Fraser of Allander
Economic Commentary

July 2016
AT A GLANCE

- The Fraser of Allander Institute forecasts a sharp slowdown in the rate of growth in the Scottish economy over the next 3 years as a result of the decision to leave the EU. There are two key reasons for this –

  1. The Scottish economy is likely to face a period of economic uncertainty and financial volatility posing a risk to investment, household incomes and growth.

  2. Trade and investment prospects will be damaged by the decision to leave the EU. As businesses and investors adjust, we expect growth to be markedly slower.

- The sharp depreciation in sterling and the anticipated stimulus from the Bank of England will help mitigate the immediate ‘shock’. Moreover, it will take time for businesses to react with no real evidence – as yet – of major changes to current plans. As a result, the largest downward revision is to growth in 2017 and 2018.

- Given Scotland’s fragile economic performance over the past 18 months, the impact of the EU referendum result is exactly what the Scottish economy did not need.

- Scotland is likely to fall short of a sustained recession with growth in each year of the forecast horizon. Within this time period however, a short ‘technical recession’ – two consecutive quarters of falling output – is highly possible.

FAI forecast Scottish GVA growth (%) by sector, 2016 to 2018

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GVA</td>
<td>0.9</td>
<td>0.5</td>
<td>0.7</td>
</tr>
<tr>
<td>Production</td>
<td>1.3</td>
<td>0.7</td>
<td>0.8</td>
</tr>
<tr>
<td>Construction</td>
<td>0.4</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>Services</td>
<td>0.9</td>
<td>0.5</td>
<td>0.7</td>
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FAI forecast of Scottish unemployment, 2016-18

<table>
<thead>
<tr>
<th></th>
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<tbody>
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<td>ILO unemployment</td>
<td>173,500</td>
<td>188,250</td>
<td>183,050</td>
</tr>
<tr>
<td>Rate (%)¹</td>
<td>6.5</td>
<td>7.0</td>
<td>6.8</td>
</tr>
</tbody>
</table>

Note: Rounded to the nearest 50. ¹ = Rate calculated as total ILO unemployment by total economically active population 16+.

Source: Fraser of Allander Institute, July 2016

GVA actual (to 2015) and forecast error range for 2016 to 2018
SUMMARY

Over the past year, Scotland’s economic recovery has remained fragile. Last week’s 0.0% growth figures for 2016 Q1 were disappointing with sharp falls in production compounded by the widely anticipated retrenchment in construction. The effects of the global oil price fall continue to feed through strongly, not just to the North Sea directly but also the onshore supply chain.

In the immediate period before the EU referendum, there had been some tentative signs of a modest improvement in the outlook. A number of business surveys reported a rise in expectations for the 2nd half of 2016.

The decision by the UK electorate to vote to leave the European Union has turned all of this on its head.


There are two key reasons for this.

Firstly, a prolonged period of economic uncertainty and financial volatility as the terms of ‘exit’ are negotiated is now unavoidable. This will carry risks for investment, household incomes and growth.

Secondly, there is a high probability that trade and investment will be damaged by the decision to become less integrated with the EU. As businesses and investors adjust their expectations to life outside the EU, we expect growth to be lower than it would otherwise have been.

The degree of impact will depend upon the nature of the revised trading agreement. Remaining in the Single Market is clearly a top priority as it will minimise the degree of dislocation, but even then, Brexit will have a detrimental effect on growth.

The impact will vary across sectors and companies, with some such as construction and retailers who rely on imports hit hard.

Whilst the risks are on the downside, it is important to not over-state them. Exiting the EU is materially different from the financial crisis of 2008 and 2009 where the global systemic effects of the crisis were much larger.

Instead the headwinds are due to an explicit decision to move to a new political, economic and trading regime, not borne out of crisis, but as a deliberate policy preference.

The effects of the UK leaving the EU on Scotland’s economy are therefore likely to be a long-term, sustained step change, whose benefits are at best undetermined and highly uncertain.

The depreciation in sterling and the anticipated stimulus from the Bank of England (and HM Treasury) should help dampen the immediate ‘shock’.

However, on balance, and in the absence of a significant fiscal policy stimulus by the UK Government, we forecast that Scottish growth will slow considerably through 2016, 2017 and 2018.

Growth is likely to be lower but remain positive on an annual basis. A short ‘technical recession’ within the next three years in Scotland – defined as two consecutive quarters of falling output – is however, highly possible.
OUTLOOK AND APPRAISAL

The Scottish economy continues to be fragile, in part due to the collapse in the price of oil with growth over 12 months of just 0.6% vs. 2.0% for the UK. Signs of improving expectations for the 2nd half of 2016 have been seriously dented by the EU referendum. We expect growth to be materially slower than our June forecast.

**Table 1:** Scottish GDP growth (%) by sector, Q1 2016

<table>
<thead>
<tr>
<th>GDP</th>
<th>Agriculture</th>
<th>Production</th>
<th>Construction</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quarterly Growth</td>
<td>0.0</td>
<td>-0.2</td>
<td>-1.2</td>
<td>-1.5</td>
</tr>
<tr>
<td>UK</td>
<td>+0.4</td>
<td>0.0</td>
<td>-0.2</td>
<td>-0.3</td>
</tr>
<tr>
<td>Annual Growth</td>
<td>+0.6</td>
<td>+2.2</td>
<td>-3.9</td>
<td>+4.8</td>
</tr>
<tr>
<td>UK</td>
<td>+2.0</td>
<td>+1.4</td>
<td>+0.3</td>
<td>+0.2</td>
</tr>
</tbody>
</table>

Source: Scottish Government, Q1 GDP Statistics

**Table 2:** The UK Labour Market, Mar-May 2016

<table>
<thead>
<tr>
<th></th>
<th>Employment (16-64)</th>
<th>Unemployment (16+)</th>
<th>Inactivity (16-64)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scotland</td>
<td>74.0%</td>
<td>5.5%</td>
<td>21.6%</td>
</tr>
<tr>
<td>England</td>
<td>74.7%</td>
<td>4.9%</td>
<td>21.4%</td>
</tr>
<tr>
<td>Wales</td>
<td>72.6%</td>
<td>4.6%</td>
<td>23.8%</td>
</tr>
<tr>
<td>N. Ire</td>
<td>69.0%</td>
<td>5.9%</td>
<td>26.6%</td>
</tr>
<tr>
<td>UK</td>
<td>74.4%</td>
<td>4.9%</td>
<td>21.6%</td>
</tr>
</tbody>
</table>

Source: ONS, LFS July

**Chart 1:** Some forecasts of the long-term impact of Brexit

Source: Fraser of Allander Institute

**Introduction**

Our previous Commentary, published in June 2016, revised down our growth forecasts for this year and next. This was in response to a weakening outlook for investment, household spending and growth in key Scottish export markets.

At the same time, the most recent data points to an ongoing divergence between Scotland and the UK. New figures published last week, estimated zero growth in the Scottish economy during the first three months of 2016. Growth over the past 12 months was 0.6% compared to 2.0% (or 1.7% excluding oil and gas) in the UK as a whole.

The outcome of the EU referendum had a material impact on our forecasts. We have therefore, taken the decision to revise them in this update to our Economic Commentary Outlook and Appraisal.

This is no trivial task. The referendum outcome took many people by surprise – not least the UK Government – and the uncertainty that has followed make short-term economic forecasts, and business planning, particularly difficult.

Over the long-run (i.e. 15+ years), the majority of economists predict that the decision to leave the EU will damage trade, labour mobility and investment as Scotland becomes less integrated with its largest international trading partner.

Productivity – the key to long-term prosperity – may also be weaker if leaving the Single Market reduces competition, product specialisation, skilled migration, inward investment and financial integration.
Table 3: Independent forecasters tracked by HM Treasury: Rapidly revising short-term outlook for 2017

<table>
<thead>
<tr>
<th>% growth</th>
<th>GDP</th>
<th>Consumption</th>
<th>Investment</th>
<th>Net Trade*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Av. forecast (June 16)</td>
<td>+2.1</td>
<td>+2.2</td>
<td>+4.3</td>
<td>-0.5</td>
</tr>
<tr>
<td>Av. ‘new’ forecast (since Brexit)</td>
<td>+0.5</td>
<td>+0.5</td>
<td>-3.5</td>
<td>+0.6</td>
</tr>
</tbody>
</table>

* net trade contribution (% of GDP)  
Source: HM Treasury

Chart 2: Businesses doing likewise - Deloitte CFO Survey: “Net balance financial prospects vs. 3 months ago”

Source: Thomson Reuters Datastream

Chart 3: Flash PMI for UK points to drop in growth (and possibility of contraction)* in Q3 2016

Source: Markit

Whether or not Brexit leads to a permanent reduction in the rate of growth or just the level of output is as yet unclear.

On the one hand the effects may be constrained to the level of output. Once the economy adjusts to life outside the EU, output will simply be a permanent and broadly constant step below the level it otherwise would have been in each and every year.

There is the potential however, for Brexit to have a much more damaging impact if it were to confine Scotland to a lower long-term growth rate (perhaps via a permanent dent to productivity growth). There is strong evidence that international investment helps boost productivity by supporting innovation and the transfer of new ideas. Similarly trade can boost competition, encouraging firms to become more efficient. If these dynamic effects were to occur, then the damage would be even greater.

Within all of this however, there will be opportunities. Some individual businesses will find new markets and sectors to operate in. There is also the opportunity to use the decision to leave the EU to undertake an overhaul of economic policy in Scotland and the UK with a renewed focus on boosting productivity and tackling the long-term structural imbalances, particularly in regional economic performance, that have built up in recent years.

Whilst the long-term risks are pretty clear and well-evidenced, the short-run dynamics are much more complex and uncertain.
Assessing the short-term impact of Brexit

By the short run, we mean a time horizon that stretches from now until roughly the end of 2018. The next three years promises to be an uncertain environment as the UK prepares to formally leave the EU (most likely now in 2019).

Transition Effects

As highlighted above, we expect the decision to leave the EU to have a detrimental impact on the long-term outlook for both the Scottish and UK economies. Investment, household incomes, employment and the long-run supply potential of the economy will all be lower.

Scotland cannot expect to be immune to these effects. The EU accounts for just over 40% of all of Scotland’s international exports – more than North America, Asia, South America, the Middle East and Australasia combined.

Scotland has also performed well in securing international investment – rivalling the South East as the second biggest area for FDI projects after London – driven, in part, by its skilled workforce but also as an access point to the Single Market. FDI has strong links to productivity through the transfer of knowledge, skills, best practice, technology, and innovation.

However, businesses will not – and cannot – adjust their plans overnight. Plant and machinery are immobile in the short-run.

Moreover, for the time being Scotland currently remains within the EU. In terms of trade, regulation and free movement nothing has changed thus far.

But it will only be a matter of time before expectations of reduced integration feed through to day-to-day investment, production operations, R&D activities, employment and household spending decisions.

In our survey of businesses published earlier this month, 40% believed that Brexit would either have a ‘slightly negative’ or ‘very negative’ impact on their future investment plans.
Productivity may also begin to be hit as resources are gradually reallocated between different sectors in the light of changing terms of trade and investment patterns.

Taken together these effects will weaken growth over the months ahead.

The lower exchange rate will help dampen some of these effects. Since the referendum, the sterling effective exchange rate has fallen nearly 10%. A fall in sterling boosts the competitiveness of Scottish exporters and the tourism sector, although as costs rise this ‘advantage’ will disappear over time. Sectors, including retail, which rely on imports will fair much less well.

The lower value of sterling also cuts the purchasing power of Scottish households as imports – particularly food and fuel – become more expensive. Moreover, many Scottish exporters do not compete solely on price, but on quality and customer service, making any competitive exchange rate boost less powerful than it once was.

Finally, it is important to understand what this depreciation actually represents. It is not some exogenous windfall bestowed on UK exporters. Instead it is a rational reaction from financial markets who believe that the growth potential and attractiveness of the UK has been damaged by the decision to leave the EU - and thus, the demand for sterling is lower.

This brings its own challenges, particularly the long-term outlook for the UK’s near record current account deficit and how it is financed.

Ultimately, the scale of this ‘transition effect’ on growth will depend upon the long-term relationship secured with the EU and how quickly Scottish and UK businesses adjust – and the costs in doing so – to the new trading environment. The less like the current arrangement any deal turns out to be, the greater the negative impact on growth and jobs.
Macroeconomic Stability

At the UK level, the decision to leave the EU was clear. However, the exact terms of exit are unknown and are likely to remain so for the foreseeable future.

As a consequence, the referendum result has ushered in a period of significant political and constitutional uncertainty.

There is clear evidence that in response to such uncertainty, businesses and households postpone spending and investment.

Macroeconomic uncertainty is not uncommon, but when it does occur it can act as a significant headwind to growth.

However more often than not, once the uncertainty is resolved the macroeconomic impacts turn out to be temporary. Decisions that have been postponed can be adjusted and then implemented at a future date. However, the longer uncertainty continues (and particularly if limited to one particular country or region) the greater the risk of permanent damage.

The current economic uncertainties are exacerbated by policy uncertainty – such as the shape of the trade deal with the EU and the future of freedom of movement. This creates a lack of clarity around the fundamental structure of the economic and political environment that businesses operate within. This will further dampen immediate growth prospects.

All of this, will not be helped by the continued volatility in financial markets.

On balance, our expectation is that the UK-EU negotiations will not be straightforward and neither will the associated financial market dynamics. Markets will react to every signal of movement that might improve/detract from clarifying next steps and the evolving nature of the UK-EU settlement.
Exchange rates and stock prices could easily deviate substantially from ‘fundamentals’ for significant periods of time.

This instability will itself act as a further drag on growth. It implies a less productive use of resources than would otherwise have been the case. It will also lead to a risk premium on lending to UK businesses and households, increasing the cost of capital. Investors have already flocked to ‘safe-havens’ like Government Gilts. This, coupled with a weakening housing market is likely to depress wealth holdings and curtail household spending.

The expectation is that this uncertainty and financial market volatility should gradually begin to fade as time progresses and key issues – such as Scotland and the UK’s trading relationships – are resolved.

For these reasons, over the next three years we expect growth in both Scotland and the UK to be lower relative to what they would otherwise have been.

We have lowered our forecast in 2016 but predict that the growth rate will be more materially impacted in 2017 and 2018 as the effects of the decision to leave the EU take time to feed through to the real economy. In the absence of a significant fiscal policy response by the UK Government, a short technical recession is a distinct possibility.
Recent Scottish economy data

Before turning to the detail of our revised forecasts, it is helpful to review the state of the Scottish economy prior to the referendum.

Since we published our forecasts in June, a series of new data have been published. Chief amongst them was last week's GDP figures for Q1 2016.

Over the quarter, services grew by +0.4% but there were sharp falls in production (-1.2%) and construction (-1.5%). This led to overall GDP growth being flat at 0.0%.

There were three key drivers of the performance this quarter.

Firstly, the ongoing impact of the downturn in the North Sea continues to have a significant impact on the domestic oil and gas supply chain. Overall manufacturing is down nearly 5.5% over the year with the Metals, Metal Products and Machinery sub-sector down nearly 23% since 2014, in part due to the challenges in oil and gas, but also wider structural weaknesses.

Secondly, growth in recent quarters has been boosted by a sharp rise in construction – driven primarily by public infrastructure. This pace of growth could only be expected for a limited period.

Thirdly, growth in the all-important services sector – whilst positive – has been slower than for the UK as a whole. Over the year services are up 1.3% in Scotland vs. 2.5% in the UK.

The indications are that the growth will remain relatively weak in Q2 even before accounting for the impact of the EU referendum result.

In particular, the closure of Longannet at the end of March is likely to have a disproportionate impact on Q2 figures – we think it could take anything up to 0.4% point off the headline number. In other words, the rest of the economy would have to grow by at least 0.5% to prevent another flat (or even negative) quarter of growth. It will be important however, to interpret this 'event' appropriately.
Table 6: Longannet closure: big impact on Q2 GDP as 20% of Scotland’s electricity generation is switched off

<table>
<thead>
<tr>
<th>2014</th>
<th>Electricity (GWh)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nuclear</td>
<td>16,333</td>
<td>33</td>
</tr>
<tr>
<td>Hydro Natural Flow</td>
<td>5,436</td>
<td>11</td>
</tr>
<tr>
<td>Other Renewables</td>
<td>13,526</td>
<td>27</td>
</tr>
<tr>
<td>Coal (i.e. Longannet)</td>
<td>10,310</td>
<td>21</td>
</tr>
<tr>
<td>Gas</td>
<td>2,716</td>
<td>5</td>
</tr>
<tr>
<td>Oil</td>
<td>814</td>
<td>2</td>
</tr>
<tr>
<td>Hydro Pumped Storage</td>
<td>494</td>
<td>1</td>
</tr>
</tbody>
</table>


As such, it represents a structural ‘level shift’ in Scottish economic data as one particular power plant is closed. It is therefore quite different from a sustained weakening in the economy’s overall performance (although it clearly raises issues about Scotland’s energy supply).

One (slightly) positive note from last week’s data was the upward revision to 2015’s performance with the economy now estimated to have been slightly more resilient than as first thought.

2015 annual growth (4Q on 4Q) is estimated to have been +2.1% up from the +1.9% published for the same period just three months ago. The pre-financial crisis boom has also been revised down, with the peak to trough recession now lower than previously estimated.

The labour market data also published last week – and which covers the 3-months up to end May – were relatively mixed.

Employment rose by 17 thousand with a fall in unemployment of 18 thousand. While positive, this was balanced somewhat by an increase in economic inactivity – those neither in work or seeking work – of 11 thousand.

When compared to the other parts of the UK, and unsurprisingly given the wider economic data, Scotland’s performance is not as strong.

Indeed, Scotland was the only part of the UK that did not post an improving employment rate or falling unemployment rate over the year.

There had been some tentative evidence of an improvement in the outlook for the Scottish economy. Pre-referendum business surveys continued to report challenging trading conditions, but there was an expectation that things would improve toward the second half of 2016.

The Royal Bank of Scotland Scottish Business Monitor – published just before the referendum – reported a net +12% of firms expecting business volumes to rise over the next six months, with rising optimism across most sectors and parts of the country.
Table 7: Latest economic growth forecasts for the UK economy – forecasts post-Referendum

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays Capital</td>
<td>+1.1</td>
<td>-0.4</td>
</tr>
<tr>
<td>Capital Economics</td>
<td>+1.6</td>
<td>+1.5</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>+1.0</td>
<td>-1.0</td>
</tr>
<tr>
<td>Fathom</td>
<td>+1.6</td>
<td>+0.6</td>
</tr>
<tr>
<td>Oxford Economics</td>
<td>+1.8</td>
<td>+1.1</td>
</tr>
<tr>
<td>CEBR</td>
<td>+1.3</td>
<td>+0.5</td>
</tr>
<tr>
<td>Experian</td>
<td>+1.1</td>
<td>+0.4</td>
</tr>
<tr>
<td>ITEM Club</td>
<td>+1.9</td>
<td>+0.4</td>
</tr>
</tbody>
</table>

Source: HM Treasury

Table 8: FAI revised forecast Scottish GVA growth (%) by sector, 2016 to 2018

<table>
<thead>
<tr>
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<tr>
<td>Services</td>
<td>0.9</td>
<td>0.5</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Source: Fraser of Allander Institute, July 2016

Chart 17: Growth to slow through 2016 with sharper slowdown in 2017 & 2018 *

Our Forecasts

As explained above, forecasting short-term growth in an environment where there is a considerable degree of uncertainty is challenging.

The aftermath of the EU referendum is a perfect example – and already at the UK level there is a considerable divergence of opinion.

To assist our understanding and to provide an up to date assessment of growth, we will continue to produce our monthly ‘nowcasts’ of quarterly growth – www.fraserofallander.org.

The advantage of a ‘nowcast’ is that it provides an indication of economic performance far in advance of official data. Our latest ‘nowcast’ estimates growth (pre-Brexit) of 0.38% in Q2 – offering little optimism for anything approaching a return to trend during the first half of 2016.

For our forecasts we continue the presentational procedure adopted in previous Commentaries. We publish only a central forecast but use estimated forecast errors to establish the likely range within which the true first estimate of the growth of Scottish GVA will lie - as shown in Chart 17.

The next 3 years – 2016, 2017 & 2018

Our central forecast is that growth will slow to 0.9% in 2016 (down from 1.4% forecast in July) followed by an even sharper downward revision in 2017 and 2018 to just 0.5% and 0.7% respectively (down from 1.9% and 2.0%).

Our forecast suggests that whilst there will be a slowdown in the rate of growth, the Scottish economy will avoid an annual recession (i.e. a full calendar year where output falls).

However, growth will be perilously close to zero in individual quarters and a short ‘technical recession’ in Scotland – defined as two consecutive quarters of falling output – is highly possible.

* Actual data up to 2015, central forecast with forecast error for 2016 – 2018
Moreover, the balance of risks are on the downside. Should negotiations with the EU start off poorly and/or the current uncertainty builds into something more akin to a crisis, then the risk of a more sustained slowdown will rise.

Growth in all sectors will slow significantly. Construction will be perilously close to zero growth in 2017, in part due to the impact of the referendum outcome, but also from a return to trend output following the strong growth through 2014 and 2015. The biggest revision will come in production, with manufacturers – particularly those who trade with the EU – facing the toughest challenge.

On the components of demand we expect that the short-term uncertainty, financial instability, higher risk premiums and challenges in the housing market, will hit investment and consumption hard over the next few years.

As highlighted above, there are preliminary signs – both from surveys and the Bank of England – that sentiment amongst households and companies has deteriorated.

Whilst the boost to net exports from the depreciation in the pound will support external demand in the short-run, it will not be sufficient to offset the wider slowdown in the economy. Indeed, part of the revision to growth in 2016 and 2017 is through weaker exports to the rest of the UK. At the same time, growth in Europe will be slower than it would otherwise have been.

Similarly, it is unlikely that further cuts to interest rates will curb a substantial fall in investment.

We therefore make a relatively small downward revision to our growth forecasts for 2016 (albeit still significantly below trend growth of closer to 2% to 2.5% per annum).

As the effects of the delayed decisions on investment and consumption build, coupled with the petering out of the boost to net international exports as inflation takes hold, our revisions to growth for 2016 and 2017 are much more significant – down 1.4% in 2017 and 1.3% in 2018.

The jobs market will slow. We now predict that unemployment will rise to 7.0% in 2017, up from its current rate of 5.5%.

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**Table 9:** FAI revised forecast %-point change from June pre-Referendum forecast by sector, 2016 to 2018

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>GVA</td>
<td>-0.5</td>
<td>-1.4</td>
<td>-1.3</td>
</tr>
<tr>
<td>Production</td>
<td>-0.5</td>
<td>-1.4</td>
<td>-1.4</td>
</tr>
<tr>
<td>Construction</td>
<td>-0.3</td>
<td>-0.8</td>
<td>-0.8</td>
</tr>
<tr>
<td>Services</td>
<td>-0.4</td>
<td>-1.3</td>
<td>-1.2</td>
</tr>
</tbody>
</table>

**Source:** Fraser of Allander Institute, July 2016

**Chart 18:** Decomposition of revision to forecast – sharp decline in investment leading the way

**Table 10:** FAI forecast of Scottish unemployment in central forecasts, 2016 to 2018

<table>
<thead>
<tr>
<th></th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>ILO unemployment</td>
<td>173,500</td>
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<tr>
<td>Rate (%)&lt;sup&gt;1&lt;/sup&gt;</td>
<td>6.5</td>
<td>7.0</td>
<td>6.8</td>
</tr>
</tbody>
</table>

Note: Rounded to the nearest 50.<sup>1</sup> Rate calculated as total ILO unemployment by total economically active population 16+.

**Source:** Fraser of Allander Institute, July 2016
Policy Responses

Following an event such as the EU referendum, it is vital that policymakers are agile and responsive. What do we recommend?

Firstly, the Bank of England and HM Treasury will be required to step forward with an immediate stimulus to counterbalance the headwinds created by both the economic and policy uncertainty and the financial market volatility.

The Bank is widely expected to cut rates and/or engage in a further round of Quantitative Easing. 44 out of 48 respondents to the latest Reuters poll expect the next change in Bank Rate to be a cut. However, there are limits on how much ‘monetary easing’ the Bank can undertake and what the impact will be with interest rates at record lows and rising import prices.

HM Treasury has signalled that it may move away from its deficit reduction plans in the short-term, with a programme of new infrastructure investment reportedly being considered. This would be welcome. If done wisely, it would not only help boost growth in the short-run but could support productivity growth and help tackle some deep rooted structural problems within the economy. Support for exporters will also be welcome, particularly in areas such as access to finance, to enable them to scope out new markets and to take advantage of the weaker pound.

Secondly, the UK Government has to set out its clear intentions and realistic objectives for the negotiation process. If businesses and investors can be reassured that the mechanisms and processes to negotiate the UK’s exit from the EU are sound and that the overall approach will be to preserve close economic linkages with Europe, this will go a long way to reducing some of the uncertainties.

It does seem however, that securing a deal on access to the Single Market without freedom of movement is highly improbable.

Thirdly, in time the Scottish Government will need to clarify its own plans for the constitution to avoid adding to the existing uncertainty.

At the same time, it must review its domestic policies for growth in the light of the referendum outcome, including any stimulus measures of their own (e.g. re-profiling infrastructure projects).

More significantly, the Government had been progressing with delivering its economic strategy with a degree of continuity. The key initiative since May has been the review into Scotland’s enterprise and skills agencies. Things have now changed with Brexit— and it is a major step change, not a relatively marginal adjustment with a gentle transition.

As Andrew Goudie and Graeme Roy have argued in their article on the new Fraser of Allander blog (www.fraserofallander.org), it is imperative that everyone – from across the political spectrum – revisits their economic thinking and priorities in the light of the referendum.

For more on Brexit and its implications for Scotland please see our new blog:
www.fraserofallander.org
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