to show signs of consistent growth. Principle among them is banking & finance, which grew by a 1.9% in Q1. The sector has seen some decline since mid-2022, but this has slowed in recent quarters. Output from banking & finance is now only 0.6% below its 2019 level.

Meanwhile, information & communication enjoyed a period of strong post-COVID-19 growth but has cooled a little in recent quarters. Still, output from the sector at the end of Q1 2024 was almost 25% higher than the 2019 average. Output in professional services declined marginally in Q1 following 14 quarters of consecutive increases. The fall in output was the result of a weak start of the year, but recent monthly data suggests a return to growth. Overall, Scotland's total services sector, whilst still short of where it would have been had pre-COVID-19 trends continued, is driving the recovery of Scotland's economy.

In the public sector, one particular concern for UK GDP in Q2 is the extent of the industrial action by junior doctors and how it will affect output from the health sector. In Scotland, on the other hand, junior doctors agreed to a pay deal in 2023 and output from the health sector in Scotland increased by 0.7% in Q1 2024. Output from the other parts of the public service sector remained weak in Q1, with public administration and education both contracting by 0.2%.

However, the performance of the production sector continues to be a concern, with a steep downward trend in output from mid-2022 weighing on Scotland's recovery. Manufacturing is the largest of the production sectors, and whilst output grew by 0.6% in Q1 2024, it has been the main driver of the falling output trend seen over the last two years. Whilst growth has fluctuated over that period, the overriding trend is difficult to ignore. Within the sector there are different growth patterns at play. Transport equipment grew by over 8% in Q1 2024, supported by machinery & transport goods export growth of 10.7% in 2023, but the sector remains small, accounting for around 4% of manufacturing in 2023. More significant is the contribution from the food & drink sector; the sector performed well during the post-COVID-19 period, with output particularly high during 2022. But since then, output has started to retreat, and the most recent quarterly GDP figures suggest that output has shrunk back to below pre-COVID-19 levels, with the export of beverages declining by 8.3% in 2023 compared to 2022.

The export performance of the mining & quarrying sector, which includes the extraction of oil & gas, has contributed to the recent output decline in the sector. The export of mineral fuels contracted by 20% between 2022 and 2023, as output from the mining sector has receded from the highs of 2022. Output shrank by a further 2.1% in Q1 2024.

Gradual cooling of the labour market as labour supply issues remain

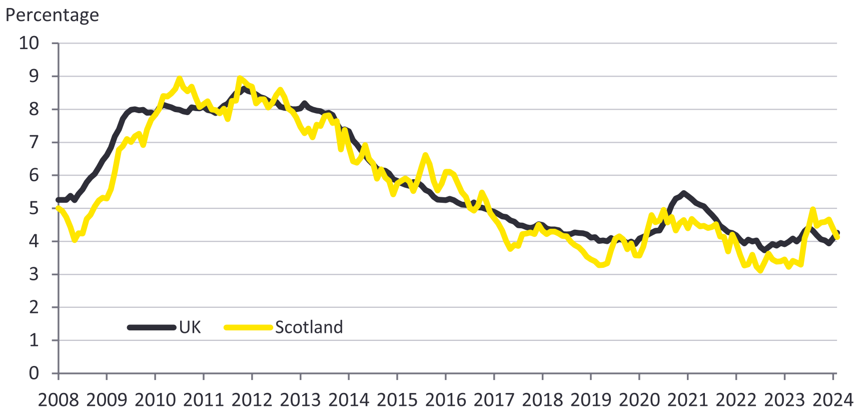
The cooling of the Scottish labour market has so far been gradual. Scotland's unemployment rate rose to 5.0% in March-May 2024, up from 4.1% in December-February 2024, with the UK rate rising only slightly to 4.5% from 4.3% over the same periods, respectively. Scottish claimant count data also shows a small increase of 3,000 claimants in May 2024 and a further rise of 1,300 in June 2024, but the claimant rate of 3.1% remains below the UK level of 3.9%. PAYE payroll data provides a mixed employment picture over recent months, but the overall trend is that Scottish employment has been flat with little change in the total between January and June 2024. Vacancies data provides a good indication of labour demand, and the number of UK vacancies continue to ease, falling by 3.3% between April-June 2024 and January-March 2024. As reported previously, comparable vacancies data for Scotland is unavailable, but ONS data for online job adverts index in Scotland fell below the pre-COVID level in April and remained around 5% below that level in June.

However, the job advert index for Scotland remains higher than in most other UK regions and nations, apart from the North East and Northern Ireland. This could indicate that labour demand is higher in Scotland, or alternatively, that there is a greater mismatch between labour demand and supply in Scotland than elsewhere. The June Business Insights and Conditions Survey (BICS) found that 25.5% of Scottish businesses with 10 or more employees are experiencing a shortage of workers. This rate had been falling in recent periods, and reached 20.6% in April, but has since increased. When businesses were last asked in January 2024 as to the reason for recruitment difficulties, the most popular cause was a lack of qualified applicants for the roles on offer, cited by 63% of affected businesses. The shortage of workers is not reported equally across sectors, with construction (35.1%) and accommodation & food services (30.2%) most affected. Key business services sectors, including administrative & support services (29.1%) and professional services (25.9%), have also been more affected than most.

Another factor at play is the high rate of inactivity in Scotland which rose again in the latest quarter, rising by 0.6 percentage points on last quarter to 23.3%, and above the UK average of 22.1%. This is markedly lower than the rate in Wales (28.7%) and Northern Ireland (27.4%), but above England (21.5%). Sickness accounted for around a third (34%) of all inactivity in Scotland in 2023, above the England rate of 28%.

Evidence on pay further supports the view that the mismatch between labour demand and supply might be a greater issue in Scotland than the UK overall. Even after April's near-10% increase in the national living wage (NLW), PAYE payroll data shows that the rate of wage increases has continued to ease in recent months, but the rate of wage growth in Scotland remains above the UK average. Median pay for Scottish workers rose by an average of 5.2% in the year to June 2024, compared to 3.6% in the UK.

Unemployment rate (aged 16-64), Scotland and UK, 2008-2024

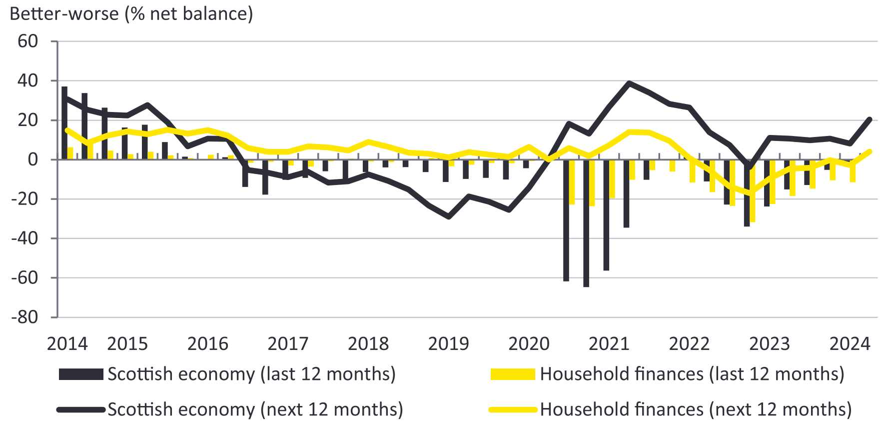


Source: ONS

Household and business confidence has improved given lower inflation

The Scottish Consumer Sentiment Indicator showed that confidence among Scottish households improved in Q2. The composite index turned positive and stood at 2.4% in Q2 2024, up from -6.2% in Q1 2024. Households reported feeling a bit better about the current state of the Scottish economy, but they are more upbeat about prospects than in the previous quarter (+19.5%). Scottish households remain downbeat about the current state of their finances, however sentiment on future household budgets increased and moved into positive territory. The improvement in survey responses for Q2 were heavily influenced by lower inflation, which has returned to the 2% target.

Consumer indicator scores and expectations, Scotland, 2014-2024



Source: Scottish Government

Meanwhile, business confidence remains positive despite signs it may have recently stagnated. The latest PMI Scotland Business Activity Index for June shows a slight decline to 51.9 from 55.2 in May. This decline meant that Scotland fell slightly behind the UK (52.3). However, over the three-month average between April and June, the Index for Scotland (53.6) was broadly comparable with the UK (53.1). Further evidence that confidence may have waned comes from Scottish BICS for June, which found that 34.4% of businesses thought their business performance would increase over the next 12 months, down from 37.3% in March. Similarly, 6.1% of businesses expected performance to decrease, up from 5.6% previously. The Scottish BICS also reported that the largest concern for businesses is falling demand of goods and services, reported by 16.3% of businesses and up from 12.5% in March.

Economic outlook

The short-term growth outlook is brighter as growth exceeds expectations

Stronger growth at the start of the year in Q1 and evidence of momentum in Q2 has improved our expectation for Scotland's growth prospects for this year. We now forecast GVA to grow by 0.9% this year, up from 0.4% forecast three months ago. Consumer spending growth will be central to the recovery as wages grow quicker than prices now that inflation pressures have receded. Investment growth should also bolster the economic growth outlook. However, the lagged impact of past monetary policy tightening and tight fiscal policy will limit the pace of the recovery. UK GVA is forecast to grow by 1.1% in 2024.

Low inflation is key to the consumer recovery and now that CPI inflation has finally made it back to the 2% target, we expect it to remain around that rate (albeit with some volatility quarter to quarter). Energy prices will be the main source of volatility, whilst the contribution from food and services should decline gradually as firms pass on the gains from lower energy bills. Meanwhile the pass-through of high wage costs, particularly in the services sector, should also fade as pay growth softens. We expect CPI inflation to average 2.5% this year and 2.2% in 2025. A concern for the MPC has been the stickiness of services inflation and we now expect they will delay the first interest cut to September with another 25-bps rate cut in November, leaving Bank Rate at 4.75% at year-end.

With wage growth cooling, albeit at a slower rate in Scotland than in the UK, lower inflation and pay growth should ease further but continue to grow in real terms, boosting personal disposable incomes. Incomes are set to rise by 2.1% this year, but we expect the boost to feed through to consumer spending in Scotland next year, prompting consumer expenditure to rise to 2.1% in 2025. GVA growth is expected to strengthen to 1.7% in 2025, with growth of 1.6% in 2026 and 2027. The GVA growth forecast for the UK is a bit stronger at 2.0% for 2025 and 2026, falling slightly to 1.9% in 2027.

Key economic indicator outlook, Scotland, 2020-2027, % y/y (unless otherwise stated)

	GVA	Personal disposable income	Consumers' expenditure	Population 000s	Employment 000s	Unemployment rate %	Migration aged 16-64 (000s)
2020	-12.0	-0.2	-12.7	5,466	2,760	4.5	13.8
2021	9.2	0.3	7.6	5,480	2,785	4.2	21.2
2022	5.9	-1.4	5.0	5,513	2,807	3.3	24.2
2023	0.1	0.3	-0.8	5,536	2,821	4.0	50.8
2024	0.9	2.1	0.6	5,563	2,856	4.5	47.5
2025	1.7	1.0	2.1	5,590	2,886	4.4	44.5
2026	1.6	1.3	2.0	5,611	2,913	4.1	39.9
2027	1.6	1.6	1.7	5,626	2,935	4.0	34.7

Source: EY ITEM Club
Note: GVA is chain linked 2019 prices. Personal disposable income and consumer expenditure are also 2019 prices. Unemployment rate is the ILO unemployment rate using Labour Force Survey data.

Consumer-led recovery supported by growth in key private services

With the prospect of stronger consumer spending, it is unsurprising that we expect consumer-facing sectors to enjoy faster growth over the forecast period, with the main boost in consumer spending feeding through to sector GVA in 2025. This year we expect arts, entertainment, & recreation to continue its robust post-COVID-19 recovery path and expand by 3.2% after growth of 5.2% in 2023. Growth will continue to drift down towards historical norms reaching 2.4% in 2025, and will finally bring output from the sector back to its pre-COVID-19 level slightly sooner than previously forecast. Accommodation & food and wholesale & retail are expected to lead growth next year, each expanding by 3.2%. However, whilst the accommodation & food sector has surpassed its pre-pandemic level, we do not expect wholesale & retail to reach that landmark until 2027.

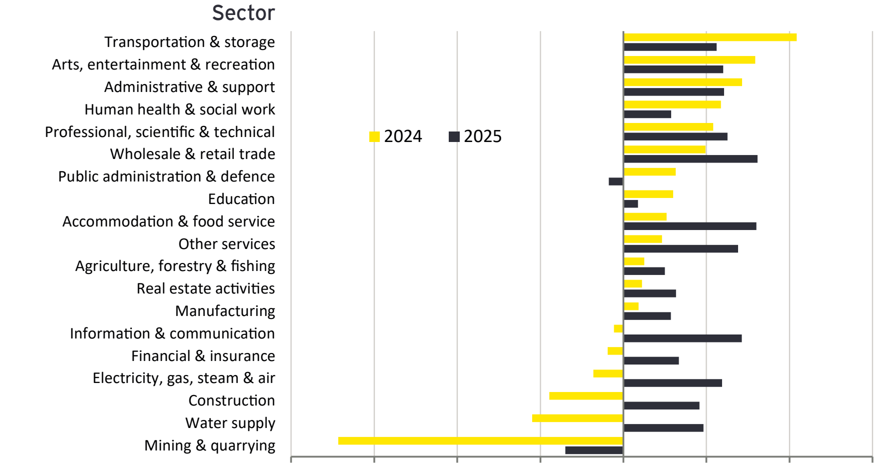
Momentum in the transport & storage sector has turned for the better, with the sector growing strongly in recent quarters. This momentum is expected to continue this year with GVA growth of 4.2%, the strongest across all sectors. The improved forecast for the sector is partly driven by the rosier outlook for consumption and economic growth, but also the resurgence of international travel. The administrative & support sector is another bright spot for 2024. The sector includes activities such as recruitment and facilities management, which should experience growing demand as wider economic activity rises, and we forecast GVA growth hitting 2.9% in 2024 and maintaining above average growth of 2.4% in 2025.

The uplift in consumer spending and business investment should filter through to rising activity in the construction sector. We continue to think that 2024 will be a challenging year for the sector as interest rates remain high, and it will take time for interest rate cuts to filter through to demand. However, the Labour government's positive stance on planning and house building, even though the issue is fully devolved to the Scottish Government, may spur activity in Scotland and could represent an upside risk to our forecast. Our current assumption is that construction activity will build next year, and that growth will accelerate in 2026.

With stronger private sector growth, the recent importance of public sector growth to the overall Scottish economy should begin to fade over the forecast horizon. We still expect output from public administration & growth to expand this year, with GVA growth of 1.3% that is slightly lower than previously forecast. However, consistent with the longer-term expectation that public finances will tighten, the sector is expected to contract next year. Output from the education sector is also likely to remain weak. Meanwhile, the health & social care will continue to be a large contributor to Scottish output, set to expand by 2.4% this year and 1.2% in 2025 and are slightly stronger than our previous forecast as demand for healthcare services post-COVID-19 continues.

Meanwhile prospects for Scotland's production sector look mixed. Higher-than-expected GVA growth in Q1 has contributed to an improved outlook for food & drink, the largest of Scotland's manufacturing sectors. However, within that, the sector is heavily dependent on exports of whisky, which have been weak in recent quarters. We expect the food & drink sector to return to growth this year as global demand strengthens. The buoyant growth in the manufacture of transport equipment is forecast to continue, driven by strong domestic and international demand as the transport and logistic sectors return to normality, but the rate of growth will slow. Overall, the prospects for manufacturing are expected to gradually improve, but will tend to lag the sector-wide average. The electricity and water sectors, however, should enjoy above average growth as they invest in infrastructure to meet regulatory requirements and the transition to net zero. Finally, we continue to anticipate that GVA from the mining sector will decline in each year of the forecast period. This reflects an assumption that the boost in oil & gas extraction following Russia's invasion of Ukraine was temporary, and the industry will revert to long-term structural decline as facilities in the North Sea are decommissioned.

GVA growth by sector, Scotland, 2024 and 2025, % y/y



Source: EY ITEM Club

Employment prospects improve with consumer sectors and healthcare driving recruitment growth

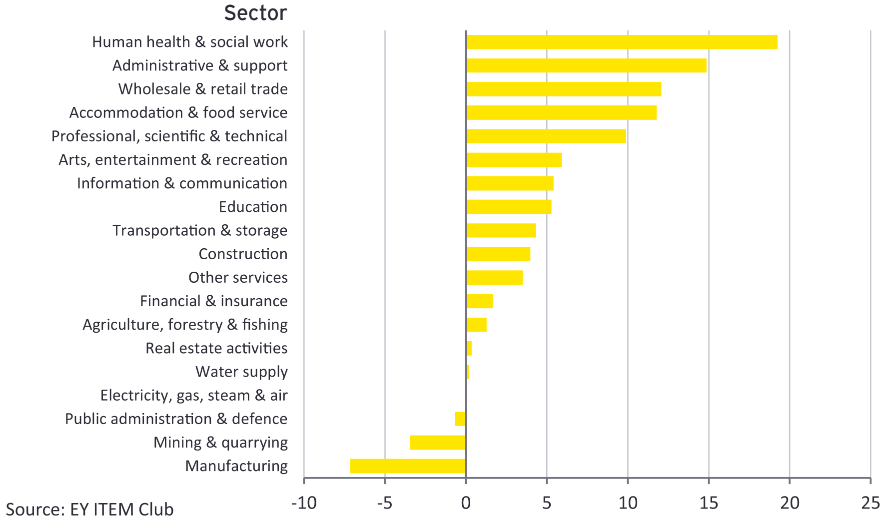
The Scottish labour market has remained relatively robust despite weak growth in preceding quarters. Unemployment has ticked up but we expect it to peak at 4.5% this year and fall to 4.1% in 2026. With further recovery in economic activity forecast this year, we expect employment to grow by 1.2% in 2024, with average growth of 1.1% sustained over the 2024 to 2027 forecast period. However, we continue to forecast weaker employment growth for Scotland than the UK, partly because of the weaker GVA growth forecast but also related to demographic and sectoral factors too.

The recovery of consumer spending, and in particular growing activity in the wholesale & retail sector, should drive jobs growth this year. We estimate that the sector has shed around 35,000 jobs since 2021 with successive losses in 2022 and 2023. We expect jobs growth of 1.5% this year, rising to 1.9% next. In total, over the 2024-27 period we expect wholesale & retail to create almost 18,000 new jobs, the second highest total across all Scotland's sectors. However, we do not expect employment to recover to previous levels, in part due to increased automation and the greater use of technology in the sector. Employment growth in accommodation & food is expected to be similarly buoyant this year to meet growing demand, and the sector is set to be one of the largest contributors to total jobs growth in Scotland, creating nearly 14,000 jobs over the four-year period.

Most sectors are expected to grow their workforces this year. Mining (which includes the extraction of oil & gas), manufacturing, and construction are forecast to reduce headcount, and in each case, this is reflective of declining output projected this year. For manufacturing, it is symptomatic of relatively weak demand but also the ongoing long-term automation in the industry. Construction employment should pick up from 2025 onwards, but manufacturing and mining are set to decline between 2024 and 2027.

We continue to expect that the sustained demand for health services will support the creation of most new jobs in Scotland both this year and over the longer term. We anticipate that the sector will account for almost a third of net employment growth in 2024, and over a fifth of the 114,000 jobs forecast for the 2024 to 2027 period. The growth in private services activity will be the other main source of additional employment growth in Scotland, with administrative & support leading the way, followed close behind by professional, scientific, & technical services. These two sectors are also expected to create a fifth of Scotland's additional jobs between 2024 and 2027.

Forecast employment growth by sector: 2024-2027 (000s)



Source: EY ITEM Club

Scottish productivity growth and potential AI boost

The new UK government proposes to introduce a new industrial strategy to foster growth and innovation, and ultimately drive productivity growth across the UK. Low productivity growth is one of the key reasons for the UK's relatively poor economic growth performance over the last 20 years. The latest Scottish government figures show Scotland's productivity (measured as output per hour worked in real terms) fell by 1.1% in 2023 compared to 2022. On this measure, Scotland's productivity is now 1.7% above the pre-COVID-19 level of 2019, but it is still 0.5% less productive than the rest of the UK.

Productivity growth is driven by the accumulation of physical and human capital, and how efficiently these inputs are used together with technological change. Scotland tends to perform well on measures of human capital. It has high qualification levels which have risen consistently over the last two decades. In 2023, 55% of people aged 16-64 held a degree level or above qualification, compared to the UK-wide average of 47%. London is the only region that outperforms Scotland on this measure, at almost 61%. Naturally, human capital is clearly more than just academic qualifications, and encompasses knowledge, skills, and competencies utilised to produce goods and services. Wages are a good proxy measure of human capital, as people with more valuable attributes, such as higher qualifications, skills, and abilities, will earn more. Average earnings for Scotland's full-time workers in 2023 were 3.1% higher the UK average.

However, capital formation has been slower in Scotland than in the rest of the country. Between 2009 and 2020, capital expenditure by both the public and private sectors grew by an average 2.7% per year, compared to 3.7% across the UK, and 5.1% in the West Midlands. Specifically, investment in ICT equipment grew particularly slowly in Scotland (1.6% compared to 4.0% across the UK) along with tangible assets such as machinery equipment. Underinvestment was also evident in transport equipment: the value of transport capital declined by close to 4% per year between 2009 and 2020, compared to an overall stagnation across the UK.

The introduction of Artificial Intelligence (AI) could bring about a transformative change in working practices and bring a sizeable productivity boost—particularly if it not only helps to automate tasks but also leads to increased innovation. In the recent Scottish BICS survey, 15.6% of businesses reported that they are currently using some form of AI technology. Rather than automating tasks, the vast majority of businesses (58%) are using AI to improve cybersecurity, whilst 35% are using AI to create efficiencies to reduce costs or increase productivity. However, just 7% are using the technology to develop a new product or services, hinting that any productivity gains, particularly in the short term, are most likely to be linked to automating tasks rather than driving innovation in Scotland.

Furthermore, although AI will displace jobs, it will also create new ones. A big question is whether the jobs that are displaced will be those that mainly involve routine work, such as in manufacturing. For jobs where human contact is essential, AI might be more of a tool than a threat. Companies need to consider how AI can help deliver new services to customers and improve efficiency; and they will also need to focus on skills training whilst treading carefully through the ethical implications. Whilst AI will offer support to productivity growth, we expect them to emerge slowly.

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