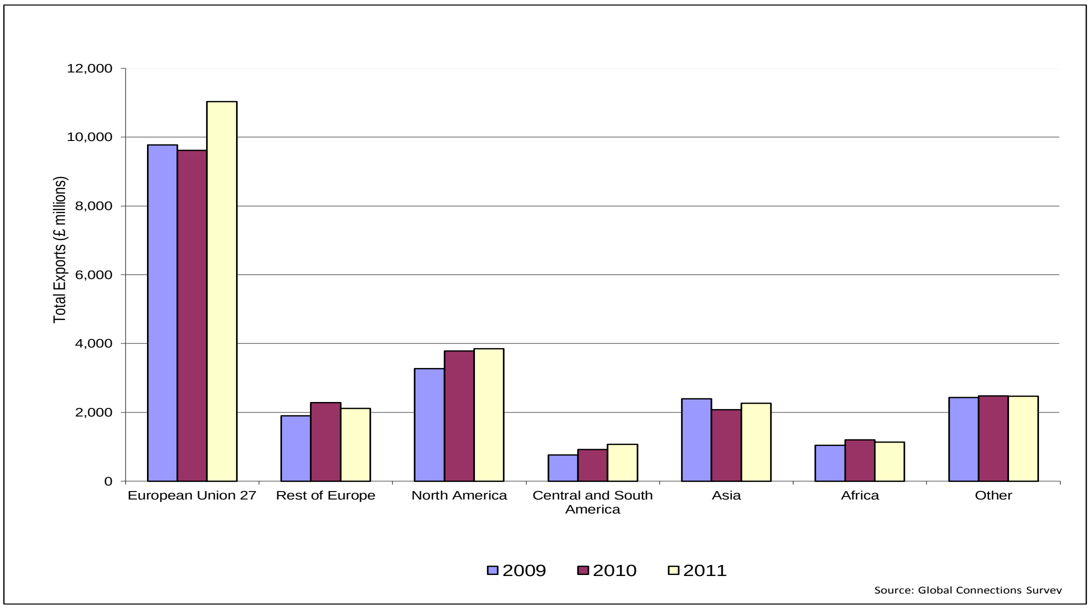
Scottish Exports

Destination of Overseas Exports



Scottish Exports

Increased business confidence, investment and growth could be triggered by an improvement in external economic conditions and an increase in demand for Scottish exports. Demand for exports will also be impacted by the trade-weighted sterling exchange rate; a depreciating exchange rate will make Scottish exports relatively cheaper, all else remaining equal, and may increase demand for them. Sterling has been depreciating over the past few months and especially so following the triple-A rating downgrade on 22 February. Following this, sterling fell to a 17-month low against a trade-weighted basket of currencies, however it is still well within the range established since the financial crisis.

It should be noted that a depreciating exchange rate also makes imports more expensive increasing the outflow of money from the economy, all else remaining equal. For example, it is estimated that around 11% of all imports by Scottish firms are from outside the UK[1] and these will become more expensive as a result of sterling weakening.

[1] Source: Scottish input-Output tables

The remainder of this chapter looks at recently released data on Scottish exports to assess the extent to which external demand could encourage a recovery in the Scottish business sector and therefore economy.

Recent Scottish Export Data

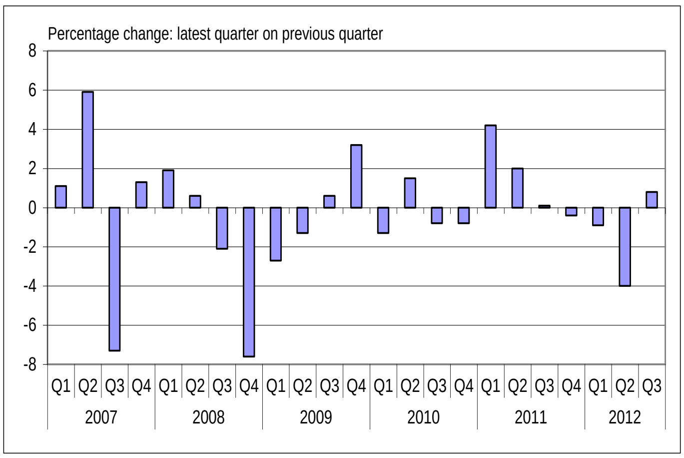
The Global Connections Survey (GCS) was published on 23 January and provided the value of Scottish exports and their international destinations up to and including 2011.

This data shows that the *value* of international exports increased by 7% between 2010 and 2011 – to £23.9 billion - and that the key international markets remained North America (16% of international exports) and the EU (46% of international exports). Between 2010 and 2011, exports increased by the highest proportion to the EU (14.7% increase), the emerging markets of Central and South America (15.8% increase) and Asia (8.7% increase). This is encouraging for growth in net trade given the much higher economic growth rates forecast in these economies than Scotland's traditional European and North American export markets.

After strong growth in the previous year, exports to North America increased by just 1.7% whilst exports to the Middle East, Africa and the Rest of Europe (non-EU) fell slightly.

Of 2011 exports, around 61% are attributable to the manufacturing sector which is dominated by food and drink (29% of manufactured exports) and 32% to the service sector (financial and insurance sector accounts for 18% of these exports), with the remainder from the Agriculture, Forestry and Fishing sector.

IME Growth rates 2007-2013 Q3



The Index of Manufactured Exports provides more recent data on the *volume* of exports from the manufacturing sector only. This shows that in Q3 2012, the volume of manufactured exports increased by just 0.8%. Over the year, manufactured exports fell by 0.8%. As at Q3 2012, export volumes are 13% below pre-recession peak levels in Q2 2007.

Surveys suggest that export performance in Q4 2012 remained subdued. The CBI Industrial Trends Survey reported the first decline in export orders in three years. The Scottish Engineering Quarterly Review reported no change in exports compared with Q3. The Lloyds

Business Monitor reported a slight deterioration compared with Q3, however expectations for future exports improved. The Bank of Scotland PMI for February reported that new export orders grew marginally, however this follows a marginal decline reported during January, reflecting the on-going fragility in export markets.

Given below trend growth in domestic markets and our key EU market over the next year (see Future Prospects, page 48), it is important to both increase the contribution of exports to GDP growth and to expand export destinations to faster growing markets.

Which firms export?

The Small Business Survey (SBS) published this month provides an overview of exporting patterns within the Scottish Small and Medium-sized Enterprise (SME) base. SMEs are defined as businesses that employ less than 250 people.

Results from the 2012 SBS show that 13% of Scottish SMEs sold goods or services or licenced products outside of the UK with a further 4% of the remainder planning to do so in the next 12 months.

Exporting activity increases with the size of the business. In 2012, 12% of the self-employed (no employees) and 13% of micro employers (1 to 9 employees) exported, compared to 22% of small-sized employers (10 to 49 employees) and 37% of medium-sized employers (50-249 employees).

In 2012, information and communication was the SME sector most likely to export (39%), followed by administrative services (25%), business services (23%) and manufacturing (22%). Transport, retail and distribution (13%), primary (5%), other services (5%) and construction (1%) were the SME sectors least likely to export.

How fast do business investment and exports need to grow?

Analysing Scottish National Accounts Project (SNAP) data allows us to estimate a rough approximation of the export and business investment growth required on an annual basis given the continued fiscal consolidation and the continued squeeze on household incomes which is limiting consumption growth.

The latest full year of SNAP data is for 2011; this shows that investment (GFCF[2]) accounts for 16% of nominal GDP and net exports -6% of nominal GDP (gross exports, 50%). The remainder consists of consumption (65%) and government expenditure (25%).

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[2] Gross Fixed Capital Formation which consists of private sector dwelling, government investment, investment by public corporations and business investment (approximately 60% of GFCF).

A stylised example can help provide an illustration of the boost required in these various components of GDP on an annual basis.

Let's assume a target of nominal GDP growth of 5% p.a. representing 3% inflation (Bank of England forecast for next two years) and 2% real growth (near trend growth). Given that government and consumption growth are not expected to grow in real terms for the next few years, assume that these grow in line with inflation at 3% p.a. Under this scenario, their contribution to nominal GDP would fall to 63% and just under 25% respectively. In order to achieve 2% real GDP growth overall under such conditions, with the burden spread equally on investment and net exports, the share of investment needs to rise to 17% GDP and the share of net exports to -5%. This implies that real growth in investment of close to 8% and real growth in exports 1.5% (nominal export growth needs to be 4.5%).[3] If one component is lower then the other needs to be higher.

Recent Progress

In value terms, the Global Connections Survey revealed that in 2011, the nominal value of exports grew by 7% (see page 42) which is above the 4.5% target set out in the example above. However, in volume terms, recent IME data shows that over the year to Q3 2012, the volume of exports fell 0.8%, below the 1.5% required (assuming import volumes remain equal). With an improvement in external conditions in 2013, it is hoped that exports can increase at a faster rate than imports.

ONS data on business investment show that net capital expenditure fell by over 12% in Scotland between 2009 and 2010 (latest data available). Therefore, a substantial reversal of this trend is needed to contribute to overall GDP growth. Alternatively, investment by the government, public corporations or investment in private sector dwellings would need to increase, with all but the latter unlikely under the current fiscal constraint. As page 38 highlighted, more recently available data on UK business investment levels show that it has increased 5.1% over the year to Q3 2012 which is more encouraging.

Conclusion - what do the recent trends in the enterprise base and enterprise behaviour mean for the future performance of the Scottish economy?

The preceding chapters have shown that Scotland now has the highest number of enterprises since the series began in 2000. The bulk of these are small in size with less than 50 employees and the rise over the past decade has been driven by small, unregistered businesses. The number of enterprises with zero employees increased particularly sharply between 2011 and 2012.

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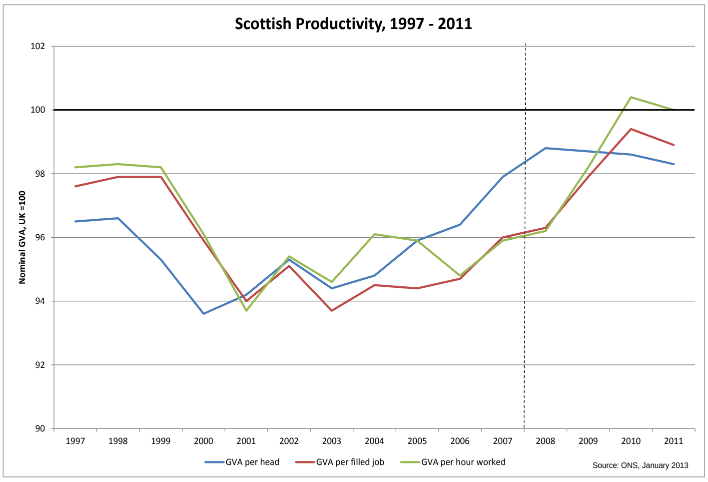
[3] Assuming that imports increase in line with inflation at 3% p.a. reflecting the depreciation of the exchange rate in response.

The Small Business Survey indicates that this rise in micro enterprises (also evident as a rise in self-employment in the labour market statistics) is due to a combination of people wanting to take advantage of an opportunity and those reporting no other choices for work. As the economy improves, real wages increase and more employment opportunities become available, some of these new micro business owners may return to employment.



Scotland has exhibited a higher rate of company liquidations than the rest of the UK in recent years, though the rate has fallen sharply in recent quarters. Despite the prevalence of so-called 'zombie' companies appearing to be similar to that in the UK as a whole, the larger shake-out implies that when economic conditions improve, the remaining business stock in Scotland could be leaner and more productive.

While only speculation at this stage, the greater insolvency rate in Scotland could already be having impacts on the productivity of the remaining business stock. Scotland certainly has not seen the productivity puzzle to the same extent as the rest of the UK, with output levels remaining similar despite a greater labour market adjustment. This has led to a closing of the productivity gap with the rest of the UK since the financial crisis (see GVA per filled job and GVA per head in the chart above).[4]

Business investment is, however, struggling to recover since the financial crisis but this pattern is not out of line with previous UK recessions. With bank financing costs having been brought down by credit easing and given evidence of substantial cash balances held by larger firms, the key factor holding back a revival of business investment appears to be a lack of confidence and demand.

An improvement in economic conditions for domestic consumers and/or the external environment could unlock this demand and help encourage a revival of business investment and growth in the economy.

[4] http://www.ons.gov.uk/ons/guide-method/method-quality/specific/economy/productivity-measures/labour-productivity/information-note.doc